

Financial Strategy 2017/18 to 2021/22**Report by Gary Fairley, Head of Finance and Integrated Service Support****1 Purpose of Report**

This report provides Council with an update on the Financial Strategy encompassing the years 2017/18 to 2021/22.

It includes:-

- An update on future years Scottish Government Grant prospects;
- Updated budget projections rolled forward for 2017/18 to 2021/22;
- A sensitivity analysis reflecting the potential impact of different scenarios;
- An update on the existing and proposed change programmes aimed at addressing the projected budget shortfalls;
- An update on reserves.

2 Background

The core objective of the Financial Strategy is that of securing the Council's continued financial sustainability during what is expected to be an ongoing period of financial constraint coupled with continuing service demand pressures and increasing customer expectations.

On 28 June 2016 Council was provided with an updated assessment of projected budgets shortfalls through to 2020/21 which, based on the assumptions set out in that report, projected a budget shortfall for 2017/18 of £11.215 million rising to £36.931 million. After encompassing the savings targets for the change programme resulted in a remaining budget gap to be addressed of £7.740 million for 2017/18 rising to £28.671 million in 2020/21.

Scottish Government grant accounts for 80% of external funding. As in previous years the prospects for and the timing of future years grant settlements are a major factor which dominate the financial projections set out in this report and will continue to dominate the remainder of the budget setting cycle and future Financial Strategy reports. It will also dictate the timing of and the extent to which Council has to reshape and reduce service budgets in order to maintain financial sustainability.

3 Scottish Government Grant Settlement

The level of uncertainty in respect of the grant settlement has increase since the last Financial Strategy report was prepared as a consequence of outcome of the EU referendum.

There are two main factors which will influence the level of grant support Council might expect for 2017/18 and beyond. Firstly a range of economic factors will

influence the resources both the UK and Scottish Governments have at their disposal. The second will be the economic and fiscal policies and also spending priorities of both Governments. In addition 2017/18 will see a shift in the fiscal framework for Scottish Government, with greater dependence on its tax and revenue powers and so a lesser dependency on Barnett formula consequentials.

An assessment of the economic factors can be made based on the information published in the autumn from the Office of Budget Responsibility and also the UK Government's Autumn Statement. The impact of Scottish Government's spending priorities will only become fully apparent when its spending plans are published.

It is expected that The Chancellor of the Exchequer will publish his Autumn Statement on 23 November 2016 which will give the first indication of how the UK Government will change its spending plans in light of the decision to leave the E.U. Over the summer the Chancellor has been quoted as stating that he may use this to "reset" Britain's Economic Policy.

Thereafter The Scottish Government will publish its own spending plans with the expectation that these will only be for the year 2017/18. The latest indications are that the spending plans will be published some three weeks after the Autumn Statement, on or about 14 December 2016. The Finance Circular setting individual Council Grant settlements is also expected to be published on the same day. However, the Cabinet Secretary has not ruled out a possible delay until sometime in January 2017. Equally the timing of the Scottish Government announcement assumes that the Scottish Parliament's Finance Committee accepts such a late publication date.

Whilst earlier announcements are a possibility it would curtail the time available to Scottish Ministers develop their own spending plans and priorities. As such the most likely scenario is that we will have details of the UK Government's spending plans on 23 November 2016 and Scottish Government's plans and a Finance Circular with the Council's own grant settlement for 2017/18 on 14 December 2016.

As a consequence of the Scottish Government priorities of Health, addressing the Attainment Gap and Policing the indications are that the future years grant settlements will remain challenging. A recently published assessment by The Fraser of Allander Institute indicates that, other than resources for new legislative burdens, there is the potential for a 13.5% or £1 billion real terms reduction in Scottish Government Grant to Local Authorities by 2020/21, partly offset by a small real terms increase in Non Domestic Rate Income.

In cash terms this level of reduction equates to a net £1 million reduction in Government Grant support per annum. Accordingly the grant projections have been revisited and are now based on this revised central planning assumption. It is also expected that specific conditions and direction of resources will continue to be a feature of future years grant settlements.

It is stressed that the grant figures set out in table 2 below are only projections and will remain so until the Scottish Government budget and subsequent announcements on grant support are published later in the year.

4 Council Tax

The budget shortfalls set out in table 2 are based on the current Band D Council Tax of £1,210 and reflect the additional income from an increase in the number of properties and the anticipated income generated by the reform of Council Tax.

For Midlothian the reform of Council Tax Bands E to H is expected to generate £1.7 million. Table 1 below sets out the impact on Council tax levels for each band.

Table 1: Increase in Council Tax Bands E-H

	Band E	Band F	Band G	Band H
Equivalent No. of Dwellings	4145.3	2927.8	1861.3	158.6
Existing Council Tax	£1,478.89	£1,747.78	£2,016.67	£2,420.00
Increased Council Tax *	£1,585.10	£1,972.30	£2,371.60	£2,964.50
Increase *	£107.00	£224.52	£354.93	£544.50
Percentage Increase *	7.3%	12.8%	17.5%	22.5%

- Note this is before a 3% increase across all bands is applied.

In respect of the additional income, estimated at £109 million nationally, this will in effect be removed from the general grant provided to Councils with Government indicating that £9 million will be distributed to offset the additional Council Tax reduction costs with the remaining £100 million distributed based on Free School Meals eligibility directly to Schools. Accordingly at this point the Grand settlement figures have been amended to incorporate this change.

The Association of Directors of Education Scotland (ADES) view is that the distribution proposed by Government for the £100 million using free School meals data will disadvantage particular parts of the country. ADES have submitted an alternative approach to Government for consideration. Even under ADES alternative Midlothian's allocation would only be £0.806 million. As such the likelihood is that a majority of the additional Council Tax collected in would in effect be distributed to schools in other Council areas.

The manifesto also set out proposals to cap the annual increase for Council Tax to 3%. For Midlothian a 3% increase is estimated to generate £1.2 million per annum and would result in Band D Council Tax rising to £1,246 in 2017/18 and to £1,403 by 2021/22. Given the grant prospects set out in section 3 of this report the Financial Strategy incorporates a 3% increase to address the projected budget shortfalls.

5 Cost of Services

The assessment of the projected cost of services for 2017/18 to 2021/22 set out in this report is has been updated over the summer months and reflects the latest

information available. Table 3 provides an analysis of the principal year on year budget changes which include the following key assumptions and cost drivers:

- Pay inflation of 1% per annum. Council should note that The Local Government Workers Trade Unions have submitted a one year pay claim for 2017/18 of a flat £1,000 per annum across all grades. For Midlothian this equates to 4.5% and an indicative cost of £3.5 million. £2.700 million more than reflected in table 3;
- The cost of the Review of Pay and Grading and subsequent incremental pay progression;
- The impact of Pension Reform and anticipated changes in the Council's contribution towards employee pensions;
- That the Apprenticeship levy of 0.5% of the pay bill, which would equate to £0.500 million, is compensated by additional grant or other funding to offset its impact ;
- Contractual inflation linked to existing contractual conditions, many of which mirror pay inflation assumptions;
- An initial provision for future years costs of maintain pay levels for procured care services at or above the living wage;
- Impact of current demand for services;
- Demographic impact of future demand for services;
- Future interest rate forecasts provided by the Council's Treasury Advisers;
- Any new government policy requiring budgetary growth will be fully funded through increased Scottish Government grant;
- Council Tax income continues to grow in line with previous trends and planned future housing growth.

Work will continue through the budget cycle to review and update the projections. This will include the projected forward purchasing prices for energy costs and the anticipated impact of contracts due for renewal during the period of this model.

The projected budget shortfalls reflecting the assumptions set out in sections 3 to 5 are therefore as follows:-

Table 2: Budget Shortfalls 2017/18 to 2021/22– 27 September 2016

	2017/18	2018/19	2019/20	2020/21	2021/22
	£m	£m	£m	£m	£m
Cost of Services	202.936	209.021	216.776	224.024	231.597
Less: Council Tax	(43.450)	(44.100)	(44.750)	(45.400)	(46.050)
Less: Scottish Government Grant	(148.816)	(147.816)	(146.816)	(145.816)	(144.816)
Budget Shortfall	9.858	17.105	25.210	32.808	40.731

As Council is aware, significant elements of the budget are either fixed or are challenging to change for a number of reasons including:-

- Historic decisions, for example, loan charges and unitary charge contractual payments;

- Specific conditions, for example the maintenance of teacher numbers and teacher pupil ratio; and
- Growing demand for services through demographic pressures.

Whilst the projected cost of service provision, Council Tax and Scottish Government grant has been projected forward until 2021/22, the projections, are very much indicative, especially so for the later years, and will undoubtedly change. However the projections do provide Council with an assessment of the key factors which influence income and expenditure and the overall impact of these on the Council's financial position for future years and highlight the extent of the challenge ahead.

It is stressed that the cost of services set out in table 2 above and the analysis set out in table 3 are only projections based on an analysis of a range of information sources. The projections and planning assumptions on which they are based will be regularly updated and reported to Council as new information becomes available.

In broad terms the budget shortfalls set out in table 2 arise for the following reasons:

Table 3: Analysis of Shortfalls – 27 September 2016

	2017/18	2018/19	2019/20	2020/21	2021/22
	£m	£m	£m	£m	£m
Opening Shortfall / (surplus)	2.668	9.858	17.105	25.210	32.808
Pay Inflation and Progression	2.350	1.893	2.344	2.297	2.451
Pensions Reform	0.350	0.000	0.000	0.000	0.000
Contractual Inflation	0.465	0.547	0.637	0.571	0.652
Demographics: Care	1.120	1.040	1.040	1.040	1.040
Demographics: School Rolls	2.098	2.260	2.770	2.798	3.083
Demand pressures: Children	0.000	0.324	0.024	0.024	0.024
School Estate Investment	0.311	0.381	1.126	0.033	0.036
Waste Disposal Costs	0.049	0.213	(0.285)	0.125	0.125
Non Domestic Rates	0.128	0.132	0.135	0.138	1.142
Borrowing Costs	0.864	(0.003)	(0.089)	0.123	(0.007)
Scottish Government Grant					
- Council Tax Reform	1.700	0.000	0.000	0.000	0.000
- Reduction	1.000	1.000	1.000	1.000	1.000
Council Tax Income	(2.850)	(0.650)	(0.650)	(0.650)	(0.650)
Other Movements	(0.395)	0.110	0.053	0.099	(0.973)
Totals	9.858	17.105	25.210	32.808	40.731

The principal movement from the figures set out in the 28 June 2016 report are as follows.

Table 4: Movement from 28 June 2016 report – 27 September 2016

	2017/18	2018/19	2019/20	2020/21	2021/22
	£m	£m	£m	£m	£m
Shortfalls 28 June 2016	11.215	20.836	28.919	36.931	-
Initial Projection for 2021/22					40.731
Pay Inflation and Progression	(0.550)	(1.896)	(2.850)	(3.393)	
Contractual Inflation	(1.198)	(2.365)	(3.490)	(4.730)	
Demographics: School Rolls	1.487	2.801	4.416	5.940	
Scottish Government Grant	(0.200)	(0.400)	(0.600)	(0.800)	
Council Tax Income	(2.250)	(2.300)	(2.350)	(2.400)	
Other	1.354	0.429	1.165	1.260	
Shortfalls 27 Sept 2016	9.858	17.105	25.210	32.808	40.731

6 Sensitivity Analysis

Given the level of uncertainty associated with the 2017/18 grant settlement and budget table 5 provides a sensitivity analysis reflecting the potential impact of different scenarios/outcomes for the two key aspects of the budget. The level of grant support and employee pay awards.

Scenario 1, a more optimistic scenario continues to assume a 1% pay award in each of the years together with a cash flat grant settlement. Otherwise all other assumptions remain as set out in section 3.

Scenario 2, a more pessimistic scenario assumes a 4.5% pay award for Local Government Staff and 2% for Teachers in 2017/18 reducing to 2% for all staff in later years and continues to assume a 3.3% reduction in government grant.

Table 5: Sensitivity Analysis – 27 September 2016

	2017/18	2018/19	2019/20	2020/21	2021/22
	£m	£m	£m	£m	£m
Scenario 1					
Central Assumption	9.858	17.105	25.210	32.808	40.731
Cash Flat Government Grant	(1.000)	(2.000)	(3.000)	(4.000)	(5.000)
Amended Shortfall	8.858	15.105	22.210	28.808	35.731
Scenario 2					
Central Assumption	9.858	17.105	25.210	32.808	40.731
Revised Pay Award Assumption	3.600	5.500	7.400	9.300	11.200
Amended Shortfall	13.458	22.605	32.610	42.108	51.931

As the scenarios demonstrate changes from the central planning assumption could have a dramatic effect on the projected budget shortfalls.

7 Change Programme

The strands of work that are necessary to address the projected budget shortfalls represent a change programme, encompassing:-

- The Delivering Excellence programme, incorporating the Shaping our Future consultations;
- The delivery of savings approved in 2016/17 and the continued control over expenditure in the current year;
- The Transformation programme;
- The EWiM programme;
- An updated Capital Strategy and Reserves Strategy;
- Operational savings encompassing financial discipline measures;
- The development of further savings options for 2017/18 and beyond.

7.1 Delivering Excellence

The Delivering Excellence framework approved by Council on 23 June 2015 supports the repositioning of services to ensure they have a greater emphasis on and achieve better outcomes for those most disadvantaged and vulnerable in the community. The framework focuses on reshaping service delivery as the most sustainable way to address the financial and service challenges and maintain financial sustainability.

The framework sets out an approach that provides the means to:

- Realise savings of the scale and magnitude required and to continue to deliver high quality services by engaging staff, partners, stakeholders and citizens to determine the nature of service delivery, the level of service standards and the method of delivering these services;
- To perform successfully in this environment, the Council will require to forward plan for the period beyond known financial settlements, to prioritise the services to be delivered and to clearly identify those services which will no longer be funded or indeed provided or may be provided through alternative mechanisms or approaches; and
- To ensure that there is achievement of the outcomes and priorities of the Council and Community Planning Partners.

Actions which contribute to the Financial Strategy continue to be developed through the framework. The Shaping our Future strand of the Delivering Excellence framework has focussed on engaging with the community and stakeholders on the challenge the Council faces and the current consultation will also provide a means to gauge public opinion on the service areas that the Council may have to change as it responds to the projected budget position.

7.2 Transformation Programme

The existing Transformation Programme is essential to the delivery of sustainable change and delivery of the Council's Financial Strategy. It remains a major focus with a continued drive towards delivering on the agreed outcomes and targets.

The future year's savings targets incorporated in the Financial Strategy are derived from those set out in the Council Transformation Programme update reports to Business Transformation Steering Group (BTSG) and are set out in table 6 below.

Table 6: Council Transformation Programme Additional Savings – 27 September 2016

	2017/18	2018/19	2019/20	2020/21	2021/22
	£m	£m	£m	£m	£m
Children's Services (a)	0.532	0.806	0.806	0.806	0.806
Services to Communities	0.200	0.800	0.800	0.800	0.800
Education	0.329	0.560	0.595	0.595	0.595
Customer Service	0.175	0.175	0.175	0.175	0.175
Health & Social Care (b)	1.555	1.555	1.555	1.555	1.555
Totals	2.791	3.896	3.931	3.931	3.931

(a) 2017/18 figure updated from report to BTSG in August 2016

(b) Savings targets reported to Council 28 June 2016.

The savings targets set out in table 6 exclude those already reflected in the 2016/17 approved budget and are predicated on the outcomes of the reviews and any subsequent decisions taken by Council and so remain indicative.

7.3 Asset Management

The position remains as reported on 28 June 2016.

7.4 Capital Strategy and Reserves Strategy

The General Services Capital Plan report on today's agenda sets out the Capital Investment requirements for the period to 2021/22 and is reflected in the revenue budget forecast in this report. The proposed Reserves Strategy is also on today's agenda.

7.5 Operational Savings

The budget projections set out in tables 2 and 3 already reflect the operational savings reported in previous year's budgets. Further operational savings will be reflected in the projections as these are identified.

7.6 Savings Options

Taking cognisance of the extent of savings anticipated to secure a balanced budget for 2017/18 and the continued challenge for later years the Chief Executive has instructed each Director to bring forward as minimum savings proposals to bridge the budget shortfall of £5 million, £15 million in total for consideration by the Strategic Leadership Group (SLG) in September 2016. As previously indicated proposals, once agreed by SLG will then be presented to the Business Transformation Steering Group (BTSG) for their consideration before being presented to Council. The timetable agreed by Council on 28 June 2016 provides for these savings proposals to be considered by Council on 20 December 2016.

7.7 Summary of Financial Strategy

The final projections incorporating impact of the various strands of the Financial Strategy and assuming a 3% per annum increases in Council Tax are as follows.

Table 7: Financial Strategy 2017/18 to 2021/22 – 27 September 2016

	2017/18	2018/19	2019/20	2020/21	2021/22
	£m	£m	£m	£m	£m
Budget Shortfall (Table 2)	9.858	17.105	25.210	32.808	40.731
Less Strands:					
Transformation Programme (7.2)	(2.791)	(3.896)	(3.931)	(3.931)	(3.931)
Asset Management (7.3)	0.000	0.000	(0.288)	(0.288)	(0.288)
Operational Savings (7.5)	0.000	0.000	0.000	0.000	0.000
Savings Options (7.6)	0.000	0.000	0.000	0.000	0.000
Council Tax Increase	(1.200)	(2.400)	(3.600)	(4.800)	(4.800)
Remaining Budget Gap	5.867	10.809	17.391	23.789	31.712

It is stressed that ultimately the achievement of savings will be dependent on decisions taken by Council.

8 Governance and Timetable

Each element of the Financial Strategy continues to have clear governance in place to ensure the timely delivery of the work stream, with proposals being reported through Business Transformation Steering Group and then to Council as appropriate.

Table 8 sets out the timetable which was agreed by Council on 28 June 2016 to support the delivery of the Financial Strategy and specifically the determination of the 2017/18 budget and Council Tax levels.

Table 8: Timetable – Key Events

Date	Event	Action
By October 2016	Development Work	<ul style="list-style-type: none"> • Development of Change Programme and savings proposals by SLG. • Shaping our Future consultation ongoing.
8 November 2016	Council	<ul style="list-style-type: none"> • Consideration of update report
November 2016	BTSG	<ul style="list-style-type: none"> • Consideration of change Programme and savings options.
20 December 2016	Council	<ul style="list-style-type: none"> • Consideration of update report and consideration of savings options.
7 February 2017	Council	<ul style="list-style-type: none"> • Consideration of update report, reflecting grant settlement. • Recommendations to set Council Tax and determine a budget for 2017/18.

Members are reminded that Council has a duty as set out in Section 93 of the Local Government Finance Act 1992 (as amended) to set its Council Tax and a balanced budget for the following financial year commencing 1 April by 11 March.

9 Focussing Resources to Key Priorities

The Financial Strategy is designed to ensure that available resources are as far as possible targeted on delivery of improved outcomes, particularly against the key priorities of:-

- Reducing the gap in learning outcomes
- Reducing the gap in health outcomes
- Reducing the gap in economic circumstances

The Midlothian Community Planning Partnership continues to prioritise the available resources towards the delivery of the partnerships key priorities and the Financial Strategy sets out for partners the parameters the Council is working within and provides a means to better facilitate the sharing of budget and resource planning information. The Delivering Excellence framework and Transformation Programme have a key role in ensuring that resources are directed towards the priorities set out in the Midlothian Single Plan.

10 Reserves

The Reserve Strategy is reported elsewhere on today's agenda.

11 Report Implications

11.1 Resources

Whilst this report deals with financial issues there are no financial implications arising directly from it.

11.2 Risk

Within any financial projections, there are a number of inherent assumptions in arriving at figures and budget provisions and therefore risks that may be faced if costs change or new pressures emerge. The following key risks and issues are highlighted in the context of this report:

- The economic outlook and decision by Scottish Government on future years grant settlements and grant distribution;
- Non-delivery or late delivery of planned savings, including those arising from reductions in the staffing establishment;
- Outstanding pay award settlements and the implications of the proposed National Living Wage;
- Impact of economic climate on range of factors including: inflation, interest rates, employment, tax and income levels, service demands;
- Cost pressures exceeding budget estimates;
- Impact of Welfare Reform and pension changes;
- The costs of implementation of national policies varying from the resources provided by government; and
- Capital investment requirements and associated cost.

The Financial Strategy aims to mitigate a number of these risks by setting out the key assumptions on which forward plans are based, and through the change programmes setting out the early identification of future saving proposals.

11.3 Single Midlothian Plan and Business Transformation

Themes addressed in this report:

- ☐ Community safety
- ☐ Adult health, care and housing
- ☐ Getting it right for every Midlothian child
- ☐ Improving opportunities in Midlothian
- ☒ Sustainable growth
- ☒ Business transformation and Best Value
- ☐ None of the above

11.4 Impact on Performance and Outcomes

The Financial Strategy is central to the way Council allocates and uses its limited resources and as such has fundamental implications for service performance and outcomes. The budget projections indicate that in 2021/22 the Council will have available in the region of £190 million for the provision of services and the pursuit of key outcomes as set out in the Single Midlothian Plan.

11.5 Adopting a Preventative Approach

Whilst the proposals in this report do not directly impact on the adoption of a preventative approach, an effective Financial Strategy in turn allows resources to be prioritised to support prevention.

11.6 Involving Communities and Other Stakeholders

Shaping our Future, the consultation strand of the Delivering Excellence Framework has and will continue to focus on informing the community and other stakeholders of the financial and service challenges and to consult on a range of options as the change programme develops.

In addition, there continues to be engagement with the recognised Trade Unions on the Council's financial position and service challenges.

11.7 Ensuring Equalities

There are no equality implications arising directly from this report. As part of the development of proposals to address the projected budget gaps EQIA's will be prepared.

An overarching EQIA encompassing the revenue budget for 2017/18 will be prepared and incorporated in the report considered by Council when it sets the 2017/18 budget and Council Tax.

11.8 Supporting Sustainable Development

There are no direct sustainability issues arising from this report.

11.9 IT Issues

There are no direct IT implications arising from this report.

12 Summary

The report provides:-

- An update on future years Scottish Government Grant prospects;
- Updated budget projections rolled forward for 2017/18 to 2021/22;
- An sensitivity analysis reflecting the potential impact of different scenarios;
- An update on the existing and proposed change programmes aimed at addressing the projected budget shortfalls;
- An update on reserves.

13 Recommendations

Council is recommended to:-

- a) Note the update in respect of the Scottish Government Grant Settlement as set out in section 2;
- b) Note the implication associated with the Council Tax reforms and the gap that will exist between revenues generated in the County and resources provided to Midlothian Schools;

- c) Note the updated projected cost of services, key assumptions and resultant budget shortfalls as set out in section 3 and continue to endorse the key assumptions on which the budget projections are based;
- d) Note the uncertainties and the potential impact of differing scenarios as set out in section 6;
- e) Note the role the current and developing strands of the Change Programme and relevant impact on the Financial Strategy as set out in tables 6 and 7;
- f) Note that the strands of the Change Programme will provide the means to identify options to address projected budget shortfalls;
- g) Note that the updated projections at this time indicate that a budget gap of £5.867 million for 2017/18 rising to £ 31.712 million by 2021/22, though these are heavily dependent on the assumptions detailed in the report;
- h) Otherwise note the contents of the report.

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