

Financial Strategy 2016/17 to 2020/21

Report by Gary Fairley, Head of Finance and Integrated Service Support

1 Purpose of Report

This report provides Council with the first draft of a Financial Strategy spanning the years 2016/17 to 2020/21.

It includes:-

- The position regarding future years Scottish Government Grant Settlements;
- Initial budget projections for 2016/17 to 2020/21;
- An update on the strands of the Financial Strategy, Developing Excellence and the Transformation Programme; and
- An update on Reserves.

2 Background

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

There are two factors which dominate the financial projections set out in this report and which will dictate the timing of and the extent to which Council has to reshape and reduce service budgets in order to maintain financial sustainability. These are:-

- The prospects for and the timing of future years grant settlements. Scottish Government grant accounts for 80% of external funding reinforcing the reliance Council has on grant support.
- The impact of the introduction of a National Living Wage on both the Council's pay bill and the cost of procured social care services.

3 Scottish Government Grant Settlement

The single most critical aspect of the financial projections in this report is the level of grant support Council can expect to secure from the Scottish Government.

The Chancellor of the Exchequer has set out the timetable for his Government's spending review with the publication of spending plans expected on 25 November 2015. The UK spending review will determine the majority of the Scottish Government's budget and will have a significant impact on the subsequent determination of grant allocations to councils. There are a number of decisions to be taken at Westminster and then Holyrood before Council will have certainty over its 2016/17 grant support and at best an indication of later years grant prospects.

The timetable itself is uncertain. In 2014 Scottish Government published its draft budget for 2015/16 in October 2014 with the subsequent publication of the appropriate finance circular on 11 December 2014. In contrast for 2016/17, as a consequence of the UK Government's spending review timetable, the expectation is that at best Scottish Government might publish a draft budget before the parliamentary recess with a finance circular then published in the week commencing 21 December 2015. However it is considered more likely that publication of both the draft budget and the finance circular will not be published until early 2016. In addition there is continued uncertainty as to whether the Deputy First Minister will publish a one year budget and grant settlement or a longer term budget and three year grant settlement.

In terms of the level of grant support Council might expect the view of Fiscal Affairs Scotland, based on the Office for Budget Responsibility's summer Fiscal Outlook, is that the UK fiscal position has changed dramatically in comparison to that set out in the Chancellor's March 2015 budget. This change has not been caused by changes to the economic outlook, rather it is policy changes that have radically altered the position including net tax increases, benefits related spending cuts and the timing of the shift into a fiscal surplus being moved back a year.

As a result the profile of cuts in day-to-day government spending is very different to that seen in March 2015. In particular the cut in spending due in 2016/17 has been eased significantly and the medium term profile of adjustment is now smoother than before. Nevertheless most of the upcoming cuts to public services continue to involve day-to-day spending rather than capital projects.

The Office for Budget Responsibility forecast now implies a real terms reduction in the Scottish Budget of close to £1 billion between 2015/16 and 2019/20 though ultimately the actual Barnett consequential of the spending plans will not be known until after the Autumn Spending Review.

Previous Scottish Government grant projections were based on a cash reduction of approximately £1.8 million per annum for 2016/17 and 2017/18. The UK position would tend to indicate a softening of this position. Assuming that Local Government maintains its share of the Scottish Budget, it is proposed that the central planning assumption for grant settlements is that of "cash flat" settlements, i.e. the overall resources from Scottish Government to councils, remains constant in cash terms other than for additional sums for new legislative burdens.

The Scottish Government grant projections are therefore now based on a "cash flat" planning assumption together with an increased share of grant reflecting the growth in Midlothian's population relative to the rest of Scotland.

It is stressed that these are early projections and will remain so until the spending review and subsequent announcements on grant support are made. Council should note that small changes from the central planning assumption could have a dramatic effect on the projected budget shortfall, for example a variation of 0.5% per annum in Scottish Government Grant would approximate to a £4 million swing by 2020/21.

4 Council Tax

The budget projections are based on a continuing Council Tax freeze with Band D Council Tax remaining at £1,210 and reflect the additional income from an increase in the number of properties.

The expectation is that the Council Tax freeze will continue for the life of the current Scottish Parliament with the prospect for later years very much dependant on the next Scottish Government's response to the findings and recommendations of The Commission on Local Tax Reform.

5 Cost of Services

The projected cost of services for 2016/17 to 2020/21 is based on the current cost of service provision for 2015/16 as set out in the Financial Monitoring – General Fund Revenue report elsewhere on today's agenda.

The impact of Financial Discipline savings presented to Council for approval today are incorporated in future year projections. Projections allow for costs arising from the General Services Capital Plan, both by way of debt charges to finance borrowing costs and revenue implications of investment.

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;
- The impact of Pension Reform and anticipated changes in the Council's contribution towards employee pensions;
- Incremental pay progression modelled in accordance with recent Making Performance Matter outcomes;
- Contractual inflation linked to existing contractual conditions, many of which mirror pay inflation assumptions;
- Actual and projected forward purchasing prices for energy costs;
- Anticipated impact of contracts due for renewal during the period of this model;
- 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.

In respect of pay, Council has agreed a cost ceiling of £1.4 million per annum for the Review of Local Government Workers Pay and Grading (for which an update is included on today's private agenda). Subsequently The Chancellor of the Exchequer, in his government's summer budget, set out proposals for a National Living Wage of £7.20 per hour from April 2016 rising to £9.00 per hour by 2020. The Council's existing pay and grading arrangements are already above the proposed 2016 level with the review expected to enhance pay levels for the lowest paid staff. However assuming a 1% per annum cost of living increase in pay levels for future years, it is anticipated that further investment in the pay bill would be necessary to maintain pay at or above the expected National Living Wage levels. The National Living Wage will also have a direct impact on the cost of procured care services. Additional provisions have therefore been included in later year's budgets for pay and contractual inflation as a consequence of the National Living wage.

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

Table 1: Budget Shortfalls 2016/17 to 2020/21 – 22 September 2015

	2016/17	2017/18	2018/19	2019/20	2020/21
	£m	£m	£m	£m	£m
Cost of Services	200.546	208.033	215.638	222.121	228.533
Less: Council Tax	(40.600)	(41.200)	(41.800)	(42.400)	(43.000)
Less: Scottish Government Grant	(154.996)	(155.496)	(155.996)	(156.496)	(156.996)
Budget Shortfall	4.950	11.337	17.842	23.225	28.537

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 2020/21, 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.

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 2: Analysis of Shortfalls – 22 September 2015

	2016/17	2017/18	2018/19	2019/20	2020/21
	£m	£m	£m	£m	£m
Opening Shortfall / (surplus)	(2.844)	4.950	11.337	17.842	23.225
Pay Inflation and Progression	3.174	2.400	2.739	2.789	2.340
Pensions Reform	2.241	0.377	0.377	0.028	0.028
Contractual Inflation	1.013	1.163	1.214	1.262	1.311
Demographics: Care	0.928	1.233	1.075	1.075	1.075
Demographics: School Rolls	0.788	0.611	0.946	1.155	1.274
Demand pressures: Children	0.388	0.213	0.000	0.000	0.000
School Estate Investment	0.320	0.692	1.158	0.033	0.036
Waste Disposal Costs	0.171	0.086	(0.113)	0.125	0.114
Borrowing Costs	(0.511)	0.475	(0.068)	(0.250)	(0.030)
Food Waste Collection	0.302	0.001	0.000	0.000	0.000
Scottish Government Grant	0.000	(0.500)	(0.500)	(0.500)	(0.500)
Council Tax Income	(0.600)	(0.600)	(0.600)	(0.600)	(0.600)
Financial Discipline	(0.416)	0.000	0.000	0.000	0.000
Other Movements	(0.004)	0.236	0.277	0.266	0.264
Totals	4.950	11.337	17.842	23.225	28.537

6 Financial Strategy

6.1 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 will be developed through the framework.

6.2 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 for programme which includes:

- Customer Service;
- Education;
- Services to Communities;
- Children's Services; and
- Integrated Service Support.

The savings targets incorporated in the Financial Strategy are derived from those set out in the Council Transformation Programme Update Report to Business Transformation Steering Group on 24 August 2015. However the savings targets reported to the Business Transformation Steering Group have since been reviewed and as a consequence the impact on these projects on the Financial Strategy has been re-evaluated to arrive at the figures set out in table 3 below.

Table 3: Council Transformation Programme Cumulative Additional Savings – 22 September 2015

	2016/17	2017/18	2018/19	2019/20	2020/21
	£m	£m	£m	£m	£m
Children's Services	0.000	0.000	0.350	0.350	0.350
Services to Communities	0.250	0.450	1.050	1.050	1.050
Education	0.473	0.742	0.765	0.765	0.765
Customer Service	0.175	0.350	0.350	0.350	0.350
Integrated Service Support	0.840	0.840	0.840	0.840	0.840
Totals	1.738	2.382	3.355	3.355	3.355

The savings targets set out above exclude those already reflected in the 2015/16 approved budget. Changes from the Business Transformation Steering Group report on 25 August 2015 are as follows:-

- Children Services – A further saving of £0.350 million was indicated for 2016/17. However, given the nature of the service and the client group there has always been a risk that the savings target will not be met, either in part or in full, if demand for new services and placements rises above current levels. Placements have risen in 2015/16, as documented in the Financial Monitoring report elsewhere on today's agenda. This directly impacts the service's ability to deliver savings and as such it considered prudent to defer the additional saving until 2018/19 onwards.
- Services to Communities – The savings associated with reshaping services have been reprofiled from 2017/18 to 2018/19 onwards.

The revised savings targets set out in table 3 and are predicated on the outcomes of the reviews and any subsequent decisions taken by Council and so remain indicative.

6.3 Asset Management

The budget projections reflect the full year impact of the first two phases of the Effective Working in Midlothian project and show a saving of £0.135 million on top of savings already incorporated in the 2015/16 budget.

6.4 Procurement

A new Contract Delivery Plan is being prepared which will place greater emphasis on more clearly defining the specification of goods and services which services procure and also strengthened contract management as a means to secure further cashable efficiencies. As this is developed the budgetary impact will be reflected in the Financial Strategy.

6.5 Efficiency and Financial Discipline

The budget projections set out in tables 2 and 3 already reflect the Financial Discipline savings identified in quarter one 2015/16 as set out in the Financial Overview report on today's agenda.

Further efficiency and Financial Discipline savings will be reflected in the projections as these are realised.

6.6 Summary of Financial Strategy

The final projections incorporating impact of the various strands of the Financial Strategy are as follows.

Table 4: Financial Strategy 2016/17 to 2020/21 – 22 September 2015

	2016/17	2017/18	2018/19	2019/20	2020/21
	£m	£m	£m	£m	£m
Budget Shortfall (Table 1)	4.950	11.337	17.842	23.225	28.537
Less Strands:					
Impact of 2015/16 approved savings	(1.225)	(1.703)	(1.703)	(1.703)	(1.703)
Transformation Programme (6.2)	(1.738)	(2.382)	(3.355)	(3.355)	(3.355)
Asset Management (6.3)	(0.135)	(0.135)	(0.135)	(0.135)	(0.135)
Procurement (6.4)	0.000	0.000	0.000	0.000	0.000
Remaining Budget Gap *	1.852	7.117	12.649	18.032	23.344

* On 16 December 2014 Council approved that any remaining budget gap for 2016/17 be offset from the budgeted surplus which would be transferred to reserves.

It is stressed that ultimately the achievement of savings will be dependent on decisions taken by Council. As table 4 highlights there is a continuing challenge in later years with savings of £23.344 million projected to be required to address the 2020/21 remaining budget gap.

7 Governance and Timeline

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 5 sets out the time line which supports the delivery of the Delivering Excellence framework and associated medium term financial plans:

Table 5: Timeline

	Incremental Months	Cumulative Months	
June 2015	1	1	Adoption of Delivering Excellence framework.
July 2015 - May 2016	11	12	Implement programme, develop service and financial proposals. Engagement with Midlothian community on financial and service challenges.
January/February 2016 *	-	-	Formal approval of 2016/17 budget.
June 2016	1	13	Update to Council setting out proposals. Proposals published.
July - November 2016	5	18	Consultation on proposals.
December 2016	1	19	Update to Council on Consultation and recommendations to set a balanced budget for 2017/18 and future years.

* As highlighted in section 2 of this report, the Scottish Government Grant Settlement and associated conditions are unlikely to be published until early 2016. Whilst Council can consider its spending priorities and budget options during the remainder of 2015, it would be prudent to consider a final budget and set Council Tax levels for 2016/17 early in 2016 once grant settlements have been published.

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.

8 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 Early Years, Positive Destinations and Economic Growth. 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.

9 Reserves

The latest projection of useable reserves as at 31 March 2016 is detailed in reports elsewhere on today's agenda and are as follows:-

Table 6: Useable Reserves – 31 March 2016

	Total	Uncommitted
	£m	£m
General Fund Reserve	16.567	10.555
HRA Balance	21.117	2.224
Capital Fund	17.335	17.335
Repairs and Renewal Reserve	2.553	0.000
Total Useable Reserves	57.572	30.114

It is necessary for the Council to retain reserves to meet unplanned or unforeseen costs. In terms of the General Fund, Council agreed on 4 February 2014 that a prudent level of general reserve be around £8.000 million or 4% of net expenditure.

The uncommitted balance on Capital Fund is retained to provide for unforeseen capital expenditure and to provide flexibility between financial years, its utilisation is subject to annual review.

Repairs and renewal reserves are fully committed. An update on the position with the HRA balance is encompassed in a separate report on today's agenda.

10 Report Implications

10.1 Resources

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

10.2 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:

- 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 Delivering Excellence framework and Transformation Programme setting out the early identification of future saving proposals.

10.3 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

10.4 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 2020/21 the Council will have available in the region of £200 million for the provision of services and the pursuit of key outcomes as set out in the Single Midlothian Plan.

10.5 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.

10.6 Involving Communities and Other Stakeholders

The Delivering Excellence Community Engagement report (also on today's agenda) sets out proposals for engagement and consultation on the service and financial challenges Council faces and the options which will emerge to address these.

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

10.7 Ensuring Equalities

There are no equality implications arising directly from this report. As part of the development of service proposals through the Delivering Excellence framework, EQIA's will be prepared.

An overarching EQIA encompassing the revenue budget for 2016/17 will be prepared and incorporated in the report considered by Council when it sets the 2016/17 budget and Council Tax.

10.8 Supporting Sustainable Development

There are no direct sustainability issues arising from this report.

10.9 IT Issues

There are no direct IT implications arising from this report.

11 Summary

The report provides:-

- The position regarding future Scottish Government Grant Settlements;
- Initial budget projections for 2016/17 to 2020/21;
- An update on delivery of the strands of the Financial Strategy, Delivering Excellence and the Transformation Programme; and
- An update on Reserves.

12 Recommendations

Council is recommended to:-

- a) Note the position in respect of the Scottish Government Grant Settlement as set out in section 2 and endorse the central planning assumption of "cash flat" settlements;
- b) Note the projected cost of services, key assumptions and resultant budget shortfalls as set out in section 3 and endorse the key assumptions on which the budget projections are based;
- c) Note the impact of the Spending Review timetable and that as a consequence Council is recommended to finalise the 2016/17 budget and set Council Tax early in 2016 once grant settlement figures are published;
- d) Note that budget projections make no provision for a Council Tax increase.

- e) Note the role the Delivering Excellence and Transformation Programme have means to identify options to address future years budget shortfalls;
- f) Note latest projections for the Transformation Programme and relevant impact of the Financial Strategy as set out in tables 3 and 4;
- g) Note that the projections indicate that a balanced budget is achievable for 2016/17 utilising reserves as previously agreed, but that there remains a projected budget gap of £23.344 million by 2020/21.

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