Midlothian Council
23 August 2022

Medium Term Financial Strategy – 2023/24 to 2027/28

Report by Gary Fairley, Chief Officer Corporate Solutions

Report for Noting

1 Recommendations

Council is asked to note:-

a) The proposed reporting schedule to support finalisation of the budget and Council Tax levels for 2023/24;

b) The update on Scottish Government grant prospects which reflects the Scottish Government's Resource Spending Review (RSR) published on 31 May 2022. Noting also that the RSR sets out extremely challenging planning parameters for Local Government which are exacerbated for Midlothian by the financial pressures associated with population growth;

c) The update on the position with 2022/23 pay claims and the associated impact for the period of the Medium Term Financial Strategy.

d) The update in respect of fiscal flexibilities and that having now received draft statutory guidance that work continues to assess the full implications of the service concession flexibility;

e) That the underlying budget gap for 2022/23 is now projected to be £13.130 million and that as a consequence of both the inflationary increase in costs and cash flat grant settlements the projected budget gap for 2023/24 now stands at £14.4 million rising to a projected £27.1 million by 2027/28;

f) Otherwise note the remainder of the report.

2 Medium Term Financial Strategy 2023/24 to 2027/28 - Background

Council last considered an update on its Medium Term Financial Strategy on 15 February 2022 where it agreed the following:

a) *Note that at its meetings of 24 and 31 January and 2 February 2022 the Business Transformation Steering Group gave consideration to recommendations to Council to enable Council to fulfil its statutory duty, as set out in Section 93 of the Local Government Finance Act 1992 (as amended), namely to set Council Tax and a Balanced Budget for 2022/23;*
b) *Consider the recommendations from the Business Transformation Steering Group meeting on 2 February 2022 that Council approves:-*
    - *The deferment of debt repayments in 2021/22 & 2022/23 to secure £6.358 million to support the 2022/23 budget;*
    - *The utilisation of £2 million from uncommitted earmarked reserves to support the 2022/23 budget ;*
    - *An allocation of £56.438 million to the Midlothian Integration Joint Board for 2022/23 in respect of delegated services (subject to final confirmation of the quantum and distribution of funding for new burdens);*
c) *Note that after incorporating the measures in recommendation b) that the remaining budget gap for 2022/23 would be £1.369 million;*
d) *Approve a one off addition of £0.250 million to the 2022/23 budget to supplement the Scottish Welfare Fund;*
e) *Approve the 2022/23 service budgets as set out in Appendix D (as revised) which includes the application of £0.250 million from the projected general reserve;*
f) *Note the amended analysis of change as set out in Appendix E (as revised);*
g) *As a consequence set a Band D Council Tax for 2022/23 of £1,442.60 as set out in appendix F;*
h) *Note that the projected general reserve remains £1.403 million above the minimum level determined by reference to the Council's Reserve Strategy;*
i) *Otherwise note the update in respect of Scottish Government grant, individual Council grant settlements and the net cost of services as set out in the report;*
j) *Delegate authority to the Chief Officer Corporate Solutions to determine if it is preferential to use the fiscal flexibility of a Loan Repayment Holiday in 2022/23 should the Statutory Instrument route be adopted by Scottish Government. In such circumstances the use of the Loans Fund review would be utilised in 2021/22 to create reserves to utilise to support the 2022/23 budget as part of the options noted in recommendation b);*
k) *In considering the recommendations above in respect of the 2022/23 budget also consider the overarching EQIA published alongside this report.*

Council will recollect that a corporate solution, principally the use of one off funding measures, was developed to support the setting of a balanced budget 2022/23. The final budget set during the last term of Council.

Accordingly, this report provides Council with an update on the development of the Medium Term Financial Strategy (MTFS) covering the budgets to be determined during this term of Council for financial years 2023/24 through to 2027/28. It includes an update on Scottish Government grant prospects, the wider economic and political factors, update on key assumptions and the current assessment of budget gaps. That being the extent to which recurring net expenditure is projected to exceed income from Scottish Government Grant and Council Tax income based on the current Band D Council Tax of £1,442.60.

The projections in this report, being based on planning assumptions, will undoubtedly change as wider economic factors change and as Scottish Government publishes its budget for each year. Indeed since preparing the projections for this report the latest Bank of England Monetary Policy report published on 4th August 2022 points to high levels of inflation continuing through 2023 which, in the absence of any additional Scottish Government grant support, would have the effect of increasing the projected budget gaps.

The aim of the Medium Term Financial Strategy is to provide a multiyear strategy aligned to the development and approval of the Midlothian Council Strategic Plan 2022-2027, *A great, green place to grow: where people and the environment flourish*. It seeks to support the Council in fulfilling its statutory duty to set a balanced budget and determine Council Tax levels annually. In that respect, the final budget for 2023/24 will be updated to reflect the actual position for Scottish Government grant and Council Tax policy once the Scottish Government's budget bill and the associated finance circular are published late in 2022. As updates are brought to Council a reassessment of pay and inflation provisions will be made taking cognisance of the Scottish Government Public Sector pay policy and the extent to which this is reflected in the grant settlement.

3 Budget Projections

At its meeting on 13 June 2022, The Business Transformation Steering Group was provided with an overview of the initial budget projections for financial years 2023/24 to 2027/28. These projections were based on key assumptions on pay inflation, government grant and Council Tax and included and reflected an initial assessment of the Scottish Government's Resource Spending Review published on 31 May 2022.

The budget projections were again updated in late July to reflect the latest assessment at that time for pay and other contractual inflation together with grant prospects based on the Scottish Government's Revenue Spending Review planning parameters. The resultant updated projected budget gaps for each of the years is set out later in the report. In respect of the impact inflation and pay pressures is having on the current financial year, the Financial Monitoring General Fund report also on today's agenda sets on the projected in year impact and the resultant call on reserves as a consequence of inflation pressures in respect of energy, fuel and contractual inflation linked to CPI/RPI which have crystalised since the budget for 2022/23 was agreed on 15 February 2022.

In the lead up to concluding the necessary budget decisions in respect of financial year 2023/34 the following reports are anticipated:-

BTSG	Council	Objective of Report
5 September	4 October	**A report for Decision-** • Presentation of proposed strategic plan. • Update on MTFS and updated projections. • Measures to secure financial balance. • Consultation and engagement arrangements for the strategic plan, MTFS and associated savings measures.
17 October	15 November	**A report for Noting** • Update including revisions to budget projections and underlying gap.
28 November	13 December	**A report for Decision** • Post consultation/engagement report on Strategic Plan. • Updated budget projections and revisions to measures required to secure a balanced budget for 2023/24. • Consideration and decision on Business Transformation Steering Group recommendation in respect of budget savings measures.
TBA	TBA February	**A report for Decision - Finalisation of 2023/24 budget** • Determine Council Tax for 2023/24 taking cognisance of settlement conditions. • Any changes as a consequence of the grant settlement required to agree a balanced budget for 2023/24.

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4 Scottish Government Grant Settlement

On 31 May 2022 Ms Kate Forbes, The Cabinet Secretary for Finance and Economy set out the Scottish Government's Resource Spending Review (RSR). The Scottish Government's first resource spending review since 2011, sets out the high-level parameters for resource spend within future Scottish Budgets up to 2026/27 and is described as providing a long-term plan focused on the outcomes, to deliver the Programme for Government and Bute House commitments. It offers a strategic funding framework for the Scottish Government and partners to plan for the future.

The RSR outlines how the Scottish Government will focus public finances in the coming years to tackle child poverty, address the climate crisis, strengthen the public sector as Scotland recovers from Covid and grow a stronger, fairer and greener economy.

The RSR and in turn the Council's own Medium Term Financial Strategy are being prepared against a back drop of inflation at a 40-year high of over 9 per cent, meaning households and businesses are under significant pressure, while still recovering from the shock of the COVID-19 pandemic. Bottlenecks in supply chains are proving more persistent than originally feared, including due to continued COVID-19 restrictions in China. The Russian invasion of Ukraine and the increases in global commodity and energy prices are continuing to exacerbate significant cost pressures across the economy, adding to the underlying impacts of EU Exit, which have meant that the UK has one of the highest rates of inflation in the G7.

The RSR highlights that Scottish Government face significant volatility in its funding outlook. It notes that the funding available to the Scottish Government can vary substantially over time as economic forecasts change and as the UK Government revises its spending plans. The difference in timing between the UK Spending Review, Office of Budget Responsibility forecasts and Scottish Fiscal Commission forecasts, which form the basis of the Scottish Government's funding envelope, has contributed to the uncertainty and as such the Scottish Government is extremely constrained through the fiscal framework, a legislative requirement to balance the budget, and by limitations on its ability to borrow or increase tax revenue to fund additional resource spending to manage these fluctuations.

Against this backdrop the RSR states that, "The Scottish Government is fully deploying the levers we have under the framework, however, it is increasingly clear that they are insufficient to manage the challenges we face". The RSR presents further specific investment to by the Scottish Government including:

- Delivering the commitment to increased year on year funding for the National Health Service investing £73 billion over the period of the RSR, with 50 per cent of that invested in community health services.

- Investing in social care and integration over the spending review period laying the groundwork for the National Care Service, bringing social care into parity of esteem with healthcare and transforming the provision of this essential service.
- More than doubling the value of the Scottish Child Payment (SCP) to £25 per week per child and rolling out the SCP in full to children under 16, by the end of 2022 and maintaining this over the spending review period.
- Implementing measures which reduce the cost of the school day, including expanding free school meal provision and working to build a system of school age childcare that is free to those on the lowest incomes.
- Funding to recruit 3,500 additional teachers and 500 support staff.
- Continuing to deliver the Scottish Attainment Fund, to tackle the poverty related attainment gap.
- Addressing backlogs in the justice system, supporting victims of crime and continuing to reduce reoffending.
- Supporting all parts of government to deliver the National Strategy for Economic Transformation.
- Delivering on the employability offer to parents by spending £670 million over the review period to help reduce child poverty – supporting thousands of parents into work, and parents already in work to increase their earnings.
- Spending £160 million over the spending review period on digital transformation to deliver better outcomes - bringing 300,000 households online through the Connecting Scotland programme and enabling access to gigabit and superfast broadband.
- £95 million of further investment across the review period to support increasing levels of woodland creation.
- Resource funding to support capital investment in low carbon infrastructure and affordable housing over the period of the Capital Spending Review including £1.8 billion to make homes and buildings warmer and an increase in active travel spending to a combined resource and capital total of £320 million a year over the period.

In respect of Local Government alongside the RSR Ms Forbes wrote to the then COSLA President, Councillor Alison Evison. Ms Forbe’s letter (which was copied to all Council Leaders and which is attached as Appendix B) states that “Reflecting the fact that Local Authorities are key partners in the delivery of the priorities set out by the spending review, the spending review baselines the £120 million added during the 2022/23 Budget Bill process and maintains General Revenue Grant, Non-Domestic Rates Income and Specific Resource Grants between 2023/24 and 2025/26 before adding a further £100 million in 2026/27”.

In a report to COSLA Leaders at their special meeting on 17th June 2022, COSLA Officials set out the implications for Local Government of the RSR. That report highlights that the RSR shows a “flat-lining” of revenue funding for Local Government at 2022/23 levels for the next 3 financial years (this includes a baselining of the £120m added during the Budget Bill) and then sees an additional £100m added in 2026/27.

This guarantees £10,612m for the next 3 years, rising to £10,712m in 2026/27. This guaranteed funding comprises General Revenue Grant (including specific grants) plus Non-domestic Rates (NDR) income. However, the total revenue settlement for 2022/23 was £12,000m because an additional £1,384m was transferred in from other portfolios, for specific purposes.

The Cabinet Secretary's letter specifies that existing transfers including for Health and Social Care, and additional teachers (c£1,000m) will be maintained, however, final details of the remaining transfers (c£345m) will not be taken until the budget in December 2022.

Commentators on the RSR have recognised the impact on Local Government, with both SPICe and Fraser of Allander stating that the proposals essentially represent a 7% real terms decrease in funding between 2022/23 and 2026/27. This is in contrast to the 4.7% real terms increase that the Scottish Government will see overall (2% if social security transfers are excluded), and the real terms increases that Health, Social Justice and Housing will see.

The COSLA Leaders report highlights that the real term decrease planned for Local Government comes on top of significant real term reductions since 2013/14, which has driven ongoing reform, rationalisation, innovation and transformation work across Local Government – across workforce, property, digital, and procurement. It notes that these are now areas that the rest of the public sector is being asked to tackle as part of the RSR, with local authorities being "invited to adopt a complementary approach".

In relation to public sector pay, the RSR has set the tone by stating a commitment to fair work, but to returning the workforce to pre-pandemic levels, targeting workforce growth in priority areas but holding the overall pay bill – as opposed to pay levels – at 2022/23 levels. Put simply, this means less but better paid jobs in the public sector.

The RSR states that Local Government is responsible for making decisions about pay, but the flat cash settlement prospects implies that a similar approach will be necessary. This will be particularly challenging, as well as risking distorted effects in some parts of the workforce dependent on commitments relating to workforce (e.g. the Pupil Teacher Ratio) and increasing demand in some areas (e.g. social care due to demographics).

In summary, the RSR presents Local Government with the prospect of cash flat grant settlements through to 2025/26 with a small increase of £100m for 2026/27. This represents extremely challenging planning parameters for Local Government which are exacerbated for Midlothian by the financial pressures associated with population growth. Unfortunately, these planning parameters are broadly in line with the Council's previous planning assumption.

As members will be aware on 21st June 2022, Scottish Government published the National Care Service (Scotland) Bill. If established, the National Care Service would allow Scottish Ministers to transfer social care responsibility from local authorities to a new, national service. This could include adult and children's services, as well as areas such as justice social work. Scottish Ministers will also be able to transfer healthcare functions from the NHS to the National Care Service. Scottish Government's intention is to have the new National Care Service established by the end of this Parliament.

The establishment of a National Care Service and Care Boards and transfer of social care responsibilities from Local Government will have a fundamental impact on future Council budgets recognising that such a transfer could encompass circa 30% of the Council's current net expenditure.

5 2022/23 Pay Claims and Future Years Pay Inflation

The 2022/23 pay claims for all of the Local Government bargaining groups have yet to be concluded. At its meeting on 17 June 2022, COSLA Leaders agreed to mandate the Resources Spokesperson to make a revised pay offer of 5% contingent on additional funding being provided by the Scottish Government. The amendment noted that this would match that offered to Agenda for Change NHS staff. Recognising the significant affordability impact this will have for Councils COSLA Leaders agreed to continue discussions to make clear to Scottish Ministers that they must urgently identify and provide additional financial resource for Local Government to protect local services and current staffing levels.

Following a meeting on 3 August 2022, Mr John Swinney, Deputy First Minister and Cabinet Secretary for Covid Recovery wrote to Councillor Katie Hagmann, the COSLA Resources Spokesperson. The letter advises that the Scottish Government is not in a position to provide the additional 3% funding (£277.5m), as requested by COSLA Leaders but recognising the challenge for Councils as employers in funding a fair and affordable pay offer for employees in the current climate advised that the Scottish Government will make a contribution towards the Local Government pay offer.

The letter confirm a Scottish Government financial contribution of £140 million in 2022/23 to support a revised pay offer and confirmed that this covered the whole local government workforce, including teachers. The letter also noted the importance of clarification around this being a recurring contribution and whilst not providing confirmation at that time due to continued uncertainty in the UK Government's fiscal stance it stated that consideration of this will be a priority in the annual budget process. Subsequently, the Depute First Minster has confirmed that the £140 million will be recurring funding.

Pay offers across all bargaining groups averaging 5% would result in an unbudgeted cost estimated at £3.8 million when compared to the 2.5% provision made in the 2022/23 budget. Midlothian's share of the £140 million is estimated at £2.4 million and therefore a 5% offer would represent a net unbudgeted cost of £1.4 million for 2022/23.

At its special meeting on 5th August 2022, COSLA Leaders confirmed that without additional, sustainable, funding from Scottish Government, Local Government will be unable to make a significantly increased pay offer to meet the trade union pay claims. Leaders remitted to the Resources Spokesperson to continue engagement with the Scottish Government to seek full funding of the shortfall needed to construct a baselined 5% offer and also remitted to the Finance Spokesperson to continue engagement with both the Scottish and UK Governments and to liaise with other local authority organisations to press for further financial help from the Treasury. COSLA Leaders will reconvene of 12 August to further consider the matter and so a verbal update will be provided to Council.

For planning purposes the projection in this report reflect a 5% offer for 2022/23 together with Council's share of the recurring £140 million contribution from Scottish Government. The effect of this would be to increase the underlying budget gap for 2022/23 and so the opening budget gap for 2023/24 by £1.4 million.

The Scottish Joint Council bargaining group Trade Unions have balloted member for industrial action targeted at waste, early years and schools. The Trade Unions mandates for industrial action represent a very mixed position across the country. In respect of Midlothian, the ballot has secured a mandate for action by GMB members in waste services only. At the time of writing, no notification of actual action has been received and so again a verbal update will be provided at the meeting on the position in respect of any action by GMB members.

As stated earlier the RSR approach to pay pressures is to return the public sector workforce to pre-pandemic levels, targeting workforce growth in priority areas but holding the overall pay bill – as opposed to pay levels – at 2022/23 levels. The feasibility of this for Local Government is questionable. Between 2006 and 2018, there was a steady reduction in Local Government workforce due to significant efficiency savings and service transformation programmes resulting in the workforce reducing by circa 15% from 2006 levels. Significant Scottish Government policy direction since 2018 and the need to respond to COVID has meant staff increases to the extent that if staffing for additional commitments is removed, the Local Government staffing levels would be back at 2018 levels.

This is in contrast to trends in other parts of the public sector which have seen Scottish Government nearly double since 2006, Scottish Government agencies grow by 15% and NDPBS more than double.

6 Update on Fiscal Flexibilities

As Council is aware COSLA and Scottish Government reached agreement on three financial flexibilities in respect of a Loans Fund Repayment Holiday, Capital Receipts and Service Contract Concessions. The former two flexibilities were adopted as part of the Corporate Solution, principally on of funding measures, to balance the 2022/23 budget and support business transformation.

In her letter to the COSLA President on 31 May 2022, Ms Forbes confirms the Scottish Government's intention to commission an independent Capital Accounting Review. The independent review will build on the review already taken forward by Directors of Finance working with key stakeholders to deliver a phased approach towards alignment with the CIPFA Code of Practice for Local Authority Accounting.

In terms of the fiscal flexibility sought for Service Contract Concessions (PPP/PFI etc. contracts) the Government have acceded to the request to recognise principal debt repayments over the asset life and for this approach to be applied retrospectively. This can also apply to the grant funded element of the principal debt repayments. The government requires that each local authority will be responsible for fully evaluating any change in method and making appropriate financial provision. The decision for making any change must be taken by the Council and may not be delegated.

Subsequently, draft statutory guidance has been received and work is underway to fully evaluate any change in the accounting treatment and associated financial provisions. This will support a determination of the prudent application of the guidance and the assessment of the impact of the flexibility on the Medium Term Financial Strategy. At the present time, the projections set out in this report assume an in year adjustment from the application of the flexibility with further work focussing on the prudence of any application retrospectively. This assessment may be hampered or delayed until the scope and potential impact of the Capital Accounting Review is better understood given both impact on the requirement to ensure that there is a prudent provision for the repayment debt associated with capital investment.

7 Projected Net Cost of Services

The current year's budget, 2022/23, approved on 15 February 2022 was reliant on £12m on one off funding measures. Since that time changes relating to pay, government grant and inflation have resulted in this figure now projected to be £13.130 million as detailed in the table below.

One of Measures in 2022/23 Budget	£m	£ m
Use of Reserves		
Utilisation of uncommitted earmarked reserves	2.000	
Utilisation of general reserves	0.250	
		2.250
One of utilisation of Covid Funding (to mitigate savings plans etc)		1.675
Deferment of debt repayments in 2021/22 & 2022/23		
- Loans Fund Review to meet repayments in 22/23 (max)	3.032	
- From use of Fiscal Flexibility (Loans Fund Repayment Holiday) + Utilise Loans Fund Review both in 2021/22 (max)	3.326	
		6.358
Non Recurring Expenditure		(0.250)
Impact of 2022/23 Contractual Inflation – Energy and PPP		1.697
Impact of 2022/23 5% pay offer (Unbudgeted cost £3.8 million less additional SG Grant £2.4m) each 1% unfunded above 2.5% added £1.5m		1.400
Underlying Budget Gap for 2022/23		**13.130**

The projections for future years in this report are predicated key assumptions in respect of Scottish Government Grant, pay and other inflation and Council Tax growth. The projections are also predicated on the current structure of public services in Scotland, as such no adjustment has been made for the implementation of a National Care service or any other changes in the structure of Local Government. As the National Care Service (Scotland) Bill progress through Parliament and toward implementation, it will be necessary to assess the impact on future year's budgets.

In respect of Scottish Government Grant, the national planning parameters for this have been defined by the RSR with cash flat settlements for 2023/24 to 2025/26 and a £100m increase for 2026/27. As the Medium Term Financial Strategy extends to 2027/28 it has been assumed that there will be a further £100m increase for that year.

In respect of pay and other inflation economic commentators the assessment at the time the budget projections were reviewed in late July were that inflation should fall as food and energy pressures ease (only have to remain flat for inflation to fall fast), though there is a risk that high wage settlements will begin a wage inflation cycle. Looking further ahead concerns could be over high inflation if world issues worsen and/or wages rise fast or in contrast, if more of a return to normal, then deflation worries could return, as demand remains low versus supply.

As such for the period of the Medium Term Financial Strategy the projections were updated to reflect the current inflationary pressures but with the in-year inflation assumption remaining at 2.5%. The Bank of England August Monetary Policy report would suggest that high inflation may continue through 2023 and so the next reassessment of budget projections is anticipated to see budget gaps increasing as the contractual inflation provisions and energy budgets are increased.

In a change to presentation from previous budget projections and the last Medium Term Financial Strategy, no increase in Band D Council Tax has been included in the projection. The only change to Council Tax income being the projected growth in properties. This approach better recognises that decisions to increase Council Tax are better positioned as part of the response to the financial challenge and also the legislative position where Council Tax levels and the resultant Council Tax income needs to be sufficient to fund the balance of expenditure not otherwise funded from government grant, fees, reserves etc.

Work will continue to review and update cost projections based on the latest information available. As such, the analysis of change set out below is provisional and will change over the term of the Medium Term Financial Strategy. The aim is to focus on 2023/24 with the objective of de risking, as far as possible, the deliverability of the 2023/24 budget and allow pre settlement updated projections to be included in the report scheduled for 14 December 2022.

Financial Outlook 2023/24 to 2027/28 - Analysis of Change					
	2023/24	**2024/25**	**2025/26**	**2026/27**	**2027/28**
	£m	**£m**	**£m**	**£m**	**£m**
Opening Gap for the Year	**13.130**	**14.391**	**18.241**	**22.215**	**24.616**
Budget Changes					
Staffing - Pay Inflation and salary progression	3.881	3.977	4.077	4.179	4.283
Contractual Inflation & Indexation	1.072	1.099	1.126	1.154	1.183
Loan Charges	0.568	0.250	0.250	0.250	0.250
Service Concession - in year adjustment	-2.336	0.000	0.000	0.000	0.000
Other	-0.011	-0.011	-0.011	-0.011	-0.012
Gross Expenditure Increases	**3.174**	**5.315**	**5.442**	**5.572**	**5.704**
Reinstate Lothain Buses Dividend	-0.450	0.000	0.000	0.000	0.000
Council Tax - Property Growth	-1.350	-1.350	-1.350	-1.350	-1.350
Scottish Government Grant	-0.113	-0.115	-0.118	-1.821	-1.824
Gross Income Increases	**-1.913**	**-1.465**	**-1.468**	**-3.171**	**-3.174**
Budget Gap to Address	**14.391**	**18.241**	**22.215**	**24.616**	**27.146**

Members will note that there is no provision made in the table above for demographic pressures. As this stage, rather than including a broad estimate, further work is being undertaken to more fully understand the probable demographic pressures across Schools, ASN and Children's Services and also how the impact will flow through the grant distribution system. In the short term, pressures would be mitigated by one of funding sources.

The tables highlight that the underlying budget gap for 2022/23 is £13.130 million. That is the extent to which the recurring expenditure in the current year's budget is funded by non-recurring funding sources.

As a consequence of the inflationary increase in costs and cash flat grant settlements the projected budget gap for 2023/24 now stands at £14.4 million rising to a projected £27.1 million by 2027/28, albeit later years are based on the existing service responsibilities with no adjustment for the consequences of the National Care Service

(Scotland) bill. These budget gaps represents the extent to which recurring service expenditure is projected to exceed recurring income.

By progressing the Medium Term Financial Strategy as an integral part of the Strategic Plan, it will support members in taking early decisions to address the projected budget gaps. Thereafter, when Council meets in February each year to finalise the budget and set Council Tax for the year ahead members will only have to consider recommendations from the Business Transformation Steering Group in respect of any matters arising from the settlement.

8 Medium Term Financial Strategy Savings Measures

Alongside development of the Strategic Plan and in cognisance of the projected budget gap for 2023/24 and beyond, the Corporate Management Team are developing those measures that would be necessary to contribute to reducing the projected budget gaps.

While these include service transformation options, the severity of the financial outlook, in part driven by the challenging planning parameters indicated by the Scottish Governments RSR, is such that it will be necessary to develop measures that have a wide ranging impact on services and which see cuts in services that communities have until now enjoyed and relied upon.

These measures will undoubtedly be unwelcomed by elected members, communities and staff but in the absence of any fundamental change in the planning parameters which flow from the Scottish Government's RSR or a very significant increase in Council Tax, they are the types of measures that will be necessary to implement to enable elected members to fulfil their statutory duty to set a balanced budget for each year.

Reflecting the extent of the challenge and the wide raging implications for service provision associated with savings measures officer and member engagement has continued over the summer with a view to presenting these alongside the draft strategic plan to the Council meeting in October 2022.

In addition to savings measures, members should note that each 1% or £14.42 per annum increase in Band D Council Tax would generate circa £580,000 per annum in additional income.

9 Next Steps

9.1 Engagement on the Medium Term Financial Strategy

As the proposed strategic plan and savings measures necessary to secure financial balance are concluded, both will be set out for public engagement with the outcome reported back to Council before any decisions are take.

9.2 Finalisation of the 2023/4 Budget and Setting Council Tax

The scheduled meetings of the Business Transformation Steering Group and Council would support the approval of the Strategic Plan and associated Medium Term Financial Strategy in December 2022 and for the decisions required in respect of the finalisation of the 2023/24 budget at Council in February 2023.

9.3 Midlothian Integration Joint Board

The Chief Officer and Chief Financial Officer of the Midlothian Integrated Joint Board (IJB) are being kept updated on the Council's budget position and are engaged in the development of the Medium Term Financial Strategy.

The indicative budget to be delegated to the IJB for 2023/24 together with future years, indicative allocations are being developed on the basis of the minimum requirements set out by Scottish Government for 2022/23 continuing. That being, the 2023/24 budget should be no less than the 2022/23 recurring budget plus the IJB's share of new monies provided in 2023/24. However, it will only be possible to formulate a formal offers for the IJB once the annual grant settlement is available and the quantum of any additional monies for delegated activities and any conditions attached to the settlement are known.

Business Transformation Steering Group will be asked to consider the formal offer arising from the settlement when it meets in January 2023 and this will form part of the final budget recommendations to Council.

9.4 Governance and Timetable

Each element of the Medium Term Financial Strategy continues to have governance in place to support the timely delivery of the work streams. Any changes will first be reported to Business Transformation Steering Group with recommendations then presented to Council.

Responsibility for setting Council Tax and determining budgets remains with Council.

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.

Members should note that the legislation contains no specific requirement for a Council to set its budget at the same time as setting its Council Tax. This is because it is implicit in setting the Council Tax that Council Tax income needs to be sufficient to fund the balance of expenditure not otherwise funded from government grant, fees, reserves etc.

As Council Tax funds the gap between expected income and expenditure, you need to first identify your proposed expenditure to determine the resulting gap that Council Tax needs to fund. If no other action is taken to redress any shortfall, then the Council Tax has to be set at a rate that will do so, otherwise the budget will not balance. Accordingly, Council Tax decisions cannot be taken in advance of other budget decisions.

Members should also continue to note that in terms of Section 112 of the Local Government Finance Act 1992 (as amended) it is an offence for members to participate in any vote in respect of setting Council Tax where the member has unpaid Council Tax. Accordingly at the Council meeting where these decisions are formally taken members would be required to disclose the fact if this section of the act applies to them and subsequently not vote on any question with respect to the matter.

10 Report Implications (Resource, Digital and Risk)

10.1 Resource

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

10.2 Digital

The adoption of digital solutions is a central strand of the Medium Term Financial Strategy.

10.3 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:

- Uncertainly over the Scottish Government's and Council's financial position;
- The economic outlook and decision by Scottish Government on future years grant settlements and grant distribution;
- The risk to service provision and service users associated with a continued decline in available resources to fund services;
- Future years Public Sector pay Policy and current and future year pay award settlements;
- Actual school rolls varying from those provided for in the budget;
- The impact of the wider economic climate on range of factors including: inflation, interest rates, employment, tax and income levels and service demands;
- Cost pressures, particularly demographic demand, exceeding budget estimates;

- The reform of public services and the implications for the National Care Service (Scotland) Bill;
- The impact of Universal Credit, and potential pension changes;
- The costs of implementation of national policies varying from the resources provided by Government;
- Potential liabilities arising from historic child abuse;
- Unplanned capital investment requirements and the associated cost; and
- Ability to continue to meet the expectations of our communities within a period of fiscal constraint.

The Medium Term Financial Strategy aims to mitigate a number of these risks by setting out the key assumptions on which forward plans are based. The consequences of the challenging grant settlement parameters mean that it is also necessary to bring forward measures to secure financial balance over the period covered by the Medium Term Financial Strategy.

The risk of not having in place a balanced Medium Term Financial Strategy is the potential elimination of available reserves, which in turn would severely limit the Council's ability to deal with unforeseen or unplanned events and also the imposition of significant cuts at short notice with limited opportunity for consultation. Early agreement of the Medium Term Financial Strategy alongside the Strategic Plan will help to prioritise available resources and so support Councillors to fulfil their statutory duties in respect of setting budgets and determining Council Tax levels.

10.4 Ensuring Equalities

The Medium Term Financial Strategy and the resource allocation measures which will support financial sustainability will, as far as the constraint on resources allow, be developed within the context of the Strategic Plan, ensuring as far as possible that resources are directed towards the key priorities of reducing inequalities in learning, health and economic circumstance outcomes.

The Medium Term Financial Strategy will continue, as far as is possible, to reflect Midlothian Council's commitment to the ethos of the Equality Act 2010 with careful consideration of the interests of the most vulnerable in our communities through the preparation of equality impact assessments.

In addition, the Strategic Plan will underline the Council's commitment in its Equality Plan to tackle inequality and promote inclusion within the limitations of the resources available. It will also allow the Council to plan and deliver services which meet the needs of our diverse communities and respond to the changes ahead.

An overarching EQIA will be published alongside the strategic plan on the Committee Management section of the Council's website and this will be updated in parallel to the Medium Term Financial Strategy report presented to the Council meeting in February 2023.

10.5 Additional Report Implications
See Appendix A

Appendices
APPENDIX A – Report Implications
APPENDIX B – Cabinet Secretaries' letter

A.1 Key Priorities within the Single Midlothian Plan

The Medium Term Financial Strategy facilitates decision on how Council allocates and uses its available resources and as such has fundamental implications for delivery of the key priorities in the Single Midlothian Plan. It helps ensure that resources are available to continue to delivery key priorities.

A.2 Key Drivers for Change

Key drivers addressed in this report:

☒ Holistic Working
☒ Hub and Spoke
☒ Modern
☒ Sustainable
☒ Transformational
☒ Preventative
☒ Asset-based
☒ Continuous Improvement
☒ One size fits one
☐ None of the above

A.3 Key Delivery Streams

Key delivery streams addressed in this report:

☒ One Council Working with you, for you
☒ Preventative and Sustainable
☒ Efficient and Modern
☒ Innovative and Ambitious
☐ None of the above

A.4 Delivering Best Value

The report does not directly impact on delivering Best Value.

A.5 Involving Communities and Other Stakeholders

The development of the Strategic Plan and associated Medium Term Financial Strategy will include a public engagement phase later in the year.

In addition, there has been and will continue to be, engagement with the recognised Trade Unions on the Council's financial position and the development of the Strategic Plan and associated Medium Term Financial Strategy.

A.6 Impact on Performance and Outcomes

The Medium Term Financial Strategy facilitates decision on how the Council allocates and uses its available resources and as such has fundamental implications for service performance and outcomes. The financial consequences of the pandemic have impacted on the availability and allocation of resources in pursuit of key outcomes as set out in the Single Midlothian Plan for both the immediate and longer term and therefore the ability of the Council to continue to deliver services in a financial sustainable manner.

A.7 Adopting a Preventative Approach

An effective Medium Term Financial Strategy will support the prioritisation of resources to support prevention.

A.8 Supporting Sustainable Development

There are no direct sustainability issues arising from this report and we will work to mitigate any sustainability issues which arise as a consequence of the Medium Term Financial Strategy.

Appendix B

Cabinet Secretary for Finance and Economy
Kate Forbes MSP

Scottish Government
Riaghaltas na h-Alba
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Councillor Alison Evison
COSLA President
Verity House
19 Haymarket Yards
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EH12 5BH

Copy to: The Leaders of all Scottish local authorities

31 May 2022

Dear Alison,

Earlier today, as part of a statement to Parliament, I published the Scottish Government's Resource Spending Review. The Review is ambitious but realistic. In setting high level multi-year portfolio spending envelopes it offers a strategic funding framework for the Scottish Government and our many partners to plan for the future. That of course includes local government which has such a significant role to play in so many areas of government.

Fiscal Context

Whilst the UK Government has belatedly taken action to mitigate some of the impact of rising energy prices on households, it has not responded to address the broader impact of inflation on business and public services.

The UK Spending Review in October 2021 set out a funding cash envelope for the Scottish Budget at a time when inflation was significantly lower and as a consequence the true spending power of those funding envelopes has already been significantly eroded. To date the UK Government has chosen not to adjust spending plans to reflect this and funding available for investment in public services through the rest of this parliament remains constrained. I would welcome the opportunity to discuss with you on what we might do collectively to raise this with the UK Government and the public in Scotland.

As you will be aware, the Scottish Budget for 2022-23 was already reduced in real terms by 5.2% relative to 2021-22 and growth in spending capacity over the rest of the parliament, once social security transfers are excluded, remains at only 2%. This low level of investment is deeply damaging to public services and once again highlights that Scotland does not currently hold the levers required to address our most pressing challenges.

The central funding position outlined in the spending review reflects a range of assumptions to inform the official forecasts, and are based on current tax policies as forecast by the Scottish Fiscal Commission. The funding envelopes set out here are indicative currently of what we can reasonably expect over the spending review years, including assumptions about additional consequential funding from UK Government beyond the spending review settlement and revenues accruing from Scotwind, but it is our annual budgets which will confirm these.

Similarly, the funding envelopes are presented at portfolio level (Level 2) and are therefore not as granular as the allocations published alongside the budget. This approach is critical so as not to constrain portfolios in the choices they make in support of our strategic priorities but does have implications for the level of detail available to make comparisons with previous years. These details, including any in-year transfers, will be confirmed as part of the annual budget process.

Vision

Despite the challenging fiscal context, the resource spending set out in this review will drive the Scottish Government's ambitious vision for Scotland's public services. We are committed to strong, responsive public services which serve individuals' needs, improve national outcomes and create the right opportunities for Scotland to be healthier, happier and more prosperous. We want public funding to build a Scotland where communities are inclusive and empowered, and people grow up loved and respected, well-educated, and healthy. I know you and other council leaders share much of this vision.

In order to achieve this, this spending review provides fresh impetus to our public services reform programme and sets out a coherent package of action that will drive progress over the life of the current Parliament, improving outcomes while driving efficiency and value for public money.

While key elements of this vision will not directly apply to local government, addressing the financial challenges facing Scotland's public services would benefit from a cross-public sector approach in order to optimise the reach of public funding to deliver the best possible services and support to our people and communities. I would therefore anticipate and welcome a complementary approach across all parts of the public sector landscape.

This package includes:

- Changes to working practices, with our Fair Work principles at their heart, to support greater flexibility and continued hybrid working across the public sector;
- A pathway to return the overall size of the public sector workforce broadly to pre-COVID-19 pandemic levels, while supporting expansion in key areas of service delivery, helping to hold total pay bill costs - as opposed to pay levels - at 2022-23 levels;
- Support through public sector pay arrangements for those on the lowest incomes faced with the hardest impacts of the cost of living crisis;
- An enhanced focus on delivering efficiency savings across the public sector, while recognising existing efficiency programmes in some sectors, which we will support through a variety of levers including;
- Fresh consideration of the public body landscape, with further engagement ahead of the next Budget about a programme of reform;

- A multi-year estates programme to make the best use of public sector property and other assets, reflecting the impact of the COVID-19 pandemic on ways of working and the delivery of services;
- An increased focus on maximising revenue through innovation, reflecting the guidance in the Scottish Public Finance Manual;
- A programme of digital reform, focused on inclusion and connectivity, developing a strong digital economy and investment in digital transformation of public services;
- The development of a strategy for public procurement that will drive greater collaboration and value for money.

I look forward to working with the new COSLA Leadership to explore how local authorities might contribute to that approach alongside the development of a new deal for local government. I will also ensure the relevant Scottish Government officials are available to COSLA to discuss the details set out in this package. I know that some local authorities have already undertaken similar reforms already and there will be the opportunity also to learn from their experience, which I would welcome.

Local Government Settlement

Reflecting the fact that Local Authorities are key partners in the delivery of the priorities set out by the spending review, the spending review baselines the £120 million added during the 2022-23 Budget Bill process and maintains General Revenue Grant, Non-Domestic Rates Income and Specific Resource Grants between 2023-24 and 2025-26 before adding a further £100 million in 2026-27.

As the majority of in-year transfers from other portfolios apply to Level 4 budgets, the strategic approach of publishing portfolio allocations at Level 2 in the spending review precludes a direct like with like comparison with previous years' overall settlement figures. Final details of the settlement including additional transitional funding to reflect the devolution of Empty Property Relief to Councils from 1 April 2023; confirmation of the approach adopted for in-year transfers; and individual Council allocations will be confirmed alongside the annual budget process.

The spending review affirms the Scottish Government's commitment to agreeing a 'new deal' for Local Government in Scotland through the development of a Partnership Agreement and Fiscal Framework. The new deal will build on the Review of Local Democracy and seek to balance greater flexibility over financial arrangements for local government with increased accountability or the delivery of national priorities so that both partners can have certainty over inputs and outcomes alongside scope to innovate and improve the delivery of services to local people and communities.

This joint aspiration coupled with the strategic approach to portfolio allocations means that the spending review makes no assumptions about the scale and scope of any transfers to local government from other portfolios in-year. However, to offer a degree of certainty, the spending review confirms that existing in-year transfers for Health and Social Care, Early Learning and Childcare and additional Teachers worth £1 billion combined will be maintained. Final decisions on the transfers from other portfolios in future years will be confirmed following the establishment of the Fiscal Framework.

The spending review also makes no assumptions about council tax nor about greater scope for discretionary revenue-raising, such as the Visitor Levy and the newly created Workplace Parking Levy, as decisions about further fiscal autonomy will be part of ongoing discussions to establish and agree the Fiscal Framework.

Alongside the resource spending review, we have also conducted a targeted review of our capital spending plans, to deal with much lower-than-expected funding from the UK Government, and to ensure capital investments align with government priorities, as set out in the Programme for Government and Bute House agreement. Whilst final allocations will be confirmed as part of the annual budget process, there are no changes to the Local Government capital allocations as set out in my letter to the COSLA President dated 4 February 2021.

Fiscal Flexibilities

In my letter to you on 9 December 2021 alongside the budget, I confirmed my intention to allow an extension of the flexibilities to allow capital receipts to be used to fund the financial impact of COVID and to fund transformational projects subject to confirmation from the UK Government that this will not result in an adjustment to Scotland's block grant.

Unfortunately, the UK Government recently rejected my request and confirmed that any use of this flexibility to fund the financial impact of COVID will result in an adjustment to Scotland's block grant. Given the constrained fiscal position, I am therefore no longer able to offer that specific flexibility to deal with the impact of COVID although the offer of flexibility on using receipts for transformational projects remains unchanged.

In that letter, I also outlined my commitment to continue working with Directors of Finance and CIPFA/LASAAC on a Capital Accounting Review. I have now received a copy of the conclusions of the Directors of Finance's review. I am extremely grateful to Directors of Finance for their work on that review but having considered their findings, it falls short of the comprehensive review that was anticipated at the outset of these discussions. As noted by both Audit Scotland and LASAAC, the review focuses on capital funding arrangements and on maintain existing statutory mitigation but does not deliver proposals for closer alignment with accounting standards.

The spending review therefore confirms the Scottish Government's intention to commission an independent Capital Accounting Review. The independent review will build on the review already taken forward by Directors of Finance working with key stakeholders to deliver a phased approach towards alignment with the CIPFA Code of Practice for Local Authority Accounting.

This review will help to enhance the future sustainability of local services and address the inconsistencies of current statutory arrangements with the requirements of the CIPFA Accounting Code but I acknowledge that it will not address the long-standing request from COSLA on flexibility regarding the accounting treatment of service concessions.

On 1 February 2022, I wrote to CIPFA/LASAAC inviting them to offer an independent view on COSLA's request, which had of course been substantially changed when Directors of Finance acknowledged that a key part of the original request would have been inconsistent with recognised accounting practice. I have now received their response to the amended request and whilst I am very grateful to CIPFA LASAAC for their consideration, the response was ultimately inconclusive on the key aspects. The fact that CIPFA/LASAAC were unable to provide a conclusive resolution to this does highlight the risks of statutory intervention and the need for a comprehensive review.

In light of the withdrawal of the request to capitalise interest payments, I am willing to accede to the request to recognise principal debt repayments over the asset life and for this approach to be applied retrospectively. I will also agree that this may apply to the grant funded element of the principal debt repayments.

This flexibility will only apply to existing service concessions and each local authority will be responsible for fully evaluating any change in method and making appropriate financial provision. The decision for making any change must be taken by the Council, that is, it may not be delegated. The Minister for Public Finance, Planning and Community Wealth will provide further details on the statutory mitigation and the remit of the independent review in due course. We will of course welcome your input to the scope and design of that review.

Conclusion

The spending review does not alter the parliamentary requirement for an annual budget process but it does provide the multi-year certainty requested by COSLA on numerous occasions. It guarantees the combination of General Revenue Grant and Non-Domestic Rates income at current levels despite a challenging UK Government Settlement and offers protection against Non-Domestic Rates revenue uncertainty post-COVID-19 and ahead of the 2023 revaluation with the addition of a further £100 million in 2026-27.

Due to the strategic nature of the portfolio allocations, it is not possible to prepare direct comparison with previous years but the spending review provides funding certainty over key transfers for Teachers and Health and Social Care. The spending review also reaffirms our commitment to working with COSLA and SOLACE to agree a new deal for Local Government in Scotland in advance of the next financial year and I look forward to commencing those discussions with the new COSLA Leadership in due course.

Yours sincerely.

KATE FORBES