

## **Financial Strategy 2019/20 to 2022/23**

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

#### **1 Purpose of Report**

This report is the first in a series of reports which will provide Council with updates on the Financial Strategy, encompassing the years 2019/20 to 2022/23, to enable Council to determine Council Tax and set a balanced budget for 2019/20 by 11 March 2019 in accordance with Section 93 of the Local Government Finance Act 1992 (as amended). It includes:-

- An assessment of the 2019/20 and future years Scottish Government Grant prospects;
- Updated budget projections for 2019/20 to 2021/22 and the initial projections for 2022/23;
- A sensitivity analysis reflecting the potential impact of different pay and grant settlement scenarios;
- An update on the arrangements for the delegation of resources to the Midlothian Integration Joint Board;
- An update on the Change Programme which will be the means to address the projected budget shortfalls;
- The proposed governance arrangements and timetable for the 2019/20 budget;
- An update on General Fund Reserves.

#### **2 Background**

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

The last Financial Strategy report was presented to Council on 13 February 2018 and provided an updated assessment of projected budgets shortfalls through to 2021/22. At that meeting Council set both Council Tax levels and the budget for 2018/19.

This report begins the process by which Council will determine its budget and set Council Tax levels for 2019/20, within the context of the longer term financial projections.

### 3 Scottish Government Grant Settlement

The Scottish Government's grant settlement is one of the most critical aspects of the financial projections in this report.

There are a number of factors which will influence the level of grant support Council might expect for 2019/20 and beyond. Among these will be a range of economic factors which will influence the resources Scottish Government has at its disposal, whether from the UK Government block grant or through tax revenues directly controlled by Scottish Government. The other main factors will be the taxation and spending priorities of the Scottish Government and the negotiations with other parties in the Scottish Parliament to support the passage of the budget bill.

Whilst an assessment of the economic factors can be made at this time based on the information available from the Office of Budget Responsibility, the Scottish Fiscal Commission (SFC) and for the 2019/20 budget process [Scotland's Fiscal Outlook](#), the Scottish Government's first five year (medium term) financial strategy (MTFS), the impact of Scottish Government's tax and spending priorities will only become fully apparent when the Scottish Government's 2019/20 budget is published in December 2018.

On 30 May 2018 the Cabinet Secretary for Finance and the Constitution published [Scotland's Fiscal Outlook](#). This, together with the accompanying Economic and Fiscal Forecasts of the SFC, is designed to be a key part of the revised parliamentary budget process that arose out of the work of the Budget Process Review Group and the development of a year-round approach to budget scrutiny. It represents the clearest statement of intent by the Scottish Government of its future funding plans made for many years. In respect of the resource budget the MTFS confirms its spending priority areas to be:

- **Health**, with a budget of around £13 billion in 2018/19, but rising to over £14 billion by 2021-22 (and with scope for further increases, not included yet, in 2022/23);
- **Police**, with a budget of around £1 billion which is protected in real terms, i.e. growing at the rate of inflation;
- **Early Learning and Childcare**, with a budget rising to over £500 million by 2021 and with implications for Local Government resource funding;
- **Attainment**, via the £750 million Attainment Scotland Fund covering the term of the Parliament;
- **Higher Education**, with a budget of over £1 billion; and
- **Social Security**, with a budget that grows to over £3 billion by 2021/22, largely due to the phased transfer of responsibilities from the UK Government.

The majority of the £12 billion remainder of the resource budget relates to Local Government.

Under the Scottish Government's central scenario the overall resource budget (ex new social security) is projected to rise from £27.6 billion in 2018/19 to £29.2 billion in 2022/23. An increase of 5.8%. The resource budget that is

utilised by the six commitments highlighted above is estimated to grow under the central scenario from 56% in 2019/20 to 64% in 2022/23 accordingly, all things being equal, the impact on the remainder of the resource budget of £12 billion would result in a reduction to £10.5 billion. This would represent a significant cash reduction of 14% over the period.

The MTFS highlights that in setting the annual budget each year, the Scottish Government will have to make careful choices in the prioritisation of commitments and expenditure in order to reach a balanced budget position. The decisions that will be taken will include consideration of the balance of funding that will be allocated to the range of priorities, to Local Government and to support other key public services across Scotland. The central funding scenario in the MTFS indicates that decisions around prioritisation of spending, options for increasing revenues, delivery of efficiencies across all budget areas and considering options for reform will need to be undertaken to accommodate these priorities and continue to support high quality public services across Scotland. The MTFS indicates that even under the most optimistic scenario, if no reprioritisation or reform were agreed and no additional revenues generated, then efficiency savings of 5% per year could be required.

In terms of public sector pay policy the Scottish Fiscal Commission's (SFC) central scenario assumes a continuation of the 2018-19 Public Sector pay policy, i.e. based on 3% up to £36,500, 2% up to £80,000 and £1,600 above £80,000 in each of the years modelled. Alternative scenarios assume 4% and 2% across the board.

Whilst the MTFS represents the clearest statement of intent by the Scottish Government of its future funding plans Government will still require to adapt these to secure support of others for the passage of future year's budget bills. The MTFS and pay scenarios of the SFC do however help inform two the key assumptions for the Council's own Financial Strategy, the prospects for the Scottish Government Grant Settlement and provisions for future pay inflation.

It is expected that as in previous years the Cabinet Secretary for Finance and the Constitution will publish the Scottish Government's budget proposals for 2019/20 in December 2018. This will follow on from the publication of the UK Government's Autumn Budget. It is anticipated that Scottish Government will publish a budget only for the year ahead and will not return to the publication of three year budgets. The Finance Circular setting out the proposed individual Council grant settlements figures and associated conditions, again for 2019/20 only, is expected to be published either alongside the budget or shortly afterwards.

Thereafter the parliamentary process for approving Government's budget is expected to be concluded in February 2019. Members will recollect that for the last two years changes were made during the parliamentary process which resulted in an additional provision in the grant settlement from that originally published.

The changes in Income Tax announced as part of the Government's 2018/19 budget were expected to raise £164 million rising to £220 million by 2022/23. It remains to

be seen whether these are the start of a journey towards higher tax rates to help offset further cuts or whether it is a one-off decision. If it is a one-off then it will do little to ease the pressure in future years for further cuts as Governments continue in their efforts to balance budgets.

On the basis of the information available from Government and independent sources the grant projections set out later in this report are now based on a central planning assumption of a 2% per annum cash reduction at a national level. It also assumes that the £125 million announced on 31 January 2018 will be mainstreamed. The lower scenario set out in section 6 assumes a cash reduction of 4% per annum with the upper scenario a cash flat position. The position at a national level is partly offset by the impact of the relative growth in the Midlothian population.

It is stressed that the grant settlement figures for 2019/20 to 2022/23 set out table 1 are projections, the actual figures being dependant on future budget decisions taken by Government. However they do provide Council with an assessment of the impact of the grant settlement on the Council's financial position. Critically they highlight the severity of the challenge ahead, based on the Government's central scenario, for the term of the Council and the extent to which service provision will have to be transformed.

#### **4 Council Tax**

The budget shortfalls set out in table 1 are based on the current Band D Council Tax of £1,283 and reflect the additional income from an increase in the number of properties.

It is assumed that grant settlement conditions will continue to provide flexibility to increase Council Tax by up to 3%. For Midlothian a 3% per annum increase is estimated to generate £1.438 million for 2019/20 rising to £1.693 million in 2022/23 and would result in Band D Council Tax rising to £1,321 in 2019/20 and to £1,444 by 2022/23.

Given the grant prospects set out in section 3 of this report the Financial Strategy incorporates the full 3% increase for each year to contribute to reducing the projected budget shortfalls.

#### **5 Cost of Services**

The projected cost of services for future years is derived from the 2018/19 approved budget detailed in appendix 1. The projections will be updated over the summer to reflect the latest information available. Changes will be incorporated into an update report proposed for Council in October 2018.

Table 2 provides an analysis of the principle year on year budget changes which include the following key assumptions and cost drivers:

- Pay inflation based on 3% up to £36,500, 2% up to £80,000 and £1,600 above £80,000 for each year for all staff groups based on the SFC's central scenario together with the cost of incremental pay progression;
- Changes in the Council's contribution towards employee pensions costs advised by Lothian Pension Fund and SPPA;
- Provision for the Devolved School Management allocation to schools based on the DSM scheme and indicative pupil numbers;
- Contractual inflation linked to existing contractual conditions, many of which mirror pay inflation assumptions;
- A provision for the future years costs of maintain pay levels for procured care services at or above the living wage;
- The impact of current demand for services;
- The demographic impact on the future demand for services;
- Borrowing costs related to the approved capital investment decisions based on 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.

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

**Table 1: Budget Shortfalls 2019/20 to 2022/23 – 26 June 2018**

|                                 | <b>2019/20</b> | <b>2020/21</b> | <b>2021/22</b> | <b>2022/23</b> |
|---------------------------------|----------------|----------------|----------------|----------------|
|                                 | <b>£m</b>      | <b>£m</b>      | <b>£m</b>      | <b>£m</b>      |
| Cost of Services                | 209.186        | 217.134        | 226.074        | 236.185        |
| Less: Council Tax               | (47.919)       | (48.519)       | (49.119)       | (49.719)       |
| Less: Scottish Government Grant | (152.073)      | (150.583)      | (149.091)      | (147.598)      |
| <b>Budget Shortfalls</b>        | <b>9.194</b>   | <b>18.032</b>  | <b>27.864</b>  | <b>38.868</b>  |

The budget shortfall in 2019/20 equates 4.4% of the net cost of services and the projections indicate this could rise to 16% by 2022/23.

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 the teacher pupil ratio; and
- Growing demand for services through demographic pressures.

These elements of the budget equate to £115 million in 2019/20 and are projected to rise to £150 million by 2022/23. Consequently the budget shortfall

expressed as a percentage of the remainder of the budget equates to 9% for 2019/20 and has the potential to rise to 45% by 2022/23.

Whilst the projected cost of service provision, Council Tax and Scottish Government grant has been projected forward to 2022/23 these are very much indicative projections based on the assumptions set out in sections 3 to 5 and will inevitably change over the period. The projections and planning assumptions on which they are based will be updated and reported to Council as new information becomes available.

The main purpose of the projections is to provide Council with an assessment of the key factors which influence income and expenditure and the overall impact these may have on the Council's financial position for future years. Critically they highlight the severity of the challenge ahead for the term of Council and the extent to which service provision will have to continue to be significantly transformed and or reduced.

Members should note that the projections are based on the continuation of the existing service delivery and funding arrangements for Local Government.

The budget shortfalls set out in table 1 arise for the following reasons:

**Table 2: Analysis of Shortfalls – 26 June 2018**

|                                      | <b>2019/20</b> | <b>2020/21</b> | <b>2021/22</b> | <b>2022/23</b> |
|--------------------------------------|----------------|----------------|----------------|----------------|
|                                      | <b>£m</b>      | <b>£m</b>      | <b>£m</b>      | <b>£m</b>      |
| Opening Shortfall                    | <b>(0.200)</b> | <b>9.194</b>   | <b>18.032</b>  | <b>27.864</b>  |
|                                      |                |                |                |                |
| Pay Inflation and Salary Progression | 4.729          | 4.894          | 5.168          | 5.353          |
| Contractual Inflation                | 0.882          | 0.896          | 0.910          | 0.925          |
| Utilities                            | 0.068          | 0.070          | 0.071          | 0.073          |
| Demographics: Care                   | 1.040          | 1.040          | 1.040          | 1.040          |
| Demographics: School Rolls           | 2.650          | 2.375          | 2.375          | 2.375          |
| 25 Hours in Primary Schools          | 0.000          | 0.000          | 0.000          | 0.000          |
| Demand pressures: Children           | 1.025          | 0.025          | 0.025          | 0.025          |
| School Estate Investment             | 0.311          | 0.208          | 0.008          | 0.012          |
| Waste Disposal Costs                 | 0.198          | (0.272)        | 0.112          | 0.129          |
| Non Domestic Rates                   | 0.125          | 0.128          | 0.131          | 0.134          |
| Borrowing Costs                      | 0.256          | (0.123)        | (0.007)        | 0.000          |
| Scottish Government Grant            | 1.489          | 1.490          | 1.492          | 1.493          |
| Council Tax Income                   | (0.600)        | (0.600)        | (0.600)        | (0.600)        |
| Full year effect of 2018/19 savings  | (2.760)        | (1.415)        | (0.829)        | (0.000)        |
| Other Movements                      | (0.019)        | 0.122          | (0.064)        | 0.045          |
| <b>Totals</b>                        | <b>9.194</b>   | <b>18.032</b>  | <b>27.864</b>  | <b>38.868</b>  |

The principal movement from the figures set out in the 13 February 2018 report are as follows.

**Table 3: Movement from 13 February 2018 to 26 June 2018**

|                                   | 2019/20       | 2020/21       | 2021/22       | 2022/23       |
|-----------------------------------|---------------|---------------|---------------|---------------|
|                                   | £m            | £m            | £m            | £m            |
| <b>Shortfall 13 February 2018</b> | <b>20.048</b> | <b>29.198</b> | <b>37.987</b> | <b>-</b>      |
| 2022/23 Initial Projection        | -             | -             | -             | 38.868        |
| Pay Inflation                     | 1.079         | 2.272         | 3.680         | -             |
| Contractual Inflation             | 0.313         | 0.708         | 1.037         | -             |
| School Rolls and Estate           | (0.935)       | (1.183)       | (1.919)       | -             |
| Children's Services               | 1.001         | 1.002         | 1.003         | -             |
| Scottish Government Grant         | 0.772         | 0.755         | 0.739         | -             |
| Council Tax Income                | 0.000         | 0.050         | 0.050         | -             |
| 2018/19 Council Tax Increase      | (1.274)       | (1.274)       | (1.274)       | -             |
| 2018/19 Policy Savings            | (6.389)       | (7.489)       | (8.083)       | -             |
| 2018/19 Operational Savings       | (2.286)       | (2.601)       | (2.836)       | -             |
| 2018/19 Loan Charges              | (0.500)       | (0.500)       | (0.500)       | -             |
| 2018/19 Transformation Savings    | (2.799)       | (2.799)       | (2.799)       | -             |
| Other Movements                   | 0.164         | (0.107)       | 0.779         | -             |
| <b>Shortfall 26 June 2018</b>     | <b>9.194</b>  | <b>18.032</b> | <b>27.864</b> | <b>38.868</b> |

## 6 Sensitivity Analysis

Given the level of uncertainty for future year grant settlements and pay awards table 4 provides a sensitivity analysis reflecting the potential impact of different scenarios for these two key aspects of the budget. As indicated earlier these scenarios are based on the MTFs and the SFC's alternative scenarios for pay of 4% and 2% across the board.

**Upper Scenario.** This is a more optimistic scenario which assumes a 2% pay award across the board in each of the years and cash flat grant settlements at a national level. All other assumptions remain as set out in section 3.

**Lower Scenario.** Is a more pessimistic scenario which assumes a 4% pay award and reducing grant income based on a 4% cash reduction per annum at a national level as set out in section 2.

**Table 4: Sensitivity Analysis – 26 June 2018**

|                          | 2019/20      | 2020/21       | 2021/22       | 2022/23       |
|--------------------------|--------------|---------------|---------------|---------------|
|                          | £m           | £m            | £m            | £m            |
| <b>Upper Scenario</b>    |              |               |               |               |
| Central Assumption       | <b>9.194</b> | <b>18.032</b> | <b>27.864</b> | <b>38.868</b> |
| 2% Pay Awards            | (1.576)      | (3.207)       | (4.930)       | (6.714)       |
| Cash flat settlement     | (3.103)      | (6.207)       | (9.313)       | (12.420)      |
| <b>Amended Shortfall</b> | <b>4.515</b> | <b>8.618</b>  | <b>13.621</b> | <b>19.734</b> |

|                            |               |               |               |               |
|----------------------------|---------------|---------------|---------------|---------------|
| <b>Lower Scenario</b>      |               |               |               |               |
| Central Assumption         | <b>9.194</b>  | <b>18.032</b> | <b>27.864</b> | <b>38.868</b> |
| 4% Pay Awards              | 1.576         | 3.207         | 4.930         | 6.714         |
| 4% cash reduction in Grant | 3.103         | 6.084         | 8.944         | 11.686        |
| <b>Amended Shortfall</b>   | <b>13.873</b> | <b>27.323</b> | <b>41.738</b> | <b>57.268</b> |

These scenarios demonstrate the significance of the impact that changes from the central planning assumption for either government grant or pay inflation have on the projected budget shortfalls.

## 7 Midlothian Integration Joint Board

As part of the budget setting process the Council will need to determine an allocation of resources to the Midlothian Integrated Joint Board (IJB). For 2018/19 the allocation was set at £39.750 million. The projected budget shortfalls set out earlier incorporate a provision for pay awards, inflationary uplifts and a sum for demographic cost pressures in respect of services delegated to the IJB.

The Change Programme proposed to Council on 13 February 2018 provided for the demographic cost pressures for future years to be significantly offset. However the motion approved by Council did not include this offset as part of the future year's budget gap projections. Consequently the proposed allocation of resources for 2019/20 and indicative allocations for future years is estimated to be as follows:-

**Table 5: IJB allocations – 26 June 2018**

|                                   | <b>2019/20</b> | <b>2020/21</b> | <b>2021/22</b> | <b>2022/23</b> |
|-----------------------------------|----------------|----------------|----------------|----------------|
|                                   | <b>£m</b>      | <b>£m</b>      | <b>£m</b>      | <b>£m</b>      |
| <b>Previous Year's Allocation</b> | <b>39.750</b>  | <b>41.817</b>  | <b>43.908</b>  | <b>46.036</b>  |
| Uplifts:                          |                |                |                |                |
| Pay and inflation                 | 1.027          | 1.051          | 1.088          | 1.114          |
| Demographic Pressures             | 1.040          | 1.040          | 1.040          | 1.040          |
| Additional Funding                | 0              | 0              | 0              | 0              |
|                                   | <b>41.817</b>  | <b>43.908</b>  | <b>46.036</b>  | <b>48.190</b>  |
| Change Programme Savings          | 0              | 0              | 0              | 0              |
| <b>Indicative Allocations</b>     | <b>41.817</b>  | <b>43.908</b>  | <b>46.036</b>  | <b>48.190</b>  |

It is recommended at this time that Council advise the IJB of the updated projections for later years, in the context of the Council's overall budget position and that discussions continue with officers of the IJB to secure a sustainable strategy for the delivery of delegated services which can be delivered within the resource allocation. This ongoing dialogue will inform the development of both the Council's and the IJB's future years Financial Strategy.



This approach will support the IJB as it develops its own Financial Strategy within the context of the financial pressures and the available allocations anticipated to be available from both the Council and NHS Lothian.

## **8 Change Programme**

### **8.1 Delivering Excellence**

The Delivering Excellence framework 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.

A draft of the refreshed Delivering Excellence Change and Transformation Strategy is set out at appendix 4. This draft strategy 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.

The future year's impact of the Change Programme proposals approved by Council on 13 February 2018 are already reflected in the projected budget gaps set out in Table 8 below.

Taking cognisance of the extent of savings anticipated to be required to secure a balanced budget for 2019/20 and the continued challenge for later years the Strategic Leadership Group is working to develop and bring forward its assessment of the most appropriate solution to secure a balanced budget for 2019/20 and also address future years projected budget gaps. This work is ongoing and a comprehensive Change Programme will be finalised and brought forward, via the Business Transformation Steering Group.

The timetable set out in section 9, if approved today, provides for these savings proposals to be first presented to Council on 2 October 2018 which will then facilitate a period of engagement with the community on the financial challenge and Change Programme through Shaping our Future, the engagement strand of the Delivering Excellence framework. This engagement is anticipated to run until mid-December 2018 and the feedback from this together with the feedback from earlier budget consultations is intended to help to inform 2019/20 budget decisions by Council early in 2019.

## 8.2 Transformation Programme

The savings targets associated with the Transformation Programme are set out in table 6 below and detailed in appendix 2. These reflect the decision of Council on 13 February 2018 other than for Children's Services which at that point included a savings target of £0.335 million for 2019/20 onwards. Given the outturn position for 2017/18 reported elsewhere on today's agenda I do not consider it prudent to incorporate a further saving for this service in the Financial Strategy at this time.

**Table 6: Transformation Programme Savings (Cumulative) – 26 June 2018**

|                            | <b>2019/20</b> | <b>2020/21</b> | <b>2021/22</b> | <b>2022/23</b> |
|----------------------------|----------------|----------------|----------------|----------------|
|                            | <b>£m</b>      | <b>£m</b>      | <b>£m</b>      | <b>£m</b>      |
| Entrepreneurial Council    | 0.348          | 0.643          | 0.868          | 0.868          |
| Shared Services            | 0.025          | 0.025          | 0.025          | 0.025          |
| Digital Led                | 0.050          | 0.150          | 0.150          | 0.150          |
| Integrated Service Support | 0.500          | 0.500          | 0.500          | 0.500          |
| Workforce                  | 0.482          | 0.632          | 0.722          | 0.722          |
| Children's Services        | 0.000          | 0.000          | 0.000          | 0.000          |
| <b>Totals</b>              | <b>1.405</b>   | <b>1.950</b>   | <b>2.265</b>   | <b>2.265</b>   |

The proposals presented to Council on 13 February 2018 include additions to the Transformation Programme as summarised in table 7 and detailed in appendix 3. Whilst these were not incorporated in the future years budget gaps approved by Council they still remain relevant and continue to be part of the Strategic Leadership Group's solution to address the budget challenge.

**Table 7: Additions to Transformation Programme – 26 June 2018**

|                               | <b>2019/20</b> | <b>2020/21</b> | <b>2021/22</b> | <b>2022/23</b> |
|-------------------------------|----------------|----------------|----------------|----------------|
|                               | <b>£m</b>      | <b>£m</b>      | <b>£m</b>      | <b>£m</b>      |
| Entrepreneurial Council       | 1.210          | 2.125          | 3.710          | 3.710          |
| Enterprising with Communities | 0.000          | 0.100          | 1.100          | 1.100          |
| Shared Services               | 0.035          | 1.035          | 2.035          | 2.035          |
| Digital Led Transformation    | 0.000          | 0.000          | 0.500          | 0.500          |
| <b>Additions to Programme</b> | <b>1.245</b>   | <b>3.260</b>   | <b>7.345</b>   | <b>7.345</b>   |

In addition the report to Council on 13 February 2018 identified the following areas which would be further developed and incorporated in future Financial Strategy reports:-

- A Disability Service Review as part of the next steps for Children's Services Review;
- Efficiencies secured through the Learning Strategy Estate, wider property asset management and asset rationalisation;
- A master plan for the Vogrie Estate and potential income opportunities it creates;

- A further review of the approaches to and resources committed to transportation of people, both clients and staff;
- A broader review of concessions for future consideration;
- Workforce, recognising that employee costs are by far the largest element of the budget.

### **8.3 Capital and Reserves Strategy**

The projected future year's budgets include a provision for the loan charges which reflects the funding strategy outlined in the draft Capital Strategy and reported separately on today's agenda and is governed by the Treasury Management and Investment Strategy which is also reported on today's agenda.

An increase in the affordable borrowing from that set out in the draft Capital Strategy, or changes from the proposed Treasury Management and Investment Strategy would inevitably lead to an increase the projected budget shortfalls for later years. In the absence of any other funding support, this will in turn require further reductions in the service budgets.

The latest projections for the General Fund Reserve are set out later in this report.

### **8.4 Operational Savings**

The budget projections set out in tables 1 and 2 already reflect the operational savings approved in previous year's budgets. It is anticipated that further operational savings will be identified as part of the Strategic Leadership Group's proposals.

### **8.5 Policy Savings**

The budget projections set out in tables 1 and 2 already reflect the savings approved in previous year's budgets. It is anticipated that further policy savings will be identified as part of the Strategic Leadership Group's proposals.

### **8.6 Bottom-up/Cross Cutting Service Reviews**

On 13 February 2018 Council agreed that the Chief Executive in conjunction with the Council Leader bring forward as part of a revised transformation programme proposals which include a bottom up/cross Council service review programme to be overseen by a 3 member cross party working group, in addition to the Council Leader, with recommendations from the working group being reported directly to Council.

A separate report is on today's agenda setting out the arrangements for the reviews together with proposals for the first three phases. As savings are identified as part of these reviews they will be reflected in the Financial Strategy.

## 8.7 Fees and Charges

The budget projections set out in tables 1 and 2 already reflect the fees and charges changes approved in previous year's budgets with future years increase estimated in table 8. It is anticipated that further fees and charges increases will be identified as part of the Strategic Leadership Group's proposals.

## 8.8 Summary of Financial Strategy

The updated projections incorporating the impact of the various strands of the Financial Strategy set out above and a 3% per annum increases in Council Tax are set out in table 8 below.

**Table 8: Financial Strategy 2019/20 to 2022/23 – 26 June 2018**

|                                       | 2019/20        | 2020/21        | 2021/22        | 2022/23        |
|---------------------------------------|----------------|----------------|----------------|----------------|
|                                       | £m             | £m             | £m             | £m             |
| <b>Budget Shortfall Table 1</b>       | <b>9.194</b>   | <b>18.032</b>  | <b>27.864</b>  | <b>38.868</b>  |
| <b>Less: Change Programme</b>         |                |                |                |                |
| <b>Transformation Programme 8.2</b>   |                |                |                |                |
| - Existing Programme                  | (1.405)        | (1.950)        | (2.265)        | (2.265)        |
| - Additions to Programme              | (1.245)        | (3.260)        | (7.345)        | (7.345)        |
| <b>Total Transformation Programme</b> | <b>(2.650)</b> | <b>(5.210)</b> | <b>(9.610)</b> | <b>(9.610)</b> |
| Operational Savings 8.4               | (0.000)        | (0.000)        | (0.000)        | (0.000)        |
| Savings Options 8.5                   | (0.000)        | (0.000)        | (0.000)        | (0.000)        |
| Bottom-up Reviews 8.6                 | (0.000)        | (0.000)        | (0.000)        | (0.000)        |
| Fees and Charges 8.7                  | (0.052)        | (0.092)        | (0.112)        | (0.130)        |
| <b>Less:</b>                          |                |                |                |                |
| Council Tax Increase of 3%            | (1.438)        | (2.937)        | (4.499)        | (6.126)        |
| <b>Remaining Budget Gap</b>           | <b>5.054</b>   | <b>9.793</b>   | <b>13.643</b>  | <b>23.002</b>  |
| <b>Budget Gap - Upper Scenario</b>    | <b>0.375</b>   | <b>0.379</b>   | <b>(0.600)</b> | <b>3.868</b>   |
| <b>Budget Gap - Lower Scenario</b>    | <b>9.733</b>   | <b>19.084</b>  | <b>27.517</b>  | <b>41.402</b>  |

The emerging Change Programme for later years will be continually updated to take cognisance of the position for future years grant and pay settlements and demographic changes recognising the critical impact these issues have on the Financial Strategy and the projected budget position.

As the Financial Strategy develops over the coming months I will, as Section 95 Officer, require to seek assurance from Directors and Heads of Service that the budget proposals put forward by them for consideration are achievable and the risks associated with delivery have been identified.

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

## 9 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. All budget proposals will be reported through Business Transformation Steering Group and then to Council as appropriate. Responsibility for setting Council Tax, determining budgets and approving savings etc. 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. The proposed timetable set out in Table 9 would support the delivery of the Financial Strategy and specifically the determination of the 2019/20 budget and Council Tax levels before the statutory date.

**Table 9: Timetable – Key Events**

| <b>Date *</b>                       | <b>Event</b>     | <b>Action</b>  |
|-------------------------------------|------------------|--|
| 26 June 2018                        | Council          | <ul style="list-style-type: none"> <li>• Consideration of updated Financial Strategy.</li> <li>• Approval of timetable and approach for the 2019/20 budget.</li> </ul>   |
| Ongoing to September 2018           | Development Work | <ul style="list-style-type: none"> <li>• Development of Change Programme and savings proposals by Strategic Leadership Group.</li> </ul>   |
| 2 October 2018                      | Council          | <ul style="list-style-type: none"> <li>• Consideration of updated projections.</li> <li>• Update on Financial and Capital Strategy.</li> <li>• Transformation proposals approved for engagement.</li> </ul>  |
| October/November 2018               | Engagement       | <ul style="list-style-type: none"> <li>• Shaping our Future engagement on Financial Strategy and Change Programme proposals.</li> </ul>  |
| Mid to late December 2018           | Grant Settlement | <ul style="list-style-type: none"> <li>• Assessment of grant settlement implications on budget.</li> </ul>   |
| 18 December 2018                    | Council          | <ul style="list-style-type: none"> <li>• Consideration of update report and feedback on engagement.</li> </ul>   |
| Late January or Early February 2019 | Council          | <ul style="list-style-type: none"> <li>• Consideration of update report, reflecting grant settlement.</li> <li>• Consideration of Change Programme and savings proposals.</li> <li>• Recommendations to set Council Tax and determine a budget for 2019/20.</li> </ul> |

*\* Based on current meeting schedule and so may require revision. Interim reports will be presented to Council as necessary.*

Members should also 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 proposed for late January/Early February 2019 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 Focussing Resources to Key Priorities**

The Financial Strategy is not only about balancing the budget, it 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 Change Programme will be central to ensuring that resources are directed towards the priorities set out in the Midlothian Single Plan.

## **11 Reserves Update**

The position for General Fund Reserves is set out in the Financial Monitoring 2017/18 – General Fund Revenue report also on today's agenda.

The uncommitted General Fund Reserve at 31 March 2018 is £4.337 million. This uncommitted reserve equates to 2% of next expenditure as a contingency in the context of the continuing challenging financial outlook, the uncertainty associated with future years grant settlements, pay awards, the economic impact of Brexit and also the potential costs to come from the historic child abuse enquiry.

Given the level of available contingent reserves I would not consider it prudent for Council to meet additional spending pressures from the contingent reserve or to use the contingent reserve as part of the strategy to secure a balanced budget for 2019/20.

Table 10 summarises the General Fund Reserve position.

**Table 10: Available General Fund Reserve 31 March 2018 – 26 June 2018**

|  | <b>£million</b> |
|--|-----------------|
| <b>General Fund Balance at 31 March 2018</b>               | <b>10.777</b>   |
| <i>Earmarked for specific purposes</i>                     |                 |
| • Budgets carried forward to 2018/19 for specific purposes | (3.244)         |
| • Earmarked for Council Transformation                     | (2.015)         |
| • Devolved School Management                               | (1.181)         |
| <b>Available Contingent Reserve at 31 March 2018</b>       | <b>4.337</b>    |

## **12 Report Implications**

### **12.1 Resources**

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

### **12.2 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;
- Given the nature of the savings options incorporated in the budget proposals the increase risk of non-delivery or late delivery of planned savings, including those arising from reductions in the staffing establishment;
- The risk to service provision and service users associated with a continued decline in available resources to fund services;
- Outstanding pay award settlements and the implications of the National Living Wage for external service providers;
- Actual school rolls exceeding 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 impact of Universal Credit, and potential pension changes;
- The costs of implementation of national policies varying from the resources provided by Government; and
- Unplanned 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 Programme activities, setting out the early identification of future saving proposals.

The projections set out in this report highlight the severity of the challenge ahead for the term of this Council and the extent to which service provision will have to be significantly transformed and or reduced.

The work of the Strategic Leadership Group to bring forward and implement a comprehensive Change Programme is critical to enable Council to address the projected budget gaps and in securing financial sustainability for the continued delivery of services.

The severity of the challenge is such that Council will require to approve a range of proposals which not only achieves a balanced budget for 2019/20 but which will also contribute to reducing future years budget shortfalls. The risk of not doing so would be the potential elimination of available reserves and so severely limiting the Council's ability to deal with unforeseen or unplanned events.

### **12.3 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

### **12.4 Impact on Performance and Outcomes**

The Financial Strategy facilitates decision on how Council allocates and uses its available resources and as such has fundamental implications for service performance and outcomes. The budget projections indicate that in 2022/23 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.

### **12.5 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.

### **12.6 Involving Communities and Other Stakeholders**

The proposed timetable set out in section 9 includes the continuation of Shaping our Future, the consultation strand of the Delivering Excellence framework. This has a focus on informing the community and other stakeholders of the financial and service challenges and provides a means 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.



## **12.7 Ensuring Equalities**

The Financial Strategy and the Change Programme proposals which support financial sustainability have been developed within the context of the Midlothian Single Plan, ensuring that resources are directed towards the key priorities of reducing the gap in learning, health and economic circumstance outcomes.

The Financial Strategy and the Change Programme proposals will continue 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 (EqIA) for all proposals. In addition, these actions underline the Council's commitment in its Midlothian Equality Plan 2017/2021 to tackle inequality and promote inclusion which support the Council in planning and delivering services which meet the needs of our diverse communities and respond to the changes ahead.

Individual assessments together with an overarching EqIA will be published alongside the Financial Strategy report in early 2019 which will set out recommendations for the 2019/20 budget.

## **12.8 Supporting Sustainable Development**

There are no direct sustainability issues arising from this report.

## **12.9 Digital Issues**

There are no direct Digital implications arising from this report.

## **13 Summary**

This report provides:-

- An assessment of the 2019/20 and future years Scottish Government Grant prospects;
- Updated budget projections for 2019/20 to 2021/22 and the initial projections for 2022/23;
- A sensitivity analysis reflecting the potential impact of different pay and grant settlement scenarios;
- An update on the arrangements for the delegation of resources to the Midlothian Integration Joint Board;
- An update on the Change Programme which will be the means to address the projected budget shortfalls;
- The proposed governance arrangements and timetable for the 2019/20 budget;
- An update on General Fund Reserves.

## 14 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 a 2% per annum reduction in grant settlements at a national level;
- b) Note the current 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 continuing uncertainties and the potential impact as outlined in the differing scenarios as set out in section 6;
- d) Note the requirement to delegate resources to the Midlothian Integrated Joint Board and the ongoing work to support the development of the IJB's own Financial Plans;
- e) Note the impact of the Change Programme and projected future years Council Tax increases and the impact on the Financial Strategy as set out in table 8;
- f) Note the governance arrangements out in section 9 and approve the proposed timetable set out in table 9;
- g) Note that the projections at this time indicate that a remaining budget gap of £5.054 million for 2019/20 rising to £23.002 million by 2021/21, though these are heavily dependent on the assumptions detailed in the report;
- h) Note that the Strategic Leadership Group is engaged in developing budget options which are intended to be presented to Council on 2 October 2018, with budget decisions being in early 2019;
- i) Note that given the level of available contingent reserves it would not be considered prudent for Council to meet additional spending pressures from the contingent reserve or to use the contingent reserve as part of the strategy to secure a balanced budget for 2019/20.
- j) Note the severity of the financial challenge and also the risks as set out in section 12.2.
- k) Otherwise note the contents of the report.

**Date** 15 June 2018

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# Appendix 1

## REVENUE BUDGET 2018/19 SUMMARY

| <b>SERVICE FUNCTION</b>                                     | <b>2018/19<br/>£</b> |
|---|----------------------|
| Management and Members                                      | 1,590,651            |
| <b>Resources</b>  |                      |
| Commercial Operations                                       | 14,024,072           |
| Finance & Integrated Service Support                        | 11,086,019           |
| Property & Facilities Management                            | 12,742,587           |
| <b>Health and Social Care</b>                               |                      |
| Adult and Social Care                                       | 39,749,938           |
| Customer and Housing Services                               | 11,274,354           |
| <b>Education, Communities and Economy</b>                   |                      |
| Childrens Services  | 15,234,429           |
| Communities and Economy                                     | 3,239,777            |
| Education   | 89,719,435           |
| Joint Boards  | 550,551              |
| Non Distributable Costs                                     | 1,338,437            |
| <b>GENERAL FUND SERVICES NET EXPENDITURE</b>                | <b>200,550,250</b>   |
| Loans Charges   | 7,060,000            |
| Investment Income   | (406,420)            |
| Business Transformation Targetted Savings                   | (1,463,224)          |
| Centrally Held Budget Provisions                            | 744,574              |
| Allocations to Housing Revenue Account, Capital Account etc | (4,934,180)          |
| <b>NET EXPENDITURE</b>                                      | <b>201,551,000</b>   |
| Utilisation / (Enhancement) of Reserves                     | (200,000)            |
| Council Tax Income  | 47,319,000           |
| Scottish Government Grant                                   | 154,432,000          |
| <b>TOTAL FUNDING</b>  | <b>201,551,000</b>   |

**GENERAL FUND SERVICES NET EXPENDITURE  
SUMMARY**

|  | £           | £                  |
|--|-------------|--------------------|
| <b>EMPLOYEE COSTS</b>                        |             |                    |
| SALARIES AND WAGES                           | 105,142,949 |                    |
| SUPERANNUATION                               | 19,254,124  |                    |
| NATIONAL INSURANCE                           | 9,748,003   |                    |
| ALLOWANCES                                   | 1,141,981   |                    |
| INDIRECT EMPLOYEE COSTS                      | -945,495    | <b>134,341,562</b> |
| <b>PREMISES COSTS</b>                        |             |                    |
| REPAIRS AND MAINTENANCE                      | 1,751,484   |                    |
| ENERGY COSTS                                 | 2,770,141   |                    |
| RENTS  | 20,336      |                    |
| RATES  | 4,990,836   |                    |
| WATER SERVICES                               | 527,804     |                    |
| FIXTURES AND FITTINGS                        | 261,473     |                    |
| CLEANING COSTS                               | 3,017,338   |                    |
| OTHER PROPERTY COSTS                         | 97,592      |                    |
| PREMISES INSURANCE                           | 101,323     |                    |
| GROUND MAINTENANCE                           | 892,343     | <b>14,430,670</b>  |
| <b>TRANSPORT COSTS</b>                       |             |                    |
| DIRECT TRANSPORT COSTS                       | 1,091,471   |                    |
| CONTRACT HIRE AND OPER LEASES                | 5,607,223   |                    |
| CAR ALLOWANCES                               | 418,482     |                    |
| VEHICLE INSURANCE                            | 46,508      | <b>7,163,685</b>   |
| <b>SUPPLIES AND SERVICES</b>                 |             |                    |
| EQUIPMENT/FURNITURE/MATERIALS                | 12,296,247  |                    |
| CATERING                                     | 1,980,263   |                    |
| CLOTHING AND LAUNDRY                         | 168,157     |                    |
| PRINTING AND STATIONERY                      | 347,150     |                    |
| SERVICES                                     | 282,014     |                    |
| COMMUNICATIONS AND COMPUTING                 | 2,205,423   |                    |
| EXPENSES                                     | 49,707      |                    |
| GRANTS AND SUBSCRIPTIONS                     | 112,322     |                    |
| OTHER SUPPLIES AND SERVICES                  | 1,519,877   |                    |
| OTHER INSURANCES                             | 498,723     | <b>19,459,883</b>  |
| <b>THIRD PARTY PAYMENTS</b>                  |             |                    |
| INTERNAL RECHARGES                           | 3,141,796   |                    |
| OTHER LOCAL AUTHORITIES                      | 1,980,485   |                    |
| VOLUNTARY ASSOCIATIONS                       | 1,032,685   |                    |
| OTHER ESTABLISHMENTS                         | 52,367,544  |                    |
| PRIVATE CONTRACTORS                          | 13,783,905  | <b>72,306,415</b>  |
| <b>TRANSFER PAYMENTS</b>                     |             |                    |
| PAYMENTS TO INDIVIDUALS                      | 37,086,424  |                    |
| OTHER ESTABLISHMENTS                         | 0           | <b>37,086,424</b>  |
| <b>GROSS EXPENDITURE TOTAL</b>               |             | <b>284,788,639</b> |
| <b>INCOME</b>                                |             |                    |
| GOVERNMENT GRANTS                            | 30,910,691  |                    |
| OTHER GRANTS & CONTRIBUTIONS                 | 14,031,727  |                    |
| CUSTOMER & CLIENT RECEIPTS                   | 15,645,861  |                    |
| RECHARGES                                    | 23,650,111  | <b>84,238,390</b>  |
| <b>GENERAL FUND SERVICES NET EXPENDITURE</b> |             | <b>200,550,249</b> |