

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

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

It includes:-

- An update Scottish Government Grant timing and prospects;
- Updated budget projections for 2017/18 to 2021/22;
- A sensitivity analysis reflecting the potential impact of different scenarios;
- An assessment of the indicative level of resources which would be provided to the Midlothian Integration Joint Board in 2017/18;
- An update on the existing and proposed change programmes aimed at addressing the projected budget shortfalls;
- An update on reserves.

2 Background

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

On 27 September 2016 Council was provided with an updated assessment of projected budgets shortfalls through to 2021/22 which, based on the assumptions set out in that report, projected a budget shortfall for 2017/18 of £9.858 million rising to £40.731 million. Encompassing the savings targets for the change programme and assuming a 3% per annum increase in Council Tax resulted in a remaining budget gap to be addressed of £5.867 million for 2017/18 rising to £31.712 million in 2021/22.

Scottish Government grant accounts for 80% of external funding. As in previous years the prospects for and the timing of future years grant settlements are a major factor which dominates the financial projections set out in this report. The Grant Settlement will continue to dominate the remainder of the 2017/18 budget setting cycle and future Financial Strategy reports and will also dictate the timing of and the extent to which Council has to reshape and reduce service budgets in order to maintain financial sustainability.

3 Scottish Government Grant Settlement

Since the last report to Council it has been confirmed that Scottish Government intends to publish its 2017/18 draft budget on 15 December 2016 and at the same time publish the Finance Circular which sets out individual Council Grant settlements.

The prospects for the 2017/18 grant settlement and also that for later years remain challenging. The projections set out below are based on a the central planning assumption, adopted on 27 September 2016, of a £1 million reduction in Government Grant support per annum with specific conditions and direction of resources continuing to be a feature of future years grant settlements.

It is stressed that the grant figures set out in table 1 below are only projections and will remain so until the Scottish Government budget and announcements on grant support are published on 15 December 2016.

4 Council Tax

The budget shortfalls set out in table 1 are based on the current Band D Council Tax of £1,210 and reflect the additional income from an increase in the number of properties together with the anticipated income generated by the reform of Council Tax as set out in the Financial Strategy report on 27 September 2016.

The additional income arising from reform is estimated at £109 million nationally, £1.7 million for Midlothian. It is anticipated that this will in effect be removed from the general grant provided to Councils with Government indicating that £9 million will be distributed to offset the additional Council Tax reduction costs with the remaining £100 million distributed based on Free School Meals eligibility directly to Schools. On this basis it is estimated that Midlothian schools allocation will be in the region of £0.500 million.

As previously reported it is expected that Scottish Government will include conditions in the 2017/18 and future years grant settlements to cap the annual increase for Council Tax to 3%. For Midlothian a 3% increase is estimated to generate £1.2 million per annum and would result in Band D Council Tax rising to £1,246 in 2017/18 and to £1,403 by 2021/22. Given the grant prospects set out in section 3 of this report the Financial Strategy incorporates a 3% increase to address the projected budget shortfalls.

5 Cost of Services

The assessment of the projected cost of services for 2017/18 to 2021/22 set out in this report reflects the latest information available. Table 2 provides an analysis of the principal year on year budget changes which include the following key assumptions and cost drivers:

- Pay inflation of 1% per annum. The Local Government Workers Trade Unions have submitted a one year pay claim for 2017/18 of a flat £1,000 per annum

across all grades. For Midlothian this equates to 4.5% and an indicative cost of £3.5 million. £2.700 million more than reflected in table 2;

- The cost of the Review of Pay and Grading and subsequent incremental pay progression;
- The impact of Pension Reform and anticipated changes in the Council's contribution towards employee pensions;
- That the Apprenticeship levy of 0.5% of the pay bill, which would equate to £0.500 million, is compensated by additional grant or other funding to offset its impact ;
- Contractual inflation linked to existing contractual conditions, many of which mirror pay inflation assumptions;
- An initial provision for future years costs of maintain pay levels for procured care services at or above the living wage;
- Impact of current demand for services;
- Demographic impact of future demand for services;
- The additional cost of delivering the statutory 25 hours of teacher contact each week in primary schools.
- Future interest rate forecasts provided by the Council's Treasury Advisers;
- Any new government policy requiring budgetary growth will be fully funded through increased Scottish Government grant;
- Council Tax income continues to grow in line with previous trends and planned future housing growth.

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

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

Table 1: Budget Shortfalls 2017/18 to 2021/22– 8 November 2016

	2017/18	2018/19	2019/20	2020/21	2021/22
	£m	£m	£m	£m	£m
Cost of Services	202.284	209.271	217.026	224.274	231.847
Less: Council Tax	(43.450)	(44.100)	(44.750)	(45.400)	(46.050)
Less: Scottish Government Grant	(148.816)	(147.816)	(146.816)	(145.816)	(144.816)
Budget Shortfall	10.018	17.355	25.460	33.058	40.981

The budget shortfall in 2017/18 equates to 4.9% of the net cost of services and is projected to rise to 17.6% by 2021/22.

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

- Historic decisions, for example, loan charges and unitary charge contractual payments;
- Specific conditions, for example the maintenance of teacher numbers and teacher pupil ratio; and
- Growing demand for services through demographic pressures.

These elements of the budget equate to £112 million in 2017/18 and are projected to rise to £140 million by 2021/22. Consequently the budget shortfall expressed as a percentage of the remainder of the budget equates to 11% for 2017/18 potentially rising to 45% for 2021/22.

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

It is stressed that the cost of services set out in table 1 above and the analysis set out in table 2 are only projections based on an analysis of a range of information sources. The projections and planning assumptions on which they are based will be updated and reported to Council as new information becomes available.

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

Table 2: Analysis of Shortfalls – 8 November 2016

	2017/18	2018/19	2019/20	2020/21	2021/22
	£m	£m	£m	£m	£m
Opening Shortfall / (surplus)	2.668	10.018	17.355	25.460	33.058
Pay Inflation and Progression	2.350	1.893	2.344	2.297	2.451
Pensions Reform	0.350	0.000	0.000	0.000	0.000
Contractual Inflation	0.465	0.547	0.637	0.571	0.652
Demographics: Care	1.120	1.040	1.040	1.040	1.040
Demographics: School Rolls	2.098	2.260	2.770	2.798	3.083
25 Hours in Primary Schools	0.160	0.090	0.000	0.000	0.000
Demand pressures: Children	0.000	0.324	0.024	0.024	0.024
School Estate Investment	0.311	0.381	1.126	0.033	0.036
Waste Disposal Costs	0.049	0.213	(0.285)	0.125	0.125
Non Domestic Rates	0.128	0.132	0.135	0.138	1.142
Borrowing Costs	0.864	(0.003)	(0.089)	0.123	(0.007)
Scottish Government Grant					
- Council Tax Reform	1.700	0.000	0.000	0.000	0.000
- Reduction	1.000	1.000	1.000	1.000	1.000
Council Tax Income	(2.850)	(0.650)	(0.650)	(0.650)	(0.650)
Other Movements	(0.395)	0.110	0.053	0.099	(0.973)
Totals	10.018	17.355	25.460	33.058	40.981

The principal movement from the figures set out in the 27 September 2016 report are as follows.

Table 3: Movement from 27 September 2016 – 8 November 2016

	2017/18	2018/19	2019/20	2020/21	2021/22
	£m	£m	£m	£m	£m
Shortfalls 27 Sept 2016	9.858	17.105	25.210	32.808	40.731
25 Hours in Primary Schools	0.160	0.250	0.250	0.250	0.250
Shortfalls 8 Nov 2016	10.018	17.355	25.460	33.058	40.981

6 Sensitivity Analysis

Given the level of uncertainty associated with the 2017/18 grant settlement and budget table 4 provides an updated sensitivity analysis reflecting the potential impact of different scenarios/outcomes for the two key aspects of the budget. The level of grant support and pay awards.

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

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

Table 4: Sensitivity Analysis – 8 November 2016

	2017/18	2018/19	2019/20	2020/21	2021/22
	£m	£m	£m	£m	£m
Scenario 1					
Central Assumption	10.018	17.355	25.460	33.058	40.981
Cash Flat Government Grant	(1.000)	(2.000)	(3.000)	(4.000)	(5.000)
Amended Shortfall	9.018	15.355	22.460	29.058	35.981
Scenario 2					
Central Assumption	10.018	17.355	25.460	33.058	40.981
Revised Pay Award Assumption	3.600	5.500	7.400	9.300	11.200
Amended Shortfall	13.618	22.855	32.860	42.358	52.181

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

7 Midlothian Integration Joint Board

The Council delegated £37.086 million of the 2016/17 budget to The Midlothian Integration Joint Board in respect of the Services included in the Integration

Scheme. The IJB subsequently issued directions and a resource allocation to the Council in respect of Social Care services to be delivered by the Council.

The equivalent sum for 2017/18 included in the cost of services set out in table 1 is £38.476 million. This includes £1.120 million uplift for demographic. The £38.476 million will be reduced by the Integrated Health and Social Care transformation programme savings of £1.550 million to arrive at an indicative allocation to the IJB for 2017/18 of £36.926 million.

As further the savings options are considered through the budget process these may impact on the level of resources which are formally offered to the IJB. In the meantime The Chief Officer and Chief Financial Officer of the IJB have been advised of the figures set out above to enable the IJB to begin consideration of its 2017/18 financial plan and the directions it will issue to The Council and NHS Lothian.

8 Change Programme

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

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

8.1 Delivering Excellence

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

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

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

or approaches; and

- To ensure that there is achievement of the outcomes and priorities of the Council and Community Planning Partners.

Actions which contribute to the Financial Strategy continue to be developed through the framework. The Shaping our Future strand of the Delivering Excellence framework has focussed on engaging with the community and stakeholders on the challenge the Council faces and the current consultation which runs until 7 November 2016 will also provide a means to gauge public opinion on the service areas that the Council may have to change as it responds to the projected budget position.

8.2 Transformation Programme

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

The future year's savings targets incorporated in the Financial Strategy are derived from those set out in the Council Transformation Programme update reports to Business Transformation Steering Group (BTSG) and are set out in table 5 below.

Table 5: Council Transformation Programme Additional Savings – 8 November 2016

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

The savings targets set out in table 5 exclude those already reflected in the 2016/17 approved budget and are predicated on the outcomes of the reviews and any subsequent decisions taken by Council and so remain indicative.

8.3 Asset Management

The position remains as reported on 28 June 2016.

8.4 Capital Strategy and Reserves Strategy

The General Services Capital Plan reported to Council on 27 September 2016 set out the Capital Investment requirements for the period to 2021/22 and is reflected in the revenue budget forecast in this report.

A Reserves Strategy was approved by Council on 27 September 2016. Section 10 of this report provides an update on the available reserves based on the Financial Monitoring 2016-17 report on today's agenda.

8.5 Operational Savings

The budget projections set out in tables 1 and 2 already reflect the operational savings reported in previous year's budgets. Further operational savings will be reflected in the update to Council on 20 December 2016.

8.6 Savings Options

Taking cognisance of the extent of savings anticipated to secure a balanced budget for 2017/18 and the continued challenge for later years the Chief Executive instructed each Director to bring forward as minimum savings options of £5 million, £15 million in total for consideration by the Strategic Leadership Group (SLG) in September 2016. On 25 October 2016 a working draft of the options developed to date by SLG, and which amount to approximately £16 million, was provided to the Leader of The Council, Councillor Johnstone, The Leader of the Labour Group, Councillor Milligan and also Councillor Baxter.

The options, which remain confidential at this point, will be further refined by SLG over the coming weeks. A final set of proposals, once agreed by SLG, will then be presented to the Business Transformation Steering Group (BTSG) for their consideration before being presented to Council. The timetable agreed by Council on 28 June 2016 provides for savings proposals to be considered by Council on 20 December 2016.

8.7 Summary of Financial Strategy

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

Table 6: Financial Strategy 2017/18 to 2021/22 – 8 November 2016

	2017/18	2018/19	2019/20	2020/21	2021/22
	£m	£m	£m	£m	£m
Budget Shortfall (Table 1)	10.018	17.355	25.460	33.058	40.981
Less Strands:					
Transformation Programme (8.2)	(2.791)	(3.896)	(3.931)	(3.931)	(3.931)
Asset Management (8.3)	0.000	0.000	(0.288)	(0.288)	(0.288)
Operational Savings (8.5)	0.000	0.000	0.000	0.000	0.000
Savings Options (8.6)	0.000	0.000	0.000	0.000	0.000
Council Tax Increase	(1.200)	(2.400)	(3.600)	(4.800)	(4.800)
Remaining Budget Gap	6.027	11.059	17.641	24.039	31.962

It is stressed 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, with proposals being reported through Business Transformation Steering Group and then to Council as appropriate.

Table 7 sets out the remaining elements of the timetable which was agreed by Council on 28 June 2016 to support the delivery of the Financial Strategy and specifically the determination of the 2017/18 budget and Council Tax levels.

Table 7: Timetable – Key Events

Date	Event	Action
November 2016	BTSG	<ul style="list-style-type: none"> Consideration of change Programme and savings options.
20 December 2016	Council	<ul style="list-style-type: none"> Consideration of update report and consideration of savings options.
7 February 2017	Council	<ul style="list-style-type: none"> Consideration of update report, reflecting grant settlement. Recommendations to set Council Tax and determine a budget for 2017/18.

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

10 Focussing Resources to Key Priorities

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

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

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

11 Reserves

The Financial Monitoring 2016-17 report on today's agenda projects that the available element of the General Fund Reserve at 31 March 2017 will be £1.345 million as detailed in table 8 below.

Table 8: Available General Fund Reserve 31 March 2017 – 8 November 2016

	£million
General Fund Balance at 31 March 2017	13.672
<i>Earmarked for specific purposes</i>	
Approved contingency level of General Fund Reserve	(8.000)
Budgets earmarked for Council Transformation	(4.300)
Borders Rail Economic Development Opportunities	(0.027)
Available General Reserve at 31 March 2017	1.345

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;
- Outstanding pay award settlements and the implications of the proposed National Living Wage;
- Impact of economic climate on range of factors including: inflation, interest rates, employment, tax and income levels, service demands;
- Cost pressures exceeding budget estimates;
- Impact of Welfare Reform and pension changes;
- The costs of implementation of national policies varying from the resources provided by government; and
- Capital investment requirements and associated cost.

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

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 is central to the way Council allocates and uses its limited resources and as such has fundamental implications for service performance and outcomes. The budget projections indicate that in 2021/22 the Council will have available in the region of £191 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

Shaping our Future, the consultation strand of the Delivering Excellence Framework has and will continue to focus on informing the community and other stakeholders of the financial and service challenges and to consult on a range of options as the change programme develops. The response to the current consultation, which concludes on 7 November 2016, will be available to inform the 2017/18 budget decisions.

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

There are no equality implications arising directly from this report. As part of the development of savings proposals to address the projected budget gap EQIA's have been prepared.

An overarching EQIA encompassing the revenue budget for 2017/18 will be prepared and incorporated in the report considered by Council when it takes decisions on savings proposals on 20 December 2016 and updated when Council sets the 2017/18 budget and Council Tax.

12.8 Supporting Sustainable Development

There are no direct sustainability issues arising from this report.

12.9 IT Issues

There are no direct IT implications arising from this report.

13 Summary

The report provides:-

- An update on Scottish Government Grant timing and prospects;
- Updated budget projections for 2017/18 to 2021/22;
- An sensitivity analysis reflecting the potential impact of different scenarios;
- An assessment of the indicative level of resources which would be provided to the Midlothian Integration Joint Board in 2017/18;
- An update on the existing and proposed change programmes aimed at addressing the projected budget shortfalls;
- An update on reserves.

14 Recommendations

Council is recommended to:-

- a) Note the update in respect of the Scottish Government Grant Settlement as set out in section 2;
- b) Note the updated projected cost of services, key assumptions and resultant budget shortfalls as set out in section 3 and continue to endorse the key assumptions on which the budget projections are based;
- c) Note the continuing uncertainties and the potential impact of differing scenarios as set out in section 6;
- d) Note the indicative level of resources which would be provided to the Midlothian Integration Joint Board to deliver the Strategic Plan as set out in section 7;

- e) Note the role the current and developing strands of the Change Programme , including the development of savings options and relevant impact on the Financial Strategy as set out in tables 5 and 6;
- f) Note that the strands of the Change Programme will provide the means to identify options to address projected budget shortfalls;
- g) Note that the updated projections at this time indicate that a budget gap of £6.027 million for 2017/18 rising to £ 31.962 million by 2021/22, though these are heavily dependent on the assumptions detailed in the report;
- h) Otherwise note the contents of the report.

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