

Financial Strategy 2017/18 to 2020/21**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 2020/21.

It includes:-

- An update on future years Scottish Government Grant prospects;
- Budget projections for 2017/18 to 2020/21;
- An update on the existing and proposed change programmes aimed at addressing the projected budget gaps;
- The proposed timetable for the 2017/18 budget; and
- 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 22 September 2015 Council was provided with an assessment of projected budgets shortfalls through to 2020/21, subsequent Financial Strategy reports on 15 December 2015, 9 February and 8 March 2016 focussed on the requirement to determine a budget for the current financial year. The 2016/17 budget was approved by Council on 8 March 2016 and included a utilisation of £2.668 million from reserves.

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

3 Scottish Government Grant Settlement

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

The expectation is that the new Scottish Government will publish its budget proposals in the autumn of 2016 covering the three years 2017/18 to 2019/20. However given the shift in responsibility for tax revenues and the impending EU referendum there are risks that the Government's budget may be published later in 2016 and or that it will only be a one year budget encompassing 2017/18. Following on from the publication of the Government's budget it is expected that the Finance Circular setting out individual Council grant settlement figures and associated conditions will be published in December 2016. Again this is expected to see a return to a three year settlement, but may be limited to 2017/18 only.

There are two main factors which will influence the level of grant support Council might expect for 2017/18 and beyond. Firstly a range of economic factors will influence the resources Government has at its disposal, whether from the UK Government or through tax revenues directly controlled by Scottish Government. The second main factor will be the spending priorities of Government. Whilst an assessment of the economic factors can be made based on the information available from the Office of Budget Responsibility and the UK Government's spending plans etc. the impact of Scottish Government's spending priorities will only become fully apparent when the budget is published in the autumn.

The CIPFA Directors of Finance section have engaged an economist to interpret the available data and the latest assessment indicates a continued cash reduction for the "unprotected" elements of the Scottish Government budgets of which the Local Government grant is the largest element. As such the indications are that the future years grant settlements will remain as challenging as that seen for the current year, with year on year cash reductions, other than for new legislative burdens. It is also expected that specific conditions and direction of resources will continue to be a feature of future years grant settlements.

The central planning assumption adopted for the Scottish Government grant projections is based on a reduction, similar to that experienced in the current year, of 3.3 % per annum. It is also assumed that government will continue to direct resources to Integrated Health and Social Care Boards via the NHS.

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 subsequent announcements on grant support are published later in the year.

Council should note that small changes from the central planning assumption could have a dramatic effect on the projected budget shortfall. For example a variation of 1% per annum in Scottish Government Grant would approximate to a £6 million movement in the total grant support projected by 2020/21.

4 Council Tax

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

The expectation, based on the new Scottish Government's manifesto, is that any additional income generated by the reform of Council Tax bands will be ring fenced for Education and further details are awaited on this. The manifesto also set out proposals to cap the annual increase for Council Tax to 3%.

For Midlothian a 3% increase is estimated to generate £1.2 million per annum and would result in Band D Council Tax rising to £1,246 in 2017/18 and to £1,362 by 2020/21. 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 2020/21 set out in this report is based on the September 2015 assessment, updated for the impact of the 2016/17 grant settlement and also the decisions taken to reduce the 2016/17 budget gap. The projections will be updated over the summer to reflect the latest information available and any changes will be incorporated into an update report proposed for Council in September 2016. 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 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;
- Actual and projected forward purchasing prices for energy costs;
- Anticipated impact of contracts due for renewal during the period of this model;
- Impact of current demand for services;
- Demographic impact of future demand for services;
- Future interest rate forecasts provided by the Council's Treasury Advisers;
- Any new government policy requiring budgetary growth will be fully funded through increased Scottish Government grant;
- Council Tax income continues to grow in line with previous trends and planned future housing growth.

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 2020/21– 28 June 2016

	2017/18	2018/19	2019/20	2020/21
	£m	£m	£m	£m
Cost of Services	201.031	208.352	214.135	219.647
Less: Council Tax	(41.200)	(41.800)	(42.400)	(42.800)
Less: Scottish Government Grant	(148.616)	(145.716)	(142.816)	(139.916)
Budget Shortfall	11.215	20.836	28.919	36.931

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

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

Whilst the projected cost of service provision, Council Tax and Scottish Government grant has been projected forward until 2020/21, the projections, are very much indicative, especially so for the later years, and will undoubtedly change. However the projections do provide Council with an assessment of the key factors which influence income and expenditure and the overall impact of these on the Council's financial position for future years 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. Council should note that small changes from the central planning assumptions could have a dramatic effect on the projected budget shortfall. For example a variation of 0.5% per annum in estimate for pay inflation would approximate to a £2.6 million movement in the cost of services projected by 2020/21.

The projections and planning assumptions on which they are based will be regularly updated and reported to Council as new information becomes available.

In broad terms the budget shortfalls set out in table 1 arise for the following reasons:

Table 2: Analysis of Shortfalls – 28 June 2016

	2017/18	2018/19	2019/20	2020/21
	£m	£m	£m	£m
Opening Shortfall / (surplus)	2.668	11.215	20.836	28.919
Pay Inflation and Progression	2.900	3.239	3.289	2.840
Pensions Reform	0.377	0.377	0.028	0.028
Contractual Inflation	1.663	1.714	1.762	1.811
Demographics: Care	1.233	1.075	1.075	1.075
Demographics: School Rolls	0.611	0.946	1.155	1.274
Demand pressures: Children	0.213	0.000	0.000	0.000
School Estate Investment	0.692	1.158	0.033	0.036
Waste Disposal Costs	0.086	(0.113)	0.125	0.114
Borrowing Costs	0.475	(0.068)	(0.250)	(0.030)
Food Waste Collection	0.001	0.000	0.000	0.000
Scottish Government Grant	2.900	2.900	2.900	2.900
Integrated Health Resources	(1.700)	(1.700)	(1.700)	(1.700)
Council Tax Income	(0.600)	(0.600)	(0.600)	(0.600)
Financial Discipline/Savings	(1.040)	(0.084)	0.000	0.000
Other Movements	0.736	0.777	0.266	0.264
Totals	11.215	20.836	28.919	36.931

6 Change Programme

The strands of work that are and will be 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.

6.1 Delivering Excellence

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

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

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

Actions which contribute to the Financial Strategy will be developed through the framework. 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 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.

6.2 Transformation Programme

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

- Customer Service;
- Education;
- Services to Communities;
- Children's Services;
- Integrated Service Support, and
- The Integration of Health and Social Care.

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) they also include the proposals set out elsewhere on today's agenda in respect of Health and Social Care and are set out in table 3 below.

Table 3: Council Transformation Programme Additional Savings – 28 June 2016

	2017/18	2018/19	2019/20	2020/21
	£m	£m	£m	£m
Children's Services	0.076	0.350	0.350	0.350
Services to Communities	0.200	0.800	0.800	0.800
Education	0.269	0.292	0.292	0.292
Customer Service	0.175	0.175	0.175	0.175
Health & Social Care	1.555	1.555	1.555	1.555
Totals	2.275	3.172	3.172	3.172

The savings targets set out in table 3 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.

6.3 Asset Management

The budget projections already reflect the full year impact of the first two phases of the Effective Working in Midlothian project. In addition the report to Council on 17 May 2016 in respect of Phase 3, Depots indicated a saving of £0.288 million which for the purposes of the Financial Strategy have been incorporated from 2019/20 onwards.

6.4 Capital Strategy and Reserves Strategy

The focus of this report is on the revenue budget the interdependencies between the Financial, Capital and Reserves Strategies need to be fully considered and in this respect updates on the Capital and Reserves Strategies will be brought forward in the autumn of 2016.

6.5 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 projections as these are identified.

6.6 Savings Options

Taking cognisance of the extent of savings anticipated to secure a balanced budget for 2017/18 and the continued challenge for later years the Chief Executive has instructed each Director to bring forward as minimum savings proposals of £5 million, £15 million in total for consideration by the Strategic Leadership Group (SLG) in the autumn. 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 set out in section 7, if approved today, provides for these savings proposals to be considered by Council on 20 December 2016.

6.7 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 4: Financial Strategy 2017/18 to 2020/21 – 28 June 2016

	2017/18	2018/19	2019/20	2020/21
	£m	£m	£m	£m
Budget Shortfall (Table 1)	11.215	20.836	28.919	36.931
Less Strands:				
Transformation Programme (6.2)	(2.275)	(3.172)	(3.172)	(3.172)
Asset Management (6.3)	0.000	0.000	(0.288)	(0.288)
Operational Savings (6.5)	0.000	0.000	0.000	0.000
Savings Options (6.6)	0.000	0.000	0.000	0.000
Council Tax Increase	(1.200)	(2.400)	(3.600)	(4.800)
Remaining Budget Gap	7.740	15.264	21.859	28.671

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

7 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 5 sets out a proposed timetable which would support the delivery of the Financial Strategy and specifically the determination of the 2017/18 budget and Council Tax levels.

Table 5: Timetable – Key Events

Date	Event	Action
28 June 2016	Council	<ul style="list-style-type: none"> Consideration of updated Financial Strategy. Approval of timetable and approach for the 2017/18 budget.
Ongoing to October 2016	Development Work	<ul style="list-style-type: none"> Development of Change Programme and savings proposals by SLG. Shaping our Future consultation ongoing.
27 September 2016	Council	<ul style="list-style-type: none"> Consideration of updated projections. Update on Financial and Reserves Strategy and Capital plans.

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

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

8 Focussing Resources to Key Priorities

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

- 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.

9 Reserves

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

Table 6: Useable Reserves – 31 March 2016

	Total	Uncommitted
	£m	£m
General Fund Reserve	24.625	16.774
HRA Balance	24.913	2.760
Capital Fund	15.378	3.378
Repairs and Renewal Reserve	3.607	0.000
Total Useable Reserves	68.523	22.912

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

The uncommitted balance on Capital Fund reflects the recommendation elsewhere on today's agenda to earmark £12 million for City Deal. The remainder is retained to provide for unforeseen capital expenditure and to provide flexibility between financial years, its utilisation is subject to annual review.

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

As indicated in section 6.4 the Reserves Strategy will be reviewed and a report brought forward to Council in the autumn of 2016.

10 Report Implications

10.1 Resources

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

10.2 Risk

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

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

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

10.3 Single Midlothian Plan and Business Transformation

Themes addressed in this report:

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

10.4 Impact on Performance and Outcomes

The Financial Strategy is central to the way Council allocates and uses its limited resources and as such has fundamental implications for service performance and outcomes. The budget projections indicate that in 2020/21 the Council will have available in the region of £180 million for the provision of services and the pursuit of key outcomes as set out in the Single Midlothian Plan.

10.5 Adopting a Preventative Approach

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

10.6 Involving Communities and Other Stakeholders

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

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

10.7 Ensuring Equalities

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

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

10.8 Supporting Sustainable Development

There are no direct sustainability issues arising from this report.

10.9 IT Issues

There are no direct IT implications arising from this report.

11 Summary

The report provides:-

- An update on future years Scottish Government Grant prospects;
- Initial budget projections for 2016/17 to 2020/21;
- An update on the existing and proposed change programmes aimed at addressing the projected budget gaps;
- The proposed timetable for the 2017/18 budget; and
- An update on reserves.

12 Recommendations

Council is recommended to:-

- a) Note the position in respect of the Scottish Government Grant Settlement as set out in section 2 and endorse the central planning assumption of 3.3% annual reduction in grant settlements;
- 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 role the current and developing strands of the Change Programme and relevant impact on the Financial Strategy as set out in tables 3 and 4
- d) Note that the strands of the Change Programme will provide the means to identify options to address projected budget shortfalls;
- e) Agree the timetable set out in section 7;
- f) Note that the projections at this time indicate that a budget gap of £7.740 million for 2017/18 rising to £ 28.671 million by 2020/21, though these are heavily dependent on the assumptions detailed in the report;
- g) Otherwise note the contents of the report.

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