

Medium Term Financial Strategy – 2021/22 & 2022/23 Budgets**Report by Gary Fairley, Chief Officer Corporate Solutions****Report for Decision****1 Recommendations**

- a) To agree the recommendation of The Business Transformation Steering Group meeting on 26 October 2020 that Council agree the three strands of the corporate solution for the 2021/22 and 2022/23 budgets.
- b) To agree to rearrange the Council meeting scheduled for 9 February 2021 to 23 February 2021 and also rearranged meetings of the Business Transformation Steering Group for the 8 and 22 February 2021 to facilitate finalisation of the 2020/21 budget after publication of the Scottish Government's proposed grant settlement on 28 January 2021.
- c) Otherwise Council is asked to note the report.

2 Purpose of Report/Executive Summary

The approval of the Medium Term Financial Strategy in June 2019 was an important step-change and one that provided greater certainty for local communities and also for employees. It allowed the Council to shift from having to consider savings each and every year at February Council meetings to planning for the medium term and in turn securing continued financial sustainability.

As a result the approval of the Medium Term Financial Strategy and, on the recommendation of The Business Transformation Steering Group, the subsequent approval of the 2020/21 budget ensured that the Council secured a strategic budget which invested in Midlothian to help it fulfil its potential to be a great place to grow.

The Medium Term Financial Strategy has provided a strong foundation on which the Council has been able to build its response to the financial impact of the Covid pandemic. A pandemic which has brought unprecedented financial challenges, risks and uncertainties for Local Government during the current financial year and which will it is anticipated will impact on Council budgets for years to come.

It is against this backdrop that a corporate solution was developed to support the achievement of balanced budgets for 2021/22 and 2022/23, the two remaining budgets which will be required to be determined during the remaining term of this Council. The corporate solution was presented to the Business Transformation Steering Group on 26 October 2020 where it was unanimously agreed:-

- a) To recommend to Council the three strands of the corporate solution presented by the Chief Officer Corporate Solutions for the 2021/22 and 2022/23 budgets;*
- b) That Member should feedback to their respective groups and if any further questions arose they be discuss with the relevant Officers; and*
- c) To pick up issues around growth and the provision of statutory services at the next meeting.*

In respect of recommendation b) Council should note that no further questions have been raised with relevant Officers.

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3 Background

Council last considered an update on the Medium Term Financial Strategy on 11 February 2020 where it unanimously agreed the following recommendations:

- a) noted the update in respect of net cost of services, resource allocation measures and Scottish Government grant and individual Council grant settlements;*
- b) noted the revision in the resource allocation measures as highlighted in Appendix 2a to the main report;*
- c) approved the exceptions outlined in Section 4.2 of the main report in respect of fees and charges and agreed these be subject to separate reports during the year;*
- d) approved the Service budgets for 2020/21 as set out in Appendix 3 to the supplementary report; Page 6 of 605*
- e) approved the allocation of £45.496 million to the Integration Joint Board for 2020/21 in respect of delegated services and in doing so noted that the uplift for demographic pressures should not be considered to be recurring funding;*
- f) set a Band D Council Tax of £1409 for 2020/21 as set out in Appendix 2 to the supplementary report and;*
- g) noted that by applying the maximum Council Tax flexibility of 4.84% in 2020/21, the remaining gap for 2021/22 is now estimated to be in the region of £3.5 million, rising to £9.7 million for 2022/23.*

As most recently reported to Council on 17 November 2020 the Covid pandemic has resulted in a projected divergence of £8.5 million from the 2020/21 budget and it is also recognised that there will be a continued impact on future year's budget.

Furthermore the pandemic has brought about a significant shift in the normal financial planning parameters and timetables that Council will have been familiar with in previous years. In particular the Scottish Government's proposed budget for 2021/22 is scheduled to be published on 28 January 2021 with the proposed Local Government settlement for the year ahead published on the same day.

The publication of the Scottish Government draft budget is some six weeks later than previously experienced and exactly six weeks before the 11 March statutory deadline by which Councils are required to set Council Tax and determine a budget for the year ahead.

The practicalities of billing arrangements to ensure direct debits can be collected for April 2021 means that for practical purposes Council Tax decision need to be made no later than the end of February 2021 which in reality means there is just over four weeks from first receipt of the proposed government grant settlement to the finalisation of the budget and Council Tax levels for 2021/22.

The Council is next scheduled to meet on 9th February 2021 then again on 23 March 2021, neither of which would provide for finalisation of the 2021/22 budget. In addition Council's Standing Orders (4.3) require that the period between successive meetings of the Council shall not exceed ten weeks. Given the timing of the publication of the grant settlement and the requirements of standing orders it is therefore proposed that the Council meeting scheduled for 9th February 2021 is rearranged to 23rd February 2021 to facilitate finalisation of the 2020/21 budget.

4 Corporate solution for 2021/22 and 2022/23 budgets

In previous years Council has been provided with updates on the prospects for both the grant settlement and the position with the budget for the year ahead commencing in June and culminating in a final report, after the government grant settlement announcement, in February.

The combination of the Council already having approved a Medium Term Financial Strategy and the impact of the pandemic on Council business has required a different approach. In addition the continued uncertainty and risk, particularly in respect of the 2021/22 financial year, mandates that a different approach is necessary.

In recognition of this over the summer and early autumn a corporate solution to support securing financial balance for 2021/22 and 2022/23 has been developed. As part of this corporate solution over the summer the Financial Services Team have concluded the review of the Loans Fund.

As Council will be aware the cost of the construction and enhancement of assets (such as schools) is capitalised and funded from a combination of means, but principally external borrowing. The loans fund advances which are made to finance capital expenditure then needs to be repaid by annual charges to the revenue account over a set period of years dependent on the asset type. The Loans Fund review sought to assess whether the period over which these advances were repaid from the revenue account was appropriate and in line with the expected useful life of the assets in question.

The conclusion of the review, carried out with expert advice from Link Asset Services (The Council's Treasury advisors), was that the period over which loans fund advances were being made was shorter than the useful lives of the assets they financed and that the period over which advances are repaid should therefore be extended. In addition the review determined that there was scope to revisit the repayment of advances in previous years and realign these which in turn gives rise to a prior year adjustment.

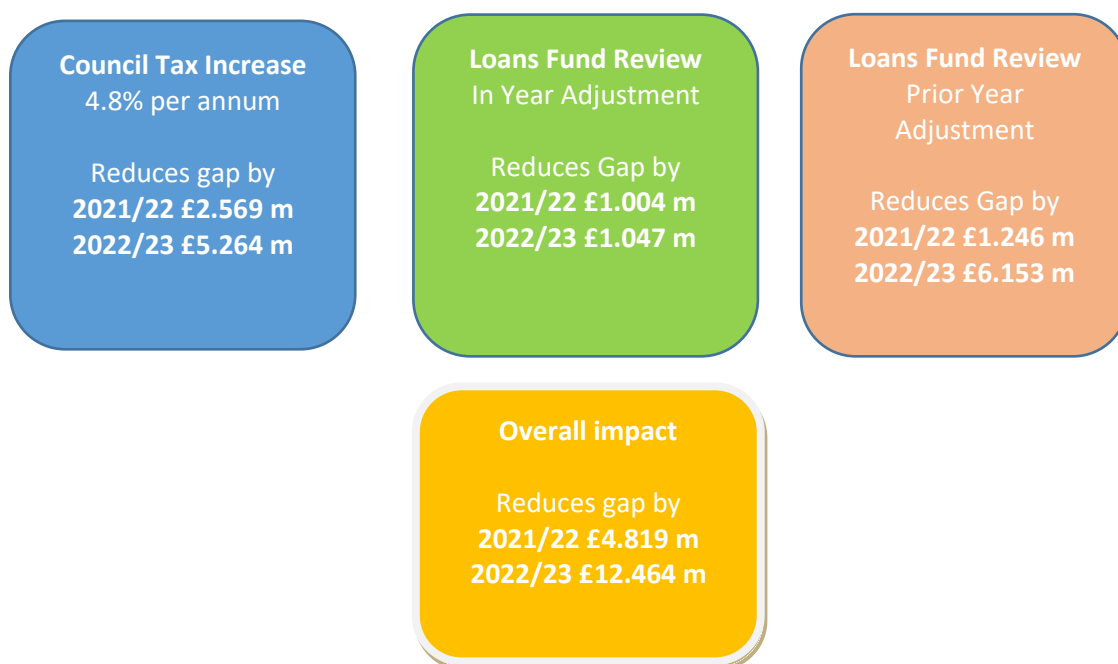
The outcome of the review is summarised in the mid-year Treasury Management review also on today's agenda. The review has also

been examined by our external auditors EY, who have indicated they are satisfied with the conclusions reached.

The Loans Fund review in turn provides two strands of the corporate solution for the 2021/22 and 2022/23 budgets. An in year reduction to the loan charges budget which is estimated at £1.004 million for 2021/22 and £1.047 million for 2022/23. Secondly the prior year adjustment, estimated at £8.250 million of which it is estimated that £7.400 million would be require to be utilised in 2021/22 and 2022/23 as part of the corporate solution.

The third strand of the corporate solution unanimously recommended to Council by Business Transformation Steering Group is to apply the maximum increase in Council Tax estimated at 4.8% per annum (3% real terms). This reflects the maximum increase stipulated as part of the conditions attached to recent government grant settlements.

Together the three strands of the corporate solution are as follows:-



Accordingly Council is asked today to consider the recommendation of The Business Transformation Steering Group meeting on 26 October 2020 that Council agree the three strands of the corporate solution for the 2021/22 and 2022/23 budgets. Council should note that without agreement to all three strands an alternative approach to securing financial balance would therefore by necessity have to be agreed.

Furthermore the adoption of such a corporate solution provides the opportunity for the Leadership Team to continue to respond to the impact of the pandemic and, through the work of the Business Transformation Board, focus on development of a financial strategy for the life of the next Council which it is anticipated will be presented early after the May 2022 elections.

5 Scottish Government Grant

5.1 Grant Settlement

As Council will be aware the Cabinet Secretary has announced that the Scottish Governments draft budget for 2021/22, together with individual Council grant settlement figures, will published on Thursday 28 January 2021. Thereafter there will be a condensed parliamentary process for the Government's budget bill.

On 25th November 2020 the UK Spending Review was announced. The high level impact for Scotland at this point is assessed at £2.4 bn, as follows:

- Non-covid revenue baseline up by £1.3 bn
- Capital down by £0.3 bn
- Covid funding £1.3 bn

The spending review also indicates that *"in order to ensure fairness between the public and private sectors, and protect public sector jobs and investment in services as Covid-19 continues to impact the public finances, the government will temporarily pause headline pay awards for some workforces. Pay rises for over 1 million NHS workers and the lowest paid will continue despite the challenging economic context"*. In respect of the lowest paid it is indicated that there would be a minimum uplift of £250 for those earning up to £24,000, representing as minimum increase of 1%.

It is expected that The Cabinet Secretary will set out Scottish Government pay policy as part of the budget announcement on 28 January 2021. Council is reminded that pay arrangements for the Local Government Workforce are determined on a bilateral basis nationally between Employers and Trade Unions (the SJC) and for Teachers on a tripartite basis between Employers, Trade Unions and Scottish Government (the SNCT). It should also be noted that the Consumer Price Index for October 2020 was 0.9%.

It is inevitable that the pay policy set out in the UK spending review will have informed the allocations to Government Departments and in turn the quantum of Barnett consequential that flow to Scotland. Accordingly divergence between pay policies will add further pressure to the Scottish Government's budget. The prospects of a reduction in the core local government settlement which therefore makes no provision for pay inflation in turn gives rise to the budget gaps which need to be bridged to secure financial balance. At present the projected divergence between grant settlements and pay provision is 4% which presents a significant financial sustainability challenge for the Council.

In respect of the prospects for the 2021/21 grant settlement, whilst the UK Spending review announcement provides Scottish Government with details of the Barnett consequential, the combination of the subsequent passing on consequential to specific portfolios within

Scotland and significant additional spending and policy commitments by Scottish Government together with prior years block grant reconciliations is such that the 2021/22 local government core settlement may still represent a year on year cash reduction as is reflected in the core planning assumption set out earlier.

5.2 Update on Financial Flexibilities

As Council is aware COSLA and Scottish Government reached agreement on three financial flexibilities in respect of Capital Receipts, Service contracts (PPP/PFI) and Loans Fund repayment holiday.

These flexibilities were designed to allow Council to utilise existing resources in alternative ways and principally to defer debt repayments until later years. Importantly they do not result in any additional funding support for local government.

In respect of the service contract flexibility there is uncertainty on what this flexibility now entails. In the press release from Cabinet Secretary on 8 October 2020, the quantum of £750m incorporated a significant sum from this flexibility. Shifting the repayment of the capital cost from the length of the contract to the life of the asset was expected to broadly half the in-year charge and bring a prior year adjustment.

However guidance from Scottish Government indicates that Councils' revenue accounts should reflect the straight line depreciation of the assets rather than the principal element of the contract payment. Given in most cases the contract payment is structured and accounted for on an annuity basis the value of the flexibility is all but lost if straight line depreciation is the requirement. Indeed for some contracts it is likely to increase revenue charges in the earlier part of the contract.

On our present understanding of the implementation of the change there is no value to this flexibility for Midlothian. COSLA, supported by representatives from the Directors of Finance section are engaging with Scottish Government officials to seek a way forward which is more in keeping with the original objectives of this flexibility. This engagement will also seek to secure a resolution in advance of Councils considering budgets.

It is expected that as the position on financial flexibilities is clarified consideration can be given to how they can support the current year's financial position and also complement the corporate solution recommended for the 2021/22 budget.

6 Projected Net Cost of Services

The pandemic has impacted on the information available on which the work to update the projected net cost of services is based. Accordingly work is continuing to review and update cost projections based on the latest information available including school rolls projections and care

demographics. The aim is to conclude this work with the objective of de-risking, as far as possible, the deliverability of the 2021/22 budget.

Council agreed on 17 November 2020 that a review of the deliverability of savings targets for the current year, as a consequence of the pandemic, be progressed and reflected in the next financial monitoring report. Concurrent with this Business Transformation Board agreed that it was also appropriate to review the savings targets reflected in future years budget projections and that the outcome of that review be reported to the next Business Transformation Board on 13 January 2021. Again this review activity will support the strategy of de-risking the deliverability of the 2021/22 and 2022/23 budgets.

This approach will ensure that the updated net cost of services is finalised in advance of the settlement announcement in January and in turn allow for Business Transformation Steering Group to make recommend a budget for 2021/22 to Council.

7 Next Steps

7.1 Finalisation of the 2021/22 Budget and Setting Council Tax

It is proposed that meetings of the Business Transformation Steering Group be rescheduled to align with the settlement announcement.

Accordingly it is recommended that meetings are rearranged for the 8 and 22 February 2021 so that the Business Transformation Steering Group can receive an update on the Scottish Government grant settlement, consider any revisions to the corporate solution as a consequence of the settlement, and make appropriate recommendations to Council.

In respect of the medium and indeed longer term position, members should note that the prior year adjustment strand of the corporate solution for 2021/22 and 2022/23 financial years is a one off measure and that accordingly the budget gaps for later years together with the increased borrowing requirement over the longer term required to fund essential infrastructure will have to be addressed as part of the development of the Medium term Financial Strategy for the term of the next Council.

7.2 Midlothian Integration Joint Board

The Chief Officer and Chief Financial Officer of the Midlothian Integrated Joint Board (IJB) are being kept updated on the Council's budget position. The indicative budget to be delegated to the IJB for 2021/22 is being determined and as in previous years will reflect uplifts for inflation and demographics. However it will only be possible to formulate a formal offer for the IJB once the grant settlement is available and the quantum of any additional monies for delegated

activities and any conditions attached to the settlement are known. Business Transformation Steering Group will be asked to consider the formal offer arising from the settlement at the earliest opportunity and this will form part of the budget recommendations to Council.

Meantime dialogue continues with the Chief Officer and Chief Financial Officer of the IJB.

8 Governance and Timetable

Each element of the Medium Term Financial Strategy continues to have governance in place to support the timely delivery of the work streams. Any changes to the budget strategy and corporate solution will first be reported to Business Transformation Steering Group with recommendations then presented to Council. Responsibility for setting Council Tax, determining budgets remains, with Council.

Council has a duty as set out in Section 93 of the Local Government Finance Act 1992 (as amended) to set its Council Tax and a balanced budget for the following financial year commencing 1 April by 11 March. Members should note that the legislation contains no specific requirement for a Council to set its budget at the same time as setting its Council Tax. This is because it is implicit in setting the Council Tax that Council Tax income needs to be sufficient to fund the balance of expenditure not otherwise funded from government grant, fees, reserves etc.

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

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

9 Report Implications (Resource, Digital and Risk)

9.1 Resource

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

9.2 Digital

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

9.3 Risk

Within any financial projections, there are a number of inherent assumptions in arriving at figures and budget provisions and therefore risks that may be faced if costs change or new pressures emerge.

The following key risks and issues are highlighted in the context of this report:

- Uncertainty over the ongoing impact on the Council's financial position, especially in respect of service income, and the uncertainty over future additional grant support to help mitigate such impacts;
- The economic outlook and decision by Scottish Government on future years grant settlements and grant distribution;
- The delivery of budget reductions. To mitigate these risks a review of existing savings is being progressed as part of the strategy to de-risk as far as possible the delivery of the 2021/22 and 2022/23 budgets;
- 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;
- Learning Estate Strategy for schools being underfunded to meet statutory functions;
- The funding position for Early Years expansion, which means that whilst delivering 1,140 hours the range of options open to parents and carers is less than was anticipated;
- 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;
- Potential liabilities arising from historic child abuse;
- Unplanned capital investment requirements and the associated cost; and
- Ability to continue to meet the expectations of our communities within a period of fiscal constraint.

The Medium Term Financial Strategy aims to mitigate a number of these risks by setting out the key assumptions on which forward plans are based, and through the adoption of the three strands of the corporate solution for 2021/22 and 2022/23 secure a means to achieve financial balance without further service reductions.

The risk of not having in place a balanced Medium Term Financial Strategy and the adoption of the three strands of the corporate solution is the potential elimination of available reserves, which in turn would severely limit the Council's ability to deal with unforeseen or unplanned events and also the imposition of significant cuts at short notice with limited opportunity for consultation.

9.4 Ensuring Equalities

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

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

In addition, these actions underline the Council's commitment in its Midlothian Equality Plan 2017 – 2021 to tackle inequality and promote inclusion within the limitations of the resources available. These actions also will allow the Council to plan and deliver services which meet the needs of our diverse communities and respond to the changes ahead.

An overarching EQIA will be published on the Committee Management section of the Council's website in parallel to the Medium Term Financial Strategy report presented to the proposed Council meeting on 23 February 2021.

9.5 Additional Report Implications

See Appendix A

Appendices

APPENDIX A – Report Implications

A.1 Key Priorities within the Single Midlothian Plan

The Medium Term Financial Strategy facilitates decision on how Council allocates and uses its available resources and as such has fundamental implications for delivery of the key priorities in the Single Midlothian Plan. The corporate solution for financial years 2021/22 and 2022/23 helps ensure that resources are available to continue to delivery key priorities.

A.2 Key Drivers for Change

Key drivers addressed in this report:

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

A.3 Key Delivery Streams

Key delivery streams addressed in this report:

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

A.4 Delivering Best Value

The report does not directly impact on delivering Best Value.

A.5 Involving Communities and Other Stakeholders

The development of the Medium Term Financial Strategy reflected a community consultation exercise carried out in 2019 which has also helped shape the drafting of the “Midlothian Promise” and the early development of the Council’s Longer Term Financial Strategy.

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

A.6 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 financial consequences of the pandemic have impacted on the availability and allocation of resources in pursuit of key outcomes as set out in the Single Midlothian Plan for both the immediate and longer term and therefore the ability of the Council to continue to deliver services in a

financial sustainable manner.

A.7 Adopting a Preventative Approach

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

A.8 Supporting Sustainable Development

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