Shetland Islands Council

Medium Term Financial Plan

2013-2018

Securing the Best for Shetland

Contents

Purpose

1.1 The purpose of this Medium Term Financial Plan (the Plan) is to set out the roadmap for Shetland Islands Council to achieve financial sustainability over the term of this Council and to align resources in accordance with the priorities of Members, as set out in the Corporate Plan.

1.2 The Plan combines all of the resources available to the Council relating to the General Fund, Harbour Account and Housing Revenue Account for both revenue and capital expenditure.

1.3 This document therefore acts as a tool for financial planning; setting out the financial resources available to the Council, describing the cost pressures over the period and therefore setting out the level of expenditure that the Council can reasonably afford on an annual basis.

1.4 In addition, the document is an integrated budget strategy and reserves strategy for the life of the current Council, ensuring that there is a clear understanding between the level of expenditure agreed for each year and the impact that this will have on the Council's reserves.

1.5 It is important to recognise that the Plan is a live document and will therefore be updated annually to reflect any changes in policy and/or changes in the level of funding available to the Council.

Benefits of the Plan

1.6 By taking a longer term view of the Council's finances over a period of five years it allows Members to work towards delivering a sustainable budget over a extended period of time, and to understand the role that each annual budget setting exercise contributes to the overall strategy of delivering financial sustainability.

1.7 It improves financial planning and financial management of the Council's revenue and capital resources.

1.8 It allows for the clear alignment of resources to the Council's spending priorities. The priorities of the Council will feed into the allocation of revenue and capital resources for each directorate over the period of the Plan and will be focused on the Council priorities set out in the Corporate Plan.

1.9 Ensuring that resources are aligned to priorities will ensure that the Council maximises the use of resources at its disposal.

1.10 Finally, this integrated Plan will help to ensure the delivery of the Council's Reserves Policy by clearly limiting expenditure to levels that comply with the policy on a Tolerable Reserves Floor.

Principles

2.1 The Plan is to be based on the following principles:

- The Council continues to be committed to achieving a level of spending that is financially sustainable during the course of the current Council term and beyond, thus safeguarding the future economic viability of Shetland Islands Council.
- The Council will determine the minimum level of reserves that it wishes to maintain by refreshing the Reserves Policy.
- The total level of expenditure available for each of the next five financial years will be determined by the level of incoming resources available and the level of reserves that Members determine to be the "Tolerable Reserves Floor".
- Members will set the level of capital expenditure to be funded from the reserves, recognising that this is at the cost of using that funding for day to day services.
- The Executive Manager – Finance will determine the level of funding required to manage significant cost pressures such as pay awards. A central allocation of funding will be set aside for cost pressures and will be allocated to directorates as required.
- These decisions will determine the level of expenditure that can be incurred on services for each of the next five years.
- Members will then be required to determine the level of resources available to each directorate for the next five years based on Council priorities.

2.2 Each directorate will know its target operating budget for 2014-15 and for the following four years.

2.3 Directors, working with their relevant Council Committee, are required to develop resourced directorate and service plans based on the target operating budgets across the Plan's timeframe.

2.4 Members will have the opportunity to review the spending proposals and options for each directorate prior to the end of 2013, and through a process of continuous assessment be able to adjust budgets at the margins to ensure that Council priorities are properly reflected.

2.5 A budget will be presented to Council in December 2013/January 2014 which sets out detailed directorate budgets for 2014-15 and indicative budgets for a further four years within the parameters in the Plan.

2.6 The Plan will subsequently be updated to reflect the approved 2014-15 budget and refreshed annually by Members during May/June each year to accommodate any shifts in Council priorities.

Assumptions

2.7 The starting point for setting a directorate's target operating budget for the year is the prior year budget. In practice what this means is that –

- If a directorate is under spent against its budget in a financial year, it will not be penalised by having the budget reduced by this amount in the next financial year;
- If a directorate achieves a higher level of recurring savings than budgeted through increased efficiency, these will be applied to the following year's target, thus giving that directorate a head start in the following year and embedding a culture of continuous improvement in service delivery;
- Similarly, if a directorate overspends against its budget, for the purposes of planning it will be assumed that the starting point for the next year was the prior year budget and not the actual spend. This will in effect mean that a directorate in this position will still be required to make the recurring savings it failed to deliver in the previous year, along with the new savings required for the new financial year.
- All savings targets to be delivered by each directorate are required to be recurring savings.

2.8 The Council sets the target operating budget for each directorate for each year. Directorates are required to prepare their budgets within these parameters. Cost pressures are managed centrally and there is a presumption against growth in budgets, thereby removing the need for directorates to seek additional funding from Members during the budget setting exercise.

2.9 The amount of funding made available to each directorate is linked to the priorities of the Council.

2.10 If a cost pressure arises during the financial year, there is a presumption against providing that directorate with additional funding. In the first instance the directorate is required to identify a saving to compensate for the additional cost and report this to Council.

2.11 There is a presumption that there will be no growth in service cost in the medium term.

2.12 In order to ensure that the annual revenue budgets are delivered, contingency measures may need to be put in place.

Budget Carry Forward Scheme

2.13 The Plan introduces a budget carry forward scheme in order to offer an incentive to services to under spend against their budgets.

2.14 If a service achieves a one-off under spend in a financial year, assuming it has delivered its budget in full, it will be permitted to carry 50% of this funding into the following financial year to support approved service priorities.

2.15 This carried forward funding will be applied to the following year's budget as a one off item and will only be available in line with approved Council service priorities.

2.16 The conditions around the scheme are:

- A service will only be granted a carry forward if its directorate had delivered its budget. If a directorate was overspent no budget carry forward would be considered.
- The under spend will be carried forward as a non-recurring budget i.e. the service would benefit in the next financial year, but it will not receive the funding in future financial years.
- Services will be required to identify their under spends and make a request for a carry forward at a date to be specified by the Executive Manager – Finance.
- A carry forward will have to be applied to approved Council service priorities.

External Funding

2.17 Shetland Islands Council will seek all external funding opportunities where there is no additional financial commitment required by the Council.

2.18 Where an external funding opportunity is available to the Council, but it requires additional investment by the Council or an ongoing revenue commitment, the following criteria should be met in full –

- The project is consistent with the priorities of the Council; AND
- The project meets the criteria of a Spend to Save initiative; OR
- Savings will be identified elsewhere to ensure that the project is cost neutral to the Council.

2.19 If these criteria are not met the Council will recognise that by seeking the external funding it is diverting its own resources away from its priorities, and therefore will choose not to pursue the funding.

Spend to Save

2.20 The Council approved a Spend to Save scheme as part of the 2012-13 and 2013-14 budget setting exercises. The purpose of the Spend to Save scheme is to provide up front funding to a service in order to effect a change that will result in recurring savings in the future.

2.21 One of the key principles of the scheme is that any funding awarded has to be recouped within 3 years from the savings that the scheme generates.

2.22 Given the need to make significant savings over the forthcoming years the Plan will make sufficient provision of Spend to Save funds to facilitate the changes necessary to deliver recurring savings. As a result the plan has made provision for £5m for spend to saved projects between 2013-14 and the end of the savings programme in 2016-17.

Context

3.1 The UK economy is struggling to recover from a double-dip recession with GDP (the country's economic output) still 2.75% lower than it was 5-years ago at the beginning of recession in the spring of 2008. This represents the most protracted period of economic decline in over a century, surpassing even the Great Depression of the 1930s.

3.2 Despite the relative strength of the Shetland economy in weathering the global and UK economic situation, Shetland Islands Council's financial situation continues to be adversely affected as a result of the reducing settlement that it is receiving from the Scottish Government each year. There is also a risk that the Council's returns from financial markets could falls below a historic average annual return of 5.75%, which would damage the value of the Council's reserves.

3.3 The UK's Public Finances have not improved at the rate at which the UK Government had projected, and therefore any recovery in Local Government's financial settlement will probably be beyond the term of the current Council. When this is coupled with the continuous cost pressures facing the Council, it is clear that further action is required to address the increasing natural drift between expenditure levels and available resources.

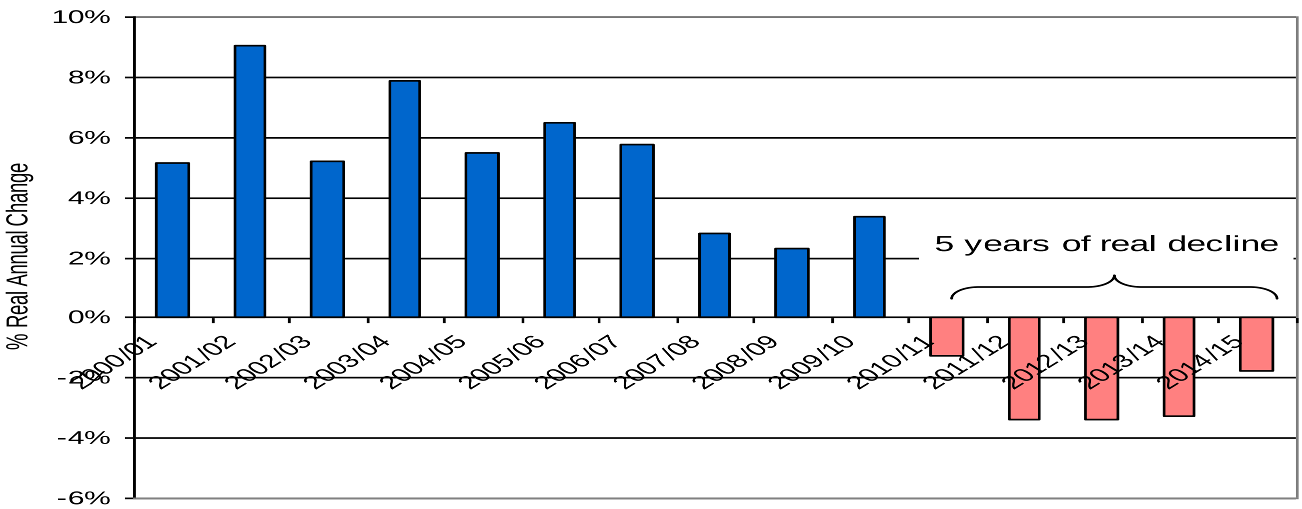
Scottish Government General Revenue Grant

3.4 The General Fund is the biggest part of the Council's activity. It represents all the revenue expenditure incurred across the Council's five directorates: Children's Services, Community Care Services, Corporate Services, Development Services and Infrastructure Services and the Chief Executive's office. General Fund net expenditure is funded from the Scottish Government General Revenue Grant, National Non-Domestic Rates Income and Council Tax. In addition, Shetland Islands Council draws on reserves to fund its General Fund Expenditure. In the future, the reserves will be enhanced by income received from the TOTAL Gas Plant.

3.5 It is important to recognise that the Scottish Government is responsible for determining the overall level of funding available to the Council from General Revenue Grant and National Non-domestic Rates (NNDR). Therefore, if there were to be an increase in the level of Non-domestic Rates coming into the Council, there would be a corresponding reduction in the level of General Revenue Grant to ensure the overall funding level didn't change. With the introduction of BRIS targets this may in the short term enhance the amount of NNDR income that the Council can retain.

3.6 The table below highlights the annual change in the amount of expenditure that the Scottish Government has had to spend on public services in the period from 2000/01 to 2014/15. The current year-on-year reduction in the amount of money that the Scottish Government has to spend has a knock on effect for Shetland Islands Council.

Real Change in Scottish Government Discretional Expenditure Limit (DEL) Expenditure



3.7 As part of the 2011 spending review, the Scottish Government determined the amount of funding that would be available to Local Government for the three year period; 2012-13 to 2014-15 inclusive. From this information the Scottish Government has set the amount of funding available to Shetland Islands Council to fund its General Fund expenditure.

3.8 The table below shows the reducing amount of revenue grant support that Shetland Islands Council has received from the Scottish Government over the past 2 years and what is known to be received for 2013-14 and 2014-15:

	2011-12	2012-13	2013-14	2014-15
	£m	£m	£m	£m
SIC funding allocation from Scottish Government	94.631	92.408	91.488	90.549

3.9 There are early indications that the one-year settlement for 2015-16 is likely to result in further downward pressure on budgets, which will have an impact on the Council's General Revenue Grant from the Scottish Government.

Returns on the Council's Reserves

3.10 The Council generated reserves during the 1980s and 1990s as a result of the excess income that it generated from the oil industry over the annual level of expenditure that it incurred.

3.11 The long term average return made on these reserves (i.e. the amount earned in interest, dividend payments and increases in the value of stocks and shares held by the SIC) over a period of 20 years has been 5.75% per year. However, in order to protect against inflation, it is prudent to assume a real rate of return as being 5.75% less inflation. Therefore, in this plan the annual income available for spending on services from the reserves is estimated at between 3% and 3.5% depending on the forecast inflation rate. A real return of 3% equates to £4.5m on £150m of reserves so is therefore a significant income stream to the Council.

3.12 It is important to recognise the significant impact that the Council's investments have on the overall value of the reserves. Due to a high percentage of the investments being in equities it results in large fluctuations in the returns, ranging from being large negative (over £20m) to large positive (Over £20m) returns in a single year. A revised Investment Strategy being proposed at this meeting will try to mitigate the fluctuations in returns.

Current Budget Gap

3.13 As a result of a widening disconnection between income received by the Council and the level of expenditure incurred by the Council over a number of years, a structural deficit had been created which peaked with expenditure being £35.6m higher than income during 2011-12. This deficit was met in full by drawing funds from the Council's reserves.

3.14 Significant work has already been undertaken to ensure that the 2012-13 budget was exceeded and a challenging budget has been set for 2013-14 which when delivered, will have ensured that the Council is over 70% of the way towards being financially sustainable.

3.15 In order to achieve a financially sustainable budget position, a further £10.5m of savings will be required over the next 3 years.

Council Priorities

4.1 The Council approved its Corporate Plan 2013-2017 on 12 June 2013. This sets out the Council's vision and priorities for the remainder of the current term.

4.2 The core priorities that have emerged are:

- ***Being a properly led and well managed council, dealing with the challenges of the present and the future, and doing that within our means;***
- ***Providing critical services for children and adults and the transport services we all need;***
- ***Mindful of how change could affect the vulnerable and disadvantaged;***
- ***Helping build a healthy economy and strong communities;***
- ***Working with all our partners to achieve the best results possible.***

4.3 This Medium Term Financial Plan seeks to compliment each of the priorities above. It sets out a pathway to ensuring that the Council lives within its means, and targets available resources at priority areas.

4.4 It is proposed that the core Council services of Children's Services, Community Care and Transport should be relatively prioritised as far as that is possible. This is a reflection on the Council's statutory obligations in these areas, the fundamental scale and cost of these services and the Council's political commitment to sustain key front-line services as a priority.

4.5 The proportions of the available budget allocated to Development, Corporate and Executive Services are proposed to decrease to allow as much spend as possible to be directed to the areas above.

4.6 These "Directorate Target Budgets" are set out in Section 12. The approved figures will be the ceilings that directorates will be required to plan against to show how services can be reconfigured to sustainably deliver the most effective and efficient outcomes possible in the medium i.e. covering the next five years.

4.7 Service plans will be developed through the planning and budgeting cycle that will start between now and October 2013, and formally reported to Council in November/December 2013.

4.8 These service plans will describe the proposals and options for service delivery within the "Directorate Target Budgets" and will also provide sufficient information for the Council to make any further adjustments between Directorates or Service areas.

4.9 Any such adjustment cannot however change the overall financial envelope; it could only be a movement of budget from one Directorate/Service to another. Any future movement between priorities would have to be done on the same basis.

4.10 These service plans will need to set out how the Council (and each Directorate / Service):

- Continue to meet any legal obligations (do what we must do)
- Seek to sustain, and if possible improve, key outcomes (key services)
- Identify and effectively manage risks (be safe and secure)

4.11 All service plans will be required to cover each of these areas; this work will need to be delivered on the timetable set out below:

- Medium Term Financial Strategy Agreed – 26 June 2013
- Directorates' Target Budgets for 2013- 2017 set – 26 June 2013
- Directorate / Service Priority Planning, Detailed Budget Planning and Strategic Risk Analysis – between August and October 2013
- Resourced and Risk Assessed Directorate / Service Plans for 2013 – 2017 communicated to Members – November/December 2013
- Resourced Directorate / Service Plans reported to Committees – November/December 2013
- Resourced Directorate / Service Plans and detailed 2014-15 Council budget reported to Council – December 2013/ January 2014

Reserves Policy

5.1 The Council had a long-standing Reserves Policy to have a "floor". This represents the minimum value that the Council is willing to accept on its Reserves. The Council's previous policy was to set this at £250m. It was recognised in 2011 that this Policy was set to be breached and therefore this was amended to build the reserves back up to £250m within 10 years (by 2021-22). In September 2012, Members agreed a new Reserves Policy of having a floor no lower than £125m.

5.2 There are two broad measures of the level of reserves held by the Council, one is an accounting measure and one is a cash measure. The table below shows the accounting value of the Council's reserves, as documented in the unaudited Statement of Accounts 2012-13:

Reserves	Opening Balance 1 April 2012 £m	Closing Balance 31 March 2013 £m
Capital Fund	(100.543)	(83.808)
Capital Efficiency/Spend to Save Reserve	(9.096)	(8.678)
Capital Fund (HRA contingency)	0.000	(10.000)
Reserve Fund	(57.128)	(18.095)
Reserve Fund (Harbour contingency)	0.000	(39.000)
Repairs & Renewals Fund	(51.577)	(44.644)
General Fund Balance	(3.000)	(3.000)
Revenue Efficiency/Spend to Save Reserve	(0.510)	(0.365)
Potential Contingent Liabilities	(0.849)	(0.865)
Discretionary Reserves	**(222.702)**	**(208.454)**
Marine Superannuation Fund	(2.021)	(1.805)
Pilot Boat Renewal Fund	(0.960)	(0.978)
Housing Repairs & Renewals Fund	(12.259)	(10.423)
Quarry Repairs & Renewals Fund	(0.153)	(0.156)
Insurance Fund	(0.293)	(0.221)
Council Tax Second Homes Receipts	(0.511)	(0.403)
Hansel Funds	(0.104)	(0.111)
School Funds	0.000	(0.087)
Central Energy Efficiency Fund	(0.043)	(0.003)
Ring Fenced Reserves	**(16.344)**	**(14.185)**
TOTAL	**(239.046)**	**(222.639)**

5.3 The cash measure of the reserves is the value of money that the Council has invested with Fund Managers. This stood at £205.7m at 31 March 2012. The significant difference between the two figures is largely as a result of the accounting figures including money that the Council has already borrowed from itself for Council House building and the purchase of tugs for the Harbour Account, but doesn't included the unrealised gains on the increase in the market value of the Council's investments.

5.4 Given the current financial situation the Plan will focus on the cash measure of reserves as only cash backed reserves can be used to keep the Council solvent.

Medium Term Financial Plan Reserves Policy

5.5 It is important to recognise that the "Tolerable Reserves Floor" set by the Council does not impact on the level of cuts required to deliver a balanced budget. Even if all reserves are utilised for the provision of services, the Council would then still have to cut expenditure to match its incoming resources in order to meet its statutory duty of setting a balanced budget.

5.6 Therefore the level at which Members decide to set the Tolerable Reserves Floor will only determine the speed of the cuts that are necessary to deliver a balanced budget and preserve a certain level of reserves for the future.

5.7 The 2012-2017 Medium Term Financial Plan sets a Tolerable Reserves Floor of £125m, measured on a cash basis. This means that Shetland Islands Council will ensure that it does not let its externally invested reserves drop below this value. However, due to the progress made with the savings programme it is now possible in the 2013-2018 Medium Term Financial Plan to increase the Tolerable Reserves Floor to **£150m** without altering the amount or timing of the savings that were proposed in 2012-2017 plan.

5.8 The Plan, when the reserves stabilise at £150m, is that the Council will **maintain this level** as opposed to seeking to build the reserves back up, as this would require an even higher level of cuts.

5.9 However, if the Council was to receive an unbudgeted windfall, the default position would be that it was used to increase the level of reserves.

Rationale for Proposed Policy

5.10 The Tolerable Reserves Floor of **£150m** balances the Council's desire to retain as high a possible level of reserves as can be managed, whilst recognising the need to ensure that the budget gap is managed down in a realistic timescale.

5.11 It would prove to be extremely challenging to aim for a higher Tolerable Reserves Floor due to the speed required to make the necessary adjustments. Conversely, to take too long at addressing the budget gap would lead to the reserves dropping to a level where they are unable to generate the levels of return required to sustain significant additional expenditure on Council services.

5.12 In the medium term, the financial outlook remains challenging, with real increases in grant income from the Scottish Government looking unlikely during the period of this Council. Therefore in order to buffer this lost income, the Council will utilise all returns generated on its reserves in order to sustain as much expenditure as possible. It is for this reason that the Plan sets the sustaining reserves at a level of £150m in the medium term as opposed to a strategy to grow them, by not using the income that they generate.

5.13 However, the Tolerable Reserves Floor will continue to be reviewed on an annual basis and could be adjusted upwards in future if the Council delivers its savings programme on time, and the stock markets operate in a favourable way.

Introduction of an Equalisation Fund

5.14 The returns generated on the Council's invested reserves during 2012-13 were exceptionally high at 14.6%, against a long term average of 5.75%. There have been large returns on this scale in the past, but also large negative returns, which has balanced out to 5.75% over the past 20 years.

5.15 It is therefore proposed that a Reserves Equalisation Fund is established which accumulates the returns over 5.75% in order that these can be released in the years when the returns fall below 5.75%. The purpose of this is to artificially smooth the investment returns, to provide a higher level of confidence when undertaking financial planning into the future.

5.16 A sum of £15m was generated on the reserves in 2012-13, which was in excess of the long term average of 5.75%. It is therefore proposed to transfer this money into a separate Equalisation Fund so that it can be released in future years when the returns on investment fall below 5.75%.

Transfers between reserves

5.17 In order to ensure that there are sufficient funds in the General Fund reserve to meet the £21.067m draw on reserves which was approved in the 2013-14 budget, it is necessary to transfer money from other funds to meet this.

5.18 At present there is £3m in the General Fund reserve, meaning it is £18m short of what will be required in 2013-14. The plan therefore proposes to transfer £10m from the Capital Fund and £8m from the Repairs and Renewals Fund to the General Fund to meet planned expenditure.

Investing Council reserves in Economic Development loans

5.19 The Plan is to continue to invest up to £3m per annum in local businesses. However it must be demonstrated that:

- The loan will generate to the Council a rate of return at least equal to the markets; and
- Due diligence work has been undertaken to ensure that any loan granted is at an acceptable risk level to the Council.

Asset Investment Plan

6.1 The Asset Investment Plan sets out the capital expenditure that the Council plans to incur over a five year period. Capital expenditure relates to spending on significant repairs and maintenance work where the result is to extend the life of a Council asset, or spending on the creation or purchase of a new asset.

6.2 Shetland Islands Council receives a capital grant from the Scottish Government each year to spend exclusively on capital, and also receives money from the sale of Council assets known as capital receipts. In addition, the Council previously had a policy to spend up to £5.6m per annum from reserves to fund the Asset Investment Plan. In total, this provides funding of roughly £10m to £11m per year to spend on capital expenditure.

6.3 The policy to draw up to £5.6m per annum from reserves to fund capital expenditure was based on the premise that this was a sustainable draw (i.e. could happen every year without negatively impacting upon the value of the reserve). However, given the current overall level of the draw on reserves, this figure is no longer sustainable.

6.4 Therefore the following Asset Investment policy was agreed by Members in the 2012-2017 Medium Term Financial Plan on 20 September 2012 –

- All capital expenditure to be focussed on the maintenance of existing assets rather than the creation/purchase of new assets, (with the exception of a new Anderson High School and high-speed broadband).
- To only use income from the Scottish Government, other capital grants and capital receipts to fund the Asset Investment Plan.
- To only make a draw on reserves for specific capital projects that are consistent with the priorities of the Council, i.e. a new Anderson High School and high-speed broadband.
- Before making a draw on reserves for capital projects, a full investment appraisal process should be completed considering whether use of reserves or borrowing provides the Council with the best value for money option.
- Focus on selling existing assets that are surplus to requirements to free up resources to fund new capital projects.

6.5 By adopting these policies the Council will reduce the capital draw on reserves which will result in a reduction of cuts to Council revenue services by a corresponding amount.

6.6 This 2013-2018 plan continues to endorse the policy at 6.4 above, and would propose the following addition –

- That all capital projects clearly demonstrate the revenue consequences arising from a capital spending decision to assist Members in understanding the full financial impact.

Harbour Account capital expenditure

6.7 Any capital expenditure incurred by the Harbour Account will be met from Capital Financed from Current Revenue (CFCR) on the revenue Harbour Account, borrowing, or capital receipts generated from the sale of Harbour Account assets. This is because the Harbour Account cannot access the Scottish Government capital grant, so any capital expenditure funded in another way would mean an unaffordable draw on reserves.

Housing Revenue Account capital expenditure

6.8 The Housing Revenue Account currently has debt of approximately £38.6m which is unsustainably high. With the abolition of Housing Support Grant, council house rents will be required to service and repay the debt.

6.9 The Plan is to stop new debt being taken out by the Housing Revenue Account to fund capital expenditure projects, whilst a solution is found to the current unsustainable level of debt carried by the HRA.

6.10 Therefore at present any new capital projects should be funded by revenue (CFCR) or through the sale of existing assets (capital receipts).

Borrowing for specific Capital projects

6.11 Shetland Islands Council was successful in securing two thirds government funding for a new Anderson High School in Autumn 2012.

6.12 The final cost for a new school will not be finalised until "financial close" estimated to be March 2014. Until now a figure of £12m has been set aside in the reserves for this cost. In order to allow for prudent financial modelling, this figure has been increased to £14m. However, this does not mean that the Council's one-third share of the cost will be as high as this, and Members will receive full cost details prior to any decision to proceed.

6.13 Given the current historically low interest rates for borrowing, the Council should give full consideration to the option of borrowing for the new Anderson High School. A separate paper on borrowing will be presented to Members to set out the pros and cons of borrowing.

Housing Revenue Account

7.1 The 22 elected Members of Shetland Islands Council are collectively the largest landlord in Shetland, responsible for the letting and management of 1,754 properties as at 31 March 2013.

Accounting treatment

7.2 The Housing Revenue Account (HRA) is a statutory account that is completely separate from the General Fund. As such, it has to be financially self-sustaining as it is not possible for the General Fund to cross subsidise council house rents. All expenditure is funded by housing rents.

7.3 In addition, the HRA can only access its own ring-fenced reserve for repairs and maintenance expenditure, which had a balance of £10.423m at 31 March 2013.

7.4 As a result of the limitations on the HRA, it has had to borrow for a significant amount of its capital expenditure which has led to it currently owing the General Fund £38.6m at 31 March 2013. The HRA borrowing from another part of the Council is known as internal borrowing.

Housing Support Grant and Sustainability

7.5 The Scottish Government has abolished the Housing Support Grant, which has been made available to the Council's HRA to support it in making its interest payments on the debt. This grant was worth £0.8m in 2012-13. Without this grant, Shetland's council house tenants will be required to meet the full burden on interest charges on the outstanding debts through increased rents or reduced service levels. In order to raise an extra £0.8m from rents to cover the lost Scottish Government contribution, it would require a 13.6% increase in rents for 2014-15.

7.6 As a result of the level of debt and the lack of financial support from the Scottish Government the HRA is currently unsustainable. The 2013-14 HRA budget required a £2.5m draw on reserves to balance the budget, which equates to 25% of the entire reserve balance. Therefore this is only a temporary solution, as to continue with this approach would result in the HRA reserve being fully diminished within 4 years.

7.7 Work is still required to negotiate with the Scottish Government and Westminster for a viable solution to this issue. The future sustainability of the HRA is linked to taking a 30 year business planning approach, and this will be progressed during the current financial year.

HRA debt policy

7.8 As discussed in Section 6, the Plan proposes a policy of not taking out any new borrowing against the HRA until the current debt issue has been addressed.

7.9 In the meantime a £10m provision has been created for the potential write off of an element of the HRA debt. This does not represent a real cost to the Council. However, it represents the Council's commitment to addressing the debt issue and provides more options regarding reaching an agreement with national government, with a potential for a matched reduction in the debt between the Council and government.

7.10 If in the future, the Council decided to write off an element of the HRA debt, it would represent an opportunity cost in the sense that a future income stream of interest and debt repayment would be lost. This type of action has been referred to as the general fund offering "debt forgiveness" to the HRA.

7.11 The 2013-2018 Medium Term Financial Plan assumes that there will be an inflow of money into the general fund in 2014-15 in respect of the HRA debt. At present it is unknown whether this will be in the form of repayment of the debt by Scottish Government/Westminster, externalising the debt, or a combination of the two. What is absolutely clear is that inaction is not a financially viable option.

Revenue spending

7.12 The HRA has one reserve (the Housing Repairs & Renewals Fund), which provides an income stream to the HRA by the returns it makes on the markets. Given the current debt issue facing the HRA it would be prudent to ensure that the HRA reserve is maintained both as a source of generating income.

7.13 The Plan sets a policy of budgeting for no more than a sustainable draw on the Housing Repairs and Renewals Fund in the medium term. In effect, this means drawing no more than 3-3.5% of the balance from the reserve in any given financial year. However in this transition year where all expenditure is to be met from revenue (no borrowing), there is need to make provision to utilise the full 5.75% return (ie not inflation proof the return) for one year.

Harbour Account

8.1 The Harbour Account primarily represents the activity that takes place at Sella Ness, with the levels of activity dependant on the oil terminal at Sullom Voe. All surpluses generated on the Harbour Account are transferred to the Council's Reserve Fund.

8.2 The first priority of the accumulated surpluses in the Reserve Fund is to sustain the Harbour Account. The Zetland County Council Act 1974 states the purpose of the Fund as –

1. To cover any losses on the Harbour Account

2. To meet any claim or demand against the Council arising from the Harbour Account

3. To meet any capital expenditure required to maintain the Harbour Account

4. To meet any repairs and maintenance costs on the Harbour

8.3 The final provision in the Act is for the Reserve Fund to be used "for any other purpose which in the opinion of the Council is solely in the interests of the county or its inhabitants".

Anticipated surpluses on the Harbour Account in the medium term

8.4 There are two main factors that will impact adversely over the level of surplus generated by the Harbour Account over the next 3 years:

- **Reduced income from the suspension of the Schiehallion Oil Field** – Approximately 40% of the Harbour Account's income comes from Schiehallion throughput. It is anticipated that this income will be lost to the Harbour Account until 2016-17.

- **Pensions Liability –** The Harbour Account has a pensions funding shortfall of approximately £8m as a result of the transfer of Shetland Towage employees to the Council. It had been agreed by the previous Council that this would be funded by a transfer from the Harbour Account to the Pension Fund of approximately £2m per annum from 2012-13 to 2015-16 inclusive.

8.5 As a result of these two factors, the Plan is budgeting for the Harbour Account to make only a small surplus in 2013-14 followed by modest deficits in each of the following 2 financial years, with a return to surpluses commencing from 2016-17.

8.6 At present, it is anticipated the Harbour Account will start to generate healthy surpluses in 2017-18 and 2018-19, but given that this is 4 to 5 years away, it is difficult to have a high level of certainty over this.

Reserve Fund Commitments

8.7 The Reserve Fund balance was £ 57.095m at 31 March 2013 and as stated above, its first use is to sustain the Harbour Account.

8.8 Following the approval of the 2012-2017 Medium Term Financial Plan a figure of £39m has been set aside from the Reserve Fund for future Harbour Account commitments. This means that the available balance on the Reserve Fund for general use was £18.095m at 31 March 2013.

8.9 The £39m commitments balance was calculated as follows:

Backlog maintenance costs	£1m	There is a build up of backlog maintenance work which has yet to be completed, and it is estimated that £1m still remains to be undertaken. The reason for this build up was that the Harbour had slowed down its investment as it anticipated closure in 2000, but as a result of new oil coming on stream, its life has been extended, but this gave rise to a backlog in maintenance.
Capital expenditure	£13m	It is now estimated that the Harbour will remain open for another 25 years. This means that the Council will be required to invest in capital infrastructure during this period to extend the life of the Harbour. This expenditure will largely be incurred on the replacement of Jetties.
Decommissioning costs c.2037	£25m	The Council owns the Harbour at Sella Ness and has a legal requirement to ensure that the site is returned to its original condition once the Harbour closes. This will involve the removal of all jetties and man-made structures at the sight. This is estimated to cost in the region of £13m. In addition to this, it is estimated that the Harbour will operate at a loss of approximately £12m over its final 3 years, as the Council will have fixed costs for maintaining the site and employing staff, whilst at the same time the income stream from oil tanker arrivals will have dried up significantly.
TOTAL	**£39m**	This represents the total provision that may be required in order to operate the Harbour Account until its closure, which is anticipated to be in the late 2030s.

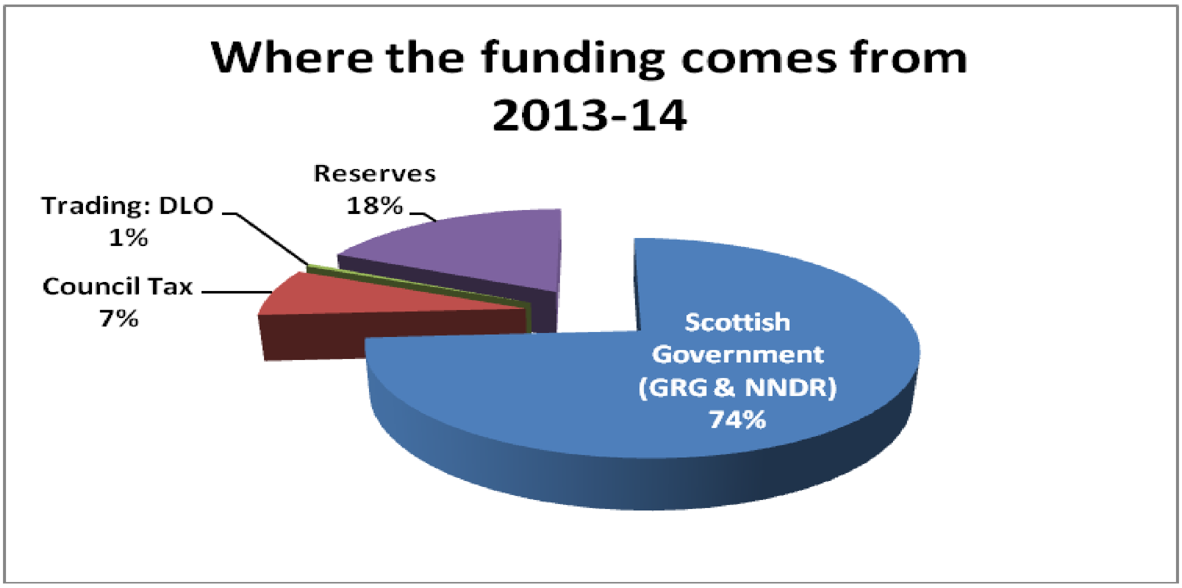
TOTAL Income

8.10 It is anticipated that the Council will start to receive a material income stream from the TOTAL Gas Plant in 2015-16, that will pick up in 2016-17 to around £5.5m per annum. However, the actual income stream is linked to the price of gas and throughput, so it is not possible to place a high level of confidence on these income figures at present. These will be reviewed each year to ensure that they are as accurate as possible with the available information. The income that is received will be processed through the Harbour Account.

Resources

9.1 In 2013-14 Shetland Islands Council's general fund will receive approximately 74% of its funding from the Scottish Government. This is made up of the core General Revenue Grant and the element of National Non-Domestic Rates that the Scottish Government grants to the Council.

9.2 The pie chart below shows where the funding comes from for the general fund budgeted expenditure in 2013-14:



9.3 The chart highlights the extent to which the General Fund requires reserves to make up the funding package. In order to achieve a fully sustainable financial position, reserves should only make up a maximum of 3% of the funding package. It is anticipated that this will be achieved during the Medium Term Financial Plan by reducing expenditure and benefiting from a recovery in the surpluses that can be generated from the Harbour Account, as well as a new funding stream from the TOTAL Gas Plant.

Estimated future resources available to the Council

9.4 The table below shows the estimated future resources available to the Council over the period of the Plan:

Source of Income	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
	£000s	£000s	£000s	£000s	£000s	£000s
Scottish Government (GRG & NNDR)	-85,955	-85,455	-83,955	-83,455	-82,955	-82,455
Council Tax	-8,600	-8,686	-8,773	-8,861	-8,949	-9,039
DLO	-564	-500	-500	-500	-500	-500
Harbour Account Surplus	-222	71	218	-4,784	-8,396	-8,000
TOTAL Gas Plant contribution	0	-109	-2,600	-5,833	-5,749	-5,439
Total Funding	**-95,341**	**-94,679**	**-95,610**	**-103,433**	**-106,549**	**-105,433**

9.5 A number of assumptions have been made around the resources available to the Council. These are set out below –

- The Scottish Government core revenue grant has been set up to and including 2014-15. The assumption made in the following years is that underlying funding will remain fixed in cash terms, reflecting the challenging economic outlook. However, because of the diminishing level of notional loan charge support available to the Council, the overall result is that the core grant will reduce by approximately £0.5m year on year after 2014-15. In addition, it is anticipated that there will be a £1m reduction in core revenue funding in 2015-16 following the one-year spending revenue.

- The level of National Non-Domestic Rate income has been set by the Scottish Government up to and including 2014-15. The assumption in this model is that this income stream will remain at the same level in subsequent years on the basis that the economic outlook will remain challenging throughout this decade. However, depending on the timing of the next revaluation, the Council may receive a short-lived windfall from the new TOTAL Gas Plant as part of the BRIS scheme.

- As a result of the high collection rates for Council Tax in Shetland, the model budgets for a higher level of Council Tax income in 2013-14, reflecting the levels collected in previous years. Beyond 2013-14, it is expected that Council Tax income will rise by 1% per annum based on the assumption that the Council will continue with the national freeze, but due to natural increases in the property base of 1% per year income from this source will increase by that amount.

- Based on the latest understanding of when the Total plant will open, it is anticipated that this will provide an income stream to the Council from 2015-16. The level of income budgeted in the model reflects our best estimation of throughput and price of gas at that time. It should be noted that as a result of this, there is a certain level of volatility as to when this income will start to flow into the Council, and the exact amount that it might be.

- It is anticipated that the Harbour Account will fail to make a surplus in 2014-15 and 2015-16 as a result of falling income levels and increased costs. However, the model budgets for a recovery in 2016-17, which will strengthen in 2017-18 and onwards once the towage pension liability has been paid off. Again however, there is a certain amount of volatility when trying to estimate the income that might be generated from the Harbour Account several years into the future.

Business Rates Incentivisation Scheme

9.6 The Scottish Government has created a Business Rates Incentivisation Scheme (BRIS) which provides an opportunity for the Council to maximise its National Non-Domestic Rates income stream.

9.7 The way in which the scheme works is that the Scottish Government sets an annual target for the level of Business Rates (National Non-Domestic Rates) that Shetland Islands Council should collect during the year. If the Council collects more than its target, it is able to keep 50% of the additional income, with the other 50% going to the Scottish Government. Therefore, there is an incentive to the Council to generate economic development to increase the tax base. Opportunities should be sought to progress this scheme.

9.10 However, the rateable values of Non-Domestic Properties are revalued every five years, and new values are incorporated into the Council's target. Therefore, depending on the timing of the next revaluation, the Council may receive a limited windfall from the new TOTAL Gas Plant and the new hotel in Brae.

Cost Pressures

10.1 Despite the drive to bring down the overall level of expenditure in order to work towards achieving a financially sustainable position, there will be cost pressures each year that put upward pressure on the levels of expenditure incurred by the Council.

10.2 It is anticipated that there will be significant cost pressures in 2014-15, with an allowance of £2.662m being budgeted to account for these.

10.3 The table below sets out the recurring cost pressures that have been considered for the 2014-15 budget, and the level of provision made for each:

Cost Pressure	Quant-ification	Description	Allowance for Cost Pressure in 2014-15 budget (£)
Pay Award	1%	It is anticipated that there will be a pay award of 1% in 2014-15	£875,095
Bus Services	Estimate	The new arrangements to be agreed by Members for bus services may result in a cost pressure for the Council.	£500,000
Children & Young People's Bill	Estimate	Changes to statutory requirements will result in cost pressures in the care of looked after children, kinship orders, minimum qualifications for foster carers, corporate parenting responsibilities, training and expansion of early learning and childcare hours.	£347,368
Demographic Pressures	2.6%	Based on the rate of Shetland's ageing population, it is anticipated that there will be extra demand on Community Care resources.	£278,000
Ferry Fuel	Estimate	Cost pressure arising from anticipated increases in the fuel used by Ferries. This could be an issue over 2 financial years.	£250,000
Utilities	Estimate	This is the anticipated cost increases for Water, Electricity, District Heating and Gas Oil during 2014-15. Where possible Procurement Scotland estimates have been applied.	£211,000
Pathfinder Replacement	Estimate	The Council's internal internet infrastructure is provided by Cable & Wireless through the Pathfinder arrangement. This contract ends at 31 March 2014. The ongoing revenue costs associated with finding a local solution are estimated to be cheaper than extending Pathfinder, however, there will still be an increase in cost of £200k p.a.	£200,000
General Inflation	2%-3%	It is anticipated that inflation will fluctuate between 2% and 3% in 2013-14. No allowance has been made, as corporate procurement efficiencies should off-set this pressure.	£0
Fuel Inflation	0%	There is no evidence to suggest that fuel prices, which are already at a historically high level, will continue to increase during 2013-14.	£0
Contract Inflation	0%	The most significant element relates to the bus contracts, but given new contracts will be in place for 2013-14, it is not anticipated that there will be significant contract inflation during the year. Any other contract inflation will have to be managed within existing budgets.	£0
TOTAL			**£2,661,463**

10.4 An allowance of 2.5% has been made for budget pressures in all future years covered by the Plan. This reflects the fact that the largest cost to the Council is salaries, and it is anticipated that there will be only modest pay awards in the medium term. In addition, general inflation (CPI) is forecast to settle at around 2.3% in the medium term.

10.5 However, it is likely that there will be specific budget pressures in future years, and as a result, these assumptions will be updated on an annual basis.

10.6 The known potential future budget pressures for specific items are as follows:

- **Anderson High School** – the current level of maintenance expenditure on the Anderson High School is insufficient to keep the building in sufficient repair beyond the short-term. It is anticipated that a new school will require an increase in repairs and maintenance expenditure of approximately £0.415m from 2016-17 over existing levels, therefore this has been added as a specific cost pressure to the 2016-17 budget line over and above the 2.5% allowance. It should be noted that if there was no replacement school, repairs and maintenance expenditure would have to increase by approximately £1m per year to address the backlog maintenance issues at the current school.

- **Bus and Air Services contracts** – these contracts have an element of indexation contained within them and as a result there will be an ongoing cost pressure associated with them.

- **Welfare Reform** – There are two potential pressures which could arise after the phased introduction of Universal Credit from Autumn 2013. The first is that there may be additional administrative burdens placed on the Council with regards to the implementation, and ongoing support of, the new arrangements. The second potential budget pressure is the risk of falling housing rents income to the HRA as a result of the housing element of benefits being paid directly to claimants instead of to the Council.

- **Severance costs** – As a result of the likely reduction in the size of the Council's workforce over the forthcoming years, it is anticipated that this will result in an increase in one-off severance payments and will also increase future pension liabilities for the Council as the fund matures and moves towards a position of 100% funded.

- **Borrowing** – If the Council finds it more cost effective to fund capital expenditure by incurring external debt, this may give rise to an additional cost pressures on the relevant revenue service budget in the form of borrowing costs.

10.7 It is not yet possible to quantify the costs associated with each of the above due to a number of uncertainties, but as more information is known, these pressures will be costed in future refreshes of the Plan.

Budget Modelling

11.1 Based on the information gathered from the Medium Term Financial Planning process the following budget model has been produced:

	Description	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
		£000s	£000s	£000s	£000s	£000s	£000s
Expenditure	Prior year recurring general fund budget	122,626	111,703	107,826	108,192	109,420	111,911
	Savings requirement	-12,526	-6,539	-2,223	-1,720	0	0
	Non-recurring general fund budget (e.g. Carry-forwards and contingencies)	7647	2,616	889	688	0	0
	Budget Pressures	1,603	2,662	2,589	2,948	2,490	2,490
	Net-recharges out	-3,164	-3,000	-3,000	-3,000	-3,000	-3,000
	Total General Fund budgeted expenditure	116,186	107,442	106,081	107,108	108,911	111,401
Core Income	Scottish Government General Revenue Grant & Non-Domestic Rates income	-85,955	-85,455	-83,955	-83,455	-82,955	-82,455
	Council Tax	-8,600	-8,686	-8,773	-8,861	-8,949	-9,039
	DLO	-564	-500	-500	-500	-500	-500
	Total Core Funding	-95,119	-94,641	-93,228	-92,816	-92,404	-91,994
	(SURPLUS)/DEFICIT ON GENERAL FUND	**21,067**	**12,801**	**12,853**	**14,293**	**16,507**	**19,408**
Deficit Funding	Harbour Account Surplus	-222	71	218	-4,784	-8,396	-8,000
	TOTAL Gas Plant contribution	0	-109	-2,600	-5,833	-5,749	-5,439
	Draw on Reserves	-20,845	-12,763	-10,471	-3,676	-2,362	-5,969
	TOTAL DEFICIT FUNDING	**-21,067**	**-12,801**	**-12,853**	**-14,293**	**-16,507**	**-19,408**
Council Reserves	Opening Reserves Balance 1 April	205,730	169,134	187,966	183,197	185,559	189,816
	Equalisation Fund adjustment	-15,000					
	Return on Investment	6,172	6,353	7,002	6,838	6,919	7,066
	Debt repayment/Debt externalisation		41,242				
	Draw on Reserves - Revenue	-20,845	-12,763	-10,471	-3,676	-2,362	-5,969
	Draw on Reserves - Capital	-2,450	-14,000				
	Draw on Reserves - Housing Revenue Account	-2,473	-500	-300	-300	-300	-300
	Draw on Reserves - Spend to Save	-2,000	-1,500	-1,000	-500		
	Closing Reserves Balance 31 March (Minimum Target Balance £150m)	**169,134**	**187,966**	**183,197**	**185,559**	**189,816**	**190,614**

11.2 The purpose of the model is to set out the level of expenditure that is affordable each year, based on the total funding available and a desire to ensure that the Council's reserves stabilise as soon as possible without falling below £150m (at 2013 prices).

Assumptions

11.3 The following assumptions have been made in the budget model:

Total General Fund expenditure

- The starting point for each year will be the prior year start point, less savings and then budget pressures added on. For example, the start point for 2014-15 is calculated as follows-

Description	Amount £m
2013-14 General Fund expenditure before savings	122.626
Less: 2013-14 savings	-12.526
Add: 2013-14 Budget pressures	1.603
2014-15 General Fund expenditure before savings	**111.703**

- The savings requirements total the same as the 2012-2017 plan, the only difference is that they are profiled differently between 2013-14 and 2014-15 because the 2013-14 budget contained a higher level of savings that had been required in the plan. This has meant that the new savings requirement for 2014-15 has been reduced to account for the extra budgeted savings in 2013-14.

- An in-year contingency for slippage in the delivery of savings has been included for each year where there is a savings requirement. For the current 2013-14 financial year, this figure was calculated as part of the budget setting exercise. In subsequent years, an allowance of 40% of the overall savings target has been included as a contingency to cover the cost of exit packages and slippage in the implementation of service changes. It should be noted that this assumes that any savings shortfall in a given financial year will be made up in full in the following financial year ie it is purely a timing difference.

- An allowance for budget pressures has been built into the model. In 2013-14 this figure has been calculated as £1.609m. In subsequent years, this has been calculated at 2.5% of the in-year General Fund expenditure before savings figure. Further details of these calculations have been discussed in section 10 of the Plan.

- Any additional budget pressures, such as general inflation will be required to be met from service budgets.

- Net recharges out are estimated to remain constant based on an expectation that there will still be the same level of service delivered to the HRA and Harbour Account and Capital from the General Fund.

- If the plan is delivered, actual spending levels on the general fund will rise in the 2016-17 budget and there will be no requirement to deliver any savings in the final budget set by this Council in February 2017 assuming the external funding continues at a level indicated in paragraph 11.1.

Total funding

- The Scottish Government core revenue grant has been set up to and including 2014-15. The assumption made in the following years is that underlying funding will remain fixed in cash terms, reflecting the challenging economic outlook. However, because of the diminishing level of notional loan charge support available to the Council, the overall result is that the core grant will reduce by approximately £0.5m year on year after 2014-15. In addition, it is anticipated that there will be a £1m reduction in core revenue funding in 2015-16 following the one-year spending review.

- The level of national non-domestic rate income has been set by the Scottish Government up to and including 2014-15. The assumption in this model is that this income stream will remain at the same level in subsequent years on the basis that the economic outlook will remain challenging throughout this decade.

- It is expected that Council Tax income will rise by 1% per annum based on the assumption that the Council will continue with the national freeze, but due to natural increases in the property base of 1% per year income from this source will increase by that amount.

- Based on the latest understanding of when the TOTAL Gas Plant will open, it is anticipated that this will provide an income stream to the Council from 2015-16. The level of income budgeted in the model reflects our best estimation of throughput and price of gas at that time. It should be noted that, as a result of this, there is a certain level of volatility as to when this income will start to flow into the Council, and the exact amount that it might be.

- It is anticipated that the Harbour Account will fail to make a surplus in 2014-15 and 2015-16 as a result of falling income levels and increased costs. However, the model budgets for a recovery in 2016-17, with a surplus of £4.8m, rising to £8.4m in 2017-18 once the towage pension liability has been paid off and throughput recovers.

Reserves

- The budget model builds in a return on investments of 3% to 3.5% for each financial year covered in the Plan. The long term average return over the past 20 years has been 5.75% so once inflation is removed from this total, a figure of 3% to 3.5% appears prudent.
- The model removes £15m from the reserves in 2013-14 to set up a separate Equalisation Fund which will be used to smooth out the impact volatile investment returns in future years.
- An injection of £41.2m will be made into the reserves at the start of 2014-15, either as a result of the government repaying the housing debt and/or the Council externalising the debt.
- After 2013-14, the only draw on reserves budgeted for capital spend is a figure of £14m for a new Anderson High School. It is assumed that apart from this item, all capital expenditure will be funded from core government capital grant, capital receipts from the sale of assets and CFCR.
- An amount of £0.5m is anticipated to be drawn from the Housing Repairs and Renewals Reserve each year after 2013-14.
- A figure of £5m will be available to fund spend to save projects between 2013-14 and the end of the savings programme in 2016-17.

Summary

11.4 In summary, over the course of the Plan it is anticipated that the reserves will generate income of approximately £40m and the total draws on reserves will total £82.5m.

11.5 If this Plan is delivered, the Council will retain a level of reserves of £150m and will have achieved a financially sustainable position.

Addressing the Budget Gap

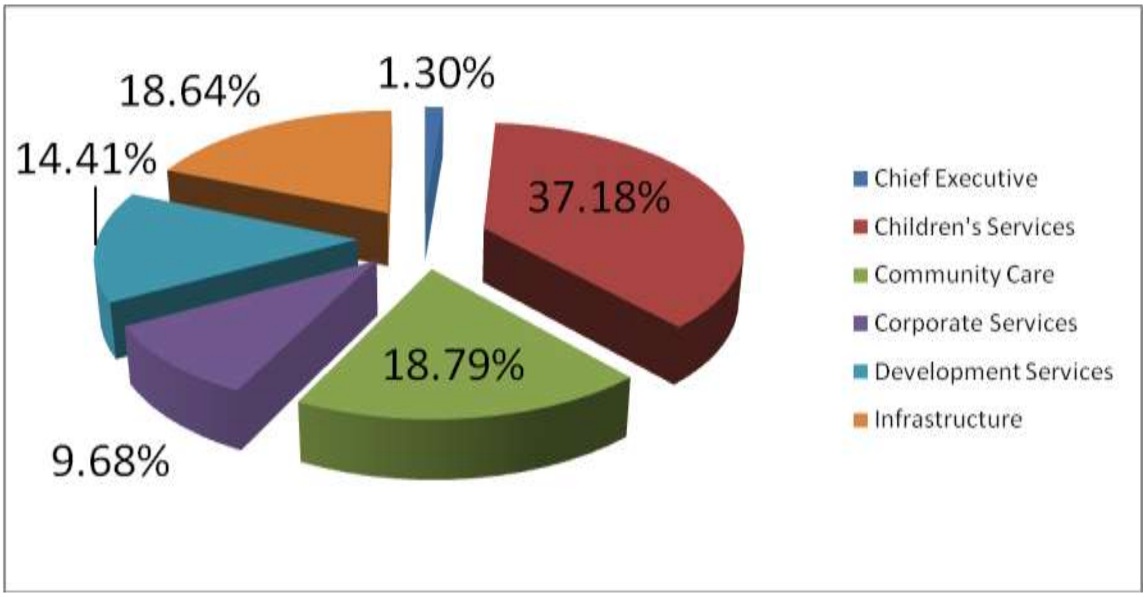
12.1 Based on the modelling performed in Section 11, the budget gap for the next 5 years is as follows:

Description	2014-15 £000s	2015-16 £000s	2016-17 £000s	2017-18 £000s	2018-19 £000s
Gap to be met by directorates	6,539	2,223	1,720	0	0

12.2 The budget gap can only be made up through a combination of increasing fees and charges and reducing costs across the Council.

12.3 It is important that the budget gap is addressed based on Members' priorities. In effect, this means that the priority directorates receive the greatest level of protection against the cuts.

12.4 The base year for the Medium Term Financial Plan was 2012-13 when the general fund budget was divided amongst directorates as follows:



12.5 Section 4 of this report describes the themes around Members' priorities and this has been used at the basis for determining an initial resource allocation to allow Target Operating Budgets to be set for each directorate across the timeframe of the Plan.

12.6 It is important to understand the Target Operating Budgets provide directorates with a financial envelope for developing a budget, but an iterative process will take place throughout the Autumn, whereby Members will have the chance to adjust directorate budgets based on the proposed budgets developed by directorates.

12.7 However, it is important to note that in order to operate within the overall financial envelope that is affordable to the Council, if Members agree to award more funding to one directorate or service, it will have to be at the cost of reducing a budget elsewhere.

12.8 Based on Members' priorities documented in the Corporate Plan, this financial plan seeks to protect Children's Services and Community Care Services and Transport. Members also expressed a desire to ensure that there were sufficient resources available to run a well managed organisation.

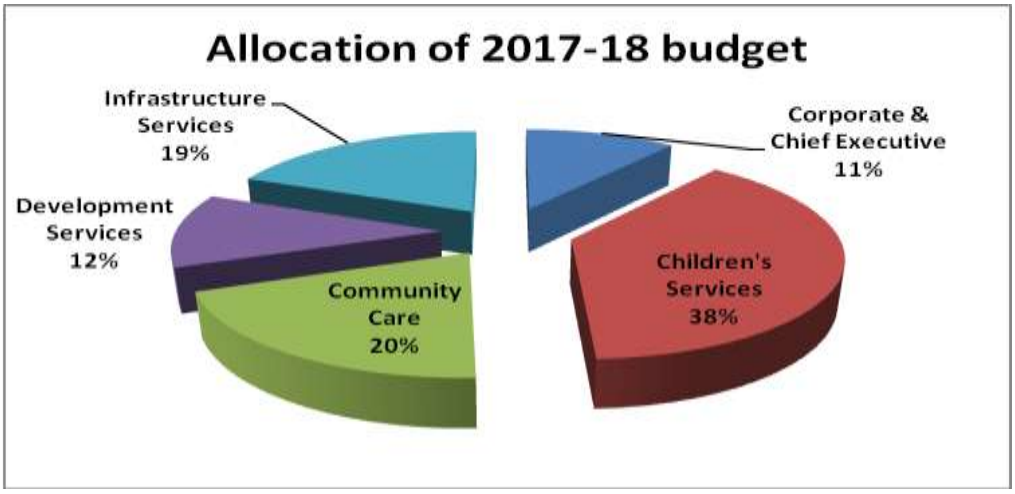
12.9 By applying these priorities and working within available resources the following Target Operating Budgets and associated budget gaps are proposed for each directorate:

2013-14 £000s	Directorate		2014-15 £000s	2015-16 £000s	2016-17 £000s	2017-18 £000s	2018-19 £000s
12,072	**Corporate & Chief Executive**	**Target Operating Budget**	**11,120**	**10,735**	**10,735**	**10,735**	**10,735**
		Budget gap	(952)	(385)	0	0	0
41,262	**Children's Services**	**Target Operating Budget**	**40,429**	**39,714**	**37,994**	**37,994**	**37,994**
		Budget gap	(833)	(715)	(1,720)	0	0
20,524	**Community Care Services**	**Target Operating Budget**	**20,114**	**19,712**	**19,712**	**19,712**	**19,712**
		Budget gap	(410)	(402)	0	0	0
13,878	**Development Services**	**Target Operating Budget**	**12,039**	**11,698**	**11,698**	**11,698**	**11,698**
		Budget gap	(1,839)	(341)	0	0	0
21,530	**Infrastructure Services**	**Target Operating Budget**	**19,025**	**18,645**	**18,645**	**18,645**	**18,645**
		Budget gap	(2,505)	(380)	0	0	0

12.10 The table below shows how the Target Operating Budgets per directorate reconcile back to the Total General Fund expenditure figure included in the budgeting model in Section 11:

	2013-14 £000s	2014-15 £000s	2015-16 £000s	2016-17 £000s	2017-18 £000s	2018-19 £000s
Corporate & Chief Executive	12,072	11,120	10,735	10,735	10,735	10,735
Children's Services	41,262	40,429	39,714	37,994	37,994	37,994
Community Care Services	20,524	20,114	19,712	19,712	19,712	19,712
Development Services	13,878	12,039	11,698	11,698	11,698	11,698
Infrastructure Services	21,530	19,025	18,645	18,645	18,645	18,645
Total directorate budgets	**109,266**	**102,727**	**100,504**	**98,784**	**98,784**	**98,784**
Cumulative Cost Pressures	1,603	4,265	6,854	9,802	12,293	14,783
Fund Manager Fees	834	834	834	834	834	834
Carry-forwards & Contingency	7,647	2,616	889	688	0	0
Total Spending	**119,350**	**110,442**	**109,081**	**110,108**	**111,911**	**114,401**
Less: Recharges Out	(3,164)	(3,000)	(3,000)	(3,000)	(3,000)	(3,000)
TOTAL GENERAL FUND EXPENDITURE	**116,186**	**107,442**	**106,081**	**107,108**	**108,911**	**111,401**

12.11 By adopting these Target Operating Budgets the relative proportion of General Fund spending would be adjusted as follows by 2017-18:



Directorate	2012-13 % of General Fund (exc Police and Fire)	2017-18 % of General Fund	Movement in % share of funding between 2012-13 and 2017-18
Corporate & Chief Executive	10.98%	10.87%	-0.11%
Children's Services	37.18%	38.46%	1.29%
Community Care	18.79%	19.95%	1.16%
Development	14.41%	11.84%	-2.57%
Infrastructure	18.64%	18.87%	0.23%
TOTAL	100%	100%	0%

Addressing the budget gap

12.12 Directorates will be required to address the budget gap set out in 12.9 above, in order to deliver budget proposals that are within the Target Operating Budgets set in 12.9 above.

12.13 There are 2 options available to directorates to fill budget gaps; identifying savings and introduce or increase existing fees and charges. In practice a combination of both options will be adopted by directorates where there is scope to do so.

Fees and Charges

12.14 Shetland Islands Council has budgeted to achieve income of £12.8m from fees and charges levied on customers in 2013-14. This represents a significant amount of income and increasing these charges and creating new charges could make a significant impact on bridging the budget gap within directorates. The table below shows the breakdown of the income:

Category	Amount (£)
Sales	2,808,349
Fees & Charges	8,982,215
Rental Income (excluding Housing)	1,041,905
TOTAL	**12,832,469**

12.15 This means that for every 1% increase in fees, charges and rents, based on the current charging bases, almost £128,325 would be raised.

12.16 In relation to fees and charges there is an expectation in the Plan that:

- Where these are already levied, consideration will be given to increasing them;
- Where there are concession fees and charges, consideration will be given to reducing these or scrapping them altogether;
- Where the Council provides a service that could be provided by the private sector, consideration is given to introducing charging in instances where this doesn't already exist.

12.17 Any decisions around fees and charges should be undertaken in compliance with the Council's charging policy.

Council Tax

12.18 It is possible for the Council to increase Council Tax in order to contribute towards bridging the budget gap, but this would be in contravention to the concordat agreement between Scottish local authorities and the Scottish Government.

12.19 The Scottish Government provides an element of additional funding to Shetland Islands Council in its financial settlement as an incentive not to increase Council Tax. This funding would be lost if the Council were to increase Council Tax.

12.20 Council Tax provides limited scope for generating income for the Council. A 1% increase in Council Tax would generate approximately £85,000, so a significant increase would be required in order to make an impact on the budget gap.

12.21 As a result of these factors, the Plan assumes that Council Tax will remain frozen for the remainder of this Council term.

Safeguards and Contingencies

13.1 There is a risk to any organisation that its budget may not be delivered. It is therefore important to ensure that there are appropriate contingency arrangements in place that can be used in order to help put the organisation back on track for delivering its budget.

13.2 This will be important to Shetland Islands Council, particularly over the next 10 months to ensure that by 31 March 2014, the organisation is clearly working towards its objective of financial sustainability by meeting its set expenditure levels. By that stage, the recurring draw on reserves for the year should be approximately half their 2011-12 levels at £13.5m, and the 2014-15 budget should include savings that will ensure that general fund net spending is no higher than £106m.

13.3 Therefore this paper sets out a number of options available regarding contingency measures to ensure that the objectives of the Plan are delivered throughout the next five years.

13.4 As a safeguard to the future viability of the Council, it would be appropriate to consider setting a date, and determining a set of measures in order to perform a "financial health check" on the Council.

13.5 It would be at this point, that if the Council failed to meet the indicators set in the health check, it would result in an escalation of the approach to dealing with the financial situation.

Contingency Measures

13.6 The Plan proposes to grant delegated authority to the Chief Executive to invoke the following measures if they are required –

- Taking decisions to make minor alterations to the level of service provision in order to stop the need to recruit to a post;
- Closing the purchase ledger as required (except for essential payments e.g. utilities);
- Removing access to ordering systems;
- Centrally close down non-essential budgets;
- Cancel training (with the exception of instances where there was a legal requirement);
- Temporary recruitment freeze (except for essential posts);
- Ban non-contractual overtime
- Stop third party grant payments
- Delaying the commencement of contracts or cancelling them
- Stopping all capital purchases (such as PCs etc)

Safeguarding Measures

13.7 Members will be provided with an annual overview of the financial position in the form of the provisional outturn report. However in addition to this, a key date should be determined for assessing whether the Plan is on course for delivery. It is recommended that this date be set as 30 June 2014.

13.8 By this time it will be clear whether the levels of savings required are being delivered and the impact that this is having on the reserves.

13.9 A financial health check would be the mechanism for assessing the Council's progress against the plan.

Financial Health Check

13.10 The key measures of the financial health check are –

- **The level of Reserves** – The level of reserves would be measured against the Medium Term Financial Plan projection. The variance threshold would be 10%. If the reserves were over 10% lower than the projection, an investigation would be undertaken to assess the factors that have caused this. If a reasonable explanation cannot be found the Council will have failed against this indicator.

- **The size of the General Fund deficit** – The size of the annual General Fund deficit would be measured against the Medium Term Financial Plan. The variance threshold would be 10%. If the deficit was over 10% larger than the planned deficit an investigation would be undertaken to assess the factors that have caused this. If a reasonable explanation cannot be found the Council will have failed against this indicator.

- **The projected draw on reserves for 2014/15 as at 30 June 2014** – Should the projected draw be over 10% greater than planned an investigation would be undertaken to assess the factors that have caused this. If a reasonable explanation cannot be found the Council will have failed against this indicator.

13.11 If the Council failed the financial health check then Members would have to consider a number of options to address this.

Consultation

14.1 Consultation and communication of the Plan and the resulting reviews will be essential if the Plan is to be implemented, and be successful in reducing expenditure but at the same time minimising the inevitable impact on services delivered to the Community.

14.2 The Plan will impact on services, communities and staff. To ensure there is a consistent and robust approach to service reviews, it is vital that consultation is part of the process. The Council has in place and is currently utilising the Community Consultation and Engagement Guide and Communications Plan. This can be found on the Council's website: http://www.shetland.gov.uk/communityplanning/documents/CommunityConsulationEngagementGuide.pdf.

14.3 Managers have also been provided with an in-depth review guide, which incorporates advice on the appropriate level of consultation. This guide ensures that issues such as risk assessment, equalities impact assessments, environmental and economic impacts etc are properly considered.

14.4 It should be recognised that the over-riding factor, in any consultation exercise is "the Council has to reduce expenditure" and expectations from any consultation exercise needs to bear this in mind.

Conclusion

15.1 Good progress has been made since the 2012-2017 Medium Term Financial Plan was adopted by Members in September 2012. The 2012-13 budget was exceeded and Members agreed a challenging 2013-14 budget that when implemented will mean that the Council will be over 70% of the way towards becoming sustainable. This has resulted in the Council being able to increase its Tolerable Reserves Floor to £150m and set aside £15m in a new Equalisation Fund which will help to smooth out future investment returns.

15.2 However, the Council continues to overspend at a rate that is unsustainable, and this updated plan follows in the footsteps of the 2012-2017 plan, which seeks to address this issue. In order to achieve that, it is important that the Council finds £10.5m of savings over the next 3 years.

15.3 The scale of the overall savings required remains unchanged from the 2012-2017 plan, as is the method of apportionment of the savings between directorates. Children's Services, Community Care and Transport continue to receive a level of protection from budget cuts at the expense of Development Services, Corporate Services and the Chief Executive's Office.

15.4 The Council has now formally adopted its Corporate Plan and the proposals in the Medium Term Financial Plan compliment that plan and target resources to ensure that it can be delivered.

15.5 The medium term future of UK Public Finance remains bleak, but by following this plan the Council will be in a far stronger financial position than it has been for many years, and will require no further savings after 2016-17 as it will be in a financially sustainable position.