



**Policy and Resources Committee  
Shetland Islands Council**

**18 November 2015  
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## **Shetland Islands Council Medium Term Financial Plan**

**F-073-F**

**Report Presented by Executive Manager – Finance**

**Corporate Services**

### **1.0 Summary**

- 1.1 The purpose of the Medium Term Financial Plan (MTFP) is to set out the financial framework within which Shetland Islands Council is expected to operate over the next five years and to present a financial strategy that will help the Council to deliver its services within the financial constraints that have been forecast.
- 1.2 Furthermore the Plan recognises the Council's clear commitment to its medium term objectives and outcomes. The Plan makes a clear case for change, as to do the same as at present will not be affordable in the future. Therefore prioritisation of resources through an agenda for change to make the required savings and deliver the required outcomes is vital to balancing future budgets.
- 1.3 The Plan asks Members to continue the huge progress already made towards reducing the underlying cost base of Council services and identifying and maximising income opportunities. By agreeing the recommendations and financial strategy contained within the MTFP it will allow the Council to develop a sustainable financial model that will ensure that the Council makes best use of all of its resources and reserves.

### **2.0 Decision Required**

The Policy and Resources Committee RECOMMENDS that the Council RESOLVES to adopt the Medium Term Financial Plan by:

- 2.1 Approving the principles of the plan set out in section 2.2 of the Plan;
- 2.2 Approving the assumptions on income and expenditure which underpin the Plan set out in sections 4, 5, 6 and 7 of the Plan;

- 2.3 Approving the Financial Strategy set out in section 13 of the Plan; and
- 2.4 Approving the Target Budgets for Services as detailed in Appendix C.

### **3.0 Detail**

- 3.1 The detailed Medium Term Financial Plan has been attached as Appendix 1 to this report.
- 3.2 The forecasts and projections incorporated into the Plan have been made based on the latest data that is available and from the examination of expert and independent opinion to ensure that a reasonable and prudent approach has been taken. This has been particularly important in establishing projections for Council income as no announcements have yet been made about funding levels beyond 31 March 2016.
- 3.3 It is clear, as with all such Plans, that the MTFP will require to be reviewed on an annual basis in order to maintain its relevance and integrity in relation to the information available and internal and external factors that impact upon it.

### **4.0 Implications**

#### Strategic

#### **4.1 Delivery On Corporate Priorities**

The development of a Medium Term Financial Plan contributes to the corporate objective of remaining financial sustainable and financially responsible in the use of resources. This also contributes to the work of the Shetland Partnership, which has set the challenge of achieving the same or more with fewer resources. The Plan proposed is consistent with the objectives of the Council to make best use of the resources it has, to support the delivery of services to Shetland.

#### **4.2 Community /Stakeholder Issues – Refer to section 3 of the Medium Term Financial Plan which covers the planning process and incorporates the Building Budgets 2015 exercise undertaken earlier this year.**

#### **4.3 Policy And/Or Delegated Authority**

The Policy and Resources Committee has authority to advise the Council in the development of its strategic objectives, policies and priorities. The determination of new strategies is a matter reserved to the Council.

#### **4.4 Risk Management**

There are a number of assumptions within the budget model that are based on the best information available to date.

These assumptions are largely around anticipated income levels (sections 4 and 5), return on investments (section 6) and cost pressures and demands (section 7). In reality the actual figures will vary from the forecast figures and therefore on an annual basis the

Medium Term Financial Plan will be reviewed so that assumptions can be updated.

A significant financial risk exists in relation to the income projections from the Harbour Account and from the Shetland Gas Plant as a result of the volatility around levels of throughput and the price of oil and gas. For example, the oil and gas price has had a significant impact on the level of income the Council is expecting to receive from the Shetland Gas Plant, when compared with the last plan. By revising the value of income downwards the robustness of the Plan is improved, removing the overoptimistic values and any complacency that may arise from having unachievable income levels.

The Plan estimates a net 5.2% return on reserves annually which results in an estimated return of £12m. Taking a long term view of investment returns is vital to providing assurance that this level of return can be achieved as markets and the value of investments will go down as well as up. A net 5.2% return has been based upon a gross return of 7.3% per annum, and is at the upper end of a range over the last 21 years that has seen longer term rates of between 3.56% and 8.19% per annum. Managing and the Council's investments through a diversified investment strategy as is currently in place and monitoring performance ensures the Council remain in a position to achieve this level of investment return over the long term.

4.5 Equalities, Health and Human Rights – None.

4.6 Environmental – None.

#### Resources

4.7 Financial

The Plan sets out the resources available to the Council over the next five financial years. The plan also proposes how these resources should be allocated between revenue and capital, and between directorates, with the overall aim of ensuring the Council continues to be financially sustainable.

The Plan recommends maintaining usable reserves around current levels in order to deliver year on year income from investments to support the revenue costs of Council Services.

4.8 Legal – The Plan recommends a financial strategy that may lead to implications for the Legal Service, an example being that the Council should capture savings from improved and robust procurement and commissioning processes, including the re-negotiation of contracts.

4.9 Human Resources – There are no direct implications arising from the Plan. In developing the actions and implementation of those in order to address the financial strategy human resource implications may arise, which will be detailed at such times.

4.10 Assets And Property – The Plan recommends that the Council focus on effective asset management and a reduction in the number of properties occupied. The Executive Manager – Capital Programme will

determine the opportunities for maximising revenue income and capital receipts from the property estate.

## **5.0 Conclusions**

- 5.1 This Medium Term Financial Plan sets out the action that needs to be taken in order to ensure that the Council acts now to address the gap between income and expenditure from 2017/18 onwards that is forecast. In acting to address the forecast gap it will provide the Council the best possible opportunity to prepare and approve a balanced budget in the future.
- 5.2 The recommendations in the Plan focus the Council on taking a long-term approach to making best use of the investment returns that are forecast and to draw an affordable and sustainable sum from those returns to support Council services.
- 5.3 The Council will require to change, to adapt to the financial climate that it faces. It will have to have identified and delivered on a number of transformational changes that not only deliver savings but focus attention on the Council's Corporate Plan objectives and outcomes.
- 5.4 The Council has refreshed and 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.
- 5.5 The medium term future of UK Public Finance remains bleak, although the forecast upturn in cash availability to the UK public sector in 2020/21 would undoubtedly be welcome.
- 5.6 The financial constraints that are presented by the Plan remain very challenging but are achievable as the Council is well placed to move forward with a recent history of delivering on its budget, being able to implement change, to take appropriate decisions and act responsibly.

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For further information please contact:  
*Jonathan Belford, Executive Manager - Finance*  
01595 744607  
[jonathan.belford@shetland.gov.uk](mailto:jonathan.belford@shetland.gov.uk)  
16 November 2015

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### List of Appendices

Appendix 1 – Medium Term Financial Plan 2015/16-2020/21



# **MEDIUM TERM FINANCIAL PLAN**

## **2015/16 – 2020/21**

### **Corporate Plan Vision:**

**By the end of this plan (2020), we want to be known as an excellent organisation that works well with our partners to deliver sustainable services for the people of Shetland.**

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**File Reference: MTFP 2015-2020 F3 Issued**



## **1. Foreword by the Executive Manager - Finance**

The Medium Term Financial Plan (the Plan) is a crucial strategic document that provides the financial framework for the delivery of Council services to the citizens of Shetland. The Plan captures data from across the various Council accounts and presents an overall projected funding position and Financial Strategy for the next five years that is based on:

- Risk aware projections in relation to income;
- Continuing a long-term approach to drawing sustained financial benefit from investments;
- A commitment to reduced costs through various means;
- Savings required being met from across all Council Services; and
- Recognising the potential benefits that will arise from pro-actively engaging with the Scottish Government to ensure a fair share of financial resources is received by Shetland for the Services delivered.

The data upon which income projections have been modelled takes into account the views, observations and conclusions of expert external parties. Finance and Service staff have provided cost information to provide robust projections. In addition engagement with Elected Members has been captured from two seminars held in August and September 2015.

A series of public events and online simulator generated increased interest in the financial issues facing the Council and the feedback received has been considered by Directors when preparing their budgets for 2016/17. The Council will continue to find ways of improving public engagement to help inform its financial planning processes during the life of the Plan.

Risk management has been an increasingly important aspect of Council governance and the Plan sets out financial risks associated with delivering Council Services and the means through which these are managed.

The Council recently approved its Corporate Plan and the emphasis on the achievement of the defined outcomes cannot be understated. The Plan recognises that those outcomes are delivered through the range of Council Services and that all will play their part in adding to that achievement. Equally all must contribute to the effective and efficient delivery of Services.

Maintaining a balanced budget in times of continuing austerity, significant public sector change and volatile external market conditions is extremely challenging. Should nothing change then future Service demands and cost pressures will significantly outstrip the resources available. The Council will need to continue to improve its productivity and efficiency in order to maintain and improve the

Services provided, as well as continue to prioritise its spending. Decisions will have to be taken that will lead to funding reductions in lower priority areas to enable funding to be maintained elsewhere.

The Plan emphasises that action needs to be taken now to achieve future savings and that changes that are proposed and implemented move the Council towards the achievement of the Corporate Plan outcomes.

The Plan will be reviewed on an annual basis to maintain its relevance and integrity in relation to the information available and the internal and external factors that impact upon it.

Jonathan Belford

Executive Manager – Finance

18 November 2015

## **2. Medium Term Financial Plan and Financial Strategy 2015/16 – 2020/21**

### **2.1 Introduction**

- 2.1.1 The Plan provides the financial planning framework for the delivery of services to the population of Shetland. It sets the financial context from which the forecasting of our resources is derived and sets out the financial strategy that provides the framework for planning Council services.
- 2.1.2 The Plan integrates with other strategic documents, fundamentally referring to the Corporate Plan and the Single Outcome Agreement, the achievements of which will be measured in the medium to long term.
- 2.1.3 Acting as a tool for financial planning the Plan considers income and expenditure across the range of Council service areas including the Council housing stock (Housing Revenue Account) and the harbours (Harbour Account). It addresses both the need for revenue and capital expenditure and how these will be funded.
- 2.1.4 For Shetland Islands the long-term benefits of having retained a proportion of the money generated from oil and gas since the 1970's is a luxury that most local authorities would be envious of. With careful and balanced strategic investment this money enables the Council to top-up its Government funding to enhance and extend its service delivery across the Islands. These long-term investments are managed in accordance with the Annual Investment and Treasury Strategy. That strategy doesn't determine the application of investment returns, this is addressed within this Plan ensuring that the use of all Council resources are included within a single document.
- 2.1.5 The economic environment within which the Council operates is extremely fluid. The Plan makes use of many assumptions based upon the information that was available at the time of writing this report. UK and Scottish government policy changes and funding decisions have a significant impact on the Council requiring the Plan to be reviewed on an annual basis.
- 2.1.6 The Plan outlines the Medium Term Financial Plan for the period 2015/16 to 2020/21 and details the strategy that the Council intends to follow in planning its service delivery and against which it will set detailed balanced budgets on an annual basis.

### **2.2 Principles of the Plan**

- 2.2.1 The Plan is based on the following Principles:
  - The Council will live within its means, and in doing so approve an annual budget that is balanced and affordable.

- The Council has agreed to use its long-term investments as an investment fund and draw a sustainable amount of the long-term anticipated return from those investments each year.
- The cost of capital will be recognised by the Council, and external borrowing will be undertaken for capital projects where the interest rate is lower than the estimated long-term return on its investments, in line with the Borrowing Policy<sup>1</sup>.
- The cost of any borrowing undertaken will be borne by the revenue budget and met by the relevant Service that will benefit from the capital investment.
- The Executive Manager – Finance will determine the costs associated with the management of significant corporate cost pressures, such as pay, pension and tax implications of national and local conditions of service. Where these cannot be applied to service budgets a central contingency will be retained and allocated to service budgets when required.
- A risk based approach will be taken to the level of growth that Services identify and a central contingency will be retained and allocated to service budgets if required.
- The Plan will identify the level of funding that can be made available for the delivery of services and estimate the gap between income and expenditure for which savings options and further efficiencies will have to be implemented.

## **2.3 Benefits of the Plan**

- 2.3.1 Forecasting the future is crucial to understanding what the Council may have to address, particularly in an environment where the demands and expectations of the Shetland public are continually changing. Add to this the duties and responsibilities placed on the Council by UK and Scottish Government policies that continue to evolve and respond to the economic and social environment within which we live.
- 2.3.2 In such an environment, where our customer's desire to maintain service levels and quality exceeds the capacity of the resources the Council has, there is a need for a clear view on what the limitations are, and how service delivery can be maximised within those resource limitations.
- 2.3.3 The Plan enables Elected Members to understand the constraints within which each annual budget setting process takes place and the overall principle of living within its means and maintaining service costs that are affordable.

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<sup>1</sup> Shetland Islands Council, Borrowing Policy and Strategy 2013 - 2018

- 2.3.4 Through adopting the Plan the financial planning and financial management of the Council's revenue and capital resources are improved. This provides a five year timeline in which to consider the implementation of change and improvement. It also allows Elected Members and Directors a longer period to plan for changes in future budget levels.
- 2.3.5 The Plan allows for the alignment of resources to the Council's spending priorities. The priorities of the Council relate to the outcomes that it aspires to achieve. The allocation of resource for each directorate over the period of the Plan will be focused on the priorities and outcomes set out in the Corporate Plan.

### **3. The Medium Term Financial Planning Process**

#### **3.1 Introduction**

- 3.1.1 Planning for the allocation of resources over the medium term is a cyclical process, with the Plan updated annually. The primary focus is to establish the financial environment within which the Council is expected to deliver Services to the Shetland public over the coming years. It is not exact but takes account of the corporate priorities and vision, outlined within the Corporate Plan, the latest economic, political policy and social data that is available and a review of known cost and demand pressures.
- 3.1.2 The Plan process captures the latest available information upon which to allow those corporate priorities and vision to be delivered within the funding available by the Council.

#### **3.2 The Corporate Plan**

- 3.2.1 The Corporate Plan sets out the Council's priorities and identifies how these priorities will contribute to the achievement of the Council's medium term outcomes as well as ensure the Council delivers on its responsibilities to the wider Shetland Partnership<sup>2</sup>. The Partnership oversees the delivery of the Community Plan, which establishes the long-term vision for Shetland.
- 3.2.2 The Plan considers the financial context for the Corporate Plan the methodology for prioritising and reviewing resources at a corporate level. Directorate and Service Plans will then identify the specific operational and management actions required to deliver the objectives and priorities, within the planned resources available.

#### **3.3 Developing the Medium Term Financial Plan**

- 3.3.1 The initial Plan was developed in 2012 and forecast the financial position of the Council through to 2017/18; this Plan therefore represents a refresh of the original year four position. During this time the Plan has been updated annually stepping forward one year and re-basing it to take account of the performance of the previous year and current environment.
- 3.3.2 The Plan throughout has considered both revenue and capital alongside each other to ensure that decisions and debate are about the Council's total financial position.
- 3.3.3 In August and September 2015 two, well attended, seminars were undertaken with Elected Members to present scenarios, projections and provide information on the analysis that had been done to support the Plan. The outcome of the seminars was information on the appetite and attitude towards risk that the Elected Members

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<sup>2</sup> The name given to the Shetland Community Planning Partnership, made up of representatives from the public, private and voluntary sectors, the community council's and the Shetland Charitable Trust.

had, an understanding of the preferred options that should be factored into the Plan and a collection of views that require to be considered.

- 3.3.4 While the views and thoughts of Elected Members have been considered it has not have been possible to incorporate the full extent of all views expressed as a balance has had to be struck in finalising the approach recommended.

### **3.4 Building Budgets**

- 3.4.1 In August 2014 the first 'Building Budget' exercise was undertaken, where members of the public were presented information on the Council's current financial position. The information was delivered in the form of a presentation by the Leader and the Executive Manager – Finance and was modelled on a bespoke system that allowed an individual or group to build their own budget, within the parameters set by the system.
- 3.4.2 This system allowed people to determine which activities should be reduced or stopped in order to meet the savings requirements of the Plan.
- 3.4.3 The information gathered from this exercise informed the 2015/16 budget setting process and with priorities such as Children's Services and Community Care Services being highlighted the Council has been able to show that these two services have faced lower funding reductions than other Council services. Feedback on the exercise asked for an online budget tool to enable more people to access the system and to increase the number of public meetings.
- 3.4.4 In late August and early September 2015 the Building Budgets exercise was extended to 7 public meetings across Shetland and a new online budget simulator tool was set up for the two week period.
- 3.4.5 These exercises have attempted to help people understand the pressures, the choices and the opportunities created by the Council, and to communicate their priorities for their family and for Shetland.
- 3.4.6 The response has been good, relative to that achieved last year however the total response did represent approximately 1% of the population. It did capture responses from across Shetland, was from almost equal numbers of males and females and was spread across the age ranges. Improvements have been made to the way the Council communicates and listens to respondents and the Council will continue to do develop this.
- 3.4.7 The online simulator set a challenge across Council and NHS Shetland (Community Health) budgets and could only be completed once an overall 3% reduction in budgets had been achieved. There was the ability to move budgets for individual Services up or down.

- 3.4.8 The Council recognises that the exercise resulted in a proportionately low response but the results do provide an idea of what Shetland feels is important – those Services that are visible to the public being most widely supported while those less visible, such as support and corporate services were identified for higher savings. Mental Health Services stood out as particularly important to respondents.
- 3.4.9 While the Plan does not model any specific options from the exercise it does provide vital information that Directors can make use of as part of their planning process for future Service delivery and modelling. This has been used in the more detailed preparation of the 2016/17 base budget.

### **3.5 Financial Decision Making**

- 3.5.1 The responsibility lies with Elected Members for making the decisions on setting and delivering balanced revenue and capital budgets. The decision making and budget setting process required to deliver the Plan is supported by a wide range of officers.
- 3.5.2 The Corporate Management Team (CMT) oversees and directs the process, Directors leading and having responsibility for:
- Identification and management of future pressures in service delivery within their areas;
  - Identification and delivery of efficiencies and savings options;
  - Leading change that delivers benefits for Council customers, staff and in the use of our resources;
  - Effective use of external sources of funding such as specific grants and fees and charges; and
  - Management of reductions in the use of resources.
- 3.5.3 Directors are, in addition to their Service finance staff, supported by an accounting team that provide data and analysis to assist with decision making and options appraisal, in addition to providing a professional financial perspective to generate and develop ideas and provide independent challenge to discussions.
- 3.5.4 The Community Planning team also provide support to the Directors to ensure timely and relevant consideration by Elected Members is given to the potential impacts of proposed decisions, both individually and cumulatively, on the Shetland public and specifically those with protected characteristics as set out in The Equality Act 2010.

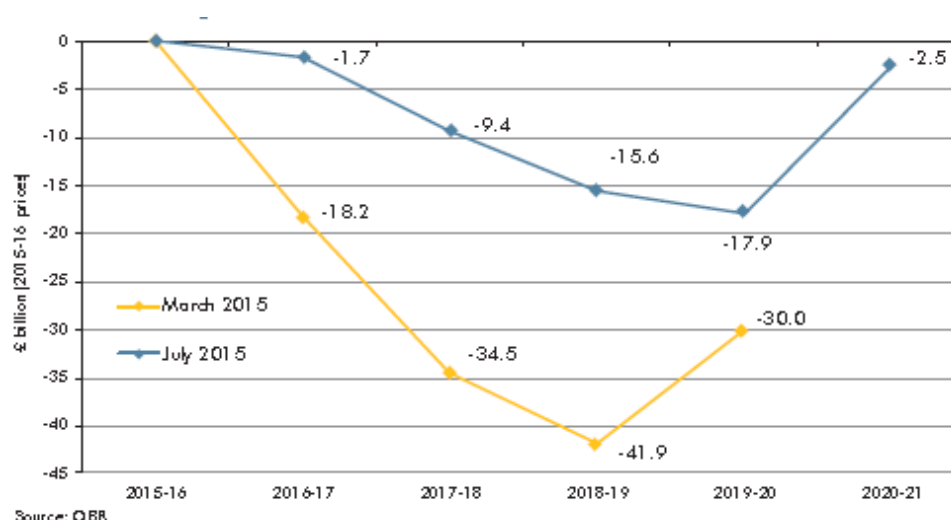


## 4. The National and Local Context

### 4.1 The UK Context

- 4.1.1 According to the Office for Budget Responsibility<sup>3</sup> (OBR) Gross Domestic Product (GDP) growth was lower than had been expected in the first quarter of 2015, although not expected to persist into the second quarter. They make reference to the specific uncertainty that remains in relation to the Greek debt crisis, and although GDP forecasts for the remainder of the year were not adjusted to reflect that specific instability the knock-on effects to the UK economy are all too clear from the experiences of 2008, 2009, 2011 and 2012, which showed that international shocks that undermine wider financial, business and consumer confidence can damage growth prospects.
- 4.1.2 Public sector net borrowing is expected to continue to fall over the next four years until a surplus is achieved in 2019/20. The July 2015 budget statement by the Chancellor of the Exchequer revised plans to achieve a surplus in 2018/19 which makes the progress towards balancing the UK 'books' a little slower than had been expected.
- 4.1.3 Despite these revised figures funding will continue to fall in real terms over the coming years, only picking up in 2020/21. At the end of the 5 year period, the upturn will not result in expenditure returning to today's level.
- 4.1.4 The chart below was produced by the OBR<sup>2</sup> and shows the latest forecasts for Resource Departmental Expenditure Limits (RDEL)<sup>4</sup>. The implication for public sector spending is continued austerity.

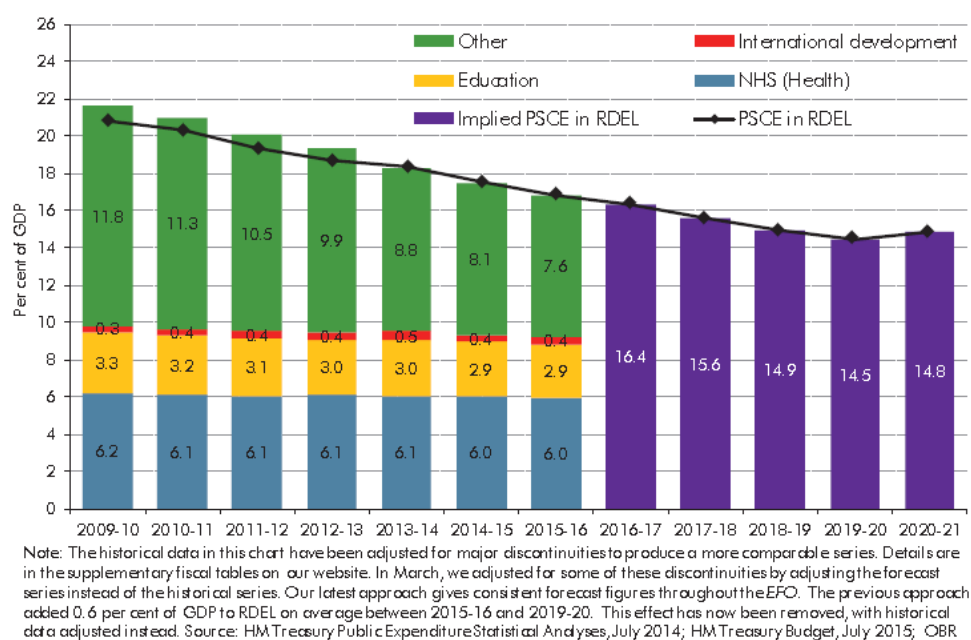
*Change in real RDEL from 2015/16*



<sup>3</sup> Office for Budget Responsibility Economic and Fiscal Outlook, July 2015

<sup>4</sup> RDEL – day to day central government spending on public services, grants and administration.

- 4.1.5 Notably the OBR<sup>5</sup> comment that RDEL spending “Between the peak in 2009/10 and the planned trough in 2019/20...is expected to have been reduced by 6.4 per cent of GDP (£120 billion in today’s terms) – with 3.3 per cent of GDP delivered in the last Parliament and 3.1 per cent of GDP in this one. At 14.5 per cent of GDP, the trough in 2019-20 would likely be the lowest share of GDP spent on public services since 1964-65, judging from the most comparable long run data.”
- 4.1.6 The following chart shows the level of RDEL and implied RDEL relative to GDP, reflecting the downward trend referred to above.



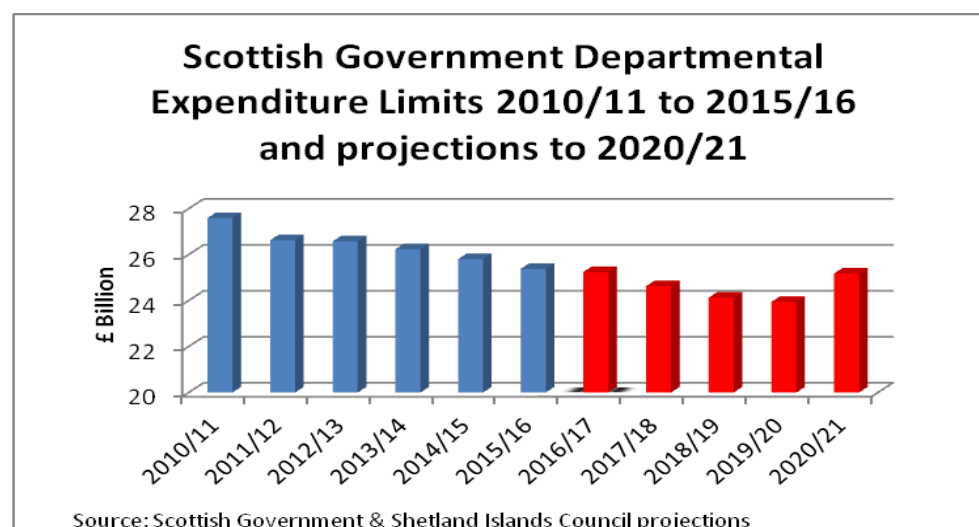
## 4.2 The Scottish Context

- 4.2.1 The primary source of funding for the delivery of Council Services is the Scottish Government through the allocation of general revenue and capital grants, and the distribution of national non-domestic rates. With 79% of the Council’s revenue funding being received in this way it is simple to see how UK and Scottish Government policies and economic forecasts impact on the level of Council funding.
- 4.2.2 No funding announcements have been made by the Scottish Government beyond the current year (2015/16). The Chancellor of the Exchequer only making his Autumn Budget Statement on 25 November 2015 so it is unlikely that there will be any certainty of how much funding Councils will receive until late December 2015 at the earliest.
- 4.2.3 In order to project forward five years a combination of known historic data and current forecasts, such as those provided by the OBR and the Scottish Government,

<sup>5</sup> Office for Budget Responsibility Economic and Fiscal Outlook, July 2015

have to be used to estimate what may happen. This represents the best information available at the time of writing.

- 4.2.4 This chart shows actual data from the Scottish Government<sup>6</sup> projected forward using OBR data described in section 4.1 above. The potential impact of Scottish Government funding naturally follows the same graph and in real terms any funding lost during the next four years will not be restored in 2020/21.



- 4.2.5 Using the data that underpins Chart 3 above falling funding to the Scottish Government will inevitably impact on local government funding. The policy decisions and priorities of the Scottish Government are therefore crucial.
- 4.2.6 Policy priorities in the 2015/16 Budget included maintaining health funding, a commitment to police numbers and no compulsory redundancies in the public sector. Local government policy priorities were to freeze Council Tax, provide funding for school education, free school meals and early years and childcare,
- 4.2.7 While it is unclear if these or if other priorities will prevail in future budgets of the Scottish Government, it is reasonable to predict that falling public sector funding overall will have an impact on the grant allocated to the Council.
- 4.2.8 In 2015/16 the allocation from the Scottish Government to local government was approximately 26% of its resources. This is supplemented by the setting and pooling of National Non-Domestic Rates. The total distributable to local government in 2015/16 is approximately £10 billion.
- 4.2.9 Shetland Islands Council receives a distribution based on the Grant Aided Expenditure (GAE) formula agreed by COSLA, this is a needs-based distribution methodology that takes into account nationally recognised indicators and weightings. The Council receives approximately 0.9% of the total distribution to

<sup>6</sup> Scottish Government, Scottish Budget Draft Budget 2015-16, October 2014

local government, in 2015/16 a sum of £86.6 million, for 0.4% of the total estimated population of Scotland<sup>7</sup>.

- 4.2.10 This may appear to be a positive proportion of Scotland's funding however the scale and remoteness of the population that the Council is delivering services to results in expensive service models. Add to this the minimum levels expected of any Local Authority and additional costs of transport and goods and services being simply more expensive then it is clear that the Council has a need for this funding.
- 4.2.11 Shetland also has transport costs on a scale that most other Local Authorities don't have to deal with, and a volume of customers that makes many, if not all, routes uneconomical to operate and therefore only exist due to Council subsidy.
- 4.2.12 There are and will be opportunities for the Council to highlight the funding issues and enter into dialogue with the Scottish Government, these opportunities should be seized. An example is the work progressing through a Routes and Services Methodology review to inform discussions on the Council's ferry services.
- 4.2.13 Island Proofing provisions within the Consultation on Provisions for a Future Islands Bill is an opportunity that cannot be missed by Shetland. The consultation refers to the concept of placing a duty on Scottish Ministers and other relevant public bodies to 'island proof' their functions and decisions, the financial implications of which for the Islands needs to be effectively communicated. The Council is preparing to develop a strong response to this consultation.
- 4.2.14 It is therefore recommended that the Council should seek all opportunities to enter into dialogue with the Scottish Government in relation to Services for which the Council does not receive its fair share of funding, or where inconsistency exists between Shetland and other local authorities;
- 4.2.15 Furthermore the Council is recommended to commit to sufficient resourcing to enable the Council to respond to the Island Proofing provisions within the current Consultation on Provisions for a Future Islands Bill<sup>8</sup>, and any subsequent work, so it adequately reflects funding and financial aspects.

### **4.3 The Shetland Context**

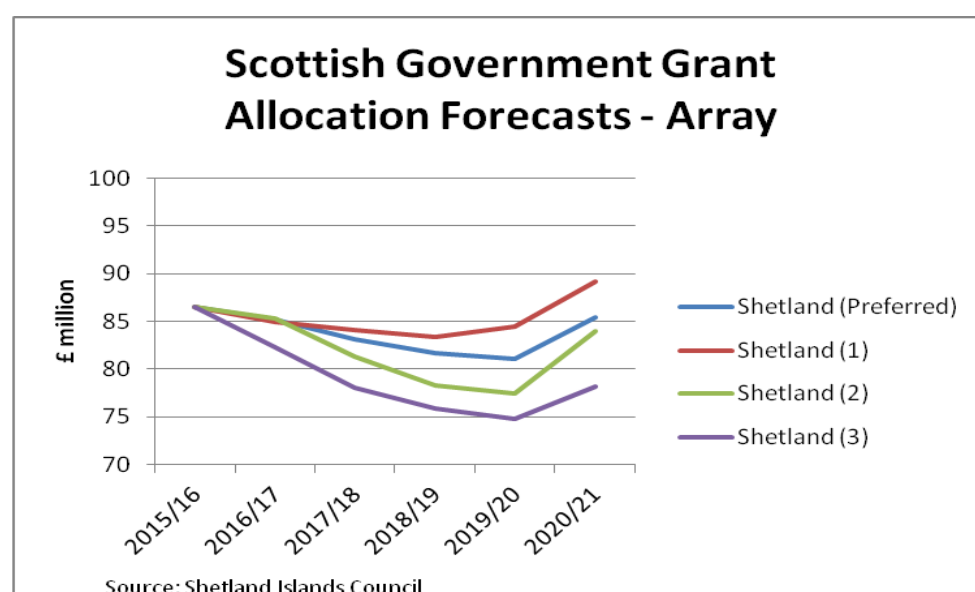
- 4.3.1 Resources are used to fund revenue expenditure across the five Directorates: Children's Services, Community Health and Social Care, Development Services, Executive and Corporate Services, and Infrastructure Services.
- 4.3.2 Net Expenditure on Services delivered from the Council's General Fund is funded by Scottish Government General Revenue Grant (GRG), a distribution by the Scottish

<sup>7</sup> National Records of Scotland, mid-year 2014 population estimates (23,230 people in Shetland out of 5,347,600 in Scotland)

<sup>8</sup> Consultation on Provisions for a Future Islands Bill, Scottish Government, September 2015

Government of the National Non-Domestic Rates (NNDR) pool, Council Tax and a draw from the returns achieved from the long-term investments (see section 6). The Council also operates a harbour account (see section 8), from which a surplus is generated and this surplus is drawn annually from reserves to support Council Services.

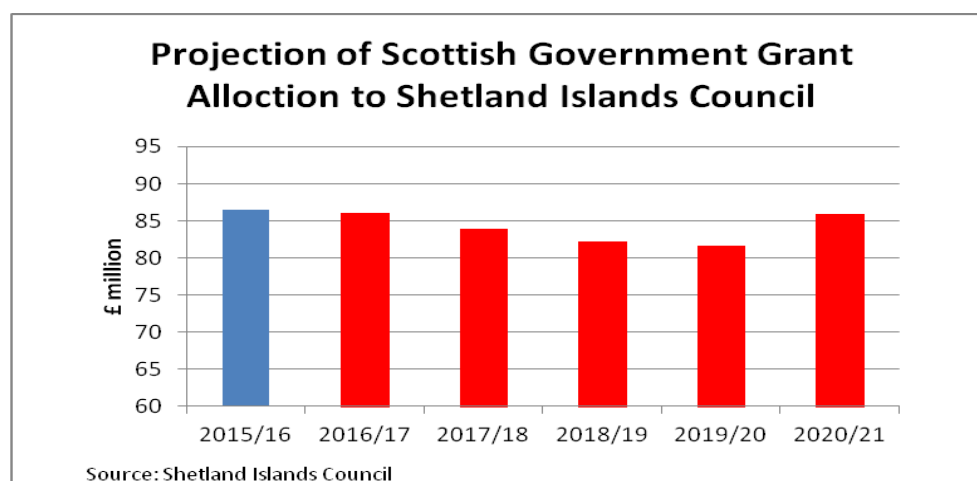
- 4.3.3 It is important to recognise that the Scottish Government is responsible for determining the overall funding available to the Council in terms of both the GRG and NNDR pool. Therefore if there were to be an increase in the level of Non-Domestic Rates collected locally by the Council, there would be a corresponding reduction in the level of General Revenue Grant to ensure the overall funding level didn't change. This reflects the fact that the Scottish Government hold the risk in terms of a shortfall in relation to the national collection of Non-Domestic Rates during the year, i.e. if there were to be an overall shortfall the Council still receives the same level of grant funding it has been basing the delivery of services on.
- 4.3.4 The introduction of the Business Rate Incentivisation Scheme (BRIS) may provide a sum that the Council can retain over and above the NNDR distribution however there has been no evidence of this to support a robust forecast.
- 4.3.5 In the absence of detailed information at a UK and Scottish Government level it is only possible to predict the future funding for the Council on the basis of publicly available information and by listening to relevant commentators. Using that approach a number of scenarios have been modelled and this has produced an array of possible funding levels for Shetland Islands Council.
- 4.3.6 In financial year 2015/16 the Council was allocated a sum of £86.6 million in GRG and NNDR distribution so this is the starting point for the chart below.



- 4.3.7 The projections in the chart above range from a forecast, as included in work sponsored by COSLA, which was acknowledged as optimistic 'Shetland (1)', to one

‘Shetland (3)’ that is based on a suggested cash reduction of 10%, front loaded. The Shetland ‘Preferred’ option uses a blend of information at DEL level and the impact of notional loan charge support reduction. The profile achieved is not overly optimistic but steers away from being too pessimistic, particularly given the financial resilience that the Council has to address changes in the short term.

- 4.3.8 Using the ‘Preferred’ option it suggests a 5.7% reduction in grant by year four before rising in 2020/21 towards current levels. This is plotted in the following chart.



- 4.3.9 It is now likely that that it will be 2020 before the Council begins to see any meaningful increase in its financial settlement resulting from more resources being available to the Scottish Government. The continued reduction in funding that is built into the GRG for Notional Loan Charge Support will undoubtedly offset any future upturn in grant funding levels. This element of GRG (£10.7 million) is falling at approximately £0.6 million per annum, and will continue to do so until it runs out.
- 4.3.10 Even with the upturn in year 5 it is unlikely that the Council will receive grant funding in the future to the same extent as it does currently.
- 4.3.11 These projections will be reassessed as actual settlement figures are announced by the Scottish Government.
- 4.3.12 The Public Bodies (Joint Working) (Scotland) Act 2014 allows Local Authorities and Health Services to integrate health and social care services in a way that best fits local needs. The Council and NHS Shetland has undertaken all of the pre-planning and received Scottish Government approval for its Integration Scheme. The chief officer has been appointed and already has responsibility across both organisations for the delivery of community health and social care services. The Plan includes within it the Council’s contribution to the Integration Joint Board, which has placed upon it similar expectations to deliver efficiencies and cost savings to those of other

Council services. This will undoubtedly align with the expectations of NHS Shetland.

- 4.3.13 The Shetland Islands Integration Joint Board (IJB) was formally constituted on 27 June 2015 and will assume full responsibility for health and social care services that have been delegated to it by the Council and NHS Shetland once it has adopted the joint Strategic (Commissioning) Plan. This will occur no later than 31 March 2016. The Head of Finance of NHS Shetland is the Chief Financial Officer and responsible to the IJB for financial leadership and financial management.
- 4.3.14 The Plan assumes that the costs associated with integration will be met from within existing resources, the opportunity for joint working aiding the effectiveness and efficiency with which community health and social care services will be delivered.

#### **4.4 Shetland in Statistics**

- 4.4.1 Shetland is an archipelago of Scotland that lies North East of the Scottish mainland, some 211 miles from Aberdeen and 298 miles from Edinburgh. Its nearest neighbour is Orkney, 50 miles away. Over 100 islands cover approximately 567 square miles, with a total coastline of 1,697 miles, and 15 of the islands are inhabited.
- 4.4.2 Approximately 30% of the population live in Lerwick with the remainder of the population being dispersed across a rural and island landscape. The dispersed nature of the population is reflected in the delivery of services, with a high emphasis on transport links to enable access to services, work, education and leisure.
- 4.4.3 The population at 2014 was estimated to be 23,230 and is projected to grow over the period to 2022 by 4.2% to 24,207. Projections based on 2012 population estimates show that the age profile of the population changes, with the under 30 population falling by 3% while the over 75 population increases by 2.9%.
- 4.4.4 Life expectancy in Shetland is above the national average both in terms of at birth and those aged 65. The ageing population may indicate the need for the volume of social care / health services increasing.
- 4.4.5 The local economy is strong, with one of the lowest unemployment rates in Scotland, 0.7% in 2014, compared to the Scottish average of 2.8%.
- 4.4.6 Employment in 2014 was estimated to be predominantly in the Service Sector, with jobs representing approximately 70% of the total. This incorporates for example local authority services, health, emergency services, retail, banking, recreation, media and communications and demonstrates how important the Shetland Islands Council and NHS Shetland are in the Shetland economy. However the Primary Sector, which includes agriculture, fishing, oil production and mining, is the economic driver in Shetland representing 13% of employment and delivered 28% of

the total economic output, some £304 million, according to the research study<sup>9</sup> on 2010/11 economic output of Shetland.

- 4.4.7 Educational attainment is above the Scottish averages, with almost all school leavers achieving positive destinations in 2013/14, the largest proportion (48.7%) leaving to take on further study or training, while a substantial number of leavers (113 or 41.7%) went straight into employment.
- 4.4.8 These facts provide information that supports the priority given to Council Services currently being delivered and for the outcomes that are important to the Council over the medium term. The statistics also provide pieces of evidence of the success that the Council has had in areas of Education and the challenges that lie ahead for Community Health and Social Care, however these statistics are a tiny proportion of the data and performance information that supports the Council's Corporate and Service planning processes. More can be found on the Council's website<sup>10</sup>.

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<sup>9</sup> Shetland Regional Accounts 2010-11: The James Hutton Institute, The University of Aberdeen and AB Associates, published May 2013.

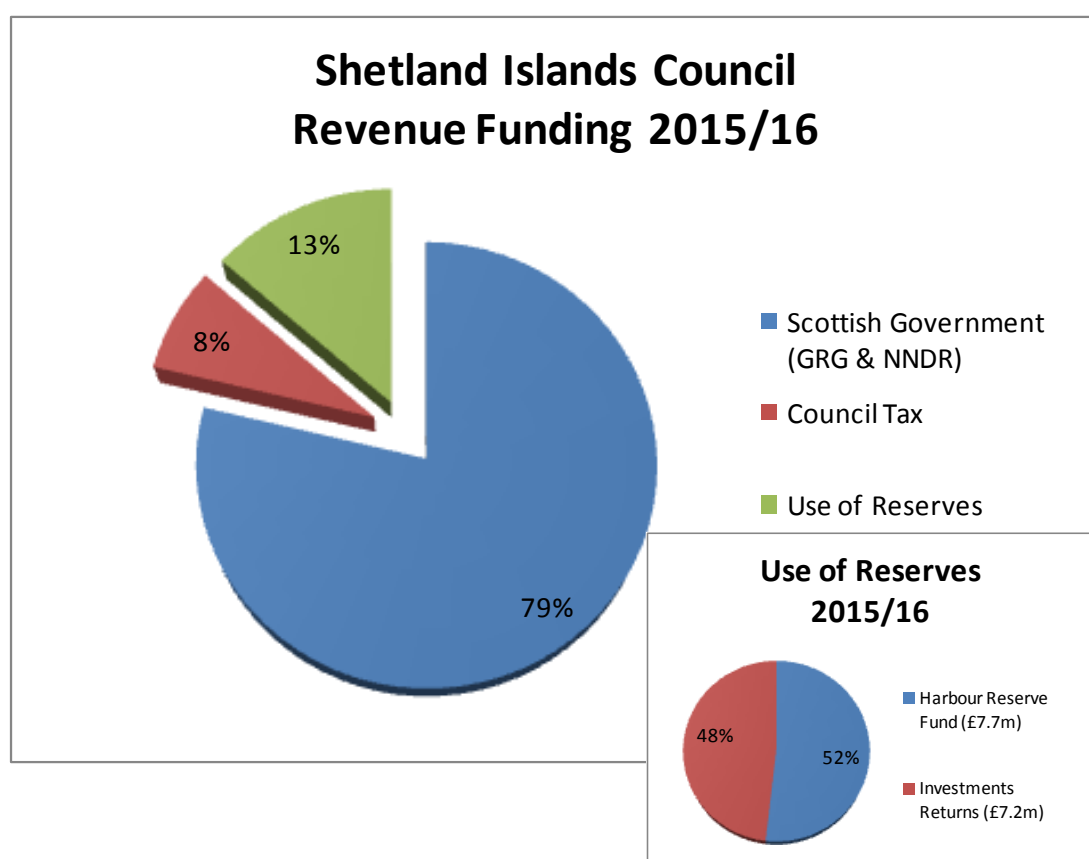
<sup>10</sup> [http://www.shetland.gov.uk/about\\_performance/default.asp](http://www.shetland.gov.uk/about_performance/default.asp)



## 5. Future Revenue Resources

### 5.1 Introduction

- 5.1.1 The Council receives a number of funding streams that enable it to deliver its full range of services. These include Scottish Government grants, Council Tax, fees and charges and in certain circumstances external funding, which has been applied for.
- 5.1.2 The General Fund revenue budget is normally structured to take account of income from fees and charges and specific external funding grants deducted from the cost of Services expenditure, therefore leaving Net Revenue Expenditure that is funded by the other income streams – Scottish Government Grant, Council Tax and the Use of Reserves.
- 5.1.3 In 2015/16 the Council will receive approximately 79% of its Net Revenue Expenditure funding from the Scottish Government.



- 5.1.4 The chart highlights the extent to which the General Fund requires reserves to balance the budget. The use of reserves comes in two forms, the surplus transferred to the [Harbour] Reserve Fund, generated from Harbour operations; and a draw from the long-term investment returns.

## 5.2 Scottish Government Grant

5.2.1 The table below shows the projected future revenue resources available to the Council over the period of the Plan.

	2015/16 £m	2016/17 £m	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m
Scottish Government (GRG & NNDR)	86.555	85.239	83.132	81.629	81.127	85.387

5.2.2 The assumptions associated with this projection are:

- The starting point of 2015/16 is the actual value of revenue grant allocated, covering General Revenue Grant (GRG) and National Non-Domestic Rates (NNDR).
- The 2015/16 value is then modelled to take account of the forecasts of Scottish Government DEL referred to in 4.2 and 4.3 above and preferred profile of future resource availability.
- The values include within them the diminishing value of the Notional Loan Charge support provided by the Scottish Government, which is understood to continue at approximately £0.6 million per annum.
- Specific initiatives that may attract Scottish Government funding in the future have not been included in the projections as any specific initiative will undoubtedly generate a cost pressure of at least equal value.

5.2.3 The array of projected scenarios, at 4.3.6 above, has been discussed at a seminar with Elected Members and the preferred scenario is reflected in the above table.

5.2.4 The year on year changes in grant funding available amount to a reduction 6.3% in cash for the next four years of 1.5%; 2.5%; 1.8%; and 0.6% respectively, before a forecast of 5% additional cash in year 5. Caution in relation to the year 5 uplift must be advised due to the significant change that will undoubtedly occur over the same period. This forecast has been made as it aligns with publicly available information and independent commentary on future public sector funding.

5.2.5 Included within the total Scottish Government Grant funding is the annual value of the National Non-Domestic Rates (NNDR) pool. The value in 2015/16 was £2.8 billion.

5.2.6 While the mechanism of grant distribution allows for each local authority to retain the NNDR that it collects from the businesses with its boundary the Scottish Government guarantees the level of funding that each local authority will ultimately receive. Therefore the risk of a national shortfall in receipts of NNDR rests with the Scottish Government.

- 5.2.7 The Scottish Government has created a Business Rates Incentivisation Scheme (BRIS) that provides an opportunity for local authorities to increase its NNDR income stream. The Scheme is based on targets.
- 5.2.8 Should the Council exceed its target NNDR, it would retain 50% of the additional rates income generated (where there was a corresponding increase in rateable value). The Scottish Government would retain the other 50%.
- 5.2.9 To achieve a 1% increase in collection against the target would amount to approximately £88,000 additional income to the Council. Any benefit that can be generated in any one year would benefit that year.
- 5.2.10 The assumption within the Scottish Government Grant projections above is that there will be limited opportunity for the Council to benefit from the scheme at present and as such no additional income has been assumed in any future years.
- 5.2.11 During any financial year the Scottish Government may issue revenue grants to Local Authorities for a particular purpose. In general these grants will be distributed for reasons described in a letter from the Government Department however will come with no specific criteria attached to incurring the expenditure. These are referred to as non-specific grants.
- 5.2.12 The number and value of these grants is not known in advance and as such has not been incorporated into the Plan. Any receipt of non-specific grant funding will be accounted for in the year it arises.
- 5.2.13 Due to the non-specific nature these grants provide the Council with the opportunity to determine the exact nature of how it will respond to the particular purpose, and how it will make use of the funding. As the Council has met its budget targets in recent years Services have not required such funding to meet the particular purpose, resulting in the funding being treated as a corporate resource. It is recommended that this practice continues.

### **5.3 Council Tax**

- 5.3.1 Council Tax is the local taxation element of the Council's funding and as shown in the chart at 5.1.3 represents 8% of the income the Council collects to pay for the net cost of services it delivers. Compared to other local authorities, with larger populations, this amounts to a relatively small share of the total required to fund services. This also reflects the high cost of service delivery in such a remote and rural location, and the need for a higher proportion of Scottish Government grant funding.
- 5.3.2 Council Tax is expressed as a value per 'Band D' dwelling, this being the value charged against a dwelling that has been placed in that particular banding, on a scale of A to H. The value is calculated after converting all dwellings into Band D equivalents. All other dwellings are charged a proportion of that Band D value.

- 5.3.3 The Band D value for Shetland is £1,053 per annum.
- 5.3.4 Due to the low dwelling base upon which the tax is levied the scope for substantial income generation is limited. The gearing effect on the Council means that for an increase in expenditure of £1 million (approximately 1% of the net expenditure budget), if the only means of recovering this was through Council Tax, then it would have to increase by approximately 18%.
- 5.3.5 However Council Tax values across Scotland have been frozen since 2007 as part of the agreement between local authorities and the Scottish Government. This has reduced the flexibility that local authorities have in relation to funding services. A fixed sum of £70 million per annum has been included as part of the local government settlement and Shetland's share of that in 2015/16 was £0.245 million, or approximately 3% of Council Tax.
- 5.3.6 There is no clear indication that this national condition is likely to change in the foreseeable future therefore the values used in forecasting Council Tax income have continued this assumption.
- 5.3.7 A year on year increase in the number of dwellings is forecast, with the historic trend being for these to continue to increase as well as households forecast to increase year on year. The rate of increase has been assumed to be 1% per annum.
- 5.3.8 The table below shows the projected future Council Tax resources available to the Council over the period of the Plan.

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
	£m	£m	£m	£m	£m	£m
Council Tax	8.421	8.505	8.590	8.676	8.763	8.851

- 5.3.9 The Plan does not try to estimate any impact of any changes that may be made by recommendations from the Commission on Local Tax Reform, the remit of which is "to identify and examine alternatives that would deliver a fairer system of local taxation to support the funding of services delivered by local government"<sup>11</sup>.

## 5.4 Fees and Charges

- 5.4.1 The Council can raise income from charging fees for a wide range of services, ranging from fares on ferries and buses to adult social care, from libraries to quarry products.
- 5.4.2 Income generation is a key strategic priority for some Services, where it can offset all or a substantial proportion of the costs associated with it. However, in adult social care for example, the Council has a statutory duty to meet assessed needs and charges are means tested therefore income will only ever assist with recovering a proportion of the costs.

<sup>11</sup> <http://localtaxcommission.scot/how-we-work/remit/>

- 5.4.3 In 2015/16 the value to be generated is £23.4 million and therefore represents a significant and important element of the Council's funding strategy.
- 5.4.4 In general for every 1% increase in those charges it would have the impact of increasing income by £0.234 million. This helps to address the rising costs of pay and price inflation and the real cost of delivering Council services, as such it is essential that prices are reviewed regularly.
- 5.4.5 There is an expectation within the Plan that a clear and robust review of fees and charges is carried out annually and that the following conditions are met:
- Fees and charges are based on full cost recovery, which is inclusive of management and administrative support costs;
  - A commercial approach to goods and services sold in the open market must be taken;
  - Consideration must be given to opportunities where fees or charges are not levied but could be;
  - Where concessions on fees and charges are offered they must be justifiable and proportionate to the costs involved in the delivery of the Service;
  - Pricing policies adopted by Services that address a strategic outcome must be fully documented, evidence based and justified to enable Elected Members to adopt or revise such pricing policies. Evidence of the impact a pricing policy is having must be gathered to inform future changes;
  - Where a pricing policy is proposed to be revised to take account of the behavioural changes of customers i.e. reduced usage / lower demand / market factors, then this must be evidence based;
  - Where national or regulatory pricing policies exist, when changes are agreed / notified these must be introduced without delay.
- 5.4.6 It is recommended that the Council improves its consistency and application of charging policies to take account of the principles outlined in the Plan.

## 5.5 External Funding

- 5.5.1 The Council has a partnership agreement with the Shetland Charitable Trust, whereby it provides funding to the Council to enable the delivery of the Rural Care Model. The funding that the Council has secured from this source has been approximately £2.5 million per annum. In 2015/16 the Trust approved a reduction in income to the Council and has signalled the intention to reduce this further to approximately £0.5 million over the next four years. Further detail on the treatment of this in the Plan is provided at section 7.3.

- 5.5.2 Beyond this unique funding stream for Shetland, limited opportunities exist for the Council to access external funding streams directly. The most significant of these however is Europe, where various thematic Funds exist, offering opportunities to local authorities and partners to apply at various times and for different time periods.
- 5.5.3 Applying for such funds can not only be a lengthy process but also a resource intensive one. Consideration by Services must be given to how the application will meet and address a Council strategic outcome. Thereby it will ensure it is targeting finite resources at the highest priorities.
- 5.5.4 Applications of this nature invariably require a financial commitment from the Council and its partners in the form of match funding. Careful consideration of how that match funding is achieved must be a primary consideration in assessing whether to apply for funding.
- 5.5.5 Services should wherever possible seek to recover from external funding sources the costs associated with managing and administering the service that is being applied for, it is not the case that costs are only limited to the direct resources required to deliver the service. Rules and conditions must be clearly understood to ensure that these costs are actually recovered when claims are made.
- 5.5.6 The Plan has not included specific external funding that may be applied for, it has been assumed that any external funding. The Development Service budget has a limited budget set aside for use as match funding to enable proposals to be constructed and applications made.

## **5.6 Shetland Gas Plant Income**

- 5.6.1 The Shetland Gas Plant has been under construction since 2011 and the Council has agreements with the partners in the project that will generate long-term revenue income based upon the pipeline throughput and gas and oil prices.
- 5.6.2 The Plan has previously taken account of forecast throughput levels and gas and oil prices to generate an anticipated income for the Council over 5 years of £12.6 million.
- 5.6.3 While a delay in starting production, now scheduled for later this year, has delayed the Council starting to receive throughput income, it is the impact of the gas and oil prices that has had a material impact on the forecast of income that the Council can make from this source.
- 5.6.4 The most recent forecasts of income have been calculated based on gas and oil prices as at August 2015. This includes a fall in the gas price of 26% and a fall in the Brent Blend price of 61%.

- 5.6.5 The table below shows the value of income that is now forecast to be generated from an estimated first gas date of Quarter 1, 2016. Note, due to the later than expected start up of the Plant, the projected income for 2015-16 is likely to be £0.250 million compared to the £1.349m budgeted for the year.

	2015/16 £m	2016/17 £m	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m
Shetland Gas Plant	1.349	0.693	0.847	1.121	1.601	1.774

- 5.6.6 The value now incorporated into the Plan over the next 5 years amounts to £6.0 million, effectively eliminating 50% of the income that had previously been forecast. This has a fundamental impact on the Plan and reveals the risks upon which the Plan relies in order to fund the current service delivery model.

## 5.7 Economic Development Activities

- 5.7.1 The Council has a history of lending to businesses in order to deliver on its Economic Development objectives. This was further extended by the transfer of Shetland Development Trust (SDT) assets to the Council in the months leading up to the formal winding up of the Trust in February 2015.
- 5.7.2 In addition to lending to businesses the SDT assets included fishing quota that is managed on behalf of the Council by the Shetland Fish Producers Organisation (SFPO).
- 5.7.3 Through the lending service and the management of the fishing quota the Council receives an income which has been included in the Plan for the first time to recognise the new assets that have been transferred. The Plan also takes into account the liabilities and support for services that have arisen from this transfer too.
- 5.7.4 The returns that are received from these activities reflect the arrangements that are in place and the Plan takes account of the financial impact of holding the assets. It is recognised that other benefits are generated by such assets and in working with Shetland businesses, however this has not been quantified for the purposes of this Plan. Socio-economic and other benefits that Shetland derives from these assets would be reported on separately by the Development Directorate.
- 5.7.5 The Council is in the final stages of the options appraisal work required to make a final decision on the future of the Commercial Lending Service and as such the Plan simply takes account of the commitment already made, and the projection for interest receivable from those loans over the period of the Plan.
- 5.7.6 The Plan has been based upon investing up to £3 million per annum in local businesses. However it must be demonstrated that:
- The loan will generate for 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.

5.7.7 Once the Council has made a decision in relation to the future of the Commercial Lending Service this will be incorporated into future Plans.



## **6. Reserves Policy and Investment Returns**

### **6.1 Introduction**

- 6.1.1 The value of long-term investments as at 31 March 2015 was £278 million of which the Council had Usable Reserves of £241 million. All of which have been invested in the financial markets for many years. The Council retains a working cash balance to finance day to day expenditure, which is supplemented by income received during the current financial year. If this Council is living within its means, and not drawing cash from the investments, the Council is able to operate effectively from the funding that it receives in a single year.
- 6.1.2 To maintain the value of the Usable Reserves the Council must live within its means, avoiding overspending on its budget, and also actively managing and understanding the impact of its decisions. For example there are a number of earmarked useable reserves that over time will inevitably be used to achieve strategic outcomes and objectives, such as the Housing Repairs and Renewals Fund; the Insurance Fund; and the Council Tax Second Homes Receipts Fund. Recognising the timing and value of the use of these earmarked reserves must therefore be taken into account when considering the long-term investment returns that aim to be achieved.
- 6.1.3 The Council, through adoption of the current MTFP and the recommendations in the Long Term Financial Plan<sup>12</sup>, has agreed the objective of maintaining the value of the Usable Reserves as it provides the cash upon which the long-term investments are based. This in turn is assumed to provide a long-term recurring funding stream to support the costs of delivering Services. This approach achieves the greatest long-term benefit for the delivery of Services in Shetland.
- 6.1.4 The value of investments can go down as well as up and therefore there needs to be a risk based approach taken in relation to withdrawing funds and the method upon which investment returns should be calculated. This is explained in the withdrawal policy below.

### **6.2 Investment Objectives**

- 6.2.1 It is important that the Council recognises its investment return objectives and the risks that are associated with the investment structure that is implemented to deliver those objectives.
- 6.2.2 The Council has the following investment return objectives:
- Achieve investment returns that are sufficient to enable an annual sum to be withdrawn, without reducing the underlying capital value;

<sup>12</sup> Long-Term Financial Plan: Council, 3 December 2014.

- Achieve investment returns that protect the capital value from the impact of inflation; and
- Investment risk is mitigated by the diversification of asset classes, global coverage and a number of fund managers.

6.2.3 Structuring the Council's investment in the financial markets will be carried out in accordance with the approved Annual Investment and Treasury Strategy<sup>13</sup>.

6.2.4 The Annual Investment and Treasury Strategy describes the risks associated with it and the mitigating actions and controls that are in place to reduce the impact and likelihood of those risks.

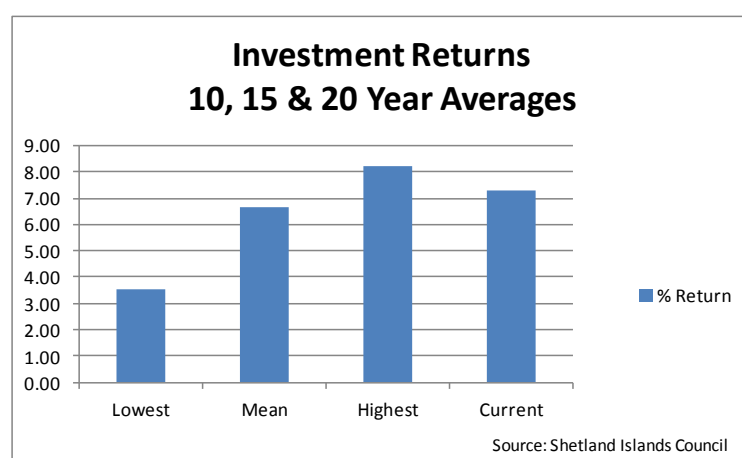
6.2.5 In following this approach the Council aims to deliver additional funding for Services over the long-term.

### 6.3 Withdrawal Policy

6.3.1 The Council has previously adopted an approach that the benefit that could be derived from the investments would be based on the long-term average performance of the investments and that the value of the investments would be protected from the impact of inflation. This is in line with the investment objectives set out in section 6.2 above.

6.3.2 This resulted in the Council agreeing that a sustainable withdrawal from the investments could amount to 5%.

6.3.3 Reviewing the investment returns over the last 20 years reveals that a range of returns have been achieved and that within this the year to year performance has, not surprisingly, been volatile. The graph below shows that despite the future value of investments being unpredictable, the returns over time have been positive. The expectation is therefore that investment returns will continue to be positive, but should not be predicted to achieve the highest levels of return that have been achieved in the past.



<sup>13</sup> The latest Annual Investment and Treasury Strategy 2015/16: Council, 30 June 2015

- 6.3.4 The challenge that the Council has is predicting how healthy those investment returns will be in the future. The graph above shows four investment return averages, which have been taken from the last 20 years of data, collating all 10 year, 15 year and 20 year average returns. The lowest average annual investment return of those was calculated at 3.56%, while the highest was 8.19%. The mean was 6.64% and the Council currently adopts a 7.3% average annual investment return.
- 6.3.5 Looking specifically at the annual investment return over the last 20 years it increased to an average of 7.91% however having adopted a rate of 7.3% in the previous Plan the Council is already seeking returns at the higher end of past performance and in doing so should be cautious of increasing this expectation any further. This approach was discussed with Elected Members in a seminar, where remaining optimistic yet measured was the view expressed. In reviewing the expectations of future returns it is recommended that 7.3% is retained.
- 6.3.6 An assumption as to the future value of inflation is available from government forecasts, which although low at present, with the Consumer Prices Index (CPI) currently<sup>14</sup> 0.0%, the Office for Budget Responsibility shows government forecasts for CPI to return to 2% by 2020. Given the long-term nature of these assumptions, looking back over the last 20 years, UK CPI averaged 2.7% over the last 10 years, 2.2% over 15 years and 2.1% over 20 years.
- 6.3.7 Using all of this as a backdrop it is not unreasonable to forecast that CPI may exceed 2% in the long-term and as such to recommend using future inflation proofing of investments at 2.1%, the 20 year average.
- 6.3.8 This results in a withdrawal policy that equates to affordable use of investment returns on annual basis of 5.2%.
- 6.3.9 The value upon which an affordable use of investment returns is calculated is vital and this should take into account the known withdrawal from investments of expected expenditure and known commitments. In doing this allows a degree of tolerance to be built into the calculations to mitigate the risk of investment fluctuations, such as those that have been experienced since the 31 March 2015, with the value of investments falling.
- 6.3.10 An investment returns base is therefore recommended to take account of the following items to ensure that the expectations of what can be affordably withdrawn from investment returns are prudent:
- Borrowing invested in the short-term ahead of its use on capital projects;
  - Earmarked General Fund reserves, excluding the £15 million equalisation fund;

<sup>14</sup> Office for National Statistics: Consumer Price Inflation, August 2015

- Discretionary Spend to Save funds that expect to be used to deliver future savings.
- 6.3.11 Calculating the investment returns base as at 31 March 2015 results in a value of £226.9 million upon which investment returns are recommended to be based.
- 6.3.12 The forecast financial outturn for the various Council accounts for 2015/16 has been included to provide a revised base for the start of financial year 2016/17 (Year 1 of this Plan) and is estimated to be £231.8 million.

#### **6.4 Affordable Use of Investment Returns**

- 6.4.1 Based on the withdrawals policy above the value of affordable use of investment returns in 2016/17 will be £12.045 million.
- 6.4.2 This sum may be used to support revenue or capital; however, it can only be used once.
- 6.4.3 The challenges of rising costs, falling income and the time it takes to make structural changes to the delivery of Council Services means that maximising the level of income from the investment returns to support Services will help to avoid unnecessary savings proposals to balance the budget. This does place significant restrictions on the Asset Investment Plan however the flexibility and prioritisation of projects of a capital nature allows greater opportunity to adapt during the five year period to the changing public sector environment.
- 6.4.4 The affordable value across the period of the Plan is subject to 2.1% inflationary increases, in line with the inflation proof approach being taken to the investment return base value.
- 6.4.5 It is recommended that the full value is allocated for use to support revenue service delivery costs throughout the life of the Plan.

## 7. Future Revenue Resource Pressures and Demands

### 7.1 Introduction

7.1.1 The Council's financial and service environment is continually changing and therefore its priorities are updated regularly in response to levels of demand and emerging need.

7.1.2 A number of factors create a demand for resources. The most significant of these include:

- The cost of maintaining services at current levels in current form, i.e. pay and price inflation;
- External factors that impact on Council income levels;
- The cost of additional demand for services arising from increased need or changing populations; and
- Changes in government policy that have an impact on Council expenditure or income, e.g. contracted out national insurance contributions, landfill tax, nursery school provision and free school meals.

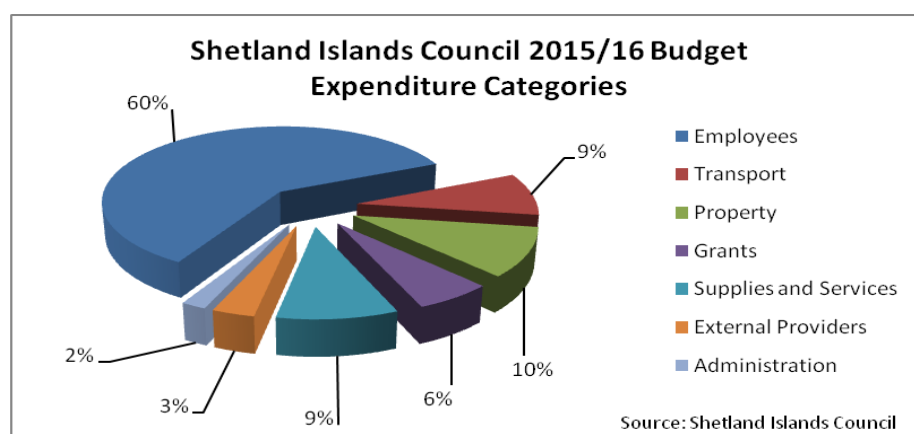
7.1.3 Each of these is considered in more detail below.

### 7.2 Pay and Price Inflation

7.2.1 One of the most significant factors creating a demand for extra resources is inflationary pressure – price rises caused by national macro-economic conditions.

7.2.2 Specific price inflation uplifts are limited within the Plan as the expectation is that Services will deliver efficiencies in order to address the majority of these inflationary cost pressures. Mitigating such costs and generating savings can be achieved through a robust approach to improved procurement and commissioning practices and better buying decisions. It is recommended that the Council capture these wherever possible.

7.2.3 The Council budget is made up of different categories of cost and, as shown in the pie chart below, the predominance of employee costs is clear.



- 7.2.4 The most significant inflationary pressure is therefore **pay related inflation**, which is agreed nationally between employee and employer organisations and applied across local government. The cost of pay related inflation has been included and forecast on a recurring basis. Costs include the pay award itself (1.5% was agreed for 2015/16 and 1% for 2016/17) beyond which the Plan forecasts a further rise of 1% per annum – in line with the cap recently announced by the Chancellor of the Exchequer in his July 2015 Budget.
- 7.2.5 In addition to this the costs arising from the national living wage and the requirement to implement a ‘holiday pay’ solution add further costs.
- 7.2.6 The cost estimated for pay across the Council in 2016/17 amounts to almost £1 million.
- 7.2.7 Beyond this the Council has employer pension costs that it must meet. National increases applied to teachers’ employer pension contributions from August 2015 and the Shetland Islands Council Pension Fund from April 2016, with a further increase in April 2017. This added a further cost pressure of almost £0.9 million in 2016/17 and almost £0.5 million in 2017/18.

### **7.3 External Factors Impacting on Additional Income**

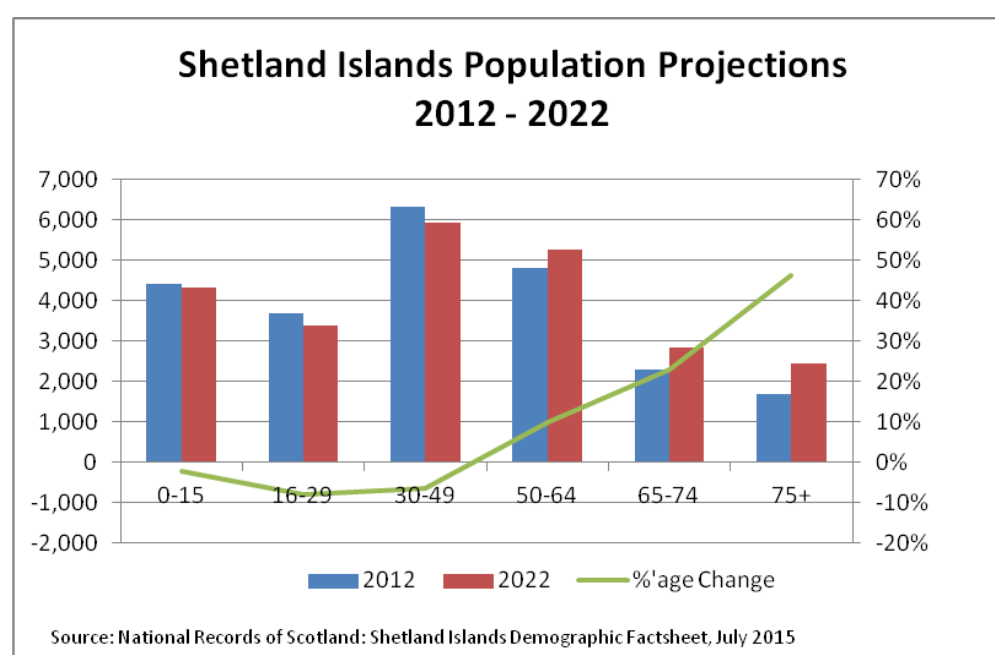
- 7.3.1 Almost 17% of the Council’s budget is based on the assumption that additional income will flow into the Council from non-governmental grants or tax collection.
- 7.3.2 The receipt of the certain additional income is dependent upon global financial market conditions and commodity prices, volumes of production, tanker movements, and so on, all of which are outside the control of the Council.
- 7.3.3 While the Plan has already described in detail the approach to long-term investments and the income that it will seek to achieve, a clear example of where a change in forecasting needs to be made is the impact of the low oil and gas price on throughput income once the Shetland Gas Plant begins production and re-assessing when production will begin. The impact is that the forecast income in the first five years is now £6 million, a reduction over the period of £6.6 million
- 7.3.4 The low oil price also has the potential to impact on the harbour operations, as media coverage of savings and cost cutting across the oil and gas sector strongly indicates the likely impact here in Shetland as well as elsewhere. The Council needs to seek ways to protect and maximise its return from the assets that it deploys to operate the harbour operation. As discussions continue to establish a greater understanding of the various factors that exist it has been prudent to continue to forecast an income stream that reflects the position in the last Plan. Further detail is included in section 8.
- 7.3.5 The decision making of other external bodies is another factor that the Council requires to take into account as it places additional financial pressure on specific

Service areas. Particularly significant is the Shetland Charitable Trust, and its financial contribution to the partnership agreement for the delivery of the Rural Care Model. The Trust has signalled its intent to reduce funding by 20% over a five year period, commencing 2015/16.

- 7.3.6 While the Council seeks to secure the funding required for the delivery of the Rural Care Model it is prudent to take account of the intended funding reductions as ultimately the Council does not determine the value of funding it will actually receive. This amounts to a cost pressure of £0.5 million over the period to 2019/20.
- 7.3.7 The overall uncertainty over the security of income that is expected from our investment, trading opportunities and external bodies has the potential to impact positively and negatively on the Plan. It is therefore essential that the Plan does not over commit the Council to income that it hopes to achieve simply to balance the budget. The evidence presented in this Plan supports a prudent and appropriate approach to forecasting the income that can be achieved taking account of the appetite for risk that has been discussed with Elected Members.

#### 7.4 Increased Need and Changing Populations

- 7.4.1 Increases in the number of people using a Service creates demands for additional resources, and these must be planned appropriately to ensure that the needs of each group can continue to be catered for in line with corporate priorities.
- 7.4.2 The Council recognises the forecasts made for Shetland by the National Records of Scotland in relation to population, and during the life of this Plan the projection is that a shift will occur in the population, from a base in 2012, towards an older overall population. This is reflected in the graph below.



- 7.4.3 The Council has made it clear in its Corporate Plan that while it is generally felt that higher demand will increase the total cost of providing care, the outcome that the Council is seeking is one where efforts are centred on encouraging healthy and active lifestyles that will help people to be independent and reduce the need for care as they get older. This promotes a positive way to approach the challenge of a changing population.
- 7.4.4 The Improvement Service has recognised the Council as a high quality and high cost provider of Services and therefore further opportunities exist to identify and implement alternative models of service delivery that reduce the individual / unit cost thereby allowing costs associated with rising numbers to be accommodated within the same total budget. These are actions that need to be considered, particularly when facing the added pressures from the intended reduction in income for social care services.
- 7.4.5 The Plan recognises that Services will need to change, to adapt and take appropriate action to enable the outcomes to be achieved and as such £0.3 million is included per annum to facilitate this.

## 7.5 UK and Scottish Government Policy Changes

- 7.5.1 Policy changes can arise from Europe, UK or Scottish parliamentary or regulatory changes and this can place new burdens on local government. Recent changes announced, in the process or being implemented or due to be implemented include European air quality standards, energy efficiency and working time directives; UK Treasury abolition of the Contracting Out National Insurance Contribution Rates; and Scottish Government Children and Young People (Scotland) Act 2014.
- 7.5.2 Financial pressures placed on the Council by these vary with funding being attached to some policy changes but for others the Council will have to address its responsibilities and find means of paying for them.
- 7.5.3 A specific example is the cost arising from the employer **National Insurance Rates** that change in April 2016, the UK Treasury having decided to abolish the discount that has applied to employer contribution rates for employees who were part of a defined benefit pension scheme. This discount amounts currently to 3.4%, with its abolition there is an additional £1.7 million to be found from the Council's budget. It's a policy that in itself doesn't improve the Service outcomes for our customers, but must be funded. This raises the basic cost year on year of our Services as they are currently structured and without changes to those structures pay related costs will become an increasing proportion of the budget.
- 7.5.4 In the future the Council will also have to address the full impact of the Pension Act 2008, which introduced **Auto-Enrolment**. The Council already applies auto-enrolment in relation to new employees, however the Council opted to defer the



implementation of the further responsibilities, which includes enrolling existing employees who are not members of the Pension Fund. The deferral was until 2017, at which time the Council will have no option but to implement the requirements of the Act. The estimated cost that has been built into the Plan is £0.8 million, from 2017/18.

- 7.5.5 Welfare Reform continues to be implemented nationally and while the work is being undertaken step by step, the impact continues to be monitored as the various elements are put in place. Universal Credit commenced in 2015/16 in Shetland and currently is in place for a limited number of applicants, this will grow over time and the Council may have to deal with administrative and ongoing support costs that are as yet unclear. The greatest concern is the impact on housing rents, and the financial position of the Housing Revenue Account (HRA), see section 9 for further detail.
- 7.5.6 The **Children and Young People (Scotland) Act 2014** includes provisions for increased early learning and childcare, up to 600 hours per annum for 3 and 4 year olds and, from August 2015, 27% of Scotland's most vulnerable 2 year olds. Free school lunches for Primary 1-3 children has been in place from January 2015 and there is the obligation on the Council to now provide aftercare support to looked after children up to the age of 25. Getting it Right for Every Child (GIRFEC) approach is enshrined in law, ensuring there is a single planning approach for children who need additional support from Services. The Council received funding support to implement these provisions which has been built into the value of ongoing grant funding support the Scottish Government provides. There has been no additional provision been included in the Plan.

## **8. Harbours**

### **8.1 Introduction**

- 8.1.1 In 1974 the UK Parliament passed The Zetland County Council Act. This Act provided certain regulatory powers and placed duties of conservancy on the Council, over the seas around its coast line. The Act provides the Council certain financial powers to borrow, invest and participate in business.
- 8.1.2 Under the Act the Council now operates a number of harbours around Shetland, the primary operation taking place at Sella Ness (the Port). The levels of activity are entirely dependent on the tanker movements through the Sullom Voe Terminal (SVT).
- 8.1.3 All the harbour operations are accumulated and accounted for through the Harbour Account. All surpluses generated on the Harbour Account are transferred to the Reserve Fund – a specific Fund held within the Council’s Usable Reserves.
- 8.1.4 The Act states the purposes of the Fund as:
- To cover losses on the Harbour Account;
  - To meet any claim or demand against the Council arising from the Harbour Account;
  - To meet any capital expenditure to maintain the Harbour Account;
  - To meet any repairs and maintenance cost on the Harbour; and
  - 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.
- 8.1.5 For many years the Council has drawn funds from the Reserve Fund to support the delivery of other Council Services, through a contribution equivalent to the annual surplus on the Harbour Account.
- 8.1.6 As a trading operation the Harbour Account is set up to make a return on the assets that are invested therein and to generate a surplus. It is recommended that the Council continue to adopt a robust pricing policy for the Port to ensure that a return on the investment made is achieved annually and that this surplus is used to deliver benefit to the Shetland public. This will be achieved by providing financial support to the Revenue Budget, thereby contributing to the delivery of Council Services.

### **8.2 Harbour Operations**

- 8.2.1 In the previous Plan, it was stated that that oil industry had announced its intention to remain at the SVT until around 2050.

- 8.2.2 This led to a financial modelling exercise being undertaken to estimate future revenue streams, costs and capital investment required to operate the Port until the extended date of 2050.
- 8.2.3 As described in section 7.3 the impact of low oil and gas prices on the industry has resulted in significant uncertainty, with widely reported cost reduction initiatives, including capital investment delayed or cancelled, job losses and operational changes. The full impact on SVT remains unclear and discussions are continuing in relation to the position and plans of the Council's customer.
- 8.2.4 At present the financial modelling continues to be reviewed in light of the extremely volatile market conditions however it remains important that certain principles are retained in terms of operating the Port for the benefit of the oil industry. These include:
- The oil industry will never be subsidised by Shetland Council Tax payers;
  - The pricing policy adopted will be full cost recovery plus a surplus, that reflects a suitable rate of return on investments;
  - The customer has defined the service level required at the Port as "24/7", which has been assumed as the continuing operating model;
  - The surpluses generated by the Port over the period to 2050 will be at least equal to the average investment return that would be generated had the capital instead been invested with the Council's Fund Managers;
  - The cost of capital investment, associated lifecycle replacement and maintenance and decommissioning will be built into the full cost of operations.
- 8.2.5 In view of the limited specific detail that exists in terms of the operational requirements, the timeframe over which changes may be made, future oil and gas price movements and the oil and gas sector response, it has been assumed that the falling surplus forecast for the next three years in the previous Plan should be retained and that a constant surplus of approximately £5.5 million will be generated in the final two years of the Plan.
- 8.2.6 This will provide a continuing level of income to the General Fund Revenue Budget to support Services and provide time for a greater level of information and knowledge to be obtained to inform future financial modelling and pricing policy.

## **9. Housing Revenue Account**

### **9.1 Introduction**

- 9.1.1 The Council is the largest landlord in Shetland, responsible, as at 31 March 2015, for the letting and management of 1,748 properties across Shetland.
- 9.1.2 The Plan has taken account of the Housing Revenue Account Business Plan.

### **9.2 Accounting Treatment**

- 9.2.1 The Housing Revenue Account (HRA) is a statutory account that requires to be kept separate from the General Fund. As such, it has to be financially self-sustaining, drawing its income from rental income generated on the housing stock. All expenditure, revenue and capital, is funded from housing rents and the Housing Repairs and Renewals Fund. It is not possible for the General Fund to subsidise council house rents.
- 9.2.2 The Housing Repairs and Renewals Fund, which only the HRA can access is part of the Council's Useable Reserves. At as 31 March 2015 there was a balance of £11.4 million.
- 9.2.3 The Housing Repairs and Renewals Fund has been excluded from the Useable Reserves on which the investment returns are based upon, as from time to time expenditure will be incurred to support the Council's delivery of social housing.

### **9.3 Housing Capital Investment**

- 9.3.1 For a number of years the HRA was overburdened by the unsustainable level of debt that it had to service. However following a tripartite agreement between the Council, the UK Government and the Scottish Government the issue of historic debt has been successfully addressed. The reduced debt level has resulted in lower annual costs for the HRA.
- 9.3.2 The HRA will only be able to fund capital expenditure in line with the Capital Funding Policy (see section 12.4) and the Prudential Code. The Council's Annual Investment and Treasury Strategy includes details of the overall capital financing requirement and other Prudential Indicators, which includes the HRA. This will ensure prudence, sustainability and affordability in all future capital investment decisions which will avoid the HRA becoming financially unsustainable in the future.

### **9.4 Housing Revenue Account Financial Policy**

- 9.4.1 In producing the HRA 30 Year Business Plan, the financial modelling that has been undertaken to inform it, provides a detailed level of data upon which future year HRA budgets should be set. The overall objective of the Business Plan is to fully cost the operational requirements of letting, maintaining and managing the Council housing stock. It is expected that the Business Plan will ensure:

- Annual HRA budgets are financially sustainable;
- There is a focus on housing rent levels being affordable;
- Capital investment is targeted at maintaining the existing housing stock, ensuring the quality standards set nationally are met and will be in line with the Capital Expenditure Policy (see section 12.3);
- Capital investment will be funded in line with the Capital Funding Policy (see section 12.4). This may include in-year revenue funding from housing rent income and where necessary borrowing, subject to complying with the Prudential Code; and
- The Housing Repair and Renewal Fund is managed effectively to have a long-term focus.

9.4.2 UK Government reform of welfare policy and specifically the change to Universal Credit alters the timing of payments and makes full payment of the housing related elements of benefits payable to the applicant. It is therefore their responsibility to pay their rent. The national and local position suggests that rent arrears have increased for the individuals that are receiving Universal Credit.

9.4.3 While this represents a very small number of people at present the position will have to be reviewed on a regular basis and where necessary incorporated within the modelling of the business plan.

## 9.5 **Housing Activities Supported outwith the HRA**

9.5.1 The Corporate Plan makes clear one of its top priorities is affordable housing. This in part is addressed through the proper and effective management of the Council's own HRA and housing stock, but is not the only mechanism that the Council has to achieve a better outcome in this area.

9.5.2 The HRA Business Plan states that the Housing Service operates within a strategic framework which links to local and national policies. These are contained in the Local Housing Strategy and underpinned by the evidence base presented in the Housing Need and Demand Assessment.

9.5.3 The five key themes of the Local Housing Strategy are Future housing supply; Homelessness; Housing Support/Housing needs of an aging population; Fuel poverty; and Private Sector.

9.5.4 These themes provide the framework for improving the housing outcomes. At the same time as seeking HRA solutions to support the Local Housing Strategy, the Council continues to work closely with Hjaltsland Housing Association to increase the supply of houses, and access additional funding options, not readily available to the Council. Added to this are options in relation to mid-market rent properties,

such as the National Housing Trust initiatives and working with developers to stimulate increased supply of affordable houses.

- 9.5.5 Income for the collection of Council Tax on 2<sup>nd</sup> homes, has, under legislation, had to be set aside for the purposes of delivering affordable housing solutions. The sum available in the Council's Usable Reserves as at 31 March 2015 was £0.8 million.

## **10. Risk Management and Financial Stability**

### **10.1 Introduction**

- 10.1.1 The MTFP process not only takes account of the resources available and cost pressures that arise from day-to-day activity, it also has to make provision for the unexpected. This helps protect services against short-term fluctuations in resources or demands, which would otherwise require changes to be made to on-going service provision.
- 10.1.2 The key mechanism for managing such uncertainty and delivering financial stability are a Cost Pressure and Contingency Provision and use of General Reserves.
- 10.1.3 In the context of the Plan, the financial risks can be broadly grouped into 3 categories:
1. Cost Pressures - Risks that can be identified with some certainty and for which a reasonable estimate of impact can be made, e.g. pay and price inflation. Where possible, key service base budgets have been adjusted to reflect the impacts as described in section 6, future revenue demands and pressures above;
  2. Contingencies - Risks that can be identified that are more certain to materialise but for which the size and scale of the risk is subject to some unknowns e.g. the uncertainty of numbers of children requiring additional support outside Shetland or the frequency and scale of ferry repairs. As such it is difficult to justify full provision within service budgets;
  3. General Reserves - Risks that can be identified, but for which the likelihood of occurrence, timing or impact are very uncertain. In these cases, the most appropriate means of delivering financial stability is through reserves and balances to ensure that significant in-year pressures do not destabilise ongoing services.
- 10.1.4 The level at which the Cost Pressure and Contingency Provision and General Reserves should be set at needs to take account of the financial risks facing the Council. The greater the level of uncertainty and the higher the potential financial impact of risks, the greater the need for provisions and reserves. Ensuring that they are maintained at a healthy level in order to manage risks is therefore an important aspect of Medium Term Financial Planning.

### **10.2 General Revenue Contingency Provision**

- 10.2.1 The Council will manage Category 1 and 2 risks through the Cost Pressure and Contingency Provision. In assessing the level of this, the key risks have been identified and estimated. Cost Pressures are recurring in nature and increase the base cost of the service being delivered (cumulative effect) whereas contingency

items are deemed non-recurring and are likely to vary year on year. Items which have been taken account of are:

1. Cost pressures - This includes pay award, the implementation of holiday pay, the impact of employer pension contribution increases and the potential for additional pension contributions arising from auto-enrolment. Policy changes that include the loss of income e.g. charges for carers/respite and working time/sleep-in arrangements.
2. Contingencies - This includes items for education and care for children delivered outside Shetland, ferry breakdown costs, winter maintenance and storm damage, supply teacher costs, relocation and interview expenses etc.

10.2.2 It is expected that not all of the forecast cost will arise in every year therefore the provision does not provide for 100% of the identified cost pressures and contingency items. Due to the Council's recent history of delivering on budget or below there has been flexibility for Services to absorb a proportion of cost pressures in year where they arise, without requiring an allocation of budget from contingency.

10.2.3 This could have material impact on the carry forward scheme that the Council operates. Where cost pressures arise that the Service has identified in advance but does not require in-year due to an overall underspend being forecast then the value available from contingency will be taken into account when calculating the Service carry forward position at the end of the financial year (see section 11.4.18).

10.2.4 Each year there will be a need to review and refine the provision in light of new and improved information on the scale and timing of cost pressures and contingencies. Where possible recurring items, once known, will be built into the Service base budgets. A list of cost pressures and contingencies will be included in the annual budget report.

### **10.3 Revenue and Capital Reserves**

10.3.1 Category 3 risks will need to be managed through General Reserves. This will provide capacity for the Council to manage the more significant and unexpected events that it may face. Three main risks aim to be mitigated by holding uncommitted reserves, namely Major Incidents, Major Disasters (e.g. Natural) and the General Financial Climate. There may be other risks that are also pertinent to be mitigated through these reserves.

Major Incident – potential for significant unplanned expenditure in support of specific circumstances;

Major Disaster – service delivery affected and resources diverted (e.g. buildings being inaccessible or disaster recovery plan / emergency plan being set in action);



Financial Climate – wider knock-on effects of market changes, austerity, and / or lower growth and the consequential impact on UK and Scottish Government budgets. There is uncertainty both in relation to the totality of resources available for the public sector and the distribution of those resources. This uncertainty applies both to Capital and Revenue resources.

- 10.3.2 The Council, as at 31 March 2015, held an uncommitted General Fund Reserve of £11.8 million which could be used to defray such expenditure.
- 10.3.3 All General Reserves form a part of the Usable Reserves of the Council and as such form part of the overall Reserves Policy that has been discussed in detail in section 6.5 above. The risk that arises in relation to Reserves is a failure to recognise that Reserves are usable only once. The Reserves Policy sets out to maintain the level of Usable Reserves and this includes the values currently held within General Reserves. In doing so the value is committed to the long-term investment returns withdrawal policy of the Council which allows a sustainable draw from the investment returns to support the Revenue Budget annually.
- 10.3.4 By committing to the long-term investment it relies upon the General Reserves remaining unspent and held as Usable Reserves.

#### **10.4 Financial Stability**

- 10.4.1 A careful balance needs to be maintained between holding too much and too little money in Reserves. If Reserves are too small, this increases the Council's exposure to risk and endangers its capacity to deliver priorities in a planned and prudent fashion. Demand-led services and an environment of ever changing legislative requirements, an increasingly litigious society, combined with reduced funding from the Scottish Government all threaten financial stability. Planning to increase Reserves beyond current levels (by delivering a surplus) prevents in-year funding from being allocated to Service budgets.
- 10.4.2 It is important to remember that Council cash is not idle. The money the Council has in Reserves is invested long-term and the Council benefits from the positive results that the Council's investment strategy delivers (see section 6). Investment return generated through the management of Council cash is used to pay for additional Service provision.

## 11. Balancing the General Fund Revenue Budget

### 11.1 Introduction

- 11.1.1 A balanced General Fund Revenue Budget is achieved when the forecast expenditure required to meet the Corporate Plan and associated Directorate and Service Plans are matched by the resources available.
- 11.1.2 Based on the information gathered from the Medium Term Financial Plan planning process a General Fund Revenue Budget financial model has been developed that indicates the forecast matching of income and expenditure over the five year period. The detail is shown in Appendix A.
- 11.1.3 In summary the Plan identifies that for financial year 2016/17 maintaining the approach taken in the previous Plan, that of 2% savings across all Services, a balance budget should be able to be achieved without further specific intervention (the detail of which will be contained in the 2016/17 budget setting process). This should enable the Council to focus on the future and the underlying funding gap of £32 million over the final four years of the Plan as shown below.

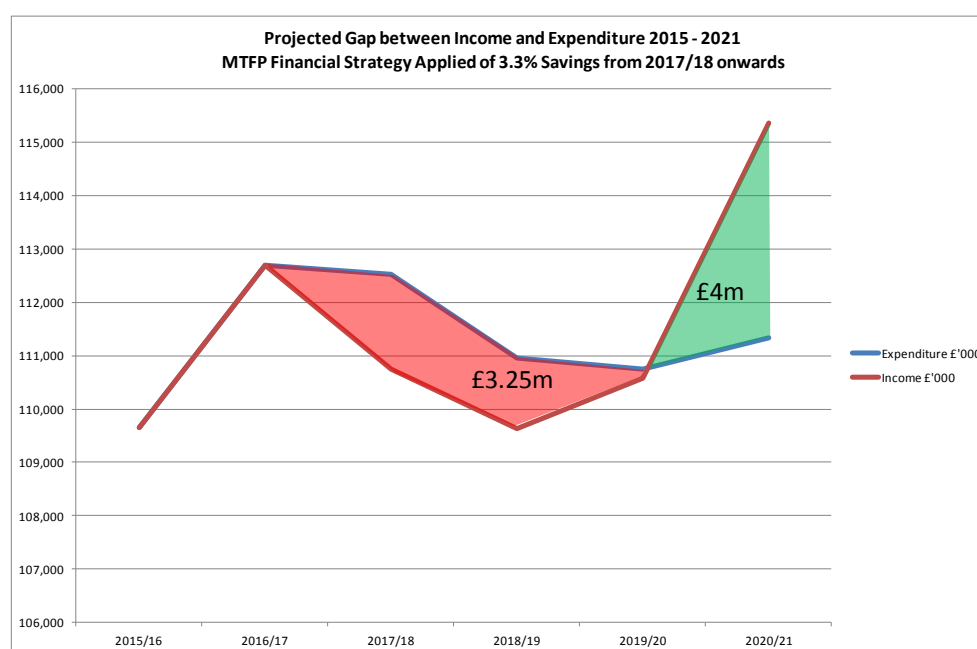
#### Shetland Islands Council

#### Medium Term Financial Plan 2015/16-2020/21

Medium Term Financial Plan 2015/16-2020/21						
	Year 1	Year 2	Year 3	Year 4	Year 5	
	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
	£'000	£'000	£'000	£'000	£'000	£'000
Total General Fund Service Expenditure	111,805	114,503	115,926	117,673	120,672	124,365
Total Trading Income	(7,731)	(6,910)	(6,719)	(6,777)	(7,871)	(8,044)
Total Core Revenue Funding	(94,735)	(93,744)	(91,722)	(90,305)	(89,890)	(94,238)
<b>Additional Financing Requirement</b>	<b>9,339</b>	<b>13,849</b>	<b>17,485</b>	<b>20,591</b>	<b>22,911</b>	<b>22,083</b>
Financed by:						
Affordable Draw from Investment Returns	(7,194)	(12,045)	(12,298)	(12,556)	(12,820)	(13,089)
Savings to 2016/17 in line with previous MTFP	(2,145)	(1,804)	0	0	0	0
Underlying future savings requirement (Funding Gap)	0	0	(5,187)	(8,035)	(10,091)	(8,994)
	(9,339)	(13,849)	(17,485)	(20,591)	(22,911)	(22,083)

- 11.1.4 What this means is that if no action is taken beyond 2016/17, and all other things remain constant in accordance with the assumptions in the Plan, then it would require one off funding of £32 million to maintain Services in their current form and at current levels. To do this would fundamentally undermine the affordable draw from investment returns and exacerbate the situation further. For every £1 million spent from Reserves equates to a loss in investment income of approximately £52,000. The effect would be cumulative resulting in an annual loss of £1.7 million from the affordable draw from investment returns.
- 11.1.5 A more appropriate, and the recommended, response by the Council will be by implementing recurring savings or managing out demand and growth pressures to the value of £10 million over the period to 2019-20. This amounts to approximately 3.3% saving per annum over the period to financial year 2019/20.

- 11.1.6 This would not address the forecast funding gap in full in 2017/18 nor the year after, however in order to provide a structured approach to delivering the total saving of £10 million and given the extent of uncertainty factored in to the Plan, by not committing the Council to front loading the savings it provides time for more certain and more accurate information to be incorporated as the Plan is reviewed.
- 11.1.7 It does not provide the luxury of taking no action now. It is vital that the Council continues to act and to identify the means through which it can deliver its Services more efficiently and more productively and in more cost effective ways, in order to address the rising costs that are faced.
- 11.1.8 The Plan models a scenario where the relatively small unfunded gap in 2017/18 to 2019/20 is recovered in 2020/21 through the projected uplift in income received. The Plan accepts that the Council is in a position to take such a risk in order to smooth out and profile the timing of when savings will be required. The results of Plan are shown in Appendix B and are demonstrated in the following graph.



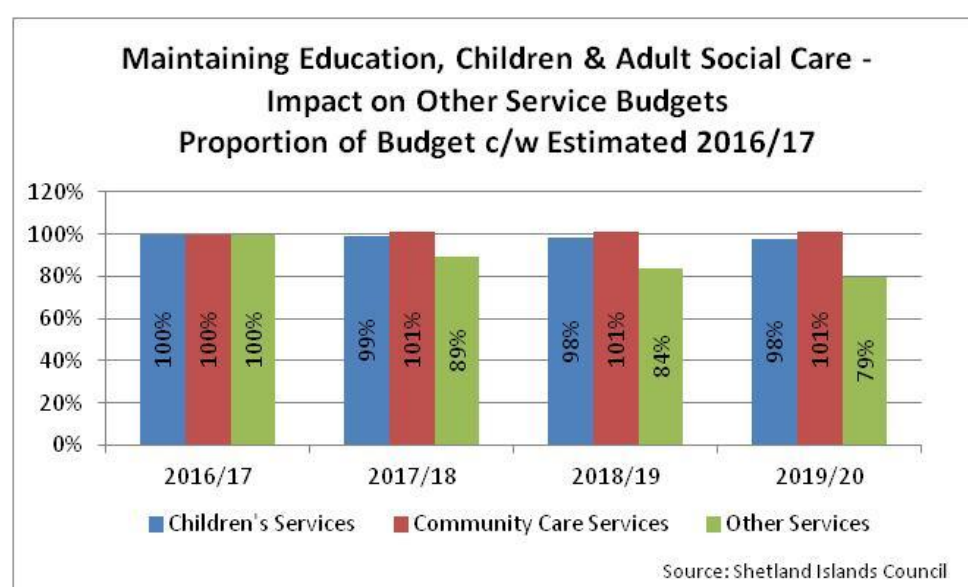
- 11.1.9 It is recommended that the Council take this overall strategic approach to ensure that action is taken to reduce the cost base now, and recognise that future decisions of the Scottish Government, capturing changing financial and oil and gas market conditions as well as updating the values of external funding will allow the Plan to be refined to quantify the full extent of future funding gaps.

## 11.2 Aligning Resources with Priorities

- 11.2.1 In order to deliver the level of change required to achieve a balanced position, all aspects of the General Fund Revenue Budget require to be reviewed. The nature of potential budget reductions has not changed; they still involve the Council becoming more efficient; increasing external resources such as fees and charges;

altering the service model for delivery and reducing or cutting service provision. This essentially requires Services to be structured in a way that maximises productivity and operates as efficiently and effectively as is possible.

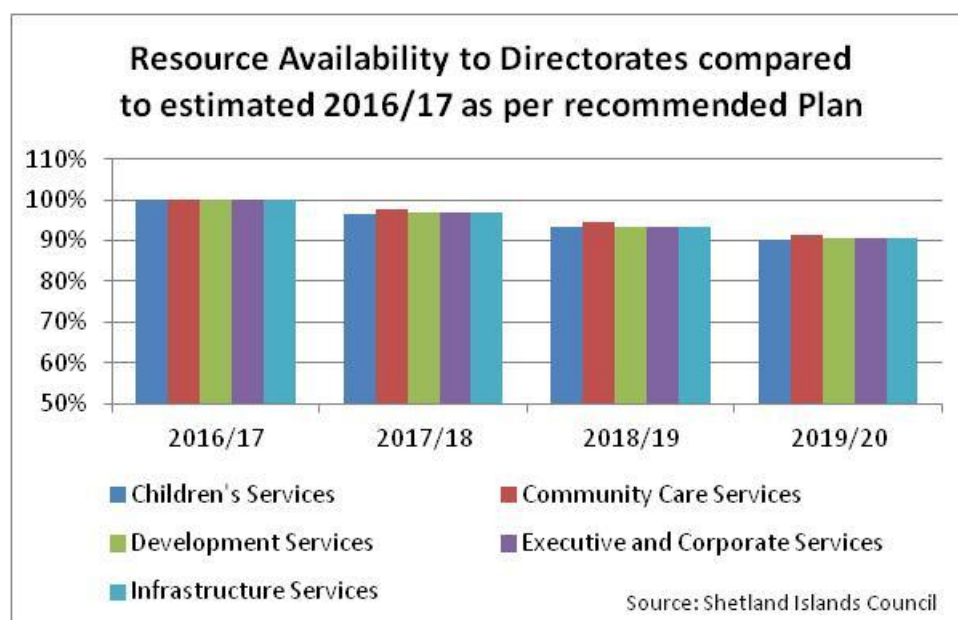
- 11.2.2 In assessing where savings need to be made, it is clear that given the size of the budget gap the Council's major areas of spend would need to be targeted in order to achieve the necessary reductions in budget. Saving a small proportion in these areas of spend would contribute significantly to the overall savings required, and would protect smaller services from the need to make disproportionately large cuts, or indeed the cessation of those services altogether.
- 11.2.3 By way of example, this can be shown in the following graph where protection has been afforded to the two largest areas of expenditure, Education, Children & Adult Social Care. The impact on the other Services of the Council by Year 4 (2019/20) results in a reduction of budget of over 20%.



- 11.2.4 The Other Services category includes a number of Services that are significant themselves and are priorities identified in the Corporate Plan, most notably transport services - buses, ferries and roads. These would bear the principal share of such a substantial funding reduction over the four year period and therefore such protection is not recommended.
- 11.2.5 There remains an underlying requirement for the Council, through the funding settlement from the Scottish Government, to deliver year on year efficiency savings and these in principle should apply to all Council Services.
- 11.2.6 Using this as a starting point provides each Service with a specific understanding of what is expected in the future, to offset the basic growth pressures that are generally applied across the whole of the Council. It is therefore recommended that all Services share the challenge of funding the gap to an equal extent.

11.2.7 To show the impact of this approach on the Council's Services a schedule of future savings / budget targets has been set out in Appendix C. It is recommended that these targets are agreed as the basis for moving forward.

11.2.8 The resource availability recommended in the Plan is represented in the following graph:



11.2.9 If the Council is to address its priorities and arrange its financial and other resources to deliver on the key objectives with a view to achieving the long-term outcomes then the Council will need to take a long-term and robust approach to this. Gathering the necessary data and evidence that supports an outcome focus is not a straightforward or quick task.

11.2.10 Within the framework of this Plan, rising cost and reducing income does not make this task any easier. However the starting point should be for Services, through their Directorate and Service Plans to focus on ways in which they will respond to ensuring that the outcomes focus is progressed within the resources they have available.

### 11.3 Assumptions for Future Resources

11.3.1 The financial modelling forecasting the budget position for 2016/17 to 2020/21 is based on a set of assumptions which have been described in detail throughout the Plan.

11.3.2 The following points are a reminder of the headline assumptions made in estimating resources for the future:

Council Tax	Band D rate frozen (grant funding support included in Financial Settlement);  Tax base increase 1% per annum (80 Band D equivalents).
SG Revenue Funding	Cash reduction in General Revenue Grant will apply for next 4 years (5.8% reduction by 2019/20);  Notional Loan Charge Support will reduce General Revenue Grant at approximately £0.6m per annum (equivalent to a further 0.6% reduction by 2019/20).
Shetland Gas Plant	Oil and Gas prices at August 2015 prices; no anticipated price increases over life of the Plan.
Harbour Surplus	Reducing surplus £5.4m to £4.9m by 2018/19;  Increasing to £5.5m for years 4 and 5 of the Plan.
Shetland Charitable Trust	Cash reduction of £0.5m by 2019/20.
Investment Returns	7.3% annual return year on year; inflation proofing at 2.1%; net return 5.2%.
SG Capital Funding	£6m Capital Grant per annum
11.3.3	The following points are a reminder of the headline assumptions made in estimating expenditure for the future:
Inflation	Pay award / Living Wage - 1.5% 2015/16; 1% 2016/17 and 1% thereafter.  Employer Pension Contributions – Teachers £0.8m from 2015/16; Local Government Pension Scheme £1.0m from 2016/17.  Holiday Pay - £0.3m from 2016/17.
Population Changes	Contingency for the impact of population changes - £0.3m from 2015/16.
Policy Changes	National Insurance Contributions - £1.7m from 2016/17.  Pension Auto-enrolment - £0.8m from 2017/18.  Children and Young People (Scotland) Act 2014 – funded by Scottish Government.
Debt	No new external borrowing is taken beyond projects already identified.

## **11.4 Management of the Budget and Budget Flexibility Initiatives**

- 11.4.1 The Council now has a history of delivering its budget outturn at or below budget. It is inevitable that significant demands will be placed on the Council and its future capacity and as such the Council will need to continue delivering robust control of its budget. This is done through devolved budget ownership (Budget Responsible Officers) and a monthly reporting process to the Corporate Management Team. It culminates in quarterly budget monitoring reports to the Council Service Committees and Policy and Resources Committee.
- 11.4.2 The Council's budget monitoring and performance reporting process includes monitoring progress in relation to the savings identified as part of the annual budget setting process. This enables management action to be taken as early as possible including corrective actions and the identification of alternative approaches.
- 11.4.3 The Council has made progress too in financial decision making, using evidence based reporting, following the building better business cases methodology and demanding fully costed options. There is also a much stronger understanding of the cost of using resources and this being taken into account when making decisions. It is recommended that the Council continue to build upon the financial management improvements that have already been made.
- 11.4.4 The Council, through the work with CMT and Directors, is positively positioned to respond to moving and prioritising financial resources it has available. To promote and support a robust approach to budget management now and in the future a number of initiatives are in place to assist officers.
- 11.4.5 **Funding for Change**
- 11.4.6 The Plan in its current form indicates the impact on expenditure and income of delivering Services in their current form through the next five years. To continue to deliver Services in the same way over the next few years will only result in overspending and a failure to address the unaffordable cost base in place for providing Council Services.
- 11.4.7 Without continuing to press for savings year on year the costs and uncertainty of existing income streams will make it impossible to provide the assurance that the Council will require, that it will balance its budget in the future.
- 11.4.8 What is clear is that the models of service delivery that the Council has cannot be afforded if nothing changes. The Local Government Benchmarking Framework as developed by the Improvement Service, in conjunction with the Scottish branch of the Society of Local Authority Chief Executives (SOLACE Scotland) and Convention of Scottish Local Authorities (COSLA), has been developing for the last four years to establish a common approach to benchmarking and this shows Shetland Islands

Council as a high cost, high quality Council. The table below shows figures from the 2013/14 exercise, this being the latest published.

A selection of LGBF 2013/14 statistics:	Shetland	Scotland	Orkney	Eilean Siar	Highland
Residential care of older people (£ pppweek)	1,057.00	368.00	834.00	625.00	407.00
Provision of care at home for older people (£ phour)	36.68	20.25	23.86	24.28	30.07
How satisfied are you with social care services	81%	55%	77%	71%	54%
Cost of refuse collection (£ ppemise)	146.66	79.94	93.50	108.27	125.40
How satisfied are you with refuse collection	94%	83%	66%	86%	83%
How satisfied are you with street cleansing	98%	96%	100%	100%	98%
Cost of secondary schools (£ ppupil)	10,539.00	6,531.00	10,434.00	12,702.00	7,456.00
Number of 4th year achieved 5 awards at SCQF level 5	50%	39%	44%	42%	42%

- 11.4.9 Change is necessary to adapt to national and local policy and the Council's own outcome aspirations, to capture the benefits of alternative ways of working and technology, to implement a more cost effective model of service delivery, or to redirect resources to improve the outcomes that can be achieved overall.
- 11.4.10 The Council acknowledges that Services themselves do not always have sufficient resources to fund the initial costs of implementing change, and to do this at the same time as continuing to deliver the existing Services. Therefore in 2016/17 the Plan provides for continued funding to be set aside from the Revenue Budget Contingency to support this, to invest in the work that will be required. The Plan incorporates a sum of £0.5 million to facilitate change.
- 11.4.11 It is recommended that decisions on the use of this funding will be approved by the Director of Corporate Services in conjunction with the Executive Manager - Finance to ensure that the funding is allocated to work that will progress the achievement of the Council's Corporate Plan priorities and there is a clear link to the achievement of the long-term outcomes.
- 11.4.12 **Budget Carry Forward Scheme**
- 11.4.13 The Plan makes provision for a budget carry forward scheme in order to offer an incentive to Directorates to effectively manage their budgets.
- 11.4.14 If a Directorate achieves a one-off revenue 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.
- 11.4.15 A 100% revenue carry-forward will be allowable if it relates to a specific contractually committed project that was not completed during the year due to slippage, or relates to ring-fenced funding.
- 11.4.16 A capital carry-forward is only allowable if it relates to a committed project that has not been completed. In these cases, 100% of the unspent budget can be carried forward if it is required to complete the project. There is no provision for the general carry-forward of capital under spends.



11.4.17 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.

11.4.18 The conditions of the scheme are:

- A Service will only be granted revenue carry forward if it's Directorate has 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, based on Period 9 information.
- A carry forward will have to be applied to approved Council service priorities.
- If a service achieves a higher actual under spend than it forecast at period 9, it will not be able to subsequently seek an increase in its carry-forward request. If a service fails to achieve the level of under spend that it forecast at period 9, it will have its carry-forward request reduced accordingly.
- A Service's carry-forward request will be reduced by a percentage which is double the percentage difference of period 9 forecast to the actual outturn position for the Directorate as a whole. For example, if at Period 9 the Directorate forecasts an under spend of 5% but the outturn is a 15% under spend, the 10% difference will result in there being a 20% reduction in the value of the carry-forward that was requested based on the Period 9 data. This provides Services with a strong incentive to ensure that they forecast as accurately as possible at Period 9.
- Where cost pressures arise that the Service has identified in advance but does not require it in-year due to an overall under spend being forecast then the value available from contingency will be taken into account when calculating the Service carry forward position at the end of the financial year, i.e. a Service will not be penalised for the Council retaining the contingency budget corporately while an under spend is forecast. This provides further incentive for Services to calculate accurate forecasts.

11.4.19 **Spend to Save and Improvement Fund**

11.4.20 The Council has in place a Spend to Save scheme. The purpose of the 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.

- 11.4.21 It is expected that the 'Funding for Change' described in section 11.4.4 will work in conjunction with this scheme to facilitate options identification and feasibility work that may be required in advance of specific actions required to deliver the change and reduce expenditure.
- 11.4.22 Due to the requirement for savings now and into the future the scheme has been reviewed to take a longer term view of how quickly the savings achieved from the use of the scheme are recouped. The underlying principle of the scheme therefore is that any funding awarded has to have a payback period no greater than 5 years.
- 11.4.23 The Executive Manager – Finance has the authority to increase this payback period to 7 years in exceptional circumstances, which may exist where additional resource benefits beyond financial savings or where the evidence of the impact on priority outcomes is compelling.
- 11.4.24 It is possible to apply for Spend to Save funding to undertake specific feasibility and option identification work if the revenue 'Funding for Change' is fully committed. In this circumstance any expenditure will be included in any subsequent request for Spend to Save funding and factored into the payback calculation.
- 11.4.25 Savings that may be derived from a Spend to Save investment can include future cost avoidance, for example waste, energy or carbon taxes, fines, penalties or charges that will improve the Council's control of future cost pressures. In this situation clear and robust evidence of the cost avoidance will have to be provided and be approved by the Executive Manager – Finance.
- 11.4.26 The Spend to Save funding can be used to support Revenue or Capital expenditure.
- 11.4.27 Due to the requirement for the Council to deliver actual savings in the revenue budget the Spend to Save funding will be provided on the following basis:
- That no interest will apply when repaying the sum invested by the Spend to Save fund;
  - Where payback is calculated as 2 years or less, 100% of the sum invested will be repaid to the Spend to Save fund; and
  - Where payback is calculated as more than 2 years, 50% of the sum invested will be repaid to the Spend to Save fund.
- 11.4.28 This will deliver earlier cashable savings into the Revenue Budget rather than having to wait until the payback period has been reached.
- 11.4.29 An example would be £0.5 million Spend to Save application for investment will generate £0.125 million of savings per annum. Payback period 4 years. If the full value of the investment has to be repaid into the fund then the saving that has been generated will only impact in year 5. By only repaying into the fund half of the investment the Service will be able to impact on the Revenue Budget in year 3.

This enables the timescales for generating an impact on the Revenue Budget to be substantially improved, providing an incentive to effect the savings quickly.

11.4.30 The other impact is that the Spend to Save fund will reduce and not be self sustaining meaning that fewer future opportunities will be able to be funded.

11.4.31 The value of the Spend to Save funds, earmarked in the Council's Usable Reserves as at 31 March 2015, was £8.3 million.

11.4.32 The Spend to Save scheme will be regularly reviewed to ensure it remains relevant to current funding levels and the financial climate.

## **12. Capital Investment Planning**

### **12.1 Introduction**

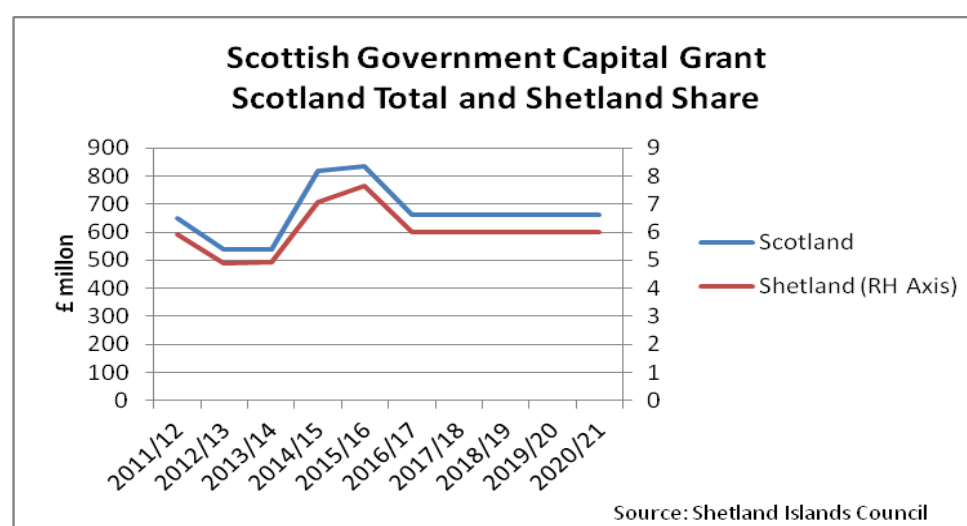
- 12.1.1 The Asset Investment Plan sets out the capital expenditure that the Council plans to incur over a five year period. Capital expenditure relates to spending on significant repairs and maintenance work where the result is to extend the life of a Council asset, or spending on the creation or purchase of a new asset.
- 12.1.2 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. Any additional spending on capital items that is greater than these funding sources effectively has a cost – the cost of capital.
- 12.1.3 In the past the Council has used its Reserves to fund capital expenditure, which itself had a cost in that by using Reserves to fund capital expenditure, the value spent from Reserves was no longer be available to generate a long-term investment return. This cost was not accounted for and recognised as a cost in the past. The Plan has ruled out using Reserves to fund capital expenditure.
- 12.1.4 The Council's resources are precious and in recommending the Financial Strategy in section 11 the investment returns that can be generated by retaining Usable Reserves, invested for the long-term, will be targeted on supporting the Revenue Budget. The consequence of this is that by maintaining the Usable Reserves value to maximise those returns there they cannot also be used to fund capital expenditure.
- 12.1.5 Now and in the future it is important that the Council recognises the cost of capital expenditure so that it is not treated as a "free resource".
- 12.1.6 This is particularly important as the Long-Term Financial Plan (LTFP) set out the extremely challenging capital investment requirements that are forecast to arise over the period to 2050. This was based on the existing asset base and projections for required capital expenditure over the period to simply sustain operational use of that asset base. The shortfall between the capital expenditure forecast and available funding expressed in the LTFP amounted to approximately £11 million year on year. To fund this would incur a cost, the cost of financing borrowing, and by 2050 that cost would be approximately £23 million per annum and represent over 20% of the Council's Revenue Budget. Ongoing recurring revenue savings would have to be identified and delivered to accommodate this rise in what would become a fixed cost. The cost of current levels of debt represents approximately 1% of the Revenue Budget.
- 12.1.7 The LTFP demonstrates that if the Council wishes to retain and operate the asset base that it currently has, there will have to be a significant transfer away from

spending money on ongoing service delivery and will instead have to make savings in order to fund the cost of capital.

- 12.1.8 A more detailed Long-Term Asset Investment Plan is in the process of being prepared, which will quantify the asset management challenge that the Council faces and is expected to make recommendations on how to more effectively manage its assets in the future.
- 12.1.9 The Capital Expenditure and Capital Funding Policies recommended below (see sections 12.3 and 12.4) are applicable to the General Fund, Harbour Account and Housing Revenue Account

## 12.2 Future Capital Resources

- 12.2.1 The Capital Grant that the Council receives from the Scottish Government is the primary source of funding for capital expenditure. In the recent past the Scottish Government through the Spending Review 2011 sought to tackle part of the austerity measures handed down through the UK funding settlement by varying the value of capital grant available, taking a proportionately larger reduction in the early years (2012/13 and 2013/14) before increasing the availability of capital funding at the end of the three year review period and into 2015/16.
- 12.2.2 This resulted in a significant reduction in capital funding for the Council, as demonstrated on the graph below. Throughout the period the Council received approximately 0.9% of the Scottish total Capital Grant available.



- 12.2.3 Projecting forward is challenging due to the lack of data to support any specific forecasts of what the Scottish Government may do. It has been assumed that a significant reduction (22%) from current levels for Shetland will arise. This being driven by the an artificially high Capital Grant value for the whole of Scotland in 2015/16 and further funding having been provided in support of the implementation of the Children and Young People (Scotland) Act 2014 in that same period.

- 12.2.4 An annual sum of £6 million is forecast to be received by the Council in Capital Grant during the life of the Plan.

### **12.3 Capital Expenditure Policy**

- 12.3.1 To address the unaffordable capital expenditure requirements of the Council the following policy is recommended:

- No growth in the asset base;
- All capital expenditure to be focussed on the maintaining the existing assets (with the exception of the previously approved new Anderson High School and digital connectivity);
- A gateway process will ensure strategic fit is demonstrated early and decisions are taken at key stages. This will be supported by a full business case, including projected future demand, and options and investment appraisal process before a project can be considered for inclusion on the Asset Investment Plan;
- No project will be considered for inclusion on the Asset Investment Plan, and existing projects will be removed, unless they have a robust financial estimate of cost. The Executive Manager – Finance will determine whether the financial estimate of cost is robust;
- All capital projects must clearly demonstrate the revenue consequences arising from a capital spending decision to assist Elected Members in understanding the full financial impact; and
- The focus will be on effective asset management, driven forward through the Asset Strategy and Implementation Plan. This will ensure that the Council occupies a reduced number of properties in the future.
- The Executive Manager – Capital Programme will determine the opportunities for the maximisation of income from the Council's property estate, which may be in the form of revenue income or capital receipts.

### **12.4 Capital Funding Policy**

- 12.4.1 To reflect the limited availability of capital funding and the cost associated with the use of capital the following policy is recommended:

- Scottish Government Capital Grant will be applied initially to short life assets (e.g. vehicles, ICT, certain maintenance);
- Capital Receipts will be targeted at core capital maintenance costs;
- Capital Funded from Current Revenue (CFCR) will be used where appropriate to fund low value, shorter life capital expenditure;

- Where available and determined as appropriate by the Executive Manager – Finance, other assets may be funded from Capital Grants, Capital Receipts and CFCR;
- All other capital expenditure will be financed by borrowing. If interest rates are lower than the return on long-term investments described in the Plan (see Withdrawal Policy in section 6.3), external borrowing will be undertaken. If interest rates are higher than investment returns, internal borrowing will be undertaken;
- The service(s) that benefit from the capital asset will be required to make sufficient revenue savings to free up budget to pay for the cost of capital (interest charges and principal repayment of debt). This will be calculated based on the amount borrowed. The only exception is in relation to the New Anderson High School project as the agreement to borrow pre-dates this Policy;
- Capital financing products are affected by external and financial market factors and can develop in a way that may enable the Council to achieve its Corporate Plan outcomes through alternative means. Where new capital financing opportunities arise, such as Scottish Government initiatives like the National Housing Trust models, then the Executive Manager – Finance will give consideration to such products, subjecting them to financial viability, affordability and risk tests, and make a recommendation prior to proceeding.
- The level of borrowing required to finance the Asset Investment Plan is called the Capital Financing Requirement (CFR). The Council will be able to manage limits for borrowing based on what it thinks is prudent, affordable and sustainable through annually agreeing Prudential Indicators as part of the Annual Borrowing & Investment Strategy.

## **13. Conclusions and Financial Strategy**

### **13.1 Introduction**

- 13.1.1 Financial planning by the Council has made a step change in recent years with improved financial management, improved financial and risk awareness and the adoption of a medium to long term approach to leading and directing the actions and activities of the Council.
- 13.1.2 This has enabled the Council to deliver Services to the Shetland public within budget and in doing so has improved the financial sustainability and resilience of the Council. However it cannot remove the need for the Council to continue to look forward and to recognise the enormous challenges that lie ahead in relation to the availability of resources, the cost pressures and the level of risk that Council has in relation to significant elements of its funding.
- 13.1.3 To continue to strengthen the financial management arrangements in place for the Council this Plan has outlined those challenges and presents a means by which decisions can be taken to not only address the forecast financial position but to move Council's Services to be focussed on delivery of the Corporate Plan objectives and outcomes.

### **13.2 Financial Strategy**

- 13.2.1 Looking forward and taking into account the principles (set out in section 2) the Plan sets out the recommended Financial Strategy to enable the effective management of financial resources for the next five years:
- To seek all opportunities to enter into dialogue with the Scottish Government in relation to Services for which the Council does not receive its fair share of funding, or where inconsistency exists between Shetland and other local authorities (see section 4.2);
  - To commit resources to ensure that the Island Proofing provisions within the current Consultation on Provisions for a Future Islands Bill<sup>15</sup> and subsequent work adequately reflect funding and financial aspects (see section 4.2);
  - To take action on costs over the life of this Plan on the basis that Scottish Government funding will not increase for years to come and that it is likely to never return to the funding level (in real terms) that it has now to deliver Services (see section 4.1);

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<sup>15</sup> Consultation on Provisions for a Future Islands Bill, Scottish Government, September 2015



- To take a prudent approach to core Scottish Government funding projections for the next five years; to take a cautious approach to the benefits that may be generated from rising oil and gas prices (see section 5); and to take a measured approach to the long-term investment returns that will be generated (see section 6), to determine the overall value of Council income;
- To treat all non-specific grants received as a corporate resource (see section 5.2);
- To improve the consistency and application of charging policies to take account of the principles outlined in the Plan (see section 5.4);
- To adopt the Investment Returns Withdrawal Policy, which includes a long-term investment return rate of 7.3% and long-term inflation rate of 2.1%, resulting in an affordable draw from investment returns of 5.2% of the investment return base (see section 6.3);
- To maintain Usable Reserves no lower than the predicted investment return base of £231.8 million as at 1 April 2016, by working annually within the funding constraints of the revenue and capital budgets (see section 6.3);
- To focus investment returns on supporting revenue expenditure (see section 6.4);
- To capture savings from improved and robust procurement and commissioning processes, including the re-negotiation of contracts (see section 7.2);
- To adopt a robust pricing policy for the Port to ensure that an annual return on investment is achieved and that the surplus is used to deliver benefit to the Shetland public (see section 8.1);
- To acknowledge the contribution that through the use of the Housing Revenue Account and other initiatives there are opportunities for the delivery of quality affordable housing in Shetland (see section 9);
- To maintain a Revenue Budget contingency to enable cost pressures and contingency items to be met on an annual basis, if and when they arise and to take a risk based approach to the value required (see section 10.2);
- To maintain an uncommitted General Fund Reserve to mitigate the risk of significant unplanned one-off events (such as Major Incident, Major Disaster and the Financial Climate) that the Council may face (see section 10.3);
- To recognise the gap between income and expenditure in future years and agree to smooth the impact over years 2 to 5 of the Plan, resulting in a Council wide target of 3.3% savings from 2017/18 onward (see section 11.1 and Appendices A and B);

- To apply a 3.3% saving target on all Directorates for financial year 2017/18 and annually thereafter (see section 11.2 and Appendix C);
- To structure Services in a way that maximises productivity and operates as efficiently and effectively as is possible (see section 11.2);
- To prioritise Service delivery that is identified as being most likely to successfully achieve the Corporate Plan objectives and outcomes in the long term or is required to fulfil the Council's statutory duties, and to agree to stop discretionary Services that do not contribute to that achievement (see section 11.2);
- To build upon the financial management improvements that have already been made, and continue to base decision making on evidence based reporting, following the building better business cases methodology, demanding fully costed options and recognise that the use of Council resources all come with a cost (see section 11.4)
- To set aside an annual sum of Funding for Change and authorise the Director of Corporate Services, in conjunction with the Executive Manager – Finance, to approve the allocation of funding to projects seeking Funding for Change (see section 11.4);
- To approve the scheme for the Spend to Save and Improvement funding earmarked within the Council's Usable Reserves (see section 11.4);
- To adopt the Capital Expenditure Policy and limit capital expenditure to a programme that is deliverable and affordable based on the estimated level of Scottish Government Capital Grant, supplemented by capital receipts (see section 12.3);
- To adopt the Capital Funding Policy and borrow in specific circumstances for capital investment, that cannot be funded from Capital Grant or capital receipts, the cost of which will be borne by the Service(s) that the investment benefits. Borrowing will be carried out under the Prudential Code framework of prudence, sustainability and affordability in line with the Borrowing Policy<sup>16</sup> (see section 12.4);
- To annually review the appropriateness and estimation of all the income and expenditure projections and risk appetite of the Council to ensure the Plan and budget setting processes remain up to date and relevant to the latest operating conditions (see section 2.1).

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<sup>16</sup> Shetland Islands Council, Borrowing Policy and Strategy 2013 - 2018

**MEDIUM TERM FINANCIAL PLAN – QUANTIFICATION OF THE FUNDING GAP****APPENDIX A**

<b>Shetland Islands Council</b>		<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5</b>
<b>Medium Term Financial Plan 2015/16-2020/21</b>		<b>2015/16</b>	<b>2016/17</b>	<b>2017/18</b>	<b>2018/19</b>	<b>2019/20</b>
		<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Expenditure	General Fund Service Expenditure	105,774	105,089	103,506	103,527	103,549
	Other Account Recharges	(1,999)	(2,029)	(2,059)	(2,090)	(2,121)
	Capital Financing Costs	1,256	1,256	1,256	1,256	1,256
	Recurring Budget Pressures	3,162	7,187	10,223	11,980	14,988
	Non-Recurring Contingency Provision	3,612	3,000	3,000	3,000	3,000
<b>Total General Fund Service Expenditure</b>		<b>111,805</b>	<b>114,503</b>	<b>115,926</b>	<b>117,673</b>	<b>120,672</b>
Trading income	Shetland Gas Plant Income	(1,349)	(693)	(847)	(1,121)	(1,601)
	Harbour Account Surplus	(6,382)	(5,417)	(5,072)	(4,856)	(5,470)
	Economic Development Investments Income	0	(800)	(800)	(800)	(800)
	<b>Total Trading Income</b>	<b>(7,731)</b>	<b>(6,910)</b>	<b>(6,719)</b>	<b>(6,777)</b>	<b>(8,044)</b>
Core Funding	GRG & NNDR	(86,314)	(85,239)	(83,132)	(81,629)	(81,127)
	Council Tax	(8,421)	(8,505)	(8,590)	(8,676)	(8,763)
	<b>Total Core Revenue Funding</b>	<b>(94,735)</b>	<b>(93,744)</b>	<b>(91,722)</b>	<b>(90,305)</b>	<b>(89,890)</b>
		9,339	13,849	17,485	20,591	22,911
Deficit Funding	<b>Financed by:</b>					
	Affordable Draw from Investment Returns	(7,194)	(12,045)	(12,298)	(12,556)	(12,820)
	Savings to 2016/17 in line with previous MTFP	(2,145)	(1,804)	0	0	0
	Underlying future savings requirement (Funding Gap)	0	0	(5,187)	(8,035)	(10,091)
		0	0	0	0	0

**MEDIUM TERM FINANCIAL PLAN WITH 3.3% SAVINGS STRATEGY APPLIED****APPENDIX B**

<b>Shetland Islands Council</b>		<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5</b>
<b>Medium Term Financial Plan 2015/16-2020/21</b>		<b>2015/16</b>	<b>2016/17</b>	<b>2017/18</b>	<b>2018/19</b>	<b>2019/20</b>
		<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Expenditure	General Fund Service Expenditure	105,774	105,089	103,506	100,119	96,824
	Other Account Recharges	(1,999)	(2,029)	(2,059)	(2,090)	(2,121)
	Capital Financing Costs	1,256	1,256	1,256	1,256	1,256
	Recurring Budget Pressures	3,162	7,187	10,223	11,980	14,988
	Non-Recurring Contingency Provision	3,612	3,000	3,000	3,000	3,000
<b>Total General Fund Service Expenditure</b>		<b>111,805</b>	<b>114,503</b>	<b>115,926</b>	<b>114,265</b>	<b>113,948</b>
Trading income	Shetland Gas Plant Income	(1,349)	(693)	(847)	(1,121)	(1,601)
	Harbour Account Surplus	(6,382)	(5,417)	(5,072)	(4,856)	(5,470)
	Economic Development Investments Income	0	(800)	(800)	(800)	(800)
	<b>Total Trading Income</b>	<b>(7,731)</b>	<b>(6,910)</b>	<b>(6,719)</b>	<b>(6,777)</b>	<b>(8,044)</b>
Core Funding	GRG & NNDR	(86,314)	(85,239)	(83,132)	(81,629)	(81,127)
	Council Tax	(8,421)	(8,505)	(8,590)	(8,676)	(8,763)
	<b>Total Core Revenue Funding</b>	<b>(94,735)</b>	<b>(93,744)</b>	<b>(91,722)</b>	<b>(90,305)</b>	<b>(89,890)</b>
		9,339	13,849	17,485	17,183	16,187
Deficit Funding	<b>Financed by:</b>					
	Affordable Draw from Investment Returns	(7,194)	(12,045)	(12,298)	(12,556)	(12,820)
	Savings to 2016/17 in line with previous MTFP	(2,145)	(1,804)	(3,409)	(3,316)	(3,205)
	MTFP Smoothing (Draw from)/Contribution to Reserves	0	0	(1,778)	(1,311)	(161)
		0	0	0	0	0

## APPENDIX C

Shetland Islands Council	Year 1	Year 2	Year 3	Year 4	Year 5
Target Budgets based on 3.3% Saving Annually	2016/17	2017/18	2018/19	2019/20	2020/21
	£'000	£'000	£'000	£'000	£'000
<b>Children's Services</b>		38,496	37,195	35,925	34,697
Adjustments		0	0	0	0
Saving		(1,301)	(1,270)	(1,227)	(1,186)
<b>Target Budget for Financial Year</b>	<b>38,496</b>	<b>37,195</b>	<b>35,925</b>	<b>34,697</b>	<b>33,512</b>
<b>Community Care Services</b>		19,353	18,914	18,290	17,687
Adjustments		200	0	0	0
Saving		(639)	(624)	(604)	(584)
<b>Target Budget for Financial Year</b>	<b>19,353</b>	<b>18,914</b>	<b>18,290</b>	<b>17,687</b>	<b>17,103</b>
<b>Development Services</b>		14,732	14,246	13,776	13,321
Adjustments		0	0	0	0
Saving		(486)	(470)	(455)	(440)
<b>Target Budget for Financial Year</b>	<b>14,732</b>	<b>14,246</b>	<b>13,776</b>	<b>13,321</b>	<b>12,882</b>
<b>Executive and Corporate Services</b>		9,823	9,499	9,185	8,882
Adjustments		0	0	0	0
Saving		(324)	(313)	(303)	(293)
<b>Target Budget for Financial Year</b>	<b>9,823</b>	<b>9,499</b>	<b>9,185</b>	<b>8,882</b>	<b>8,589</b>
<b>Infrastructure Services</b>		19,981	19,322	18,684	18,067
Adjustments		0	0	0	0
Saving		(659)	(638)	(617)	(596)
<b>Target Budget for Financial Year</b>	<b>19,981</b>	<b>19,322</b>	<b>18,684</b>	<b>18,067</b>	<b>17,471</b>
<b>Council Target Savings Annually</b>		<b>(3,409)</b>	<b>(3,316)</b>	<b>(3,205)</b>	<b>(3,098)</b>