Shetland
Islands Council

REPORT

To: **Special Shetland Islands Council** **19 August 2009**

From: **Head of Finance**

Long Term Financial Planning –
COUNCIL RESERVES AND BUDGET STRATEGY, 2010/11 AND BEYOND

Report No: F-025-F

1. INTRODUCTION

1.1 This report looks at the wider implications of the Council's financial circumstances upon its main reserves (Capital Fund, Reserve Fund, Repairs and Renewals Fund) and opens up some policy issues for consideration. It also draws conclusions from that analysis to give direction to the budget exercise for next year (2010/11).

2. BACKGROUND

2.1 The Council's financial policy framework and budget strategy are founded upon its financial circumstances, and should be reviewed (and, if appropriate, amended) when those circumstances change. The key annual milestone that triggers a review is when the key financial facts of the old financial year are known (when performance against budgets is determined, and when a draft balance sheet has been prepared and submitted for audit). That time is now upon us and this report addresses those issues.

2.2 The outturn for the last financial year (2008/09) was reported to the Council on 1 July 2009 (2008/09 – Provisional Financial Outturn, Report F-013-F, (Min Ref 90/09) and The Capital Programme Outturn 2008/09, Report CPSD-11-09-F (Min Ref 91/09)). The Council's Abstract of Accounts 2008/09, including the provisional balance sheet, has been submitted for external audit by the due date of 30 June 2009.

2.3 The detail of these financial outcomes will be summarised in the sections that follow, which deal separately with each of the main accounts and funds of the Council. The main findings, however, are that there was significant under-spending on most fronts, and some examples of greater than expected income, which resulted in drawings upon Council Reserves significantly lower than anticipated. While this was partly offset by the investment returns on those Reserves also being lower than expected (due to the worst financial crisis and economic recession in decades), the Reserves ended 2008/09 some £13 million higher than planned at £280 million.

2.4 £280 million in the Reserves is some £30 million above the £250 million Reserves Floor Policy limit (set in 2005), and some £10 million higher than the Good Case scenario, which was considered when that Policy was established.

2.5 The other key components of financial policy were also more than met in 2008/09. The Council is seeking to reduce its reliance upon the Reserves to support General Fund revenue expenditure to zero over several years (the target was £4 million in 2008/09, but the actual draw on Reserves was only £1.4 million). And the Council policy limit for contributions from the Reserves to fund the General Fund Capital Programme is £20 million per annum (but only £14.3 million had to be drawn from Reserves in 2008/09).

2.6 These favourable financial circumstances from last financial year (2008/09) should be noted with some satisfaction. While some of the under-spending arises from an inability to recruit into some vacancies, and from undesirable delays to some projects, a significant portion of the under-spending arises from officers restraining spending while doing everything possible to maintain high quality public services. There are growing signs that Budget Responsible Officers around the Council are increasingly aware of the Council's financial constraints and policies, and are making a valuable contribution to the achievement of corporate financial objectives. This is very welcome and will hopefully continue into the future. Given the terrible macroeconomic background, the prospect of much less favourable financial settlements from the Scottish Government after 2010/11, and the challenges facing the Council (most notably the challenge of funding the implementation of Single Status), it is extremely helpful that the Council continues to spend within the boundaries of financial policy.

2.7 In the rest of this report the favourable results from last year will be set against the way things are looking in the current financial year (2009/10), and the findings and conclusions which can be drawn from that analysis will then be used to review the financial policy framework and propose budget strategies for next year (2010/11).

3. GENERAL FUND/HARBOUR/RESERVE FUND

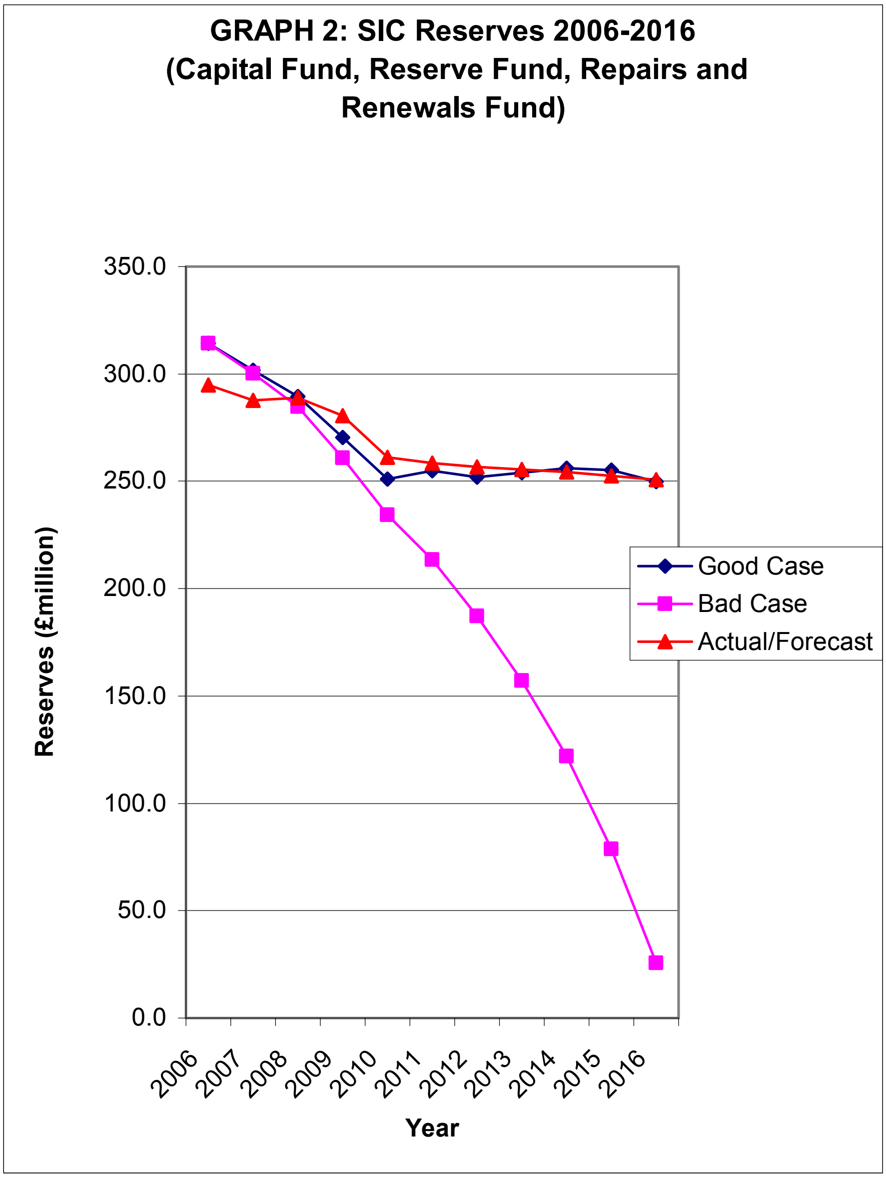
3.1 General Fund Reserves

3.1.1 The Council's General Fund Reserves (primarily the Capital Fund, Reserve Fund, Repairs and Renewals Fund) grew from under £200 million in 1995 to an all time high of £345 million in 2003. Since then the Reserves have declined to £280 million in March 2009. The pattern is shown in Graph 1 below (and the data behind that are set out in Appendix A).

GRAPH 1:
SIC Reserves 1998-2009
(Capital Fund, Reserve Fund, Repairs and Renewals Fund)

3.1.2 This major decline in the Reserves from 2003 is a trend that is completely new in the history of the Council, and was recognised and built into Council financial policy in 2005. The Reserves Floor Policy requires the decline to be halted at a minimum level of Reserves of £250 million, and Graph 1 shows evidence that the decline in the Reserves has been significantly slowed down since the Policy was introduced. The Policy is therefore working, and is having the desired effect.

3.1.3 The Policy requires the Council to continue the good progress of the last few years, and to try to make a soft landing for the Reserves at the minimum figure of £250 million. The current financial model (which covers the period up to 2016), upon which the Council's Long Term Financial Planning is based, suggests that this remains a feasible objective, which is a real and valuable achievement. The current forecast for the Reserves is set out in Graph 2 below (and the data behind that are set out in Appendix B).



3.1.4 Graph 2 shows that from 2006 to 2009 the Council has moved the Reserves above the Bad Case scenario (which was based on no change in Policy in 2005) and the Good Case scenario (which was the foundation for the Reserves Floor Policy set in 2005), and on the assumptions contained in the financial model will go on to achieve the Policy objective of a soft landing for the Reserves at no less than £250 million at 2016. This would be a very satisfactory result, but depends on the assumptions in the model about future spending and income, and upon the Council managing to meet these assumptions in practice. That will be considered in some detail below.

3.2 General Fund/Harbour/Reserve Fund Outturn 2008/09 (Last Year)

3.2.1 The spending programmes which impact upon the General Fund Reserves are General Fund spending, Harbour Account profits, and Reserve Fund direct spending, and these are described below in respect of last year (summarised in and Appendix C). Table 1 below summarises the effects upon the General Fund Reserves.

TABLE 1	2008/09 (Last Year)		
	Planned	Actual	Variance Fav/(Adv)
	£million	£million	£million
GENERAL FUND RESERVES			
Opening Balance at 1 April	(287.6)	(289.0)	1.4
Investment Returns	(19.7)	(13.2)	(6.5)
Net Spending met from Reserves	39.9	21.8	18.1
Closing Balance at 31 March	**(267.4)**	**(280.4)**	**13.0**
Closing Balance (cf Policy Good Case)	**(270.3)**	**(280.4)**	**10.1**
Closing Balance (cf Reserves Floor Policy)	**(250.0)**	**(280.4)**	**30.4**

3.2.2 General Fund net revenue spending from Reserves was only £1.4 million (compared with the policy target of £4.0 million). The origins of the under-spend of £2.6 million were widespread, reflecting the downward pressure on spending which has been achieved around the Council. The biggest areas of under-spending were in Community Care, Children's Services and Education Service, where employee costs budgets were all significantly under-spent. This was partly due to delays in the Montfield Care Home project, but was mainly due to all of these services operating throughout the year well below the budgeted level of employee numbers. Staff turnover, recruitment delays and vacancy levels were the main factors. Despite these challenges the indications are that managers and staff managed to maintain good service delivery throughout the year.

3.2.3 Some might argue that under-spending which is the result of circumstances is not a positive thing, and may in fact be evidence of over-budgeting. While I agree that over-budgeting is to be deplored (it sterilises valuable resources against alternative use) and should be avoided by all Budget Responsible Officers, under-spending against a valid budget (whether forced by circumstances or achieved through efficiencies) is in fact financially valuable for the Council, and all Budget Responsible Officers should be encouraged to seek out opportunities to under-spend and should declare them as early as possible to give the Council the chance to consider alternatives. The Chief Executive is working with the Executive and Heads of Service to develop processes to promote efficiencies and the early declaration of under-spends.

3.2.4 Two Special Items (one-off factors) drew more than expected from the Reserves during last year. The cost of meeting Single Status liabilities was £2.8 million (£0.8 million more than expected, due to difficulties in precisely forecasting these liabilities in advance), and the final deal with the Shetland Charitable Trust to purchase Islesburgh assets was concluded at £4.3 million (£0.3 million above the expected price). However, the other Special Item (a contribution to the SIC Pension Fund to meet the ongoing burden of absorbing Shetland Towage Limited employees into the Pension Fund), which was forecast to cost £4.0 million in 2008/09, did not take place in the year, resulting in a temporary saving to the Reserves.

3.2.5 General Fund Capital Programme spending only required £14.3 million from the Reserves, £5.7 million less than expected. This was partly due to under-spending and slippage on capital projects, but also due to a new General Capital Grant (£2.4 million) from the Scottish Government, together with some unanticipated specific grants and capital receipts. These contributions towards funding the Programme from outside the Reserves are now significant and valuable, and should be reflected in future financial planning.

3.2.6 Harbour Account net income (which is contributed to the Reserve Fund) was £1.1 million more than expected at £3.2 million. This was due to tight expenditure control and better than expected income, notably from Blacksness Pier (some £0.3 million). This favourable result was achieved in adverse circumstances, with traffic through the Port of Sullom Voe in decline, and is therefore particularly noteworthy. The officers concerned deserve considerable credit for this positive achievement.

3.2.7 Reserve Fund spending was £5.8 million less than planned, at £2.2 million. This mainly arose from the one-off absorption of the Shetland Development Trust and its reserves back into the Council.

3.2.8 In summary, all of the above items combined gave a total draw from Reserves of £21.8 million, which was £18.1 million less than the planned level of £39.9 million. In financial terms this is a very beneficial result.

3.2.9 It was particularly fortunate that actions and circumstances combined to give a major under-spend from Reserves in the year, because investment returns were £6.5 million less than planned, due to very poor market conditions (the worst economic crisis in many decades). Results would have been considerably worse, had it not been for the sensible Council policy of valuing its Reserves at Book Value (i.e. at cost of purchase), rather than at current market values (which would currently be much lower). This policy is appropriate for long term financial planning because it is not distorted by short-term fluctuations in markets (either up or down) and is the approved valuation method for local government final accounting.

3.2.10 The combined effects of under-spending from Reserves, offset by the poorer investment returns, left the Reserves at £280 million at 31 March 2009, still some £30 million above the Reserves Floor Policy, and £10 million above the Good Case scenario used by the Council to set the Policy.

3.3 General Fund/Harbour/Reserve Fund Forecast 2009/10 (This Year)

3.3.1 The spending programmes which impact upon the General Fund Reserves are General Fund spending, Harbour Account profits, and Reserve Fund direct spending, and these are described below in respect of this year (and summarised in Appendix C). Table 2 below summarises the effects upon the General Fund Reserves.

TABLE 2

	2009/10 (This Year)		
	Planned	**Actual**	**Variance Fav/(Adv)**
	£million	**£million**	**£million**
GENERAL FUND RESERVES			
Opening Balance at 1 April	(267.4)	(280.4)	13.0
Investment Returns	(18.7)	(19.6)	0.9
Net Spending met from Reserves	30.0	38.9	(8.9)
Closing Balance at 31 March	**(256.1)**	**(261.1)**	**5.0**
Closing Balance (cf Policy Good Case)	**(250.9)**	**(261.1)**	**10.2**
Closing Balance (cf Reserves Floor Policy)	**(250.0)**	**(261.1)**	**11.1**

3.3.2 General Fund net revenue spending from Reserves is forecast to meet the policy target level of £3.0 million this year. The main assumption behind this forecast is that the half-year effect of introducing Single Status in late 2009 (estimated at around £2.0 million) can be met from existing budgets. This depends upon the kind of under-spending seen last year continuing this year, and that officers will continue to vigilantly pursue savings and efficiencies wherever possible (and the initial indications from the first quarter are that this appears to be the case).

3.3.3 Three Special Items (one-off factors) are forecast to draw more than expected from the Reserves during this year. Some of the under-spending last year was in respect of spending which will now happen this year, and on 1 July 2009 the Council approved carry forwards of those commitments which will draw £1.4 million extra from the Reserves this year. The costs of meeting the accumulated liabilities of Single Status up to the point of implementation are now estimated at £6.0 million (which was not provided for in this year's plan, which originally envisaged that implementation would now be in place). The other Special Item (a contribution to the SIC Pension Fund to meet the ongoing burden of absorbing Shetland Towage Limited employees into the Council pension scheme), which was forecast to cost £4.0 million in 2008/09, did not take place in that year, but is now calculated to cost £8.3 million this year. This increase of £4.3 million is a disappointing blow, but stems from an independent actuarial valuation, which takes into account the latest thinking on pension liabilities, pensioner longevity and Pension Fund investment returns. It is, perhaps, some consolation that this cost to the Reserves is in the form of a contribution to another local reserve, and one which will reduce contributions from the Council to the Pension Fund in future, all other things being equal.

3.3.4 General Fund Capital Programme planning allows for £20 million to be drawn from Reserves this year, but given the new General Capital Grant, and a reasonable set of assumptions for specific capital grants and capital receipts, it is now forecast that only £17.2 million will be required from Reserves. Past evidence suggests there may be further improvements on this forecast as the year progresses.

3.3.5 Harbour Account net income (which is contributed to the Reserve Fund) is forecast at the planned level of £4.0 million this year. This will require continued tight expenditure control and continued good income results from Sullom Voe and Blacksness. The initial indications from the first quarter of the year provide grounds for optimism.

3.3.6 Reserve Fund spending is planned at a £7.0 million draw from the Reserves. Predictions in this area are always difficult, because much of the Reserve Fund spending, especially in Economic Development, is demand led and driven by emerging events during the year. Nevertheless, there is a long established pattern of under-spending which gives grounds for confidence that an overspend will not occur.

3.3.7 In summary, all of the above items combined give a total forecast draw from Reserves of £38.9 million, which is £8.9 million above the planned level of £30.0 million (entirely due to Special items costing more than originally anticipated).

3.3.8 It is taken to be the case that the assumed long run real rate of return on investments of 5.0% will be achieved this financial year. This may seem optimistic in the current fraught economic circumstances, but it is always prudent to plan on the basis of the long run assumption unless there are grounds for believing that this long run assumption is no longer valid, and I hold to the view that it is still valid. In addition, it may be that by March 2010 the markets will be pricing in the prospects of future economic recovery, and to some extent this is already evident as I write this in early August 2009 (equity markets are up by over 15% from 31 March 2009 levels).

3.3.9 The combined effects of forecast spending from the Reserves, alongside assumed levels of investment returns, will leave the Reserves at £261 million at 31 March 2010, still some £11 million above the Reserves Floor Policy, and £10 million above the Good Case scenario used by the Council to set the Policy. It should be noted though that the Special Items for this year will bring the Reserves down to quite near the Reserves Floor, which limits future room for manoeuvre within the financial policy framework.

3.3.10 Overall, it is pleasing to be able to report that despite the very unfavourable economic background and the huge challenge of implementing Single Status the Council is managing to operate within its existing financial policy framework in the current year.

3.4 General Fund/Harbour/Reserve Fund Forecast 2010/11 (Next Year)

3.4.1 The spending programmes which impact upon the General Fund Reserves are General Fund spending, Harbour Account profits, and Reserve Fund direct spending, and these are described below in respect of next year (and summarised in Appendix C). Table 3 below summarises the effects upon the General Fund Reserves.

TABLE 3	2010/11 (Next Year)		
	Planned	Actual	Variance Fav/(Adv)
	£million	£million	£million
GENERAL FUND RESERVES			
Opening Balance at 1 April	(256.1)	(261.1)	5.0
Investment Returns	(17.9)	(18.3)	0.4
Net Spending met from Reserves	20.8	20.8	0.0
Closing Balance at 31 March	**(253.2)**	**(258.6)**	**5.4**
Closing Balance (cf Policy Good Case)	**(254.8)**	**(258.6)**	**3.8**
Closing Balance (cf Reserves Floor Policy)	**(250.0)**	**(258.6)**	**8.6**

3.4.2 General Fund net revenue spending from Reserves is forecast to meet the policy target level of £2.0 million next year. The main assumption behind this forecast is that the full year effect of Single Status (estimated at around £4.0 million) can be met from no growth-projected budgets. This depends upon the kind of under-spending seen in recent years continuing next year, and that officers will continue to vigilantly pursue savings and efficiencies wherever possible, and that cost recovery will be successfully pursued after the implementation of Single Status. There is no doubt that this is a challenging assumption, but the alternative to it is to make expenditure cuts elsewhere and/or adjust the financial policy framework. My view is that we should proceed along this ambitious path until there is incontrovertible evidence that it cannot be maintained. Past experience gives grounds for optimism.

3.4.3 There are currently no Special Items (one-off factors) forecast to make a draw from the Reserves during next year. If anything emerges during the budget process then its impact upon policy will then need to be considered.

3.4.4 General Fund Capital Programme planning allows for £15 million to be drawn from Reserves next year (a reduction from £20 million which has been flagged up as part of Council policy for some time now). However, in view of the recently established General Capital Grant, and the continuing pattern of specific grants and capital receipts, I consider it to be prudent to allow for gross spending of up to £20 million on projects next year. In other words, financial circumstances have changed sufficiently to allow General Fund Capital Spending plans to be maintained at £20 million per annum next year, and for the remaining years up to 2016. This is a valuable contribution towards the difficult challenge of balancing the many capital aspirations against available resources.

3.4.5 Another valuable contribution to General Fund Capital Programme planning would be the establishment of a five-year spending Programme (compared to the merely one year Programme which currently exists), which is being actively pursued at present. If this is successfully achieved I would recommend that we move from a one year spending target of £20 million to a five year spending target of £100 million. This provides extra flexibility (allowing one year to be higher or lower than average so long as the average is maintained over five years). This extra planning flexibility would be a valuable dividend from the desirable move to five year planning.

3.4.6 Harbour Account net income (which is contributed to the Reserve Fund) is forecast at the planned level of £4.0 million next year. This will require continued tight expenditure control and continued good income results from Sullom Voe and Blacksness. On the face of it this assumption will be harder and harder to meet as time goes on and existing business streams at Sullom Voe decline further. However, there are some grounds for optimism that new business can be anticipated and developed, and that further efficiencies can be achieved in the Harbour/Towage operations. Managers of the service are actively working at present to make that happen. Again, there is no doubt that this is a challenging assumption, but the alternative to it is to make expenditure cuts elsewhere and/or adjust the financial policy framework. My view is that we should proceed along this ambitious path until there is incontrovertible evidence that it cannot be maintained.

3.4.7 Reserve Fund spending is planned at a £7.8 million draw from the Reserves next year. Predictions in this area are always difficult, because much of the Reserve Fund spending, especially in Economic Development, is demand led and driven by emerging events during the year. Nevertheless, there is a long established pattern of under-spending which gives grounds for confidence that an overspend will not occur. More work will need to be done with Economic Development on this prediction, however, in view of the completion of the process of integrating Shetland Development Trust programmes into the Council.

3.4.8 In summary, all of the above items combined give a total forecast draw from Reserves of £20.8 million next year, which is in line with the level included in long term financial planning.

3.4.9 It is built into the financial model that the long run rate of return on investments of 5.0% will be achieved next financial year. It is always prudent to plan on the basis of the long run assumption unless there are grounds for believing that the long run assumption is no longer valid, and I do not take that view.

3.4.10 The combined effects of forecast spending from the Reserves, alongside assumed levels of investment returns, will leave the Reserves at £259 million at 31 March 2011, still some £9 million above the Reserves Floor Policy, and £4 million above the Good Case scenario used by the Council to set the Policy. It should be noted though that the forecasts for next year bring the Reserves down to quite near the Reserves Floor, which limits future room for manoeuvre within the financial policy framework. Nevertheless, these forecasts indicate that the Council is still on course to maintain its financial policy framework in adverse circumstances, which is a significant achievement.

4. HOUSING REVENUE ACCOUNT

4.1 The Housing Revenue Account drew £1.8 million from the Housing Repairs and Renewals Fund last year (2008/09). This was £0.8 million less than planned, and the Fund ended the year with £10.6 million in Reserve. There was an overspend of £0.6 million on revenue repairs and maintenance to the housing stock, but this was more than offset by an under-spend of £1.3 million on financing costs, mainly on the program of acquisition of additional housing stock which is financed from current revenue. The HRA debt outstanding at 31 March 2009 was £43.7 million, down £16.9 million (28%) from the peak of £60.6 million in March 1997. It is also the case that interest rates are at historically low levels, so the servicing costs on this much-reduced amount of debt are also at historically low levels.

4.2 It is a cause for concern that revenue repairs and maintenance is requiring support from HRA Reserves again, since that obviously diminishes the chance to use those Reserves to support the acquisition of new housing stock, which is a very high priority given the length of the public sector housing waiting list. Besides the costs of revenue repairs and maintenance, the financial prospects for the HRA are relatively benign, and it is therefore timely to consider what might be done about the waiting list problem.

4.3 The big question is what are the available resources, which might be applied to a major programme of public sector housing construction, for which several ideas and projects are under consideration? To be frank, in order to pin down the figure with precision there will need to be more work done between Finance and Housing to clarify all the spending and income prospects and to develop further a Housing Revenue Account financial model equivalent to the one used to assess General Fund prospects. However, given the Reserves in hand (£10.6 million), the fall in debt outstanding (£16.9 million), and the scale of the waiting list problem, it's my view (accepted by Services Committee on 7 May 2009) that Housing should develop project plans for additional housing units of up to £20 million over a five year planning period. While the spending plans are being developed the financial model can be developed in parallel, and both can come together to inform Council decisions in due course.

5. ECONOMIC BACKGROUND TO THE COUNCIL'S BUDGET STRATEGY

5.1 The inflationary background to this budget exercise is the best for many years (with CPI inflation forecast to be below the Government target of 2% for the remainder of this year, and with RPI inflation in negative territory). Inflation pressures look likely to stay depressed for 2010/11.

5.2 The UK is in very deep recession, and while that hasn't affected Shetland to anything like the extent of other areas it is important for the Council to avoid amplifying any recessionary trends by cutting back inappropriately if it can be avoided. It is satisfying, through a combination of good planning, good implementation and good fortune, that there appears to be no pressing need for the Council to cut back on the strategy it has already outlined. It may be a valuable coincidence that the Council should achieve better value for money from continuing its spending plans through a period of low demand, which is constraining market prices.

5.3 The three-year financial settlement for local government was set by the Scottish Government in late 2007, and was very satisfactory for this Council, although much of the extra funding was connected to specific Government spending priorities. The year three (2010/11) figures from that settlement are built into the projections for next year. As yet, no planning has been done to respond to likely reductions in external funding beyond 2010/11, but the continuation of tight expenditure control and of operating within financial policy limits sets the best possible environment in which to meet that challenge in due course.

6. GENERAL FUND/RESERVE FUND BUDGET STRATEGY

6.1 The current strategy for the General Fund revenue budget is to continue to reduce the demand upon the Reserves year on year. The specific targets are to reduce the demand on Reserves to £2 million in 2010/11, and to steadily reduce the demand thereafter, achieving zero in 2012/13.

6.2 The current strategy for the General Fund Capital Programme is to limit the drawings upon Reserves to £20 million per annum, for as long as that can be sustainably supported. Current forecasts suggest that ongoing Capital Programme funding from Reserves should come down to £15.0 million per annum from 2010/11, but that capital spending plans can be maintained at up to £20 million per annum due to the expected contributions from General Capital Grant, specific grants and capital receipts. If the Council is successful in moving from a one year Programme to a five year Programme then the policy should be revised to £100 million of spending plans over five years (with flexibility on the annual totals within that).

6.3 The ongoing Reserve Fund Programmes, which are mainly made up of the Council's contribution to Economic Development, are projected at £7.8 million in 2010/11.

6.4 The strategy should therefore be to ask Budget Responsible Officers to prepare budgets with these targets in view, with any need to increase spending in one area to be met by a corresponding decrease in another area.

7. HARBOUR ACCOUNT BUDGET STRATEGY

7.1 Efficiency savings, especially the potential unlocked by the merger of Harbour and Towage operations, need to be pursued to drive down operating costs at the Port of Sullom Voe. Charging levels also need to be looked at in the context of realistic throughput forecasts from the oil industry. New business needs to be sought from all realistic sources. All of these measures need to be pursued with a view to striking a balance between the viability of the Sullom Voe Terminal and maintaining profitability at the Port.

7.2 The profitability of the Port of Sullom Voe and, increasingly, Blacksness Harbour are very important to the Reserve Fund and the forecast for the Council's Reserves assumes that the current projected level of profitability is maintained through to 2016. If that is not achieved cuts in spending elsewhere will be required to compensate for income shortfalls.

8. HOUSING REVENUE ACCOUNT BUDGET STRATEGY

8.1 The key budgetary objective of the HRA should be to constrain revenue expenditure to the fullest possible extent, in order to liberate resources for the key priority of acquiring and constructing new housing units to help tackle the waiting list problem.

8.2 More work needs to be done on the scale of this problem and the scope to respond to it, but it is provisionally assumed that a programme of £20 million over the next five years should be fundable, and projects should be developed with that figure in mind. Once the financial modelling exercise is concluded that figure can be revisited and revised as appropriate.

9. POLICY AND DELEGATED AUTHORITY AND LINKS TO THE CORPORATE PLAN

9.1 Responsibility for overall budget strategy stands referred to the Council. It is ultimately for Council to consider this report and its recommendations and to decide upon the budget strategies for 2010/11 and beyond.

9.2 The policy direction arising from this report should also provide the foundation for 2010/11 Service Plans, and will be the basis on which Budget Responsible Officers should prepare the 2010/11 budgets.

10. CONCLUSIONS

10.1 The Council did very well last year in managing to reduce its demands upon the Reserves at a time when investment returns were very poor. The early indications are that this positive achievement is continuing in the current year, despite the continuing economic problems and the challenges, which the Council is facing. These favourable outcomes are sufficient to allow the Council to maintain its existing, prudent financial policy framework. That framework is a sound basis on which to proceed, at least until the prospects for the next Scottish Government financial settlement and Viking Energy are known (which should happen in the next 18-24 months).

10.2 The Council's **£250 million Reserve Floor** policy should again be reaffirmed, the prime reason being to provide sustainable future funding for the General Fund Capital Programme and Reserve Fund Programmes. Any reduction in the Reserves Floor would permanently reduce the resources available for these Programmes.

10.3 The target for 2010/11 for use of Reserves is in three parts (£2 million funding for General Fund revenue support, £15 million for the General Fund Capital Programme, £7.8 million for the Reserve Fund Programme). These, which are compatible with the Reserves Floor policy, should be the overall targets for 2010/11, with an increase in use of Reserves in any one area having to be compensated by a reduction in another area. Greater flexibility on funding for the General Fund Capital Programme may be introduced if the Council is successful in moving to a five year spending plan in this area.

10.4 Over the course of the 2010/11 budget exercise, which ends in February 2010, Members will be presented with more detailed information on progress towards those targets.

10.5 The **Harbour Account** should continue to pursue efficiency savings on its operations at Sullom Voe and the other harbours, and should also review charges and pursue new business opportunities with a view to at least maintaining levels of profitability at £4.0 million per annum.

10.6 The **Housing Revenue Account** should minimise the use of HRA Reserves to support revenue spending, thereby maximising the extent to which Reserves can be dedicated to the additional housing stock programme, which should be planned on the assumption of £20 million being available over the next five years.

11 RECOMMENDATIONS

11.1 I therefore recommend that the Council considers this report and:

11.1.1 Reaffirms the existing £250 million Reserve Floor policy (i.e. that Council discretionary Reserves will be maintained at or above that level);

11.1.2 Establishes a limit for drawings on Reserves in 2010/11 of £2 million for General Fund revenue support, £15 million for General Fund Capital Programme support, £7.8 million for Reserve Fund Programme support), with extra flexibility on General Fund Capital Programme support if the Council successfully moves to a five year Programme;

11.1.3 Pursues efficiency savings and appropriate charging levels to at least maintain the level of profitability on the Harbour Account at £4 million per annum;

11.1.4 Minimises revenue spending out of Reserves and maximises investment of Reserves over several years in additional housing stock (starting with a £20 million programme for the next five years, subject to the findings of the forthcoming financial modelling exercise).

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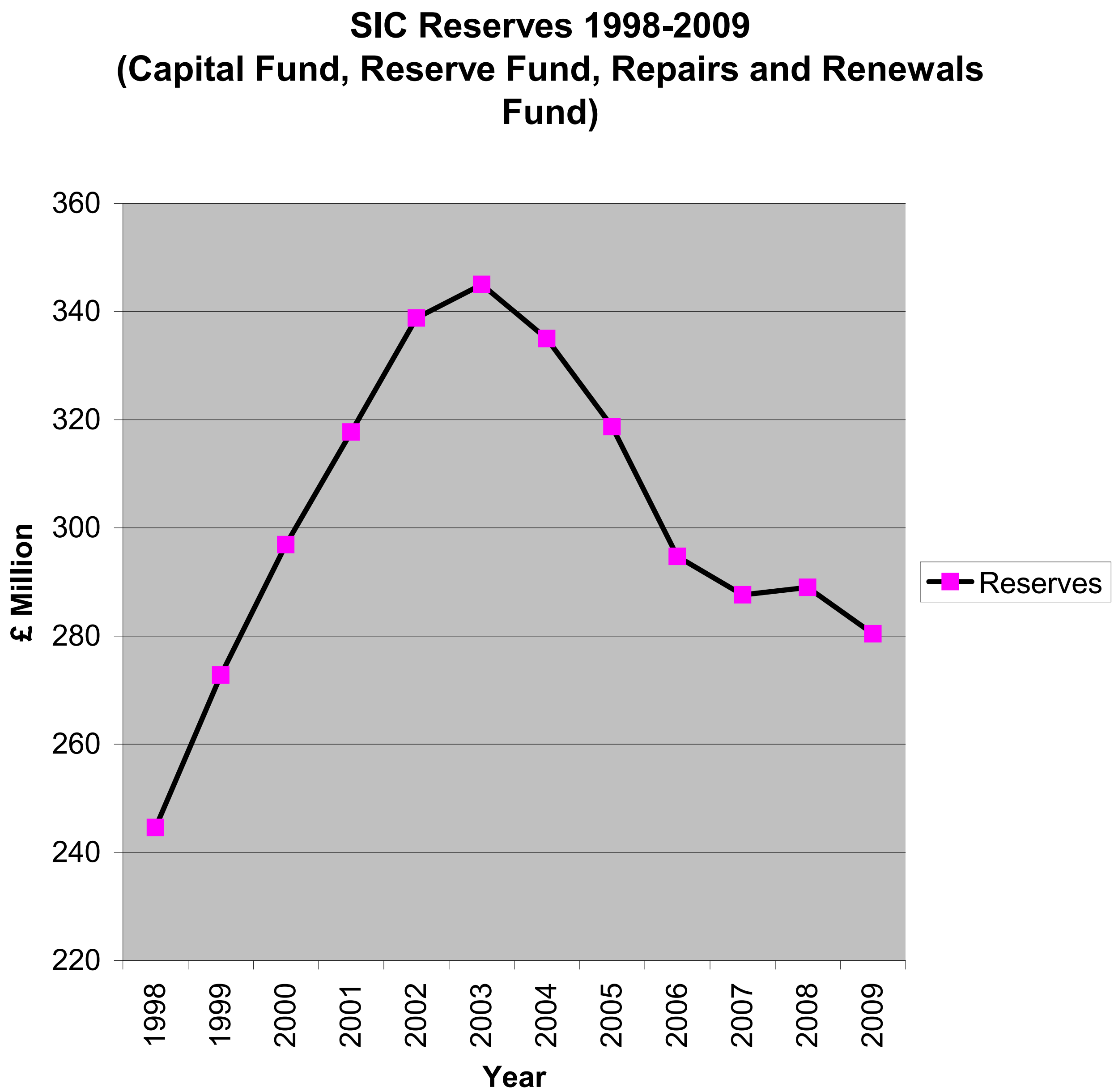
APPENDIX A

Shetland Islands Council Discretionary Reserves

(values on Balance Sheet at cost)

As at 31 March	Capital Fund	Capital Receipts Reserve	Reserve Fund	Repairs & Renewals Fund	TOTAL	Annual Increase	Annual Inflation	Real Annual Growth	All Item RPI (Mar93=100)	Reserve Index (Mar93=100)
	£million	£million	£million	£million	£million	%	%	%	No.	No.
1993	124.8	0.0	36.4	55.4	**216.6**				100.0	100.0
1994	115.9	0.0	34.2	50.5	**200.6**	(7.4)	2.3	(9.7)	102.3	92.6
1995	108.3	0.0	38.3	47.7	**194.3**	(3.1)	3.5	(6.6)	105.9	89.7
1996	107.6	1.6	44.2	44.1	**197.5**	1.6	2.7	(1.1)	108.8	91.2
1997	104.3	27.6	53.4	44.9	**230.2**	16.6	2.6	14.0	111.6	106.3
1998	109.3	23.9	57.6	53.8	**244.6**	6.3	3.5	2.8	115.4	112.9
1999	124.8	23.9	68.4	55.7	**272.8**	11.5	2.1	9.5	117.8	125.9
2000	133.8	27.8	81.2	54.1	**296.9**	8.8	2.6	6.2	120.9	137.1
2001	142.2	28.0	84.2	63.3	**317.7**	7.0	2.3	4.7	123.6	146.7
2002	148.5	21.5	96.9	71.9	**338.8**	6.6	1.3	5.3	125.3	156.4
2003	153.2	13.8	104.0	74.0	**345.0**	1.8	3.1	(1.3)	129.1	159.3
2004	146.8	3.9	108.8	75.5	**335.0**	(2.9)	2.6	(5.5)	132.5	154.7
2005	153.1	0.0	88.7	76.9	**318.7**	(4.9)	3.2	(8.1)	136.8	147.1
2006	126.5	0.0	88.4	79.8	**294.7**	(7.5)	2.2	(9.7)	139.8	136.1
2007	117.7	0.0	84.5	85.4	**287.6**	(2.4)	4.0	(6.4)	145.4	132.8
2008	115.7	0.0	84.1	89.2	**289.0**	0.5	3.6	(3.1)	150.6	133.4
2009	113.7	0.0	84.5	82.2	**280.4**	(3.0)	(0.4)	(2.6)	150.0	129.5

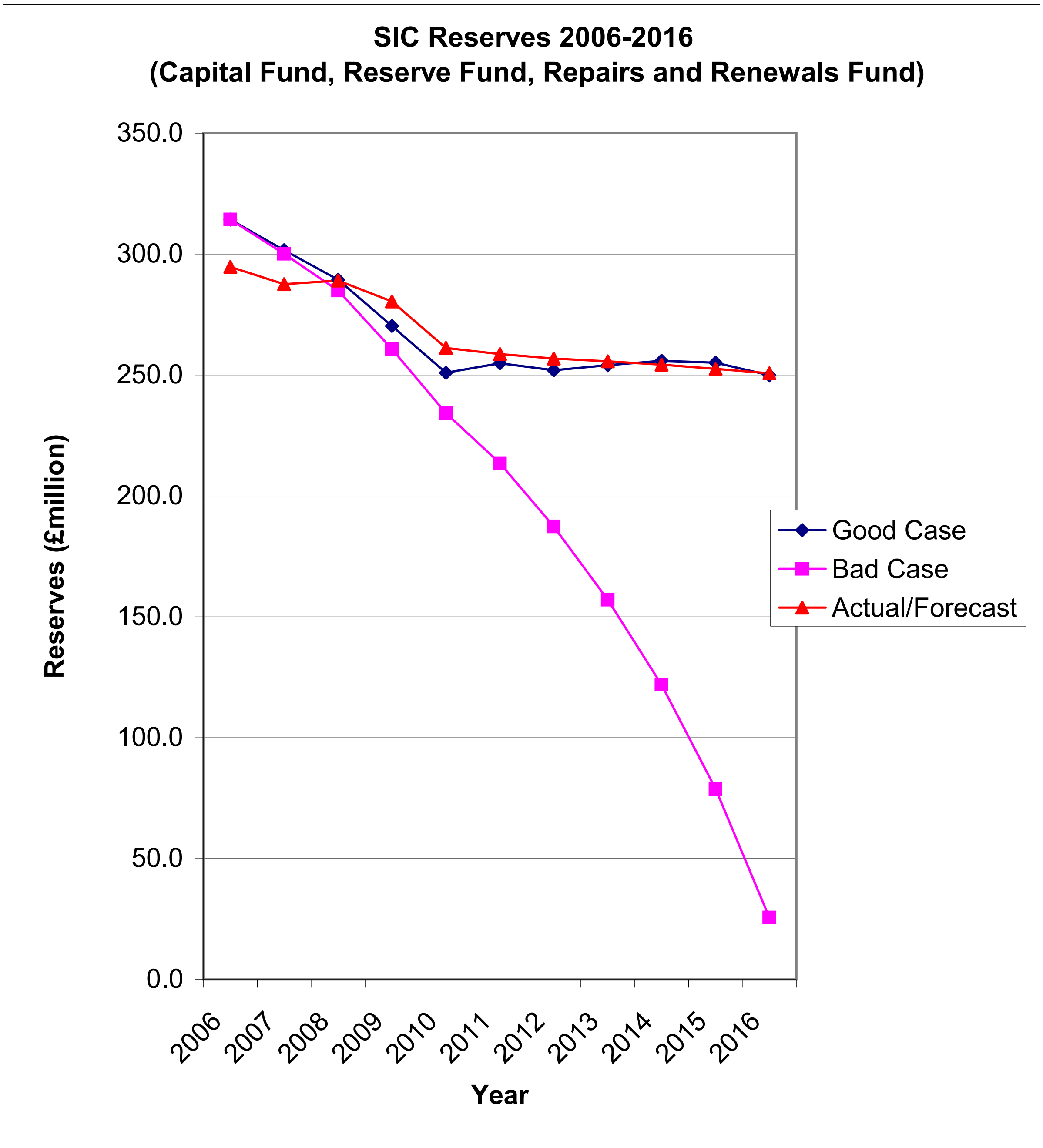


APPENDIX B1

Shetland Islands Council Discretionary Reserves

CURRENT FORECAST (values on Balance Sheet at cost)

As at 31 March	Bad Case	Good Case	Actual/ Forecast
	£million	£million	£million
2006	314.3	314.3	294.7
2007	300.1	301.6	287.6
2008	284.9	289.4	289.0
2009	260.7	270.3	280.4
2010	234.2	250.9	261.1
2011	213.5	254.8	258.6
2012	187.3	252.0	256.8
2013	157.0	254.0	255.6
2014	121.9	255.9	254.2
2015	78.8	255.1	252.6
2016	25.6	249.9	250.6



APPENDIX B2

Shetland Islands Council Discretionary Reserves

(values on Balance Sheet at cost)

Projection: Actual plus Revised Assumptions

As at 31 March	Capital Programme Expenditure (3)	Special Items	Reserve Fund Programme Expenditure	General Fund Revenue Deficit (1)	TOTAL RESERVES (2)
	£million	£million	£million	£million	£million
2005					**(318.7)**
Investment Returns					(16.9)
Harbour Surpluses (4)					(5.2)
Expenditure	14.6	20.1	7.4	4.0	46.1
2006		**(4 ferries)**			**(294.7)**
Investment Returns					(18.6)
Harbour Surpluses (4)					(2.0)
Expenditure	14.5	1.8	7.8	3.6	27.7
2007		**(Single Status)**			**(287.6)**
Investment Returns					(27.4)
Harbour Surpluses (4)					(4.5)
Expenditure	18.5	1.7	7.5	2.8	30.5
2008		**(Single Status)**			**(289.0)**
Investment Returns					***(13.2)***
Harbour Surpluses (4)					***(3.2)***
Expenditure	***14.3***	***7.1***	***2.2***	***1.4***	***25.0***
2009		**(Islesburgh,SS)**			**(280.4)**
Investment Returns					(19.6)
Harbour Surpluses (4)					(4.0)
Expenditure	17.2	15.7	7.0	3.0	42.9
2010		**(STL,SS, c/f)**			**(261.1)**
Investment Returns					(18.3)
Harbour Surpluses (4)					(4.0)
Expenditure	15.0	0.0	7.8	2.0	24.8
2011					**(258.6)**
Investment Returns					(18.1)
Harbour Surpluses (4)					(4.0)
Expenditure	15.0	0.0	8.0	1.0	24.0
2012					**(256.8)**
Investment Returns					(18.0)
Harbour Surpluses (4)					(4.0)
Expenditure	15.0	0.0	8.1	0.0	23.1
2013					**(255.6)**
Investment Returns					(17.9)
Harbour Surpluses (4)					(4.0)
Expenditure	15.0	0.0	8.3	0.0	23.3
2014					**(254.2)**
Investment Returns					(17.8)
Harbour Surpluses (4)					(4.0)
Expenditure	15.0	0.0	8.4	0.0	23.4
2015					**(252.6)**
Investment Returns					(17.7)
Harbour Surpluses (4)					(4.0)
Expenditure	15.0	0.0	8.6	0.0	23.6
2016					**(250.6)**

Notes

Gross Long Term Investment Returns (%)	7.0
Inflation Rate (%)	2.0
Real Investment Return (%)	5.0

(1) SIC policy involves reducing the draw on Reserves to support revenue to £0 by 31 March 2012.
(2) SIC policy is to maintain Reserves at no less than £250 million (the "Reserves Floor").
(3) SIC policy is to allocate £20 million per annum from Reserves to support the Capital Programme.
(4) Harbour surpluses are running well below the normal £8 million per annum at present (mainly due to poor traffic levels through Sullom Voe.

3.

APPENDIX C

Shetland Islands Council

Financial Summary

	2008/09 (Last Year)			2009/10 (This Year)			2010/11 (Next Year)		
	Planned	Actual	Variance Fav/(Adv)	Planned	Forecast	Variance Fav/(Adv)	Planned	Revised Plan	Variance Fav/(Adv)
	£million	£million	£million	£million	£million	£million	£million	£million	£million
GENERAL FUND SPENDING									
Revenue									
Net Spending to be met from Reserves	4.0	1.4	2.6	3.0	3.0	0.0	2.0	2.0	0.0
Special Items									
Carry Forward from Previous Year				0.0	1.4	(1.4)			
Single Status one off costs	2.0	2.8	(0.8)	0.0	6.0	(6.0)			
Islesburgh purchase from Shetland Charitable Trust	4.0	4.3	(0.3)			0.0			
Shetland Towage: contribution to Pension Fund	4.0	0.0	4.0	4.0	8.3	(4.3)			
Capital									
Net Spending to be met from Reserves	20.0	14.3	5.7	20.0	17.2	2.8	15.0	15.0	0.0
HARBOUR ACCOUNT									
Net Income to be contributed to Reserves	(2.1)	(3.2)	1.1	(4.0)	(4.0)	0.0	(4.0)	(4.0)	0.0
RESERVE FUND SPENDING									
Net Spending to be met from Reserves	8.0	2.2	5.8	7.0	7.0	0.0	7.8	7.8	0.0
TOTAL NET SPENDING MET FROM RESERVES	**39.9**	**21.8**	**18.1**	**30.0**	**38.9**	**(8.9)**	**20.8**	**20.8**	**0.0**

GENERAL FUND RESERVES									
Opening Balance at 1 April	(287.6)	(289.0)	1.4	(267.4)	(280.4)	13.0	(256.1)	(261.1)	5.0
Investment Returns	(19.7)	(13.2)	(6.5)	(18.7)	(19.6)	0.9	(17.9)	(18.3)	0.4
Net Spending met from Reserves	39.9	21.8	18.1	30.0	38.9	(8.9)	20.8	20.8	0.0
Closing Balance at 31 March	**(267.4)**	**(280.4)**	**13.0**	**(256.1)**	**(261.1)**	**5.0**	**(253.2)**	**(258.6)**	**5.4**
Closing Balance (cf Policy Good Case)	**(270.3)**	**(280.4)**	**10.1**	**(250.9)**	**(261.1)**	**10.2**	**(254.8)**	**(258.6)**	**3.8**
Closing Balance (cf Reserves Floor Policy)	**(250.0)**	**(280.4)**	**30.4**	**(250.0)**	**(261.1)**	**11.1**	**(250.0)**	**(258.6)**	**8.6**