Appendix 1

Shetland Islands Council

Medium Term Financial Plan

2012-2017

Securing the Best for Shetland

Contents

Purpose

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

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

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

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

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

Benefits of the Plan

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

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

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

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

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

Principles

2.1 The Plan is be based on the following principles:

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

2.2 Each directorate will know its target operating budget for 2013-14 and for the next four years.

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

2.4 Members will have the opportunity to review the spending proposals and options for each directorate prior to the end of 2012, and through a process of continuous assessment be able to adjust budgets at the margins to ensure that Council priorities are properly reflected.

2.5 A budget will be presented to Council in February 2013 which sets out detailed directorate budgets for 2013-14 and indicative budgets for a further four years within the parameters in the Plan.

2.6 The Plan will subsequently be updated to reflect the approved 2013-14 budget and refreshed annually by Members during August/September each year to accommodate any shifts in Council priorities.

Assumptions

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

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

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

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

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

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

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

Budget Carry Forward Scheme

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

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

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

2.16 The conditions around the scheme are:

- A service will only be granted a carry forward if its directorate had delivered its budget. If a directorate was overspent no budget carry forward would be considered.
- The under spend will be carried forward as a non-recurring budget i.e. the service would benefit in the next financial year, but it will not receive the funding in future financial years.
- Services will be required to identify their under spends and make a request for a carry forward at the end of period 9, with a deadline of informing Finance by 15 January each year.
- A carry forward will have to be applied to approved Council service priorities.

External Funding

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

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

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

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

Spend to Save

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

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

2.22 Given the need to make significant savings over the forthcoming years the Plan will make sufficient provision of Spend to Save funds to facilitate the changes necessary to deliver recurring savings.

Context

3.1 The UK is currently in a double-dip recession with GDP (the country's economic output) at the end of June 2012 still 4.62% lower than it was at the beginning of recession in the spring of 2008. This represents the most protracted period of economic decline in over a century, surpassing even the Great Depression of the 1930s.

3.2 Despite the relative strength of the Shetland economy in weathering the global and UK economic situation, Shetland Islands Council's financial situation continues to be adversely affected as a result of the reducing settlement that it receives from the Scottish Government and lower returns from the financial markets on its invested reserves.

3.3 Based on the latest projections, it is likely that it will take longer for the global economy to recover than originally anticipated and, as a result, will probably be beyond the term of the current Council.

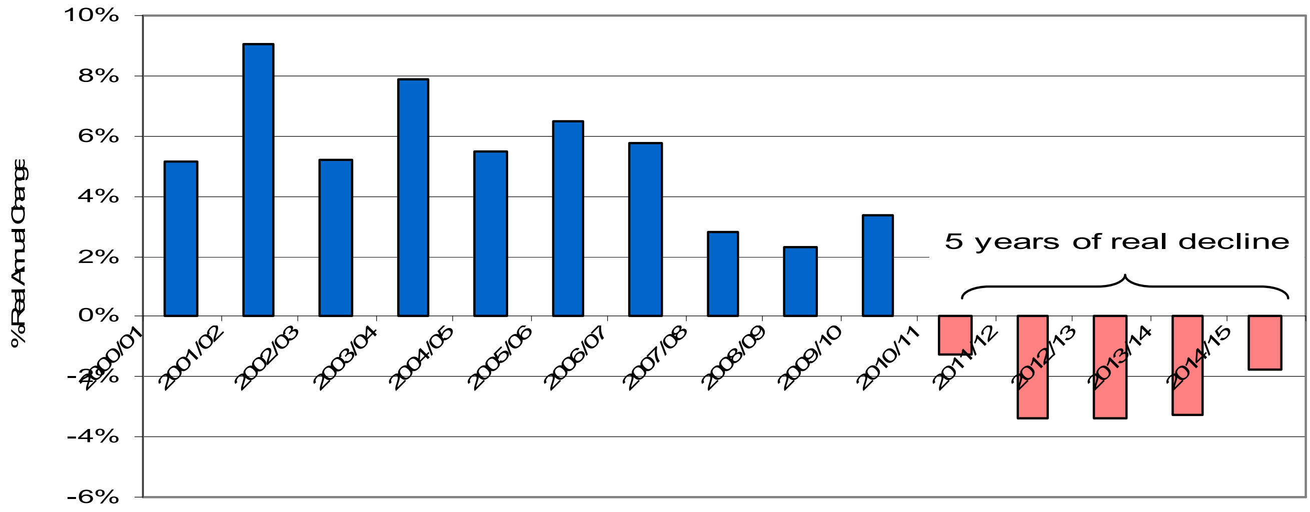
Scottish Government General Revenue Grant

3.4 The General Fund is the biggest part of the Council's activity. It represents all the revenue expenditure incurred across the Council's five directorates: Children's Services, Community Care Services, Corporate Services, Development Services and Infrastructure Services and the Chief Executive's office. General Fund net expenditure is funded from the Scottish Government General Revenue Grant, National Non-Domestic Rates Income and Council Tax. In addition, Shetland Islands Council uses surpluses on the Harbour Account, as well as draws on reserves to fund its General Fund Expenditure

3.5 It is important to recognise that the Scottish Government is responsible for determining the overall level of funding available to the Council from General Revenue Grant and National Non-domestic Rates. Therefore, if there were to be an increase in the level of Non-domestic Rates coming into the Council, there would be a corresponding reduction in the level of General Revenue Grant to ensure the overall funding level didn't change.

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

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



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

3.8 The table below shows the reducing amount of revenue grant support that Shetland Islands Council will receive from the Scottish Government over the forthcoming years:

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

Returns on the Council's Reserves

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

3.10 The long term average return made on these reserves (i.e. the amount earned in interest, dividend payments and increases in the value of stocks and shares held by the SIC) over a period of 20 years has been 5.75% per year. However, given the current global financial crisis it is prudent to reduce the estimated return to 2% in the medium term. With a reserves balance of £125m, this would generate annual income of £2.5m for the Council to spend on core services.

3.11 The forecast reduction in income on reserves from a 5.75% to a 2% return would result in a loss of income of £5.8m per year, based on a reserves level of £193m, which was the balance at the start of the year. This represents a significant loss of income to the Council.

Surpluses Generated from the Harbour Account

3.12 It is anticipated that a combination of reduced income into the Harbour Account as a result of the suspension of the Schiehallion field, and an increased cost base as a result of the requirement to make additional contributions for the next four years to the Pension Fund for ex-Shetland Towage employees, will result in no surplus being generated on the Harbour Account until 2016-17.

3.13 Based on the best knowledge at present, it is expected that surpluses on the Harbour Account will fully recover to the 2011-12 level by 2017-18. Therefore, in the medium term, this represents a loss of income to the Council of approximately £2m to £3m per annum.

Housing Revenue Account

3.14 The financial position of the Housing Revenue Account is a significant challenge for the Council. This is as a result of the need to invest in the current housing stock to meet Scottish Housing Quality Standards targets by 2015 as well as managing the pressure for new build housing to meet a backdrop of having to service (i.e. pay interest) and repay a historic debt on the HRA, which stood at £40.6m on 31 March 2012.

3.15 There is limited scope for the HRA to manage down the debt through increases in rent charges as a result of the fact that Shetland Islands Council already charges between the third and fourth highest rents in Scotland.

3.16 In addition, the Scottish Government has announced its intention to scrap the Housing Support Grant, which has been made available to the Council's HRA to support it in making its interest payments on the debt. This grant was worth £0.761m in 2012-13. Without this grant, Shetland's Council House Tenants will be required to meet the full burden on interest charges on the outstanding debts through increased rents or reduced service levels.

3.17 There is a risk to the HRA around increases in interest rates. At the current level of debt, a 1% increase in interest rates will lead to approximately £0.4m of an increase in costs on the HRA per annum. For tenants of the Council, this would equate to an increase in rents of £4.51 per week, for every 1% increase in the interest rate.

Current Budget Gap

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

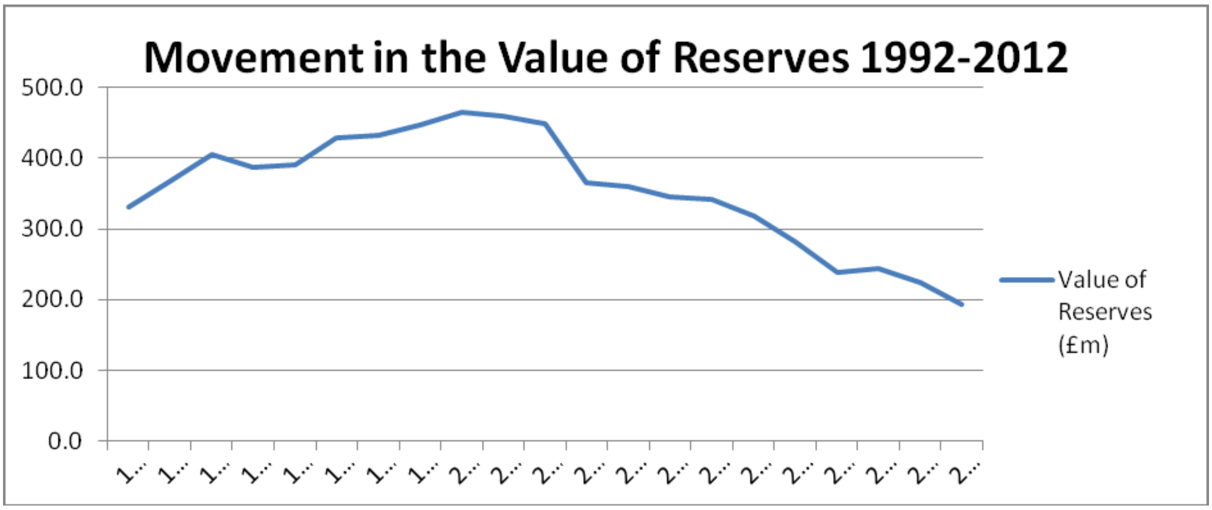
3.19 The table below shows how the total draw on reserves for the year was made up:

2011-12 Draw on Reserves	Actual Draw from/(contribution to) Reserves £m
General Fund	31.803
Housing Revenue Account	0.007
Harbour Account	(2.185)
Total Revenue Draw	**29.625**
Asset Investment Plan	5.945
Total Draw on Reserves in 2011-12	**35.570**

Reserves Levels

3.20 The result of the Council's structural budget deficit is that the reserves have decreased from a value of £465m (in today's prices) in 2000 to the current value of £193m in 2012.

3.21 The table below shows how the value of the Council's reserves (converted into today's prices) has been steadily decreasing for 12 years since 2000:



3.22 In the face of reducing income as explained above, lower returns on reserves and a current structural deficit of £35.6m per year, the Council's reserves will be zero by 2016/17 if no corrective action is taken.

Council Priorities

4.1 Input on extending the horizons of the Councils current short term service plans (one / two years) to medium and longer term service plans (two / five years) has come from a combination of analysis of Members manifestos, interviews with Members and office bearers, the work of management and directorates and the principles of good governance and best value.

4.2 The core themes that have emerged are:

- ***A soundly led and managed Council, living within its means;***
- ***Focused on delivering essential services efficiently and effectively, particularly those critical services for children, the elderly and transport;***
- ***While being mindful of how change could affect the vulnerable and disadvantage;***
- ***Conscious that a healthy economy and strong communities underpin Shetland's long term viability;***
- ***Awareness that we must all work together across the Council and with all our partners to achieve the best results.***

4.3 To lead the remaining stage of matching spending with income, guideline allocations of the overall "Council Target Budget" for each directorate need to be established. Work on historic and current spending patterns, factoring in savings reviews and assessments already underway, looking at typical spending patterns across other Councils, and taking account of Members' priorities expressed in manifestos, meetings and interviews have all been done.

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

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

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

4.7 These service plans will be developed through the planning and budgeting cycle we are about to start, between now and December 2012, and formally reported to Council in February 2013.

4.8 These service plans will describe the proposals and options for service delivery within the "Directorate Target Budgets" and will also provide sufficient information for the Council to make any further adjustments between Directorates or Service areas. That will require information to be provided within the service plans about what higher and lower allocations would deliver (perhaps 5% each way).

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

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

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

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

- Medium Term Financial Strategy Agreed – 20 September 2012
- Directorates' Target Budgets for 2013- 2017 set – 20 September 2012
- Directorate / Service Priority Planning, Detailed Budget Planning and Strategic Risk Analysis – between September/November 2012
- Resourced and Risk Assessed Directorate / Service Plans for 2013 – 2017 communicated to Members – November/December 2012
- Resourced Directorate / Service Plans reported to Committees – January 2013
- Resourced Directorate / Service Plans and detailed 2013-14 Council budget reported to Council – February 2013

Reserves Policy

5.1 The Council has had a long-standing Reserves Policy to have a "floor". This represents the minimum value that the Council is willing to accept on its Reserves. The Council's policy has been to set this at £250m. It was recognised in 2011 that this Policy was set to be breached and therefore this was amended to build the reserves back up to £250m within 10 years (by 2021-22).

5.2 There are two broad measures of the level of reserves held by the Council, one is an accounting measure and one is a cash measure. The table below shows the accounting value of the Council's reserves, as documented in the unaudited Statement of Accounts 2011-12:

Reserves	Opening Balance 1 April 2011 £m	Closing Balance 31 March 2012 £m
Capital Fund	(108.404)	(100.542)
Capital Efficiency/Spend to Save Reserve	(5.000)	(9.096)
Reserve Fund	(61.621)	(57.364)
Repairs & Renewals Fund	(62.900)	(51.576)
General Fund Balance	(3.000)	(3.000)
Revenue Efficiency/Spend to Save Reserve	(0.500)	(0.510)
Potential Contingent Liabilities	(11.400)	(0.849)
Discretionary Reserves	**(252.825)**	**(222.937)**
Marine Superannuation Fund	(2.582)	(2.021)
Pilot Boat Renewal Fund	(0.942)	(0.960)
Housing Repairs & Renewals Fund	(12.035)	(12.259)
Quarry Repairs & Renewals Fund	(0.150)	(0.153)
Insurance Fund	(0.222)	(0.293)
Council Tax Second Homes Receipts	0.000	(0.511)
Hansel Funds	(0.090)	(0.104)
Central Energy Efficiency Fund	(0.052)	(0.043)
Ring Fenced Reserves	**(16.073)**	**(16.344)**
TOTAL	**(268.898)**	**(239.281)**

5.3 The cash measure of the reserves is the value of money that the Council has invested with Fund Managers. This stood at £193.2m at 31 March 2012. The significant difference between the two figures is largely as a result of the accounting figures including money that the Council has already borrowed from itself for Council House building and the purchase of tugs for the Harbour Account.

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

5.5 Under either measure the long-standing policy of £250 million has been breached and, given the scale of the structural deficit that the Council is in, there will be a requirement for further large draws on reserves in the short term. It is therefore unrealistic to believe that the Council's reserves could reach a level of £250m (measured on a cash basis) by 2021-22.

The Value of the Reserves to the Council

5.6 The table below provides an indication of the level of annual returns that would be earned on various reserve floor levels. The medium term annual income level is based on a 2% return and the long term estimated annual income level is based on a 5.75% return, which is the historical average.

Level of Reserves £	Medium Term Estimated Annual Return on Reserves £	Long Term Estimated Annual Return on Reserves £
10,000,000	200,000	575,000
20,000,000	400,000	1,150,000
30,000,000	600,000	1,725,000
40,000,000	800,000	2,300,000
50,000,000	1,000,000	2,875,000
60,000,000	1,200,000	3,450,000
70,000,000	1,400,000	4,025,000
80,000,000	1,600,000	4,600,000
90,000,000	1,800,000	5,175,000
100,000,000	2,000,000	5,750,000
110,000,000	2,200,000	6,325,000
120,000,000	2,400,000	6,900,000
130,000,000	2,600,000	7,475,000
140,000,000	2,800,000	8,050,000
150,000,000	3,000,000	8,625,000

5.7 The table demonstrates the significance of the reserves for generating an income stream for the Council to use on providing services, particularly in the longer term when financial markets should recover.

5.8 For example, in the long term, a minimum level of reserves of £125m, would generate income of £7.2m per annum which could be used to fund services.

5.9 If the Council chooses a policy to fully utilise the reserves, this will cease to be an income stream for the Council.

Medium Term Financial Plan Reserves Policy

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

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

5.12 The Plan sets a Tolerable Reserves Floor of **£125m**, measured on a cash basis. This means that Shetland Islands Council will ensure that it does not let its externally invested reserves drop below this value.

5.13 The Plan, when the reserves stabilise at £125m, is that the Council will only **maintain this level** as opposed to seeking to build the reserves back up.

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

Rationale for Proposed Policy

5.15 The Tolerable Reserves Floor of £125m balances the Council's desire to retain as high a possible level of reserves as can be managed, whilst recognising the need to ensure that the budget gap is managed down in a realistic timescale.

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

5.17 In the medium term, the financial outlook remains challenging, with real increases in grant income from the Scottish Government looking unlikely during the period of this Council. Therefore in order to buffer this lost income, the Council will utilise all returns generated on its reserves in order to sustain as much expenditure as possible. It is for this reason that the Plan sets the sustaining reserves at a level of £125m in the medium term as opposed to a strategy to grow them, by not using the income that they generate.

Investing Council reserves in Economic Development loans

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

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

Asset Investment Plan

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

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

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

6.4 The table below sets out the Asset Investment Plan as it currently exists, showing that the anticipated draw on reserves for 2012-13 is £5.1m.

	2012-13	2013-14	2014-15	2015-16	2016-17
Income					
Government Capital Grant	4,795,000	4,457,000	6,382,000	5,000,000	5,000,000
Projected Capital receipts	500,000	500,000	500,000	500,000	500,000
TOTAL	**5,295,000**	**4,957,000**	**6,882,000**	**5,500,000**	**5,500,000**
Expenditure					
Contractually Committed Expenditure	6,444,247	1,030,000	0	0	0
Maintenance Programme	3,394,350	5,162,000	5,429,000	4,981,000	4,833,000
New Developments (Growth)	510,000	1,790,000	4,345,000	7,356,006	6,321,328
TOTAL	**10,348,597**	**7,982,000**	**9,774,000**	**12,337,006**	**11,154,328**
Budget Gap (ie Draw on Reserves)	**5,053,597**	**3,025,000**	**2,892,000**	**6,837,006**	**5,654,328**

6.5 The table also demonstrates that if the Council adopted a policy of focussing on maintenance only from 2013-14, with a little re-profiling of the programme, it could do so within the existing income that the Council receives from Scottish Government and the sale of assets.

6.6 In essence, the table shows that the draw on reserves for capital expenditure is mainly used to fund the creation of new assets. If the Council adopted a policy of only maintaining existing assets, using only core funding from the Scottish Government and capital receipts, it would save a potential draw on reserves of up to £5.6m per annum.

6.7 This reduction in the capital draw on reserves could be used to offset the level of savings required from revenue, which funds the day to day services.

6.8 The following Asset Investment policy is set in the Plan –

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

6.9 By adopting these policies the Council will reduce the draw on reserves by £5.6m annually which will result in a reduction of cuts to Council revenue services by a corresponding amount.

Harbour Account capital expenditure

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

Housing Revenue Account capital expenditure

6.11 The Housing Revenue Account currently has debt of approximately £40.6m which is unsustainably high. With the abolition of Housing Support Grant, council house rents will be required to service and repay the debt. If interest rates rise this will result in council house rents having to increase or standards of maintenance decreasing.

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

6.13 The Plan is to manage down the level of debt to a sustainable level. Work is currently underway to model the HRA over a 30 year period in order to assess what level of debt is affordable. Once this has been established, a report will be presented to Council proposing steps to address this issue.

Funding for a new Anderson High School

6.14 If Shetland Islands Council is successful in securing government funding for a new Anderson High School then the Council will be required to make a capital contribution to this project.

6.15 At present a figure of £12m has been set aside in the reserves for this cost. However, if the time comes to make this contribution, Members will be asked to commit to the principle of considering external borrowing as a means to fund the project, along with the use of reserves.

6.16 This would involve an assessment as to which option presents best value for the Council.

Housing Revenue Account

7.1 The 22 elected Members of Shetland Islands Council are collectively the largest landlord in Shetland, responsible for the letting and management of 1,772 properties as at 31 March 2012.

7.2 Housing was identified as a key priority in the majority of Members' election manifestos and forms a key constituent part of the Plan.

Accounting treatment

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

7.4 In addition, the HRA can only access its own ring-fenced reserve, which had a balance of £12.259m at 31 March 2012.

7.5 As a result of the limitations on the HRA, it has had to borrow for a significant amount of its capital expenditure which has led to it currently owing the General Fund £40.6m at 31 March 2012. The HRA borrowing from another part of the Council is known as internal borrowing.

Housing Support Grant and Sustainability

7.6 The Scottish Government has announced its intention to scrap the Housing Support Grant, which has been made available to the Council's HRA to support it in making its interest payments on the debt. This grant was worth £0.9m in 2011-12. Without this grant, Shetland's council house tenants will be required to meet the full burden on interest charges on the outstanding debts through increased rents or reduced service levels.

7.7 As a result of the level of debt and the lack of financial support from the Scottish Government the HRA is currently unsustainable.

7.8 Work is still required to negotiate with the Scottish Government for transitional arrangements to taper the impact of the decision to scrap Housing Support Grant.

HRA debt policy

7.9 As discussed in Section 6, the Plan proposes a policy of not taking out any new borrowing against the HRA until the current debt issue has been addressed. Work is currently underway to model the HRA over a 30 year period in order to assess what level of debt is affordable.

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

7.11 If in the future, the Council decided to write off an element of the HRA debt, it would represent an opportunity cost in the sense that a future income stream of interest and debt repayment would be lost.

Revenue spending

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

7.13 The Plan sets a policy of budgeting for no more than a sustainable draw on the Housing Repairs and Renewals Fund in the medium term. In effect, this means drawing no more than 2% of the balance from the reserve in any given financial year.

Harbour Account

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

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

1. To cover any losses on the Harbour Account

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

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

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

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

Anticipated surpluses on the Harbour Account in the medium term

8.4 There are two main factors that will impact adversely over the level of surplus generated by the Harbour Account over the next 4 years:

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

- **Pensions Liability –** The Harbour Account has a pensions funding shortfall of approximately £8m as a result of the transfer of Shetland Towage employees to the Council. It had been agreed by the previous Council that this would be funded by a transfer from the Harbour Account to the Pension Fund of approximately £2m per annum for the next 4 financial years.

8.5 As a result of these two factors, the Plan is budgeting for the Harbour Account to make no surplus in each of the next 3 financial years, with a return to surpluses commencing from 2016-17

8.6 Members should note that there is a risk that the Harbour Account could operate in deficit at some point over the next 3 years, which would require to be funded from the Reserve Fund.

Reserve Fund Commitments

8.7 The Reserve Fund balance was £ 57.364m at 31 March 2012 and as stated above, its first use is to sustain the Harbour Account.

8.8 Work is underway to understand the requirements that the Harbour Account will have on the Reserve Fund in the future. Early discussions have estimated the following:

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

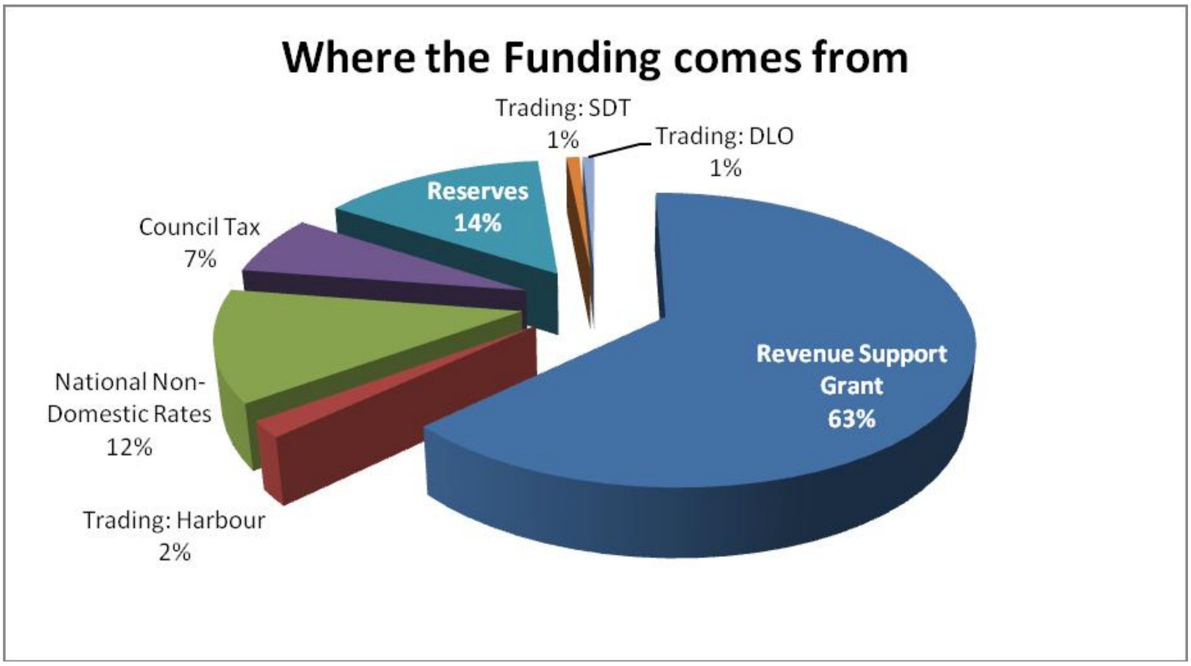
8.9 It has yet to be determined whether the Harbour Account will actually require £39m from the Reserve Fund in future. However, until a final and more certain figure is determined it would be prudent to earmark an amount of £39m within the Reserve Fund for use by the Harbour Account to ensure that it is not utilised on day-to-day Council services.

8.10 As a result the Plan earmarks £39m within the Reserve Fund, as set out above, to provide for potential future spending commitments on the Harbour Account.

Resources

9.1 At present, Shetland Islands Council's general fund receives approximately 75% of its funding from the Scottish Government. This is made up of the core General Revenue Grant and the element of National Non-Domestic Rates that the Scottish Government grants to the Council.

9.2 The pie chart below shows where the funding comes from for the general fund budgeted expenditure in 2012-13:



9.3 The chart highlights the extent to which the General Fund requires reserves to make up the funding package. In order to achieve a fully sustainable financial position, reserves should only make up a maximum of 2.5% of the funding package.

Estimated future resources available to the Council

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

Source of Income	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Scottish Government Core Revenue grant	-75,650	-69,911	-67,440	-66,940	-66,440	-65,940
Non domestic rates	-15,035	-16,177	-17,699	-17,699	-17,699	-17,699
Council Tax	-8,036	-8,529	-8,614	-8,700	-8,787	-8,875
Total Gas Plant Income	0	0	0	0	-2,057	-4,517
Trading (inc Harbour Account)	-4,069	-500	0	0	-1,000	-3,000
Total funding	**-102,790**	**-95,117**	**-93,753**	**-93,339**	**-95,983**	**-100,031**

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

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

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

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

- Based on the latest understanding of when the Total plant will open, it is anticipated that this will provide an income stream to the Council from 2016-17. The level of income budgeted in the model reflects our best estimation of throughput and price of gas at that time. It should be noted that as a result of this, there is a certain level of volatility as to when this income will start to flow into the Council, and the exact amount that it might be.

- It is anticipated that the Harbour Account will fail to make a surplus in 2013-14, 2014-15 and 2015-16 as a result of falling income levels and increased costs. However, the model budgets for a recovery in 2016-17, with a surplus of £1m, rising to £3m in 2017-18 once the towage pension liability has been paid off.

Business Rates Incentivisation Scheme

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

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

Cost Pressures

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

10.2 It is anticipated that there will be significant cost pressures in 2013-14, with an allowance of £3.095m being budgeted to account for these.

10.3 The table below sets out the recurring cost pressures that have been considered for the 2013-14 budget, and the level of provision made for each:

Cost Pressure	Quant-ification	Description	Allowance for Cost Pressure in 2013-14 budget (£)
Pay Award	1%	It is anticipated that there will be a pay award of 1% in 2013-14.	£951,000
Pension Auto-enrolment	10% opt out	A change in legislation means that all staff members will automatically be enrolled in one of the Council's pension schemes as opposed to actively having to seek membership. Staff will in future have to actively seek to opt out. As a result of this it is anticipated that only 10% will opt out, pushing up costs, as currently a significant number of part time/casual workers are not members of a pension scheme.	£1,673,000
Demographic Pressures	2.6%	Based on the rate of Shetland's ageing population, it is anticipated that there will be extra demand on Community Care resources.	£260,000
Utilities	6%	Anticipated level of increase during 2013-14.	£211,000
Council Tax Benefit Administration	£23m nationally	It is not yet known what the formula will be for dividing this across all Scottish local authorities, but it is not considered significant. Therefore no allowance has been created.	£0
General Inflation	2%-3%	It is anticipated that inflation will fluctuate between 2% and 3% in 2013-14. No allowance has been made, as corporate procurement efficiencies should off-set this pressure.	£0
Fuel Inflation	0%	There is no evidence to suggest that fuel prices, which are already at a historically high level, will continue to increase during 2013-14.	£0
Contract Inflation	0%	The most significant element relates to the bus contracts, but given new contracts will be in place for 2013-14, it is not anticipated that there will be significant contract inflation during the year. Any other contract inflation will have to be managed within existing budgets.	£0
TOTAL			**£3,095,000**

10.4 An allowance of 2% has been made for budget pressures in all future years covered by the Plan. This reflects the fact that the largest cost to the Council is salaries, and it is anticipated that there will be only modest pay awards in the medium term. In addition, general inflation is forecast to settle at around 2% in the medium term.

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

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

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

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

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

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

Budget Modelling

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

Description	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
	£000s	£000s	£000s	£000s	£000s	£000s
General Fund expenditure before savings	140,828	121,793	113,693	107,984	107,810	108,134
Savings/Gap to be met by directorates	-15,351	-11,195	-7,871	-2,223	-1,720	0
Contingency for savings slippage	3,000	2,799	1,968	556	430	0
Net Recharges out (to other funds - HRA etc)	-5,568	-5,568	-5,568	-5,568	-5,568	-5,568
Budget pressures	0	3,095	2,163	2,048	2,045	2,051
Total General Fund expenditure	**122,909**	**110,924**	**104,384**	**102,797**	**102,996**	**104,618**
Scottish Government Core Revenue grant	-75,650	-69,911	-67,440	-66,940	-66,440	-65,940
Non domestic rates	-15,035	-16,177	-17,699	-17,699	-17,699	-17,699
Council Tax	-8,036	-8,529	-8,614	-8,700	-8,787	-8,875
Total Gas Plant Income	0	0	0	0	-2,057	-4,517
Trading (inc Harbour Account)	-4,069	-500	0	0	-1,000	-3,000
Total funding	**-102,790**	**-95,117**	**-93,753**	**-93,339**	**-95,983**	**-100,031**
Budget gap on General Fund (Total expenditure less total funding)	**20,119**	**15,807**	**10,631**	**9,458**	**7,013**	**4,586**
Opening Reserves Balance 1 April	**193,170**	**163,437**	**151,149**	**144,042**	**139,215**	**125,236**
Add: Return on Investment (interest, dividends, increase in share price etc)	3,863	3,269	3,023	2,881	2,784	2,505
Add: Repayment of Internal Borrowing (HRA and Harbour)	3,327	3,000	3,000	3,000	3,000	3,000
Fund Manager fees	-753	-637	-590	-563	-545	-491
Spend to Save	-1,372	-2,000	-1,750	-500	0	0
One-off Budget Adjustments 2012-13	-9,628	0	0	0	0	0
Less: Capital draw on reserves	-5,054	0	0	0	-12,000	0
Less: Budget gap required to be funded from reserves (as per above)	-20,119	-15,807	-10,631	-9,458	-7,013	-4,586
Closing Reserves Balance at 31 March	**163,434**	**151,259**	**144,313**	**139,679**	**125,915**	**126,356**
In Year Draw on Reserves	**-36,923**	**-18,557**	**-13,131**	**-10,708**	**-19,763**	**-5,336**

11.2 The purpose of the model is to set out the level of expenditure that is affordable each year, based on the total funding available and a desire to ensure that the Council's reserves stabilise at £125m.

Assumptions

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

Total General Fund expenditure

- A sum of £3.864m will be removed from general fund expenditure and the same sum removed from the Scottish Government core revenue grant from 2013-14 to reflect the fact that Police and Fire services will be operated at a national level.

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

Description	Amount £m
2013-14 General Fund expenditure before savings	121.793
Less: 2013-14 savings	-11.195
Add: 2013-14 Budget pressures	3.095
2014-15 General Fund expenditure before savings	**113.693**

- An in-year contingency for slippage in the delivery of savings has been included for each year where there is a savings requirement. For the current 2012-13 financial year, the figure has been set at £3m based on a quarter 1 projection of the overall shortfall in the delivery of savings. In subsequent years, an allowance of 25% of the overall savings target has been included. It should be noted that this assumes that any savings shortfall in a given financial year will be made up in full in the following financial year ie it is purely a timing difference.

- An allowance for budget pressures has been built into the model. In 2013-14 this figure has been calculated as £3.095m. In subsequent years, this has been calculated at 2% of the in-year General Fund expenditure before savings figure. Further details of these calculations have been discussed in section 10 of the Plan.

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

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

- An assumption has been made that the £3m of savings arising from the implementation of the Blueprint for Education will not be delivered in 2013-14 as previously indicated, and as a result, the savings target has been reduced from £14.195m to £11.195m. Instead the savings arising from the Blueprint for Education have been profiled to be delivered over 2014-15, 2015-16 and 2016-17 as set out in the Blueprint report, and the total savings delivered will now total £3.558m.

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

Total funding

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

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

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

- Based on the latest understanding of when the Total plant will open, it is anticipated that this will provide an income stream to the Council from 2016-17. The level of income budgeted in the model reflects our best estimation of throughput and price of gas at that time. It should be noted that, as a result of this, there is a certain level of volatility as to when this income will start to flow into the Council, and the exact amount that it might be.

- It is anticipated that the Harbour Account will fail to make a surplus in 2013-14, 2014-15 and 2015-16 as a result of falling income levels and increased costs. However, the model budgets for a recovery in 2016-17, with a surplus of £1m, rising to £3m in 2017-18 once the towage pension liability has been paid off.

Reserves

- The budget model builds in a return on investments of 2% for each financial year covered in the Plan. The long term average return over the past 20 years has been 5.75% but given the global financial crisis, it is prudent to revise this figure down in the medium term. It should be noted that there is a high level of volatility around investment returns, so the actual figure could be considerably higher, or lower in a given year.

- The model budgets for the repayment of internal borrowing from the HRA and Harbour Account, with no new borrowing being granted. If this materialises, then the reserves will be boosted by approximately £3m per year in the medium term. In order to minimise the level of cuts required in these challenging economic times, the model utilises the repayment of debt to fund General Fund services over the medium term.

- After 2012-13, the only draw on reserves budgeted for capital spend is a figure of £12m for a new Anderson High School. It is assumed that apart from this item, all capital expenditure will be funded from core government capital grant and the receipts from the sale of assets.

Summary

11.4 In summary, over the course of the Plan it is anticipated that the reserves will generate income of approximately £36m and the total draws on reserves will total £104m, meaning a net reduction of £68m from £193m to £125m.

11.5 If this Plan is delivered, the Council will retain a level of reserves of £125m and will have achieved a financially sustainable position.

Addressing the Budget Gap

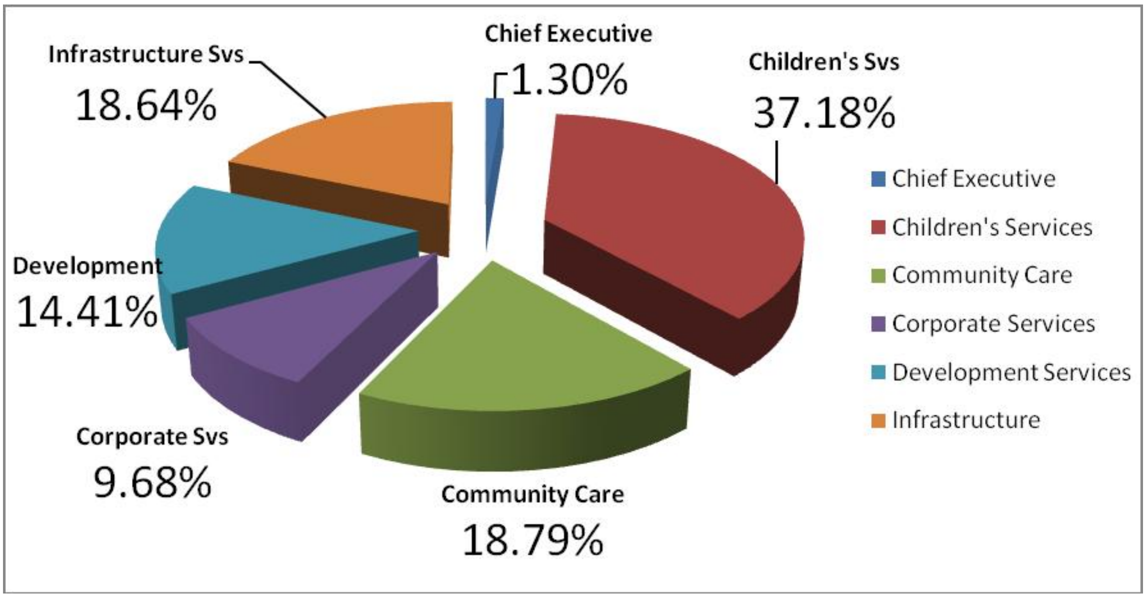
12.1 Based on the modelling performed in Section 11, the budget gap for the next 5 years is as follows:

Description	2012-13 £000s	2013-14 £000s	2014-15 £000s	2015-16 £000s	2016-17 £000s	2017-18 £000s
Gap to be met by directorates	15,351	11,195	7,871	2,223	1,720	0

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

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

12.4 The budget set on 9 February 2012 allocated the General Fund budget between the directorates (excluding Police and Fire) as follows:



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

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

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

12.8 Based on a broad understanding of Members' priorities the Plan seeks to protect Children's Services and Community Care Services and Infrastructure Services. Members also expressed a desire to ensure that there were sufficient resources available to run a well managed organisation.

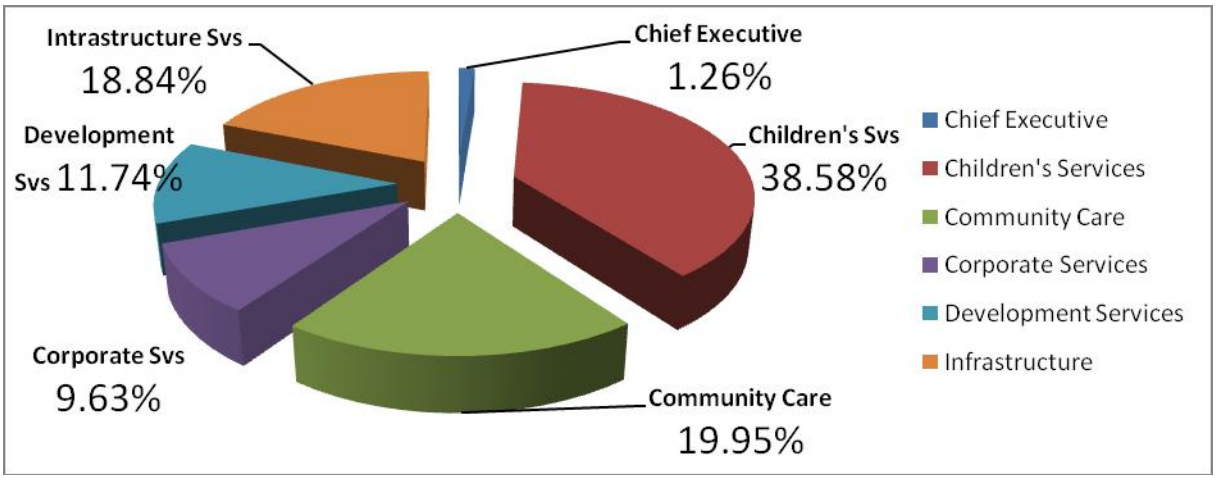
12.9 By applying these priorities, working within available resources and applying a 2% efficiency target for each directorate that is not specifically targeted, the following Target Operating Budgets and associated budget gaps are proposed for each directorate:

2012-13 £000s	Directorate		2013-14 £000s	2014-15 £000s	2015-16 £000s	2016-17 £000s	2017-18 £000s
1,586	**Chief Executive**	**Target Operating Budget**	**1,456**	**1,331**	**1,246**	**1,246**	**1,246**
		Budget gap	(130)	(125)	(85)	0	0
45,278	**Children's Services**	**Target Operating Budget**	**41,382**	**40,542**	**39,827**	**38,107**	**38,107**
		Budget gap	(3,896)	(840)	(715)	(1,720)	0
22,886	**Community Care Services**	**Target Operating Budget**	**20,524**	**20,114**	**19,711**	**19,711**	**19,711**
		Budget gap	(2,362)	(410)	(402)	0	0
11,791	**Corporate Services**	**Target Operating Budget**	**10,760**	**9,810**	**9,510**	**9,510**	**9,510**
		Budget gap	(1,031)	(950)	(300)	0	0
17,545	**Development Services**	**Target Operating Budget**	**15,588**	**11,942**	**11,601**	**11,601**	**11,601**
		Budget gap	(1,957)	(3,646)	(341)	0	0
22,707	**Infrastructure Services**	**Target Operating Budget**	**20,888**	**18,988**	**18,608**	**18,608**	**18,608**
		Budget gap	(1,819)	(1,900)	(380)	0	0

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

	2013-14 £000s	2014-15 £000s	2015-16 £000s	2016-17 £000s	2017-18 £000s
Chief Executive	1,456	1,331	1,246	1,246	1,246
Children's Services	41,382	40,542	39,827	38,107	38,107
Community Care Services	20,524	20,114	19,711	19,711	19,711
Corporate Services	10,760	9,810	9,510	9,510	9,510
Development Services	15,588	11,942	11,601	11,601	11,601
Infrastructure Services	20,888	18,988	18,608	18,608	18,608
Cumulative cost pressures	3,095	5,258	7,306	9,351	11,402
Total directorate budgets	**113,693**	**107,985**	**107,809**	**108,134**	**110,185**
Slippage	2,799	1,968	556	430	0
Total Spending	116,492	109,953	108,365	108,564	110,185
Less: Recharges Out	(5,568)	(5,568)	(5,568)	(5,568)	(5,568)
TOTAL GENERAL FUND EXPENDITURE	**110,924**	**104,384**	**102,797**	**102,996**	**104,617**

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



Directorate	2012-13 % of General Fund (exc Police and Fire)	2017-18 % of General Fund	Movement in % share of funding between 2012-13 and 2017-18
Chief Executive	1.30%	1.26%	-0.04%
Children's Services	37.18%	38.58%	1.40%
Community Care	18.79%	19.95%	1.16%
Corporate Services	9.68%	9.63%	-0.05%
Development	14.41%	11.74%	-2.66%
Infrastructure	18.64%	18.84%	0.19%
TOTAL	100%	100%	0%

Addressing the budget gap

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

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

12.14 There is an expectation that each directorate will deliver 2% efficiency savings each year prior to identifying any additional savings that may be required.

Fees and Charges

12.15 Shetland Islands Council has budgeted to achieve income of £9.6m from fees and charges levied on customers in 2012-13. This represents a significant amount of income and increasing these charges and creating new charges could make a significant impact on bridging the budget gap within directorates. The table below shows the breakdown of the income:

Category	Amount (£)
Sales	1,524,798
Fees & Charges	6,958,984
Rental Income (excluding Housing)	1,158,631
TOTAL	**9,642,113**

12.16 This means that for every 1% increase in fees, charges and rents, based on the current charging bases, almost £100,000 would be raised.

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

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

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

Council Tax

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

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

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

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

Safeguards and Contingencies

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

13.2 This will be important to Shetland Islands Council, particularly over the next 18 months to ensure that by 31 March 2014, the organisation is clearly working towards its objective of financial sustainability by meeting its set expenditure levels. By that stage, the draw on reserves for the year should be approximately half their current levels, and the 2014-15 budget should include savings that will ensure that general fund spending is getting near to the £100m per annum mark.

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

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

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

Contingency Measures

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

- Taking decisions to make minor alterations to the level of service provision in order to stop the need to recruit to a post;
- Closing the purchase ledger in period 10/11/12 as required (except for essential payments e.g. utilities);
- Centrally close down non-essential budgets;
- Cancel training (with the exception of instances where there was a legal requirement);
- Temporary recruitment freeze (except for essential posts);
- Ban non-contractual overtime
- Stop third party grant payments
- Delaying the commencement of contracts or cancelling them
- Stopping all capital purchases (such as PCs etc)

Safeguarding Measures

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

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

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

Financial Health Check

13.10 The key measures of the financial health check are –

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

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

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

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

Consultation

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

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

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

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

Conclusion

15.1 This Plan sets out the action that needs to be taken in order to ensure that the Council achieves a financially sustainable budget. In doing so, it will safeguard the future service provision, ensuring that there are reserves available to sustain an enhanced level of public services in Shetland.

15.2 The Plan follows on from the work already undertaken that resulted in the 2012-13 budget being approved on 9 February 2012, which included a savings requirement of £15.4m for the year.

15.3 Whilst work is progressing well towards delivering the 2012-13 budget, there are still significant challenges ahead for the public sector in Scotland. It is anticipated that it will take at least another decade before public sector spending levels reach the levels last seen in 2009-10. Given that the Scottish Government core grant forms a significant part of the funding available to Shetland Islands Council, it is not possible for the organisation to be sheltered from the wider financial challenges facing every public sector body in Scotland.

15.4 In addition, the Council's reserves, which have provided a significant income stream to the Council over the past 20 years, are not immune from the global financial crisis. The medium term outlook is that the returns from the reserves will be less than half the long term average, representing a material decrease in income to the Council.

15.5 When taking these two factors together, it is imperative that the Council delivers the recurring savings targets in this Plan if it wishes to retain an acceptable level of reserves into the future.