F-42-23 Appendix 1

MEDIUM-TERM FINANCIAL PLAN

2023-2028

Contents

1. Introduction

This Medium-Term Financial Plan (MTFP) continues to seek to give insight into the challenges faced and is a key component of effective financial planning.

We continue to live in an uncertain world, living with ambiguity caused by global and more local issues. Councils across the UK often operate on the basis of one-year financial settlements from central government. A lack of certainty on future funding is no excuse for not developing medium-term plans. Planning ahead will enable us to navigate the potentially choppy waters ahead more easily and ensure decisions are made with the knowledge of longer-term financial implications.

Our MTFP is a key document in a wider suite of plans and strategy documents, occupying a position between long term strategies and detailed, short term, operational plans. The MTFP attempts to summarise, in one place, a consideration of factors that may affect our Council's financial position over the next five years, aligned with the Scottish Government's Medium Term Financial Strategy period. It brings together a range of assumptions on future income and expenditure which allows us to identify where, and when, we can expect to face financial pressures. This will support discussions on the need to adapt to new ways of working and changes to the way we deliver services.

For ease, we have summarised our key financial planning assumptions in Section 3 of this document, with further detailed information contained in Annexes A-D. In Section 4, we have translated our assumptions and financial modelling into three different scenarios:

- An optimistic, upside scenario,
- A central, most likely scenario, *and*
- A pessimistic, downside scenario.

It is important to note that these scenarios are intended to illustrate the potential impact on the Council's financial position and the scale of the challenge we may face, based on the fiscal environment in which we operate. They should not be treated as a budget, but rather as the baseline against which we should be aiming to demonstrate positive change and progress towards becoming a financially sustainable Council.

Figures in Medium Term forecasts tend to be large and look concerning. This has to be seen in the context of mapping out an uncertain future and it can be seen across all public sector organizations that completion of such exercises generate large deficit figures, not least the Scottish Government itself whose deficit was estimated at £1.9 billion but go on to say 'of course, this gap cannot be allowed to manifest itself in reality.'

The financial forecasts and scenarios that we set out here are primarily focused on revenue spend and the General Fund, which is how we fund day-to-day service delivery. In addition to services funded by the General Fund, we also operate fifteen ports and fifteen harbours across Shetland and manage more than 1700 houses as Shetland's largest social landlord. As required by law, we manage and account for these operations separately from the General Fund, through our Harbour Account and Housing Revenue Account (HRA). We have not included any specific scenario planning for either the Harbour Account or HRA in this document. The HRA operates in the context of a 5 year Strategic Housing Plan. ***<u>We will be working to develop a similar structure for harbour related income</u>*** which is a key aspect for the financial forecast.

Many of the priorities outlined in *Our Ambition* have significant capital and longer-term revenue implications that have not yet been quantified. We have further work to do in translating or linking those ambitions to specific, measurable, achievable, realistic, and time-bound plans. This is essential so that we can improve our medium and longer-term financial planning for both revenue and capital, as part of the actions for the Council to demonstrate it is financially sustainable. Our capital spending plans are shown in the Asset Investment Plan, on a rolling five-year basis, presented each year, alongside our revenue budgets. It is recognized though that some more strategic capital elements would sit out-with this window.

We know we have more work to do to develop a MTFP that shows the pathway to financial sustainability. The purpose of this Plan is to highlight the scale of the challenge facing the Council in advance of the 2024/25 budget-setting process. The MTFP is reliant on the more detailed plans that underpin the delivery of the priorities outlined in *Our Ambition*. To that end, we have to aim to develop a MTFP that is more clearly linked to the transformational activities required to deliver the priorities in *Our Ambition* to enable financial sustainability. This will help ensure we are always looking ahead with due regard for longer-term financial implications in our decision-making and budgeting processes.

There is no way to disguise the fact that the figures presented in this document are stark. And that will come as no surprise to those familiar with our finances. We are not the only Council to face significant financial challenges, but unlike others, forced to accept an annual financial straightjacket, we have been able to tolerate year-on-year funding reductions and growth in our cost base by using our reserves in an unsustainable way. In the plainest possible terms, we still have a huge challenge on our hands if we are to become financially sustainable while focused on delivering all the priorities identified in *Our Ambition*.

Previously we have switched to describing this document as a Medium Term Financial 'Outlook', in part as this was an accurate description of the document, as it lacked elements that would constitute it being a 'Plan'. It is felt that a return to 'Plan' is appropriate and as such that the document contains actions and recommendations consequential to the findings outlined so that this does indeed represent a plan to address key areas felt helpful to improve the position in the future. These can be found in on Page 20.

2. Economic and Fiscal Outlook

We have reviewed a number of sources of analysis and forecast on wider economic matters.

The Fraser of Allander institute describe 'mounting economic pressures from the last year in the shape of high levels of inflation and rising interest rates are continuing to challenge businesses and consumers alike' and that 'outlooks for 2024 and 2025 have worsened in the face of ongoing high inflation.'

They go on to suggest that 'inflation is forecasted to slow slightly towards the end of this year (2023), with the BofE (Bank of England) estimating CPI (Consumer Price Index) of 8.2% in Q3 of 2023, falling to 3.4% by Q2 of 2024, and CPI back to 2% (the BoE target) by 2025. However, this does not mean that prices will start to come down - only they will not be rising as quickly.'

Ernst and Young publish a regular forecast looking at a range of economic drivers. They suggest the 'reversal of last years (2022) energy price shock presents a powerful counter to the headwind of higher interest rates.' Nonetheless they note 'as of June 2023, the retail price of gas and electricity was 110% higher in the UK compared with January 2020, versus rises of 50% in the Eurozone and only 25% in the US.' They also note an interesting phenomenon of 'greedflation' whereby firms exploit 'a narrative of 'unavoidable' increases in prices to expand margins' as an unquantifiable element which might cause unexpected results.

Separately they suggest that 'just as with energy, the food inflation outlook is improving'. Energy and food are important elements as these are unavoidable costs for individuals in our communities, and impact on their well-being, but also represent large elements of costs incurred by the Council as well.

Inflation predictions are similar, with an expectation to 'end this year (2023) at just under 5%, before declining to 2% in late 2024'.

The Bank of England's (BoE) recent report, supporting the most recent rise in base rate from 5.0% to 5.25%, notes 'sharp increases in energy, food and other import prices over the past two years have had second-round effects on domestic prices and wages. These second round effects are likely to take longer to unwind than they did to emerge.'

Another area of interest to the Council is staff costs. The BoE notes that 'the outlook for wage growth is particularly uncertain' but 'given the role that the rise in headline inflation appears to have played in the increase in wage growth, the projected easing in wage growth is consistent with the projected fall in inflation.'

The Office of Budget responsibility (OBR) have a useful paper on fiscal risks and sustainability. This contains a detailed analysis of energy price movements and a consideration of factors in play now that renewable costs have now come into equivalency with increased process for traditional sources.

They note wryly ‘the 2020s are turning out to be a very risky era for public finances. In just three years, they have been hit by the COVID pandemic in early 2020, the energy and cost-of-living crisis from mid-2021, and the sudden interest rate rises in 2022, whose consequence continues to unfold’.

In a separate publication the ‘Economic and Fiscal Outlook’ the OBR suggest the ‘near –term economic downturn is set to be shorter and shallower; medium term output to be higher; and the budget deficit and public debt to be lower. But this reverses only part of the costs of the energy crisis, which are being felt on top of larger costs for the pandemic.’

They indicate that ‘real household disposable income (RHDI) per person – a measure of real living standards- is expected to fall by a cumulative 5.7% over the two financial years 2022/23 and 2023/24…..the largest two year fall since records began in 1956-57.’

Previous versions of the MTFP have stressed the importance of understanding the wider economic and fiscal environment, when developing financial planning assumptions that informed the creation of a MTFP. This included consideration of GDP position, unemployment rates, inflation and Government borrowing. The logic was that performance of the UK economy has a significant effect on UK public finances in the short and medium-term, ultimately affecting the core funding we receive from the Scottish Government. This economic and fiscal context used a range of independent economic forecasts alongside the Scottish Government’s Resource Spending Review to inform the assumptions and financial modelling that underpinned each of the three scenarios that was set out in this MTFP.

However, whilst these elements of analysis are interesting, it is far from conclusive these are meaningful levers. It does not seem likely that this type of analysis ever led to a conclusion that the economic situation was buoyant and Local Authority funding was in a great place. Shetland operates in a somewhat fixed labour market so movement in overall levels of unemployment are less important than the local position. Inflation rates may be increasing or decreasing, but it is the impact on the cost of things being bought by the Council that has the impact on our budgets. The recent reports mentioned previously were noteworthy for their tone of uncertainty permeating throughout. It is therefore not intended to build on these uncertain, external, macro considerations, but rather to focus on the perceived impact closer to home.

The majority of our funding emanates from the Scottish Government, so their documentation is of more immediate relevance to our considerations.

The Scottish Government published Investing in Scotland’s Future: Resource Spending Review on May 2022, which indicated a challenging outlook for the public sector in Scotland.

Funding for Local Government is expected to remain flat in cash terms between 2022/23 and 2025/26, before modestly increasing by £100m in 2026/27.

Since the Resource Spending Review was published in May 2022, further spending reductions were announced in direct response to increased inflation and costs and further reductions were indicated.

Broadly since then, the Scottish Government’s spending power has been eroded because of the effect of inflation, which means the Scottish Government cannot deliver everything it planned to deliver with the same resources.

The Scottish Government published Scotland’s Fiscal Outlook. The Scottish Government’s Medium Term Strategy in May 2023. Of immediate note is a forecast that their forecast is to see CPI inflation will fall rapidly with relative stability between 0 and 2% from 2024 to 2028.

Forecasts are for block grant to increase slightly over the period. There is a reduction in capital funding planned over the next five years. This updated strategy sets out the medium-term fiscal outlook and provides the context for the Scottish Government’s spending decisions in light of a succession of economic shocks, including the COVID pandemic, the war in Ukraine, supply chain frailties and the recent period of high inflation, all driving significant pressures on the economy, society and the public finances.

This latest update indicates an increase in overall funding compared to the Scottish Government medium term Financial Strategy (MTFS) published in May 2022 but this is eroded by the sustained rates of high inflation.

The outlook for the Scottish Government's block grant, together with the Scottish Government's stated spending commitments; the wider economic outlook and increasing demand pressures on public expenditure indicate that the local government settlement in 2024/25 will continue to be challenging.

What does this mean for us?

As a local authority, most of our income comes from Scottish Government through the general revenue grant, non-domestic rates and any ring-fenced funding allocated for specific purposes. We also generate income from local taxpayers, by levying Council Tax and charging for services where this is permitted. So, most of our income is effectively raised from tax receipts in one form or another.

Although the economy is moving back to closer to its pre-pandemic shape, new challenges are to be faced whilst Governments seek to rebalance public finances following inflation and interest rates shocks and addressing the cost-of-living pressures for households and businesses across the country.

Higher inflation effectively means the spending power of public services is less than last year. A flat funding settlement for 3 years equates to funding reductions in real terms because quite simply, the money doesn't go as far as it did last year.

All of this taken together points to yet another challenging fiscal environment for Scotland. And while the Scottish Government has discretion to allocate funding towards national priorities, we expect spending on health to be protected in the current climate. And that will most likely result in less funding for local government in the medium-term. It is also important to see any figures in light of further transfers of functions as figures may present an increasing position but do not reflect functions (and costs) which have been moved in the meantime.

3. Our Financial Planning Assumptions

Trying to predict the future in an uncertain world is a tricky task. As a local authority, we provide a range of public services across Shetland for the benefit of individuals and businesses. Public services are sensitive to changes in the external environment and must be able to adapt to the ever-changing demands of the society we serve, often without the benefit of the certainty of future funding.

To help us plan for a range of possibilities, we have developed a set of assumptions covering different aspects of our income and expenditure. In this section, we explain the key assumptions and describe the variations to those assumptions that apply in the three different scenarios we outline – the central, upside and downside scenarios.

Annex B provides a more concise summary of the assumptions used in each scenario, alongside the predicted financial implications (Annex C) and a financial forecast of income and expenditure (Annex D).

Our Income

In the summary shown at Annex A – part 2, 11 lines of income types are shown. The following attempts to describe each of these and their treatment in the model.

i) Scottish Government funding GRG+NDR

The most significant component of our funding comes from the Scottish Government by way of the general revenue grant (GRG) and a share of national non-domestic rates (NDR). Whilst the LA collects NDR this is contributed into a Scotland wide fund, from which we receive back an income. In our case this is greater than the sum that we collect locally. Collection of rates therefore has no immediate effect on the grant received. The Scottish Government allocates funding to the 32 Scottish Local Authorities via an established distribution methodology, based on a range of different indicators. The total quantum of funding available to local government is not known until the Scottish Government presents its annual budget each year, although it is expected to remain at around £10.6bn until 2025/26. The Local Government Finance Settlement ('the settlement') confirms the allocation to each Local Authority. There remains a commitment from the Scottish Government to provide a multi-year financial settlement to local authorities, which would help provide more certainty for planning purposes, but this has not yet come to fruition. The recent Verity House agreement discussion also promises to establish a less intrusive financial funding approach and a reduction in the use of separate, ring fenced allocations in favour of a more outcomes driven relationship. For the purposes of the plan, and in line with Scottish Government forecasts, income is assumed flat for the period in the central scenario with small increases and decreases for the positive and negative scenarios.

ii) Scottish Government Specific Revenue Grant – ferry Income

Following a successful #MyFerry campaign, the settlement for 2021/22 included the full operating costs of our inter-island ferry services for the first time. Increased pay and price inflation, particularly for staff costs and marine fuel, mean we expect the cost of operating inter-island ferries to remain at £23m in 2024/25, level with 2023/24 but some £5.6m more than the funding we received from the Scottish Government in 2022/23. We have assumed costs (and hence matched grant income) will increase by 4% in future years.

There is a risk, given the pressures on the Scottish Government's own budget, that we may not receive funding to meet the full operating costs in 2024/25, however as this is now relatively well established, the upside scenario assumes the full funding will be received with uplifts in line with cost increases, the downside scenario assumes funding provided in the future is flat at 2023/24 level and central scenario assumes a mid-point.

iii) Council Tax – Charge

As a Local Authority we are obliged to levy a Council Tax on the local population to help pay for public services. Over the years, the Scottish Government has offered funding to Councils in return for freezing Council Tax, or sought to limit increases in Council Tax by imposing a Council Tax Cap. In 2022/23, Councils were given discretion to set Council Tax without any constraints. This Council made the decision to freeze Council Tax in 2021/22 rates, 2022/23 saw a 3% increase and 2023/24 a 4.5% increase was applied in 2023/24.

For planning purposes, the following rates are used for years 2024/25 onward - downside (2%) central (4%) and upside (6%).

Subject to the approval of each annual budget, this would mean the Council Tax bill for an average Band D property would increase from the current rate of £1,261 in 2023/24 by 2027/28 to £1,591 (upside), £1475 (central) or £1365 (downside). It should be noted this is the council tax element only the water and sewerage fees collected on behalf of Scottish water is dealt with separately.

Council Tax – Tax Base

In previous years modest growth of the Council Tax base has been included to reflect the continued development of housing across Shetland and in line with the aspirations of the Local Development Plan. There has been a slowdown in development because of the pandemic during 2020 and 2021. Inflation affecting building material etc. also continues to depress house building efforts in public and private spheres.

The increased level of regulation on homes used for short lets has seem a transition of a number of properties dealt with through rates transferring to Council Tax.

Scottish Government proposals to increase charges on 2nd homes and empty properties may also serve to see homes returned to active usage or through implementation of higher charges, generate additional income.

There would be a logic to reflecting increases in the base but there is also an emerging pattern seeing larger numbers of single person households who receive a discount, so whilst there are increases, decreases are also occurring. For ease the underlying position is left and the annual Council Tax uplift is treated as the only moving part.

The recent, unexpected statement on a Council Tax freeze causes confusion. It is assumed that the freeze will be partly funded so the result will fall into the range proposed.

Fees and Charges

The Council provides a range of services to individuals, businesses, and other organisations. Fees and charges form an important source of income but are also important in helping us achieve our objectives and to help us influence behaviours in support of achieving those objectives.

We do not have complete freedom to charge for all the services we provide. Many services are provided for no direct charge, such as education, domestic refuse collection and street lighting for example, and others are set nationally. We do retain discretion to set fees and charges for a wide range of other services. The provision of all services come at a cost, usually driven by the human resources required to provide those services. Our charging policy seeks to recover the cost of services, which are themselves impacted by external inflationary pressures.
All three scenarios assume that we will continue to increase our fees and charges broadly in line with inflation, to offset the pressures faced by us.

Fees and charges might reasonably reflect the OBR's target Consumer Prices Index (CPI) measure of inflation *plus* an adjustment to reflect the higher costs associated with the procurement and delivery of goods and services in a remote, rural island setting. From a high of 11.1% in October 2022 CPI sits at 6.7%. In previous times fees have not increased at this level. It is also to be noted that our costs are heavily driven by staff costs, so this might be a more meaningful measure in future.

In 2023/24 an increase of 4.9 % was used. It is proposed this stays in place as a default on an ongoing basis, however ***departments will be encouraged to carry out more in depth reviews to agree a strategic position whereby fees cover costs or members are asked to agree a funding strategy that specifies a level of subsidy that is in place from the council.***

In the central and upside scenarios, we assume 4.9%. For the downside scenario, we estimate fees and charges will increase by a lesser amount, 3.0%, meaning the Council bears more of the financial impact of higher inflation in delivering services.

iv) Commercial Income and Interest on balances

The Shetland Gas Plant has been operational for several years and has provided a further income stream based on ground rent and throughput. Previous assumptions regarding future income have proven optimistic over the long-term because of lower-than-expected volumes of gas and lower gas prices, although that trend has been reversed since September 2021 and income in excess of £ 1 million has been seen consistently, with c£1.7 million of income in 2022/23.
The upside model is set at a flat level, at a conservative £1.5 million and the central £1.25 million and downside model at £1.0 million. This might prove to be an optimistic long term forecast as previous years have seen significantly lower income on occasion, but as this seems to be a mix of pessimism and optimism this seems a reasonable position. The long term future of the gas facility also needs to be borne in mind and there is a need to ***develop a forecast for wider Oil and Gas related income, where this is not captured as part of the Harbour analysis.***

v) Other grants

It is a feature of the current environment that funding is fragmented across a bewildering array of grants and funders. Each funder seeks to deliver its specific agenda within wider service provision through application of targeted funds. This phenomenon is hoped to reduce with the meaningful implementation of the Verity House agreement, but the reality remains to be seen. In almost all cases these funds are seen as additionally so they specifically fund an explicit aspect, assuming no change elsewhere, so these funds create equal and opposite additional expenditure. In some cases they actually create a pressure as costs incurred are greater than the funds received. In the immediate period going forward these funds need to receive two elements of review. ***In the first instance each grant should be seen to contribute to the organizational infrastructure required to support them so an agreed % (8%?) should be approved for application to central costs. Further efforts should be taken to apply some of the funding towards costs already incurred in the area, thus reducing the burden on the core budget.*** To this end the upside scenario assumes, on a flat basis, that a 10% element can be used to support existing budgets, downside sees no such utilization and central take a 5% midpoint. Whilst this in effect reduces the impact of existing expenditure for ease of presentation it is treated as an increase in income.

vi) *Specific Grant –AHS*

This is funds received to support Anderson High School costs, this is assumed flat in all scenarios.

vii) *Fish Quota*

An unusual element of funding is the fish quote held by SIC. This is managed on our behalf by LHD and typically brings in an income of between £800K and £1.2 million annually.
These figures are used for the upside and downside models and the central model assumes £1 million.

viii) *Recharges to other funds*

This is an important element, covering charges moving to other funding sources. This normally includes Capital, Housing account and Harbour account. For the first two this represents a charge that relieves the General Fund of costs, albeit at the cost for another element. This will for example include charges for staff costs attributable to capital projects and an increasingly interesting discussion will be around the use of limited staff availability as a key constraint in capital projects, rather than funds going outwith the organization to commercial interests. However this is an early discussion so this area is assumed flat across all scenarios, for the moment.

ix) *Crown Estate*

The Council has been receiving income from Crown Estate as part of an agreed distribution of funds. As with grants above, an attempt needs to occur to address central costs and also additionality, so again the upside scenario assumes, on a flat basis, that a 10% element can be used to support existing budgets, downside sees no such utilization and central take a 5% midpoint. Whilst this in effect reduces the impact of existing expenditure for ease of presentation it is treated as an increase in income.

Other Sources of Income

Ports and Harbours

The Council operates 15 ports and 15 harbours around Shetland. Harbour operations are managed and accounted for through the Harbour Account, which is kept separate from the General Fund, in accordance with the Zetland County Council Act 1974.

The Harbour Account receives no direct public funding, nor can it be subsidised by the General Fund or Council Taxpayers. Instead, harbour operations rely on Harbour Charges which are collected for purpose of managing, maintaining and/or improving harbour services and facilities. Harbour Charges are set annually based on full cost recovery *plus* a return on our investment in ports and harbours. This charging regime ensures the Harbour Account can operate effectively and generate a surplus each year. Any surplus generated is credited to the Harbour Account Reserve Fund and can be utilised by the Council to support General Fund activity.

Previously an annual contribution of £6m was assumed to be made to the General Fund to support public service delivery while ensuring sufficient resources will be held to fund decommissioning activity whenever required. In 2023/24 £18 million was transferred from the Harbour reserve to the general fund to balance the 2023/24 position. Had this not happened then other elements of the reserves would have been used in lieu, as an unsustainable draw on reserves. This causes a pause in the harbour funds contributing to the growth of reserves. The long term future of the harbour and its associated income is also a major element of uncertainty for any future forecast. The 5 year plan referenced above should start to refine future income estimates for the harbour and the Shetland Gas plant.

Investment Income

We are fortunate amongst our peers in that we hold a healthy level of reserves. Our reserves are held as long-term investments, managed by external Fund Managers on our behalf, which provide us with additional income to supplement the funding we receive from other sources.

Our investment strategy is predicated on investments achieving, on average, a return of 7.3% over the long-term. The target return rate of 7.3% has two aims:

i) 'inflation-proofing' - to protect the value of our underlying investments from the effects of inflation. For this 'inflation-proofing' element, we anticipate our underlying investments to grow by 2.1%, on average, over the long term. Whist this rate has been out of line with current levels of inflation it is expected to return to this level.

ii) growth in investments. Growth of 5.2% in the investments over and above that of inflation allows us to 'bank' those returns to supplement our general spending. This is the element of our investment income that we refer to as our 'sustainable draw from reserves'.

Previous plans were predicated on withdrawing circa £14- 15m in each year of this plan without eroding the underlying investment base in a way that would affect future investment returns.

Withdrawing too much from the investments in any one year will reduce the underlying investment base and reduce future investment returns. Positive investment growth of 7.3%, or indeed 5.2%, is not guaranteed and will fluctuate from month to month, and from year to year. We therefore need to limit how much we withdraw so that we protect and maintain the buying power of our underlying investments, so they continue to generate returns for years and decades to come.

All three scenarios outlined in this Outlook assume we will maximise the funding available from investment returns in line with the investment strategy.

There is more discussion of investment income in Annex F.

Our Expenditure

i) Pay

As an organisation that delivers public services, pay is the most significant element of our annual expenditure. Approximately 80% of our net revenue budget is spent on pay every year. Pay across local government is centrally negotiated on behalf of all 32 Scottish Councils. At the time of writing, there is ongoing action for non-teaching staff pay awards for 2023/24 and no clarity on any further pay award proposals covering the period beyond 1 April 2024 for either teaching or non-teaching staff. Typically teaching uplifts are described as fully funded, although this is often not entirely the case, pay awards for non-teaching staff tend to be only partially or entirely unfunded. Broadly, teacher salaries represent 20% of salary costs.

The Distant Islands Allowance (DIA) is paid in addition to a base salary, but forms part of our overall pay bill. The DIA is also negotiated centrally on behalf of all Councils, but separately from the main pay awards for teaching and non-teaching staff. Any increase to the DIA takes effect from 1 October each year. This has increased by c4% annually.

Across all scenarios, we assume parity between pay awards negotiated on behalf of teaching and non-teaching staff.

As inflation starts to drop we would expect pressure on pay award levels to reduce. In the downside model we assume overall costs of 4% which are unfunded (so a 4% increase), in the upside model we assume 4% with all costs fully funded (so a 0% change), and the central model assumes 4% increases with a 2% gap (so a 2% increase). These changes re applied to salary and DIA.

ii) Pensions

Almost all our staff and our elected members are automatically enrolled in a pension scheme:

i. Non-teaching staff are enrolled in the Local

Government Pension Scheme (LGPS) which is administered by us as the local authority.

ii. Teacher's Pension Scheme (STPS) which is administered by the Scottish Public Pensions Agency.
iii. Both the LGPS and STPS are statutory schemes, and we are required to participate as an employer.
iv. Employer contributions and are set by the scheme's respective administering authority. Contribution rates are obviously linked to salaries which are expected to increase, as set out above.

The LGPS scheme that we administer for non-teaching staff was formally valued during 2021 which resulted in increased employer contributions rates being set with effect from 1 April 2022. In the meantime indications are that our fund is now fully funded, due to movements in bond yields which underpin the actuaries calculations.

Employer contribution rates to the STPS are currently 23.0%.

All models assume a static position for STPS contributions from 2023/24.

LGPS contributions expected to remain at 22.0%. The upside scenario takes an optimistic view that our locally administered LGPS scheme will achieve a financial position following the next triennial valuation (in 2023/24) that would allow employer contribution rates to be reduced from 2024/25 onwards. We would estimate this in the upside model as a 4% reduction to 18% (an 18% reduction), downside remaining at 22% and central a 2% reduction to 20% (a 9% reduction). It is noted that pension costs are treated as static against an increasing pay bill which is not correct, but this approach is taken for simplicity.

Pension costs shown relate to prior decisions to reduce fund early retirements.

Other staff costs are assumed flat across the period.

iii) Non-Pay costs

Non-pay inflation covers the impact of inflation on a variety of goods and services that we need to purchase for us to deliver public services.

We have used a general inflation factor to estimate the impact on the costs of administration, premises and property, supplies, services, and transport. The same factor is also applied to 'Fees and Charges' as outlined in the previous section, 4.9%. We use this for the downside model but assume 3.9% and 2.9% for the central and upside models.

Fuel and energy costs are subject to greater volatility. We have now adjusted our previous assumptions across all three scenarios to reflect a significantly different outlook on fuel and energy compared to our previous assumptions. We have applied an additional 1% compared to the other costs to reflect this uncertainty.

Further detail on the inflationary factors applied in each scenario are contained in Annex B.

iv) Unitary charge

The unitary charge relates to the new Anderson High School and the Design, Build, Finance and Maintain (DBFM) agreement. The amount paid each year includes repayment of the building itself plus any associated service charges. Increases in the annual charge are contractual, based on annual indexation rather than general inflation. Previous plans have used 0.5% so this will continue in use for all models.

v) Borrowing

In recent years, our capital grant allocation has averaged circa £5.5m per year, which is used to partially fund maintenance of assets, infrastructure, and our estate. We spend roughly £12m a year to maintain our existing assets, infrastructure, and estate, so we are increasingly reliant on capital receipts, reserves and borrowing where necessary, to fund not only investment in new assets, but also to fund the maintenance of our existing asset base.

The model assumes that repayment of borrowing costs remain static throughout the plan period, for all scenarios. It is however to be noted that elements of previous borrowing are now due for repayment so this has to be reflected. This sees £3 million being repaid in 2024/25 and £8 million being repaid in 2027/28. These lump sum repayments should see interest repayment reduce but these are treated as flat which allows some scope for future borrowing within the period. This leaves £38 million of borrowing yet to be repaid.

Borrowing rates are fixed over the long term so can be seen to be unchanged across the period.

Further detail about our plans for capital investment in 2024/25 will be presented as part of our revenue and capital budgets in the first quarter of 2024.

vi) Contingency

We will maintain a contingency for unforeseen emergency costs at the 2023/24 level of £3.5 million.

vii) Grants to other organizations (including Service Contracts)

This includes grants to other organizations, but also include bus contracts (£2.8 million), air contracts (£1.1 million), Social Care self-directed support (£3.3 million) and £1.1 million for Home energy efficiency schemes. Given the wide diversity of costs here, this has had the standard MTFP uplifts applied.

viii) Contribution to IJB

This is an offset of income and expenses resulting in an overall net income position from the IJB, at budget level. This is maintained as flat throughout all models.

4. Scenario planning

We have developed a financial model that allows us to quantify the financial impact of changes in the external environment over the next four years.

- To illustrate the uncertainty we face, we have used scenario planning to model the impact of the key assumptions, in three different scenarios:
- an optimistic, upside scenario,
- a central, most likely scenario, and,
- a pessimistic, downside scenario.

We have used our 2023/24 budget as the baseline starting position for developing financial forecasts for each scenario, along with the following principles that guide the development of future revenue budgets:

- we will set balanced budgets, as required by law, so we can live within our means,
- a clear policy of restraint where we will continue to utilise *some* of the returns achieved from our long-term investments to supplement core General Fund revenue budgets. We will limit the amount we use each year to a sustainable draw to ensure the longevity of underlying investment base for generations to come,
- the cost of capital, including additional borrowing, will be recognised in revenue budgets, to reflect the recurring cost of servicing debt each year,
- a risk-based approach will be used to manage uncertainty, with a prudent level of contingency held centrally to help mitigate financial pressure that services may face.
- We will develop more detailed plans to facilitate the delivery of priorities identified in *Our Ambition*

The scenarios outlined in this section provide an illustration of the likely financial position over the next four years, on a 'like-for-like' basis that does not factor in any future or planned changes to service provision. The purpose of this is to demonstrate the budgetary deficit we will likely face if we do not change what we do and how we do things.

We have developed two overall summaries. The first (Annex D) show the structural position without any use of harbour income and reserves. This reflects an underlying position if the harbour was to stop functioning (a reality at some point in the future), and we had no access to our income from invested funds. This is part to answer the question of why do we not spend the reserves, and shows the scale of the issue we would face where we attempting to balance our budget with only the Government funds and local income to do so. This is shown at Graph 1 on Page 15.

The second table (Annex E) shows the position assuming receipt of £18 million a year from the harbour and £15 million a year from invested funds. This is the model we use in the subsequent commentary. This is shown at Graph 1 on Page 16.

Even the most optimistic scenario with favourable funding settlements and cost approaches indicates financial pressure each year, with a significant cumulative budgetary deficit building by 2027/28.

The Central Scenario

Our central scenario reflects the most probable outcome, or the mid-case estimate of our likely financial position. Excluding the effect of any major change in service provision, this scenario anticipates an additional £14.0m net revenue expenditure in 2024/25 compared to the 2023/24 baseline starting position, driven by pay and price inflation. We expect some additional funding of £2.0m in available funding, which effectively results in a likely additional financial pressure of £12.0m in 2024/25.

Further financial pressure is expected in subsequent years. If left unaddressed, these pressures translate into annual budgetary deficits which move from £15.7m in 2024/25 to £30.5m by 2027/28. On a cumulative basis, this amounts to £81.3m by 2027/28.

Further detail about the planning assumptions and financial forecasts from this scenario can be found in Annexes A-E.

The Upside Scenario

Our upside scenario reflects an optimistic, or best- case estimate of our likely financial position if these circumstances transpire. Excluding the effect of any major change in service provision, this scenario anticipates an additional £9.8m net revenue expenditure in 2024/25 compared to the baseline starting position. The scenario assumes an increase of available funding of £4.2m over the period. However, a deficit of £5.6m still exists in 2024/25 which represents growth in baseline budgets that we have not managed to address in previous years.

Financial pressure is expected until 2027/28, however this pressure is less than that envisaged in the central scenario. Collectively, this provides some relief to the pressures anticipated in the less optimistic central and downside scenarios.

Over the four year period, the estimated financial pressures translate into annual budgetary deficits which range from £9.3m to £14.5m. On a cumulative basis, this amounts to £30.8m by 2027/28.

Further detail about the planning assumptions and financial forecasts from this scenario can be found in Annexes A-E.

The Downside Scenario

Our downside scenario reflects a pessimistic, worst-case scenario where the cards are stacked against us. Excluding the effect of any major change in service provision, this scenario anticipates an additional £18.2m next revenue expenditure in 2024/25 compared to the baseline starting position. This scenario factors in a pessimistic outlook in terms of income, seeing a reduction of £0.4 million which further intensifies the financial pressure faced by changes in the external environment. The net effect is a likely budgetary deficit of £18.6m in 2024/25.

Further financial pressure is expected in subsequent years. Over the period, the estimated financial pressures translate into annual budgetary deficits of between £22.2m and £51.2m. On a cumulative basis, this totals £135.4m by 2027/28.

Further detail about the planning assumptions and financial forecasts from this scenario can be found in Annexes A-E.

Summary of scenario planning

The scenarios are intended to illustrate a range of possible outcomes, based on an up-to-date interpretation of the external environment and how the economic and fiscal outlook will affect our likely financial position in the future. The charts and tables on the following pages provide a summary of the range of outcomes that we have modelled under each scenario. In particular these separately graph the impact with and without the harbour income in and of themselves reflect an optimistic and pessimistic position. The scenarios are not intended to form a menu, from which we pick and choose the bits we like and ignore the less palatable options. That does not make for effective financial planning.

Setting out a range of different fiscal scenarios in advance will help inform decision-making over the medium term. Prudent decision-making, where decisions are made with a clear understanding of the longer-term financial implications will help us manage our financial position over the medium-term. We can clearly see that we have a huge challenge ahead of us, even in the most optimistic of the scenarios. As we develop our annual budgets in the years to come, we do so with an acute awareness that we need to take action to ensure our financial sustainability in the longer-term.

We also know from '*Our Ambition'* that we have aspirations for a more sustainable Shetland; environmentally, economically, socially, and financially. Having a commitment to community sustainability, will on occasion work contrary to achieving financial sustainability for the Council, so we know there will be challenging decisions when it comes to prioritising our resources.

This document is unable to provide all the answers to the obvious challenge we face. Effective public financial management cannot be achieved in a vacuum, and as mentioned in the introduction, this document is intended to illustrate the scale of challenge in the years ahead.

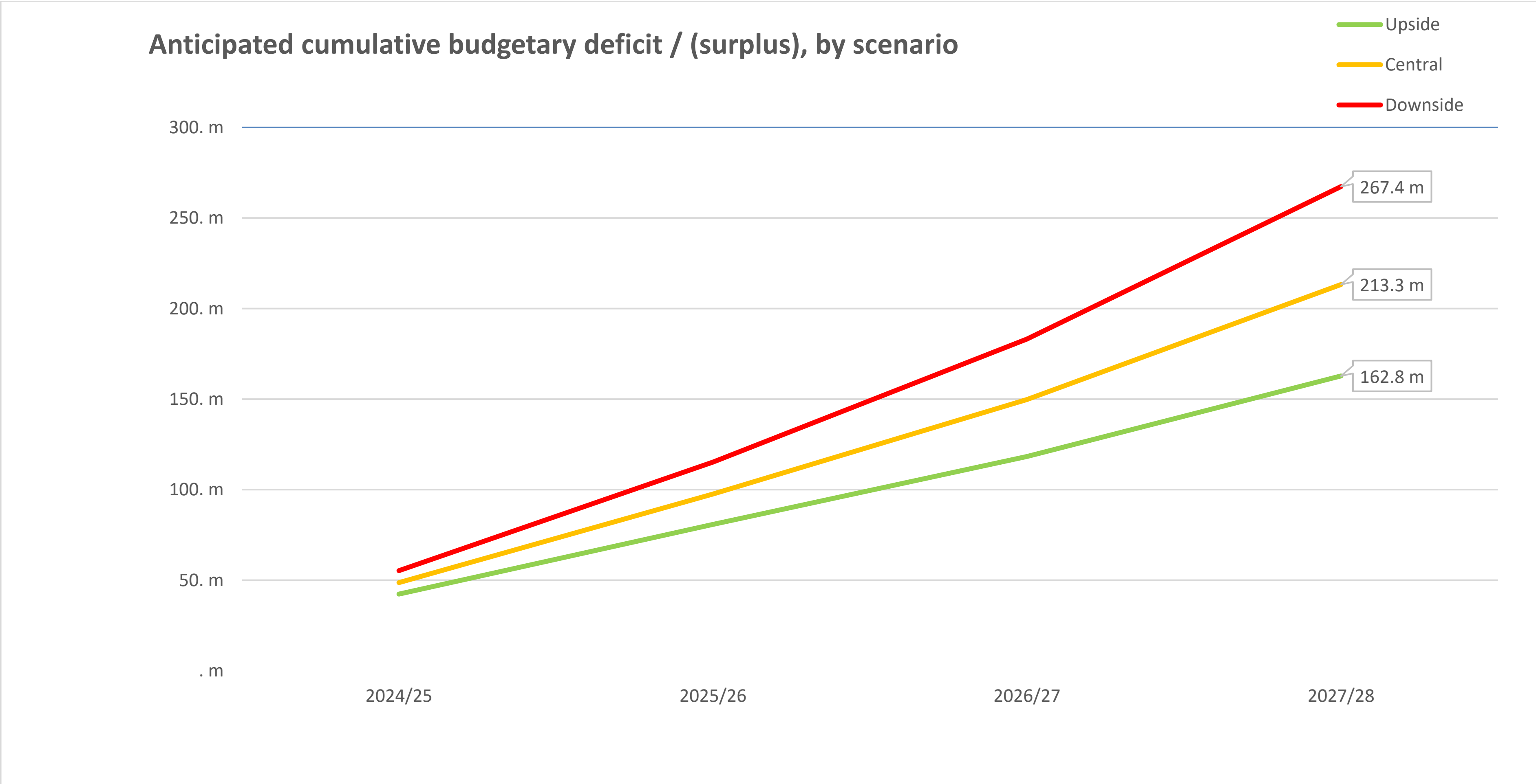
Other Issues

There has been discussion previously regarding a MTFP for ZetTrans. Given the one to one relationship it does not seem necessary that a stand-alone plan is created but ZetTrans does need to have in mind the Council's position when looking at its own and ultimately the challenges faced by the Council finances will impact on ZetTrans in the future.

Previous versions of the MTFP have also considered demographics. This is a relevant issue changes in patterns of young people will drive school services or an aging population will impact on Social Care services. Much as with his document isolated analysis tend to create a concerning picture and in reality these changes happen gradually and so the change is occurring but it happens in small, imperceptible steps. Future MTFP will spends some time looking back at the demographic changes already happened and those foreseen.

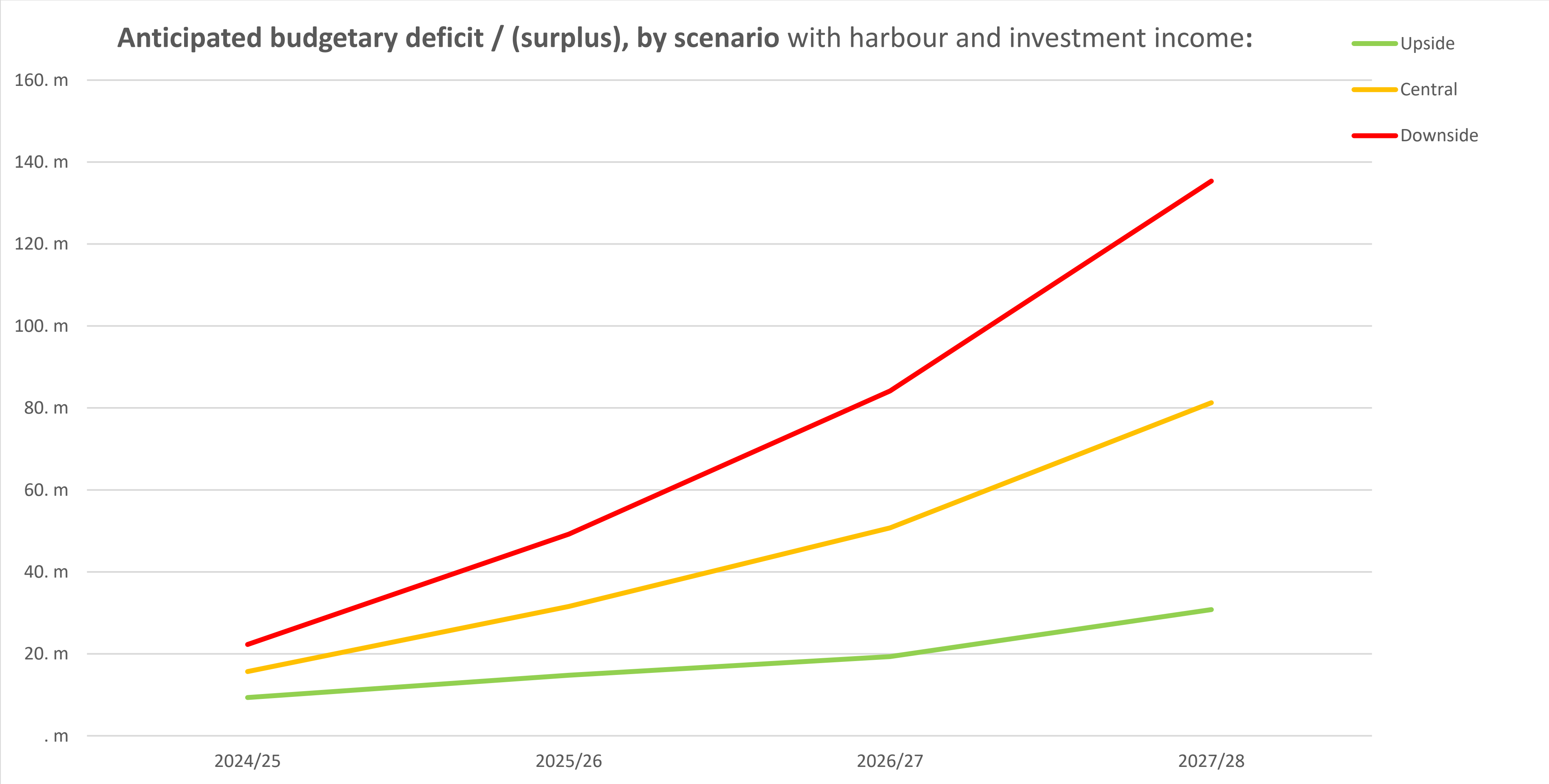
It is also important that MTFP are assessed. Future MTFP will assess the forecasts of prior versions and establish the reality of what was foreseen and what actually occurred. This should bring an element of 'actual' experience to the discussion.

Graph 1 - Anticipated cumulative budgetary deficit / (surplus), by scenario, without harbour income and investment income:



	Scenario	2024/25	2025/26	2026/27	2027/28
Cumulative Budgetary Deficit / (surplus)	**Downside**	55.3 m	115.2 m	183.1 m	267.4 m
	Central	48.7 m	97.6 m	149.7 m	213.3 m
	Upside	42.3 m	80.8 m	118.3 m	162.8 m

Graph 2 Anticipated cumulative budgetary deficit / (surplus), by scenario, assuming harbour income and investment income:



	Scenario	2024/25	2025/26	2026/27	2027/28
Cumulative Budgetary Deficit / (surplus)	**Downside**	22.3 m	49.2 m	84.1 m	135.4 m
	Central	15.7 m	31.6 m	50.7 m	81.3 m
	Upside	9.3 m	14.8 m	19.3 m	30.8 m

5. Next Steps

Our attention in the coming months will be to set our revenue and capital budgets for 2024/25.

Budget-setting 2024/25

We know from experience that adopting a short- term attitude to balance annual budgets on a yearly basis compromised our ability to plan for intelligent and outcomes-focused change to service delivery. We have acknowledged in the past that internal capacity constraints result in us not being able to deliver all the changes we would like to make as quickly as we would like, or that we bring in consultants at a premium which might offset any financial savings we might expect. We are still experiencing difficulties in recruitment which is limiting the ability of services to devote resources to projects without affecting day-to-day service delivery. We need to prioritise which aspects of financial planning and *Our Ambition* we can genuinely focus on with the limited resources we have at our disposal.

We also understand the benefit of investment in early intervention and prevention – despite the inherent difficulty in quantifying the benefits that might flow from targeted investment, to us or even other organisations.

The 2020/21 budget committed to taking action to help us live within our means, by taking advantage of our strong financial position and a short-term use of reserves to support projects that would lead to longer-term reform of public services.

This developed a four-point strategy with the aim to mitigate growing demand for services, increase income streams and reduce cost base and overall expenditure. The strategy included a range of actions planned under 4 broad categories:

1. Investment – actions designed to reduce the need for services and/or reduce the cost of providing services
2. Efficiency – actions designed to reduce the cost of services without changing service levels
3. Commercialisation – actions designed to increase our income
4. Retrenchment – actions designed to reduce our role in providing services.

It remains as critical to embed the four-point strategy during 2024/25 and onwards and commit to delivering tangible, cash-releasing savings as part of future revenue budgets if we are to demonstrate any progress towards aligning our planned expenditure with the likely level of income illustrated by this document. Moreover, our failure to address our longer-term financial sustainability will rightly limit our ability to borrow from the Public Works Loans Board to fund investment in new assets, so the revenue position impacts directly on the capital position.

Links to other plans and strategies

i) '*Our Ambition*'

This strategic plan – which is closely aligned with the Shetland Partnership Plan, sets out our strategic key priorities that we will seek to achieve over the next five years, focuses on delivering better outcomes for Shetland. We need to focus on the priorities that we can genuinely deliver and convert those priorities into Specific, Measurable, Achievable, Relevant and Time-bound (SMART) actions with quantified investments and potential efficiencies and savings that could be made. The Council will need to prioritise which projects to take forward, recognising that it cannot deliver everything in *Our Ambition,* even in the next four years.

ii) Workforce Strategy

This plan is, by its nature, heavily focused on the financial resources that we are likely to have at our disposal over the medium term. Our finances are not the only precious resource we have available. We wouldn't be able to deliver a fraction of the services that we currently deliver without significant human resources – our staff. The Workforce Strategy is effectively the MTFP- equivalent for our people and is focused on making sure that we have the right people in the right the place to deliver our key priorities. The strategy uses three guiding principles to inform future workforce planning:

- the right shape,
- the right skills, and
- the right culture.

The Workforce Strategy was published in December

2020 and was followed by the publication of a more detailed Workforce Plan in September 2021. Annual revenue budgets will reflect changes to workforce planning assumptions and will be factored into future financial planning assumptions once embedded. ***It is important that any plans are underpinned by a clear staffing table that describes the existing staffing in place, both actual and ideal.*** This then provides a benchmark for comparison with future periods and also against which to measure effects of actions taken.

iii) Revenue Budgeting

This plan has focused on the financial implications of a changing fiscal environment on our General Fund net revenue budgets. We pay for all day-to-day services through the General Fund, and this is where we expect to face significant recurrent financial pressure. Our annual budget forms the operational plan for how we expect to manage that ongoing financial pressure. We expect to set our 2024/25 budget in February or March 2024 in line with the approach outlined in the previous section.

Our ability to reduce revenue expenditure in future years will have a direct impact on whether we can deliver all aspirations set out in *Our Ambition*. We need to translate those aspirations into Specific, Measurable, Achievable, Relevant and Time-bound (SMART) objectives, including feasible timescales. That will enable decision-makers to prioritise which projects move forward each year, with due consideration to both capacity constraints within the organisation and also the financial constraints which we expect to face. A failure to adequately plan ahead, to address our long-term financial sustainability, will result in this Council being unable to borrow the significant sums required to finance new investments. This is because we will not be able to demonstrate that our capital plans are prudent, affordable, and sustainable as required by the Prudential Code.

iv) Capital Budgeting

We set our capital spending plans as contained in the AIP, on a rolling five-year basis, each year alongside our revenue budgets. We expect to present our plans for capital expenditure for the 2024/25-2028/29 period in February or March 2024.

We intend to create better links between our MTFP and the AIP in future iterations, so that we can clearly show the longer- term financial implications of our priorities, particularly on reserves. This will enable us, and our stakeholders to monitor progress and more importantly, measure success. Given our use of reserves for revenue purposes we would need to focus on holding capital spend to the grant level provided to avoid a further unsustainable draw on reserves.

Financing our plans

Day-to-day revenue budgets are funded primarily by grant funding received from the Scottish Government, supplemented by Council Tax and income received from our investments. Our Treasury Management and Investment Strategy is updated each year, at the same time as we set our annual revenue and capital budgets. This strategy is a statutory requirement and sets out how we manage our day-to-day cash flow requirements and investments, and how we intend to finance our spending plans for the forthcoming financial year, including the use of capital receipts, borrowing and income from our long-term investments. We will present our updated Treasury Management and Investment Strategy in February or March 2024, with our budget plans.

Financing our future capital plans, however, is becoming increasingly difficult. We have a statutory obligation to comply with the Prudential Code when determining how much we can afford to borrow in order to finance planned capital expenditure. Our long-standing financial unsustainability means we will not be able to comply with the requirements of the Prudential Code when we know increasing our borrowing will result in additional revenue costs in excess of the resources we expect to have at our disposal.

The alternative, and perhaps more obvious source of funding would, of course, be using our reserves. And while that remains an option, the trade-off will undoubtedly be less funding available to support our annual revenue budgets. Our current expectation, based on the central model, would be for £30.7m to be drawn from reserves to support revenue expenditure in

2024/25, rising to £45.5m in 2027/28.

Any unsustainable draw on investments would result in a lower underlying investment base generating the returns we rely upon to supplement our annual revenue budgets. This would only act to increase pressure on services to accommodate a reduction in available funding in the future.

We need to accept that we cannot achieve everything that we seek to achieve with our available resources and will need to prioritise which projects are taken forward in the future, with due regard for the longer-term financial implications on both revenue and capital budgets. A failure to prioritise will likely result in a future Council being forced into making very difficult decisions on service provision.

Redeveloping *Our Medium-Term Financial Plan*

And finally, having an MTFP in place to inform future budgeting and to guide decision-making is an important component of effective financial management.

We intend to update the financial planning assumptions and financial modelling contained in this plan as part of a revised MTFP once we have defined the objectives, timescales, milestones, and measures of success of the projects contained in Our Ambition. Having SMART plans in place will help us quantify the potential socio-economic benefits against the cost of investment, to help us prioritise which of the 70+ actions in Our Ambition we will focus on in the short term. This activity will also help inform the development of future budgets.

6. Summary

Once again, there is no way to sugar coat the figures presented in this document – they are a stark reminder that we are not living within our means. It shouldn't come as a surprise. We already know that we are not in a financially sustainable position and our auditors regularly remind us of our predicament.

We are not the only Council to face significant financial challenges, indeed the Scottish Government's own equivalent documents have stark level of deficit indicated, but we have been in an enviable position to use our reserves to meet the shortfall between the income we receive and what we spend delivering services. We have been able to tolerate year-on-year funding reductions and accommodate growth in our cost base, but this has been achieved by using our reserves in an unsustainable way. Our failure to address longer- term financial sustainability will effectively mean we will not be in a position to borrow to fund investment in new assets, curtailing the aspirations of *Our Ambition*. If we continue to manage our finances in this way, our reserves will ebb away. Whilst there has been debate about the speed of this, the time frame is not the important element the fact remains that regardless of timescale this will be the consequence, and that would not be a position we would wish to occur. That will leave future Councils with very difficult decisions to make.

This plan sets out the scale of the financial challenge that we face in plain terms. It will inevitably look similar to prior versions as we have not yet progressed this as far as required. This also creates comment that 'the Council has been saying this for years and yet we are still seeing our reserves increase'. This is a case where reality has caught up with perception. When in the past budgets were set, this was with an expectation that we were setting budget at a very high level and underspends were almost guaranteed, now the costs have increased such that these budgets are now under some pressure, so the situation is now really facing us and there is no slack in the system. In addition whilst increases in reserves may be seen, the buying power of this in face of inflation is markedly less.

We need to use these tools to prioritise our activities and develop tangible and SMART plans that lead to sustainable changes in how we deliver services so that we begin to live within our means. To this end various point have been picked out of the plan and reflect an intent to deliver some key actions that will assist with the future progress to seeing a better financial underpinning.

PLAN OBJECTIVES

Develop a 5 year Plan for Harbour income and planned expenditure

Develop a forecast for wider Oil and Gas related income, where this is not captured as part of the Harbour analysis.

Carry out more in depth reviews of charging to agree a strategic position whereby fees cover costs, or members are asked to agree a funding strategy that specifies a level of subsidy that is in place from the Council.

In the first instance each external grant should be seen to contribute to the organizational infrastructure required to support them, so an agreed % (8%?) should be approved for application to central costs.

Further efforts should be taken to apply some of the (external) funding towards costs already incurred in the area, thus reducing the burden on the core budget.

It is important that any plans are underpinned by a clear staffing table that describes the existing staffing in place, both actual and ideal.

Develop further work to quantify key elements of Our Ambition, in particular we need to create better links between our MTFP and the AIP in future iterations, so that we can clearly show the longer- term financial implications of our priorities.

These general points will need to be converted into clearer, SMART objectives to ensure delivery during 2024/25.

Annex A – Base Position 2022/23 + 2023/24 – EXPENDITURE

GENERAL FUND REVENUE	2022/23 Actual	2023/24 Budget
EXPENDITURE		
STAFF COSTS		
Pay	*99,707,481*	*102,839,147*
DIA	*5,232,780*	*6,019,031*
Pensions	*1,397,698*	*1,438,035*
Other Staff Costs	*260,202*	*160,628*
Pensions (Excluding Teachers)	13,877,530	15,339,132
TOTAL STAFF COSTS	***113,585,011***	***118,178,279***
NON STAFF COSTS		
Administration Costs	*4,055,662*	*4,021,565*
Property Costs (excl. Energy)	*7,526,694*	*7,493,711*
PPP / Unitary Charge (AHS)	*3,986,959*	*3,854,121*
Supplies & Services	*21,326,249*	*15,281,753*
Transport Costs (excl. Fuel)	*12,137,131*	*15,526,281*
Energy Costs	*3,749,733*	*4,957,311*
Fuel Costs	*999,617*	*961,006*
Financing Costs	*1,471,639*	*1,683,305*
Contingency	*23,798*	*3,500,000*
Grants to Organisations/Individuals	*16,056,723*	*15,817,080*
SIC Contribution to IJB	- *1,660,930*	- *1,262,900*
TOTAL NON STAFF COSTS	**69,673,274**	**71,833,233**
TOTAL EXPENDITURE	**183,258,285**	**190,011,512**

Annex A – Base Position 2022/23 + 2023/24 - INCOME

GENERAL FUND REVENUE	2022/23 Actual	2023/24 Budget
INCOME		
General Revenue Grant	*-47,153,700*	*-58,345,000*
National Non-Domestic Rates	*-35,321,997*	*-24,302,000*
Specific Revenue Grant(s)	*-21,072,760*	*-24,989,082*
Council Tax	*-10,253,748*	*-10,769,970*
Income (Fees & Charges)	*-14,249,661*	*-14,174,523*
Commercial Income + Interest on Balances	*-1,972,449*	*-1,399,807*
Income (Other Grants)	*-11,055,878*	*-9,592,684*
Income (Specific Grant - AHS)	*-3,237,490*	*-3,295,035*
Fish Quota	*-864,233*	*-1,000,000*
Recharges to Other Funds	*-4,095,163*	*-3,844,299*
Crown Estate Income	*-1,607,992*	*-1,600,000*
TOTAL INCOME	**-150,885,072**	**-153,312,400**
GAP	**32,373,213**	**36,699,112**
Harbour Income		18,000,000
Investment returns		15,000,000
Unsustainable Draw		3,699,112

Annex B – Assumptions Used 2024/25 + 2025/26

	24/25			25/26		
	Downside	Central	Upside	Downside	Central	Upside
INCOME						
General Revenue Grant	-0.5	0	0.5	-0.5	0	0.5
National Non-Domestic Rates	-0.5	0	0.5	-0.5	0	0.5
Specific Revenue Grant(s)	0	2	4	0	2	4
Council Tax	2	4	6	2	4	6
Income (Fees & Charges)	3	4.9	4.9	3	4.9	4.9
Commercial Income + Interest on Balances	-29	-11	7	0	0	0
Income (Other Grants)	0	5	10	0	0	0
Income (Specific Grant - AHS)	0	0	0	0	0	0
Fish Quota	-20	0	20	0	0	0
Recharges to Other Funds	0	0	0	0	0	0
Crown Estate Income	0	5	10	0	0	0
TOTAL INCOME						
EXPENDITURE						
Administration Costs	4.9	3.9	2.9	4.9	3.9	2.9
Property Costs (excl. Energy)	4.9	3.9	2.9	4.9	3.9	2.9
PPP / Unitary Charge (AHS)	0.5	0.5	0.5	0.5	0.5	0.5
Supplies & Services	4.9	3.9	2.9	4.9	3.9	2.9
Transport Costs (excl. Fuel)	4.9	3.9	2.9	4.9	3.9	2.9
Energy Costs	5.9	4.9	3.9	5.9	4.9	3.9
Fuel Costs	5.9	4.9	3.9	5.9	4.9	3.9
Financing Costs	179	179	179	-64	-64	-64
Contingency	0	0	0	0	0	0
Grants to Organisations/Individuals	4.9	3.9	2.9	4.9	3.9	2.9
SIC Contribution to IJB	0	0	0	0	0	0
Pay	4	2	0	4	2	0
DIA	4	2	0	4	2	0
Pensions	0	0	0	0	0	0
Other Staff Costs	0	0	0	0	0	0
Pensions (Excluding Teachers)	0	-9	-18	0	0	0

Annex B – Assumptions Used 2026/27 + 2027/28

	26/27			27/28		
	Downside	Central	Upside	Downside	Central	Upside
INCOME						
General Revenue Grant	-0.5	0	0.5	-0.5	0	0.5
National Non-Domestic Rates	-0.5	0	0.5	-0.5	0	0.5
Specific Revenue Grant(s)	0	2	4	0	2	4
Council Tax	2	4	6	2	4	6
Income (Fees & Charges)	3	4.9	4.9	3	4.9	4.9
Commercial Income + Interest on Balances	0	0	0	0	0	0
Income (Other Grants)	0	0	0	0	0	0
Income (Specific Grant - AHS)	0	0	0	0	0	0
Fish Quota	0	0	0	0	0	0
Recharges to Other Funds	0	0	0	0	0	0
Crown Estate Income	0	0	0	0	0	0
TOTAL INCOME						
EXPENDITURE						
Administration Costs	4.9	3.9	2.9	4.9	3.9	2.9
Property Costs (excl. Energy)	4.9	3.9	2.9	4.9	3.9	2.9
PPP / Unitary Charge (AHS)	0.5	0.5	0.5	0.5	0.5	0.5
Supplies & Services	4.9	3.9	2.9	4.9	3.9	2.9
Transport Costs (excl. Fuel)	4.9	3.9	2.9	4.9	3.9	2.9
Energy Costs	5.9	4.9	3.9	5.9	4.9	3.9
Fuel Costs	5.9	4.9	3.9	5.9	4.9	3.9
Financing Costs	0	0	0	471	471	471
Contingency	0	0	0	0	0	0
Grants to Organisations/Individuals	4.9	3.9	2.9	4.9	3.9	2.9
SIC Contribution to IJB	0	0	0	0	0	0
Pay	4	2	0	4	2	0
DIA	4	2	0	4	2	0
Pensions	0	0	0	0	0	0
Other Staff Costs	0	0	0	0	0	0
Pensions (Excluding Teachers)	0	0	0	0	0	0

Annex C – Results – 2024/25 + 2025/26

	24/25			25/26		
	Downside	Central	Upside	Downside	Central	Upside
INCOME						
General Revenue Grant	58,053,275	58,345,000	58,636,725	57,763,009	58,345,000	58,929,909
National Non-Domestic Rates	24,180,490	24,302,000	24,423,510	24,059,588	24,302,000	24,545,628
Specific Revenue Grant(s)	24,989,082	25,488,864	25,988,645	24,989,082	25,998,641	27,028,191
Council Tax	10,985,369	11,200,769	11,416,168	11,205,077	11,648,800	12,101,138
Income (Fees & Charges)	14,599,759	14,869,075	14,869,075	15,037,751	15,597,659	15,597,659
Commercial Income + Interest on Balances	993,863	1,245,828	1,497,793	993,863	1,245,828	1,497,793
Income (Other Grants)	9,592,684	10,072,318	10,551,952	9,592,684	10,072,318	10,551,952
Income (Specific Grant - AHS)	3,295,035	3,295,035	3,295,035	3,295,035	3,295,035	3,295,035
Fish Quota	800,000	1,000,000	1,200,000	800,000	1,000,000	1,200,000
Recharges to Other Funds	3,844,299	3,844,299	3,844,299	3,844,299	3,844,299	3,844,299
Crown Estate Income	1,600,000	1,680,000	1,760,000	1,600,000	1,680,000	1,760,000
TOTAL INCOME	152,933,856	155,343,187	157,483,203	153,180,387	157,029,580	160,351,605
EXPENDITURE						
Administration Costs	4,218,622	4,178,406	4,138,190	4,425,334	4,341,364	4,258,198
Property Costs (excl. Energy)	7,860,903	7,785,966	7,711,029	8,246,087	8,089,618	7,934,648
PPP / Unitary Charge (AHS)	3,873,392	3,873,392	3,873,392	3,892,759	3,892,759	3,892,759
Supplies & Services	16,030,559	15,877,741	15,724,924	16,816,056	16,496,973	16,180,947
Transport Costs (excl. Fuel)	16,287,069	16,131,806	15,976,543	17,085,135	16,760,946	16,439,863
Energy Costs	5,249,792	5,200,219	5,150,646	5,559,530	5,455,030	5,351,521
Fuel Costs	1,017,705	1,008,095	998,485	1,077,750	1,057,492	1,037,426
Financing Costs	4,696,421	4,696,421	4,696,421	1,690,712	1,690,712	1,690,712
Contingency	3,500,000	3,500,000	3,500,000	3,500,000	3,500,000	3,500,000
Grants to Organisations/Individuals	16,592,117	16,433,946	16,275,775	17,405,131	17,074,870	16,747,773
SIC Contribution to IJB	- 1,262,900	- 1,262,900	- 1,262,900	- 1,262,900	- 1,262,900	- 1,262,900
Pay	106,952,713	104,895,930	102,839,147	111,230,821	106,993,849	102,839,147
DIA	6,259,792	6,139,412	6,019,031	6,510,184	6,262,200	6,019,031
Pensions	1,438,035	1,438,035	1,438,035	1,438,035	1,438,035	1,438,035
Other Staff Costs	160,628	160,628	160,628	160,628	160,628	160,628
Pensions (Excluding Teachers)	15,339,132	13,958,610	12,578,088	15,339,132	13,958,610	12,578,088
TOTAL EXPENDITURE	208,213,979	204,015,707	199,817,434	213,114,394	205,910,186	198,805,876
NET POSITION	55,280,123	48,672,519	42,334,231	59,934,006	48,880,605	38,454,271

Annex C – Results – 2026/27 + 2027/28

	26/27			*27/28*		
	Downside	Central	Upside	Downside	Central	Upside
INCOME						
General Revenue Grant	57,474,194	58,345,000	59,224,558	57,186,823	58,345,000	59,520,681
National Non-Domestic Rates	23,939,290	24,302,000	24,668,356	23,819,593	24,302,000	24,791,697
Specific Revenue Grant(s)	24,989,082	26,518,614	28,109,319	24,989,082	27,048,986	29,233,691
Council Tax	11,429,178	12,114,752	12,827,207	11,657,762	12,599,342	13,596,839
Income (Fees & Charges)	15,488,884	16,361,945	16,361,945	15,953,551	17,163,680	17,163,680
Commercial Income + Interest on Balances	993,863	1,245,828	1,497,793	993,863	1,245,828	1,497,793
Income (Other Grants)	9,592,684	10,072,318	10,551,952	9,592,684	10,072,318	10,551,952
Income (Specific Grant - AHS)	3,295,035	3,295,035	3,295,035	3,295,035	3,295,035	3,295,035
Fish Quota	800,000	1,000,000	1,200,000	800,000	1,000,000	1,200,000
Recharges to Other Funds	3,844,299	3,844,299	3,844,299	3,844,299	3,844,299	3,844,299
Crown Estate Income	1,600,000	1,680,000	1,760,000	1,600,000	1,680,000	1,760,000
TOTAL INCOME	153,446,508	158,779,790	163,340,464	153,732,691	160,596,488	166,455,669
EXPENDITURE						
Administration Costs	4,642,176	4,510,677	4,381,686	4,869,642	4,686,593	4,508,755
Property Costs (excl. Energy)	8,650,145	8,405,114	8,164,753	9,074,002	8,732,913	8,401,531
PPP / Unitary Charge (AHS)	3,912,222	3,912,222	3,912,222	3,931,783	3,931,783	3,931,783
Supplies & Services	17,640,043	17,140,355	16,650,194	18,504,405	17,808,829	17,133,050
Transport Costs (excl. Fuel)	17,922,307	17,414,623	16,916,619	18,800,500	18,093,794	17,407,201
Energy Costs	5,887,542	5,722,326	5,560,231	6,234,907	6,002,720	5,777,080
Fuel Costs	1,141,337	1,109,309	1,077,886	1,208,676	1,163,665	1,119,923
Financing Costs	1,690,712	1,690,712	1,690,712	9,653,963	9,653,963	9,653,963
Contingency	3,500,000	3,500,000	3,500,000	3,500,000	3,500,000	3,500,000
Grants to Organisations/Individuals	18,257,982	17,740,790	17,233,458	19,152,623	18,432,681	17,733,229
SIC Contribution to IJB	- 1,262,900	- 1,262,900	- 1,262,900	- 1,262,900	- 1,262,900	- 1,262,900
Pay	115,680,054	109,133,726	102,839,147	120,307,256	111,316,400	102,839,147
DIA	6,770,591	6,387,444	6,019,031	7,041,415	6,515,193	6,019,031
Pensions	1,438,035	1,438,035	1,438,035	1,438,035	1,438,035	1,438,035
Other Staff Costs	160,628	160,628	160,628	160,628	160,628	160,628
Pensions (Excluding Teachers)	15,339,132	13,958,610	12,578,088	15,339,132	13,958,610	12,578,088
TOTAL EXPENDITURE	221,370,007	210,961,671	200,859,790	237,954,069	224,132,908	210,938,543
NET POSITION	67,923,498	52,181,881	37,519,326	84,221,378	63,536,420	44,482,875

Annex D – Summary of Results

	24/25			*25/26*			*26/27*			*27/28*		
	Downside	Central	Upside	Downside	Central	Upside	Downside	Central	Upside	Downside	Central	Upside
TOTAL INCOME	152,933,856	155,343,187	157,483,203	153,180,387	157,029,580	160,351,605	153,446,508	158,779,790	163,340,464	153,732,691	160,596,488	166,455,669
TOTAL EXPENDITURE	208,213,979	204,015,707	199,817,434	213,114,394	205,910,186	198,805,876	221,370,007	210,961,671	200,859,790	237,954,069	224,132,908	210,938,543
NET POSITION	-55,280,123	-48,672,519	-42,334,231	-59,934,006	-48,880,605	-38,454,271	-67,923,498	-52,181,881	-37,519,326	-84,221,378	-63,536,420	-44,482,875
CUMULATIVE				-115,214,130	-97,553,125	-80,788,502	-183,137,628	-149,735,005	-118,307,828	-267,359,006	-213,271,425	-162,790,703

Annex E – Summary of Result including Harbour and Investments income

	24/25			*25/26*			*26/27*			*27/28*		
	Downside	Central	Upside	Downside	Central	Upside	Downside	Central	Upside	Downside	Central	Upside
TOTAL INCOME	152,933,856	155,343,187	157,483,203	153,180,387	157,029,580	160,351,605	153,446,508	158,779,790	163,340,464	153,732,691	160,596,488	166,455,669
TOTAL EXPENDITURE	208,213,979	204,015,707	199,817,434	213,114,394	205,910,186	198,805,876	221,370,007	210,961,671	200,859,790	237,954,069	224,132,908	210,938,543
NET POSITION	-55,280,123	-48,672,519	-42,334,231	-59,934,006	-48,880,605	-38,454,271	-67,923,498	-52,181,881	-37,519,326	-84,221,378	-63,536,420	-44,482,875
HARBOUR & INVESTMENT	33,000,000	33,000,000	33,000,000	33,000,000	33,000,000	33,000,000	33,000,000	33,000,000	33,000,000	33,000,000	33,000,000	33,000,000
CUMULATIVE	-22,280,123	-15,672,519	-9,334,231	-49,214,130	-31,553,125	-14,788,502	-84,137,628	-50,735,005	-19,307,828	-135,359,006	-81,271,425	-30,790,703

Annex F - Using our investments

As explained in the body of this plan, we hold long-term investments that are externally managed in a diverse portfolio. These investments fluctuate in value on a daily basis, but the general trend over the long-term has seen a positive return on the investments held, far more than the level of interest that may have been generated if we had invested the underlying resources in an interest-bearing savings account.

Previously for the purposes of financial planning, the value of underlying investments was used to estimate how much was affordable to withdraw from the investments to support the annual budget, without creating a risk to the underlying asset base or future performance. This was because it is impossible to estimate how well the financial markets will perform in any one year, and to recognise that there is an element of risk in the markets we are invested in. Positive returns are not guaranteed every year, and some years will see a contraction in the value of our investments. There was previously an intent to discount the ‘noise’ caused by the volatility and daily, weekly, monthly, and quarterly fluctuations seen when reporting the gross value of the investments every quarter. This is a cautious and reasonable approach, however as significant time has elapsed since the original investment this does not seem as reasonable basis as the fluctuations are unlikely to see a reversal of the position to lower than the level initially invested. We have based the following on market value.

Our investment strategy is predicated on our externally managed investments achieving, on average, an annual return of 7.3% over the long-term. The target return rate of 7.3% has two aims and can be split into two elements:

- 'inflation-proofing' - to protect the value of our underlying investments from the effects of inflation. For this 'inflation-proofing' element, we anticipate our underlying investments will increase annually by 2.1%, on average, over the long term. When inflation is factored in, this means the buying power of our underlying investments is maintained into the future.
- growth in investments, for which we anticipate being able to utilise 5.2% of returns over and above that of inflation-proofing element. This is the element of our investment returns that is available for general spending which we are using to supplement our annual revenue budgets.

If we can limit the amount that we take from our investment returns to the ‘sustainable draw’, as set out in Table D1 below, we are confident that we can withdraw between £15m in the next four years without eroding the underlying investment base in a way that would affect future investment returns. With an increase in value of investments a figure of £20 million seems like a more representative value for unsustainable draw (Table D2). The model seems robust with an annual draw of about £37 million depleting reserves by 2041/42 (Table D3). That said this has to be seen in the context of the forecast figures in the MTFP which are significantly in excess of this. These look more positive than has been seen previously mainly due to use of the current value of investments as the base but it should be borne in mind this assumes an unrealistic assumption of ongoing income from harbour on an fixed base, but also assumes a guaranteed annual return of 7.3%. It should also be noted that there is currently £49 million of borrowing also to be repaid.

In addition these figures are overstated as £70 Million of reserves are for capital and £19 Million are for the HRA so these would remain locked up for these purposes and are not available for general use. The position is therefore more complicated than presented, but the tables are for general indicative purposes, so not all factors are reflected.

Table D1. Estimated value (using market value) if withdrawals are limited to a sustainable amount of £15 million:

Year	Opening Balance	Additions/Growth		Withdrawals / Transfers		Closing Balance
		+ 2.1%	*+ 5.2%*	Sustainable Draw	Unsustainable Draw	
2023/24	377	8	20	-15	-	390
2024/25	390	8	20	-15	-	403
2025/26	403	8	21	-15	-	417
2026/27	417	9	22	-15	-	433
2027/28	433	9	23	-15	-	449
2028/29	449	9	23	-15	-	467
2029/30	467	10	24	-15	-	486
2030/31	486	10	25	-15	-	507
2031/32	507	11	26	-15	-	529
2032/33	529	11	28	-15	-	552
2033/34	552	12	29	-15	-	578

Table D2. Estimated value (using market value) if withdrawals are £20 million:

Year	Opening Balance	Additions/Growth		Withdrawals / Transfers		Closing Balance
		+ 2.1%	*+ 5.2%*	Sustainable Draw	Unsustainable Draw	
2023/24	377	8	20	-15	-5	385
2024/25	385	8	20	-15	-5	393
2025/26	393	8	20	-15	-5	401
2026/27	401	8	21	-15	-5	411
2027/28	411	9	21	-15	-5	421
2028/29	421	9	22	-15	-5	431
2029/30	431	9	22	-15	-5	443
2030/31	443	9	23	-15	-5	455
2031/32	455	10	24	-15	-5	468
2032/33	468	10	24	-15	-5	482
2033/34	482	10	25	-15	-5	498

Table D3. Estimated value (using market value) if withdrawals are £37 million:

Year	Opening Balance	Additions/Growth		Withdrawals / Transfers		Closing Balance
		+ 2.1%	*+ 5.2%*	Sustainable Draw	Unsustainable Draw	
2023/24	377	8	20	-15	-22	368
2024/25	368	8	19	-15	-22	357
2025/26	357	8	19	-15	-22	346
2026/27	346	7	18	-15	-22	335
2027/28	335	7	17	-15	-22	322
2028/29	322	7	17	-15	-22	309
2029/30	309	6	16	-15	-22	294
2030/31	294	6	15	-15	-22	279
2031/32	79	6	14	-15	-22	262
2032/33	262	6	14	-15	-22	244
2033/34	244	5	13	-15	-22	225
2034/35	225	5	12	-15	-22	204
2035/36	204	4	11	-15	-22	182
2036/37	182	4	9	-15	-22	159
2038/39	159	3	8	-15	-22	133
2039/40	133	3	7	-15	-22	106
2040/41	106	2	6	-15	-22	77
2041/42	77	2	4	-15	-22	45
2042/43	45	1	2	-15	-22	12
2043/44	12	0	1	-15	-22	-25

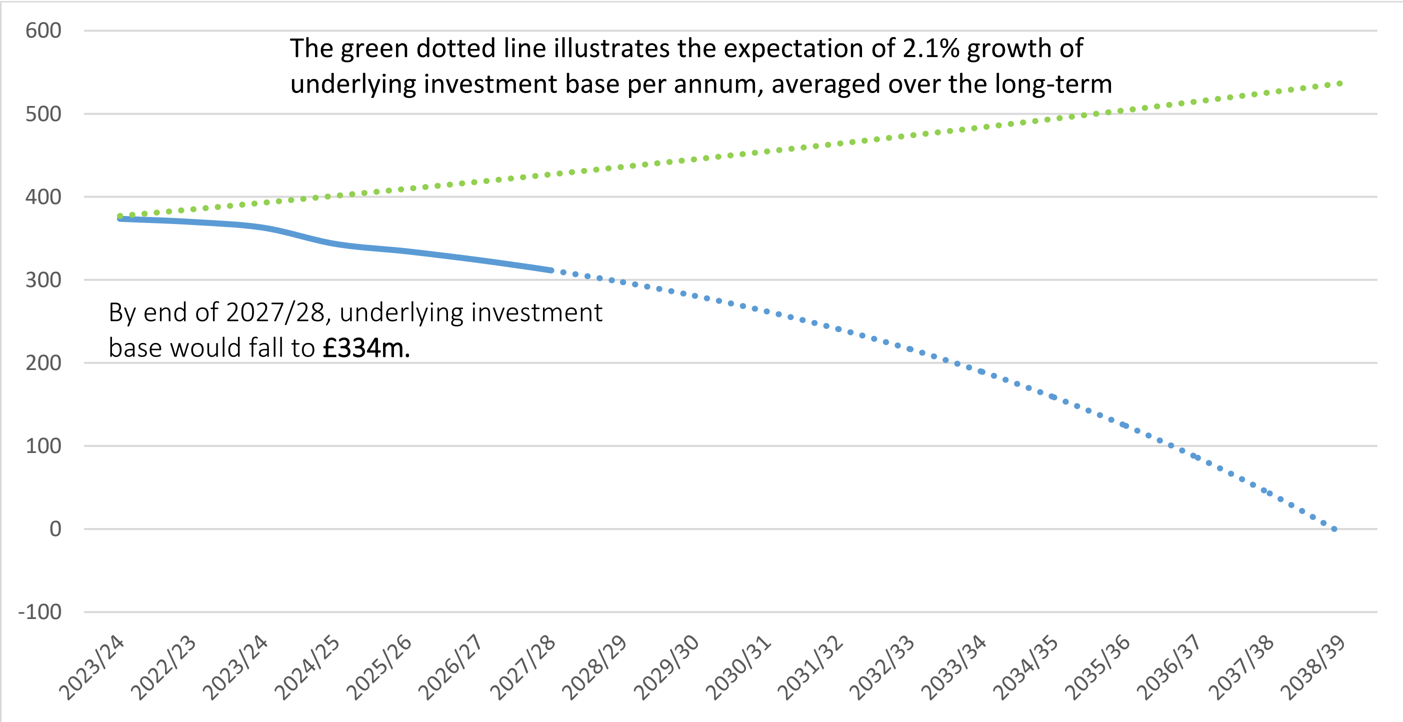
In recent years, we have taken more than the sustainable draw so that we can set a balanced budget. The scenarios we have described in this plan have been prepared on the basis that we will use *only* the sustainable draw to support future revenue spending. All three scenarios predict budgetary deficits, which vary in scale, in each of the years covered by the planning period.

Table D4 and chart D1 help illustrate the impact on our investments if we were to use the reserves to meet the anticipated budgetary deficits in the medium-term and beyond. Table D2 details the estimated impact on underlying investment values, and chart D1 plots that trajectory, compared to our investment strategy assumption on growth of investments.

Table D4. Estimated value of underlying investments if withdrawals are made to balance annual budgets:

Year	Opening Balance	Additions/Growth		Withdrawals / Transfers		Closing Balance
		+ 2.1%	***+ 5.2%***	**Sustainable Draw**	**Unsustainable Draw**	
2023/24	377	8	20	-15	-16	374
2024/25	374	8	19	-15	-16	370
2025/26	370	8	19	-15	-19	363
2026/27	363	8	19	-15	-31	343
2027/28	343	7	18	-15	-19	334
2028/29	334	7	17	-15	-20	324
2029/30	324	7	17	-15	-21	311
2030/31	311	7	16	-15	-22	297
2031/32	297	6	15	-15	-23	281
2032/33	281	6	15	-15	-24	262
2033/34	262	6	14	-15	-25	241
2034/25	241	5	13	-15	-27	217
2035/36	217	5	11	-15	-28	189
2036/37	189	4	10	-15	-29	159
2037/38	159	3	8	-15	-31	124
2038/39	124	3	6	-15	-32	86
2039/40	86	2	4	-15	-34	43
2040/41	43	1	2	-15	-36	5

Chart D1. Impact on underlying investment values if used to manage annual budget deficits:



Annex G - Data sources used to inform Economic and Fiscal Outlook and Financial Planning Assumptions:

Office for Budgetary Responsibility:

- *Fiscal Risks & Sustainability Report, July 2023*
- *Economic and Fiscal Outlook*, March 2023

EY Item Club:

- *Summer Forecast*, July 2023

Fraser of Allander Institute:

- *FAI Economic Commentary, June 2023*

Bank of England

- *Monetary Policy Report, August 2023*

Scottish Government:

- *Investing in Scotland's Future : Resource Spending Review, May 2022*
- *The Outcome of the targeted Review of the capital Spending Review – Updated Spending Allocations for 2023-24 to 2025-26, May 2022*
- *Scotland's Fiscal Outlook. The Scottish Government's Medium Term Financial Strategy*