Orkney Islands Council

Medium Term Financial Strategy 2025/26 to 2029/30

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Contents

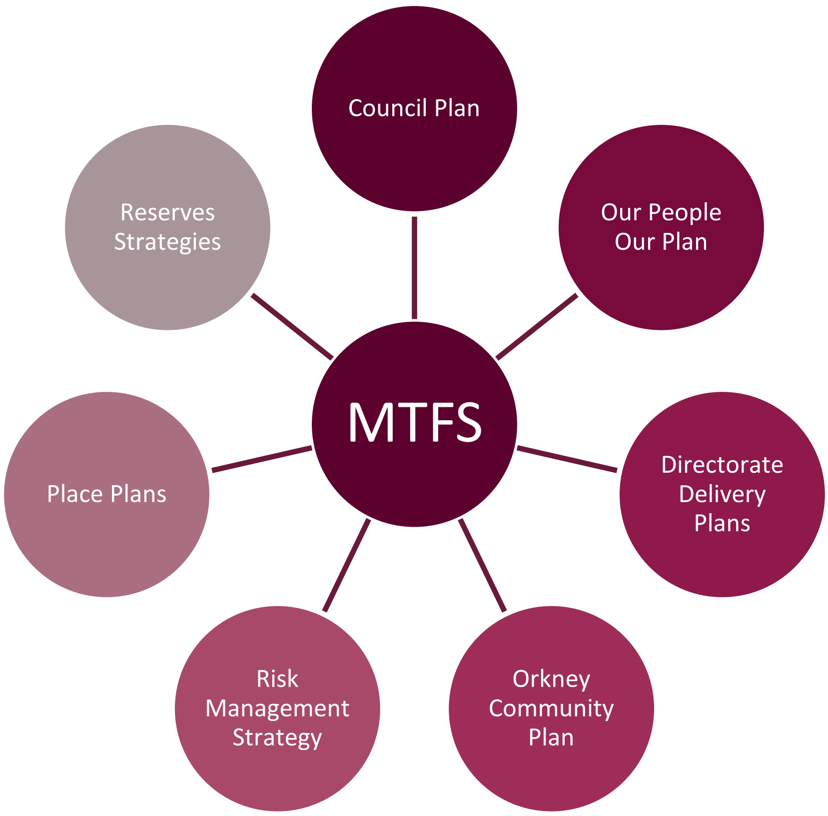
1. Background

1.1. The previous Medium-Term Financial Strategy (MTFS) was presented to the Policy and Resources Committee at its meeting of 30 June 2023, covering the period 2023/24 to 2027/28, aligning with the Council Plan, and the term of this Council. This Medium-Term Financial Strategy covers the period 2025/26 to 2029/30.

1.2. Medium-term financial planning is challenging within our complex fiscal landscape: global economic conditions, political priorities, and local needs must be evaluated, and certain assumptions made to project beyond the 'known' funding period. It serves as a planning document for the use of resources over the medium-term and is a useful tool for planning purposes rather than a definitive statement of resourcing over its term.

The role of the Medium-Term Financial Strategy is to provide a medium-term perspective on the Council finances, supporting a broad approach to budget evaluation and formation.

1.3. The Medium-Term Financial Strategy draws information from a variety of policies which have been developed to provide the financial framework within which the Council operates, for example:



1.4. In reality the limiting factor for the Medium-Term Financial Strategy is funding, and, as much as the Medium-Term Financial Strategy draws on Council policies and plans, ultimately the funding envelope restricts the ambition of these plans. Political objectives and service improvements generally must be delivered from within existing budgets.

1.5. However, taking a longer-term view of the Council's finances over a period of five years allows Members to understand the role that each annual budget setting exercise has in contributing to the Council achieving its corporate objectives and political aspirations whilst securing a financially sustainable Council.

1.6. Improved financial planning and financial management of the Council's revenue and capital resources means that services have a longer timescale to plan for future changes in budget levels, as they can see what may happen to budgets through to 2029/30.

1.7. Whilst the principal financial focus is on maintaining General Fund services and their associated revenue budgets, linkages are made in relation to the Council's Capital Programme and Non-General Fund Services, where appropriate.

Principles of the Medium-Term Financial Strategy

- Resources will be redirected within the Council in accordance with a clear strategy based on risk, Council priorities, funding, and performance levels.
- Ongoing reassessment and reconfiguration will determine the sustainable level of expenditure that can be incurred on services over each of the next five years.
- Sustainable use of General Fund balances and strategic reserves to manage the timing of baseline savings.
- Sustainable use of General Fund balances and strategic reserves to invest in income generating opportunities which will help bridge the identified funding gap for each of the next five financial years.
- Phased introduction of identified Service redesign/transformation savings to help bridge the identified funding gap.
- A maximum level of capital expenditure that can be incurred each year, recognising that any expenditure over and above what can be funded from General Capital Grant, designated reserves or capital receipts will need to be financed through borrowing, which will in turn create an ongoing revenue cost pressure.

2. Current Situation

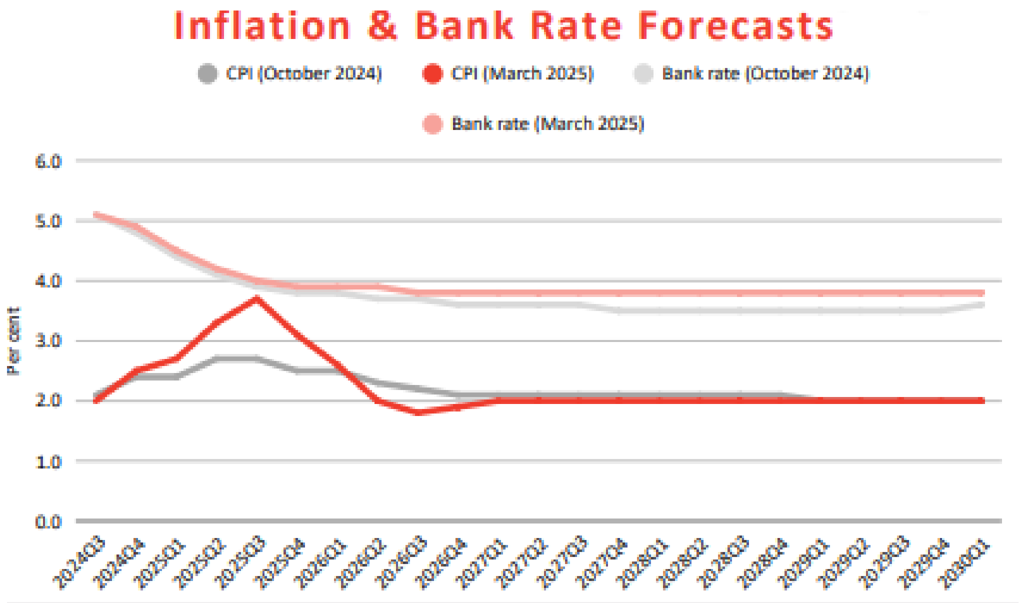
The economy

2.1. Over the next five years, global economic growth is expected to remain moderate but uncertain. The recent wave of tariffs in the United States of America (US) has significantly altered global growth projections. The International Monetary Fund (IMF) has downgraded their forecasts from 3.3% to 2.8% in 2025. This adjustment reflects the adverse effects of increased trade barriers, which are expected to dampen investment and household spending worldwide.

2.2. Overall, the global economy faces heightened risks. Inflation is expected to rise. The Bank of England is considering interest rate cuts to counteract the economic uncertainty. Meanwhile, stock markets have reacted negatively, with investors wary of a potential US recession.

2.3. The combination of this global trade environment and domestic policy measures will shape the UK's economic outlook for the next 5 years. As stated above, interest rates are expected to gradually decline, inflation is expected to return to the Bank of England's 2% target by mid-2026, pay pressures are forecast to ease as "rising labour costs and weak business sentiment have seen a weaker labour market" (KMPG Economic outlook). However, challenges persist, including, the already, elevated labour costs due to recent increases in the National Living Wage and Employers National Insurance Contributions, which may dampen business investment.

2.4. The Office of Budget Responsibilities (OBR) latest forecasts for the bank rate and Consumer Price Index (CPI) indicate a significant spike in inflation (inflation is forecasted to reach 3.7% in Q3) following increases to employer national insurance contributions, household energy bills and council tax; all of which took effect in April. The bank rate forecast indicates a modest rise from October.

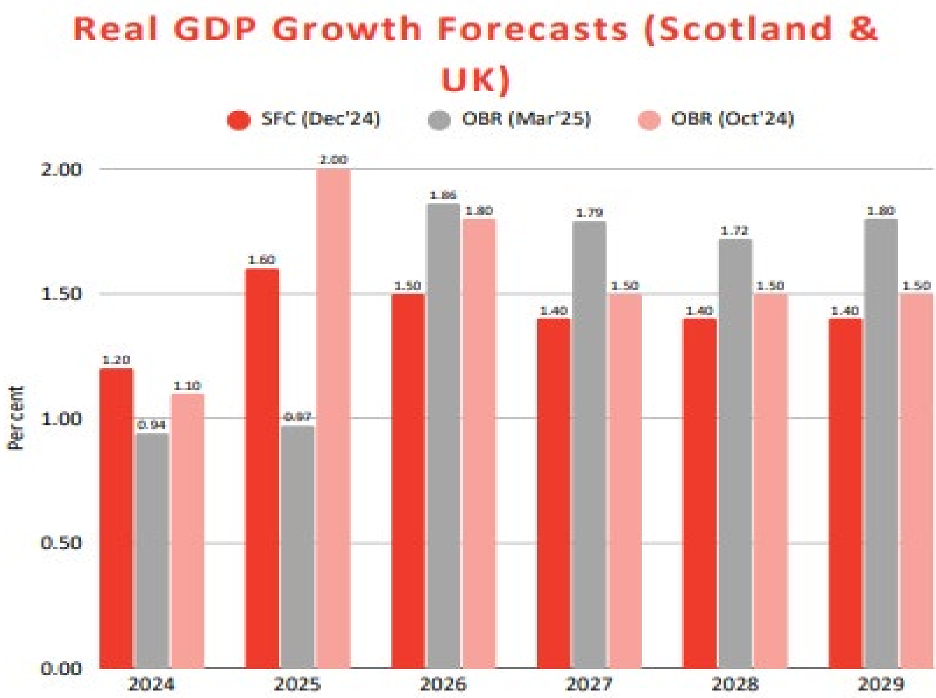


Fraser of Allander Institute Economic Commentary, April 2025

2.5. “The near-term upward revisions [in inflation] feed into the sentiment that February’s unexpected drop merely represents the ‘calm before the storm’. While the longer term outlook remains optimistic, rising household costs and uncertainty surrounding President Trump’s tariffs cast a shadow of uncertainty for the months that lie ahead for the remainder of 2025 and the beginning of 2026.” (Economic Commentary, April 2025)

2.6. In the UK Governments November 2024 budget, the government announced significant fiscal measures, including £40 billion in tax increases starting in 2025, aimed at funding public services and investment projects. While these measures are designed to support economic growth, their effectiveness will depend on global economic conditions and domestic policy implementation. The Chancellor faces a significant challenge to adhere to her fiscal rules while pursuing a growth agenda. The fiscal headroom remains tight with the risk of downgrade to the UK economic growth forecast high.

2.7. At a Scotland level, latest forecasts in April 2025 from the Fraser of Allander Institute show Gross Domestic Product (GDP) growth forecasts for “2025 and 2026 have been downgraded to reflect economic conditions in both the UK and the world economy. We expect growth in 2025 to now be similar to growth in 2024 at 0.9%, before increasing to 1.1% in 2026 and 2027.” (Economic Commentary, April 2025)



Fraser of Allander Institute Economic Commentary, April 2025
(SFC - Scottish Fiscal Commission; OBR – Office of Budget Responsibility)

2.8. Financial challenges continue to intensify across the public sector. Local authorities in Scotland continue to face significant financial pressures primarily due to real-terms funding cuts, rising service demands, and inflationary pressures. Audit Scotland reported that local governments continue to face severe financial pressures, necessitating urgent transformation and collaboration to maintain essential services

(Local government in Scotland: Financial bulletin 2023/24). The Convention of Scottish Local Authorities (COSLA) in response stated, “Councils are now being faced with a very difficult balancing act, where they must continue to deliver day-to-day services with increasingly higher demands, whilst at the same time transforming the way they deliver those services to adapt in a time of rapid change” (COSLA Response).

2.9. Workforce and demand pressures have deepened post-pandemic, and funding is projected to further decline in real terms, making radical change necessary. Audit Scotland, in their Local Government Budgets 2025/26 Briefing, noted that “at the time of setting their budgets, councils identified a difference of £647 million between anticipated expenditure and the funding and income they receive. If savings in 2025/26 are not delivered, or are made through non-recurring means, then there is potential that these gaps will widen further” (Local government budgets 2024/25). Local authorities are making cuts, hiking taxes, raising charges and drawing on reserves to cover the budget gap, the commission found.

2.10. The situation underscores the need for innovative solutions to ensure sustainable public service delivery in Scotland.

2.11. Audit Scotland emphasises the need for urgent transformation in local government services to ensure sustainability, highlighting that relying on reserves is not a long-term solution (Local government in Scotland: Financial bulletin 2023/24).

With political uncertainty and unpredictable international relations there is greater economic, and therefore financial uncertainty over the medium term.

2.12. The Scottish Fiscal Commission (Scotland's Economic and Fiscal Forecasts) predicts councils will need to adapt to real-term funding reductions while managing inflationary costs and workforce challenges. The latest fiscal reports indicate that local government budgets “will remain tight”, requiring councils to make difficult decisions on service provision and investment priorities.

2.13. By 2029, councils will likely need to implement structural reforms to maintain financial sustainability, with a focus on efficiency savings, digital transformation, and community engagement. The Scottish Government’s economic bulletins highlight ongoing fiscal challenges, including uncertainty in tax revenues and social security spending. Local authorities will need to collaborate with public and private sectors to develop innovative funding solutions and ensure essential services remain accessible. The next five years will be critical for shaping Scotland’s local government landscape, requiring strategic planning and financial resilience to navigate economic uncertainties.

2.14. The Accounts Commission “urged local authorities to be upfront about the "scale of financial challenge being faced", empathising that “Councils must reform "at a pace and depth we've not yet seen" to avoid facing unsustainable losses” (BBC News).

Orkney context

2.15. "Orkney's economy is relatively prosperous, with low unemployment and high household income levels" (Orkney.com). It is characterized by a blend of traditional industries and emerging sectors, underpinned by strategic investments aimed at sustainable growth.

- **Employment Rate**: 88.3% for individuals aged 16 to 64, surpassing the Scottish average of 74.7%.
- **Unemployment Rate**: 1.7%, lower than the national average.
- **Economic Inactivity**: 11.7%, significantly below Scotland's average of 22.5%. (Office of National Statistics)

2.16. A comprehensive list of local indicators for Orkney can be found on the Office of National Statistics (ONS) website (Local indicators).

2.17. However, despite these positive indicators, Scottish, national and global socio-economic pressures continue to put a strain on the Council's budgets, requiring careful financial management to sustain essential services despite recent funding increases.

2.18. Orkney Islands Council continues to receive significantly less per capita funding than its island counterparts. This financial disparity places considerable strain on the council's ability to deliver services and maintain fiscal stability. Lobbying of the Scottish Government has shown some success, for example: the Local Government Settlement 'floor' has reduced to relatively negligible levels; revenue funding for ferries and one-off 'connectivity funding for 2025-26; and SINA (Special Islands Needs Allowance) is to be reviewed as part of the 2026-27 budget setting process.

2.19. On the other hand, Scottish Government policy continues to influence local spend through ring-fenced funding, the need to constantly report spending for national priorities, and significantly in 2024/25 the Council Tax freeze.

Scottish Government exerts control through budget settlements and policy agreements that condition certain funding on compliance with national objectives. These constraints reduce flexibility for councils to address local priorities or innovate in service delivery, even when overall funding appears to increase nominally. As a result, local authorities often face real-terms budget pressures despite headline funding rises.

Review against 2023-2028 strategy

2.20. The MTFS 2023/24 to 2027/28 highlighted significant funding shortfalls, forecast to rise to £27.1m by 2027/28. The following tables set out to assess the accuracy of the assumptions used, and the success of the actions taken to manage the funding gap.

2.21. The budget efficiencies achieved are significantly below the savings, service redesign and charging required by the MTFS. The 2023/24 to 2027/28 MTFS required a target, from all sources, of £18.2m for the three years shown in the table below.

Year	Efficiency Savings
2023 to 2024	£nil
2024 to 2025	£2,162,600
2025 to 2026	730,700
Total	**£2,893,300**

2.22. 2024/25 budgetary savings include reduction in employers pension contribution rate, the re-introduction of 1% reduction in staff budgets for anticipated staff turnover, and the introduction of Second Homes Council tax surcharges. 2025/26 budgetary savings reflect proposals brought forward by Service Directorates across a number of service areas, including the introduction of Telecare and Day Care charges.

2.23. The Budget and Council Tax setting process for 2024/25 outlined Directorate savings targets for 2025/26, 2026/27 and 2027/28. The proposals presented during the 2025/26 Budget and Council Tax setting process did not achieve the targets set for 2025/26, or the subsequent years.

	2025/2026	2026/2027	2027/2028	Total
Total savings	557,700	753,600	2,091,300	3,402,600
Total income	173,000	39,700	700,000	912,700
Total	**730,700**	**793,300**	**2,791,300**	**4,315,300**
Target	2,000,000	3,000,000	4,000,000	9,000,000
% of target	37%	26%	70%	48%
Difference	**-£ 1,269,300**	**-£ 2,206,700**	**-£ 1,208,700**	**-£ 4,684,700**

2.24. In addition to not achieving the savings targets, service pressures have continued to impact the baseline budget over the period to date.

Year	Service Pressures	One-offs	Total
2023 to 2024	£nil	£nil	**£nil**
2024 to 2025	£1,621,500	£1,706,800	**£3,328,300**
2025 to 2026	£561,400	£2,037,600	**£2,719,800**

2.25. The Scottish Government settlement has increased significantly against the MTFS assumption. The model included a 1% year on year increase, in reality far greater uplifts have been received, albeit to help fund high pay award for SJC and Teachers pays, and the Council Tax freeze in 2024/25.

Year	MTFS	Update
2023 to 2024*	£63.388m	£65.147m
2024 to 2025*	£64.833m	£72.194m
2025 to 2026***	£65.481m	£74.296m

* Actual / ** Forecast / *** Budget

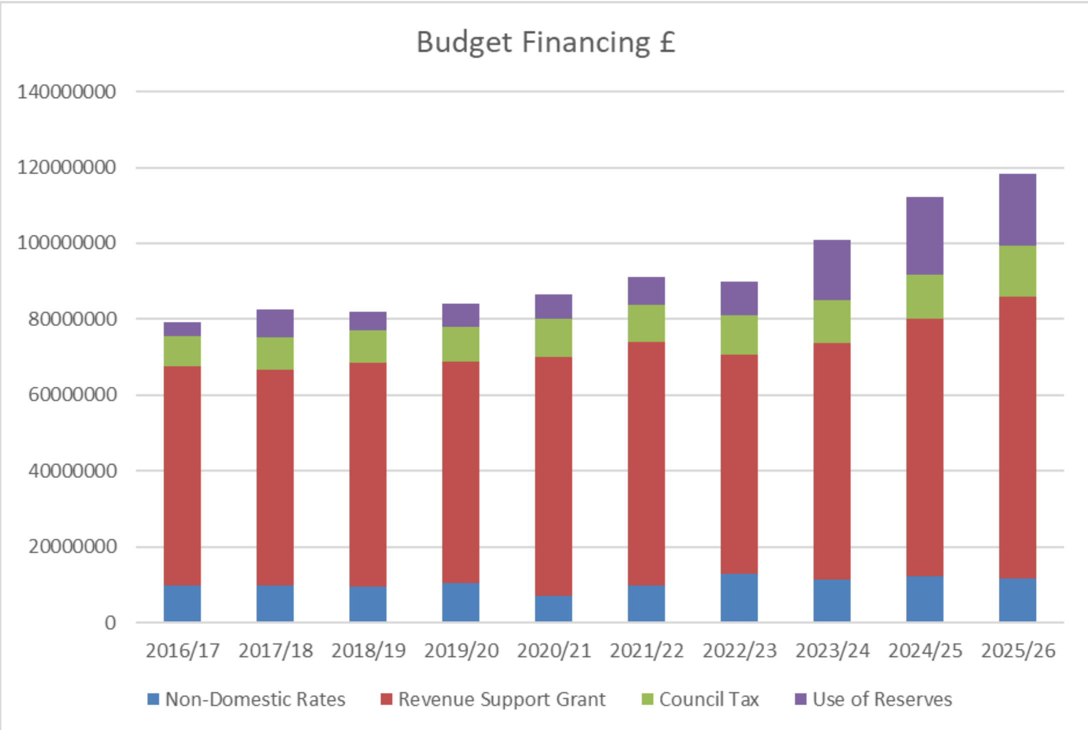
2.26. Use of reserves has made up the difference to balance the budget. The Budget and Council Tax setting process for 2024/25 also outlined indicative General Fund contributions from the Strategic Reserve of £20m, £18m, 15m, and £11m for 2024/25, 2025/26, 2026/27 and 2027/28 respectively. These were significantly higher than the figures included in the 2023/24 to 2027/28 MTFS. The following table shows the current, best estimate, for Strategic Reserve Fund contributions.

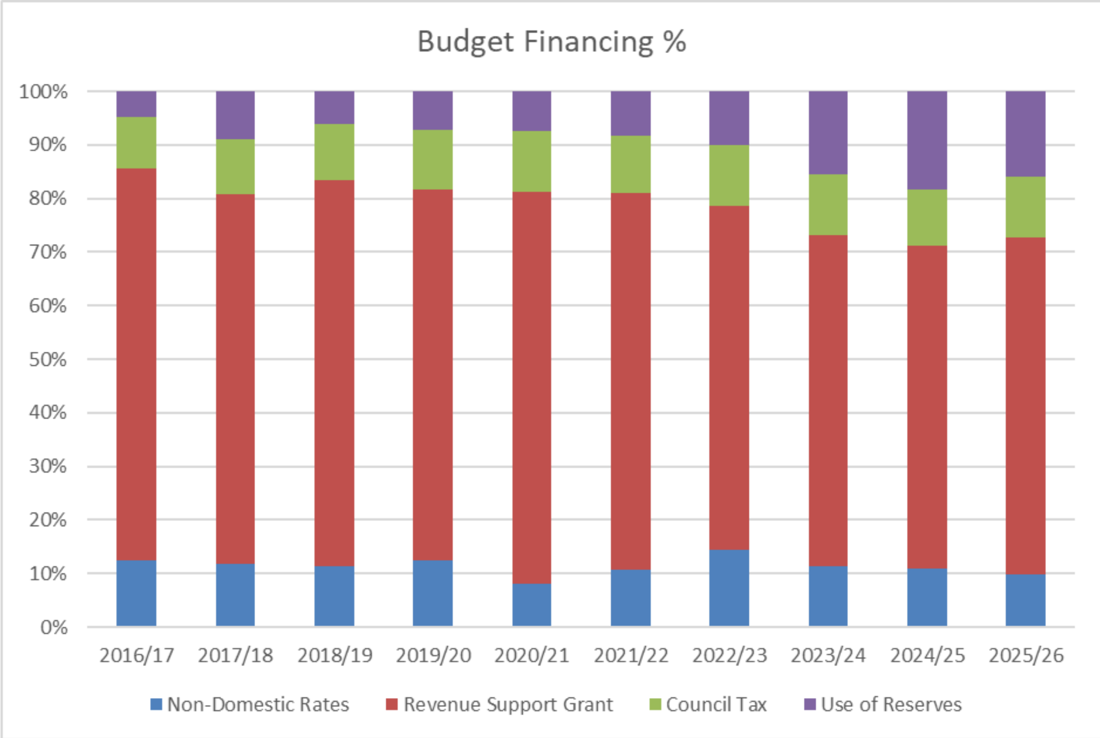
Year	MTFS	Update
2023 to 2024*	£6.350m	£6.662m
2024 to 2025**	£6.350m	£21.000m
2025 to 2026***	£6.350m	£18.431m

* Actual / ** Forecast / *** Budget

2.27. Finally, despite the 2024/25 Council Tax freeze Orkney Islands Council agreed a 15% Council Tax increase for 2025/26, meeting the members aim of achieving the Scottish average for Council Tax during the term of this Council.

2.28. The following graphs provide an illustration of how budgets have increased over the last 10 years, and how the financing split has changed.

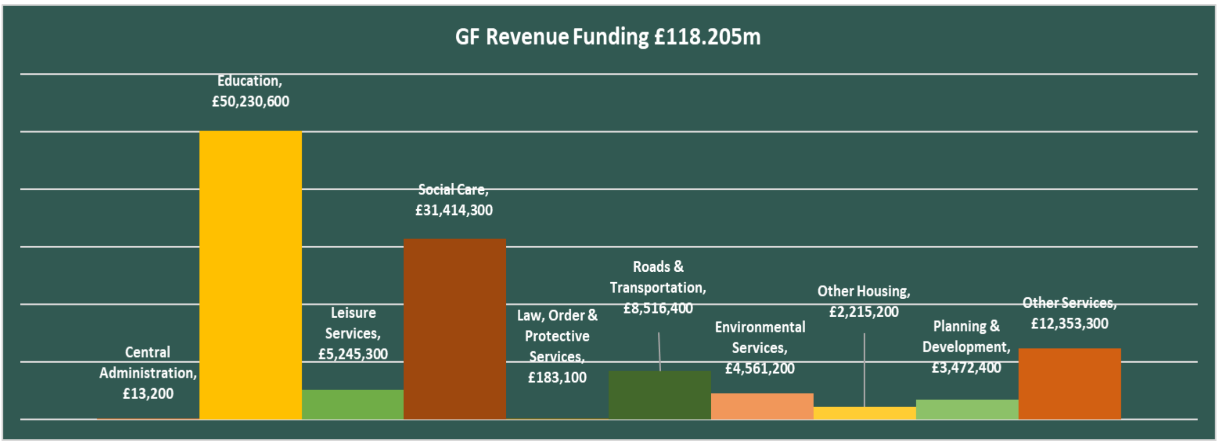




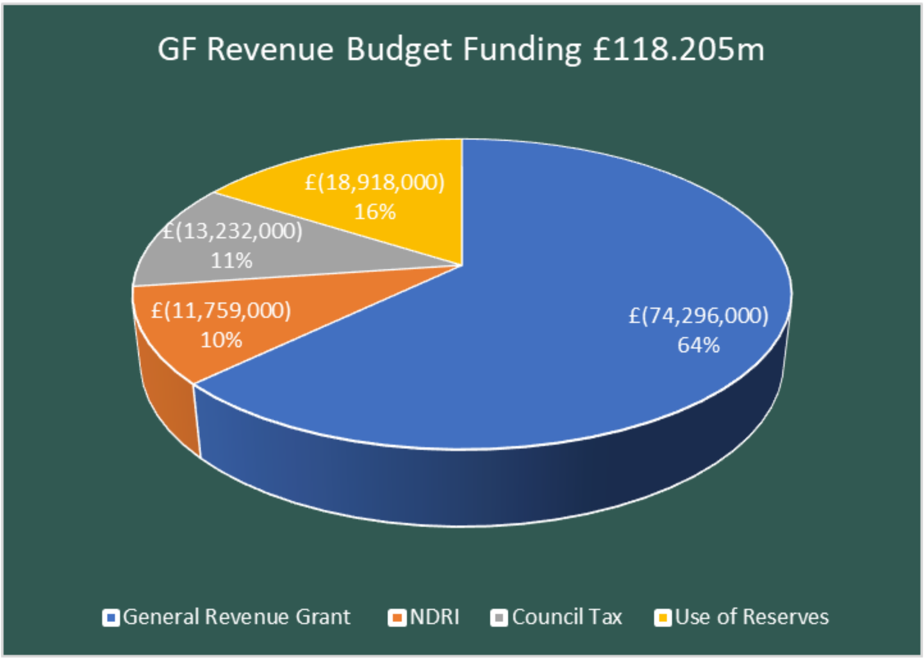
MTFS re-set

2.29. The annual budget process identifies increases in service demand over and above service budgets. There are also inflationary pressures which must be considered. The Council's annual budget uplifts in recent years have reflected a prudent approach, with minimal uplifts due to the constrained financial position. This approach has resulted in all Council services having to find additional efficiency savings within their approved budgets to cover the impact of price increases.

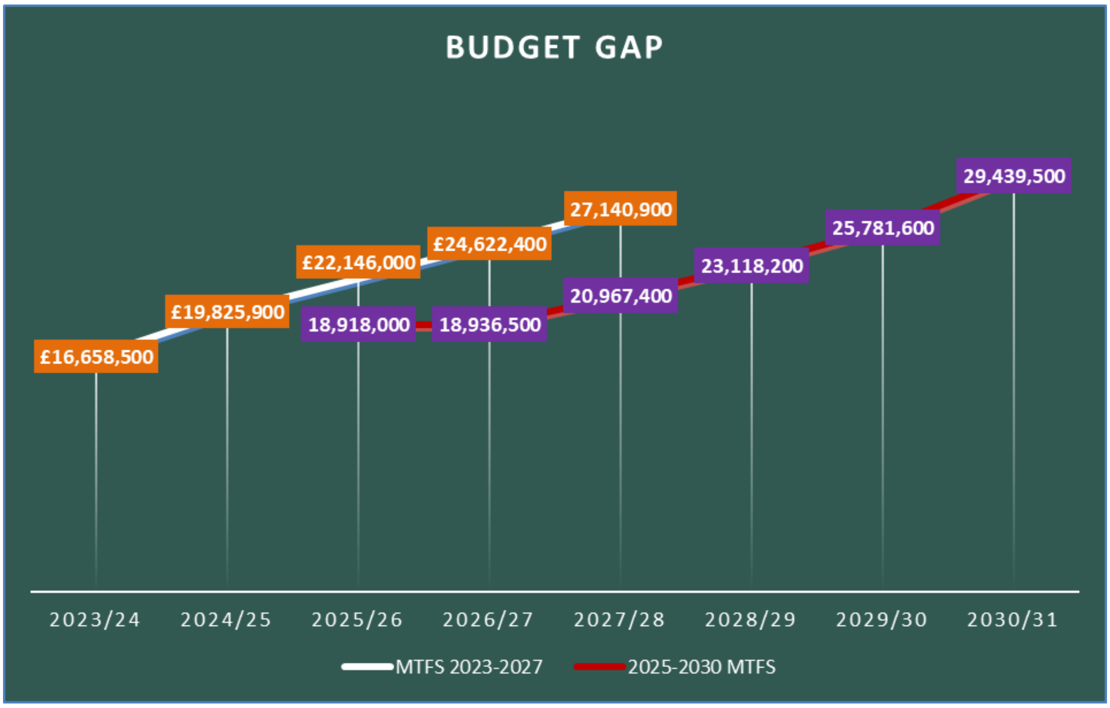
2.30. The 2025/26 General Fund budget of £118.205m is allocated across the following services:



Funded by:



2.31. The 2023/24 MTFS identified significant funding shortfalls, as indicated in the graph below. Subsequent Budget and Council Tax setting papers have reinforced this projected position. This re-set MTFS indicates some positive movement in financial forecasts which have helped postpone the growth of the funding gap. However, the funding gap that the Council could face over the 5-year period of this strategy is still significant.



2.32. The general recognition that further spending reductions need to be considered in a strategic and transformative manner, in the context of potential future income streams being progressed by the Strategic Projects team over the medium-to-long term.

2.33. The results of the budget setting public engagement exercise carried out over December 2024 and January 2025, showed a general willingness to:

- Increase Council Tax to protect public services;
- Increase service charges rather than see service cuts; and
- Review, and reduction, of service levels to preserve service.

2.34. The budget survey, including several charging lines, received 1,077 responses, representing less than 5% of the electorate – although a significant improvement on previous budget consultations.

2.35. The Trade Union consultation, conducted at the same time, provided the following response:

- Their overall position is they do not wish to see a reduction or cuts to services; they are concerned about the impact of 'austerity' to public services over the past 15 years.
- They believe that the focus should be on measures to increase revenue and welcome the work the Council has undertaken on this.
- Additional revenue should be derived from those most able to pay with visitor levy/Cruise ship income/Council Tax increases supported.

2.36. The key financial risk areas facing the Council over the medium term are summarised below:

- Level and reduction in real terms of Scottish Government funding.
- Pay awards.
- General inflation.
- Economies of scale.
- Level of competition / choice.
- Demographics, in particular ageing population.
- Investment return volatility.
- Housing shortages.
- Recruitment and retention.
- Increasing levels of demand.
- Increased cost of borrowing.

2.37. A risk register against this strategy is included at Annex 1.

Investment returns

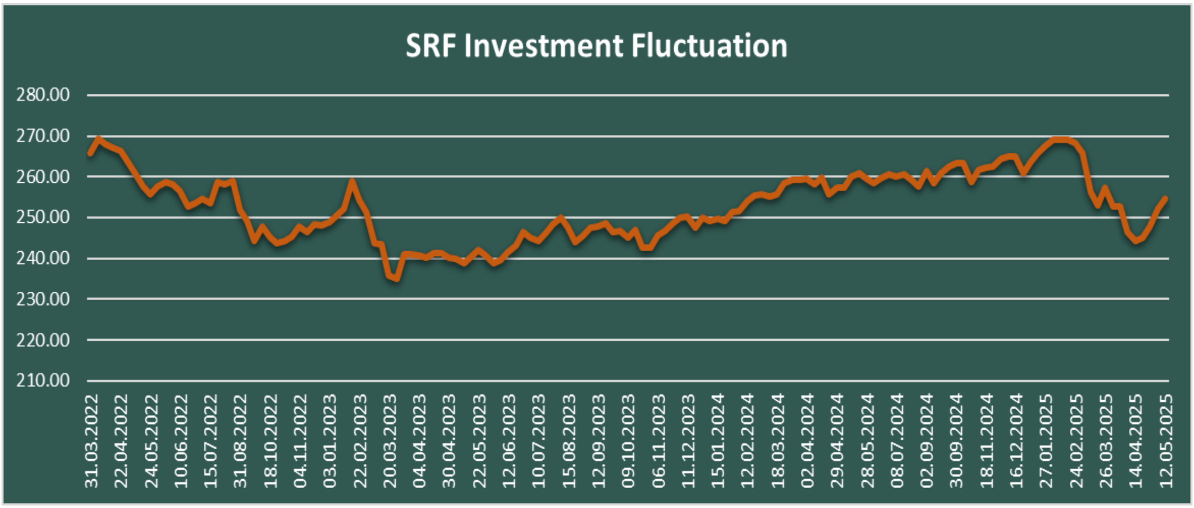
2.38. Over the past three years, financial markets have experienced significant volatility driven by global economic shifts, geopolitical tensions, and monetary policy changes. 2022 was marked by intense market volatility and widespread declines across equities and bonds. Global central banks, led by the US Federal Reserve, aggressively raised interest rates to combat soaring inflation caused by pandemic-related supply chain disruptions, labour shortages, and the Russian invasion of Ukraine. As equity and bond markets both struggled, consumer confidence and investment decisions were impacted.

2.39. 2023 and 2024 saw a mixed recovery. The bond market stabilised, although yields remained elevated. US tech stocks led global gains, but these were uneven and equity recovery remained weak. The FTSE 100 showed resilience, driven by strong performances in energy and financial sectors. However, political instability, including leadership changes and Brexit-related trade negotiations, continued to weigh on investor sentiment. The Chinese economy struggled, and political disruption in Europe added uncertainty to European markets. However, as inflation gradually cooled central banks were cautious of further fiscal tightening.

2.40. In 2024 and into early 2025, financial markets showed increased optimism, fuelled by expectations of rate cuts in major economies. The FTSE 100 reached new highs in early 2025. However, structural concerns including Brexit-related trade frictions, low productivity, and tight labour markets continued to cap UK investor enthusiasm compared to US or European markets. Further volatility in equities and bonds were caused by the introduction of US tariffs.

2.41. The past three years have been marked by economic recalibration, cautious monetary policy, and evolving investor strategies with markets remaining sensitive to policy shifts and macro-economic surprises.

2.42. The following graph shows the Strategic Reserve Fund investment portfolio balances from 1 April 2022 to 12 May 2025. Within this period £24m was withdrawn to meet spending commitments.



2.43. Over the next five years (2025–2030), financial markets are expected to experience a complex mix of slowing global growth, structural inflationary pressures, and technological transformation. Central banks, including the Bank of England, are likely to gradually normalise monetary policy, with interest rate cuts in the near term before stabilising at higher-than-pre-pandemic levels. Equity markets may deliver moderate returns, with market leadership moving away from a narrow group of tech giants toward sectors benefiting from artificial intelligence integration, energy transition, and infrastructure investment.

2.44. In the UK, markets will likely be influenced by ongoing fiscal pressures, political developments, and post-Brexit economic adjustments. Fixed income investments yields may become more attractive in a higher-for-longer rate environment, while geopolitical risks and climate-related events could introduce bouts of volatility. Investors will need to focus on adaptability, risk management, and strategic diversification to capitalise on opportunities in the evolving financial environment.

3. Strategy and Assumptions

3.1. A funding gap of £18.9m or 16.0% exists in the 2025/26 General Fund budget, funded by a draw on both General Fund and, predominately, Strategic Reserve Fund (SRF) reserves. The level of the funding gap versus the level of investment returns on Strategic Reserve Fund and falling General Fund balances makes this approach untenable in the medium term.

3.2. With savings proposals over the 3-year period, 2025-2028, of £4.3m were identified during the 2025/26 budget setting process against a target of £9.0m set in February 2024. It is recognised that the previous incremental approach to finding service savings is at an end.

Options available to bridge the funding gap are as follows:

- Increasing Council Tax.
- Fee income generation.
- Access external funding streams.
- Lobby for fairer settlement, in total and in focused areas.
- Efficiency measures and reduction in bureaucratic processes.
- Service redesign/transformation.
- Service reduction/removal.
- Capacity building within communities – working with NHS Orkney and 3rd sector.
- Recycle in year revenues, savings, other reserves, and balances, for example use of wind farm revenues or cruise liner passenger dues from Strategic Reserve Fund.

3.3. Financial projections set out in the graph at paragraph 2.31, above, contain assumptions which in turn bring risks and uncertainties. Changes in these assumptions can have a material effect on the outcome. The projections make assumptions in three broad categories:

- Issues known about or which are reasonably foreseen which create upward cost pressure e.g., pay pressure; indexation; known policy change commitments; etc.
- Issues which can be anticipated as areas of budget risk but where the extent of the risk is uncertain e.g., the cost of the ageing population; waste tonnages; etc.
- Issues which could create cost pressures but are speculative at this stage e.g., national insurance; superannuation; energy prices etc.

3.4. With much political and economic uncertainty around both the scale and timing of any funding reductions, it is not possible to provide a definitive medium-term budget. The projections produced contain several assumptions which are considered most likely.

Price increase assumptions	2026/27	2027/28	2028/29	2029/30
Staff costs	3%	3%	2%	2%
Budget uplifts	2%	2%	2%	2%
CPI on charges	2%	2%	2%	2%
Council tax	2%	2%	2%	2%

Notes:

- Staff costs – The Scottish Government allowed for up to three pay rises of 3% in 2024-25, 2025-26 and 2026-27 depending on previous pay agreements. Given recent pay awards, this assumption has been included at a higher rate for 2026/27 and 2027/28 before falling fall back in line with projected inflation.
- Budget uplifts – acknowledging we cannot continue to restrict budgets, by ignoring inflation.
- CPI on charges – per CPI inflation forecast on graph at paragraph 2.4, above.

3.5. It is worth emphasising that assumptions reflecting the best case would produce a budget better than predicted, and assumptions reflecting the worst case would deliver a budget poorer than predicted. Multiple scenario assumptions are limited in their value and are not included in the Medium-Term Financial Strategy and it is expected that readers understand that this is a prediction, and the outcome could be better or worse as more "knowns" are identified. A basic illustration on scenario analysis is included at paragraph 5.9, below.

Council tax

3.6. Council Tax rates were frozen in 2024-25. In 2025/26, all Scottish councils implemented significant Council Tax increases ranging from 8% to 15.6%, with an average increase of 9.6%.

3.7. The Council Tax level for 2025/26 was recommended by the Policy and Resources Committee on 25 February 2025 and agreed by Council on 4 March 2025. This budget saw Council Tax increase by 15% and achieved the Council strategy to bring Council Tax up to the national average within the term of this Council.

3.8. The Scottish average Band D Council Tax for 2025/26 is £1,543.30 with Orkney equivalent at £1,574.60.

3.9. There is uncertainty over Council Tax increases, given the Scottish Parliament elections due to take place in 2026. The table above includes inflationary increases only in the MTFS assumption, however it is likely that to retain the Scottish average, achieved in 2025/26, the Scottish average increase for Band D Council tax would need to be applied.

Fee income generation

3.10. The Council has budgeted to achieve income of £10.7m from fees and charges, sales, rents and lettings to external customers in 2025/26. The Council needs to assess what we could be charging for but currently do not, or where our charges are significantly below national averages.

3.11. The Council has an approved Charging and Concessions Policy which provides a clear framework to monitor and review service charging. The policy describes several charging options that could increase fee income revenues.

Four ways to increase revenue:

- Increase the number of customers.
- Increase the average transaction size.
- Increase the frequency of transactions per customer.
- Raising prices.

3.12. Services need to assess the unit costs for each service delivery and seek to maximise the return to the Council. They also need to have a pricing strategy for the revenue streams which achieve the desired outcome for the service and ensure the sustainability of the Service provision, and ultimately Council finances.

3.13. The Corporate Charging Working Group was established to review the charging policy and consider changes to existing charges and where appropriate the introduction of new service charges. It has a key role to play as the Council looks to increase the level of income generated through charging to recover a greater proportion of the cost of providing certain services thereby reducing the need for service reductions elsewhere.

Access external funding streams

3.14. The Council will continue to make the case for additional external funding wherever possible to reduce the net cost of Council services. Applying for specific grant funding for revenue and capital spend needs to be maximised, to reduce the borrowing requirement on capital projects, and to protect Council budgets.

3.15. The Council now employs two dedicated grants officers to support service officers complete successful funding applications. The support offered by these grants officers needs to be harnessed to maximise the benefit to the Council.

Lobby for fairer settlement

3.16. As stated at 2.17, above, Lobbying of the Scottish Government has shown some success.

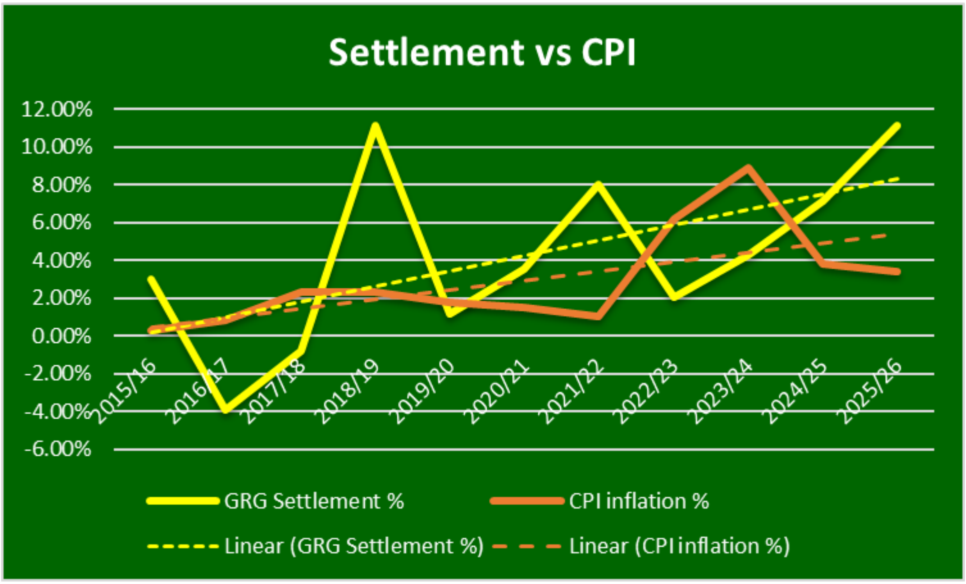
3.17. However, further dialogue with the Scottish Government is required to ensure a ‘fairer’ settlement for Orkney. Orkney Islands Council continues to receive significantly less per capita funding than its island counterparts.

Per Head Difference	Total Revenue Funding £'000	Ferries Grant £'000	Assumed Council Tax £'000	Net of Ferries & C. Tax Funding £'000	Populatio n #	Per Head £
Orkney	105,994	20,804	8,462	76,728	22,000	3,488
Shetland	118,916	24,679	8,475	85,762	22,900	3,745
Eilean Siar	118,038	0	9,845	108,193	26,200	4,130

3.18. Removing this financial disparity will not balance the Council's general fund budget but would go a considerable distance to financial sustainability if, for example, Orkney were able to match the Western Isles per head funding – an additional £14.1m.

3.19. Lobbying of the Scottish Government should be done in a focused and in total to attempt to reduce the disparity.

3.20. A focused analysis of the settlement figures against existing service costs will identify specific areas where the Council, its location and/or demographics, result in disproportionate funding shortfalls. A strategic approach to lobbying the Scottish Government may be beneficial.



3.21. The above graph shows that the settlement has more or less ran alongside CPI historically. It should be noted that the peaks in 2018/19 and 2021/22 reflect the ring fencing of certain funding streams. Commitments made by the Scottish Government as part of the Verity House Agreement to reduce ring-fenced funding appear to be reflected in 2025/26 settlement. However, COSLA contend that the increase in GRG does not provide councils with greater autonomy or discretion when setting their own budgets. (Local government budgets 2025/26)

3.22. The increases from 2023/24 reflect the growth in the ferry funding, funding for pay awards and increases to Real Living Wage and the Council Tax freeze in 2024/25.

3.23. Protectionism of some services further limits local solutions to the funding shortfall, for example Teacher numbers and Free School Meals.

3.24. The most recent Scottish Government Medium-Term Financial Strategy (MTFS) was published on 25 May 2023. This document outlined the government's fiscal outlook and strategic priorities for the period from 2023–24 to 2027–28. As of December 2024, the Finance Secretary indicated that the Scottish Governments MTFS would only be published after the conclusion of the UK Government's Spending Review in the Spring of 2025. However, the Scottish Budget for 2025/26, presented in December 2024, outlines funding expectations for both revenue (resource) and capital spending in the subsequent years.

3.25. The Scottish Government anticipates that day-to-day (resource) funding will experience modest growth in real terms over the medium term. Specifically, funding is projected to increase by approximately 0.5% to 1.4% per year in real terms between 2025/26 and 2028/29. This growth is contingent on the UK Government's fiscal policies and the performance of devolved tax revenues. However, the Institute for Fiscal Studies (IFS) suggests that actual growth might be closer to 0.5% annually, considering current assumptions. (Fiscal Outlook)

3.26. Add to that the difficult trade-offs between spending in 2026/27 and beyond, given this relatively slow growth in funding. For example, if day-to-day spending on health and social care was increased by 3% a year in real terms and funding for councils via the main finance and local government portfolio increased by 1.5% a year in real terms, other areas could face cuts to spending of between 1.7% and 5.6% in real terms each year from 2026/27 to 2028/29. (Fiscal Outlook)

3.27. The pressures are mixed for capital, where the Scottish Government provided a 7% real terms increase in overall capital spending for 2025/26, but the IFS projects that capital funding will decline by 4.1% in real terms in 2026/27, with subsequent years seeing flat or reduced levels, primarily due to a freeze in UK Government capital funding and a reduction in capital borrowing by the Scottish Government (Medium-Term Outlook). In addition, 2025/26 finance settlement saw a significant fall in loan charges support which puts additional pressure on revenue budgets.

In conclusion, it is unlikely that the Scottish Government settlement will match in real terms the funding pressures faced by the Council, but it is not unreasonable to assume a cash increase over the period of the Medium-Term Financial Strategy, this is estimated at 1.5% for 2026/27 and 2027/28, falling to 1.0% thereafter (i.e. 50% of wage increase assumption).

Efficiency measures

3.28. There will be a need for services to continue to find savings and efficiencies while maintaining or even improving public outcomes.

- When cost cutting in existing functions is appropriate, explore both radical approaches to restructuring and more traditional tactics.
- Don't overlook the substantial benefits that can come simply from identifying key activities and making them more effective.

3.29. Strategies the Council could explore include:

- Embrace digital transformation, for example, self-service portals, cloud based systems or use of AI (artificial intelligence)
- Shared services & collaboration, for example, joint procurement or sharing services or data with other councils,
- Process re-engineering, for example, rethink how services are delivered to improve speed and reduce duplication using methodologies like Lean Management or Kaizen
- Workforce optimisation, for example, cross training of staff to cover multiple functions or training staff in effective use of digital tools to enhance productivity.
- Energy and environmental efficiency, for example, savings in lighting, heating, and facilities management and fleet optimisation.
- Community engagement, for example, community led support programs, volunteering and partnerships with other public bodies, local businesses and third sector.
- Financial and asset management, for example, asset rationalisation, maximise alternative funding, preventative maintenance to reduce long-term costs and regular audits to manage budget issues.
- Data-Driven Decision Making, for example, performance dashboards or predictive analytics.

3.30. However, given the level of savings delivered through the Change Programme, and subsequent initiatives, since 2011 many of these strategies are in progress, or have been explored in the past. Not that that should prohibit revisiting some, or exploring others, going forward. However, it is anticipated that significant service redesign, or transformation, is required to continue to meet the needs of the people of Orkney within the funding available.

The key difference between efficiency strategies and transformation strategies in local government lies in their scope and long-term impact.

Efficiency strategies refine what already exists:

- Focus on optimising current operations: do more with fewer resources.
- Typically involve cost-cutting measures, process automation, and workforce productivity improvements.
- Aim to reduce waste and enhance service delivery without fundamentally changing how services are structured.

Transformation strategies seek to reshape local government for long-term sustainability.

3.31. Some governance arrangements add to the necessary controls of the Council to protect itself, and our staff. However, some processes have been built up over 50 years and need overhauled and brought up to date. Many require updating to align with technological advances and the enhanced capabilities of IT systems, or combat recruitment issues.

3.32. There is a requirement to review, update, replace or remove significant policies, procedures, and processes (including reviewing risk appetite), with deference to governance and scrutiny requirements, without being onerous, inefficient and expensive to administer.

3.33. Reducing the friction created through bureaucracy will speed up the Council dynamic. Officers want autonomy and trust. The Council needs a way to let officers move quickly and make decisions.

Service redesign or transformation

3.34. The Scottish Government and the Accounts Commission emphasise local government transformation as essential for delivering better outcomes, particularly in the face of rising demand, financial pressures, and changing public expectations. Based on their guidance and strategic reports, the key elements of transforming local government services are:

- Person-Centred, Outcomes-Focused Services
- Strong Leadership and Vision
- Community Empowerment and Participation
- Partnership and Collaboration
- Digital Innovation and Data Use
- Financial Sustainability and Efficiency
- Workforce Transformation
- Continuous Improvement and Innovation

Is the current operating model fit for purpose?

- An effective operating model is a key element to create value and deliver services in constantly changing environment.
  - Can we restructure services to take advantage of current and projected trends?
  - Do we understand which activities drive value?
- The operating model should be based on strategic direction not legacy.
- Top-down design; bottom-up validation.

Services should consider the service experience through the customer's eyes.

3.35. Ask ourselves "why does the OIC exist?" If we were redesigning services from the bottom-up what would the provision look like, and what would the Council add in over and above the minimum requirement for that service's delivery?

3.36. For example, there is an opportunity to redesign services in the post COVID era. Increased use of technology will give services the ability to focus the resources in the correct areas and take account of changes in the way stakeholders work, rest and play, for example, the impact of hybrid working, or the changing demographics of the community. This will include an integrated approach to software development which makes the performance of tasks more intuitive for both internal and external users.

Information systems	Systems which interact with each other	Reports generated from systems	Analysis tools	Manual systems
• Need to be up to date with technological developments	• Need to share data with minimum intervention	• Need to remove manual manipulation	• Need to be able to run effectively from data exported	• Need to be stripped down and build up again where/if required

3.37. Giving officers access to holistic and homogeneous systems will create efficiencies which, over time, should crystalise savings.

3.38. Effective data sharing with other local authorities, particularly other island authorities, may reveal service delivery methods which we can learn from.

Building capacity within communities

3.39. The significant demographic pressures which public bodies face are particularly acute in Orkney. Increased community, third sector and voluntary participation will be necessary to manage the expected increase in demand for services that will materialise. With significant synergy and overlap in service provision within Orkney by the Council, NHS Orkney and the third sector, there is room for more joined up working. This will require re-prioritisation of resources to provide more integrated and outcome-focussed services which will ensure that the reducing public resources available will deliver the value the Council seeks through its partnering arrangements.

3.40. The Community Empowerment (Scotland) Act 2015 introduces a range of opportunities for communities to become more engaged and involved in the delivery of local services. For example, communities can request property asset transfers to take direct responsibility for Council properties for community purposes. Communities can also make participation requests where it is felt that the voices of certain communities are not being heard.

3.41. Another example is Community Led Support (CLS). While originating in health and social care, the principles of CLS such as collaboration, local decision-making, strengths-based approaches, and community involvement can be applied across a wide range of sectors. These include housing, education, employment services, and community development. Any area that benefits from more person-centred, locally driven and relational ways of working could adopt the CLS model to improve outcomes, build trust, and make services more responsive to the needs and strengths of individuals and local communities.

Use of reserves and balances

3.42. The pressure to draw more from reserves to preserve services and jobs is recognised. With volatile Strategic Reserve Fund investment returns in recent years, it is not possible to ascertain what a "sustainable" draw on reserves might look like.

3.43. In 2012, the Council agreed a 'floor' value for the Strategic Reserve Fund investment portfolio, although arbitrary and historical, it did provide a method of assessing the future proofing of the fund.

3.44. An Investment Strategy review was carried out by Hymans Roberston in 2024. The modelling showed that the expected nominal return on investments is 7.7%, which is much higher than the previous projected return in 2021 (5.2%) and is driven by the risk-free rate of return on risk-free assets such as government bonds if held to maturity. However, it is noted that the volatility on the returns has also increased to +/-10% (2021 +/-7.7%) in any one year.

3.45. The Review reflected the indicative future drawdowns of £18m, £15m and £11m in financial years 2025/26, 2026/27 and 2027/28 respectively required from the Strategic Reserve Fund to support General Fund services.

3.46. These substantial draws from the Strategic Reserve Fund have further ceded ground against the Strategic Reserve Fund 'floor'.

3.47. The conclusions provided by Hymans Robertson were:

- Assuming the SRF reverted to a lower level of distribution (from the elevated short term funding plans) the current strategy would be expected to generate sufficient returns to rebuild and grow the value of the Fund.
- If distributions were kept at higher levels of around £10m per annum. longer term then it will take the Fund longer to get back on target and any meaningful reduction in the expected levels of return would impact on the sustainability of the Fund value.
- Simple stress tests carried out show that any short-term negative returns can have a significant impact on outcomes and therefore while the focus of the analysis was primarily on returns, also need to be mindful of the volatility of returns and the potential for them to impact on outcomes and the ability to meet desired cash funding plans.

3.48. The market may perform better or worse than forecast, therefore the Review recommended that the current expected return of 7.7% per annum can support the current short term spending plans and longer-term distributions of £6.35m per annum (from 2028/29 onwards).

3.49. In addition to investment returns, however, there has been a change in the treatment of passenger harbour dues, which provided surpluses are achieved, will contribute approximately £2m of resources to support corporate objectives. The Community Wind Farm project at Quanterness is also anticipated to contribute circa £2m from 2028/29.

Market volatility on investments, oil port surpluses, cruise liner activity and, most importantly Council decisions, will have a significant bearing on whether headroom is restored over the next five years.

3.50. The Council has General Fund reserves consisting of non-earmarked and earmarked reserves. As part of the annual budget setting process these reserves are reviewed to assess the appropriateness of maintaining each of these earmarked balances. As at 31 March 2024, the Council had non-earmarked reserves of £3.4m. The balance being slightly above the approved policy to hold 2% net revenue budget as contingency. However, given the level of annual overspending against budget in 2023/24 and 2024/25, a more prudent approach would be to restore the 4% non-earmarked reserves target.

3.51. Any residual General Fund balances identified through the review process in future years will be redirected before consideration of any additional contributions are made from the Strategic Reserve Fund. However, the level of budget overspending across the Council makes this difficult to imagine the circumstances where this may be possible during the term of this strategy.

Service pressures and service growth

3.52. Service pressures and a desire to grow services is included in every strategy and plan generated. It is expected that throughout the period of this Medium-Term Financial Strategy any pressures or growth ambitions are achieved from within approved budgets, in addition to generating budget underspends which can be allocated corporately to ensure the delivery of all Council services.

3.53. Only in very exceptional circumstances should service pressures or growth be approved without being self-funded or able to secure ongoing external funding.

3.54. However, it is important to understand the full extent of services pressures, for example, the estimated annual cost to ‘maintain’ Orkney’s roads, or the extent of the demand on the Council estate for improvements, repairs and maintenance, or the shortfall in IT and plant replacement and improvements. The top-sliced capital programmes were enhanced for the three year period 2025-2028, but the reducing General Capital Grant will require a review of the allocations at the end of that period, without elevating the pressures on the Council infrastructure.

3.55. The MTFS projections continue to reflect ‘one-off’ service pressures included in the 2025/26 budget setting process which have continued for several years, for example children’s residential and out of Orkney placements.

Budget allocation

3.56. In order to deliver a fair and systematic approach to the allocation of financial resources across the Council, it is necessary to analyse key resource information to ensure that future service budgets better reflect the relative importance of such information.

3.57. Four key elements are used to assist in decision-making about the future allocation of resources:

3.58. **Risk** (including statutory, reputational, and political risk) is seen as a significant element. Some services must be delivered by law, however, significant discretion over the level of service exists, with some services having more scope than others to reduce current service levels before a critical level is reached in terms of capacity to deliver even a basic level of service or fail to meet their statutory obligations.

3.59. **Council Priorities** are very important in shaping local services to local needs. However, the flexibility to redirect resources away from other statutory requirements, ring-fenced funding and Scottish Government policies and priorities is limited.

3.60. **Budget to Funding** can be explained as the level of funding provided through the settlement which should be closely linked to how much is spent on a particular service area, however, factors such as demography, need and other funding pressures are also considered. For example, some benchmarking information might be readily available to show how the Council compares with other local authorities - number of child placements, cost of child placements, number and cost of independent living packages with two to one or more support, spend for km of road, cost per child for education, etc.

3.61. Councils have some discretion to reallocate funding based on their local priorities and this is reflected in the current allocation of budget within the Council which has evolved over many years through political choice during the budget setting processes.

3.62. **Performance** levels should be kept under review. The Council must continue to deliver the best possible services from within the resources made available to it and look for continuous improvement wherever possible. The ability to achieve high performance may reduce, however, as funding levels reduce.

With reduced funding levels and a mix of performance levels across Council services, there could be a need to redirect resources from areas of very high performance to areas where performance needs to improve. It is also important not to create a culture in which poor performance is considered the norm and is rewarded.

4. Non General Fund

4.1. The following section explains, subject to the general strategy and assumptions, outlined above, how other sections of the Council's finances are expected to perform.

Treasury Management

4.2. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low-risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

4.3. The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing needs of the Council, essentially the longer-term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

4.4. The Council agrees a Treasury Management Strategy annually. It details who the Council can invest with and the maximum amount that can be invested. These limits are based on credit ratings supplied by independent credit rating agencies.

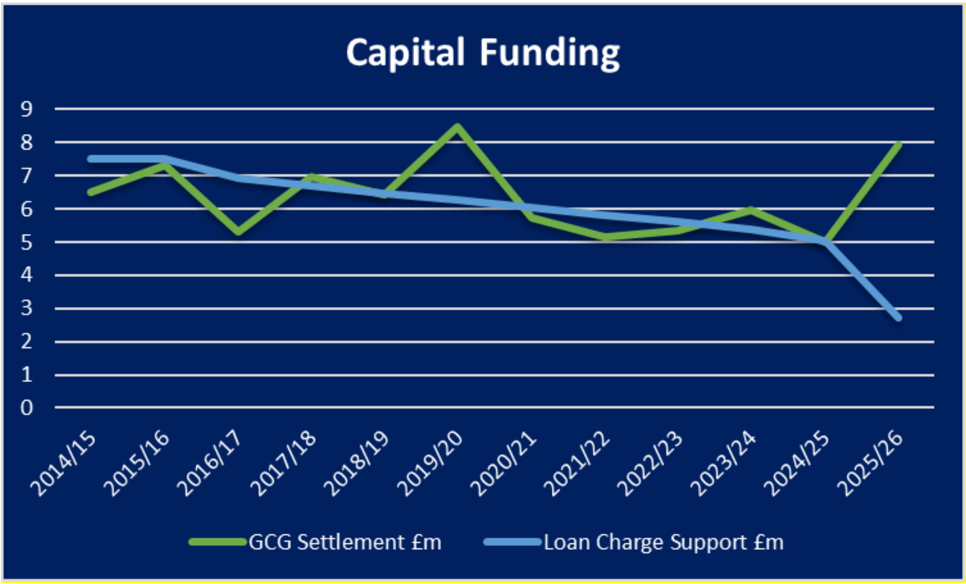
4.5. The Local Government Investment (Scotland) Regulations 2010 came into force with effect from 1 April 2010 and permits local authorities to make investments subject to them gaining the consent of Scottish Ministers. Finance circular 5/2010 subsequently set out the terms of that consent and requires local authorities to "have regard to" the 'Prudential Code for Capital Finance in Local Authorities' and the Treasury Management in the Public Services: Code of Practice and Cross-sectorial Guidance Notes' when managing their investments.

Capital Programme

4.6. Capital investment priorities are based upon Corporate Asset Management Planning principles. CIPFA's (Chartered Institute of Public Finance and Accountancy) Prudential Code for Capital Finance sets out a best practice approach for determining a capital investment strategy and aims to ensure that spending plans are affordable, prudent, and sustainable. The Code requires councils to take account of asset management and option appraisal factors to comply with Best Value. A long-term capital strategy will be developed to improve forward planning beyond the current timescale of the rolling 5-year capital programme.

4.7. When the Council takes on additional borrowing to fund capital expenditure it must be sure that it can afford to meet the principal and interest repayment costs. The following graph shows the decreasing support in General Capital Grant (GCG) and

Loan Charges support provided by the Scottish Government in the annual settlement.



4.8. Falling Loan Charges support means that, after the application of grant funding contributions, the cost of new investment in service infrastructure will require to be funded from efficiency savings and/or income generation going forward. Loan charges are not charged direct to individual services but managed as a corporate cost.

4.9. The Council's existing capital programme includes approved capital project expenditure of £45.749m over the 5-year period 2025 to 2030 which, after allowing for £35.467m in respect of use of reserves, capital receipts, capital grants and revenue contributions, leaves an identified capital financing borrowing requirement of £10.282m.

4.10. With reference to paragraph 3.54, above, the majority of the General Capital Grant is allocated to finance the Councils top-sliced capital programmes.

Revenue implications of the Capital Programme should be incorporated into future years' revenue budgets to fully integrate the revenue and capital budget processes. Preference should be given to those projects which deliver revenue savings and can be crystalised into revenue budgets.

4.11. The Council's net capital financing requirement is forecast to increase from £83.517m to £117.286m over the 3-year period from 2025 to 2028, being a net increase of £33.769m after allowing for the repayment of principal.

4.12. The Council's authorised limit for external debt is scheduled to increase from £95m to £135m over the 3-year period 2025 to 2028, to accommodate the Community Wind Farm project, and the operational boundary for external debt is also expected to increase from £90m to £125m across the same period. As a key prudential indicator, the authorised limit represents a control on the maximum level of borrowing and as a limit beyond which external debt is prohibited. This limit is set and revised by the Council. As such, this represents a level of external debt that could be afforded in the short term but is not sustainable over the longer term. The graph above shows cash reductions in the General Capital Grant, and Loan Charges support, in addition to real term reductions.

Housing Revenue Account

4.13. The Housing Revenue Account expenditure budget for 2025/26 is set at £4.129m, a decrease of £0.078m or 1.8% over the previous year's figures. The Housing Revenue Account is financed almost entirely by rents and other charges paid by Council tenants and cannot be funded in any way from the General Fund and revenue raised through the Council Tax.

The Council is required to maintain a separate Housing Revenue Account covering income and expenditure in respect of specified houses, buildings, and land. There is a legal requirement for Housing Revenue Account income and expenditure to be in balance at the end of each financial year.

4.14. The Housing Revenue Account capital programme must be met from existing resources or funded through prudential borrowing. The Loan Charges budget in respect of repayment of debt has decreased by £0.188m to £0.635m for 2025/26.

Scapa Flow Oil Port

4.15. The Council maintains a separate trading account for Scapa Flow Oil Port in terms of Section 67 of the Orkney County Council Act 1974 which requires the Council to keep separate accounts in respect of the harbour undertaking to distinguish capital from revenue and income from expenditure.

4.16. The current Flotta Oil Terminal operator requires a 24-hour, seven day per week harbour operation to facilitate tanker movements. From the point of view of the Council, this means that there is a requirement to continue to resource this activity accordingly to maintain an appropriate level of service.

4.17. The income levels for the Scapa Flow Oil Port account are dependent on tanker throughput. The current terminal operator has provided estimates of tanker numbers, which indicate a decrease in the number of tankers from historic levels. The income projections for 2025/26 are based on tanker predictions of 12 tankers for the year, and 40 ship-to-ship transfers.

In general, Scapa Flow Oil Port is expected to trade profitably and deliver a return to the Strategic Reserve Fund. A net income budget of £0.354m was set for 2025/26.

Miscellaneous Piers and Harbours

4.18. The Council maintains a separate trading account for Miscellaneous Piers and Harbours to distinguish it from the General Fund services. This is to demonstrate to harbour users that the dues paid for using the Council's piers and harbours is ring-fenced for the provision of harbour services or applied to the maintenance of the piers and harbours. A budget surplus of £2.215m is anticipated for the Miscellaneous Piers and Harbours Account for financial year 2025/26.

4.19. Income projections for the account are based on a similar level of trade to previous years with the application of increased charges in line with the budget strategy. In recent years, the level of cruise liner visits heavily influences the level of harbour operations the Harbour Authority can undertake. A forecast 232 liners are expected in Orkney in 2025.

4.20. Miscellaneous Piers and Harbours are required to operate within their budget provision and any surpluses built up over previous periods.

4.21. As stated in paragraph 3.49, above, there has been a change in the treatment of passenger harbour dues, which provided surpluses are achieved within the Miscellaneous Piers and Harbours, will mean a contribution of approximately £2m to the Strategic Reserve Fund to support wider Council services impacted by cruise liner activity.

UHI Orkney

4.22. Unlike most other colleges of further and higher education, UHI Orkney remains part of Orkney Islands Council.

4.23. UHI Orkney is an academic partner in the University of the Highlands and Islands although it is incorporated under the Council.

4.24. The Post 16 Education (Scotland) Act 2013 established Regional Strategic Bodies, which receive funding from the Scottish Funding Council. UHI, as a Regional Strategic Body, is the principal funder of UHI Orkney. In addition, UHI Orkney claims grants from various external bodies such as Highland and Islands Enterprise, Skills Development and the Student Awards Agency for Scotland.

UHI Orkney aims to realise a surplus each financial year or at the very least to achieve a break-even position.

Strategic Reserve Fund

4.25. The purpose of the Strategic Reserve Fund is to support projects which provide benefit to the Orkney community as a whole such as the development of industrial estates, harbour infrastructure and recreational projects, while supporting economic development activity in general across the Council area. The Strategic Reserve Fund is also required to support the long-term objective of managing the implications associated with declining oil related revenues on the economy of the islands and to contribute to the decommissioning costs of the Flotta terminal at the end of its life.

4.26. The Council considered the Strategic Reserve Fund revenue budget in February 2025. The approved contribution from the Strategic Reserve Fund for 2025/26 was set at £18m, together with indicative budgets for 2026/27 and 2027/28 of £15m and £11m respectively.

The contribution to the General Fund from the Strategic Reserve Fund is treated as a funding source and allows the Council to supplement the funding received from the Scottish Government and the taxes raised locally from Non-Domestic Rates and Council Tax.

4.27. The section on Use of Reserves, above, provides more information on Strategic Reserve Fund, including the findings of the 2024 Hymans Robertson Strategic Reserve Fund Investments Strategy Review.

4.28. In addition to the General Fund contribution there are several other budgeted commitments on the Strategic Reserve Fund that are also expected to be drawn down over the next three years, including:

- £0.392m towards the Island Games 2025.
- £1.351m towards Strategic Projects.
- £0.466m towards Islands Growth Deal projects.
- £0.667m towards Community Development Fund projects.

4.29. This list of commitments/disbursements only reflect current decisions and exclude any potential additional requests. Future decisions identifying the Strategic Reserve as a funding source will further reducing the balance of useable reserves, and future earning power of the investment portfolio.

Orkney Islands Council Pension Fund

4.30. The Council is the administering authority for the Orkney Islands Council Pension Fund. As with all other service areas, a revenue budget has been prepared and approved.

4.31. The main expenditure items are staff costs, third party payments for the pension fund software system and professional advisers' costs.

4.32. An actuarial valuation of the assets and liabilities of the Pension Fund, required every third year by the Administration regulations, is currently being undertaken. The results of this valuation could result in higher/lower employer contributions required from the Council. The next valuation will take place in 2026/27.

4.33. A +/- 1% change in the employers' rate would equate to a additional cost /saving of approximately +/- £0.70m to the General Fund.

Reserves Strategy

4.34. In determining long term financial plans and preparing budgets, the Council needs to consider the establishment and maintenance of reserves in accordance with its statutory powers. Reserves can be held for three main purposes:

- Working balances to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing – this forms part of General Reserves.
- A contingency to cushion the impact of unexpected events or emergencies – this also forms part of General Reserves.

- A means of building up funds often referred to as Earmarked Reserves, to meet known or predicted liabilities.

4.35. The General Fund Reserves Strategy was reviewed by the Policy and Resources Committee in February 2025. As at 31 March 2024, the Council held reserves and balances totalling £24.491m.

Balancing the annual budget by drawing on general reserves may be viewed as a legitimate short-term option; however, it is not normally prudent for reserves to be deployed to finance recurrent expenditure. The Chartered Institute of Public Finance Accountants (CIPFA) has commented that local authorities should be particularly wary about using one-off reserves to deal with shortfalls in current funding.

4.36. There is no generally recommended target level of uncommitted General Fund Reserves although local authorities do tend to have a target range of between 2% to 4% of their net revenue expenditure. The review of the Reserves strategy agreed the non-earmarked General Fund balance be set at 2% of the 2025/26 net revenue budget as a contingency for in-year pressures.

5. Mind the gap

5.1. Taking the starting position as the 2025/26 final budget and applying the assumptions above, how will the Council achieve a balanced budget over the medium term?

Mind the gap	2025/26	2026/27	2027/28	2028/29	2029/30
Shortfall with base assumptions	£18,918,000	£18,936,500	£20,967,400	£23,118,200	£25,781,600
SRF Contribution	(16,431,000)	(13,000,000)	(9,000,000)	(7,000,000)	(7,000,000)
County Fund Contribution	(2,000,000)	(2,000,000)	(2,000,000)	(2,000,000)	(2,000,000)
GF Reserves & Balances	(487,000)				
Sub-total	**£0**	**£3,936,500**	**£9,967,400**	**£12,118,200**	**£14,781,600**

5.2. The sub-total above, provides the ‘gap’ that as a Council we need to manage. The approach to managing these shortalls is addressed as follows:

Mind the gap	2025/26	2026/27	2027/28	2028/29	2029/30
Sub-total	**£0**	**£3,936,500**	**£9,967,400**	**£12,118,200**	**£14,781,600**
Advance SRF re Wind Farm				(2,000,000)	(2,000,000)
New Charges, Efficiencies & Transformation		(3,936,500)	(9,967,400)	(12,118,200)	(14,781,600)
Sub-total	**£0**	**£0**	**£0**	**£0**	**£0**

5.3. New charges, efficiencies and transformation could include legislative changes, for example, visitor levies. Cruise liner visitor levies are currently being consulted on by the Scottish Government, and any legislation would likely fall into the period of this MTFS.

5.4. It includes any potential income from other Council Strategic Projects, for example other Community Wind sites, or possible Scapa Flow Deep Water Quay revenues applicable to the General Fund. It also includes service reviews of current charges, and ensuring the Council charges where it is can, or charges meet service costs if possible.

5.5. It also includes Council Tax increases above the assumed 2% increases included in the model.

5.6. The savings proposals presented during the 2025/26 Budget and Council Tax are also not reflected in the new charges, efficiencies and transformation line. These are summarised as follows:

			2026/2027		2027/2028		Total
ELH	Savings	£	251,600	£	1,598,300	£	1,849,900
	Income	£	1,700	£	-	£	1,700
ESR	Savings	£	68,000	£	100,000	£	168,000
	Income	£	-	£	700,000	£	700,000
NSI	Savings	£	350,000	£	363,000	£	713,000
	Income	£	38,000	£	-	£	38,000
OHAC	Savings	£	-	£	-	£	-
	Income	£	-	£	-	£	-
SPBS	Savings	£	84,000	£	30,000	£	114,000
	Income	£	-	£	-	£	-
Total savings		£	753,600	£	2,091,300	£	2,844,900
Total income		£	39,700	£	700,000	£	739,700
Total		£	793,300	£	2,791,300	£	3,584,600

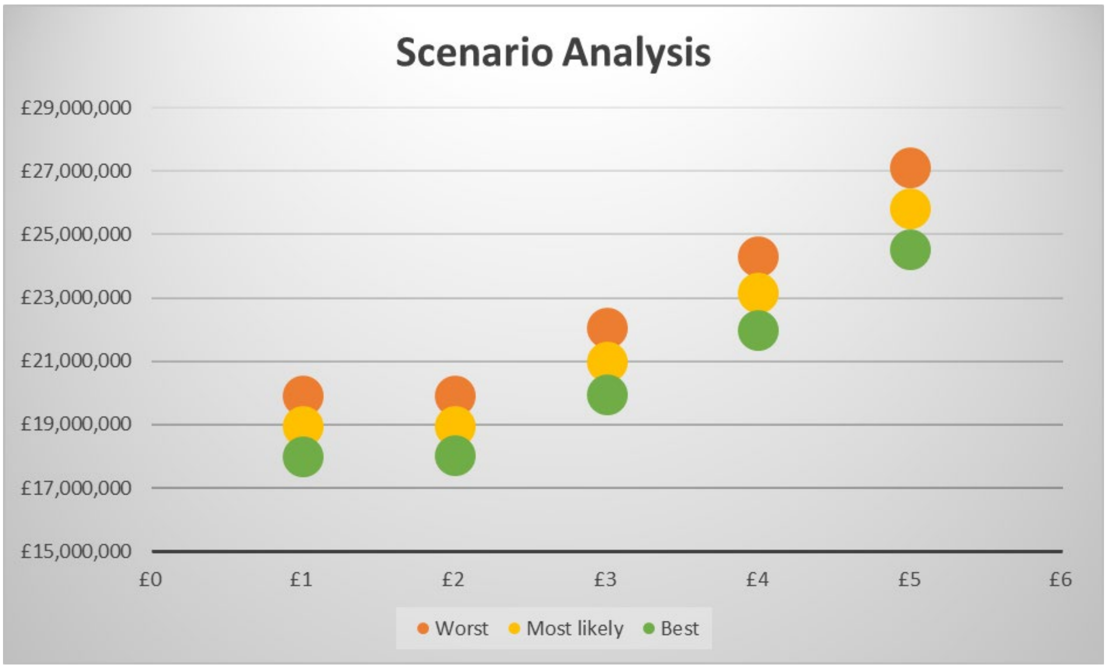
5.7. In order to balance the projected 2026/27 budget, based on the MTFS assumptions, the Council will have to identify additional funding, charges or efficiencies of £3,143,200. For 2027/28 £6,382,800 would have to be found.

Finding innovative solutions to reduce service costs and/or increase revenues is paramount.

5.8. Service redesign and efficiencies will require services to minimise spend over a number of years, deliver actual cash savings as well as improved operating processes which will ensure service provision is not significantly impacted, and reflecting the changing service user needs.

5.9. The risks associated with the assumptions in the Medium-Term Financial Strategy include forecast error, economic performance (including inflation assumptions), changes to Scottish Government spending, political pressure, and demand-led need. The following scenario analysis, very basically, illustrates the variation that could occur.

YEAR	2025/26	2026/27	2027/28	2028/29	2029/30
Worst	£19,863,900	£19,883,300	£22,015,800	£24,274,100	£27,070,700
Most likely	£18,918,000	£18,936,500	£20,967,400	£23,118,200	£25,781,600
Best	£17,972,100	£17,989,700	£19,919,000	£21,962,300	£24,492,500



5.10. To be successful this Strategy requires corporate acceptance across the Council, from elected members down, and from front line staff up.

5.11. Other local authorities are quite clear that they are looking at stopping services and consequent staffing reductions. For example,

- Dundee City Council planned to cut 400 jobs and close community facilities, including sports centres, community golf courses, swimming pools, and seven libraries, to address an £18 million budget shortfall.

- Midlothian Council proposed closing three libraries and community centres, removing school crossing patrols, and reducing staff at Roslin and Dalkeith libraries to save £153,000.

- Glasgow City Council reduced green bin collections from three-weekly to monthly, closed the Queens Glasshouse, removed kerbside glass collections, and reduced CCTV monitoring from 24/7 to 12 hours daily.

- Aberdeenshire Council cut spending on playparks by over 80%.

- North Ayrshire Council planned to cut 35 full-time teaching jobs to save £1.3 million following demographic changes.

5.12. Unlike other local authorities, Orkney is not proposing a list of closures and cuts, but, if funding is not forthcoming, ultimately savings generated through “efficiencies and service redesign” will incorporate some reduction or removal of service.

5.13. Failure to identify the required funding, or reduce costs, in 2026/27 and 2027/28 may well result in more extreme measures being required in the future. The Medium-Term Financial Strategy has to remain agile and reactive to changes in assumed data, this will be reflected annually in the budget setting process.

6. Summary

6.1. The Medium-Term Financial Strategy has been prepared against a background of significant challenges facing the Council finances. The growing contribution from reserves to meet in-year service costs is not sustainable, and baseline budgets need to return closer to funding levels.

6.2. The Medium-Term Financial Strategy covers a five-year period for which Government spending plans have yet to be finalised. Funding beyond 2025/26 is still uncertain although it is assumed that real term reductions in both General Revenue Grant and General Capital Grant will continue to add pressure to local authority finances. The Medium-Term Financial Strategy identifies a “likely” funding gap from 2025/26 to 2029/30.

The financial context is increasingly challenging, but the Council has a track record of identifying, delivering, and achieving budget out-turn within the approved budgets supported by a framework of effective financial planning. This approach will need to continue to ensure that a sustainable medium-term financial position can be maintained.

6.3. The Medium-Term Financial Strategy requires services to maximise income streams, minimise costs and redesign services which will feed into the budget setting process and help towards bridging the funding gap.

6.4. The Council will ensure that it maintains support to priority front-line services, and it will seek to prioritise those services that are most needed. The Council needs to be satisfied that reducing resources are used to maximum effect and allows the Council to continue to deliver services to users at acceptable performance levels. It will also allow the Council to develop new and better ways of working and improve the efficiency of services it provides.

6.5. The ongoing sustainability of the Strategic Reserve Fund is however fundamentally important to the future delivery of services in Orkney and therefore any contributions must have due regard to the long-term sustainability of the Strategic Reserve Fund.

6.6. This Medium-Term Financial Strategy’s obligations remain broadly similar to the 2023/24 to 2027/28 strategy, namely:

- To maintain Council Tax at national average.
- To maximise fee income generation.
- To maximise external funding streams.
- To continue lobbying for fairer a settlement from the Scottish Government.
- To continue to search for efficiencies.
- To continue to look at the way we deliver our services, including innovative service redesign.
- To continue to build capacity through effective partnership working.
- To continue to ensure that the draw on reserves is sustainable.

- To limit any service growth to cases where very exceptional circumstances arise.

6.7. The Corporate Leadership Team will review the strategy in conjunction with the annual revenue budget setting process. The strategy will be reviewed periodically to ensure that it continues to be aligned to overall Council objectives and priorities and that the Council continues to be able to set a balanced budget year on year.

Annex 1: Risk Register: MTFS 2025/26 – 2029/30

No	Risk Category	Risk	Potential Consequences	Potential Financial Risk	Assessment of Risk			Control in Place	Assessment of Residual Risk		
					Likelihood	Impact	Score		Likelihood	Impact	Score
1	Economy and Funding	Level and Reduction in real terms of Scottish Government funding.	Less funding from Government, reduction in ability to provide services, take on of other agencies' responsibilities.	1% variation of future General Revenue Grant in region of £750k	5	3	15	Estimate of reducing resources over the 5 year period built into the MTFS.	3	3	9
2	Economy and Funding	Inability to increase local funding because of Council Tax freeze.	Adverse effect on ability to raise income and therefore provide services.	1% variation of council tax in region of £120k	4	3	12	Verity House Agreement requires LA consultation, OIC 25/26 increase of 15% to Scottish Average	3	3	9
3	Economy and Funding	Volatility of investment returns	Returns fall below expecations, and impact ability of SRF to support GF in the future	As value of investments fall, the ability to return 'sustainable' amounts will also fall. Multi-million pound impact.	5	5	25	Investment Strategy seeks to reduce investment risk. Regular monitoring through Investment Sub-committee. Strategy to reduce draw over time.	4	3	12

No	Risk Category	Risk	Potential Consequences	Potential Financial Risk	Assessment of Risk			Control in Place	Assessment of Residual Risk		
					Likelihood	Impact	Score		Likelihood	Impact	Score
4	Economy and Funding	Flotta Oil Terminal Decline	Draw on provision for site restoration	£40m reduction in balances would reduce returns, based on investment strategy 7.7% return by ~£3.0m per annum	5	5	25	Engagement with Repsol to plan for impact.	5	4	20
5	Economy and Funding	Inflationary pressures driving up costs, in turn wage pressures	Budget overspends, service reduction, or cuts	1% on pay for GF would cost ~£1m 1% on other costs ~£1.2m	5	4	20	MTFS includes assumptions on pay and inflation increases	5	3	15
6	Economy and Funding	Economies of scale, lack of competition, choice or financial stability for Council tendered contracts.	Increased cost to Council, delays in completion		5	3	15	Contract Standing Orders, Procurement and Financial Regulations	3	3	9
7	Economy and Funding	Downturn in harbour activity	SFOP and MPH fail to deliver budget surpluses	2025/26 budget includes £2.6m of surpluses, of which ~£2.3m are included in GF budget affordability	4	4	16	Budget monitoring, Harbour Master Plan, Communication with industry (Repsol / Cruise)	5	3	15
8	Budget Control	Failure to set a balanced budget by 11 March each year	Breach of statutory provision		3	3	9	Governance processes	1	3	3

No	Risk Category	Risk	Potential Consequences	Potential Financial Risk	Assessment of Risk			Control in Place	Assessment of Residual Risk		
					Likelihood	Impact	Score		Likelihood	Impact	Score
9	Budget Control	Failure of budgetary control processes	Unexpected overspends in revenue and / or capital budgets. Additional draw on reserves	2024/25 service budget lines overspent by £3.5m to £4.0m	5	5	25	Budget monitoring, budget setting process	4	4	16
10	Budget Control	Future demographics - Social Work. Ageing population, more children with complex needs.	Additional revenue and capital costs	Out of Orkney Placements 'one-off' service pressure £500k included in MTFS	5	4	20	MTFS assumptions include inflationary increases to help mitigate demographic pressures; recurring 'one-off' costs included in MTFS	4	3	12
11	Budget Control	Risk of significant overspend due to demand pressures	Unexpected overspends in revenue and / or capital budgets. Additional draw on reserves	2024/25 service budget lines overspent by £3.5m to £4.0m	5	4	20	Budget monitoring, budget setting process	4	4	16
12	Budget Control	Unable to crystalise savings / charges / funding required to deliver a sustainable budget	Additional draw on reserves Council being put in special measures	2024/25 service budget lines overspent by £3.5m to £4.0m	5	4	20	Budget setting process	4	4	16
13	Budget Control	Increased risk of overspend given pressures arising from OHSCP integration	Additional draw on reserves	Agency cost premium for 2024/25 was in region of £3.2m alone	5	5	25	Budget monitoring, budget setting process	4	5	20

No	Risk Category	Risk	Potential Consequences	Potential Financial Risk	Assessment of Risk			Control in Place	Assessment of Residual Risk		
					Likelihood	Impact	Score		Likelihood	Impact	Score
14	Budget Control	UHI Orkney failure to achieve break-even position	Additional draw on Council reserves, or pressure on GF	2025/26 draft budget showing £1.2m shortfall in funding	5	4	20	Budget monitoring process, budget setting process Officer task force initiated	5	3	15
15	Budget Control	Unable to restore 4% non-earmarked GF reserve contingency	Additional draw on SRF	2024/25 service budget lines overspent by £3.5m to £4.0m	3	5	15	Budget monitoring, financial management	3	4	12
16	Debt Management	Build up of debt in NDR, CT, Rent or sundry debt	Potential pressure on revenue budgets as greater amounts need to be written off.	Increase in debt levels / reduction in collection rates for Council tax £150k per annum	5	3	15	Robust policy framework in place to pursue debt. Debt recovery arrangements indicate this risk is being managed with significant improvement in recent years over debt management and recovery.	4	2	8
17	Environment	Extreme weather	Cost of winter maintenance or reparation in respect of high winds or flooding	2023/24 winter treatment budget was overspent by £1.1m; 2024/25 forecast ~£300k overspend	3	4	12	OIC Tactical Response processes, Service operational plans, Government funding (Bellwin)	3	3	9

No	Risk Category	Risk	Potential Consequences	Potential Financial Risk	Assessment of Risk			Control in Place	Assessment of Residual Risk		
					Likelihood	Impact	Score		Likelihood	Impact	Score
18	Pension Fund	Local Government Pension Scheme - increase in employer contributions	Increased costs to the Council through increased employer contributions and impact on service budgets	1% change in contribution rate in region of £700k	3	3	9	Pension Fund Investment Strategy	2	3	6
19	Projects	Contract risks	Council could enter into partnerships without appropriate financial and legal arrangements in place.		3	5	15	Ensure projects have adequate governance in place, including use of specialists, were relevant	2	5	10
20	Projects	Development of major strategic projects requiring funding	Government support not forthcoming, costs to be met from Council funds		4	4	16	Ensure projects have adequate governance in place, including member approval at key points along project	2	4	8
21	Projects	Level and cost of borrowing.	Increased financial risk as level of borrowing increases, ability to meet interest and capital repayments		2	4	8	Treasury Management Policies, financial controls	2	3	6
22	Capital	Borrowing for capital projects will increase loan charges costs	Current 'contingency' removed from GF budget		4	3	12	CPA process, governance processes, budget monitoring	4	2	8