

Agenda Item	<b>5.</b>
Report No	<b>RES/11/20</b>

**Committee:** Corporate Resources Committee

**Date:** 3<sup>rd</sup> June 2020

**Report Title:** Covid 19- Financial Resilience

**Report by:** Executive Chief Officer- Finance and Resources

## **1. Purpose/Executive Summary**

- 1.1 All Members will be keenly aware of the emergence of Covid-19 and its significant impact on daily life throughout the world. At the present time there are still huge uncertainties about how any sort of normality may return or indeed if we will be returning to a new normal.
- 1.2 Highland Council and its staff, partners and communities have all stepped up to provide a response to the immediate challenges posed and Members will be aware of the support that the Council has been providing to the vulnerable as well as providing care for key workers. At the same time the Council has been continuing to provide essential public services.
- 1.3 This paper aims to summarise the wider areas where Covid-19 will impact significantly on Highland Council's operations and budget and will leave Members in no doubt that the financial challenges facing the Council are of a scale and immediacy never before seen.
- 1.4 It is simply not possible to say with any certainty what the direct financial impact on the Council will be, save that it will be significant. As outlined in this report and appendix, two different potential scenarios have been modelled- in the 'mid case' scenario a budget gap of £65.7m is projected, whereas in the most severe a gap of £96.9m is projected.
- 1.5 A further factor to note is that the impact on the wider Highland economy is expected to be very large as businesses fold and jobs are lost. The long-term impacts of these factors will be felt by the Council, both in terms of reduced income generation and increasing demand for services over many years to come.
- 1.6 A Highland Council Recovery Board has been established to lead and plan the Council's emergence from lockdown and provide strategic coordination for a Recovery Action Plan for Council services. The Board will provide oversight and direction for the Council's partnership with communities and partners to support the Highland Region's return to wellbeing, prosperity and economic success. The Recovery Board will report its progress to full meetings of the Highland Council.

## **2. Recommendations**

### **2.1 Members are asked to:**

- i. Discuss this report and note the significant adverse impact Covid 19 is expected to have on the Council's budget in every likely scenario;
- ii. Acknowledge a further report will be brought to the full Highland Council meeting on the 25<sup>th</sup> June outlining the Council's potential response to dealing with this financial impact;
- iii. Make representations to Government that the Council may require significant further financial support or other intervention from Government in order to manage its budget in financial year 2020/21

## **3. Implications**

- 3.1 **Resource-** As outlined in this report the Covid 19 crisis is expected to impact significantly on the Council's budget. The estimated negative impact in any scenario is expected to be in excess of the Council's general fund non-earmarked reserve.
- 3.2 **Legal-** In March 2020 the Council set a balanced budget for financial year 2020/21 as is required by statute. Although not a clear legal requirement the significant changes to that budget as a result of Covid 19 will require a formal reassessment of that budget which will be brought to the June Council meeting.
- 3.3 **Community (Equality, Poverty, Rural and Island)-** This report does not identify any specific impacts of this nature however the financial, economic and social crisis facing the Council will impact on spending which in turn will affect services, and demand for services, across the Council.
- 3.4 There are no specific Climate Change / Carbon Clever or Gaelic implications arising as a direct result of this report.
- 3.5 At this time the level of risk the Council faces is greater than perhaps ever before. The risks cover those to our staff and their health and wellbeing, to the health, safety and wellbeing of our communities and risks to the provision of essential Council services. This report focuses specifically on the potential financial impact of the Covid 19 crisis and there are so many variables and future uncertainties that forecasting and modelling is impossible to do with any accuracy. There is a significant risk that any particular scenario that the Council chooses to plan for may be significantly different from what actually transpires, with the Council potentially facing a financial deficit that significantly outweighs its reserves.

## 4. Covid 19- budgetary impacts

4.1 The emergence of Covid-19 and the government response to it will impact on the Council's budget as a result of the factors listed immediately below. More information on each factor is provided in the remainder of this section:

- The requirement to provide new services
- A requirement to enhance, or an increased cost to provide existing services
- Increasing demand for certain services
- Reductions in service income from fees and charges
- Reduced collections of council tax
- Increased support required for partner organisations
- Challenges in delivery of planned budget savings
- Savings in certain areas where services have stopped or reduced.
- Inability to recharge revenue costs to capital or other non-general fund budget as a result of normal work not being undertaken.

4.2 As part of the immediate response to the Covid 19 crisis the Council is providing new services. The most significant of these include the provision of Humanitarian Assistance Centres, Food provision for vulnerable people, and Childcare provision for Key Workers. In addition the Council is administering the business grants scheme and scheme around rateable relief. Whilst additional funding has been received from government to cover some of the costs of these services it is at present unclear how long the services will need to be provided for and whether there is an expectation that they will form 'business as usual' for the remainder of the financial year and beyond.

4.3 As a result of Covid 19 the way services are provided has needed to change. In many cases these changes have brought additional cost, with examples including a need for increased levels of PPE for certain staff groups or increased fleet costs associated with waste collections. As further services are reintroduced and facilities reopened it is anticipated that additional costs will be incurred. Staff absence is also considerably higher than normal as staff are ill or shielding; not all of those absences may be able to be covered in the longer term without incurring additional cost.

4.4 Certain areas of the Council are already seeing an increasing demand for the services they provide, such as the Welfare service. In some cases, increased service demands have been met by the use of volunteers deployed from their normal roles. As those volunteers return to their normal roles, ways of managing extra service demands will need to be found. Other services areas, in particular social work, are expecting to see service demands increase over time as the longer-term societal impacts of lockdown and job losses begin to be felt.

4.5 For 2020/21 the council has budgeted for over £55m of fee and charge income from a variety of sources including marine fuel sales; planning fees and building warrants; ferry, pier and harbour dues; school meal sales; car parking; commercial property rentals; commercial refuse collection; garden waste collection and licencing.

Many of these income streams have dropped to near zero almost overnight and the trajectory of any recovery is hugely uncertain. It is not expected that any 'lost' income will be regained later in the year as pent-up demand is released. In some cases it may take many years for income to return to the currently budgeted level.

4.6 In the 2020/21 budget the Council has assumed a net Council Tax income of around £130m. This figure takes account of the Council tax increase approved by Members,

allows for a growth in the Council tax base (i.e. the number of properties billed), and makes a general provision for council tax bad debts (i.e. Council Tax that will not be recovered).

As a result of the Coronavirus crisis two key impacts are expected. Firstly, the number of new properties being constructed is expected to be below assumptions as building activity has slowed and a general slowdown in the housing market occurs. Secondly the wider economic impact of Covid 19 is expected to result in increased levels of business failure and unemployment- this is expected to lead to a significantly lower level of Council Tax being collected. A linked impact is that the level of previous years' outstanding debt collection will not be as high as budgeted.

- 4.7 The Council has two key partner organisations, HighLife Highland and Eden Court, for whom the Council holds a significant degree of risk if the organisations were to fail. In both cases the Council is landlord to the organisations' properties as well as being the guarantor for any pension fund deficit that the organisations hold. Due to these risks the continued existence of these organisations as a going concern is key to averting even great financial pressure on the Council. As both these organisations have been incredibly hard-hit by the Covid crisis- chiefly due to significant, almost total reductions in income, both have approached the Council seeking financial support.
- 4.8 The approved budget for 2020/21 includes around £16m of planned budget savings in order to deliver a balanced budget. A significant portion of these savings may not be delivered due to a variety of factors outwith the Council's control- whether that be commitments to critical external suppliers to ensure their ability to remain a going concern or Covid response requirements of Council staff diverting capacity away from savings delivery. Planned savings in certain areas such as Early Years and School Transport have become more challenging to deliver as a result of recent government policy interventions. In addition the majority of budget savings that relate to increased income generation are unlikely to happen.
- 4.9 As a result of lockdown certain services have either stopped or reduced. Some budget savings will arise as a natural result of that, such as savings in the cost of food to provide school meals (albeit this is offset by school meals income loss as outlined in section 4.5), energy cost savings from closed buildings and reduced costs relating to staff travel. Whilst some costs are expected to reduce as a result of current circumstances a significant number of costs are contractually committed and cannot be reduced.

Significant areas of spend where the Council is not expecting to be able to make any savings at all include contracted staff (permanent employees), adult social care costs paid to NHS Highland, loans charges, PPP contract costs and welfare costs. These areas alone account for well in excess of £500m of spend- meaning that the Council is unable to reduce costs across the vast majority of its overall budget

- 4.10 The Council employs a significant number of staff through its revenue budget, the cost of whose work is normally recharged to the Council's capital programme, Housing Revenue Account, Arm's Length Organisations and other non-general fund bodies. Examples of staff for whom such charges are made include our architects, engineers and project managers; grounds maintenance staff; and property and maintenance staff. As some of these staff have not been able to do their normal work as they have been involved in the Covid 19 response, are off sick or in the shielding category, or cannot work due to lockdown restrictions, it will not be possible to recharge their costs outwith the general fund. In short this means that there will be a shortfall against budgeted

income in the Council's revenue budget.

## 5. Scenario Planning

- 5.1 For each of the factors listed in section 4 key questions need to be asked. These include how quickly the impact will happen, how big the impact will be, how long the impact will last, and how quickly and at what trajectory any recovery will take place.
- 5.2 Given the number of variables at play it is sensible to do some scenario planning to model what the overall impact might be. The permutations and number of scenarios are infinite but for the purposes of this report two outline scenarios have been modelled:
- **Mid case- Lockdown period ends at June with a subsequent lockdown period October to December. Slow recovery trajectory thereafter**
  - **Worst case- Lockdown state effectively becomes the new normal with Covid response activities required to increase and continue throughout the year.**

At this stage, due to the uncertainties about the immediate future and the move out of lockdown through the four phases of recovery as outlined by the Scottish Government the modelling of a 'best case' scenario is not reported. Financial performance information for the first two months of 2020/21 is however demonstrating that the Council is already significantly impacted with fee and charge income particularly badly affected.

- 5.3 The scenarios modelled do not at this stage capture the effects of any management action taken to try to mitigate any budgetary impact, nor do they capture any additional funding that may be coming from government (confirmed funding to date is detailed in section 6 of this report).
- 5.4 The figures do not include any assessment of the impact on adult social care as at this stage it is the Council's understanding that all additional costs in this area will be fully funded by the government.
- 5.5 Neither of the scenarios outlined should be considered an 'expected' scenario- the number of unknowns and potential changes make it impossible to predict. The scenarios are intended to convey just how significant an impact this crisis will have on the Council's budget and prepare Members for the likely need to take some incredibly difficult decisions as the year progresses.
- 5.6 Whilst the more extreme scenario might not be considered probable it is possible. As such it is important that Members do not discount this scenario as any approach taken to address this crisis will most likely need to be modified as the year progresses as circumstances change. Having some notion of how an extreme scenario would be dealt with will give options for dealing with the scenario that does play out.
- 5.7 A summary of the estimated budget gap that will arise under each of the two scenarios modelled can be seen below. **Appendix 1** provides a fuller explanation of the individual elements and assumptions that sit behind this.

	<b>Estimated budget gap before action</b>
<b>Mid case</b>	<b>£65.7m</b>
<b>Worst case</b>	<b>£96.9m</b>

## 6. Additional Funding received

- 6.1 The Scottish government have already made available a number of separate funding streams to support specific initiatives and spend on specific items. All the items that are being allocated to or through local government are detailed below. A number of other funding streams are being allocated through other public and third sector bodies.

At present there has been no guarantee that government will underwrite any overspend that the Council may incur as a result of Covid 19.

### **Funding to support additional or increased services**

- 6.2 The Scottish Government has supplemented the existing Scottish Welfare Fund by £45m. Of this £22m has already been allocated to local authorities with the remaining £23m current held centrally by Scottish Government to be '*provided later, to be targeted at where it is most needed.*' Of the £22m already distributed Highland has received £0.738m which has been added to Council's existing Scottish Welfare Fund budget and to be administered in the same way as existing fund. All of this funding is passed on to Highland residents in need of Welfare Support.
- 6.3 £50m of additional funding is being held centrally by Government to provide extra headroom for an increase in Council Tax Reduction payments and other welfare benefits devolved to the Scottish Government. This is a 'reserve fund' so will only be allocated by Government if required, with measures being put in place to allow the tracking CTR caseload and spend for each authority.
- 6.4 A national food fund of £30m has been made available to Councils, of which Highland will receive £1.119m. This funding is to support free school meal provision and non-shielded people and communities at risk.
- 6.5 The Scottish Government has made over £1.4bn of funding available to provide support for business, primarily in the form of business grants. While local authorities are responsible for the administration of the vast majority of this funding, we do not stand to benefit from it in any way. Highland is expecting to be allocated a little over £100m of this funding and as at the time of writing this report 4,661 grants have been awarded with a value in excess of £51.7m.
- 6.6 As mentioned in section 5.4 this paper does not contain any estimate of the impact of Covid 19 on adult social care. Scottish Government has made a commitment to funding in this regard that '*Local Authorities have been assured that the additional financial support they need to scale up services to meet the clear additional demands arising from the current situation will be met by the Scottish Government, aligned to local plans already in place.*' With regard to adult social care a mobilisation plan is being managed and implemented by NHS Highland.

On the 12<sup>th</sup> May Scottish Government made an initial allocation of £50m nationally, Highland's share £2.338m, to support health and social care mobilisation plans. This funding will be passed to integration boards via the NHS.

- 6.7 Scottish Government has committed £0.6m nationally to provide 7-day-a-week death registration services. Highland's share of this funding is still to be formally confirmed.

### **Funding to support core Council budgets**

- 6.8 On the 5<sup>th</sup> May the Scottish Government confirmed that £155m of funding through Barnett consequentials, arising as a result of the UK government providing additional funding for local authorities, will be allocated in full to Scottish local authorities. While the distribution methodology for this funding is still to be agreed it is expected that Highland's share will be in the region of £7m. It is not anticipated that any restrictions will be placed on how this funding can be used.
- 6.9 The Council has received £2.373m of a national £50m 'Hardship Fund'. This fund is not intended for any specific purpose but local authorities can use this resource as they see fit to respond flexibly to the COVID crisis to help people and communities. Highland has already committed some of this funding to supplementing ward budgets for allocation at local discretion.

## **7. Addressing the budget gap**

- 7.1 In the most basic terms, for the Council to deliver a balanced budget in financial year 2020/21 the level of expenditure it incurs needs to be offset by the receipt of an equivalent amount of income. In any scenario where a budget gap is forecast the two options to address that gap are to increase income or reduce expenditure.

### **Increasing income**

- 7.2 The Council receives income from three main sources, government funding, council tax, and fees and charges. As highlighted in section 4 of this report the Covid crisis is expected to have a significant impact on two of those income streams. Section 6 of this report provides details of additional funding that has already been received or confirmed.
- 7.3 The Council set its Council tax rates for financial year 2020/21 at the budget meeting on the 5<sup>th</sup> March 2020. As it stands, legislation does not permit for the rates already agreed to be increased. As outlined in section 4.5 the other factors that influence overall council tax income are the size of the collection base and the collection rate. By actions it takes the Council would be able to impact on collection rates but any action taken would most likely only partially mitigate the impact of the reducing ability of taxpayers to pay.
- 7.4 The impact of Covid 19 on the income generated from fees and charges is perhaps the most significant of all the factors at play. The actual level of income generated depends on both demand for services and the price to the customer. Whilst the Council could look to adjust prices (either up or down depending on price elasticity of demand) to maximise income, the current circumstances have led to an almost complete drop in demand for certain services, effectively making pricing levels irrelevant. The impact of external factors outwith the Council's control means that the Council actually has very little scope to affect this income stream. The Council could look to explore the feasibility of charging for certain services that are currently provided free of charge- in many instances there are legislative barriers to this.
- 7.5 With such limited scope to influence council tax and fee and charge income the only real way for income to increase significantly is if additional funding is provided by government. Whilst some income has already been provided, some specific to meet

new expenditure costs and others for more general purposes, it is expected that significant further government funding may be needed to balance the Council's budget. Given the impact of Covid 19 on the national economy it is unclear at this stage whether the government will be able to afford to inject further funds into local government.

- 7.6 One other area of income that is worth exploring is around income streams that are required by government policy to be used for specific purposes. Already government have announced relaxation around the spend of ring-fenced funding streams such as that associated with the roll out of 1140 hours of early years education and the Pupil Equity Fund (PEF). It is hoped that government will be similarly flexible with other funding streams, such as that which comes from Council Tax on second homes, and gives clear guidance that all such funding streams can be repurposed to meet any overall budget gap the Council faces as a result of Covid 19.

### **Controlling expenditure**

- 7.7 The Council has the ability to control, or reduce, its expenditure in order to try to deliver a balanced budget. In practice though, the ability to simply 'turn off the tap' of expenditure does not exist. As outlined in section 4.9 of the report a large portion of the Council's budget is contractually committed and can only be reduced by effecting changes to, or terminating those contracts. In many cases the contractor would not be prepared to accept changes. The biggest element of those contractual costs relates to the Council's permanent staffing.
- 7.8 Given the nature of the services the Council provides it is not easy to reduce or stop services. Whilst some services have stopped or reduced as a direct consequence of the lockdown others continue to be provided. The additional cost of returning services to 'normal' levels will need to be considered as part of their reintroduction with the return of costly or non-critical services delayed further in an attempt to effect spending reductions.
- 7.9 A further report on controlling the Council's expenditure and delivering a balanced budget will be brought to the full Council meeting to be held in June. Ahead of that meeting operational controls have already been effected around staffing costs including a suspension in recruitment, staffing contractual changes, and supply, agency and overtime use. In addition, all temporary staffing arrangements will be reviewed.

On the non-staffing side all contracts are to be reviewed to ensure the contracted services are being fully delivered and to ensure that that service delivery is still a key requirement of the Council. All purchase cards are to be suspended with only a proportion reintroduced for critical staff. All non-contractual spend is suspended and the number of budget holders is to be minimised. In short, a simple message of 'Do not spend' has been made to staff. Whilst there may be exceptions to this message each and every exception needs to be ratified by the Council's senior management team.

## **8. Impact on capital budgets**

- 8.1 Whilst this report does primarily focus on the impact of Covid 19 on the Council's revenue budget there will undoubtedly be significant impacts on the Council's capital programme too. Those impacts can be considered under two main categories, firstly the impact on projects already underway, and secondly on projects not yet contractually committed.
- 8.2 The lockdown period brought about by Covid 19 has seen all on-site work on capital



projects cease. The impact of this cessation on the Council's own staff is described in section 4.10. The impact on external contractors is also significant as they have had to de-mobilise and will have to remobilise their project staff. This process will add time and cost to capital projects and contractors will also see increased costs from extending equipment contracts or sub-contractors. The cost and availability of construction materials may also be adversely impacted and there is likely to be supply chain disruption. Social distancing on construction sites is also likely to add cost and time to capital projects. There are likely to be many other factors that will also affect a project's ability to be delivered on time and on budget and in many cases the risk of additional contract costs will sit with the Council.

- 8.3 In terms of contracts not yet committed it is expected that contractual prices will rise, in part from some of the factors listed above, but also due to a likely contraction in the construction sector as businesses fail due to the impact of Covid 19. The failure of a contractor on a live project would also bring significant extra cost.

## **9. Reserves**

- 9.1 As outlined elsewhere on this committee agenda the draft revenue outturn position for the Council is showing an underspend of £7.6m. This underspend is to be added to the Council's non-earmarked general fund reserve, increasing it to £15.5m. Whilst this reserve does allow some contingency against unexpected events, the potential financial impact of Covid 19 could far exceed any ability the Council has to manage this crisis without government funding interventions.

Designation: Executive Chief Officer- Finance and Resources

Date: 20<sup>th</sup> May 2020

Author: Edward Foster, Head of Corporate Finance

Background Papers:

## AGENDA ITEM 5 - APPENDIX 1

### Appendix 1

Factor	Mid case		Worst case	
	Assumptions	Impact £m	Assumptions	Impact £m
Cost of new service provision	Requirement for new services remains for 9 months with increasing inability to maintain these services using existing staffing resource	7.2	New services required to be provided on a 'year round' basis with existing staff no longer able to be deployed to those areas	9.6
Increased cost of existing services	Building recommissioning and decommissioning carries significant costs to meet health and safety and physical distancing requirements. Cleaning requirements increase. Cost of social distancing in buildings and on transport lead to inefficiencies and additional costs.	11.9	Many services brought back, but at increasing costs due to physical distancing, PPE requirements etc. Retention payments for supply and agency staff to be made all year. Absence cover costs are high. Cleaning costs increase significantly	14.0
Increased demand for services	Impact of lockdown sees recurring increases in demand for children's social care and welfare	4.5	Significant additional social work demands as a result of wider economic disruption with an increasing number of children 'looked after'. Significant additional welfare spend needed due to permanent increase in demand.	7.4
Reductions in fees and charges income	Many income streams severely impacted and generating significantly below budgeted levels. Wider economic impacts mean demand does not return quickly when lockdown periods end	21.5	Continuing declines across the majority of income streams with a number of significant service generating effectively zero income all year.	35.0
Reduced Council Tax collection	Collection rate reduces by 3%	3.9	Collection rate reduces by 5%	6.5
Cost of support for Partner Organisations	Services are brought back on a piecemeal basis but income generation well below 'normal' levels as physical distancing applies	4.0	Furlough scheme ends after October, facilities effectively closed all year with very little income generated	6.9
Non-delivery of planned budget savings	Income related savings not delivered at all and 25 % of all other savings not delivered	6.3	Income related savings not delivered at all and 50 % of all other savings not delivered	9.5
Loss of recharge income	Average of seven months of recharge income foregone- some recharging possible during lockdown periods as non-site based work proceeds but majority of site based activity ceases.	10.5	No recharges possible for entire year due to lockdown and work not being done	18.0
Savings arising naturally from service cessation/reduction	6 month savings in food energy and travel.	-4.0	Significant energy, food and travel savings (albeit base level of energy consumption is required)	-10.0
<b>TOTAL</b>		<b>65.7</b>		<b>96.9</b>