Agenda Item	4
Report No	HC/32/20

Committee: **Highland Council**

Date: **1st October 2020**

Report Title: **Revenue budget update report- October 2020**

Report By: **Executive Chief Officer – Resources and Finance**

1. Purpose/Executive Summary

1.1 Members were due to receive a budget update at the Council meeting on the 10th September however due to a number of emergent matters Members agreed to defer discussion of that item to today's Special Council meeting.

1.2 An unchanged version of the report due to be considered by Members on the 10th September is provided as **Appendix 2** to this report. Members are asked to consider the recommendations of that report in light of the changing wider context as identified in this report.

1.3 An all-Member budget briefing was held on the 21st September and the key items covered in that briefing are included in this report. The most significant updates relate to:

- Changing Covid context;
- Update on expected funding;
- Scottish Government proposed 'funding flexibilities' for local government

1.4 Over recent days the context around Covid has changed significantly, most particularly in light of announcements made by the First Minister on the 22nd September. The prevalence of Covid across Scotland, the UK and worldwide is increasing significantly and new restrictions on activity are coming into effect. It is too early to say what the economic and societal impacts of these restrictions will be but it is clear that the restrictions will impact on the demand for Council services and the way in which those services are provided.

1.5 From a funding perspective it appears as though risks identified around government funding support may be crystallising. Whilst no formal communication from government has been received informal suggestions through COSLA are that the funding receivable through the income recompense scheme is expected to be significantly less than had been expected. The initial response from the Scottish Government to the Council's request for flexibility around the use of council tax income from second homes is also not as positive as had been hoped. The combined effect of these two items may be to increase the current year budget gap from a potential near-balanced position to a deficit of around £11.254m.

1.6 The Scottish Government has put forward a number of proposals for 'funding flexibilities' that they may make available to help local government manage the financial impact of Covid. This report provides a little more detail on what each option entails. Ultimately the use of any option would require the Council to borrow to support its revenue budget. The interest associated with that borrowing and need to repay the sums borrowed would place further constraints on the Council's revenue budget in future years.

1.7 At this point there is only limited detail available on the potential funding flexibilities for Members to consider It is the professional advice of officers that now is not the appropriate time for Members to be making any decisions on whether they wish to use those flexibilities. If the Council does record an overspend in financial year 2020/21 it is expected that Members need to choose between using those flexibilities, using other contingencies or financing any deficit through reserves. Further updates on the evolving financial situation will be brought to Council throughout the remainder of the year.

1.8 The announcement by the Chancellor of the Exchequer on the 23rd September that there would not be an Autumn Budget adds a further element of uncertainty around future years' funding.

1.9 This report is intended to highlight the ever-increasing uncertainty facing the Council in the current climate. None of the emergent information is positive and it all intimates short- and medium-term adverse impacts on the Council's financial position. Members are encouraged to consider this context when making any financial commitments. However, on balance it is important to note that the Council has evidenced significant improvement in managing the fiscal challenges faced through prudence and tighter budget controls and member scrutiny .At the time of a National Pandemic our communities and our staff have demonstrated outstanding resilience and capacity to work together and support our drive to be a sustainable Council ; it is important that we go forward with confidence in having a range of options to deliver a sustainable Council and communicate with confidence to our Highland communities the capacity to deliver services , provide support and take care of the most vulnerable with our partners all within the financial capabilities open to us as an organisation.

2. Recommendations

2.1 Members are asked to:

i) Consider the changing context as outlined in this report and take these factors into consideration as part of any future decision-making.

Agree the following recommendations as presented in the Council report of the 10th September (which is provided as **Appendix 2**):

ii) Agree to continue to lobby both UK and Scottish Governments for additional funding as outlined;
iii) Agree the release of the £3m Crown Estate Investment Funds;
iv) Agree to the release of the £2.293m Roads Investment Funds;
v) Agree to hold back spend on the remaining investment funds as detailed in section 10.4 (of **Appendix 2**) until there is greater certainty on the budget position;
vi) Consider the medium-term financial context and acknowledge the significant financial risks facing the Council;
vii) Note that budget update reports will continue to be provided to all Council meetings as agreed at the Council meeting on the 25th June.
viii) Agree to progress the capital projects as outlined in **Appendix 2**.

Members are additionally asked to:

ix) Agree to set aside the sum of £10.9m from the Council's General Fund non-earmarked reserve to offset the expected increase in the Council's budget gap arising as a result of reduced expectations of funding from the income recompense scheme and changed expectation that the income from second homes council tax will be able to offset the budget gap, as outlined in section 5.

3. Implications

3.1 Resource- As outlined in this report the impact of Covid 19 on the Council's budget is expected to be significant and long-lasting.

The Council's non-earmarked balances currently stand at £23.249m. That position reflects the 2019/20-year end position of £15.451m, plus the approved increase in reserves of £4.909m agreed in March, plus the DSM balance transferred into general reserves as agreed by Council in June.

If the Council records a year end overspend this could be funded from the Council's reserves or potentially by using the proposed funding flexibilities. Any use of those flexibilities, which requires borrowing to support revenue budgets, would have financial implications for future years linked to the repayment of sums borrowed and associated interest charges. Those repayment costs would require equivalent revenue budget savings to be made.

The financial outlook for future years looks increasingly challenging, with the Council likely to have to manage the continuing impact of Covid at the same time as seeing funding streams under significant pressure.

3.2 Legal- The Scottish Government's proposed funding flexibilities are likely to require some kind of legislative or regulatory adjustments to be made. Some of the proposed flexibilities are complex and the process of making those required adjustments may take some time.

3.3 There are no specific Community (Equality, Poverty, Rural and Island), Climate Change / Carbon Clever or Gaelic implications arising directly as a result of this report.

3.4 Risk factors are considered in more detail in **Appendix 2**. In terms of the specific issues raised in this report the governmental response to Covid and very fluid national circumstances bring with them great uncertainty.

As the funding flexibilities are only proposals at this stage there is a risk that they may not be made available to local authorities.

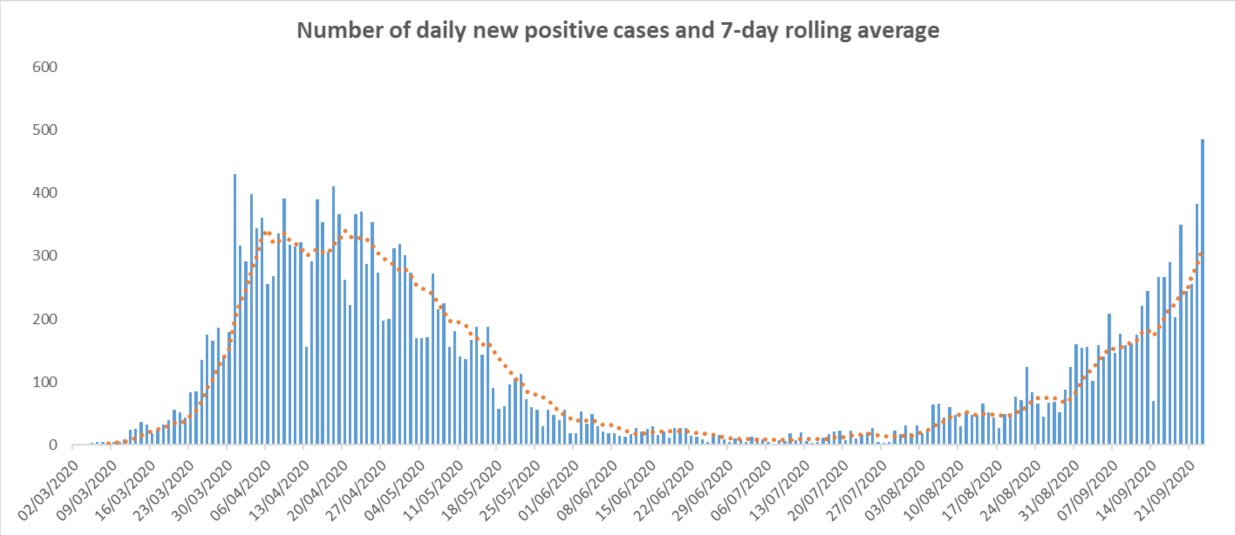
Given the very challenging short-term circumstances facing the Council there is a risk that any decisions taken for short-term benefit may bring with them significant long term ramifications for the Council's financial sustainability.

4. The changing Covid context

4.1 Members will undoubtedly be aware of the significant changes in the wider context of Covid in recent weeks. As such this report will not go into any great detail on this matter but will just highlight some of the significant recent developments. This changing context is likely to impact significantly on the Council in terms of service provision, demand for services, the potential requirement to provide new or additional services, all of which will impact on the Council's financial position.

4.2 The Scottish Government provides a vast source of information on Covid on its website. The information comprises key guidance, information and support and can be accessed via the following link:
https://www.gov.scot/coronavirus-covid-19/

4.3 The prevalence of Covid in the Scottish population is increasing significantly as can be seen from the below table from the Scottish Government website:



4.4 On the 22nd September the First Minister addressed the nation on the Covid crisis, responding to the rising number of Covid cases as seen in the table above. A transcript of the address can be found via the following link:
https://www.gov.scot/news/first-minister-nicola-sturgeons-address-on-coronavirus-measures/

Of key importance that address refers to Governmental priorities in the coming months, many of which relate to the provision of Council services including:

- Saving lives and protecting health.
- Keeping schools open.
- Restarting NHS services.
- Ensuring care homes are safe.
- Protecting jobs and livelihoods

4.5 In order to address those priorities a number of restrictions are being brought into effect in order to bring Covid back under control. A number of further measures are also under consideration with the possibility of a 'circuit break' lockdown also mooted.

5. Update on expected funding and impact on budget gap

5.1 The table below was included in the paper for the 10th September Council to reflect the forecast budget gap from the Quarter 1 revenue budget monitoring along with potential mitigations of that gap. Since that report was published there have been significant revisions to two figures contained therein as a result of new information that has emerged. An additional column has been added to the table to reflect the updated position with the changed figures highlighted.

		10/9/20	NOW
		£m	£m
	Forecast 2020/21 overspend as per Q1 monitoring	**28.259**	**28.259**
Less expected changes from the reported position:			
	Improvement in HLH/Eden Court deficit position	-2.150	-2.150
	Schools return- high level estimate of reductions from original forecast of transport and other costs	-2.500	-2.500
	Other improvements in reported service positions (per section 4.5)	-0.900	-0.900
	REVISED BUDGET GAP	**22.709**	**22.709**
Less expected further funding:			
	Education funding- additional teachers	-1.431	-1.431
	Education funding- schools reopening	-1.200	-1.200
	Education funding- school reopening	-1.800	-1.800
	HAC funding	-0.651	-0.651
Less potential further funding:			
	£50m Barnett consequentials- July announcement	-2.373	-2.373
	Income recompense scheme- UK government July announcement	-12.000	-4.000
Less lobbying for funding flexibility			
	Second homes Council Tax	-2.900	0.000
	RESIDUAL BUDGET GAP AFTER POTENTIAL ADDITIONAL FUNDING	**0.354**	**11.254**

5.2 On the 2nd July the UK government announced a scheme to recompense Councils for lost fee and charge income. Details of the relevant press release can be seen below: https://www.gov.uk/government/news/comprehensive-new-funding-package-for-councils-to-help-address-coronavirus-pressures-and-cover-lost-income-during-the-pandemic

5.3 Details of the scheme remain unclear but emergent information suggests that the Scottish Government is looking to commit to local government only £90m of Barnett consequentials arising from the scheme. Whereas previously the Council had anticipated it might receive around £12m from the scheme that recompenses Councils for 75p for every £1 of lost fee and charge income, a revised assessment based on the £90m national sum is that only £4m may accrue to Highland.

5.4 The Council previously agreed to request flexibility from the Scottish Government around the use of second homes Council Tax income. A formal response has been received which does not allow the Council the level of flexibility sought, instead suggesting that this money can only be 'borrowed' from the Landbanking Fund, rather than permanently reallocated. This flexibility only offers a cashflow solution, rather than a funding solution and therefore has been removed from the updated mitigations.

5.5 The combined effect of these two items increases the forecast budget gap from a potential near balanced year-end position to an overspend of £11.254m. Any year end overspend that transpires would need to be funded through contingency funds, reserves or the use of funding flexibilities.

6. Funding flexibilities

6.1 On the 9th September the Finance Secretary wrote to the Chancellor of the Exchequer outlining a number of 'funding flexibilities' that the Scottish Government are looking to offer local government in order to deal with funding pressures arising as a result of the Covid crisis. A copy of that letter is included as **Appendix 1** to this report.

6.2 At this stage the four different options outlined are conceptual only and the Council has received no further detail than that included in the letter. All the information that follows is officers' interpretation of what each option may entail. Some of these options are technically complex and so at this time it is not possible to ascribe robust values to each option.

6.3 All but one of the options are within the gift of the Scottish Government to bring about, the other option requires agreement from the UK Treasury. Some of the options will require regulatory changes and therefore it may take some time before the full detail and availability of these options is confirmed.

6.4 It should be made clear that none of these options reflect additional government funding flowing to local authorities, but rather afford authorities a number of accounting flexibilities. In each case these flexibilities would require the Council to take on additional borrowing to support its revenue budget.

6.5 As Members will be aware all borrowing requires repayment. The value of any benefit to the revenue budget taken in financial year 2020/21 as a result of the options will need to be repaid, along with associated interest costs. These repayments will be over the long term, potentially up to around 30 years. The longer the term over which repayments are made, the greater the amount of interest cost that will be incurred. Highland already spends over 10% of its revenue budget on loans charges (or over 13% if PPP debt costs are included) which is one of the highest levels in Scotland.

6.6 In order to make these debt repayments the Council will have to find equivalent savings in its annual revenue budget. This may come from savings in the costs in the provision of services, or reductions in the amount of capital investment financed through the revenue budget. Either way the requirement to repay debt will mean there is less funding available for the provision of services or investment in assets.

6.7 The advice from officers is that Members are not asked to choose between any options at this point but do so later in the financial year when there will be a need to decide upon the balance between the potential use of reserves or contingencies against the use of these funding flexibilities.

6.8 One further item that is currently unclear is whether these options will be time-limited and only able to be taken in the current financial year or will remain open in order to help address any future years' impacts of Covid. If these options are not time-limited it would afford the Council greater flexibility to address any financial challenges arising.

6.9 The subsequent sections of this report provide further information on each of the following options:
1. Capital grant funding switched to revenue or Councils borrow to offset Covid revenue costs
2. Flexibility to use capital receipts to offset Covid revenue costs
3. 'Credit arrangements'- changed accounting arrangement around PPP/PFI schools
4. Loans fund repayment holiday

6.10 Once further clarity on the detail of each option emerges officers will look to fully articulate the associated financial impacts and share with all Members .

7. Option 1- adjustment to capital grant funding

7.1 Option 1 is the option that requires the agreement of the UK treasury as both variants of this option require adjustment to the UK Government's capital settlement to the Scottish Government.

7.2 Two variants of this option are proposed, the first reflects the Scottish Government changing a portion of its capital funding to local authorities to revenue funding, the second allows local authorities the ability to directly borrow to finance revenue Covid costs.

7.3 Under both options the impact on the Council is very similar. If capital grant funding is switched to revenue grant funding the Council would need to undertake additional borrowing to offset the foregone capital grant. The only slight difference between the options might arise in the repayment period of any debt.

7.4 Under this option the Scottish Government has requested a very specific amount of flexibility from the UK government, namely £156m. This national sum may afford Highland flexibility of around £7m to £8m.

7.5 Whilst the accounting treatment around this option will influence the total associated cost a rough guide based on PWLB 20 year borrowing rates is that repaying this debt over a 20 year period may result in an annual repayment a little over £0.5m and a total interest cost over the period in excess of £2m.

8. Option 2- capital receipts flexibility

8.1 Option 2 would afford Councils the flexibility to use capital receipts received in 2020/21 and 2021/22 to offset revenue Covid costs. Previous precedents for the use of capital receipts to fund revenue costs do exist.

8.2 This option may not be that useful for Highland given our historically low level of capital receipts. In 2019/20 capital receipts were £0.9m and in 2018/19 receipts were around £0.5m. If the Council were so minded it could seek to dispose of assets in order to generate additional receipts however it may be difficult to identify suitable assets for disposal that are not required for operational purposes and would yield a significant receipt. In any eventuality the market value for assets may be significantly depressed as a result of Covid.

8.3 Capital receipts are currently used to fund the capital programme, so if they are instead used for Covid revenue costs this would increase the borrowing required to fund the capital programme.

9. Option 3- 'credit arrangements'

9.1 This option is the most technically complex of the options presented and relates to the accounting treatment of PPP, PFI and possibly NPD schools. In all these different contractual models for the provision of school properties the annual unitary charge made to the providers covers the annual running and lifecycle maintenance costs of the properties, along with the initial construction and financing costs.

9.2 These contracts with the providers have a lifespan of 25-30 years and at the end of that period full ownership of the properties passes over to the Council with the full construction cost of the properties paid off. At the point of handover the Council will become liable for the ongoing running and maintenance costs associated with the properties.

9.3 This option does not propose any amendments to the respective contractual terms but rather reflects an accounting adjustment around the debt repayment profile associated with the properties. As the properties are considered to have a lifespan in excess of the contractual term (the Council normally accounts for school's lifespan up to 60 years) the accounting adjustment would relate to reprofiling the debt repayments from the contractual 25 or 30 years to a more 'normal' period up to 60 years.

9.4 This option may work in either of two ways. Firstly it may just allow any outstanding debt associated with the properties to be spread over a longer term. Secondly it may allow a credit to be taken to reflect 'overpayments' made to date, with that credit then repaid over the remaining asset life. The possibility of taking a credit may mean that this option can release a significant sum of funding into the revenue budget- but the larger the sum released the greater the repayments required in future years.

9.5 For context the Council has four schools provided under PPP1 with a 25-year contractual expiry date of July 2027, 11 schools provided under PPP2 with a 30-year contractual expiry date of 2036 and one community campus provided under the NPD model with a 25 year contractual expiry of 2040. Just under £527m of outstanding payments remain to be made under these contractual arrangements, reflecting £149m of outstanding debt liability and £378m of interest and service charges.

10. Option 4- loans fund repayment holiday

10.1 Members may recall that the annual loans fund repayment, made through the Council's revenue budget, comprises two key elements. The first element, the 'principal', relates to the repayment of the initial capital investment for which borrowing was undertaken. The second element is the 'interest' element, which reflects the annual interest payable on the Council's external borrowing.

10.2 Option 4 relates to the ‘principal’ element of the annual loans charge and suggests the possibility of reprofiling the planned 2020/21 principal repayment over a period up to 20 years from 2021/22 onwards. This ‘repayment holiday’ would mean the Council does not pay off its outstanding principal as quickly as planned but would realise an underspend against the loans charges budget in 2020/21 which could be used to offset Covid revenue costs.

10.3 Highland’s loans fund principal repayment for 20/21 is around £30.8m, so the repayment of that debt could be rescheduled over the period 2021/22 to 40/41. As a rough estimate if the loans fund repayment holiday was taken an underspend of £30.8m would occur against the loans fund revenue budget in 2020/21. If the repayment of that sum took place over the next 20-year period, an additional annual loans charge of around £2.2m could be expected. Over that 20-year period around £13.5m of additional interest charges could be payable.

11. Summary of options

11.1 Full details of the options would need to be provided before officers are able to do a complete assessment of the choices available. That assessment would need to consider the potential revenue impact of any option in 2020/21 and whether any blending of options was available. The recurring revenue budget impact in future years will also need to be taken into account.

11.2 In headline terms options 3 and 4 would appear to offer a much greater potential for a one-off benefit to the 2020/21 budget. The trade-off for that larger one-off benefit is a much-increased recurring annual cost reflecting the payback of the 2020/21 benefit. Options 3 and 4 appear to be more complex options and so full clarity of those options will be required in order to properly understand their limitations.

11.3 Also key will be an understanding of whether any of these options are time-limited as the Council may make different choices if certain options are only accessible for a short time. If certain options are time-limited but others available permanently that may influence the choice of any funding flexibility taken.

Designation: Executive Chief Officer- Finance and Resources

Date: 24th September 2020

Authors: Edward Foster, Head of Corporate Finance

Background Papers:

https://www.highland.gov.uk/download/meetings/id/76864/item_4_corporate_revenue_monitoring_report_to_30_june_2020

https://www.highland.gov.uk/download/meetings/id/76798/item_13_budget_impact_of_covid-19_%E2%80%93_understanding_the_gap https://www.highland.gov.uk/download/meetings/id/76701/item_6_annual_accounts_201920_and_revenue_budget_202021

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Rt Hon Rishi Sunak MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

9 September 2020

Dear Rishi,

Councils have played a crucial role in supporting local communities throughout the pandemic. I recognise and welcome the additional funding for Councils already announced by the UK Government to help meet their additional costs, together with the lost income scheme to address the additional financial impact on Councils of lost income from sales, fees and charges. As you would expect during this difficult period, there remains unmet funding pressures for Scottish Councils both in the short term for the immediate mobilisation effort and as we move into the recovery phase in the medium term.

While drawdowns from reserves may be sufficient to make a contribution for a number of Councils to address these, particularly high pressures or low reserves mean this is unlikely to be enough for all Councils. In the absence of further additional funding other financial flexibilities are necessary.

We have worked jointly with the Convention of Scottish Local Authorities (COSLA) to identify a package of financial flexibilities for our Councils to address the funding pressures they face due to COVID. None of these flexibilities are for additional funding, but they are vital if we are to ensure our Councils remain financially sustainable and critically to protect local services as Councils seek to balance their budgets and support the recovery phase.

Our assessment is that none of these measures should adversely impact the Scottish Budget. With the exception of the Capital Grant/borrowing proposal, which requires your formal approval, the three remaining proposals are in our view within Scottish Ministers' gift and an exercise of our powers. However, given the nature and scale of the financial flexibilities, to be transparent and ensure there is no risk to the Scottish Budget, we are sharing with you details of our proposed measures.

Capital Grant/Borrowing
The Scottish Government provides Councils with a non-specific General Capital Grant to fund capital expenditure. In 2020-21 this grant totals some £468 million. During lockdown the construction sector came to a complete standstill for four months, and as a result Councils are seeing underspends against their current capital budgets due to the resultant slippage of projects which cannot be recovered in the current financial year.

Our preference is to allow Councils to spend up to £156 million (£468 million x 4/12) of the capital grant to fund revenue pressures arising from COVID. Due to significant COVID pressures on the Scottish Government's resource position, we do not have scope to manage this switch within our current budgetary allocations and are therefore seeking for this transfer to be undertaken by offering up to a £156 million underspend in the overall Scottish capital budget.

Alternatively, we ask that our Councils can borrow for COVID revenue funding pressures, up to £156 million. We recognise that allowing our Councils to borrow for revenue purposes is cost neutral for the Scottish Government budget only where the UK Government includes this as a facility within the Scottish Government Spending Review. In the absence of such a facility such borrowing is conditional on Scottish Government budget cover equal to the amount of borrowing being permitted. We would therefore provide a corresponding underspend of £156 million within the overall Scottish capital budget.

Capital receipts received in 2020-21 and 2021-22
There is precedent for allowing capital receipts to meet significant one-off revenue funding pressures, and COVID related costs meet the usual criteria. Whilst COVID has also had an impact on the sale of assets, permitting this facility over two financial years will support Councils with their financial recovery from COVID.

Credit arrangements
From 2021-22 the public sector will adopt a new accounting standard – IFRS 16 Leases. IFRS 16 introduces a new lease definition with an increased focus on control of the underlying asset. This sees most leases on-balance sheet with the lessee recognising a right-of-use (ROU) asset and a lease liability. The IFRS 16 approach is to treat the transaction as a purchase of an asset on a financed basis.

This will mean a local authority will be required to recognise additional assets on its balance sheet, and at the same time this will bring these assets within the scope of the statutory capital framework. This will further increase the complexity of local authority accounts. We are seeking to reform the statutory framework for leases by reverting back to proper accounting practices, that is no statutory adjustments for leases.

Service concession arrangements are akin to a lease. The statutory intervention on service concession arrangements in Scotland was introduced in 2010 to address a financial impact when service concession assets, mostly schools, were first brought onto a local authority's balance sheet. The current statutory arrangements require the repayment of the liability to be charged to the revenue account over the contract period, usually 25 years. Accounting standards allow depreciation of the asset to be over the useful life of the asset where the asset will remain with the authority at the end of the contract period.

For consistency we wish to see the statutory reforms, i.e. reverting to accounting standards, being applied to all leases and service concession arrangements. We have assessed that this will generate a saving for Councils, as the cost is spread over the useful life of the asset rather than the contract period. Allowing a local authority to revert in either 2020-21 (early) or 2021-22 (as planned) will allow any saving arising from the restatement to be available to fund the financial impact of COVID.

Loans fund repayment holiday
The statutory arrangements for the repayment of borrowing in Scotland, like the English minimum revenue provision (MRP), requires a local authority to make an annual repayment they consider prudent. As an exceptional measure we plan to allow a local authority to take a loans fund repayment holiday, the maximum permitted being the planned repayment for 2020-21, which is estimated at some £400 million. A council will be required to repay the missed payment within the period of the loan fund advance but, where the loan period exceeds 20 years, within 20 years.

Each council is facing different financial pressures arising from COVID, and by offering a package of financial flexibilities to Scottish Councils we consider this will enable them to tailor a financial solution that fits their circumstances.

Councils are currently reworking their budgets to take into account the financial impact of COVID and are therefore looking for some certainty as to the funding and financial flexibilities available to them to manage their financial position. I would like to be able to be in a position to confirm these flexibilities before the end of September, i.e. the financial year midpoint, to provide Councils with the certainty they need as they are now urgently engaged in reviewing their budget plans and the options they will need deploy to reach a balanced position. I would therefore request your early response to my capital grant/borrowing proposal, and a confirmation that there is no risk to the Scottish Budget from our other proposals.

I can confirm that the financial flexibilities contained in this letter are being proposed following full and comprehensive discussions with COSLA, on behalf of all 32 local authorities in Scotland, and they are in full support of me making this request. To reach this point, I have been working closely with COSLA's Resources Spokesperson Councillor Gail Macgregor, who is writing to you separately to confirm their position and full support for the financial flexibilities outlined in this letter.

I trust this letter is helpful in informing you of our intentions and look forward to an early response. I am happy to discuss any aspects with you or the Chief Secretary who I have copied this letter to.

KATE FORBES

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APPENDIX 2

Committee:	**Highland Council**
Date:	**10th September 2020**
Report Title:	**Revenue budget 2020/21- update report**
Report By:	**Executive Chief Officer – Resources and Finance**

1. Purpose/Executive Summary

1.1 The impact of Covid 19 on the Council's operations and budget in the first part of financial year 2020/21 has been significant with effects expected to continue to be felt throughout the remainder of the year. This report provides an update to the previous revenue budget reports considered at the meetings of the Council held on the 25th June and 30th July.

1.2 Whilst virtually every aspect of the Council has been affected the areas most significantly impacted from a financial perspective relate to income generated from fees and charges as well as the additional costs associated with the schools return. Some of this has already been partially mitigated by confirmed additional government funding.

1.3 It is still early in the financial year and so many assumptions need to be made about what might happen in the remainder of the year in order to forecast what the Council's financial outturn might be.

1.4 Members will no doubt be aware that Covid 19 is still prevalent in society with local lockdowns use in Scotland and across the UK, cases local to Highland continuing to be identified, increasing tourism and movement of people bringing increased risks of spread, and cases in continental Europe and worldwide in some instances increasing to levels last seen in March. The onset of winter is also considered by some scientists to be another risk factor to an increasing rate of transmission of the virus. All of these factors may result in legislative or other guidance being issued from Government which could impact on Council activity. This report will not speculate on the further potential spread of Covid 19 but does recognise the significant risks to the Council's income and operations that Covid 19 poses.

1.5 The quarter 1 revenue monitoring report as presented to the Corporate Resources Committee on the 20th August forecasted a 'central' scenario of a year-end overspend of £28.259m if no further action was taken or no further government funding received (beyond that already confirmed). The report also identified the key variables that could impact most significantly on that outturn position and portrayed a number of scenarios that could emerge. A range of possibilities still lies ahead, from a balanced budget being delivered to an even greater overspend being incurred.

1.6 This report provides an update on significant changes to the factors underpinning the gap, providing an updated assessment of the gap of £22.709m; the potential mitigations that would see the gap reduced over the remainder of the year; and the potential risks that could increase the gap over the remainder of the year.

1.7 In a most positive outcome, should the expected further funding be received from government; and spend over the remainder of the year is managed prudently as outlined in service budget monitoring reports it is possible that a near-balanced budget may be delivered by year end.

1.8 Given the Covid backdrop to this report there are a greater number of risks to this assumed position than ever before. Those risks fall into two categories and could impact on the position either positively or negatively. The first risk is the risk of forecasting with any accuracy- we are in an unprecedented time of uncertainty and assumptions made about the financial impact of Covid or funding to be received may be inaccurate. As we are in an early stage of the year those inaccuracies may be amplified throughout the remainder of the year. The second key risk is the risk of a resurgence of Covid 19, with another lockdown scenario having the potential to have a significant adverse impact.

1.9 As a result of these uncertainties the report proposes a number of contingency items which require certain planned investment priorities to be paused pending greater clarity emerging on the financial position. At this stage Members are not being asked to cancel these planned investments, merely to pause that investment in order that those funds can be repurposed should the situation deteriorate later in the year. The ability of the Council's reserves to supplement any contingency is also covered by the report.

1.10 This report does not look in any detail at financial years 2021/22 and beyond however it does acknowledge that there is great uncertainty over the medium-term financial sustainability of the Council. It is expected that it will take many years for the fee and charge income generated by the Council to return to pre-Covid levels, which will limit the Council's ability to spend. Additionally, there is no suggestion at present how future years' grant funding settlements will be impacted by Covid, or whether additional funding support already provided in financial year 2020/21 may be replicated for future years.

1.11 In order to help the Council's recovery from Covid 19 the Council has developed a Recovery Action Plan, with eleven key priorities, the delivery of which is overseen by the Recovery Board and reported to Council. The Recovery Plan aligns with transformation and redesign activity across the Council to lead the Council out of the current health and economic crisis and support the Council's financial recovery.

1.12 The report also seeks approval for some essential capital works, already included in the approved capital programme, which require urgent contractual commitments in order to meet specific project requirements.

2. Recommendations

2.1 Members are asked to:

i. Agree to continue to lobby both UK and Scottish Governments for additional funding as outlined in this report;
ii. Agree the release of the £3m Crown Estate Investment Funds;
iii. Agree to the release of the £2.293m Roads Investment Funds;

iv. Agree to hold back spend on the remaining investment funds as detailed in section 10.4 until there is greater certainty on the budget position;
v. Consider the medium-term financial context and acknowledge the significant financial risks facing the Council;
vi. Note that budget update reports will continue to be provided to all Council meetings as agreed at the Council meeting on the 25th June.
vii. Agree to progress the capital projects as outlined in **Appendix 2.**

3. Implications

3.1 Resource- As outlined in the report the impact of Covid 19 on the Council's budget is expected to be significant. Whilst there is greater uncertainty about what the overall impact will be in 2020/21 a number of potential mitigations are proposed that could offset any overspend.

Should the Council not be able to fully mitigate the impact in-year any overspend would need to be funded from the Council's reserves. Non-earmarked balances currently stand at £23.249m. That position reflects the 2019/20-year end position of £15.451m, plus the approved increase in reserves of £4.909m agreed in March, plus the DSM balance transferred into general reserves as agreed by Council in June.

If the Council records a year end overspend the default position is that this is funded from the Council's reserves. Though considered unlikely it is possible that if government funding is not realised or in a worse-case scenario the Council could record a deficit that exceeds the value of its reserves

3.2 Legal- The Council has no specific requirement to revisit its approved budget for the year however it is seen as entirely appropriate that, in light of the current circumstances, Members have the opportunity to regularly review the potential impacts of Covid 19 on the Council's budget.

3.3 Community (Equality, Poverty, Rural and Island)- There are no specific community issues that arise directly as a result of this report however the planned pause in using investment funds would mean that the benefits to specific groups that might accrue from that investment will be deferred.

3.4 There are no specific Climate Change / Carbon Clever or Gaelic implications arising directly as a result of this report however reduced building use and travel is expected to reduce the Council's carbon footprint.

3.5 The impact of Covid 19 has resulted in significant levels of uncertainty at both a societal and economic level. There is limited historical precedent to intimate to us what the future holds and how the Council and wider society recovers from this crisis.

The impact of Covid 19 on the wider Highland economy may be exacerbated as schemes of government support for business come to an end. Those wider economic impacts may in turn increase demand for Council services such as those relating to social work, social care, employment and welfare, as well as reducing demand from business for activities that generate income for the Council.

Whilst there are a significant number of individual risks it is important to highlight to Members two important and very different categories of risk. The first of those is external factors, out with the Council's control that will impact on the Council. Covid 19 is a prime example of such a factor- the Council has very little ability to control it but is heavily affected by it. The changing prevalence of Covid in society, and government responses to it, may require significant changes in Council service provision.

Whilst Covid remains the most significant external risk factor other significant factors must also be considered, including the potential impact of Brexit. The recently published Redress for Survivors (Historical Child Abuse in Care) (Scotland) Bill may expose the Council to a significant financial liability. More usual risk factors, more specific to the services the Council provides, such as the impact of adverse weather or a bad winter must also not be discounted.

The second key category of risk is the inability to forecast with accuracy. Even if we had complete understanding of what would happen with Covid or any of the other external factors it can be very difficult to ascribe values to those risk factors. Insofar as is possible actual experience of the financial impact to date of Covid has been used to inform forecasts but there is no guarantee that spend or income in future will bear resemblance to the past.

As highlighted earlier in this report two of the biggest financial impacts of Covid are expected to be on the Council's fee and charge income streams and costs associated with the schools return. Regarding the Council's income streams the actual experience of the last few months has shown significant reductions in income compared with the equivalent quarter last year. What that data does not tell us however is how quickly, on what trajectory, and to what level those income streams may recover. As the year progresses we will gain better information on the actual impact on our income streams and have greater trend data from which to extrapolate- but it is unlikely that we will be able produce financial forecasts with a similar level of confidence as a 'normal' year.

Other areas of forecast, such as schools return costs, are very much emergent as the Council's planned response activity to the wider environment becomes clearer. At the time of writing schools have just returned and arrangements for that school return are being finalised. Once the clarity and certainty of the continuation of those activities is received it becomes easier to forecast the associated costs. As such, as the year progresses and we are clearer about how service provision has changed, the forecasting of costs should become more accurate.

As this report highlights, a significant amount of income is forecast to be received under the Government's scheme to recompense local authorities for fee and charge income lost as a result of Covid. Whilst it feels appropriate to include an estimate of income to be received under the scheme the ability to accurately forecast what level of income will be received is severely compromised by the lack of public detail available on the scheme. Should the forecasted level of income be over-optimistic drastic contingency action will need to be taken which could significantly affect all services owing to the expected income being in the region of £12m.

4. The budget gap

4.1 A Quarter 1 revenue monitoring report was presented to the Corporate Resources committee on the 20th August that outlined a 'central scenario' for the in-year budget gap of £28.259m. A link to that report is provided in the background papers section of this report. The key assumptions used and factors underpinning the gap are listed below with greater detail provided in the Resources Committee report:

- No second lockdown;
- The gap only includes government funding where the exact allocation to Councils had been confirmed;
- No increase or decrease in overall staff numbers;
- No new contractual challenges such as the transport related issues as reported to the 30th July Council;
- Education return costs as reported to the Education committee on the 2nd July
- Significant fee and charge income loss across a variety of service areas;
- Specific pressures in relation to supporting High Life Highland and Eden Court, demand pressures on children's social care budgets, and property return costs;
- No allowance for bad winter/Brexit impacts.

4.2 The position reported reflect an improvement on the position last reported to full Council, on the 30th July, when a budget gap of £35.734m was reported. Given the dynamic nature of the Council's response to Covid, the emergent nature of Government policy response to Covid and greater certainty in terms of costs and income actually incurred as time passes, combined with the regularity of reporting to the Council and Corporate Resources committee it is natural that the forecast budget gap figure will change with every report presented.

4.3 The most significant factor underpinning the improvement between full Council and Resources Committee reflects the first full appraisal of the impact of Covid across all individual budget lines across the Council completed as part of the quarter 1 monitoring. Whereas reporting to that point had primarily focussed on the areas thought to be most significantly affected by Covid the Q1 monitoring has taken all budget lines into account. In particular, the estimated impact of the lockdown period at the start of the year along with the management controls put in place to carefully manage recruitment and limit all spend to essential-only items has resulted in a number of forecast underspends across a wide variety of expenditure categories and services.

4.4 As in any other year all services will look to manage spend within their approved budget allocations and take any appropriate management action to mitigate any forecast overspends. In some cases, this may be by trying to manage down any forecast overspends, in other cases this may be by finding mitigating underspends elsewhere across the service budget. Whilst the potential variances are more significant this year as a result of Covid this core approach to management of budgets remains. There will continue to be budget monitoring as part of all service committees.

4.5 Corporate controls on spend have continued with robust scrutiny and approval of all planned recruitment and best value management of agency and overtime spend, scrutiny of all letting of contracts and the restriction of purchase cards to essential users only. Travel has been significantly restricted across the organisation, focus remains on optimising delivery of approved 2020/21 budget savings and officers continue to ensure that all income due is appropriately invoiced and recovered.

4.6 Since the position was reported to Corporate Resources committee further information has emerged around the potential level of support that might be required by High Life Highland and Eden Court. In the case of High Life Highland actions taken by management have seen their forecast deficit reduce from £3.3m to £1.5m. Whilst this position reflects a significant improvement, High Life face challenges around longer-term financial sustainability with a larger deficit forecast for 2021/22 as customer income takes time to recover. Eden Court have been awarded £0.750m of government cultural funding which, along with management action taken, should ensure the charity is able to deliver a balanced budget in year.

4.7 A high-level review of other areas of Council costs most specifically affected by Covid has also identified other areas where spend forecasts can be reduced. The following improvements, totalling £3.4m have been identified:

- Schools return costs- potential reductions in spend associated with school transport and other premises related costs of £2.5m
- Key worker childcare hubs- duplication of reporting of £0.9m pressure across both Education and Health and Social Care monitoring statements

4.8 Considering the above the budget gap in now estimated at a revised £22.709m. This figure will continue to be revised and updated with reports brought back to Members throughout the remainder of the year.

5. Mitigating the gap

5.1 Details of already confirmed funding are provided in **Appendix 1** and this funding is reflected in the Q1 reported position. The following sections of this report provide further information on additional income that may come into the Council from government and how this may impact on the budget gap. If this funding comes in as hoped it is possible that a balanced budget could be realised. There is however a significant risk that funding may not come in at the expected level, leaving the Council to find mitigating actions to offset any shortfall.

5.2 Funding from Government has been split into two sections below. Section 6 covers those funding streams where government has confirmed the total funding available for local authorities as a whole but where allocations to individual authorities are still to be formally confirmed or have just been formally confirmed.

5.3 Section 7 covers areas where a government commitment to provide funding has been made but limited details of the funding scheme, or total national funding allocation is available. The funding assumed in this section contains much greater risk than in section 6.

5.4 As agreed by Council in June the Council continues to lobby government for flexibility around how the income from second homes council tax is used. Whilst no formal response has yet been received from government the assumptions in this report are made on the basis that a positive response will be forthcoming.

5.5 The table below provides a summary of the revised budget gap as well as the potential additional funding streams and demonstrates the possibility of a near balanced budget if additional funding comes in as expected.

		£m
	Forecast 2020/21 overspend as per Q1 monitoring	**28.259**
Less expected changes from the reported position:		
	Improvement in HLH/Eden Court deficit position	-2.150
	Schools return- high level estimate of reductions from original forecast of transport and other costs	-2.500
	Other improvements in reported service positions (per section 4.5)	-0.900
	REVISED BUDGET GAP	**22.709**
Less expected further funding:		
	Education funding- additional teachers	-1.431
	Education funding- schools reopening	-1.200
	Education funding- school reopening	-1.800
	HAC funding	-0.651
Less potential further funding:		
	£50m Barnett consequentials- July announcement	-2.373
	Income recompense scheme- UK government July announcement	-12.000
Less lobbying for funding flexibility		
	Second homes Council Tax	-2.900
	RESIDUAL BUDGET GAP AFTER POTENTIAL ADDITIONAL FUNDING	**0.354**

6. Confirmed Government funding streams

6.1 As reflected in the table at 5.5 above government have confirmed the availability of four different funding streams, all of which can be used to offset costs included in the budget gap figure. An explanation of each of the funding streams is provided below.

6.2 On the 4th August the Council received a formal letter offering a grant of £2.205m for the recruitment of additional teachers and support staff for the education recovery phase over academic year 2020/21. This funding reflects the allocation of a national £50m for this purpose. The table at 5.5 reflects only part of this income as the costs estimated for education recovery that form part of the budget gap include £1.431m of additional costs which could be offset by this income. Education colleagues continue to review both the costs associated with the schools return as well as developing plans for the utilisation of this additional funding resource.

6.3 A further £30m of resource is due to be allocated for the same purpose with Highland's share expected to be £1.323m for academic year 2020/21. It is likely that this further funding will require additional expenditure to be incurred to offset it and therefore will not impact on the Council's budget gap.

6.4 On the 23rd July the Scottish Government confirmed a £20m fund to 'be allocated to help councils with additional costs associated with new health protection measures, school transport, enhanced cleaning and other essential logistical issues.' https://www.gov.scot/news/funding-for-more-teachers/

Details of how this funding will be allocated have not yet been confirmed but are planned to include an element to reflect rurality. An assumed allocation of £1.2m to Highland has been allowed for. This funding will be used to offset costs associated with the schools return already included in the forecast budget gap.

6.5 On the 30th July the Scottish government confirmed a further £30m for the education recovery fund, intended to '*support cleaning, facilities management, school transport and other practical issues that are vital in ensuring a safe return to schools.* https://www.gov.scot/news/phase-3-continues-with-further-indicative-re-opening-dates/

Details of how this funding will be allocated have not yet been confirmed but an assumed allocation of 6% to Highland has been allowed for. Again, this funding will be used to offset costs associated with the schools return already included in the forecast budget gap.

6.6 Finally, the Council has been offered a grant of up to £0.651m, payable over the period 1st July to 30th September, to continue support to individuals at risk as a result of Coronavirus to access food and other essentials, including those asked to self-isolate under Test and Protect. The costs associated with this activity are included in the Council's forecast budget gap and therefore this grant income can be used to offset those costs.

6.7 Assuming that these different funding streams will be able to close the budget gap does carry an element of risk, in some cases the funding allocation has not yet been formally confirmed and in others funding will only be received to offset certain categories of spend. It is however expected that the Council will be able to make claims that comply with the grant funding offers.

7. Assumed Government funding streams

7.1 The two funding streams outlined below both reflect funding schemes that have been announced by the UK government but for which the applicability to Scotland or total funding amounts are unclear. In both cases Barnett consequentials will transfer to Scotland but the Scottish Government will need to decide on whether to allocate all the funding to local authorities as well as a method of allocation.

7.2 On the 2nd July the UK government announced a non-ringfenced cash funding allocation for local authorities. The Barnett consequentials associated with this funding confer £50m on Scotland. Whilst the Scottish Government has made no formal announcement of how this funding will be used initial discussions with COSLA have intimated that the government will look to make this funding available to local authorities. Based on previous allocations of funding it has been assumed that if this funding is fully passed on £2.373m will be allocated to Highland.

7.3 On the 2nd July the UK government also announced a scheme to recompense Councils for lost fee and charge income. Details of the relevant press release can be seen below: https://www.gov.uk/government/news/comprehensive-new-funding-package-for-councils-to-help-address-coronavirus-pressures-and-cover-lost-income-during-the-pandemic

7.4 Since the announcement of the scheme very little further detail has been forthcoming. We are aware that the scheme announced by the UK government will not apply directly to Scotland but instead Barnett consequentials will flow to Scotland. At this stage there is no suggestion of the value of the UK government's scheme and hence the level of those Barnett consequentials. Scottish Government, through discussion with COSLA, have confirmed that they are minded to replicate the UK scheme in Scotland, but may adjust the scheme parameters to suit local circumstances.

7.5 In terms of trying to place a value on the potential benefit of the scheme to Highland we can only use the limited level of detail that is publicly available, namely that Councils will be liable to fully meet the first 5% of any income losses themselves, with 75p in every £1 of lost income thereafter met by additional government funding. The budget forecasts include an assumed income shortfall in the region of £18m. A figure of £2m has been allowed for to reflect the first 5% of income loss that the Council has to meet itself, although that figure may need to increase depending on the complexities of the scheme and whether it is only the affected income streams that are included or all income streams. Allowing for 75p in the pound to be recompensed gives a high-level estimate of £12m of potential funding through this funding stream. If Highland were to receive this level of funding a national pot of around £250m may be required.

7.6 Making assumptions about such a significant level of additional funding coming to Highland is inherently very risky, particularly with regard to the income recompense scheme where very little detail of the scheme or level of funding to Scotland is confirmed. Whilst it does seem appropriate that some assumption about these funding streams coming to Highland is appropriate because of the positive ongoing discussions between COSLA and the Scottish Government there is a significant risk that the funding that comes to Highland is well below expected levels. For this reason, it is very important that the Council holds significant contingencies to mitigate this risk.

8. Lobbying for flexibility

8.1 Previously, when facing extreme financial pressure, the Scottish Government has allowed the Council to repurpose part of the income received from Council Tax on second homes normally ring-fenced for investment in affordable housing.

8.2 At the June Council meeting Members agreed to request the same flexibility from Government this year and a formal letter making this request was sent by the Council Leader to the Finance Secretary. At the time of writing a formal response from the Finance Secretary is awaited.

8.3 Given the extreme circumstances the Council is facing and the historic precedent that has been set it is assumed that Government will grant the same flexibilities this year to help the Council balance its budget. This would release £2.9m of funding to help mitigate the gap. There is a risk that Government may not agree to the request which will leave the Council needing to find an equivalent amount from other sources.

9. Risks

9.1 Section 3.5 of this report provides explanation of some of the risk factors facing the Council in these wholly unusual circumstances. This section of the report aims to attribute some high-level estimates for the potential values of these risks, and it is important to note that these are high level estimates only given the uncertainties.

9.2 Risks can be summarised as ones related to Covid, and how the Council's service provision may be impacted by changes in the wider Covid context. A second national or reginal lockdown is a particular risk. Potential changes to services and demand for services will have a financial impact.

9.3 There is also a significant forecasting risk, with the risk that there is still no certainty around a range of assumptions and therefore forecasts will have to be continually adjusted. This is particularly true in respect of income, where the assumptions about the trajectory of recovery in income streams may not be borne out.

9.4 As highlighted in sections 6, 7 and 8 of this report there are varying degrees of risk associated with funding streams and flexibilities that require government approval. There are heightened risks around the near £15m of funding the potentially may be receivable from government as part of the income recompense scheme and distribution of other Barnett consequentials.

9.5 Additionally, there are risks that do not relate to Covid, with the normal risks faced by the Council such as bad weather or a hard winter. More specific other risks include Brexit and the recently published Redress for Survivors (Historical Child Abuse in Care) (Scotland) Bill. For these last two items in particular it is very difficult to estimate the potential risk exposure to the Council.

9.6 The table below provides high level estimates for what the worst-case impact of any risk might be in the current financial year and it is thought highly unlikely that all risks would materialise at these levels. If any of these risks do materialise the financial impact could be anywhere in the range between zero and the value shown below.

Potential worst-case cost of risks		
Second lockdown	15.000	Predominately income impact- which could potentially be mitigated by extra government funding through income recompense scheme
Schools return- enhanced arrangements	3.000	Additional government funding could come through to offset significant extra costs
NHS- Adult Social Care	4.000	Initial expectation that government meets all additional ASC costs due to Covid
Further supplier support/contractual challenges	3.000	
Additional recruitment (non-schools)	2.000	
Challenges in savings delivery	1.000	
Winter	1.000	
Brexit	1.000	

Service pressures- demand-led	2.000	Looked after children biggest risk area- but significant level of pressure already built into figures
BRIS	1.095	
Total potential cost risks	**33.095**	
Funding risk	14.373	Risk that assumed government funding does not transpire
TOTAL VALUE OF RISKS	**47.468**	

10. Contingencies

10.1 Given the high potential value of risk as detailed in the table above the Council needs to have a plan to deal with any adverse movement in the position. For this reason, being able to identify contingencies now would be of real benefit.

10.2 Some of the potential contingencies could mean not spending planned investment funds now, until there is greater clarity on the future. The permanent removal of these funds is not recommended at this stage, the most prudent approach is that no contractual commitments are made against these funds until there is greater confidence in the Council's future financial sustainability. The total value of contingencies comes to £7.893m.

10.3 Given their consideration of potential risks to the Council's budget as outlined in this report, balanced against the potential social and economic benefit that could accrue from the allocation of these funds, it is the proposal of the Council's Administration that the **Crown Estate funds of £3m and Roads Investment funds of £2.293m are released for spend now**, with spend against all other funds detailed in the table below formally paused until greater certainty on the Council's financial sustainability is received.

10.4 The table below provides a list of the remaining potential contingency items against which spending could be held back. The total value of these remaining contingencies comes to £2.600m:

Potential remaining contingency items:	**£m**
Highland Deal	1.000
Rural Transport	0.500
Play parks	0.100
20/21 change fund (unallocated element)	1.000
Total	**2.600**

10.5 In addition to these suggested contingencies the Council has existing contingencies by way of its reserves and balances. The Council's main reserve, the non-earmarked general fund reserve, currently stands at £23.249m, or just under 4% of the Council's annual revenue budget. The target level for this reserve, approved by Council, is 3% of the annual revenue budget which equates to around £18m.

10.6 Any amount of this reserve could be used to offset any overspend that occurs in the year. In light of the potential challenges facing the Council in the current year and 2021/22 and beyond (as covered in section 11) it is not recommended that any commitments are made that would reduce the level of this reserve from its current level. Having a reserve at a greater level than the target could allow the Council the opportunity to invest in the recovery of the Highland region over the coming years.

Given the extreme nature of the risks the Council is currently facing it is suggested that it would be appropriate to hold a level of reserve in excess of the normal target level. It is good practice to hold a level of reserves that reflects the risks the Council is facing- given that risks have substantially increased reserves should be increased accordingly.

10.7 The Council also holds a number of earmarked reserves with a total value of £17.956m as at the 30th June. There are a variety of reasons for holding earmarked balances and in extreme circumstances it would be possible to 'unearmark' a small proportion of these balances to address any budget deficit. It should be noted however that much of the earmarked balances relates to external funding that cannot be repurposed, such as developer contributions or SALIX funding. The expected drawdown of a number of the other balances is also already reflected in the monitoring statements or covered elsewhere in this report.

10.8 The continued careful management of budgets by managers throughout the remainder of the year may yield further budget underspends from those already reported. As the year progresses a greater understanding of the potential level of underspends will develop and will be reported through the normal quarterly monitoring reports to service committees.

10.9 At this stage, and given the significant uncertainties, specific cuts to budget services are not being proposed. The situation will continue to be monitored closely and if the budget gap cannot be mitigated by the approach set out, then specific spending reductions will need to be identified for approval by Council at a future meeting.

10.10 The level of contingencies currently held can be considered to be £25.849m, which would reflect the approach to the use of the investment funds detailed at 10.4 along with the complete use of all non-earmarked reserves. Whilst a review of earmarked balances could have a limited impact in increasing those contingencies the total identified contingency would still be considerably below the £47.468m of potential risks identified in section 9.6.

10.11 Under current legislation the Council is not able to borrow to fund revenue activities with borrowing restricted to use for funding capital investment. The Council may also borrow for cashflow purposes. As such the Council cannot borrow explicitly to fund the activities related to the Covid response or to offset lost income.

10.12 The Council has begun an exercise to review its annual Loans Fund charges which could yield an initial saving to the revenue budget. This saving would accrue by rescheduling outstanding loans charges repayments by deferring a portion of the planned repayments into later years. The conclusion of this review will fully articulate the options open to Members but may afford the opportunity for revenue budget savings in 2020/21. This approach would however constrict the Council's ability for capital investment in the future. Given the challenges around maintaining and investing in the Council's asset base it is suggested that any benefits that might accrue from this review are used for capital investment purposes unless a situation of exceptional revenue budget crisis emerges.

10.13 If the Council records a year end overspend the default position is that this is funded from the Council's reserves. Though considered unlikely it is possible that in a worse-case scenario the Council could record a deficit that exceeds the value of its reserves. Whilst it is thought that the Council would be able to borrow to cover any cashflow issues that might emerge from such an eventuality it is expected that any budget set for 2021/22 would require to be balanced as well as ensure any 2020/21 deficit is reimbursed. As reported elsewhere in this section it is recommended that reserves are maintained at as high a level as possible given the level of uncertainty.

11. 2021/22 and beyond

11.1 In an ordinary year this September Council meeting would most likely be presented with a report outlining the potential financial settlement and estimated budget gap for the years ahead. Although the Council's focus is rightly on managing the budget gap in the current year Members are asked to be mindful of the extreme challenges the Council is likely to face in the coming years.

11.2 Thinking ahead to next year's budget there is huge uncertainty over the level of income the Council will receive. It is unclear how any funding from government, by far the Council's largest income source, will be affected by Covid. In addition, the Council's own fee and charge income streams are highly unlikely to return to 2020/21 budgeted levels for some time. If the Council's income falls substantially then expenditure will need to be reduced accordingly. This may require a strategic reappraisal of services and service levels which has the potential to impact on the Council's staff, communities and service users.

11.3 The impact of Covid in 2020/21 has the potential to be largely mitigated by additional government funding but it is unclear how sustainable it would be for that additional funding to continue indefinitely. The impact of Covid on the Council's income and expenditure is however expected to be felt across future years and if there is no additional government income to offset those issues the Council will need to manage any ensuing budget gap itself.

11.4 The wider economic impact of Covid on the Highland economy may cause demand for certain services to increase substantially as adverse impacts are felt by families and businesses. Managing increasing service demand with reducing resources will prove challenging.

11.5 When the Council approved its budget in March 2020 a number of savings were approved for financial years 2021/22 and 2022/23. Despite the approval of those savings a residual budget gap of £24.135m was forecast over the two years. Given the current circumstances a number of the approved savings may no longer be deliverable, and the budget gap will likely be considerably widened by Covid impacts. A number of other key assumptions underpinning the forecast gap will also need to be reviewed and may adversely impact on the gap.

11.6 The financial impacts of Brexit and the recently published Redress for Survivors (Historical Child Abuse in Care) (Scotland) Bill remain uncertain, and these matters will need to be considered when developing the medium-term financial plan.

12. Next steps

12.1 The biggest underlying factor across the current financial context is uncertainty. Circumstances have been constantly changing and nearly all these changing circumstances will impact on the Council's budget. Officers will continue to update financial forecasts with budget update reports presented to all subsequent Council meetings. In addition, regular quarterly monitoring reports will be brought to the Corporate Resources committee.

12.2 Particular focus will continue to be placed on the biggest cost risk factors as identified throughout this report as these items have the greatest potential to significantly alter the forecast position. All areas of spend will however continue to be reviewed.

12.3 Income factors are also particularly important to monitoring the budget gap. Continued dialogue with Scottish Government and COSLA should help gain much-needed clarity on additional funding streams for the current year as well as potential settlements for 2021/22. Additionally, fee and charge income will continue to be closely monitored to see whether income levels are as expected.

12.4 Detailed work on the 2021/22 budget will need to commence which will inevitably necessitate looking at expenditure reductions. This work will need to tie in with the work of the Recovery board and Redesign board as a reimagined Council will be necessary to address the challenges and ambitions of the future.

13. Capital

13.1 An update was provided to Members as part of the June Council report that outlined some high-level impacts of Covid on live capital projects. Work across the programme is now back underway.

13.2 Approval was given at the June meeting for officers to progress a number of projects, already in the existing capital programme, where contractual commitments were required. **Appendix 2** to this report provides a further list of projects, again within the approved capital programme, for which Member approval to enter into contractual commitments is sought.

13.3 All of the projects contained within **Appendix 2** reflect essential items where contractual commitment will be required between now and financial year end. A total gross value of £33.571m of projects is sought for approval, with this spend expected to be split across the current financial year (£20.363m) and future years (£13.208m).

13.4 A number of the projects detailed are supported by external funding sources with £5.5m of Early Years capital funding attributable to a variety of education projects. In addition, certain flood prevention projects will be 80% funded from government. Finally, insurance monies will provide for the work approved for Lochaber High School and Park Primary school.

13.5 Proposals for further project approvals may be brought to subsequent meetings of the Council. Over the coming months the Council will look to develop its capital strategy which will be informed by the Revised Council Programme, Recovery Plan, move to a corporate landlord model and also an assessment as to how individual projects meet the Council's aspiration for a low carbon, digitally enabled and partnership driven future. It is also recognised that there is a need to prioritise capital investment to modernise adult social care provision including e.g. Cala Sonas / Melvich and a report will be brought back to the Council once there has been further dialogue with the Scottish Government and NHS Highland. The capital strategy will then inform a new capital programme to be in place well before the expiration of the current programme at the end of financial year 2022/23.

13.6 A vital factor underpinning the agreement of any new capital programme will be affordability. Members are reminded that core capital grant funding from government for financial year 2020/21 is £7.660m below the level budgeted when the capital programme was agreed. If the 2020/21 funding level continues into future years this will again be lower than the level budgeted. At this stage there has been no suggestion from government around what future capital funding settlements may be.

13.7 The largest element of funding of the Council's capital programme comes through borrowing, supported by the Council's revenue budget. As referenced throughout this report that revenue budget is coming under increasing challenges. To maintain or increase the proportion of the Council's budget that is devoted to loans charges is likely to require finding equivalent savings in service revenue budgets.

13.8 Given the current funding uncertainties for both revenue and capital now would not be the opportune moment to produce a new capital plan. Instead work will focus on the Council's capital strategy with a report outlining the key aspects of that strategy to be brought to Council by the end of the year. Once a capital strategy is formally approved by the Council that will allow a new capital programme to be developed in the new year that both meets the strategic investment priorities as well as aligning with overall affordability limits.

Designation: Executive Chief Officer- Finance and Resources

Date: 19th August 2020

Authors: Liz Denovan, Executive Chief Officer- Finance and Resources; Edward Foster, Head of Corporate Finance

Background Papers:

https://www.highland.gov.uk/download/meetings/id/76864/item_4_corporate_revenue_monitoring_report_to_30_june_2020

https://www.highland.gov.uk/download/meetings/id/76798/item_13_budget_impact_of_covid-19_%E2%80%93_understanding_the_gap

https://www.highland.gov.uk/download/meetings/id/76701/item_6_annual_accounts_201920_and_revenue_budget_202021

Appendix 1

Covid-19- confirmed additional funding

This paper provides detail of additional funding that has been provided to local authorities in response to Covid 19. Funding is primarily coming through a £350m communities fund (detailed in the first table below). Support for business funding, which LAs are administering on behalf of government, is included in the second table. Other discrete funding announcements made outside these are covered in the third table.

£350m communities fund

Element	National Amount	HC share	Administered by:	Notes
Hardship Fund	£50m	£2.373m	HC	Local authorities can use this resource as they see fit to respond flexibly to the COVID crisis to help people and communities.
Scottish Welfare Fund (distributed)	£22m	£0.738m	HC	Added to Council's existing Scottish Welfare Fund budget and to be administered in the same way as existing fund
Scottish Welfare Fund (undistributed)	£23m	-	SG	Held centrally by SG- to be *'provided later, to be targeted at where it is most needed.'*
Increased Eligibility for Benefits and Increased Council Tax Reduction Scheme	£50m	-	SG (but may come to local authorities)	To provide "extra headroom" for CTR and Social Security payments, undistributed at the moment. This is a 'reserve fund' so will only be allocated by Government if required- they are '*putting in place measures to allow us to track CTR caseload and spend for each authority, so we can allocate the funding as appropriate.'* SG suggestion to COSLA that £25m will be distributed in September.
Food Fund- FSM and vulnerable groups	£30m	£1.119m	HC	To support free school meal provision and people and communities at risk (non-shielded).

Food Fund- Third sector	£10m	-	Third sector	For investment in third sector organisations that are responding to food insecurity both at a national and local level
Food Fund- Shielding	£30m	-	SG	For a nationally procured programme to deliver food for those who are unable to leave their homes due to being at highest clinical risk, known as the shielded group
Wellbeing Fund for 3rd sector partners	£50m	-	SG / Third sector	For charities and other third sector organisations to support at-risk people who may be worst affected by the crisis.
Supporting Communities Fund	£40m	-	SG- and HIE locally	This fund is available to community organisations including those that are not registered charities to support small-scale community resilience. The fund will be allocated through community anchor organisations (CAOs) that are already playing a key active role in providing services within the community.
Third Sector Resilience Fund	£20m	-	SG	To support charities, voluntary organisations and social enterprises that already deliver vital services in communities that find themselves in financial difficulties directly as a result of the Coronavirus pandemic.
Scottish Government Reserve	£25m	-	SG	Flexible reserve held by SG

Support for business funding

Fund	National Amount	Highland Allocation	Notes
Business support fund- phase 1	£1,188.2m (initially only £950.2m allocated to local authorities)	Total allocation £94.7m, Highland share of initial allocation £75.72m	To support grant payments of £10k to eligible small businesses and £25k to eligible larger businesses
Business support fund- phase 2- totalling £220m (individual elements below)			£120m nationally to extend small business grant scheme, £100m to support self-employed people and micro and SMEs
Extension of small business grants scheme	£120m	tbc	For those with multiple properties- receive 75% of grants for subsequent properties

Newly Self Employed Hardship Fund	£34m	£812,433. Initially only 60% of total national amount allocated.	One-time payments of £2,000 to eligible applicants
Creative, Tourism & Hospitality Enterprises Hardship Fund	£20m	-	Managed by the Enterprise Agencies in partnership with Creative Scotland and VisitScotland for creative, tourism and hospitality companies not in receipt of business rates relief
Pivotal Enterprise Resilience Fund	£45m	-	Managed by the Enterprise Agencies for vulnerable SME firms who are vital to the local or national economic foundations of Scotland
Bridging Bursaries	£1m	-	To top up Creative Scotland's Bridging Bursaries in the not-for-profit sector.

Other items

Fund	National Amount	Highland Allocation	Notes
Spaces for People	£10m	£0.753m	'Bid-in' funding for temporary active travel infrastructure. Highland successfully submitted a bid for £0.753m for active travel interventions across Highland.
Community Care	£50m	£2.338m (to NHS Highland)	Funding paid directly to NHS Highland in respect of Health and Social care mobilisation plans
Additional Funding Support for Local Government	£155m	£7.357m	Additional funding for Scottish local government via Barnett consequentials.

Capital Programme 2020/21 - Projects for Approval **Appendix 2**

Project Name	Description of works	2020/21 commitment	Future Years' commitments	Comments
Learning Estate Improvement Programme	Future Priorities	150		Additional funding to allow further development of agreed priorities
Other Projects				
Farr High	Replacement of Modular Unit	350		Relocation of modular unit to replace condemned unit
Lochaber High	Flood Damage Reinstatement	1,000		Full cost to be determined
Park Primary	Fire Reinstatement Phase 1	1,000		Demolition of damaged building; short/medium-term measures, includes relocation of modular units
ELC/School Estate Improvement Programme				
Ardersier Primary	ELC/Roll Pressure	625		Includes relocation of modular unit
Auldearn Primary	ELC/Roll Pressure	1,250		Critical ELC Project
Avoch Primary	ELC/Roll Pressure	1,450		Critical ELC Project
Duncan Forbes Primary	ELC/Roll Pressure	1,500		Critical ELC Project
Glenurquhart Primary	ELC/Roll Pressure	475		Includes relocation of modular unit
Kirkhill Primary	ELC/Roll Pressure	625		Includes relocation of modular unit
Lochcarron Primary	ELC/Condition	800		Critical ELC Project; includes relocation of modular units
Mulbuie Primary	ELC/Condition	400		Critical ELC Project; includes relocation of modular unit
Newtonmore Primary	ELC/Roll Pressure	750		Critical ELC Project
Obsdale Primary	ELC/Roll Pressure	900		Critical ELC Project
Strathpeffer Primary	ELC	125		Critical ELC Project
EDUCATION TOTAL		**11,400**	**-**	

Project Name	Description of works	2020/21 commitment	Future Years' commitments	Comments
Roads Structural - Overlay/Inlay		1,100		The Condition of Roads in Highland has deteriorated markedly over the last 10 years - In 2011 we had the 11th best road network in Scotland; we are now at 25th place ; a fall of 14 places . In order to prevent further deterioration of the road network , it is essential that we undertake our annual programme of structural surfacing and surface dressing of our roads, which has been approved by Area Committees. It is also essential that we get approval now to undertake this work, because of its seasonal nature. These programmes are mainly delivered between April and September before the start of the winter season. If this decision is deferred, it will impact on our ability to deliver the programme. It is also important to be aware that much of these capital works are delivered by our in-house teams, so if this work is not done, there will be revenue consequences, as there is insufficient resource in the revenue budget alone to cover our staffing and Plant costs. Time critical.
Roads Surface Dressing		745		Justification as above.
Roads Structural Integrity Improvements		30		This is for essential road safety infrastructure, in particular the replacement of road signs in visitor hotspots to aid drivers but also to support enforcement action for inappropriate road usage where necessary.
Stromeferry Rockface		515		Stabilisation works completed in 19/20, with construction of works to stabilise a very high risk slope programmed to commence in Autumn 2020.
South Loch Ness		360		•Dores VIS – part of ongoing planning application/developer negotiations, very important to continue work here to realise these being delivered as mitigation works although timescales unknown – Cat 3 as dates may be dictated by planning decisions/committees and developer start times. •Croachy VIS – development of prelim design nearing completion and this awaits confirmation of funding opportunities for delivery – Cat 3. •Farr Gateway & surfacing works and Calanour Twin Track – still awaiting contribution from CS due to current hold on their capital spend – Cat 3.

Project Name	Description of works	2020/21 commitment	Future Years' commitments	Comments
Invercoe Bridge		1,000	2,845	Short term delays to progressing this project could cause delays of up to a year or more due to restrictions on when construction in the river can take place. If bridge is not replaced this year then we need to repair undermining to south support and consider whether the bridge needs to be weight restricted or closed. This is on the key access route to Kinlochleven and weight restricting or closing the bridge would be highly disruptive. If we do not proceed with full scheme - will lose the environmental window - but will have to spend money on emergency scour protection to a bridge which is to be demolished.
Glenmore Bridge		55	820	Glenmore Bridge carries B8007 Salen to Kilchoan road over the Glenmore River near Glenborrodale. It is a two span reinforced concrete bridge. The road is the only road link to Kilchoan and Ardnamurchan Point and is therefore a vital local and tourist route. Almost every component of the bridge has defects and overall it has one of the lowest condition scores of our entire bridge stock. There are scour issues around the foundations and in the river bed immediately downstream of the bridge. The parapets are badly corroded and are not compliant with current standards. Repair and refurbishment of the bridge is beyond economic possibility and it needs to be replaced in its entirety. Preliminary design has been completed and a preferred road alignment and bridge option has been chosen using a single span bridge of prestressed concrete beams on reinforced concrete abutment. Land negotiations ongoing.

Project Name	Description of works	2020/21 commitment	Future Years' commitments	Comments
Torbreck Bridge		334		Torbrek Bridge crosses the Holm Burn at Ness Side and is a both a traffic route and also a safer routes to school route. The burn downstream of the bridge is very heavily scoured. Historically sheet piling and concrete apron works have been installed to protect the bridge against the scour. This old protection work has now been scored and is collapsing leading to the potential loss of this bridge. These works (in the burn) require a license from SEPA – and the license conditions limit the construction window from June to October. Works are required urgently to protect further scour and the potential loss of the bridge. Delay in award will result in the loss of the environmental window of construction leading to a delay of 12 months and the potential loss of the bridge in storm/spate conditions. The contractor is prepared to start, following award, as soon as construction works can resume – anticipated mid to late June, for completion by October.
20mph Zones		22		Required to make permanent some of the temporary spaces for people project work.
Inshes Roundabout		50		Progress works at Beech Avenue, part of the Inshes Junction scheme
LED Lighting Enhanced		1,000		No committed expenditure at present, but budget is required to complete LED Programme which will secure energy efficiency measures and reduced energy costs. However if carry forward from 2019/20 is secured, this year's budget of £2.060M could be re-profiled over next 2/3 years. Delivery of LED programme to date have avoided additional annual energy costs of £1.15m in 2019/20.
Lighting Columns		250		Cat 2/3 expenditure required for replacement of faulty component parts identified through inspections to date. There is a health & safety risk if this work is not undertaken expeditiously. HEALTH & SAFETY
Caol Flood Prevention Scheme		250	7,207	80% grant funded from Scottish Government - already received grant monies. Already slippage in programme but still some float not to compromise grant funding cycle. Communities remain at risk of flooding until works complete. Could be deferred but be mindful of grant conditions.

Project Name	Description of works	2020/21 commitment	Future Years' commitments	Comments
Drumnadrochit Flood Prevention Scheme		250	2,336	80% grant funded from Scottish Government - already received grant monies. Already slippage in programme but still some float not to compromise grant funding cycle. Communities remain at risk of flooding until works complete. Could be deferred but be mindful of grant conditions.
Conon Bridge Flood Scheme		575		Works to protect area from flooding and also permit constrained housing including affordable housing.
ECONOMY AND INFRASTRUCTURE TOTAL		**6,536**	**13,208**	
Waste Infrastructure				
Waste disposal and recycling	Part of the waste infrastructure replacement programme	150		Skips, bottle banks, recycling receptacles required to ensure ongoing service delivery
Waste disposal	Compactors required to ensure saving achieved	114		The costs is linked to an agreed savings measure to reduce haulage costs
Refuse collection and recycling	6 refuse collection vehicles	896		6 RCVs required to ensure ongoing service delivery - part of the Council's vehicle programme. Vehicles to be ordered with lead-in time of 12 months.
COMMUNITIES AND PLACE TOTAL		**1,160**	**-**	
Fire Safety				
Bridgend Primary School	Fire Safety Work to Structure & Fabric	100		Statutory Works to improve compartmentation and component integrity
Engineering Compliance				
Helmsdale Primary School	Upgrade of Electrical System	25		Electrical system at end of serviceable life - compliance with BS7671 and EAWR
Tarradale Primary School	Boiler replacement	100		Statutory compliance and service provision
Various buildings	Underground Heating Pipework	200		Replace corroding pipework
Asbestos Removal				
Charleston Academy	Asbestos Removals	10		Removal of asbestos components that can no longer be managed in-situ.
Fortrose Academy	Asbestos Removals	20		Removal of asbestos components that can no longer be managed in-situ.
Nairn Academy	Asbestos Removals	10		Removal of asbestos components that can no longer be managed in-situ.
Highland Wide Various Asbestos Removals Works	Asbestos Removals: Programme	20		Removal of asbestos components in support of other Capital Works.

Project Name	Description of works	2020/21 commitment	Future Years' commitments	Comments
Highland Wide Properties	Asbestos Cement Roofs	20		Removal of asbestos components that have reached the end of their Service Life
Structure and Fabric - Buildings				
Tarradale Primary School	Roof Replacements and associated works Phase 2	80		Component Failure: End of Service Life
Property Security				
Kingussie High School	Security works advised by Police Scotland	80		Essential works on the advice of Police Scotland
Lochaber High School	Security works advised by Police Scotland	80		Essential works on the advice of Police Scotland
Nairn Academy	Security works advised by Police Scotland	40		Essential works on the advice of Police Scotland
Highland Council Headquarters	Security works	40		Essential Security Works
Highland Wide - Security Improvements	Highland Wide - Security Improvements	100		Essential Security Works
Facilities Management Compliance - Schools				
Nairn Academy & Charles Kennedy Building	Provide Storage Containers	9		Units required for Equipment Storage
Schools & Offices	Purchase of Winter Gritting Equipment & Accessories	8		Essential equipment to enable FM service to carry out core duties
Catering Compliance - Schools				
Kingussie High School	Installation of extraction canopy and essential roof repairs	50		Requirement from Environmental Health report, which graded the kitchen as Improvement Required because of lack of ventilation
Duncan Forbes Primary School	Upgrade kitchen, including extraction canopy	75		Ventilation requires upgraded to allow essential equipment replacements / improvements
Property Asset Management				
Property Rationalisation	Property Rationalisation Projects	200		Work to support Moves and Changes
HOUSING AND PROPERTY TOTAL		**1,267**	**-**	
TOTAL CATEGORY 3 APPROVAL SOUGHT		**20,363**	**13,208**	