

Agenda Item	11
Report No	HC/35/20

Committee: Highland Council

Date: 29th October 2020

Report Title: Revenue budget- update report

Report By: Executive Chief Officer – Resources and Finance

1. Purpose/Executive Summary

- 1.1 Members received a report on the 2020/21 revenue budget at the special Council meeting held at the start of this month. That report highlighted a potential residual year end budget gap of £11.254m.
- 1.2 The report of the 1st October also outlined ‘fiscal’ flexibilities, planned to be introduced by the Scottish Government, to provide Councils with the flexibility to manage their finances through the Covid challenge. This report provides a brief position update on the development of the flexibilities.
- 1.3 This report does not provide any updated figures for the potential year end budget gap but signposts Members to the quarter 2 revenue budget monitoring that will be reported to the Corporate Resources committee on the 11th November. Initial indications suggest that the forecast deficit will be slightly reduced, albeit significant risk and uncertainty lies ahead.
- 1.4 Planning work is underway to look ahead to the 2021/22 budget and this report outlines some of the areas of key assumptions and scenario planning that will be presented to Members in December. As with the 2020/21 budget significant uncertainty lies ahead and so it is important that a range of potential scenarios are provided to Members to help with the budget planning process.
- 1.5 As part of the wider context for the future budget setting process this report also brings to Members’ attention two reports by external bodies. These reports, by the Fraser of Allander Institute and Audit Scotland leave no doubt over the size of the challenge that lies ahead.

2. Recommendations

- 2.1 Members are asked to:
 - i) Note the contents of the report

3. Implications

- 3.1 Resource- At the Council meeting on the 1st October Members agreed to set aside £10.9m from the Council's non-earmarked reserve to offset the increased funding gap arising from reduced expectations of government funding support. After those funds are set aside the Council's non-earmarked balances stand at £12.349m. If the Council records a year end overspend this could be funded from those set-aside funds, the Council's non-earmarked reserves, contingency funds previously identified 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 proposed funding flexibilities are likely to require legislative or regulatory adjustments. Some of the proposed flexibilities are complex and the process of making those required adjustments will 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- As reported previously to Members the Covid context means risk and uncertainty remain incredibly high. Other significant financial risk factors, for example Brexit and a severe winter, must also be considered. As the financial year progresses the potential financial impact of those risks reduces, however potential longer-term impacts remain.

As the Scottish Government has reaffirmed its commitment to enacting the funding flexibilities the risk that they may not be made available to local authorities appears to be diminishing.

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. Position as reported to Council- 1st October 2020

- 4.1 In the Council report of the 1st October Members were provided with an estimated £11.254m year-end overspend position on the 2020/21 revenue budget. This figure was based on the quarter 1 revenue monitoring position, updated for any subsequent changes in significant assumptions.
- 4.2 The reported figure reflected a 'central scenario' but identified a number of significant risk areas which could impact adversely on the reported position. A number of risks specific to Covid were highlighted, including a second lockdown, enhanced education return arrangements, increased adult social care costs and further contractual challenges. These risks still remain live.
- 4.3 A 'funding risk' was identified, noting that assumed government funding may not transpire. Given changes made to the assumed government funding in the 1st October report there is now a high degree of confidence that this revised level of funding will be received.
- 4.4 A number of non-Covid risks were also identified although these were identified as being potentially less significant than those related to Covid. Such risks included increased demand for particular services, a severe winter, and additional costs related to Brexit.
- 4.5 Any year end overspend that transpires would need to be funded through contingency funds, reserves or the use of funding flexibilities. As agreed at the previous Council meeting the value of contingency budgets totals £2.6m. The Council has also set aside £10.9m of funds from its general reserves to offset the impact of reduced expectations of government funding. The general fund non earmarked reserve currently stands at £12.349m. The potential value of funding flexibilities has not been fully clarified but could be in excess of £50m.

5. Latest update- fiscal flexibilities

- 5.1 As part of the 1st October report Members were informed of four proposed 'fiscal flexibilities', part of a package intended to be made available by the Scottish Government to local authorities to help ensure short-term financial sustainability.
- 5.2 The four proposed funding flexibilities were as follows:
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.
- 5.3 Of these four options all but the first are within the gift of the Scottish Government to bring about with the first requiring the approval of the UK treasury to effect. On the 8th October the Cabinet Secretary for Finance sent a letter to COSLA's Resources Spokesperson confirming that the UK Treasury would not allow the first proposed flexibility to be introduced. This letter can be seen at **Appendix 1**.

- 5.4 The letter also confirms the Scottish Government's intention to bring forward flexibilities 2-4 which will require Statutory Guidance to be issued and Statutory Regulations to be changed. Given the complexities of these options this may take some time and COSLA are looking to the Scottish Government to provide an expected timetable for this development work.
- 5.5 Until the full detail of the flexibilities becomes clear it will not be possible to exactly quantify the value of each to Highland. It is expected that flexibilities 3 and 4 could have the greatest potential value to the Council, option 4 potentially being around £31m.
- 5.6 What does seem clear is that the flexibilities will be available in both the current financial year and financial year 2021/22. Use of the flexibilities in financial year 2021/22 may therefore be considered during the 2021/22 budget process.
- 5.7 A key paragraph from the letter concerning the use of the Council's own reserves and how use of the flexibilities may be prioritised is included below.
'Having said that I wish to be clear that this should not be seen as an opportunity to maintain or grow reserves. Local authorities are expected to take into consideration the contribution their reserves can make to meet their funding pressures. In terms of the financial flexibilities my expectation is that local authorities will first consider the additional resources available from capital receipts and the change in accounting arrangements for service concession arrangements before taking advantage of a loans fund repayment holiday.'
- This paragraph sets a very clear intention from Government about how the flexibilities may be used. A full understanding of the terms of use is required before any decisions can be made on Highland's approach.
- 5.8 The letter from the Cabinet Secretary also confirms an expected national sum of £90m for the income recompense scheme and the intention that this will be fully passed on to local authorities along with £49m of additional funding coming from Barnett consequentials. Highland has included assumed income from both of these funding streams in forecasting its year end budget deficit.

6. Quarter 2 revenue budget monitoring

- 6.1 As is standard process the Council's quarter 2 corporate revenue budget monitoring will be brought to the meeting of the Corporate Resources Committee on the 11th November. Work on producing this report is currently underway with initial workings indicating an improving position across a number of budget areas. Detailed quarter 2 service statements will also be brought to the forthcoming round of strategic committees.
- 6.2 The quarter 2 revenue monitoring statement will form the basis of the report that will be brought to the December meeting of the Council, which will both help understand and inform decisions taken about the current year's budget but also consider any potential longer term impacts of Covid that will impact on the 2021/22 budget and beyond.

7. 2021/22 revenue budget

- 7.1 Officers have begun work to model the size of any potential budget gap in financial year 2021/22 as well as look at options as to how that budget gap may be mitigated.

- 7.2 In terms of estimating what any budget gap may be assumptions in a number of key areas are required around:
- Changes in government grant funding;
 - The impact of any staff pay award;
 - Covid impact on income and expenditure.
- 7.3 In any normal year forecasting these items with accuracy is incredibly difficult and that challenge has only been increased this year. As such it is intended that a range of scenarios will be presented to Members in December that will outline the potential variability in the budget for next year.
- 7.4 **Appendix 2** provides an extract from a paper commissioned by Scottish local authority Section 95 officers from John McLaren, a Scottish political economist. The paper usefully highlights the underlying factors to the uncertainty over future funding as well as suggestions for prudent financial planning.
- 7.5 It will be essential that any budgetary approach proposed for financial year 2021/22 is flexible and able to adapt to changing circumstances. In particular, it is likely that Members may need to revisit the 2021/22 budget during the course of the year to ensure it meets the prevailing circumstances.

8. Wider budget context

- 8.1 Two further reports which help provide wider context on the operational, financial and wider economic environment are also brought to Members' attention.
- 8.2 Audit Scotland produce two annual reports on local authorities and a link to their 2020 overview of local government is provided below:
https://www.audit-scotland.gov.uk/uploads/docs/report/2020/nr_200623_local_government_overview.pdf

It should be noted that the report was originally produced before the Covid pandemic struck with some minor updates to reflect the emergent Covid situation. A number of key messages within the report will still be of relevance.

- 8.3 Many of the key messages contained within the report are items that have previously been highlighted by Audit Scotland as being worthy of consideration across all local authorities. Those include:
- The significance of demographic and social change and the need for local authorities to take cognisance of these factors in their planning;
 - The importance of medium and long-term financial planning for making well-informed decisions and to effectively manage continuing financial challenges;
 - Radical thinking is required to find longer term solutions to meet the changing requirements of communities and service users and to improve outcomes;
 - Collaboration with partners, including NHS boards, the voluntary and private sectors, and local communities is essential to make best use of local resources;
 - Workforce planning is fundamental to ensure that councils have the leadership capacity, staff and skills they need to deliver change.

Highland Council is already addressing many of these factors through its recovery action plan which has specific workstreams around community empowerment, financial recovery strategy, workforce planning and development, service redesign, IT transformation, digital transformation, asset management and leadership, culture and performance.

- 8.4 The Fraser of Allander Institute are a widely respected economic commentator who provide wider commentary on the national financial position. A link to their September 2020 Economic Commentary can be found below.

<https://www.sbs.strath.ac.uk/download/Fraser/202009/20200930-Commentary.pdf>

- 8.5 The Fraser of Allander report provides a wider economic commentary and the executive summary contains the following telling statement about the challenges ahead: *'What is striking about the immediate outlook is just how uncertain it is - indeed, it is hard to think of a past occasion when the range of possible outcomes has been so wide. What we can agree on however, is that the task of rebuilding our economy will take years'*.

- 8.6 The third section of the report provides some regional data across Scotland which suggests that across a number of measures Highland's local economy has been disproportionately hit by the Covid pandemic.

- 8.7 The final section of the Fraser of Allander report provides an outlook for the Scottish budget for 2021/22. Again, the heightened level of uncertainty and financial challenge facing the Scottish Government is highlighted and whilst the report suggests no solutions it does highlight a number of areas of significance to local authority services and budgets:

'Whilst health and social care spending will remain elevated, the impact of the crisis on the labour market, and particularly the opportunities facing young people, will necessitate a robust increase in spending on further and higher education, and skills and employability initiatives. There will be difficult questions over how much to subsidise public transport in the face of reduced demand; and how to support the locations most affected by Covid, whether those are town centres or the places most reliant on tourism

Increased costs and reduced revenues facing schools and local authorities will need to be addressed. And further support for the most vulnerable groups is likely to be required. So, whilst the budget envelope is likely to remain at an unprecedentedly high level, the pressures on that budget will be acute. Some reprioritisation seems inevitable, and there is no guarantee that all portfolios will see spending increases.'

Designation: Executive Chief Officer- Resources and Finance

Date: 15th October 2020

Author: Edward Foster, Head of Corporate Finance

Background Papers:

https://www.highland.gov.uk/download/meetings/id/77128/item_4_revenue_budget_update_report-october_2020

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

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Clr Gail Macgregor
COSLA Resources Spokesperson

By email

8 October 2020

Dear Gail,

As we discussed on Friday, I have now received a reply from the Chief Secretary to the Treasury to my letter of 9 September on the financial flexibilities for local government.

I am pleased to report that this was a generally positive response and the Chief Secretary did not raise any issues that would impact on the Scottish Budget for three out of the four measures we proposed. However, I have written to Chief Secretary to raise my strong concerns with his proposal in response to our request to utilise £156 million of local authority capital budget directly for Covid resource costs. The intention of our proposal was to allow a more targeted use of capital underspends that currently cannot be utilised due to COVID restrictions and backlogs. The aim of the proposal was to provide additionality to Local Government in resource spending power directly, in recognition of COVID pressures on local authorities and the relative balance of pressures between resource and capital.

However the Chief Secretary's response would not allow for any additionality, instead just reprioritising future Barnett resource consequentials that would have flowed to the Scottish Government anyway. Yet these consequentials will likely be linked directly to a number of COVID related spending proposals that the Scottish Government would wish to consider passing on directly (such as Self-Isolation Payments and further business support). His proposal is therefore very different from what was requested and provides no such additionality to Local Government.

Tha Ministearan na h-Alba, an luchd-comhairleachaidh sònraichte agus an Rùnaire Maireannach fo chumhachan Achd Coiteachaidh (Alba) 2016. Faicibh www.lobbying.scot

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I have stressed that our proposal to directly utilise capital budget, without impacting resource, would result in no detriment to the overall UK Government funding position. It would provide essential support to local authorities that have been at the frontline in responding to COVID. I have therefore asked that this specific request is reconsidered for the benefit of local authorities. Until that matter is resolved to our satisfaction you will appreciate that given the stance the Chief Secretary has taken we cannot implement the proposed capital to revenue budget transfer.

We can, however, now proceed with arrangements to implement the other three remaining measures which taken together will still confer a substantial additional package of spending power which could be worth up to £600 million. This will help address unmet funding pressures for Scottish councils both in the short term for the immediate mobilisation effort and as we move into the recovery phase. Further details will be brought forward in the form of Statutory Guidance, and a change in Statutory Regulations, but local authorities can now plan on the basis that the following substantial package of measures will be available:

Capital Receipts Received - Dispensation for both 2020-21 and 2021-22 through Statutory Guidance to allow Councils to place capital receipts in the Capital Grants and Receipts Unapplied Account and then used to finance Covid expenditure (revenue).

Credit arrangements - At present Councils are required by statutory guidance to charge the debt element of service concession arrangements to their accounts over the contract period. A change to the accounting treatment will allow the debt to be repaid over the life of the asset rather than the contract period, applying proper accounting practices. Councils will have the flexibility to apply this change in either 2020-21 or 2021-22. This approach will apply to all credit arrangements going forward.

Loans Fund Principal Repayment Holiday - The flexibility being offered is a loans fund repayment holiday which will permit a council to defer loans fund repayments due to be repaid in either 2020-21 or 2021-22 (but not both).

Whilst agreeing these flexibilities, the Chief Secretary asked me to reconsider making the flexibilities available in relation to capital receipts and the loans fund holiday. These flexibilities have not been made available to English authorities.

In the absence of further additional funding I am satisfied that these further financial flexibility measures are necessary.

Having said that I wish to be clear that this should not be seen as an opportunity to maintain or grow reserves. Local authorities are expected to take into consideration the contribution their reserves can make to meet their funding pressures. In terms of the financial flexibilities my expectation is that local authorities will first consider the additional resources available from capital receipts and the change in accounting arrangements for service concession arrangements before taking advantage of a loans fund repayment holiday.

I have been clear that in order to respond effectively to the COVID-19 pandemic national and local governments must have the necessary fiscal levers. Working together in partnership we have delivered a game changing package of financial flexibilities, enabling each local authority to make informed decisions about spending at a local level.

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Maireannach fo chumhachan Achd Coiteachaidh (Alba) 2016. Faicibh www.lobbying.scot

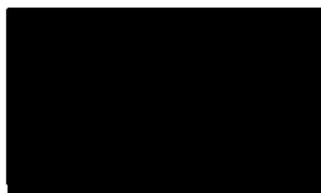
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I can also confirm that that I am happy to agree the list of proposed principles COSLA officials have shared for the Lost Income scheme to help compensate councils for the loss of income they are experiencing caused by COVID. My officials will share some detailed comments but I am broadly content with the COSLA proposals. The COSLA principles will form the basis for the operation of the scheme and we will look to COSLA to gather the data, undertake the necessary validation checks, including Section 95 Officer sign-off, and confirm the indicative allocations to the Scottish Government. I would urge you to prioritise this work and secure Leaders agreement so that the indicative allocations can be confirmed as soon as possible. As you know we still await confirmation of the consequential from the UK Government so the allocations can only be indicative at this stage with final allocations to be paid as a redetermination to the local government finance settlement at the financial year end.

Additional funding for the scheme estimated at £90 million will ensure that councils can manage the immediate loss of income they are facing and also includes support for ALEOs. Together with the recently announced extra £49 million, which can be used to top up support for ALEOs, this will mean an overall package worth up to almost £750 million of extra funding and financial flexibilities.

These are excellent and critically important examples of how the Scottish Government is working in partnership with COSLA and local authorities to ensure that we are doing everything within our power to save jobs, protect our public services and reboot our economy.

I am happy for you to share this letter more widely with Council Leaders and I will be sharing it with the Parliament's Finance Committee and Local Government and Communities Committee.

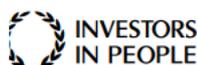


KATE FORBES

Tha Ministearan na h-Alba, an luchd-comhairleachaidh sònraichte agus an Rùnaire Maireannach fo chumhachan Achd Coiteachaidh (Alba) 2016. Faicibh WWW.lobbying.scot

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Summary and Conclusions

The Scottish Government is likely to consider GRG and NDRI (and possibly CT) together when setting the Local Government resource budget for 2021-22.

In terms of the size of any % rise or fall vs the 2020-21 budget, it is impossible to say at present as it will depend on:

- How long the pandemic lasts and how effective any vaccine turns out to be;
- How the Scottish and UK governments react to economic and budgetary pressures;
- How the public and businesses react to the emerging medical/health evidence and government policies;
- Local conditions, in terms of higher expenditures and/or lower revenues;
- The degree to which the LG budget is seen as a priority for extra funding or as a potential source of savings. Given the pressing funding pressures relating to: the NHS; 'levelling up'; business support; police; and schools; the prospects for LG funding may seem worrying, at least outside the areas of schools and adult social care, although even here any top ups may not suffice given the different circumstances each council will face;
- The impact from Brexit, particularly a hard version, which may require emergency funding;
- Whether or not the Scottish Government gains increased borrowing powers which would allow it some spending leeway.

Any such budget calculation is also complicated by what assumptions are made for the baseline (2020-21 budget) figure - be it the original allocation, the current position, or the expected final outcome. The importance of this point is discussed in a recent IFS paper ('Spending Review 2020: COVID-19, Brexit and beyond', see <https://ifs.org.uk/uploads/GB2020-Spending-Review-2020-COVID-19-Brexit-and-beyond-1.pdf>) which highlights the role of illustrative scenarios and how the choice of baseline affects the associated budget growth rate.

Taking an overview of where we stand now, a best guess on what emerges might be:

- The pandemic remains under control and an effective vaccine is available by the end of the financial year;
- However, even if this, optimistic, timeline is achieved, the UK Government has indicated that a nationwide vaccine roll out would not be available until the end of 2021, possibly also an optimistic timeline. This suggests that maintained high levels of public service funding would be seen at least for 2021-22 and possibly beyond, although tapering down over time;
- As a result, the Scottish resource budget might fall from its 2020-21 high but not down as far as its 2019-20 baseline level;
- SFC, NDRI and CT should recover in 2021-22, but not to their 2019-20 levels, unless large rises in charges are imposed.

In terms of planning, given the on-going heightened level of uncertainty, it would seem prudent at present to:

- Accept such a high degree of uncertainty as an inevitable, and lasting, element of the budget process, rather than striving for false certainty;
- As a result, follow the practice of economic forecasters and use a variety of illustrative scenarios when looking at what outcomes might emerge;
- Expect, and if possible anticipate, (multiple) adjustments to budgets and spending needs over time as normal practice for now;
- Use scenario planning as a tool to allow for rapid reaction to such changes in circumstances.

Extracted from October briefing for Directors of Finance by John McLaren.