

Agenda Item	8
Report No	HC/41/23

The Highland Council

Date: **26 October 2023**

Report Title: **Budget Update, Revenue and Capital**

Report By: **Head of Corporate Finance**

1. Purpose/Executive Summary

- 1.1 This paper presents an overview on the current position and future challenges relating to capital and revenue budgets of Highland Council. It takes cognisance of the budget decisions taken in March 2023, and the update on capital and revenue spend brought to full Council in September 2023.
- 1.2 As was highlighted in report to Members on 14 September, it is forecast there is a significant financial gap for the coming years, with a projected 2024/25 budget gap of £60-70 million.
- 1.3 The paper establishes the base capital budget position and the concomitant costs of funding the capital programme. It presents a number of options that might be available to fund future capital spending.
- 1.4 It also gives an update on the kinds of issues that will need to be considered and potentially addressed in setting a revenue budget for 2024 - 2025, as well as describing the advantages of setting a multi-year budget (2024 – 2026).
- 1.5 Lastly, the paper reiterates the legal obligation of Council Members to set a balanced budget and outlines the timeline and process by which that budget will be set by Highland Council.

2. Recommendations

- 2.1 Members are asked to:
 - i. note the update provided in relation to the capital programme;
 - ii. note the update provided in relation to revenue budget and financial outlook;
 - iii. agree the budget timetable as set out in **Appendix 1**; and
 - iv. note the draft sample survey questions as outlined in **Appendix 2** which will be accompanied by a budget simulator.

3. Implications

3.1 Resource

The report provides further update to Members on key financial issues and actions being progressed.

3.2 Legal

3.2.1 Councils are required to set a balanced budget for each financial year. Section 93 (2) of the Local Government Finance Act 1992 requires councils to set council tax rates before 11 March in any year.

3.2.2 Section 93 (4) states – ‘in calculating such part of the total estimated expenses to be incurred by a local authority as falls to be met out of council tax, account shall be taken of any means by which those expenses may otherwise be met or provided for’.

3.3 Community (Equality, Poverty, Rural and Island)

This report provides a detailed update in respect of the proposed budget timetable and plans for budget engagement and consultation, for Member agreement.

3.4 Climate Change / Carbon Clever

The report highlights the need to align budget strategy to the three priorities shared between COSLA and Scottish Government, as established in the Verity House Agreement (June 2023), one of which is to “transform our economy through a just transition to deliver net zero.”

3.5 Risk

The report is based on a range of assumptions and information available to inform budget planning. In making assumptions, officers consider both risk and opportunity and to ensure that the Council’s financial plans are affordable, prudent, and sustainable. Circumstances may alter, and assumptions may need revisited, and Members will be kept informed through regular reports. Financial sustainability has been established as one of the Council’s corporate risks.

3.6 Health and Safety (risks arising from changes to plant, equipment, process, or people)

No specific implications to highlight.

3.7 Gaelic

No specific implications to highlight within this report.

4. Alignment Budget Planning to the Council Programme

4.1 Highland Council established an ambitious programme for change in 2022. This programme needs to be reviewed considering national developments emerging from the Verity House Agreement, which has three specific areas of priority focus: delivering sustainable person-centred public services approaches, tackling poverty and ensuring a just transition to net zero.

4.2 The Council Programme also requires to be updated to reflect local discussions relating to the need to revise the Highland Outcome Improvement Plan (HOIP). Lastly, the Programme needs to reflect the fiscal challenges facing local government across the country and locally. This is especially true, given the level of activity which will be required to develop a change programme to meet the estimated budget gap.

- 4.3 The work to reconcile the existing plan with the future work programme, which is required to ensure that Highland Council can process the budget setting process, will be presented for political consideration and approval.
- 4.4 This process should highlight the considerable achievements of the Programme including enhanced resources to improve the roads network, housing repairs effected, improvements in school attainment, the development and implementation of an in-house bus service, approved Highland's Family First strategy, delivery of affordable homes across Highland through the Affordable Housing Supply Programme, the successful bid and now partnership of the Inverness and Cromarty Green Freeport, et cetera).
- 4.5 It should also reflect the major future challenges that the Council will face relating to:
- Population: depopulation of rural areas; increased population in urban areas; population shift caused by the Freeport; an ageing population, a reducing working age population;
 - Economic diversification: ensuring that investment is brought to rural areas; growing entrepreneurship; creating pathways for young people and those out of work into sustainable employment; enabling environmental sustainability; and
 - Infrastructure: developing housing, roads, and educational solutions for the future.

5 Update on Capital Programme

5.1 Outlining the Base Capital Programme Budget

- 5.1.1 Considering the challenging budget position, Highland Council agreed in March 2023 to review its capital programme. Consequently, in September 2023, it agreed a five-year capital programme valued at £343 million (HC/31/23). The programme (which can be found [here](#)) includes the following areas and amounts of spend:
- £161.5m - School Estate
 - £45.5m - Estate Asset Management
 - £41.7m - Road repairs and modifications
 - £21.1m - Bridges
 - £13.5m - ICT
 - £13.2m - Vehicles and Plant
 - £11.1m - Planning and Development
 - £11.1m - Harbours and Ferries
 - £6.1m - Waste Management
 - £4.4m - Active Travel
 - £4.1m - Bereavement Services
 - £2.7m - Health and Social Care Programme
 - £2.2m - Community and Leisure Facilities
 - £2.2m - Lighting and Communications
 - £1.1m - Housing (Non-HRA)
 - £0.7m - Flood Prevention studies
 - £0.7m - Car Parks
 - £0.1m - Public Conveniences

- 5.1.2 It was agreed that a number of previously earmarked projects would be deferred. The deferred list includes schools earmarked for Learning Estate Investment Programme round 3 (LEIP3) funding, a number of flood prevention schemes and specific capital projects. This list will be reassessed in future if conditions change.
- 5.1.3 The agreement of that 5-year programme has now allowed Council to progress planning and delivery of that capital investment, with ongoing updates in relation to project progress, financial monitoring and stakeholder engagement being part of normal and regular monitoring to strategic committees.
- 5.1.4 Since that report, a number of actions associated with the new capital programme and recommendations made by the Council have been progressed. These include:-
- Re-profiling target – the capital programme approved by the Council included a re-profiling target, recognising that the profile of spend was still heavily front-loaded into the earlier years of the 5-year period, and to manage within the affordability assumptions required some further re-profiling. Officers are developing recommendations to re-profile which includes the assessment of the current 2023/24 capital budget and forecast spend levels. There will be a requirement for some specific project decisions to amend the delivery profile of certain projects and budgets. This would all be within, and would not alter, the overall programme totals approved by the Council.
 - Self-funding projects and income assumptions – the capital programme includes a number of projects which are predicated on external income, and self-funding/spend-to-save outcomes. A review of income assumptions to ensure all are up to date, reasonable and risk-assessed is underway. Should the outcome of this review have any material impact on programme funding, positive or negative, this will be reported back to Members.
- 5.1.5 The agreed report recommendations on 14 September referred to material circumstances which may lead to subsequent review of funding assumptions and capital priorities, including potential for consideration of any deferred projects. There has been no material change in circumstance since the 14 September Council meeting, however the following section provides update on relevant matters.
- LEIP Phase 3 School Bids – at the time of writing this report there remains no announcement on LEIP Phase 3 bid outcomes, or clarity of when an announcement may be forthcoming.
 - Interest Rates – since the 14 September Council meeting, the Bank of England Monetary Policy Committee (MPC) met on 21 September and decided not to increase base rates, with base rate being held at 5.25%. While there had been market expectations that an increase to 5.5% was likely, there has not been a material change to interest rate forecasts and the Council's affordability assumptions. The interest rate position is kept under regular review and the Corporate Resources Committee receives regular reports on treasury activity and performance. The next scheduled Bank of England MPC meeting is 2 November.

5.2 Options to Review the Capital Programmes in Future

- 5.2.1 The decision to right-size the capital programme was taken considering the high borrowing costs that the Council bears to sustain it and the delays to LEIP 3 funding. With £840 million of historic debt relating to previous capital programmes, the annual

costs of borrowing for the original programme were unaffordable. Over five years, the revised annual capital programme would on average cost £69 million per annum – which remains a considerable investment in infrastructure.

5.2.2 In September 2023, Members also agreed that if there was a material change in circumstances, the capital programme would be further reviewed. Such material changes might be:

- a need to find funds for emergency action relating to the safety or security of buildings;
- a need to find match funding for successful bids for external funding for key infrastructure projects; and/or
- a significant change in the cost of borrowing, which either made the capital programme more or less affordable – creating the opportunity for more projects to be delivered, or, alternatively, fewer.

5.2.3 Any future increases in the capital programme spend would have to be costed and paid for, in terms of any increase in borrowing required to pay for new projects which might be added to the programme. Such options for the future include:

- capitalising a revenue stream in order to match fund against any new sources of external investment that might become available through external funding;
- borrowing money in some other way, such as through the UK Infrastructure Bank, or the Scottish National Investment Bank;
- using capital funds to enable actions which improve the Council's revenue position; and
- using non-earmarked reserves on a one-off basis for a specific project.

5.2.4 All these options have risks for the Council, in terms of increasing revenue costs associated with increased borrowing or reducing available reserves to support future Council sustainability. These risks would have to be managed, were any new projects to become worthy of consideration. Risks include communications, given the potential for significant stakeholder reaction to any potential decisions in this area. Strategic priorities need to be established for future capital spending programmes. These will reflect the principles for affordability, achievability, deliverability, and best value outlined in the Treasury Green Book guidance.

5.2.5 Future strategic priorities for capital investment need to reflect local and national priorities: national, to enable the accessing of available funding sources; local, to meet the specific needs of communities and the wider Council programme priorities. The following need to be effectively weighed within the prioritisation process:

- the local priority to be:
 - sustainable for our communities;
 - ambitious in embracing change; and
 - connected to our partners and in terms of infrastructure development; and
- the national priority to:
 - tackle poverty;
 - enable a just transition to net zero; and
 - enable sustainable person-centred public services.

6 Developing a Multi-Year Approach to Revenue Budget Planning

6.1 Revenue Budgets

6.1.1. A number of critical factors that make up the revenue budget. These are in effect, as follows:

- the income the Council derives on an annual basis from government grant allocation; and
- any other sources of recurring income the Council can derive from its activities, including Council Tax.

6.1.2. The available revenue spend is programmed to be spent on a number of factors which relate to the practices of the Council, which include:

- staffing costs;
- the costs of materials and resources;
- costs associated with commissioning and procurement; and
- the budgets the Council makes available to other organisations which deliver on its behalf.

6.1.3. The two lists provided above show the factors making up the revenue budget and those involved in how it is disbursed.

6.2 Limiting Factors

6.2.1. A number of limiting factors which affect revenue budgets over a year, can lead to pressures building up and potentially to an overspend position. These are not controllable by the Council and include:

- inflationary pressures;
- costs of materials changing;
- availability of supplies and suppliers;
- in-year changes to procurement of services through national schemes; and
- emergency response and recovery activity for which the Council is liable.

6.3 Developing an Approach to Dealing with Revenue Budget from 2024 Onwards

6.3.1. The process below documents how the Council will work through its process of establishing its revenue budget planning for 2024 - 2025 From this process, a number of options for managing the challenge the Council faces will follow.

6.3.2. The first step is to bottom out the precise nature of the gap that we face. This is contingent on confirmation from Scottish Government of the actual quantum of funding available to Highland Council for 2024 – 2025.

6.3.2. The report to Council on 14 September set out a range of scenarios and financial forecasts for the forthcoming 4 financial years, 2024/25 – 2027/28. The scale of the budget gap, the implications for the Council, and the need to take a multi-year financial planning approach were all set out within that report. The medium case scenario forecast that a budget gap of £61.7 million needed addressed for 2024/25, with the 3-year and 4-year forecasts under that scenario being £108.3 million and £127 million, respectively.

6.3.3. Three-financial years is considered the minimum period that the Council should take forward its financial plans and would be the appropriate time period for the

forthcoming period. Ongoing financial planning, which would intended to be on a rolling 3-year basis, will therefore focus initially on the financial years 2024/25 to 2026/27.

- 6.3.4 For the budget setting process, a number of solutions in relation to the next three-year period are being developed. This will enable a multi-year approach to be taken, in recognition of the scale of change required to address the gap in available finance. The current projected three-year gap is £108.3 million. This projection contains assumptions on the following:
- the quantum of funding available from Scottish Government;
 - the costs associated with borrowing to repay historic debt;
 - any costs of increased staff pay which the Council is directly liable for; and
 - the likely need to provide for cost pressures arising from inflation, contract price increases and new service demands and requirements.

7. Mechanisms to Deal with the Identified Gap

- 7.1 This section describes a number of actions which can be taken to address the gap when it is fully understood. These actions, if agreed, will underpin the activities of the Council. Some of them are only deliverable over a longer period and will therefore require a multi-year approach to put into practice. These actions fall into a number of categories which will be developed further over the next few months:

7.2 Mechanisms to clarify projections

- 7.2.1 As the national budget setting processes of UK and Scottish Governments become clearer and the dimensions of funding for local government pay settlements are agreed, the Council's budget position will be clearer and a figure will be established as being our actual gap for 2024 – 2025 and indicative gap for 2025 – 2027 (the three-year period).

- 7.2.2 Additionally, work will be done to clarify the precise position in relation to available reserves, especially to review earmarked reserves and those which are not earmarked. The future viability of the Council in future depends on a figure being established for a minimum level of reserves in relation to our future projected revenue.

- 7.2.3 This is anticipated to be notionally around 3% of the total revenue budget, which would equate to £21 million at present.

7.3 Means to derive corporate financial solutions based on Current or Future Fiscal Flexibilities

- 7.3.1 There are a number of areas in which fiscal flexibility exists that the Council may exploit. These include the following: Public – Private Partnership (PPP) concessions; opportunities to reprofile debt; Transient Visitor Levy (TVL) from April 2026; Income that may be derived in future from second homes. This list is not exhaustive and may be added to in the budget setting process.

- 7.3.2 Work will be done by officers to model options for these and other areas, to show how much they might reduce the overall gap and how the process to implement them as savings options might be achieved over time, including measures such as smoothing.

- 7.3.3 PPP financial flexibilities – the Council’s Treasury Advisor has been appointed to prepare a report and analysis in terms of options and financial modelling of the PPP financial flexibilities which were described in the report of 14 September. The current intent is the output of this work would be formally reported to Council in December, with an all-member briefing arranged in advance of that.
- 7.3.4 Debt Reprofiling – During 2020-21 the Scottish Government worked jointly with the Convention of Local Authorities (COSLA) to identify a package of financial flexibilities for Councils, to address the funding pressures they faced due to the pandemic. One of the financial flexibilities agreed was to allow a local authority to reduce the statutory repayment of debt. It was agreed at full council in March 2023 that Highland Council could take advantage of the flexibility given by Scottish Government. This meant that £29.3m of loans fund principal repayments were not charged to the revenue budget in 2022/23, effectively creating a significant underspend against the 2022/23 loans charge budget and leading to an increased level of general reserves at financial year end. Further actions to reprofile debt in future will continue to be monitored.

- 7.3.5 The Council will continue to make representations for maximum fiscal flexibility in terms of the intention of the Verity House Agreement.

7.4 Maximising the Council’s income generation activities

- 7.4.1 The Council will continue to develop savings proposals which can increase the Council’s capacity to generate new and improved sources of revenue from income. These were included as an appendix to the report which came to Council in September 2023 and include the following:

- a review of existing fees and charges, based on Highland Council data and national benchmarking;
- opportunities for schemes to derive increase in funding from tourism, or other areas of potential service delivery;
- making certain, existing Council services available to the private sector at cost; and
- making Council services available to other public sector partners at cost.

7.5 Options for the redesign of services

- 7.5.1 The Council are considering a number of redesign options which might aid the financial position, including:

- the further integration of teams working to deliver services in local areas;
- the amalgamation of some services;
- the in-sourcing of particular services to the Council might enable more sustainable delivery models, especially where there has been or may be market failure (school transportation);
- the out-sourcing of a number of other services has to be considered where it might be more efficient and effective for the Council to enable private providers to operate services;
- reviewing existing out-sourcing and commissioning arrangements;
- sharing costs of services, or actual services with other local authorities or key partner agencies operating in Highland; and

- efficiencies that might be derived from increased levels of digitisation and automation.

7.6 Delivering Savings

7.6.1 There are a number of specific processes that can be deployed to meet the residual budget gap through savings options. These are listed below:

- review of the delivery of certain non-statutory services;
- the critical control of non-essential departmental spend;
- commissioning and procurement; and
- mechanisms to reduce the demand for services should be considered.

7.6.2 Strategies are being developed through which that forecast gap could be addressed. These will be for future Member consideration.

7.6.3 This work is being progressed on a multi-year basis, in recognition of the scale of the gap, the significant challenge that closing that gap on a sustainable basis will represent, and the time needed to develop and implement proposals which will place the Council on a sustainable financial footing.

7.6.4 In the next few months, in advance of budget setting and following on from it, the following areas will need to be reviewed as priority and be used to support member understanding in planned workshops:

- Income Generation
- Energy Consumption and Production
- Workforce Planning Including Hybrid Working
- Asset Review
- Adult and Children's Services
- Education
- 3rd Sector Commissioning
- Employability and Skills
- Enterprise Services
- Supply chain sustainability

7.7 Housing Revenue Account (HRA)

7.7.1 The current state of play with the Housing Revenue Account also requires to be addressed through longer term planning. This is because significant amounts of the HRA goes to funding historic debt.

7.7.2 There are circa 14,750 social houses managed by Highland Council, deriving an HRA of £63 million. Of this, 42% of that revenue goes to servicing historic debt and cannot be used to address the needs of existing tenants and also can fund fewer new build projects.

7.7.3 The inability to maintain existing properties in some areas to a sufficient standard, leads to challenges in sustaining social housing tenancy and potentially increases the potential for homelessness.

7.7.4 Therefore, a longer-term approach is required to address this, and a review is taking place. A report will be brought to Members in due course.

7.7.5 HRA budgets and council house rents are set separately to the Council's revenue budget and further opportunities to discuss this in greater detail will be provided.

8. Engagement

8.1 Managing Communications with the Stakeholders

8.1.1 Members considered an outline approach to budget engagement at the Council meeting in September. An engagement strategy has been further developed as set out below.

8.2 Staff budget engagement

8.2.1 A budget savings suggestion form was launched on Staff Connections in mid-September. In the first month, over 57 suggestions have been received across a range of themes. All suggestions will be considered and feedback will be given to staff on whether their suggestion has merit and if it can be taken forward.

8.2.2 A number of online and in-person staff engagement sessions have been arranged to meet staff and listen to suggestions for improvements and savings.

8.2.3 A Staff Partnership Forum will take place on 14 November which will provide an opportunity for staff side engagement.

8.2.4 A report will be made to a December Council on the findings from the staff feedback.

8.3 Proposed engagement with communities and service users (phase one)

8.3.1 It is proposed that our budget engagement for 2024/25 is themed in line with the approved Council Programme, "Our Future Highland".

8.3.2 Budget engagement will initially focus on awareness raising of the Council's budget, how we spend our resources and the challenges and priorities for 2024-25 and future years. During this phase, we will also seek views on themes and priorities and what matters to local communities across Highland.

8.3.3 A budget simulator tool is currently being developed. This tool has been used in previous years to demonstrate the challenges of prioritising and balancing the Council's budget.

8.3.4 The Council website has a [budget page](#) where we can publish budget information and promote engagement and feedback.

8.3.5 Previously, we have used videos and online leaflets using accessible info-graphics to explain the Council's budget and challenges. A previous example can be found here: <https://youtu.be/a7odrZ7U1Vg>

8.3.6 A new video will be created and published on the website and social media during November.

8.3.7 An email address yourvoice@highland.gov.uk is also published on the webpage for those who wish to submit ideas or questions.

8.3.8 A survey will run during November with emerging themes reported to Council in December. This will be accompanied by a budget simulator, as has been used in previous years.

- 8.3.9 **Appendix 2** contains sample survey questions that are being worked up for use in engaging with the wider public.

9 Next Steps

- 9.1 The timetable has been set out as **Appendix 1** to this report. Specific dates for certain activities will require further refinement and clarification, a number of which are linked to external factors such as Scottish Government Financial Settlement dates.
- 9.2 At this stage there is no confirmation from Scottish Government on Settlement dates, with uncertainties around UK Government Budget stated as a factor by Scottish Government Officials.
- 9.3 A programme of briefings for Members on areas related to this paper will be established, to allow deeper engagement with the principles of budget planning and following on from the successful previous programme of briefings for Members on the capital programme, which ran in August 2023.

Designation: Head of Corporate Finance

Date: 12 October 2023

Author: Brian Porter, Head of Corporate Finance

Background Papers: Council 14 September, Mid-Year Revenue Budget Update and Capital Programme Review

https://www.highland.gov.uk/download/meetings/id/82167/item_11_mid-year_revenue_budget_update

https://www.highland.gov.uk/download/meetings/id/82168/item_12_capital_programme_review

Appendices:

Appendix 1 – Budget Timetable

Appendix 2 – Draft Budget Survey

Appendix 1: Budget Timetable

Month	Officer	Stakeholder	Formal/Governance
SEP	Budget/financial assumptions and modelling.	Budget consultation and engagement: Outline approach reported to Council.	14 Sept Council: Capital Programme approved. Financial outlook scenario planning.
OCT	Verity House and Fiscal Framework: Officer consideration of emerging proposals incl. review of ring-fenced funds.	Staff Budget Suggestions: online staff suggestion portal goes live. Publication of budget webpage	26 October Council: Updated financial outlook, multi-year planning approach, budget timetable.
NOV - DEC	Budget Development: Development of saving options. Identification and review of pressures and budget adjustments.	Phase 1 budget engagement: Broad engagement on themes/priorities. Member workshops: <ul style="list-style-type: none"> • Thematic Areas of Council Activity • Addressing the base budget gap through fiscal flexibility • HRA Public engagement Context video Survey Budget simulator tool Email address Partner Engagement Consultation and engagement on specific proposals. Staff Partnership Forum: staff side engagement 14 November. Budget suggestions Analysis of staff and member budget suggestions	14 Dec Council: Financial flexibilities report and Reserves strategy. Verity House update. Budget update and decisions as appropriate. Scottish Government: Publication of Draft Budget for 2024/25 (estimated Mid-December)
JAN - MAR	Budget Proposals: Finalisation of proposals. Risk and impact assessment screening.	Phase 2 budget engagement: Consultation and engagement on specific proposals with stakeholders Updated communications for stakeholders	Scottish Parliament: Feb/Mar formal consideration of Local Government Finance Order for 2024. 29 February Special Council: Budget and Council Tax setting.

Appendix 2: Draft Budget Survey – some sample questions

We would like to know what matters most to you. Weight the following range of services by importance – (1-5) in order of importance with 1 being high and 5 being low.

[A list of service functions will be included]

How do you think the Council can be more efficient?

Free text

How do you think the Council could bring in more income?

Free text

Do you think the Council could do more to support the economy in the Highlands?

Yes / no / don't know

If yes, suggestions:

Free text

Equalities monitoring questions