From: Peter Oakford, Deputy Leader and Cabinet Member for Finance, Corporate and Traded Services
Zena Cooke, Corporate Director of Finance

To: Cabinet 22nd June 2020

Subject: **Capital Programme 2020-23 and Revenue Budget 2020-21**

Classification: **Unrestricted**


**Summary**:

This report provides an update on the financial impact of the Covid-19 outbreak and subsequent economic fallout, including the additional funding provided by central Government, the Council's estimated costs for the emergency response, and the potential loss of income and delays to savings plans. These have been assessed against the approved 2020-21 revenue budget together with an initial assessment of other issues arising from the first month's budget monitoring.

The overall assessment is that there is a significant shortfall in the emergency grant received to date resulting in a substantial projected overspend. The magnitude of the variances is such that it is proposed to undertake a fundamental review of both the revenue budget and capital programme which will require a major recast to be reported to and approved by County Council in September. This could include revised operating budgets for individual services, including revised savings plans and the use of reserves.

At the time of writing, it is understood that the Government is planning to make an announcement on council finances. It is not known what will be announced, so the estimates and assumptions in this report may need to be revised, depending on what the Government set out in relation to council finances.


**Recommendations**:

a) Cabinet is asked to endorse a fundamental review of the 2020-21 revenue budget and 2020-23 capital programme in light of the significant changes since the budget was approved in February 2020.
b) Cabinet is asked to consider and propose a revised revenue budget for 2020-21 and 2020-23 capital programme to be presented to and approved by County Council on 10th September 2020.
c) Cabinet is asked to note that despite the significant financial impact the Corporate Director of Finance is not considering a section 114 notice at this time.

## 1. Background

1.1 The 2020-21 revenue budget and 2020-23 capital programme were approved by County Council on 13th February 2020. The approved net revenue budget requirement was £1.064bn. This was funded £0.753bn from council tax[1], £0.252bn un-ring-fenced government grants, and £0.059bn retained business rates. The capital programme included planned spending of £1.014bn over the three years (£0.472bn in 2020-21) with £0.621bn funded from external sources and government grants, and £0.393bn from KCC resources and borrowing (with consequential financing impact on current and future revenue budgets).

1.2 On 11th March the Covid-19 outbreak was declared a pandemic. On the same day the Chancellor announced the March 2020 Budget. The Budget was in two parts, the first part dealt with the immediate response to the emergency, and the second part was the typical presentation of medium-term tax and spending plans. The economic forecasts (and therefore the medium-term spending, tax and borrowing projections) were before the effects of the additional Covid-19 measures. Effectively these were out of date even at the time of publication. The Chancellor of the Exchequer has made a number of subsequent announcements on additional spending to tackle the outbreak and measures to support the economy which means they are now further out of date.

1.3 The Council had to act quickly in response to the pandemic and on 18th March staff were told to work from home wherever possible. This was in advance of announcements on 20th March closing schools, restaurants, pubs, indoor entertainment venues and leisure centres, and the more substantial lockdown imposed on 23rd March banning all non-essential travel and contact outside the home.

1.4 The Council's response has focussed on protecting the safety and wellbeing of all Kent residents, especially the most vulnerable as well as supporting its principal suppliers in line with government guidelines. Some of the main aspects of the response has included making additional payments to all residential, nursing, homecare and day care adult social care providers towards additional costs they are incurring during the emergency; procurement and distribution of additional personal protective equipment (PPE) to both staff and care providers; maintaining payments to early years and childcare providers even where they have had to close down; maintaining payments to bus companies and home to school transport providers to sustain the market during the slump in journeys during lockdown and school closures; securing additional temporary mortuary provision.

1.5 Inevitably some of the Council's own facilities have also had to close such as children's centres, country parks, libraries, waste disposal and recycling facilities, etc. In the main the Council has continued to incur contractual and staffing costs for these services even though facilities were closed.

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[1] based on estimated net band D equivalent tax base of 554,625.61 properties, band D tax charge of £1,351.26 (including £118.62 social care levy), and collection fund surplus

1.6 It is important to emphasise that any amounts in this report are only an initial assessment of the potential impact of the Covid-19 outbreak on the council's revenue and capital budgets for 2020-21 and 2021-22 based on the latest available information. This is a unique situation and whilst the Council has responded incredibly well, there remains a significant amount of uncertainty that makes financial planning far more challenging than would usually be the case. A key part of the uncertainty is how much funding the Government will provide and whether this will cover all the costs incurred by the Council as well as the losses in income.

## 2. Cost Estimates

2.1 As soon as the pandemic was announced arrangements were made to capture information about the additional costs the Council would incur. In March 2020 a total of £1.705m of additional spending and lost income associated with the Covid-19 response was accounted for within the final 2019-20 accounts. This included distress payments to bus providers, PPE purchases, and IT equipment and licences to support home working. The first tranche of Emergency Grant funding of £39m was received on 27th March, this was used to offset this expenditure with the remaining £37.3m transferred to a specific reserve to be drawn down to support spend in 2020-21.

2.2 Initially there was very little guidance on the expectations on local authorities. The Government did issue three Procurement Policy Notes (PPN) although these related to suspending aspects of procurement procedure rather than guidance on the type of expenditure the government anticipated local authorities would incur. The Council produced local guidance on the expenditure and income to be captured. This included:

- Additional costs incurred in response to the initial emergency e.g. temporary mortuary, procurement of PPE, etc.
- Additional costs to support market sustainability e.g. payments to support social care providers in meeting Covid 19 related additional costs, payments to home to school transport providers even though no service has been provided due to closures, etc.
- Future demand increases e.g. adult social care where the Council has to assume responsibility following hospital discharges, children's social care due to increased demand following the easing of lockdown restrictions etc.
- Delays in delivering savings
- Loss of income
- Workforce pressures associated with demand increases

2.3 The Ministry of Housing, Communities and Local Government (MHCLG) has asked local councils to provide a monthly return setting out estimates of the impact of the Covid 19 pandemic. Two returns have been submitted to date setting out estimates of additional spending, delayed savings and potential lost income.

2.4 The latest return submitted in May asked for information on the amount of emergency grant allocated to services to date. The return showed forecast spending/delayed savings of £100.4m, and £17.1m potential loss of income.

2.5 Income losses for KCC do not include the impact of additional council tax discounts for households facing a decline in income, or collection losses for other households unable to pay, or losses on business rate collection for business not in receipt of additional Covid-19 reliefs. At this stage these income losses will be borne by billing authorities (districts and boroughs in Kent) in 2020-21 with precepts for upper tier authorities unchanged from the amounts built into 2020-21 budget. There will be an impact on the distribution of funds from the Kent business rate pool in 2020-21, but this has yet to be modelled or quantified.

2.6 Costs and income loss estimates will continue to be refined in light of further evidence. This is likely to continue to include both upward and downward changes. The very latest information on additional spending and losses of income incurred to date as at the end of May is £35m.

2.7 The MHCLG has recently written to all authorities to give more guidance on the spending it expects local authorities to prioritise during the Covid-19 crisis. The guidance is still relatively high level, but in general it accords closely with the spending included in the MHCLG submissions to date. A risk rating to the £100m in our May submission has been applied. This identifies £61m as green rated (clearly matches the MHCLG criteria), £34m amber rated (has links to the guidance but needs further clarification) and £5m red rated (could be considered to be outside the guidance). Consequently, the Corporate Director of Finance (Section 151 Officer) is confident at this stage that the Council can fully justify the emergency grant allocated to date pending any revisions to the estimated amounts based on the further evidence outlined in paragraph 2.6.

2.8 It is important to note that the cost estimates at this stage do not include any impact of a second wave of infections or changes in spending for the recovery phase. There is also no assumption of costs that could be recovered through furloughing of staff through the Government's Job Retention Scheme other than those employed through trading companies that have suffered a loss of income.

## 3. Government Funding Allocations

3.1 MHCLG has made £3.2 billion available to support local authorities through an emergency grant. This funding is un-ringfenced on the basis that councils are best placed to determine the specific needs of their local communities. The emergency grant has been paid in two tranches in March and May which total £66.9m for the council. It should be noted that the two tranches of emergency grant funding were distributed using different methodologies which meant that the Council received significantly less in the second tranche of funding than the first.

3.2 The Government also announced advance payments of social care grants and grants to compensate for existing business rate discounts before the additional discounts announced since the covid-19 outbreak. These grants were already built into the Council's 2020-21 budget and therefore do not constitute extra funding towards additional costs and loss of savings, they merely represent an advance to assist cashflow. The Council's share of these grants is £33.4m.

3.3 On 13th May the Government announced an additional £600m grant to be paid to adult social care authorities to help manage infection control in care homes. This is in addition to the emergency grant and advance of existing grants outlined in paragraphs 3.1 and 3.2. This grant amounting to £18.9m for KCC is specifically aimed at preventing and controlling COVID-19 in all registered care homes. It is included in this report for completeness but is assumed will be spent on additional payments to all care homes (including those with no council clients) and other new measures to manage infection control. The grant cannot be used to fund expenditure already incurred and is not included in the additional spending analysis. It is possible that as a result of this grant some of the future cost estimates included in the April and May MHCLG submission do not now materialise, but given the criteria that needs to be met, even if that is the case, the amount is not likely to be significant. The local NHS are also in receipt of their share of £1.3bn government funding, to support the hospital discharge process and to avoid hospital admissions. The Council is currently negotiating a pooled fund which would enable some of the Council's costs related to admission avoidance to be met from the NHS allocation.

3.4 The Government has also announced a ring-fenced £300m grant which will be paid to local authorities to support the consequence management of local Covid-19 outbreaks (including the provision of infrastructure) by upper and lower tier Authorities. Kent's share has been confirmed as £6.3m. The Government has also announced £167m of funding to support bus operators and councils over a 12 week period, with up to £21.5m to be paid to local councils. Again there is very limited detail at this time, with only the announcement of the first 4 weeks' allocation.

3.5 Details of the funding announcements for KCC are set out in table 1 below.

Table 1

| Table 1 Government Grant allocations | £000s | Comments |
|---|---|---|
| **Additional Grants** | | |
| Emergency Grant tranche 1 | 39,012 | KCC's share of the additional £1.6bn first announced in 11th March Budget and paid on 27th March |
| Emergency Grant tranche 2 | 27,934 | KCC's share of the further additional £1.6bn announced 18th April and to be paid on 14th May |
| **Total Emergency Grant** | **66,946** | |
| | | |
| Adult Social Care Infection Control Grant | **18,878** | KCC share of additional £0.6bn announced on 13th May |
| | | |
| **Advance of Grants already in Settlement and Approved Budget (not new money, only eases cashflow)** | | |
| *Business Rate Compensation Grant* | *12,662* | *Grant we would normally have received in monthly instalments throughout 2020-21 and already built into 2020-21 budget but paid in full on 27th March* |
| *Social Care Support Grant and Improved Better Care Fund* | *20,728* | *Grants we would normally have received in monthly instalments throughout 2020-21 and already built into 2020-21 budget. 1/4 of the grant was paid in April and the remaining 3/4 to be paid in nine monthly instalments from July* |
| Total Early Avances | **33,390** | |

3.6 At the time of writing, it is understood that the Government is planning to make an announcement on council finances. It is not known what will be announced, so the estimates and assumptions in this report may need to be revised, depending on what the Government set out in relation to council finances.

## 4.0 Analysis of Current Revenue Budget

4.1 The balanced budget approved at County Council in February this year was a net revenue requirement of £1,063.654m for 2020-21. The budget was set pre-Covid 19 and included a number of elements that will now need to be reviewed and revised in order to ensure the budget remains balanced and takes account of future funding pressures.

4.2 The 2020-21 budget includes £30.2m of savings and income. Some of these represent the full year effect of savings from the 2019-20 budget or rollout of existing charging policies. Some are new proposals. The new proposals would result in a full year effect in 2021-22 and continued roll out of existing charging policies would deliver additional income towards 2021-22 budget gaps. Table 2 summarises the savings in 2020-21 budget.

Table 2

| 2020-21 Savings | Full Year Effect of 2019/20 Savings £m | New Proposals £m | Financing £m | Total £m |
|---|---|---|---|---|
| ASCH | 6.5 | 3.1 | 1.6 | 11.2 |
| CYPE | 0.9 | 0.9 | 0.0 | 1.7 |
| GET | 2.2 | 0.9 | 0.0 | 3.1 |

| | | | | |
|---|---|---|---|---|
| PH | 0.0 | 4.6 | 0.7 | 5.3 |
| S&CS | -0.1 | 0.3 | 0.0 | 0.1 |
| FI&U | -0.2 | 3.9 | 5.2 | 8.8 |
| **Total** | **9.2** | **13.6** | **7.4** | **30.2** |

4.3 The 2020-21 revenue budget also includes a number of funding sources totalling £40m that are not permanent and could be considered unsustainable, particularly in the current financial climate.

4.4 It is likely that the assumptions regarding deliverability of both the savings and some of the non-permanent funding will need to change and this will have a direct impact on the likely shortfall in funding for this year as well as the longer term implications for next year and beyond.

4.5 The projected out-turn for the current year will need to be reviewed to identify the budget pressures that have continued from last year.. The first quarterly budget monitoring report will set out the early projected out-turn for the year and will be used to inform the funding shortfall and the areas of focus. This may highlight areas of reduced activity and spend resulting in projected underspends. These underspends will be considered as part of the budget review process and options to address the budget gap for 2020-21.

## 5. Medium Term Impact

5.1 A significant proportion of the additional costs and losses on income will be one-off in 2020-21. However, if billing authorities are not compensated for tax collection losses in 2020-21 the Council will have to bear its share through collection fund deficit that has to be included in the 2021-22 budget. If the recession lasts longer throughout 2020-21 and into 2021-22 there could also be an impact on the tax base for future years' budgets.

5.2 There is no detail of when the Spending Review planned for 2020 will take place. The Government have confirmed that the move to 75% business rate retention and reforms to funding distribution through Fair Funding reform and reforms to business rate retention will not go ahead for next year. In the absence of government spending plans a revenue medium term financial plan (MTFP) was not published for 2020-23. However, some potential scenarios have been modelled, which start with a presumption of another roll forward settlement based on similar principles to 2020-21 i.e. Government grants are repeated but only increased for inflationary uplift where funded from the annual uplift in business rates. It is assumed that Council Tax continues to be subject to referendum limits on excessive increases.

5.3 Spending projections range from a low of +5% to a higher +7% for the usual factors associated with increased demand due to demographic changes, increased prices due to inflation, etc. These spending demands are before any ongoing impact of Covid-19 beyond 2020-21. The impact of these projections on the net budget are shown in table 3 below.

Table 3

| Scenarios | 2020-21 Net Budget £m | 2021-22 Net Additional Spending £m | 2022-23 Net Additional Spending £m | 2023-24 Net Additional Spending £m |
|---|---|---|---|---|
| **Lower Case** | **1,063.7** | **1,116.8** | **1,172.7** | **1,231.3** |
| **Higher Case** | | **1,152.6** | **1,233.3** | **1,319.6** |

5.4 The most straightforward funding scenario is to assume a similar rollforward settlement for future years to 2020-21. Under this scenario it is assumed the same 4% council tax increase is permitted (2% referendum threshold plus 2% social care), growth in tax base is similar to previous years, and government grants continue at the same level with uplifts in line with CPI for those grants funded from business rates. Under the roll forward funding scenario these projections based on the lower +5% spending projections would leave a gap of between £17.6m in 2020-21 (and up to £53.4m based on the higher +7% spending projection), and further gaps of between £12m to £40m in subsequent years compared to spending projections as shown in table 4 below.

Table 4

| | 2020-21 £m | 2021-22 £m | 2022-23 £m | 2023-24 £m |
|---|---|---|---|---|
| Council Tax | 749.4 | 787.2 | 826.9 | 868.6 |
| Retained Business Rates | 55.9 | 57.0 | 58.1 | 59.2 |
| Government Grants | 251.8 | 255.0 | 258.3 | 261.6 |
| Collection Funds | 6.5 | | | |
| **Total Funding** | **1,063.7** | **1,099.2** | **1,143.3** | **1,189.4** |
| Savings Requirement Lower case | | **-17.6** | -29.4 | -41.9 |
| Savings Requirement Higher case | | **-53.4** | -90.0 | -130.2 |

5.5 If the council tax referendum threshold were increased (and the Council was willing to raise council tax), each 1% increase would reduce the gaps by £7m.

5.6 If the recession is short with a bounce back during 2020-21 there would be little medium term impact. There would be an impact if billing authorities are not fully compensated for additional discounts and collection losses this year. Council tax losses in 2020-21 would arise from a combination of additional claimants for support discounts under local council tax reduction schemes (LCTRS) where additional households are in receipt of welfare benefits/substantially reduced incomes, and higher losses on collection. Business rates losses would arise from those businesses that have seen significant decline in trading activity but do not benefit from the additional reliefs granted to retail/leisure/hospitality premises and nurseries. This is the first recession where local authorities would suffer tax losses following the introduction of business rate retention and localisation of council tax benefit. If a combined 2% unfunded deficit is assumed in 2020-21 this would increase the gap for 2021-22 to between £33.7m to £69.5m as shown in table 5 below. The scale of collection fund deficits in 2020-21 will not be known for some time and 2% is only shown for illustrative purposes. This would be a one-off impact and have no lasting effect on future years' gaps.

Table 5

| | 2020-21 £m | 2021-22 £m | 2022-23 £m | 2023-24 £m |
|---|---|---|---|---|
| Council Tax | 749.4 | 787.2 | 826.9 | 868.6 |
| Retained Business Rates | 55.9 | 57.0 | 58.1 | 59.2 |
| Government Grants | 251.8 | 255.0 | 258.3 | 261.6 |
| Collection Funds | 6.5 | -16.1 | 0.0 | 0.0 |
| **Total Funding** | **1,063.7** | **1,083.1** | **1,143.3** | **1,189.4** |
| Savings Requirement Low | | **-33.7** | -29.4 | -41.9 |
| Savings Requirement High | | **-69.5** | -90.0 | -130.2 |

5.7 If the recession is deeper and lasts longer there could be a significant medium term impact. If an unfunded collection fund deficit of 5% is assumed throughout 2020-21 and reductions in the council tax and business rate tax bases into 2021-22 are of a similar magnitude, the gap in 2021-22 increases to £116.8m to £152.6m as shown in table 6 below.

Table 6

| | 2020-21 £m | 2021-22 £m | 2022-23 £m | 2023-24 £m |
|---|---|---|---|---|
| Council Tax | 749.4 | 740.5 | 770.1 | 848.9 |
| Retained Business Rates | 55.9 | 47.6 | 49.1 | 51.0 |
| Government Grants | 251.8 | 255.0 | 258.3 | 261.6 |
| Collection Funds | 6.5 | -43.1 | 0.0 | 0.0 |
| **Total Funding** | **1,063.7** | **1,000.0** | **1,077.4** | **1,161.6** |
| Savings Requirement Low | | **-116.8** | -95.2 | -69.7 |
| Savings Requirement High | | **-152.6** | -155.8 | -158.0 |

This is effectively doubling the number of working age households claiming support discounts under LCTRS. This scenario would not see the council tax base recovering until 2023-24 (as recovery leads to households no longer qualifying for support). The tax yield would still increase from the assumed 4% per annum increases but the reduced base means this delivers lesser amounts. The business rates tax base is assumed to take longer to recover and the council would not receive any funds from the business rate pool. A longer recession is also more likely to increase spending demands into future years. An additional £30m of spending due to higher demands for Council services could increase the upper end of the gap projection to £180m.

5.8 The Council would have to find sustainable savings to cover a large proportion of this gap to avoid increasing the forecast gaps in later years.

## 6. Capital Programme

6.1 The approved capital programme identifies £1,014m investment in infrastructure over the 3 years 2020-21 to 2022-23, this includes £121m of new schemes not included in previous programmes including a significant investment in highways asset management and priority remedial works. Capital investments are funded by a combination of government grants, developer contributions, external funding, capital receipts and borrowing. The approved programme included a preliminary figure for the 2019 schools commissioning plan together with assumed basic need grant but was still subject to confirmation at that time.

6.2 A fundamental review of the capital programme is being undertaken as the funding sources (borrowing, capital receipts, developer contributions, etc.) will also be impacted by Covid 19. It should be noted that avoiding borrowing would only reduce the revenue costs of borrowing and the Minimum Revenue Provision and would not impact until 2021-22. Capital receipts flexibility can still be used to support revenue transformation spending although our ability to attract receipts is limited in the current circumstances.

## 7. Financial Assessment of Impact and Resilience

7.1 The shortfall in government grant compared with the estimates of additional spending, income and savings losses is currently estimated to be £50.5m for 2020-21. As stated earlier, this shortfall does not include any costs for a potential second wave of infections or the additional costs for recovery.

7.2 The estimates will continue to be refined and changed as actual expenditure is recorded and more information becomes available. The shortfall in funding has significant implications for the Council's budget for 2020-21 and 2021-22. Concerns regarding the funding shortfall have been put in writing and raised with MHCLG directly by the Council and through Kent Leaders, the Kent Finance Officers' Group, the County Councils Network and the Society of County Treasurers.

7.3 Given the magnitude of the projected overspend in 2020-21 it is proposed to undertake a fundamental review of both the revenue budget and capital programme which will require a major recast to be reported to and approved by County Council in September. This could include revised operating budgets for individual services, including revised savings plans and the use of reserves. The review of the 2020-21 revenue budget and capital programme will feed into the budget planning for 2021-22.

7.4 At this stage the Corporate Director of Finance is satisfied that the Council has sufficient general reserves to cover the potential shortfall in 2020-21 after taking account of under spends that are likely to be identified in the regular budget monitoring reports. These underspends will arise where some of the Covid-19 costs that have been identified would have been incurred anyway e.g. payments to home to school transport providers. The Corporate Director of Finance considers it is appropriate to identify these as Covid-19 related costs at this stage as they amount to non-productive expenditure. The 2019-20 out-turn report (elsewhere on this agenda) shows an overall underspend of £3.21m but it does also highlight a number of overspends, in particular the significant overspend in Children's Services totalling £8m that will also impact on the projected out-turn for 2021-22. However, at this stage there is no need to consider issuing a formal Section 114 notice to curtail expenditure.

7.5 The 2021-22 budget could be the most challenging the Council has ever faced, even more so than the most difficult years of austerity. Unlike austerity the impact of recession will eventually see a bounce back recovery. However, depending on the length of the recession, any Government response to provide local authorities with additional compensation, and the outcome of the local government finance settlement for 2021-22, the Council could be facing a substantial savings requirement both in year and next year. It is therefore critical that a comprehensive review of the current year's budget together with a review of reserves is undertaken alongside an assessment of the Council's approach to financial management. If this budget review does require the Council to use general reserves in 2020-21 these will need to be replenished in 2021-22 and later years in order to safeguard the Council's financial resilience and ensure adequate reserves for future unforeseeable eventualities.

## 8. Recommendations

**Recommendations:**

a) Cabinet is asked to endorse a fundamental review of the 2020-21 revenue budget and 2020-23 capital programme in light of the significant changes since the budget was approved in February 2020.
b) Cabinet is asked to consider and propose a revised revenue budget for 2020-21 and 2020-23 capital programme to be presented to and approved by County Council on 10th September 2020.

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| c) Cabinet is asked to note that despite the significant financial impact the Corporate Director of Finance is not considering a section 114 notice at this time. |

## 9. Background Documents

9.1 KCC's Budget webpage
https://www.kent.gov.uk/about-the-council/finance-and-budget

9.2 KCC's approved 2020-21 Budget

9.3 Emergency Grant Notifications

9.4 Other Additional Grant Notifications

9.5 MHCLG Letter 28th May

## 10. Contact details

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