Key questions and issues for finance portfolio holders during the COVID-19 pandemic

Guidance

Note: this guidance is correct as at 14 May

Introduction

The ongoing COVID-19 pandemic has already had a significant impact on local council finances, the effects of which will continue through the current period of lockdown and beyond. This paper seeks to outline and discuss key strategic issues that elected members, particularly those in finance and wider leadership positions, should consider. Whilst the current, and potential future, financial impact of the current pandemic will vary from authority to authority, this paper poses questions that are wide enough to be capable of being discussed within the local context.

As locally elected community leaders, elected members have a central responsibility to formulate, express and then deliver strategic plans that are based on the needs of their local communities. Whilst this has not changed, the pandemic is currently making policy formulation significantly more challenging and will require re-thinking many fundamental assumptions that underpin the council's Medium Term Financial Strategy (MTFS). The most effective response to uncertainty and risk is prior planning which provides a clear strategic direction, whilst remaining flexible enough to adapt to changing circumstances. This can be achieved by the construction of various scenarios, each with differing but clearly identified assumptions, of what the coming months and years may look like for the council, its key partners and wider local community.

The paper is divided into two sections. The first section will consider key financial questions relating to the council's immediate and forecasted year-end financial position. The second will then consider key financial questions relevant both to the medium and longer term.

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Questions relating to the immediate financial situation

Key questions

- What is the overall impact of the pandemic on the council's current financial position and its ability to deliver the 2020/21 approved revenue and capital budgets?
- What financial support will be available to local councils from central government?
- How will the crisis affect the council's financial resilience?

What is the overall impact of the pandemic on the council's current financial position and its ability to deliver the 2020/21 revenue and capital budgets?

It is likely that elected members will already have received information from officers on the pandemic's immediate financial impact on the council's budget position. Whilst there are likely to be variations between councils due to their geography, demographics and service responsibilities, it is almost certain that any such information will be reporting overspending against the approved 2020/21 budget. Such overspending will be due to both unforeseen, but necessary, expenditure and reduced income from fees and charges and possibly from reduced returns from commercial undertakings. This leads to two immediate financial concerns; the immediate cashflow position of the council and its ability to meet the 2020/21 budget.

Concerns about negative cashflows can always be addressed via short term borrowing, but there is a cost to this and so, over the past few weeks, government has made a series of announcements designed to alleviate the pressure on councils' cashflow position. These include additional grant funding, the upfront payment of some grants that would usually have been paid in instalments and allowing councils to postpone business rates payments to central government. However, cashflow issues may continue to emerge as the crisis continues, for example, if commercial income remains reduced over the coming months. Accordingly, finance portfolio holders will need to seek assurances from their Section 151 Officer as they continue to closely monitor this aspect of the council's finances.

The second immediate issue is the council's ability to meet the agreed 2020/21 budget and, where the pandemic has caused variations from budget, whether it is still possible for the council to fulfil its overall legal duty to maintain a balanced budget.

It should be noted that councils still have a legal duty to deliver best value and so will need to ensure that public money is spent wisely in its response to the pandemic and that the council does not incur additional costs that could reasonably be avoided. However, the scale of the crisis means that budget deficits are likely to be impossible to avoid and are also likely to increase in the event of only a gradual relaxation of public health measures such as social distancing. Most councils already have budget forecasts to the year end as part of their regular financial monitoring arrangements, but, given the current uncertainty, finance portfolio holders will need to understand the range of assumptions that officers are making as they report. It is also suggested that reporting a range of potential scenarios might be of use at this time.

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It should be remembered that local councils are prevented in law from going into overall financial deficit and so it is likely that Section 151 Officers will have already begun to construct such scenarios given their duties under law. However, whilst the council is likely to be in ‘immediate response mode’ at present, senior elected members should be informed of and involved in understanding the strategic implications of the changing financial situation. This is especially important if the Section 151 Officer considers they have no choice but to report to the council under Section 114 of the Local Government Finance Act 1988 if they consider that the council’s budget is likely to become illegal due to the scale of expenditure and losses during the crisis.

If the government does not fully reimburse councils for their full losses, councils will find that their reserves will be depleted, or even exhausted, and ongoing savings will be required. Should the council be unable to balance its budget at the year end, any overspend will need to be met by reserves. Members will be familiar with the reserves that the council currently holds, and the balance between earmarked and unearmarked reserves, but may need to revisit the reason for holding such reserves in the light of the crisis.

Councillors will also need to consider how the approved capital programme has been affected by the crisis. For example, anticipated capital receipts may now be delayed, reduced or become completely unrealisable. Programme slippage may also affect service delivery assumptions. These will be particularly important where councils are using ‘invest to save’ strategies, as delays in the capital element of the project will lead to knock-on effects in the revenue budget as any anticipated revenue savings become delayed, reduced or unrealisable.

What financial support will be available to local councils from central government?

Government guidance and funding is still evolving, and definitive answers are not yet available, but ministers have made a series of undertakings to compensate councils in full for their additional costs as they respond to the crisis. Additional funding has already been made available, though this is unlikely to be sufficient as the crisis continues. The Local Government Association (LGA) is arguing for the government to provide additional grant funding to all councils to enable them to respond to the crisis and emerge from it with the capacity to resume local services and rebuild local economies. Additional financial freedoms and flexibilities would also enable councils to respond appropriately to their own local circumstances and local needs.

Whilst there is no automatic compensation scheme available to local councils in the event of unplanned expenditure, Section 155 of the Local Government and Housing Act 1989 enables government to reimburse the costs of local authority actions taken in the immediate phase of a government designated emergency. This is popularly known as the ‘Bellwin scheme’. At present the LGA is not arguing for a Bellwin type scheme on the basis that it is based on a claims system and does not usually fully compensate councils for the full costs of an event.

Whilst no firm proposals are currently available on how councils will be compensated, it would be prudent for Finance portfolio holders to seek assurance from officers that the council’s financial system has been adapted to ensure that the full cost of the council’s crisis response can be captured, should government or auditors wish to validate any future funding in terms of actual cost.

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It should be noted that the Bellwin scheme is only intended to cover the additional costs incurred in meeting the crisis. The latest guidance, written in October 2017, specifically excludes compensation for any longer-term costs and, significantly for the current debate, does not include any reimbursement for loss of income. Ministers have suggested that the additional funding already provided includes recognition of income loss as well as increased expenditure, but there is no clarity over the nature, size and timing of a full recovery package. Clearly, this remains a significant area of financial risk for every council.

Given this, it is essential that senior councillors focus on the likely impact that the crisis, and its aftermath, will have on income levels both now and potentially into the future. An obvious area of concern is the loss of income from car parking and leisure facilities, but councils who have a more widely developed commercial strategy will also need to consider the potential of losses on all aspects of the council's current portfolio. This may include potential losses of anticipated dividend income from companies and also losses of rental income as tenants deal with the effect of the lockdown on both the short and longer-term financial viability of their business.

All of these immediate in-year financial issues then lead to wider questions on the council's ability to meet its current MTFS, together with fundamental questions on longer-term financial resilience. The second section will consider these issues.

How will the crisis affect the council's financial resilience?

Financial resilience has become a key issue over the past few years as councils have responded to significant reductions in grant funding and to growing demand for services. Given the potential strain the crisis will place on the level of local authority reserves, together with any ongoing changes in council expenditure and income, the financial resilience of individual councils, and potentially the entire local government sector, needs to be reconsidered.

It is also likely that the council's approved budget includes savings from transformation and efficiency programmes. Should such savings now be considered unrealisable, councillors will need to ensure that alternative plans are developed and approved to maintain the council's ongoing financial resilience.

Whilst the nature, scale and level of government support is crucial, senior councillors will wish to work with officers to understand their council's potential longer-term financial position and plan a response.

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Questions relating to the MTFS and longer-term financial resilience

- How is the crisis affecting the local economy?
- How will the immediate crisis and its aftermath affect the assumptions made in the MTFS?
- What is the future of local government funding in the medium term?
- How will the council's role in leading and supporting the local community be shaped by the crisis and how will this affect priorities and plans?

How is the crisis affecting the local economy?

The pandemic is likely to be having far-reaching effects on every local community and the council will need to closely monitor and re-evaluate its own contribution to the wellbeing of their local area. Elected members have an important role to play as elected community leaders and it is important that they work with officers to influence not only the initial response to the crisis but also to recognise that it may now be impossible to deliver the full range of policies and plans that informed the council's approved budget. It may also be concluded that local priority and need has been changed by the pandemic and that policies, services and plans now need to be reconsidered and adapted in the light of the crisis. Accordingly, members may need to revisit their council's policies and plans and work with officers so that the council can articulate and deliver its revised objectives and priorities. Such policy changes are also likely to affect the council's financial planning.

How will the immediate crisis and its aftermath affect the assumptions made in the MTFS?

The MTFS is not only based on assumptions on the state of the national and local economies over the next three years but is also the financial expression of the council's policy. Therefore, every council is likely to have to fundamentally evaluate its MTFS in the light of the pandemic.

The COVID-19 crisis is likely to be long-lasting and far reaching, affecting more than one financial year. It could be difficult for councils to reduce their spending back to pre-crisis levels and income streams will not necessarily bounce back quickly, especially if the local economy is in recession. This means that the assumptions underlying later years in the MTFS will almost certainly need to change, making the 'budget gap' for 2021/22 and beyond larger.

In terms of the economic position, local government funding will be considered in the next section, but councils will need to take account of the fact that a downturn in the economy is likely to affect local tax revenues and other income streams as well as affecting demand for certain services.

Councils may also need to review their commercial investment portfolios in the light of the pandemic with a view to confirming that the portfolio continues to provide the council with the overall financial security and liquidity it requires. This will be particularly important if the council's cash-backed reserves have become depleted as a result of the crisis.

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Councils may need to re-evaluate both individual investments and the portfolio as a whole if the underlying assumptions made at the time of the investment decision in terms of both anticipated income streams, estimated future capital values and overall risk have changed.

Elected members will already have crucial connections with the local community and are best placed to understand local need and it is essential that the voice of the community is heard through its locally elected representatives as local priorities are reconsidered and potentially reshaped. Local situations will vary significantly, but, for example, should remote working become a permanent feature for some organisations, councils may find that they will need to reconsider their current approach to the provision of commuter car parking and transportation. Accordingly, councils may need to revisit their capital strategy as well as its MTFS.

What is the future of local government funding into the medium term?

The immediate financial position of local councils has already been discussed above, but the pandemic has also introduced further uncertainty into the ongoing debate over the funding of the local public services.

Local councils have consistently lobbied government over their concerns on the viability of the current system of local government finance, both in terms of the inadequacy of the total amount of resources available in meeting increased service demand and also on the fairness of the mechanism used to distribute funding between individual authorities. Prior to the pandemic, government had already announced an overall increase in their funding to local councils and was due to consult over the coming months on a new system of funding allocation, known as the Fair Funding Review, which was to be implemented from 2021/22. Understandably, the government has recently announced a further delay in the implementation of the Fair Funding Review, but it is currently unclear whether the expected reset of the Business Rates allocation system, which was also due to be implemented from 2021/22, has also been delayed.

Local government funding is linked to the wider health of both the local and national economy as it still derives a significant proportion of its funding from taxation. The Office for Budget Responsibility (OBR) is currently predicting a severe hit to the UK economy in the current year, with significant increases in government debt. Whilst the OBR is also suggesting that the UK economy is likely to bounce back once the pandemic is over, government will need to address the overall state of the public finances in terms of future taxation and spending. Traditionally, government has looked to local councils to contribute to their plans for the recovery of the public finances of the country, but, given the increased public awareness of the role local councils play in the provision of essential public services, in particular through the care sector, it is far too early to speculate what shape this will take.

The government has provided support to businesses through the lockdown by further expanding the system of Business Rates reliefs, which were previously only available to small businesses. Government has also continued to compensate local councils for consequent reduction in funding through the Section 31 grant system. However, it is possible that the legacy of the pandemic will lead to more fundamental questions on the longer-term viability of business rates as a form of taxation. As Business Rates currently forms a key plank of local councils funding, any changes to the current system will require a wider debate on how local councils are funded.

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Despite all of this uncertainty, the fundamentals of council financial governance and control still require councils to prepare and approve balanced budgets. In doing so, it is essential that local politicians continue to represent their local communities and evaluate how the local priorities, strategies and plans need to be adapted in the light of the pandemic. This work will need to be coordinated and lead by elected mayors, council leaders and finance portfolio holders to provide officers with strategic direction they need to revise the council's MTFS and annual budget which will be recommended to full council early in the new year.

How will the council's role in leading and supporting the local community be shaped by the crisis and how will this affect priorities and plans?

Whilst the focus of this paper is on finance, it remains the case that local council budgets should be the financial expression of the needs, concerns and priorities of the local community. Whilst elected councillors and officers alike are currently concentrating much of their effort on the immediate response to the crisis, senior councillors will also need to take time to reflect on how the pandemic will change their communities, affect the demand for council services and potentially re-shape the way that the council approaches workforce and service delivery over the longer term. This, together with planning a response to the impact of the wider economic and fiscal measures implemented by government, will require local political leaders to reconsider the council's financial dynamics, strategies and budgets, starting with the 2021/22 budget setting process.

Local councils are known for their agility and resilience when facing difficult and changing circumstances and these skills will be tested again over the coming years.

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