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COVID-19 and English council funding: how are budgets being hit in 2020–21?

Economic and Social Research Council

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Preface

The authors would like to thank Mike Heiser, Bevis Ingram and Aivaras Statkevicius from the Local Government Association for help in relation to the data used in this report, as well as the funding available to councils to address the COVID-19 crisis. The authors would also like to thank Paul Johnson for comments on an earlier draft. In addition, they gratefully acknowledge funding from the Local Government Association and co-funding from the UKRI/ESRC COVID-19 Rapid Response funding programme (Je-s grant reference ES/V005073/1) and the ESRC-funded Centre for the Microeconomic Analysis of Public Policy (ES/M010147/1). However, all opinions and any errors or omissions in terms of analysis are the responsibility of the authors only.

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Executive summary

The public health and economic effects of the COVID-19 crisis are creating a perfect storm for councils' finances, simultaneously increasing spending and reducing incomes. For example, personal protective equipment (PPE) and social distancing requirements have increased unit costs for a range of services, and most notably adult social care, where many service users are particularly vulnerable to the health effects of COVID-19. Councils are taking on additional responsibilities to house rough sleepers, support those shielding at home, and help with the testing, tracing and control of COVID-19 outbreaks. And the wider economic effects of the crisis are hitting councils' various income sources to different extents as households and businesses radically change their behaviour and struggle to pay tax bills, rents and service charges.

Building on previous work by researchers at IFS on the financial risk and resilience of different councils and by the Local Government Association (LGA) on councils' own expectations of the financial impact of the COVID-19 crisis as reported to the Ministry of Housing, Communities and Local Government (MHCLG), this report:

- examines the scale and nature of forecast impacts on spending and income from sales, fees and charges (SFCs) and commercial and other sources;
- explores how impacts may vary across council types, regions and council characteristics;
- compares the impacts with the financial resources provided to councils by central government and with the resources available to them in the form of reserves;
- considers the implications for future funding policy.

It is important to be upfront about the limitations of this approach. Forecasting spending and income during such an uncertain period is, of course, difficult. And different councils will have made different assumptions and may have interpreted some questions asked of them differently. This means estimates are subject to potentially significant margins of error, which we can only partially address via robustness and sensitivity checks. However, reported pressures are comparable to costs in Wales, where funding for councils is distributed on the basis of claims for verifiable costs. And patterns across councils align with the risk factors – such as particular reliance on SFCs and commercial income – identified in our earlier work. This suggests there is genuine and valuable information that is worth exploring.

A multi-billion-pound problem …

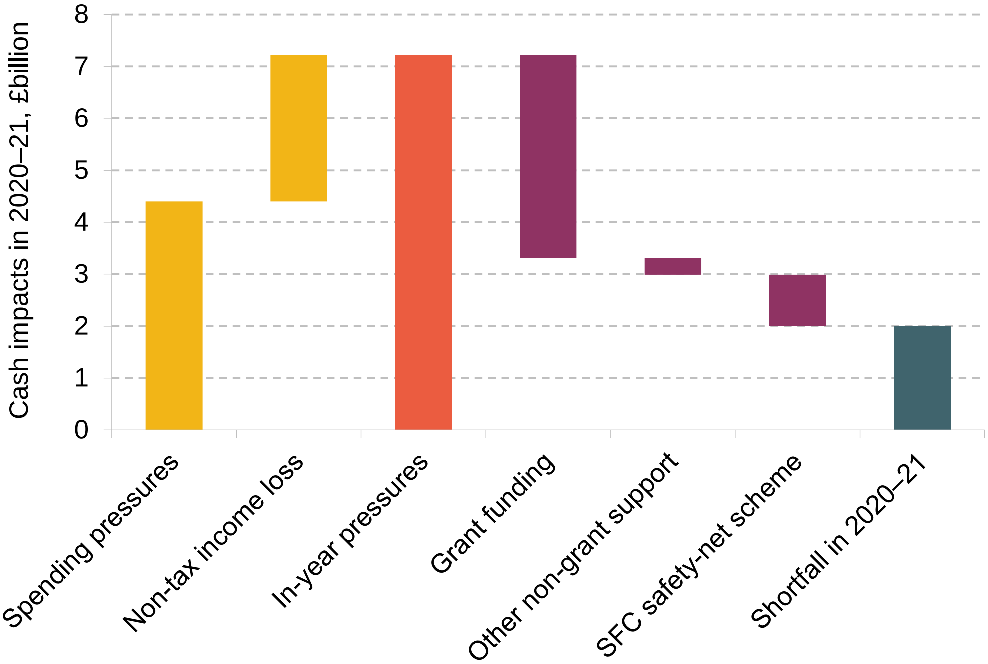
Bearing these caveats in mind, councils forecast spending pressures of £4.4 billion during 2020–21, with around £1.8 billion of those estimated to have been incurred between April and June. They also forecast a £2.8 billion shortfall in non-tax income, with £1.3 billion of this arising between April and June. Taken together, this means in-year pressures are forecast to be £7.2 billion, with billions of pounds more in losses in local tax collections also hitting councils' main budgets from next year.

Estimates vary significantly across councils, with shire districts especially hard hit on the income side and hence facing the biggest hit overall, measured as a percentage of their pre-crisis expenditure. Income losses are relatively more important for areas with high population densities and low levels of deprivation. Spending pressures are relatively more important for areas with high levels of deprivation.

… that has only been partly addressed

The forecast pressures exceed the funding and support provided by central government. Councils have been provided with £3.6 billion of additional general-purpose grant funding and, following stakeholder discussion, we assume that they have access to around £0.3 billion of specific grant funding and £0.3 billion in other non-grant support to address their stated spending pressures. In addition, we estimate councils could have almost £1 billion of losses in SFCs (around half the total) compensated by the new SFC safety-net scheme – although this is tentative given that the data available so far do not allow us to model this scheme particularly accurately. However, taken together, this £5.2 billion in additional financial support still leaves a shortfall of £2.0 billion across the sector as a whole relative to current forecasts of pressures, as illustrated in Figure ES.1.

Figure ES.1. Baseline forecast of unmet spending and non-tax income pressures in 2020–21 (£ billion)



Note: Baseline scenario, which takes councils' forecasts of spending and income pressures as given. 'Non-tax income loss' excludes council tax and business rates (losses of which will affect councils' main budgets *next* year). 'Grant funding' includes general-purpose and specific grants. 'Other non-grant support' refers to NHS cost-sharing and Coronavirus Job Retention Scheme.

Source: Table 3.2.

Altogether, councils report that they are holding £3.3 billion in reserves that they could use to absorb such shortfalls this year. But these reserves are not distributed in line with forecast pressures. Over four in ten councils would still face a shortfall if they used all the reserves they consider to be 'available' for use this year, with the remaining shortfall for these councils amounting to £0.9 billion. Of course, councils may in fact be able to use more reserves than they say they could, especially given that almost one in five say none of their reserves are usable. But without additional funding, if they were to address forecast spending and non-tax income pressures in full by drawing down reserves, just over one in four would be left with reserves (relative to their pre-crisis expenditure) of less than one-half of the pre-COVID average for their council type, up from around one in six in March this year.

Pressures may, of course, turn out to be higher or lower than currently forecast. And further pressures loom in the coming years too, with shortfalls in council tax and business rates revenues this year having to be reflected in councils' main budgets from next year, and the potential for ongoing impacts to spending and income, especially if a COVID-19 vaccine is delayed. If the government wants to avoid cuts to services, additional funding will therefore be needed in the coming years. Additional support and/or financial flexibilities – especially if pressures are revised further upwards – may also be needed for 2020–21 if the government wants to avoid some councils depleting a significant portion of their overall reserves or making in-year cuts to services.

Key findings

1 Councils forecast spending pressures of £4.4 billion and non-tax income pressures of £2.8 billion in 2020–21. Taken together, this equates to a financial hit equal to 13.0% of pre-crisis expenditure. Adult social care accounts for £1.8 billion of the spending pressures, with unspecified unachieved efficiency savings accounting for the next-biggest chunk, at £0.6 billion. Reductions in SFCs on transport account for £0.8 billion of the loss in income, with reductions in commercial income (such as from commercial rents and trading companies) forecast to be £0.6 billion.

2 Approximately 41% of the spending pressures (£1.8 billion) and 45% of the income pressures (£1.3 billion) are estimated to have taken place between April and June (Q1). This implies that pressures are forecast to be less than half their Q1 levels in the remainder of the financial year. Of course, forecasting is subject to significant uncertainty, especially in the current environment, and pressures may abate by more or less than councils have assumed. If pressures in the remainder of the year turn out to be two-thirds of Q1 levels, for example, annual spending pressures and non-tax income pressures would each be around £1 billion higher than councils have forecast.

3 There is significant variation in forecast pressures across councils, especially for non-tax income. For example, just over three in ten councils expect non-tax income to fall by the equivalent of less than 5% of their pre-crisis expenditure, while almost one in six expect a reduction of 20% or more. Shire districts, which are especially reliant

on income from SFCs and commercial activities, are forecasting combined pressures averaging 23% of pre-crisis expenditure, compared with less than 15%, on average, for other council types. Differences across regions are not robust to sensitivity checks, but there is more robust evidence that non-tax income losses are higher in more densely populated areas, which typically rely more on the most at-risk income sources such as parking fees.

4 The government has provided £4.8 billion of general and specific grant funding for councils to meet spending and non-tax income pressures this year. However, discussions with stakeholders suggest that councils may not have accounted for all of this – and the new responsibilities entailed – when forecasting their pressures. In our baseline scenario, we therefore account for around £3.9 billion of additional grant funding. On top of this, councils forecast savings of £27 million due to furloughing people as part of the Coronavirus Job Retention Scheme and £293 million of cost-sharing by the NHS. We also tentatively estimate councils could have around £1 billion of their losses in SFCs compensated by the ‘safety net’ scheme announced last month.

5 Taken together, councils’ forecasts for spending and non-tax income and our baseline scenario for funding imply a funding shortfall of approximately £2 billion this year, although uncertainty about pressures and funding availability means there is scope for the gap to be much bigger or smaller. For example, if pressures in the remainder of the year are two-thirds (as opposed to less than half) of those between April and June, the shortfall would be around £3.5 billion.

6 Relying on reserves to meet these unfunded pressures would lead to a significant increase in the number of councils with low reserves relative to their pre-crisis expenditure. Under our baseline scenario, for instance, the proportion with reserves below half of the pre-crisis average for their council type would increase from around one-in-six to just over one-in-four. The proportion with reserves below a third would increase from around one-in-sixteen to around one-in-seven. Councils

in such a situation could face a tricky trade-off between making in-year cuts or making cuts in coming years to rebuild their reserves.

7 If the government wants to ease this trade off, several options are available. The simplest approach would be to increase the general grant funding it gives councils. But providing additional funding to all would be a costly way to support those councils facing the greatest problems, and more targeted support would be cheaper. One option would be to follow the example of Wales, where councils submit claims based on the additional costs they have incurred, subject to some vetting. Temporary powers to borrow to cover day-to-day spending could also be considered, and have been identified by the OECD as a sensible way to give local areas more flexibility and autonomy to respond to the crisis as they see fit.

1. Introduction

The public health and economic effects of the COVID-19 crisis are creating a perfect storm for councils' finances, simultaneously increasing spending and reducing incomes. For example, personal protective equipment (PPE) and social distancing requirements have increased unit costs for a range of services, and most notably adult social care, where many service users are particularly vulnerable to the health effects of COVID-19. Councils are taking on additional responsibilities to house rough sleepers, support those shielding at home and help with the testing, tracing and control of COVID-19 outbreaks. And the wider economic effects of the crisis are hitting councils' various income sources to different extents as households and businesses radically change their behaviour and struggle to pay tax bills, rents and service charges.

In earlier work, we highlighted how variation in reliance on different revenue streams and in the demographic and socio-economic characteristics of their residents mean different councils will likely be affected in different ways and to different extents by the crisis.[1] This suggested that while councils serving more deprived areas had populations that are more vulnerable to the medium- to long-term effects of the COVID-19 crisis, councils in more affluent areas rely more on the sources of income being hit now, potentially putting them at greater financial risk in the short term.

But how are these risks crystallising? In this report, we use councils' own estimates of the financial impact of COVID-19 to examine the scale and variation in impacts on budgets in 2020–21. In particular, we use councils' estimates of the effects of the crisis on service costs and on income from sales, fees and charges (SFCs), commercial activities and other sources to:

- examine how effects may vary across council types, regions and council characteristics;

[1] Ogden and Phillips, 2020a.

- compare the impacts with the resources provided to councils by central government and with the resources available to them in the form of reserves.

It is important to note that councils are also collecting substantially less tax from local taxpayers. This could lead to a cash-flow problem for some councils, especially among shire districts. However, accounting rules mean that these shortfalls will not affect councils' main budgets this year. Usually, shortfalls in one year would have to be addressed the following year, but the government has announced that councils will be able to spread shortfalls this year over three years (2021–22, 2022–23 and 2023–24). We will consider the potential scale of these shortfalls as part of our next report, on the medium-term outlook for local government spending and revenues, in the autumn. This allows us to focus on the short-term in-year impacts in this report, which proceeds as follows.

Chapter 2 examines how estimated impacts vary across service areas and income sources and between councils of different types, in different regions, with different characteristics. Chapter 3 looks at the extent to which the funding and burden-sharing mechanisms put in place by central government will compensate councils for increases in spending and lost income. It also looks at whether financial reserves would be sufficient for councils to bear any remaining impacts themselves. Chapter 4 concludes, and discusses the implications of our findings for policymaking. The appendix provides further information on the data we use and our methodological assumptions and choices. An online spreadsheet appendix provides further breakdowns of results, and allows the user to select from several scenarios for pressures and funding to see the sensitivity of estimates of funding shortfalls to modelling choices.

2. The spending and income impact of COVID-19

In this chapter, we analyse councils' estimates and forecasts of the impact of COVID-19 on their spending and income. These are recorded in returns to the Ministry of Housing, Communities and Local Government (MHCLG), with the April, May and June returns available at the time of writing.

The returns ask councils to estimate the increase in spending and decrease in income that have resulted from the COVID-19 crisis, relative to pre-COVID plans. Figures are available for April, May and June as well as for the full financial year (2020–21), separately by service area and income source. The returns also ask for information on the use of additional grant funding councils have been given to help them address the COVID-19 crisis, contributions to and from service delivery partners (such as local NHS bodies and social care providers) and the scope for using financial reserves to offset spending and income pressures.

Full details of these data and our methodology can be found in the appendix. However, it is worth noting up front that estimates of the financial impacts of the COVID-19 crisis on councils are necessarily tentative for several reasons. First, we are only part way through the year, and the paths of both the COVID-19 epidemic and the economy – which will matter greatly for councils' spending and income – are highly uncertain. Second, and related to this, different councils are likely to have made different assumptions about how quickly and how far their spending and income patterns will return to normal. And third, different councils are likely to have taken different decisions over their response to the crisis – for example, in relation to the support provided to households and policies on care fees. Differences in estimated impacts across councils could reflect differences in assumptions and responses, as well as differences in exposures to the effects of the COVID-19 crisis. However, these data provide the best available evidence on the financial impacts of the COVID-19 crisis on councils, and robustness checks provide a way of seeing how sensitive estimates are to the first two of these issues.

2.1 The scale and nature of the impact

Table 2.1 shows councils' own estimates of the impact of COVID-19 on spending by service and on income by source for the first three months of 2020–21 and the full year. Figures for April and May are, where possible, based on provisional out-turns data, while figures for June and the full year are forecasts. The table shows that, overall:

- Total spending pressures in 2020–21 are forecast to be £4.4 billion. Adult social care accounts for approximately £1.8 billion of this, far higher than the £0.3 billion accounted for by children's social care, the service with the next-highest impact in cash terms. Almost £1 billion is accounted for by 'other spending pressures', the most significant of which is unachieved efficiency savings as a result of disruption to planned activities and investments, at £0.6 billion.
- Total income losses are forecast to be £6.5 billion. Council tax (£1.9 billion) and business rates (£1.8 billion) are the two largest contributors to this in cash terms. However, as discussed in the introduction to this report, these losses only hit councils' main budgets from 2021–22 onwards, when reconciliations between forecasts and out-turns need to be made. In addition, in most of the country, 50% of business rates accrue to central government (the 'central share'), meaning 50% of the losses will as well. And a safety net system compensates councils for especially large falls in their share of business rates revenues. We therefore exclude the figures for council tax and business rates in the remainder of this report, and will instead focus on them in our next report, on the medium-term financial effects of the COVID-19 crisis.
- Excluding council tax and business rates, income losses are forecast to be £2.8 billion, with reductions in sales, fees and charges (SFCs) income accounting for almost £2 billion of this. Almost two-thirds of this reduction in SFCs income is accounted for by shortfalls for transport services (£0.8 billion) and culture and leisure services (£0.5 billion).

Table 2.1. Estimated increases in expenditure and losses in income as a result of the COVID-19 crisis: £ million

Pressures	April	May	June	2020–21	Q1 % year
Spending pressures					
Adults’ social care	248	275	300	1,788	46%
Children’s social care	32	33	36	305	33%
Education	15	16	15	254	18%
Transport	9	9	11	62	46%
Public health	3	3	8	96	16%
Housing and homelessness	29	31	31	205	45%
Culture and leisure	20	22	26	192	35%
Environment and regulation	56	40	39	220	61%
Planning and development	2	2	2	15	45%
Police and fire	1	1	0	3	71%
Finance and corporate	43	30	45	274	43%
Other (incl. unachieved savings)	144	121	121	987	39%
Total spending pressures	**603**	**583**	**634**	**4,400**	**41%**
Income pressures					
Council tax (CT)	236	297	249	1,868	42%
Business rates (BR)	231	247	219	1,849	38%
Transport SFCs	135	140	122	785	51%
Culture and leisure SFCs	65	66	64	484	40%
Planning SFCs	23	22	22	151	44%
Other SFCs	107	93	89	537	54%
Commercial	97	64	68	626	37%
Other	31	38	39	237	45%
Total income	**924**	**966**	**872**	**6,538**	**42%**
Income excl. CT and BR	**457**	**422**	**404**	**2,821**	**45%**

Note: Final column is the percentage of the full-year pressure that is accounted for by pressures occurring in the first quarter (April–June). Figures may not sum due to rounding.

Source: Authors’ calculations using MHCLG (2020a and 2020b).

- Councils estimate that the first quarter of 2020–21 (April, May, June) saw spending pressures of £1.8 billion and losses in non-tax income of £1.3 billion. It is notable that measured on a per-capita basis, this is broadly comparable to the additional spending and loss of income in Q1 estimated by councils in Wales.[2]
- Reported Q1 spending and non-tax income pressures are 41% and 45% of the full-year forecasts, respectively. This implies that monthly spending and income impacts are forecast to be less than half their Q1 levels in the remainder of the financial year.[3]

  There are two notable exceptions to this pattern – education and public health services, where spending pressures are forecast to be around 1.5 and 1.75 times *higher* in the remainder of the year than in Q1. This may reflect the return of many more children to school from September, with implications for home-to-school transport, and the new responsibilities councils have for managing local outbreaks, announced on 11 June, which at least some councils seem to have taken account of when submitting their returns to MHCLG.[4]

Monthly figures suggest spending pressures were already falling over the course of Q1 for environment and regulation services. And they also suggest some rebound in income from transport and other SFCs was taking place, perhaps associated with the reopening of non-essential retail and the resumption of more normal activities as lockdown was eased.

For adult social care though, estimated pressures were rising during the quarter: from £248 million in April to £300 million in June. And additional spending on housing and homelessness is estimated to have been steady at around £30 million per month. Such trends need not continue and spending could instead fall in the coming months, especially if councils were purchasing services or equipment up front. But if they do not fall back as much as councils' forecasts imply, the financial

2 Welsh councils faced additional costs and reductions of income of £173 million by the end of June (BBC News, 2020). This is approximately 5.6% of the pressures in England, and Wales's population size is also 5.6% of England's. However, it is worth noting that councils in Wales have greater responsibility for schools spending than those in England, and some of the costs incurred in Wales may relate to free school meals, for instance.

3 If councils had forecast the same level of pressure each month of the year, pressures in the first quarter of the year would account for 25% of their full-year estimates. For 41% of annual spending pressures to arise in the first three months implies the pressure in each of the remaining nine months must be on average 48% of the monthly pressures in the first quarter.

4 DHSC, 2020b.

impact could be significant. For example, if pressures are two-thirds of their Q1 level (as opposed to just under a half) in the remainder of the year, total spending pressures would amount to £5.5 billion (as opposed to £4.4 billion). Non-tax income losses would be £3.8 billion (as opposed to £2.8 billion). We consider how such more pessimistic scenarios could affect councils' financial sustainability when considering the sufficiency of government 'compensation' in the next chapter.

In the meantime, to provide a better sense of scale, Table 2.2 shows forecast full-year pressures, measured three ways: per capita; as a percentage of estimated baseline spending/income for each item;[5] and as a percentage of an adjusted measure of councils' revenue expenditure.[6] It shows that:

- Relative to pre-COVID plans for net expenditure on services, we estimate pressures are greatest for housing and homelessness (almost 12%), adult social care (just over 10%), finance and corporate services (just under 10%) and culture and leisure (9%). Pressures are less than 5% for other services and estimated to be less than 1% for education and for police and fire services.[7]
- Relative to pre-COVID plans for income generation, income from SFCs from culture and leisure services is forecast to decline by over 50%, but the small size of this income source in councils' overall budgets means this is equivalent to less than 1% of overall adjusted revenue expenditure. In contrast, SFCs from services other than transport, culture and leisure, and planning are forecast to decline by just 6%, but the fact that this income source is much larger means this translates into just over 1% of adjusted revenue expenditure. The almost one-third forecast fall in transport SFCs equates to 1.4% of adjusted revenue expenditure.

5 '% of item' is the pressure as a percentage of the estimated baseline for each item pre-COVID. See the appendix for detail of the baseline used for each spending and income line.

6 Adjusted gross revenue expenditure = Gross revenue expenditure – Ring-fenced grants for schools + Net income from commercial trading services + Investment and interest income. See the appendix for more detail.

7 The only council with policing responsibilities is the City of London Corporation, and its activities differ markedly from most other police forces. However, 14 councils have responsibility for fire services, covering 16% of the population of England.

Table 2.2. Estimated increases in expenditure and losses in income as a result of the COVID-19 crisis: £ per capita, % of item and % of adjusted revenue expenditure

Pressures	Per capita (£)	% of item	% of adjusted revenue expenditure
Spending pressures			
Adults' social care	32	10.14%	3.22%
Children's social care	5	3.11%	0.55%
Education	4	0.76%	0.46%
Transport	1	2.95%	0.11%
Public health	2	2.89%	0.17%
Housing and homelessness	4	11.86%	0.37%
Culture and leisure	3	9.01%	0.35%
Environment and regulation	4	4.49%	0.40%
Planning and development	0	1.56%	0.03%
Police and fire	0	0.55%	0.00%
Finance and corporate	5	9.90%	0.49%
Other (incl. unachieved savings)	17	n/a	1.78%
Total spending pressures	**78**	**n/a**	**7.92%**
Income pressures			
Transport SFCs	14	31.65%	1.41%
Culture and leisure SFCs	9	54.50%	0.87%
Planning SFCs	3	13.94%	0.27%
Other SFCs	9	5.96%	0.97%
Commercial	11	n/a	1.13%
Other	4	n/a	0.43%
Income excl. CT and BR	**50**	**n/a**	**5.08%**

Note: Per-capita figures may not sum due to rounding.

Source: Authors' calculations using MHCLG (2020a and 2020b).

Have councils' estimates of pressures been increasing or decreasing over time?

As highlighted in the introduction to this chapter, councils have been asked to submit returns each month since April. The returns for April were something of a pilot for MHCLG and are not used in this report, but the returns for May and June ask for a broadly comparable set of information on spending and income pressures. It is therefore worth asking how councils' expectations changed between May and June, as more information, including about the easing of lockdown, became available.

Table 2.3 shows, for each spending area and each income source, the percentage change in forecast full-year pressure between the May and June returns, as well as the share of councils that increased or reduced forecast full-year pressures by 20% or more between May and June.

It shows that between May and June, full-year forecasts for spending pressures increased by 21% overall, on average, with particularly dramatic increases for public health (358%), education (80%), and culture and leisure services (54%). There was also a more modest increase in forecasts for losses in non-tax income of 6% overall, on average, driven by a 29% increase in losses in SFCs from culture and leisure services.

One likely reason for the increase in forecast pressures is a change in the guidance provided by MHCLG when it sent out the returns to councils. In May, it asked councils to assume that 'current restrictions remain in place until the end of July 2020 and thereafter the situation reverts entirely back to a position you anticipated prior to Covid-19'. Following this guidance would necessarily mean much smaller forecast pressures in Q2–Q4 of the year than in Q1: pressures for eight of the nine months in Q2–Q4 would be zero! For the June returns, the guidance was revised to state that councils should use their own planning assumptions for annual forecasts. To the extent that councils' own planning assumptions are for pressures to continue into August and beyond, this change in guidance would be expected to increase forecast full-year pressures, even if councils' own expectations have not changed.

Table 2.3. Changes between May and June in estimated increases in expenditure and losses in income as a result of the COVID-19 crisis

Pressures	% change in pressure	% of councils increasing forecast by ≥20%	% of councils reducing forecast by ≥20%
Spending pressures			
Adults' social care	+22%	50%	9%
Children's social care	+3%	33%	15%
Education	+80%	55%	20%
Transport	+9%	46%	18%
Public health	+358%	53%	18%
Housing and homelessness	+13%	37%	13%
Culture and leisure	+54%	54%	12%
Environment and regulation	+9%	40%	15%
Planning and development	–6%	38%	23%
Police and fire	–16%	46%	36%
Finance and corporate	+44%	40%	15%
Other (incl. unachieved savings)	+7%	33%	19%
Total spending pressures	**+21%**	**46%**	**6%**
Income pressures			
Transport SFCs	+6%	30%	15%
Culture and leisure SFCs	+29%	45%	12%
Planning SFCs	+3%	27%	27%
Other SFCs	–1%	32%	27%
Commercial	0%	29%	27%
Other	+3%	32%	24%
Income excl. CT and BR	**+6%**	**27%**	**11%**

Note: The percentages of councils reporting changes in full-year forecasts of +/– 20% or more are calculated for only those councils that reported some positive pressure related to that service / income source in their May and/or June return. Where a council reported some positive pressure for the first time in its June return, this has been counted as an increase of at least 20%.

Source: Authors' calculations using MHCLG (2020a and 2020b).

However, the significant variation in changes across service areas and income sources, and especially the relatively high numbers of councils showing either big increases or big decreases in forecast pressures, suggest councils have also been updating their own assumptions as new evidence becomes available. For example, the fact that spending pressures for environment and regulation services were already abating during Q1 2020–21 may be one reason why the average forecast annual pressure was revised up by just 9%.

The very large increase in forecast annual pressures for public health services is driven by a proportion of councils making very large increases: just nine councils that increased their forecasts for this area account for more than half of the total revision across the sector. This likely reflects the fact that some councils revised up their forecast pressures for this service area to reflect the additional responsibilities councils have under the Test and Trace scheme. As mentioned above, these responsibilities and the associated funding were announced on 11 June 2020, just a few days before councils had to submit their June returns. It appears that some councils took account of these responsibilities (and the funding) when submitting their returns, but many more did not. We can therefore expect a further increase in forecast spending pressures for public health services in the next set of returns, for July.

2.2 The variation in impacts across England

Underlying the aggregate figures discussed so far are significantly different impacts for different councils. To some extent, this will reflect differences in the impact of the COVID-19 crisis on local populations and economies, and hence on councils' costs and income. It will also reflect differences in councils' exposure to different financial risks – such as differing degrees of reliance on the most at-risk income sources such as SFCs from transport and culture & leisure services. But it will also reflect their differing responses to the COVID-19 crisis, with different councils taking different decisions on how much to change service offerings and what support to provide their residents with. And most problematic for our purposes, councils are likely to have assumed different things about when and to what extent spending and income will return to normal.

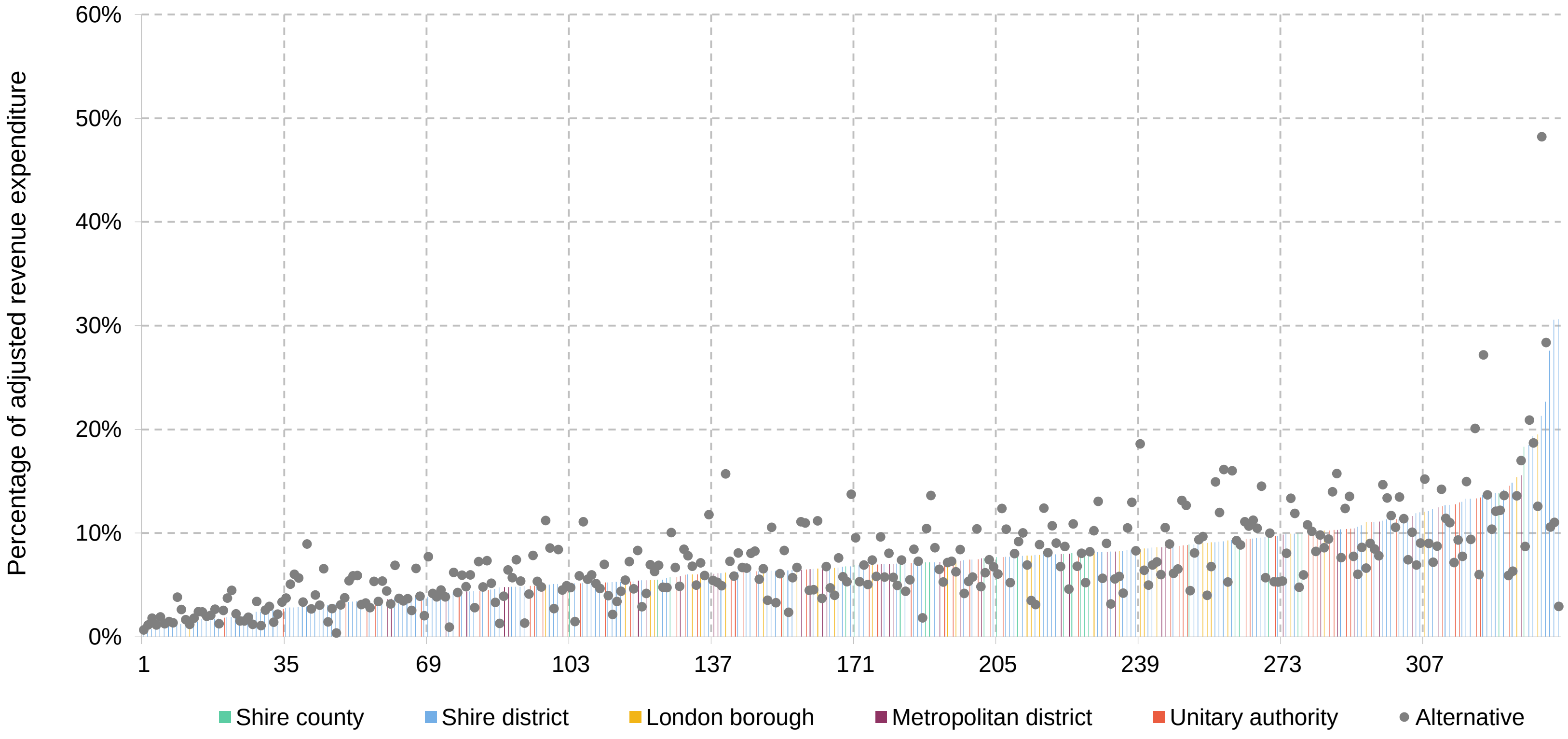
Bearing these issues in mind, Figures 2.1 and 2.2 show the distribution of spending pressures and income pressures, both measured as a percentage of adjusted revenue expenditure, across all councils. The coloured bars show councils' own forecasts for the whole of 2020–21, with the colours indicating council type. The grey circles provide a robustness check where, rather than use each council's own full-year forecast estimates, their forecasts for Q1 (April–June), which should be more reliable, are scaled up according to the average ratio between Q1 and full-year pressures for each *type* of council. This removes the effect of councils of a given type making different assumptions about when things return to normality.[8] But it also removes any genuine differences in the timing and nature of impacts due, for example, to differences in the speed and type of agreements reached with suppliers, tenants, etc., except to the extent these differ between council types. These alternative forecasts for full-year spending and income pressures therefore have pros and cons relative to the forecasts provided by councils themselves, so we do not consider either a 'preferred' estimate. When findings are consistent across both sets of forecasts, we can have more confidence that they reflect genuine differences in impacts though.

Figure 2.1 shows a wide range of forecast spending pressures. Based on councils' own full-year forecasts, 28% of councils are forecasting spending pressures equivalent to 5% of adjusted revenue expenditure or less, while 18% are forecasting spending pressures of 10% or more. Councils of different types can be found across the distribution, although most of those with the lowest forecast pressures (including 46 out of the lowest 50) are shire district councils.

The graph also shows that the alternative forecasts based on projecting Q1 2020–21 figures forward are often quite different from councils' own full-year forecasts. This implies councils are assuming pressures will abate to quite different extents over the remainder of the year. However, there is still a positive correlation between councils' own and these alternative estimates, with a correlation coefficient of 0.63 when comparing councils' own and the alternative forecasts of spending pressures measured as a percentage of adjusted revenue expenditure.

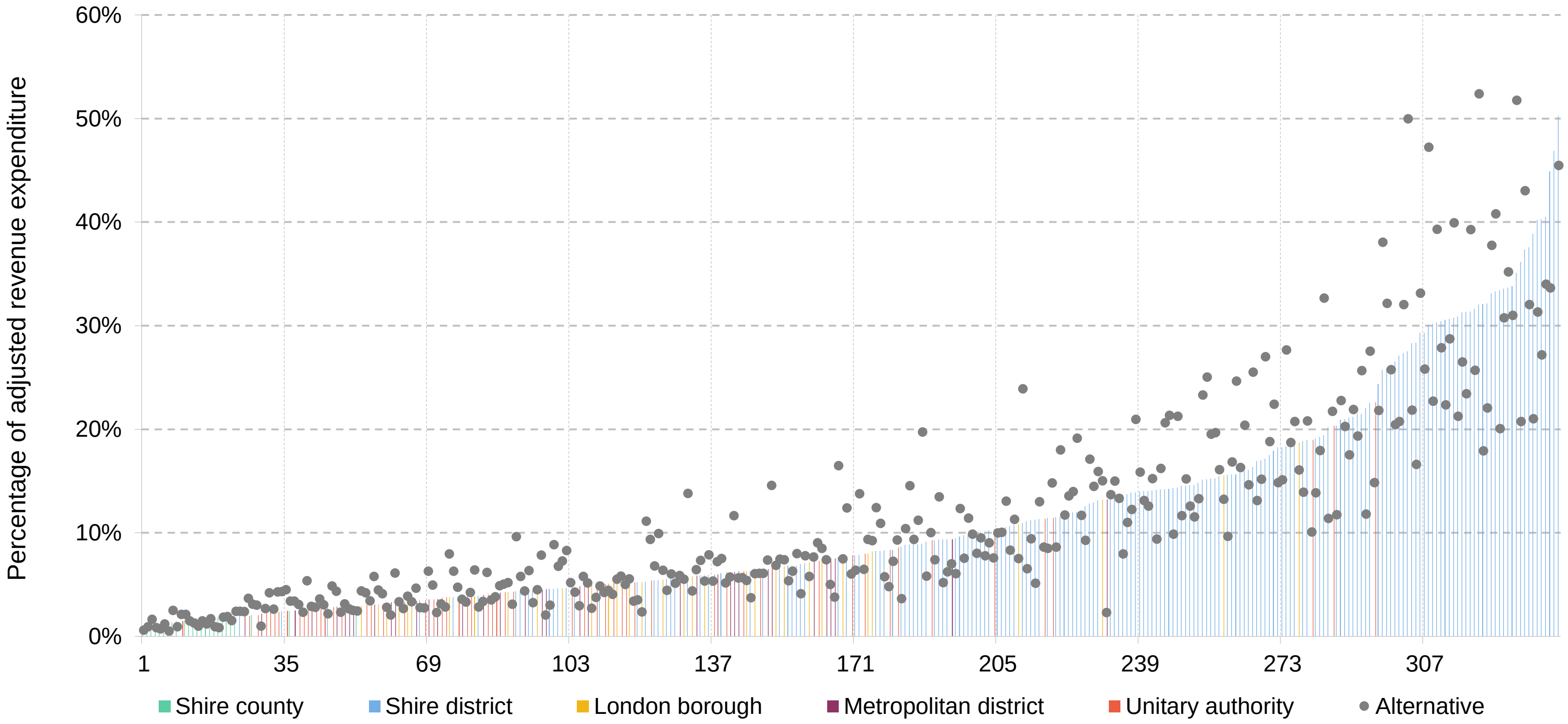
8 This does retain differences in the average ratio between Q1 and full-year pressures of different council types though. We chose this approach given that the specific responsibilities of different council types differ, and pressures may abate differently for different services and income streams.

Figure 2.1. Distribution of forecast spending pressures by council (full year, % of adjusted revenue expenditure)



Source: Authors' calculations using MHCLG (2020a and 2020b).

Figure 2.2. Distribution of forecast non-tax income pressures by council (full year, % of adjusted revenue expenditure)

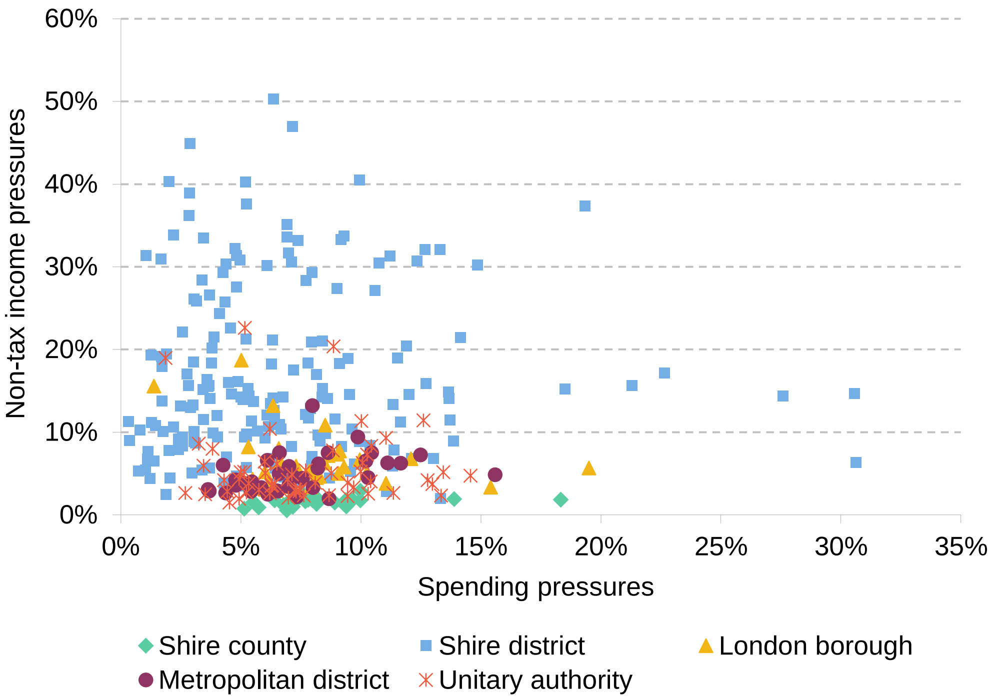


Source: Authors' calculations using MHCLG (2020a and 2020b).

Figure 2.2 shows an even wider range of forecast impacts on non-tax incomes. Councils' own estimates suggest one in three councils expect a reduction in non-tax income equivalent to less than 5% of adjusted revenue expenditure. On the other hand, one in six expect a reduction of 20% or more. There are clear patterns across council types, with all bar two of the 56 councils forecasting a greater-than-20% hit being shire district councils. And non-tax income losses are forecast to amount to 3% or less of adjusted revenue expenditure for all shire counties.

Many of the councils that estimate they will face especially high absolute losses of non-tax income are those that rely on these income sources for a significant proportion of their revenue expenditure. This aligns with our expectations, and gives us further confidence that the returns provide useful information about impacts on individual councils.

Figure 2.3. Correlation between forecast spending and non-tax income pressures (full year, % of adjusted revenue expenditure)



Source: Authors' calculations using MHCLG (2020a and 2020b).

Figure 2.2 also shows sometimes significant variation between councils' own forecasts and projections based on Q1 figures. However, the correlation between these two measures is much greater than for spending, with a correlation coefficient of 0.89. This implies that councils are making more similar assumptions to each other about how income pressures evolve over the rest of the year than they are about the evolution of spending pressures.

Figure 2.3 shows councils' own forecasts for spending (on the horizontal axis) and non-tax income pressures (on the vertical axis) and indicates very little correlation between forecasts of these two pressures. So, while some councils are forecasting low or high pressures on both the spending and non-tax income sides of their budgets, others are forecasting low pressures on one side and high pressures on the other. This is reassuring in one respect, suggesting that councils' returns are not simply 'optimistic' or 'pessimistic' across the board, but are trying to account for the different pressures being felt for different services and income sources.

Council type

Perhaps unsurprisingly given the patterns illustrated in Figures 2.1 and 2.2, Figure 2.4 shows that while shire district councils forecast spending pressures that are a little below average (6.2% of adjusted revenue expenditure versus 7.9%), their income losses are much larger on average than councils as a whole (17.0% versus 5.1%). This reflects their high reliance on income from SFCs and commercial sources – itself a product of the types of services they are responsible for, which include off-street parking, leisure and culture (except libraries), planning and development. Conversely, while shire counties forecast spending pressures of broadly a comparable magnitude to other upper-tier councils (8.1% of adjusted revenue expenditure), their forecast non-tax income losses (1.6% of adjusted revenue expenditure) are substantially lower than those for other upper-tier councils, which again reflects the division of responsibilities in two-tier areas.

In areas with single-tier local government, average spending pressures are broadly comparable between London boroughs (8.2%), metropolitan districts (8.0%) and unitary authorities (8.0%). However, forecast income pressures are higher for London boroughs (6.2%) than for the other two types of single-tier council (5.1% and 5.3%, respectively), perhaps reflecting the high reliance on SFCs income in the capital, especially from parking.

Figure 2.4. Forecast pressures by council type (% of adjusted revenue expenditure)

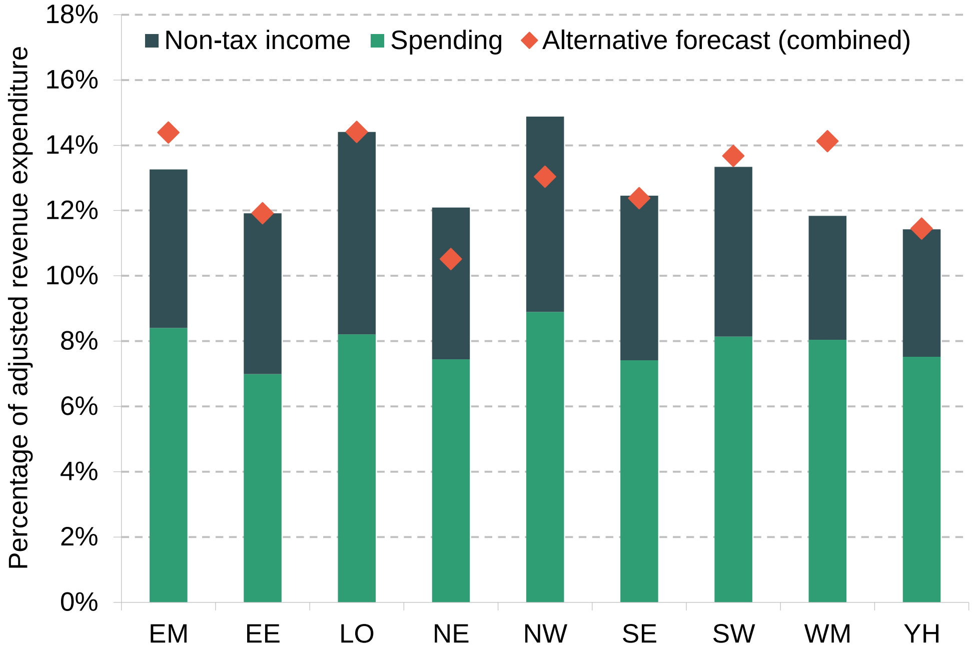
Source: Authors' calculations using MHCLG (2020a and 2020b).

On the income side, these patterns are in line with the risks identified in Ogden and Phillips (2020a), which highlighted reliance on SFCs income – specifically from culture and leisure, parking, planning and trade waste – as a risk factor for councils' short-term financial exposure to the COVID-19 crisis. The patterns therefore provide a degree of reassurance about the overall reliability of the returns councils have submitted to MHCLG.

Region

Figure 2.5 shows forecast pressures by region, with the bars showing councils' own forecasts and the red diamonds showing the alternative forecasts as a robustness check.

Figure 2.5. Forecast pressures by region (% of adjusted revenue expenditure)



Note: EM = East Midlands; EE = East of England; LO = London; NE = North East; NW = North West; SE = South East; SW = South West; WM = West Midlands; YH = Yorkshire and the Humber.

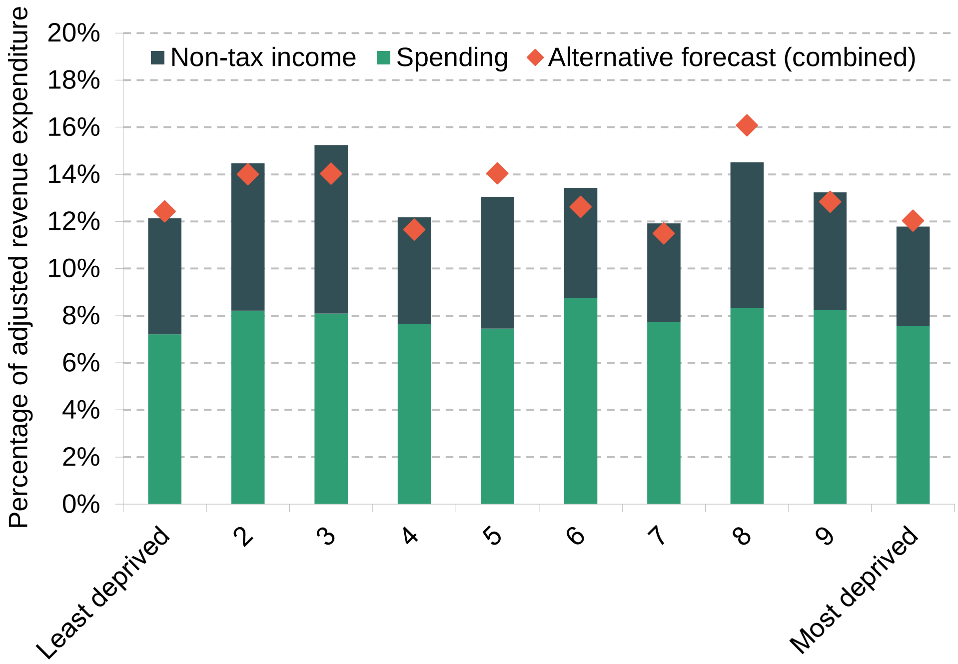
Source: Authors' calculations using MHCLG (2020a and 2020b).

Based on councils' own forecasts, average spending pressures are expected to be highest as a percentage of adjusted revenue expenditure in the North West (8.9%) and East Midlands (8.4%) of England, and lowest in the East of England (7.0%). Non-tax income pressures are expected to be highest in London (6.2%) and the North West (6.0%) and lowest in the West Midlands (3.8%) and Yorkshire and the Humber (3.9%). This means overall pressures are forecast to be highest on average in the North West (14.9%) and London (14.4%) and lowest in Yorkshire and the Humber (11.4%).

However, the alternative forecasts based on projecting forward impacts in Q1 2020–21 show a somewhat different pattern. For example, the average overall pressure in the North West (13.0%) places this region mid-table on this basis. This suggests that the higher-than-average pressures implied by councils' own forecasts in the North West are driven by their assumption that pressures in Q2–Q4 will persist at a higher level than councils in other regions have assumed. On the other hand, councils in the West Midlands face the third-highest pressure, on average, of all regions (14.1%) using the alternative forecasts. This suggests that the lower-than-average pressures implied by councils' own full-year forecasts in the West Midlands are driven by pressures abating more in Q2–Q4 than councils in other regions have assumed.

As discussed earlier, differences in the extent to which pressures will abate in the remainder of the year could be genuine, reflecting, for example, the timing and type of agreements reached with suppliers, tenants, etc. and the policies put in place by different councils. But they could also reflect differences in the assumptions councils have made about when things return to normal. Bearing this in mind, we do not consider the evidence on regional differences in impacts to be robust enough to draw firm conclusions from. However, it is clear that councils in all regions face significant spending and non-tax income pressures, of between 10% and 15%, on average.

Figure 2.6. Forecast pressures by deprivation (% of adjusted revenue expenditure)



Note: Figures for lower-tier districts and upper-tier counties are combined to the upper-tier county level in shire areas. Deprivation is measured by the average score of upper-/single-tier councils according to the English Index of Multiple Deprivation 2019.

Source: Authors' calculations using MHCLG (2020a and 2020b).

Deprivation

Figure 2.6 shows impacts by deprivation level, with the bars showing councils' own forecasts and the red diamonds showing the alternative forecasts as a robustness check. It shows variation across different deprivation decile groups, but no clear distributional pattern. This is the case both if we look at councils' own forecasts and if we look at our alternative forecasts.

Multivariate analysis

To further explore the distributional patterns, we have also conducted multivariate regression analysis.[9] This examines the effects of a variable (for example, deprivation), controlling for a range of other variables (such as population density, region and COVID-19 death rates). This analysis shows that:

- Controlling for other variables, spending pressures are higher in pounds-per-capita terms in more deprived areas. However, measured as a percentage of adjusted revenue expenditure, councils' own forecasts for spending pressures are not any higher in more deprived areas. To some extent though, this appears to be driven by councils in more deprived areas assuming pressures will abate more in Q2–Q4 of the year: alternative forecasts for full-year spending pressures based on projecting Q1 pressures forward are statistically significantly higher in both per-capita and percentage terms in more deprived areas.
- Perhaps surprisingly, forecasts of spending pressures are not correlated with the share of the population aged 70 or over or with COVID-19 death rates as of mid June. The latter suggests that it is the preparation for and/or mitigating the potential impacts of COVID-19 rather than dealing with actual impacts that is the main driver of councils' higher spending. The former suggests that councils have been incurring additional expenses in services for people across the age spectrum (including, for example, younger adults with learning disabilities), as opposed to expenses being disproportionately concentrated on the over-70s. Forecasts of spending pressures facing adult social care services are also not correlated with the population aged over 70 or COVID-19 death rates.
- Controlling for other variables, non-tax income pressures are larger as a percentage of adjusted revenue expenditure in areas with *higher* population

[9] Regression results can be provided on request.

density, and this is robust to using councils' own forecasts of the full-year pressures or our alternative forecasts based on projecting Q1 2020–21 impacts forward. There is some evidence that non-tax income pressures are larger in areas with *lower* deprivation once one controls for population density, but this relationship is only just statistically significant. As with spending, overall non-tax income pressures are not correlated with either the share of the population aged 70+ or COVID-19 death rates as of mid June.

- Taking spending and non-tax income pressures together, there are no statistically significant relationships between overall pressures, measured as a percentage of pre-crisis revenue expenditure, and any of the variables we consider: population density, deprivation, the share of the population aged 70 or over, or COVID-19 death rates as of mid June. This suggests that while different councils are forecasting different pressures overall, these forecasts do not vary systematically between different types of places.

2.3 Summary

This chapter has examined the spending and non-tax income pressures councils are facing as a result of the COVID-19 crisis. It has shown that forecast pressures are large: around £4.4 billion or 7.9% of adjusted revenue expenditure on the spending side and £2.8 billion or 5.1% of adjusted revenue expenditure on the income side. Forecasts vary significantly across councils, reflecting not only differences in the impacts of the COVID-19 crisis on different parts of the country, but also: differences in the exposure of different councils to the crisis as a result of variation in their reliance on the income sources hit hardest; differences in their decisions about how to respond to the crisis; and differences in their assumptions about how and to what extent pressures will abate after the first quarter of 2020–21.

It is not possible to perfectly control for these factors. And some results (such as differences in impacts between regions) are not robust to alternative ways of forecasting full-year impacts. However, it is clear that shire districts, with their particular reliance on SFCs and commercial income, are facing proportionally larger income and hence overall pressures than other types of councils. It is also clear that per-capita spending pressures are a bigger issue for more deprived areas, whereas income pressures as a proportion of revenue expenditure are a bigger issue for areas with higher population densities (and, once one controls for population density, *less* deprived areas). Differences in the extent and speed with which spending and income pressures abate could therefore have quite different implications for different types of councils and for deprived versus affluent and rural versus urban areas.

The impact of these pressures on different councils – and on the sector as a whole – also depends on the support provided by the government and the reserves available to councils themselves. These are the issues we turn to in the next chapter.

3. To what extent has the government protected councils?

In this chapter, we examine the extent to which the funding and burden-sharing mechanisms put in place by central government will compensate councils for the increases in spending and lost income discussed in the previous chapter. We also look at whether councils' financial reserves would be sufficient for them to bear any remaining impacts themselves.

3.1 The scale and nature of support provided

The government has announced a range of additional grants to help councils address the spending and income pressures arising from the COVID-19 crisis, including:

- approximately £3.6 billion of extra **general-purpose grant funding** (A);
- £600 million of funding ring-fenced for **infection control** in adult social care services, much of which must be used to support measures in care homes (B);
- £500 million from a **council tax hardship fund** to provide top-ups to council tax support (i.e. reductions in council tax bills to low-income households) and other support for households facing hardship (C);
- £300 million in **Test and Trace service support grant** to cover the public health responsibilities of councils in managing local outbreaks (D);
- up to £222 million from an **active travel fund** to support improvements to cycling and walking facilities, much of which will not be available until next financial year (E);
- a £63 million **emergency assistance grant** to provide support to households struggling to afford food and other essentials (F);
- around £50 million to help with **reopening high streets safely** (G);

- £3.2 million to cover the costs of providing **emergency accommodation** to rough sleepers (H);
- £105 million for **interim support** for rough sleepers and those at risk of homelessness, to fund interim accommodation or help them to secure tenancies (although £20 million of this comes from the refocusing of existing budgets) (I).

All told, this amounts to £5.5 billion of additional grant funding for local government. However, in working out whether councils have sufficient resources to meet the spending and non-tax income pressures discussed in the previous chapter, we need to include only the additional funding that is available to meet them. If part of this funding is to be used instead to pay for other activities – such as new responsibilities councils have not taken account of when filling in their returns to MHCLG – we do not want to offset it against the spending and non-tax income pressures they have identified.

Unfortunately, we do not know for sure which pressures and which funding streams councils have accounted for when filling in their returns. We therefore test the robustness of findings in this chapter to two different measures of additional grant funding.

Our baseline measure includes:

- £3.6 billion of extra **general-purpose grant funding**, across three tranches (A);
- £150 million of the total £600 million funding for **infection control** in adult social care services, reflecting the fact that councils have had to pay over at least 75% of the funding to care homes, including those that only provide care to private customers (B);
- £53.2 million of the total £300 million **Test and Trace service support grant**, where councils appear to have included their new responsibilities in their returns (D);
- £20 million from the **active travel fund** which has been provided directly to councils to support temporary changes to cycling and walking facilities due to COVID-19 (E);
- £50 million to help with **reopening high streets safely** (G);
- £3.2 million to cover the costs of providing **emergency accommodation** to rough sleepers (H).

Our more generous measure also includes:

- the remaining £450 million of funding for **infection control** in adult social care services, in case councils have included payments to external care providers in their estimates of the spending pressures they have faced (B).

In both scenarios, we *exclude* £500 million of council tax hardship funding (C) as this will reduce council tax revenues, which will hit councils' main budgets next year (and which we will analyse in our next report). We also exclude around £200 million of active travel funding (E) that has been allocated to other types of authority or is designed to fund projects with somewhat longer horizons, as well as £63 million for emergency assistance (F) and the latest £105 million of rough sleeping funding (I).[10]

Our baseline measure therefore includes approximately £3.9 billion of grant funding, and our more generous measure £4.4 billion.

The SFCs 'safety net' and other support

In addition to extra grant funding, we model three other ways in which central government is helping councils address spending and non-tax income pressures.

First, councils are able to **furlough staff** whose salaries are usually funded by income from SFCs or commercial sources, with the government paying affected individuals up to 80% of their usual earnings under the Coronavirus Job Retention Scheme. 81 councils report that they are using this scheme, offsetting around £27 million of losses in SFCs income. This amounts to 5% of these councils' SFC losses, on average, but little more than 1% of overall SFC losses.

Second, NHS **clinical commissioning groups** (CCGs) are part-funding adult social care spending pressures. 103 out of 151 councils with responsibility for adult social care have reached agreements with the CCGs in their areas so far. Among these, CCGs will pay for an average of 23% of adult social care pressures, which sums to £293 million in total.

[10] Decisions around which sources of grant funding to include or exclude, and how we have estimated which councils have included spending pressures relating to the Test and Trace system, are described fully in Table A.1 in the appendix.

Third, a **'safety net' for SFCs income** will provide compensatory payments of 75p for every £1 by which SFCs income falls below 95% of what councils planned to raise prior to the COVID-19 crisis. Full guidance has yet to be published, although the government has outlined a set of principles for what SFCs income will be in the scope of this scheme.[11] These state that rental and investment income, and income losses that are the result of voluntary action (for example, closure of services) out of line with central government advice will be considered out of scope.

Pre-COVID forecasts for overall SFCs income in 2020–21, let alone in-scope SFCs income, are not currently available. We model this important scheme as best we can using the latest out-turns data for total SFCs income as well as overall SFCs pressures, as discussed in the appendix. Both sets of figures may include some income recorded as SFCs that is actually out of scope (for example, rent on properties held not for investment purposes, but as part of ongoing regeneration schemes), but also *exclude* some income that has been recorded as commercial income but may be in scope (such as parking, trade waste, or other services that have been organised as trading companies). Our estimates of the compensation councils could receive should therefore be seen as indicative and subject to potentially significant margins of error.

Bearing this in mind, our baseline estimate is that this compensation could be worth £985 million across the sector as a whole. How much this scheme is ultimately worth will depend not only on what SFCs (and trading companies') income is deemed in scope, but also how the public health and economic impacts of COVID-19 evolve locally and nationally during the remainder of this year.[12]

Combined with savings as a result of the furlough scheme and cost-sharing with CCGs, our baseline measure of **non-grant support** equals £1.3 billion. We also test the sensitivity of our results to a more generous scenario, whereby those councils that have yet to reach a cost-sharing agreement with their CCG reach an agreement where their CCGs shoulder the average share of the burden agreed in existing deals. On this basis, the total non-grant support would amount to approximately £1.4 billion. In the event that councils sustain larger losses of SFCs income (as in

[11] MHCLG, 2020d.

[12] It is also possible that councils may be able to recover some lost non-tax income, although this would interact with the SFC safety-net scheme so that some compensation would be lost if councils recovered lost SFCs income in-year. See the appendix for more discussion.

Table 3.1. Summary of assumptions underlying funding and pressure scenarios

Funding scenario	Funding included	Pressures scenario	Calculation of pressures
Baseline	£3.9 billion of grant funding, including 25% of the funding for infection control in adult social care £27 million from furloughing staff £293 million in transfers from CCGs for councils that have already reached agreement Between £981 million and £1,631 million through the SFC safety-net scheme, depending on the pressures scenario (the scale of income losses)	**Baseline**	Councils' own annual forecasts for spending and non-tax income pressures
		Alternative	Projection of each council's April–June pressures forward in line with overall trends for councils of their type[a]
		Pessimistic	Projection of each council's April – June pressures forward so that pressures in Q2–Q4 of the financial year are two-thirds of Q1 level[a]
Generous	As above, except: An additional £450 million for infection control A further £120 million in transfers from CCGs, from assuming that councils yet to reach agreement with their CCGs reach an agreement to share costs in line with the average in existing agreements	**Baseline**	As above
		Alternative	As above
		Pessimistic	As above

[a] Except for public health, which is based on each council's own reported figures.

our pessimistic scenario for pressures), they may receive more compensation through the SFC safety-net scheme, taking the total value of non-grant support to £2.1 billion.

Taken together with the additional grant funding, the total financial support for councils to address COVID-related spending and non-tax income pressures this year amounts to between £5.2 billion (in our baseline scenario for pressures and funding) and £6.4 billion (in our more generous scenario for funding and more pessimistic scenario for pressures), as illustrated in Table 3.1.

3.2 How big a funding shortfall could there be?

Under all scenarios, the funding that councils are set to receive is less than the spending and non-tax income pressures they forecast they will face this year. This is illustrated in Table 3.2, which shows the pressures and funding for all councils under these two funding scenarios and three scenarios for pressures:

- councils' own forecasts for spending and non-tax income pressures ('baseline');
- alternative forecasts based on projecting each council's April–June pressures forward for the rest of the year in line with overall trends for councils of their type ('alternative');
- a more pessimistic forecast, where rather than average spending and non-tax income pressures in Q2–Q4 of the financial year being less than half what they are estimated to have been in Q1, they are two-thirds as large ('pessimistic').

It should be noted that these scenarios are intended to illustrate the sensitivity of estimates to different assumptions, and they do not represent upper and lower bounds on the potential impact of the COVID-19 crisis, which remains uncertain.

Bearing this in mind, Table 3.2 shows that under our baseline scenarios for both funding and pressures, spending and non-tax income pressures in 2020–21 are forecast to exceed available funding by just over £2 billion, which equates to around 3.6% of adjusted revenue expenditure. Our alternative pressures scenario (i.e. projecting forwards pressures from Q1 rather than using councils' own full-year forecasts) makes very little difference to this estimate for the sector as a whole – with the slightly narrower range of SFCs losses under this scenario very slightly reducing the amount of support provided by the SFCs safety-net scheme.

Table 3.2. Forecast funding shortfalls under different scenarios for spending and income pressures and funding levels: all councils (£ million)

Funding scenario	Pressures scenario	Spending pressures	Income pressures	Total pressures	Grant funding	Other support	Total support	Shortfall (£m)	Shortfall (% of adjusted revenue expenditure)
Baseline	Baseline	4,400	2,820	7,220	3,910	1,310	5,220	2,000	3.6%
	Alternative	4,400	2,820	7,220	3,910	1,290	5,200	2,020	3.6%
	Pessimistic	5,460	3,850	9,310	3,910	1,940	5,850	3,460	6.2%
Generous	Baseline	4,400	2,820	7,220	4,360	1,420	5,790	1,440	2.6%
	Alternative	4,400	2,820	7,220	4,360	1,410	5,770	1,450	2.6%
	Pessimistic	5,460	3,850	9,310	4,360	2,060	6,420	2,890	5.2%

Note: Shortfall = Total pressures – Total support. This sum includes councils that are expected to receive more in support than the pressure they face, and so would individually have a negative shortfall. See Figure A.2 in the appendix for an illustration of the composition of these estimates. Figures may not sum to totals due to rounding.

Source: Authors' calculations based on MHCLG (2020a and 2020b).

Our pessimistic scenario (i.e. where pressures abate less in Q2–Q4 of the financial year) is very different though. Assuming that from July 2020 to March 2021 councils experience two-thirds of the monthly pressures they reported experiencing between April and June increases our estimates of the spending and income pressures faced by 24% and 36% respectively. This takes the total pressure arising in 2020–21 from £7.2 billion to £9.3 billion, showing the sensitivity of all these results to the assumptions councils have made about how quickly things return to normal.

As our pessimistic scenario involves councils losing more income from SFCs, it also sees the government providing much more in compensation for these losses, which explains the increase in other support between the baseline/alternative and the pessimistic scenarios. This additional funding only partially compensates for the additional losses, leaving councils' overall shortfall increased by about £1.4 billion compared with the baseline and alternative scenarios.

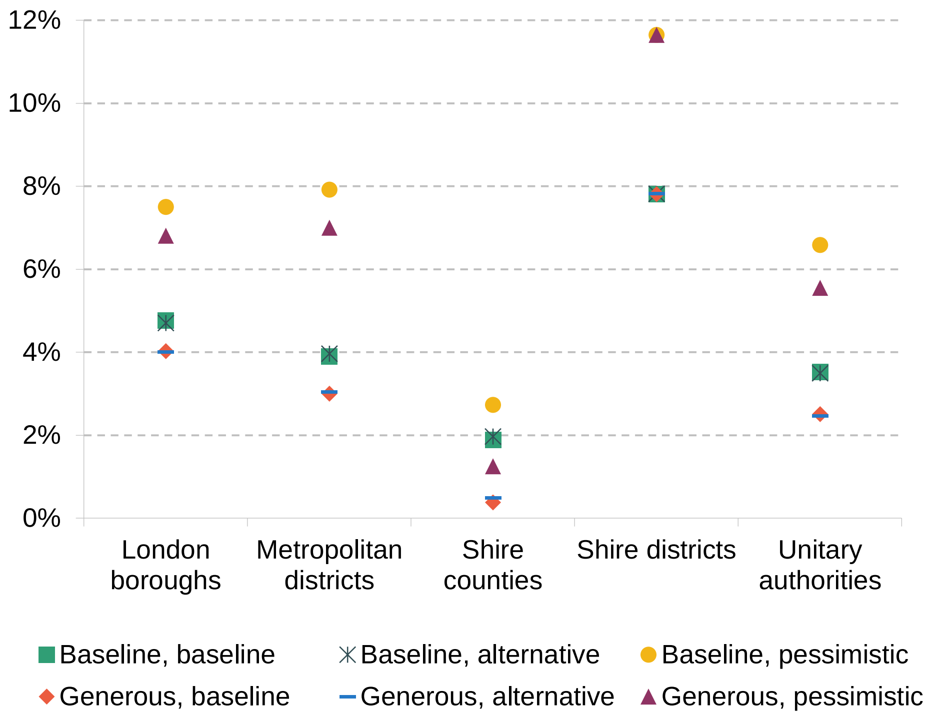
Finally, comparison of the baseline and generous funding scenarios shows that if councils can use the Infection Control Fund in full to address the social care pressures they are reporting, and those councils without agreements with their CCGs reach comparable agreements, the shortfall would be reduced by just under £600 million.

Figure 3.1 shows that, on average, councils of all types are forecasting unmet spending and non-tax income pressures. However, there are differences in the scale of the funding shortfall. For example, under both baseline forecasts for pressures and funding available, shire counties face a shortfall of around 2% of adjusted revenue expenditure, on average. This compares with just under 8%, on average, for shire district councils. Single-tier councils (London boroughs, metropolitan districts and unitary authorities) lie in between, with average shortfalls of between 3.5% and 4.8%.

These differences reflect the differences in average forecast pressures shown in Figure 2.4 in the previous chapter. This showed that shire districts forecast spending and non-tax income pressures equivalent to 23% of adjusted revenue expenditure. Additional grant funding and other support (such as the SFCs safety net) are projected to offset around 15 percentage points of this under our baseline scenario (hence the 8% remaining shortfall). In contrast, shire counties forecast spending and non-tax income pressures of just under 10% of adjusted revenue expenditure, on average. Additional grant funding and other support offset around 8 percentage points of this. In other words, shire district councils are set to receive proportionately more support than shire counties, but differences in their forecast pressures outweigh this.

Underlying these averages is significant variation across councils, with some forecasting pressures that are lower than the additional grant funding and other support we estimate they will receive. However, the vast majority of councils would face a shortfall under each of the scenarios we examine: between 80% (in the generous funding and alternative pressures scenario) and 95% (in the baseline funding and pessimistic pressures scenario).

Figure 3.1. Forecast funding shortfalls under different funding and pressures scenarios for different council types (% of adjusted revenue expenditure)



Note: Forecast funding shortfall is total pressures less total support, as a percentage of adjusted revenue expenditure. Figures are means for each council type, weighted within types by pre-crisis revenue expenditure.

Source: Authors' calculations based on MHCLG (2020a and 2020b).

3.3 Do councils have enough reserves available to address this shortfall?

There are several ways councils could address this shortfall. One option would be to cut spending on more discretionary services, although spending per resident on many of these has already been cut by over 40% since 2009–10.[13]

Another way councils may manage the shortfall is to draw on their existing reserves. In total, councils went into the crisis with reserves of £17.5 billion, and meeting unexpected financial pressures is one of the reasons that councils hold reserves. However, there are several reasons why a council would not want to deploy all of these reserves to meet pressures this year. First, some will have been put aside to meet definite spending commitments such as Private Finance Initiative (PFI) costs, and are therefore not usable. Second, some will represent saving by councils in advance of major investments or expected rises in demand for and costs of council services in future. These are not committed per se (investments could be postponed or cancelled, for example), but there could be costs involved in changing plans (such as loss of benefits from postponed or cancelled investments). Third, holding reserves is one of the few ways for councils to prepare to meet unexpected shocks in future years. A prudent council would seek to keep reserves as insurance against further shocks down the line; and councils will likely want to hold back reserves to address the longer-term impacts of the *current* shock (i.e. the COVID-19 crisis) on spending and revenues next year and beyond. When councils are left with no reserves and a budget shortfall, they have no option other than to cease all but the most essential spending by issuing a so-called Section 114 notice.

It is not clear from councils' published accounts what portion of their reserves may be considered 'usable', or how much a council could run down those usable reserves while still being confident that it would be able to manage any future pressures. However, the returns councils have submitted to MHCLG ask them to estimate what fraction of their reserves they already plan to use over the next few years and hence that they think cannot be 'deployed' to address the COVID-19

13 Harris, Hodge and Phillips, 2019.

crisis.[14] We can therefore examine how many councils would face a funding shortfall that is larger than the reserves they estimate to be 'deployable' under our different scenarios. As a robustness check, we also consider an alternative measure of usable reserves, which assumes that each council can use the same proportion of its reserves as the average percentage reported by councils of the same type.

It is important to note that when filling in their returns, councils may have been incentivised to understate their 'deployable' reserves, in the hope of increasing the likelihood of MHCLG (and ultimately HM Treasury) providing additional support to councils. To address this concern, we also consider councils' overall reserves, estimating how many would be left with low reserves relative to the pre-crisis average for councils of their type.

Analysis based on 'deployable' reserves

Taking their responses to the returns at face value, 19% of councils say that they have no deployable reserves, while another 19% report that they can use at least half of their reserves.[15] This implies that even councils facing very similar shortfalls and with very similar levels of overall reserves could have remarkably different abilities to cope with funding shortfalls.

In aggregate across the sector, councils report that they have £3.3 billion in deployable reserves. This would be sufficient to meet the aggregate funding shortfall in five of our six scenarios: all except the scenario based on our baseline assumption for funding and pessimistic scenario for spending and non-tax income pressures. However, neither pressures nor deployable reserves are evenly distributed across the country, and underlying this aggregate figure could be a significant number of councils that do not have sufficient deployable reserves even in one of the more benign scenarios.

[14] Councils were asked what percentage of their unringfenced reserves ('other earmarked' and unallocated reserves) was 'programmed for expenditure within the next three to four years within your Medium Term Financial Strategy and therefore seen internally as unavailable for unforeseen circumstances'.

[15] Councils were asked separately about their unallocated and their 'other earmarked' reserves, and on average they considered a higher proportion of the former to be usable. 37% reported they could use at least half of their unallocated reserves, while 16% reported that they could use at least half of their earmarked reserves. 30% of councils said that they could not deploy any of their unallocated reserves, while 41% said they could not deploy any of their earmarked reserves.

Table 3.3. Share of councils for which funding shortfalls exceed 'deployable' reserves, and the extent of this excess, based on different estimates of the share of reserves that are deployable

Funding scenario	Pressures scenario	(1) Own estimates (%)	(1) Gross remaining shortfall (£m)	(2) Type-average estimate (%)	(2) Gross remaining shortfall (£m)
Baseline	**Baseline**	43.7	925	17.4	625
	Alternative	41.3	995	20.1	694
	Pessimistic	51.9	2,005	32.7	1,532
Generous	**Baseline**	39.8	694	14.7	503
	Alternative	38.9	771	18.0	533
	Pessimistic	49.3	1,677	30.4	1,285

Note: Percentages are estimates of the share of councils for which (1) their funding shortfall exceeds their own estimate of deployable reserves and (2) their funding shortfall exceeds an alternative estimate based on the average share among councils of their type that is deployable. 'Gross remaining shortfall' is the total shortfall left amongst those councils after they have used all of their deployable reserves.

Source: Authors' calculations using MHCLG (2020a and 2020b).

Table 3.3 shows estimates of the percentage of councils whose funding shortfall exceeds (1) their own estimate of deployable reserves and (2) an alternative estimate based on the average share among councils of their type that is deployable. It shows that according to their own estimates, over four in ten councils have insufficient deployable reserves given both our baseline and alternative forecasts for pressures, and our baseline estimate of grant and other funding available. Despite £3.3 billion of reserves being available across the sector as a whole, around £1 billion of the £2 billion shortfall in funding would remain unaddressed. If instead we use council-type averages for deployable reserves, only around two in ten councils would have insufficient reserves under these scenarios, with £0.6–0.7 billion of the funding shortfall remaining unaddressed.

The table also shows that our more generous scenario for funding only modestly reduces the gross remaining shortfall after drawdown of deployable reserves. Using councils' own estimates of deployable reserves, it reduces the shortfall by between just over £220 million (in our alternative scenario for pressures) and just under £330 million (in our pessimistic scenario for pressures). This is far less than the almost £600 million of additional funding for social care counted in this scenario, and reflects the fact that only a relatively small part of this would go to those councils with insufficient deployable reserves.

This illustrates what is a more general challenge facing central and local government as they tackle the financial impacts of the COVID-19 crisis: widely varying risks and degrees of financial resilience across councils make it costly to provide enough support for the hardest-hit councils via simple formula-based grant funding. Put simply, under this system of funding allocation, other councils need to be provided with more than they strictly require, to ensure those with the biggest pressures and/or lowest reserves receive enough.

Consider the case where the government wanted to address the unaddressed shortfall of £925 million under our baseline assumptions for funding and pressures and councils' own estimates of deployable reserves. Using the formula used to allocate the latest £500 million of general grant funding to councils, it would cost £4.0 billion to ensure that 90% of councils have their unaddressed shortfall met, over four times the initial unaddressed shortfall.[16]

On the other hand, using councils' own estimates of pressures and deployable reserves and trying to channel funding only to those councils that report needing more would risk unfairness to those councils that have built up larger reserves and identified a larger share as deployable. It would also further incentivise councils to overstate pressures and understate their deployable reserves, as the funding they receive would depend directly on their returns to MHCLG, rather than indirectly. As we discuss in Chapter 4, such a scheme would require a system of safeguards

[16] It is also worth noting that the amount that would be required to offset the unaddressed shortfall in funding is highly sensitive to assumptions about deployable reserves. For example, if rather than use each council's assessment of the share of its reserves that are deployable, we use estimates based on the average percentage reported to be usable by councils of the same type, it would cost the government £1.7 billion to meet the remaining shortfall for at least 90% of councils.

and checks to ensure the veracity of returns, as is planned for the SFCs safety-net scheme.

Table 3.4 shows that despite facing higher average funding shortfalls, a lower proportion of shire district councils have insufficient deployable reserves than for other types of councils. This reflects the fact that shire district councils have higher reserves, on average, than other types of councils (see Box 3.1 later) and state that a higher proportion of their reserves are deployable: 31%, compared with 22% for shire counties, for example. This demonstrates the importance of financial resilience as well as risk for determining which councils will face the biggest financial challenges as a result of the COVID-19 crisis.

Table 3.4. Share of councils for which funding shortfalls exceed 'deployable' reserves under the baseline funding and pressures scenarios, by council type

	(1) Own estimates (%)	(1) Gross remaining shortfall (£m)	(2) Type-average estimate (%)	(2) Gross remaining shortfall (£m)
London boroughs	54.5	210	42.4	118
Metropolitan districts	72.2	295	36.1	229
Shire counties	48.0	100	12.0	28
Shire districts	31.9	79	6.9	19
Unitary authorities	56.1	241	28.1	232
All councils	**43.7**	**925**	**17.4**	**625**

Note: See note to Table 3.3. Figures for gross remaining shortfalls may not sum due to rounding.

Source: Authors' calculations using MHCLG (2020a and 2020b).

Analysis based on total reserves

Given uncertainty about how much reserves are actually deployable, we may also wish to consider the impact of funding any shortfall on the total reserves that councils would have at the end of 2020–21, and in particular on the number that would see their reserves fall to 'low' levels.

The level of total reserves varies significantly between councils, even when expressed as a percentage of adjusted revenue expenditure (which should account for differences in council size). As highlighted in Box 3.1, there are systematic differences in reserves balances relative to revenue expenditure across different types of councils. We therefore vary the threshold below which a council can be said to have 'low' reserves by council type.

At the end of 2020–21, in the absence of the COVID-19 crisis, we would have expected 17.1% of councils to have had total reserves of less than half of the average for their type of council and that 6.5% would have had reserves of less than one-third of the average for their council type.[17] These thresholds are somewhat arbitrary but, in the absence of recommended thresholds, we use these as proxies for having relatively 'low' and 'very low' reserves.

Table 3.5 shows the share of councils whose reserves would fall below these thresholds at the end of the 2020–21 financial year in each scenario, given the difference between the pressures they would face and the financial support provided by government.[18] It shows that addressing the shortfall in funding implied by our scenarios (of between £1.4 billion and £3.5 billion) by drawing down reserves would see a significant increase in the share of councils with reserves below these thresholds. This would potentially increase the financial risks that they face and in some cases might necessitate cuts to services down the line as councils seek to rebuild their reserves.

[17] Estimated level of total reserves at end of the 2020–21 financial year, as a proportion of adjusted revenue expenditure. This is taking into account reserves movements planned for the year before the COVID-19 crisis, and excluding the impact of Section 31 grants relating to business rate reliefs. See the appendix for further detail.

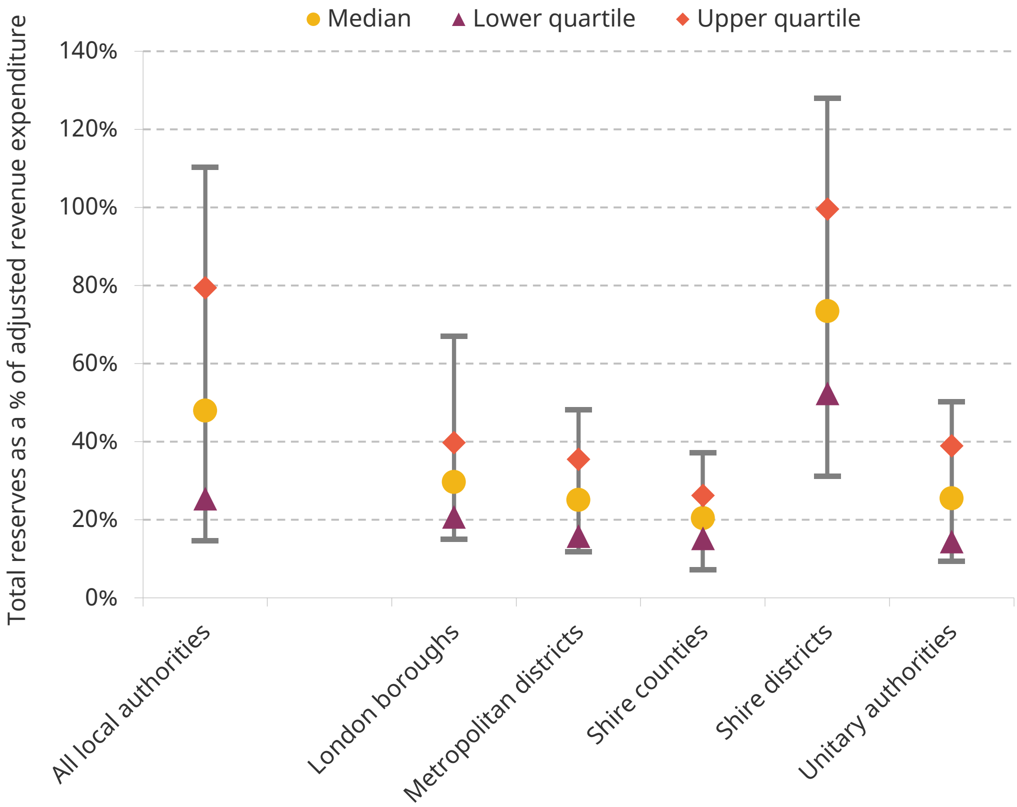
[18] Note that this analysis excludes the impacts of the accounting treatment of reductions in business rates revenues as a result of the reliefs granted to the retail, hospitality and leisure sectors and the associated Section 31 grants paid to councils to offset these reductions. See the appendix for further detail.

Box 3.1. Variation in councils' reserves, March 2020

Together, councils had reserves of £17.5 billion at the end of March, which is equivalent to 31.5% of adjusted revenue expenditure. There is wide variation in the level of reserves though, as illustrated in Figure 3.2. It shows that:

- One in ten councils had total reserves equivalent to less than 15% of their adjusted revenue expenditure, while another one in ten had reserves of more than 110%.
- There are notable differences across councils of different types. The median shire district has total reserves of 73% of adjusted revenue expenditure; but the median is less than 30% for all other types and just 20% for shire counties.

Figure 3.2. Distribution of total reserves pre-COVID, for different council types (% of revenue expenditure)



Note: The graph plots points in the distribution of councils' estimates of their total 'other earmarked' and unallocated reserves balance as of 31 March 2020, where each distribution is within councils of the same type. The dark grey bars show the range of the distribution, excluding the 10% largest and 10% smallest within each type.

Source: Authors' calculations using MHCLG (2020b).

Table 3.5. Share of councils with less than 50% or less than 33% of the average reserves for a council of their type at the end of 2020–21

Funding scenario	Pressures scenario	Reserves after funding shortfall	
		<50% average	<33% average
Baseline	Baseline	25.7%	14.5%
	Alternative	26.0%	12.7%
	Pessimistic	32.2%	17.4%
Generous	Baseline	22.1%	13.0%
	Alternative	23.9%	11.2%
	Pessimistic	30.1%	16.5%

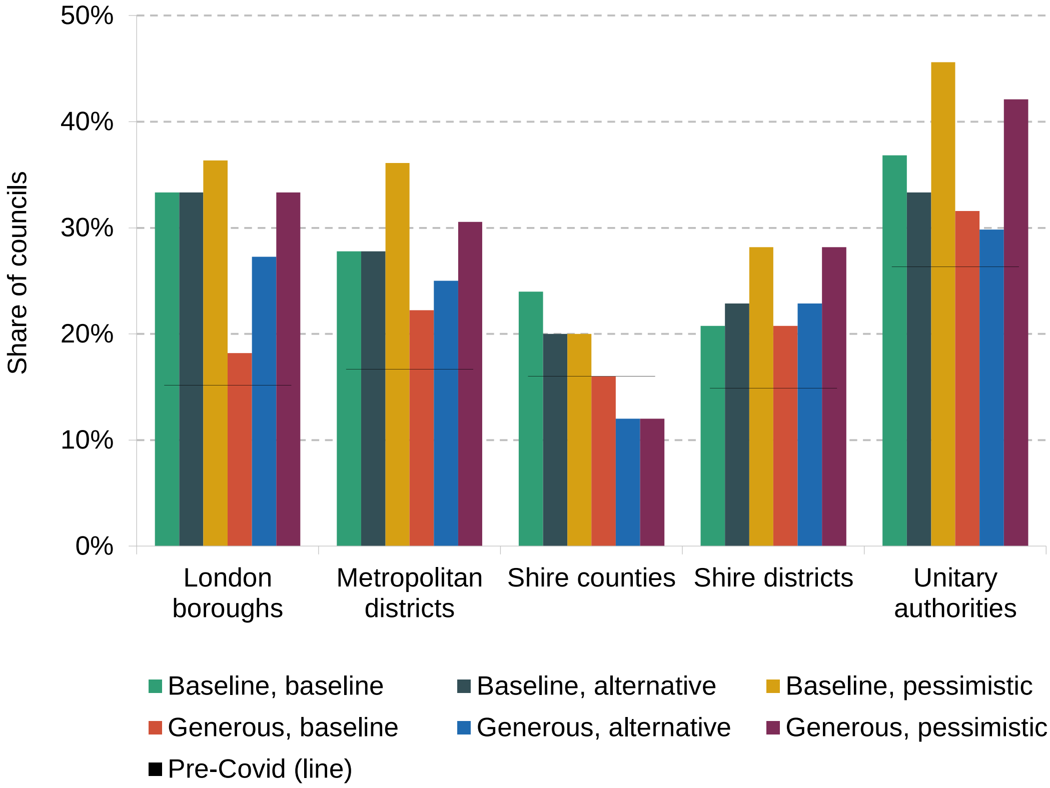
Note: Average reserves are as a percentage of adjusted revenue expenditure. The average reserves for each council type are as follows: London boroughs, 34%; metropolitan districts, 29%; shire counties, 23%; shire districts, 79%; unitary authorities, 29%.

Source: Authors' calculations using MHCLG (2020a and 2020b).

The magnitude of the changes in the share of councils with 'low' and 'very low' reserves is unsurprisingly sensitive to both the spending and non-tax income pressures and the funding made available. Under our baseline assumptions for both pressures and funding, for example, the share of councils with reserves below 50% of the pre-crisis average for their type of council would increase from around one-in-six to around one-in-four, while the share with reserves below 33% would increase from around one-in-sixteen to around one-in-seven. Under the pessimistic scenario though, the increases would be to almost one-in-three and around one-in-six, respectively. But the qualitative picture is the same across the scenarios considered: an increase in the share of councils with low and very low reserves levels, although these would remain a minority of all councils.

Figure 3.3 shows that the share of councils with reserves below 50% of the pre-crisis average for their type of council would increase for single-tier and shire district councils under all the scenarios we consider. Under our more generous scenario for funding, the proportion of shire counties with reserves of less than 50% of the average for counties would remain steady or perhaps even fall though. This is related to the fact that counties as a group are forecast to have a very low funding shortfall overall if we assume the full value of the Infection Control Fund is available to address social care spending pressures and remaining councils reach agreement with the CCGs in their area. However, under our baseline scenario for funding, one or two additional counties would see their reserves pushed below half the average for their type of council, depending on which scenario for spending and non-tax income pressures we look at.

Figure 3.3. Share of councils with less than 50% of the average reserves for a council of their type at the end of 2020–21, by council type and funding and pressures scenario



Note: The horizontal black line shows the share of councils of each type expected to have less than 50% of the average reserves for that type of council at the end of 2020–21, in the absence of the COVID-19 crisis. Bars describe the same share under different scenarios for funding and pressures. Average reserves are as a % of adjusted revenue expenditure.

Source: Authors' calculations using MHCLG (2020a and 2020b).

4. Conclusion and discussion

This report has examined councils' estimates of the impact of the COVID-19 crisis on spending and non-tax incomes in 2020–21 – and whether the government has provided enough funding to address these issues.

The short but not particularly helpful answer is that we do not know for sure. The future path for both the public health and economic crisis caused by COVID-19 is highly uncertain: will cases rebound as in the US and parts of Spain, necessitating an economically costly reimposition of more stringent social distancing measures? Or will the recent uptick be a blip and a vaccine reduce costs in the social care sector before the year is out? We simply do not know.

Moreover, in undertaking this research, it is clear that different councils have made different assumptions about the pace at which pressures abate and have taken account of different additional responsibilities (such as with the Test and Trace scheme). Some responses look like simple mistakes or misinterpretations of questions.

These uncertainties and comparability and data quality issues mean that our findings are necessarily tentative. But through a range of scenarios, it does appear likely that a not-insignificant subset of councils could need additional financial support to cope with spending and non-tax income pressures this year, or otherwise face the difficult decision over whether to significantly draw down reserves or make in-year cutbacks to services. Cash-flow issues related to business rates and council tax this year, and the impact of shortfalls in these revenues on councils' main budgets next year and beyond, discussed in Geraghty (2020), are likely to require further consideration too.

Just how much and precisely which councils will need support is much less clear, which makes up-front targeting of additional funding difficult. Significant variations in forecast pressures – while potentially partly the result of differences in assumptions councils have made when filling in the returns – especially on the income side, make this even harder to do.

If the government decides it does want to provide additional support to local government, the different options available to it come with different pros and cons.

Providing additional general-purpose grant funding would be simplest. But ensuring enough additional funding reaches those councils with the biggest issues using the sorts of formula-based approaches used so far would mean other councils getting more additional funding than they strictly need. Such an approach could therefore be expensive, costing multiples of what potentially could be achieved via a more targeted approach.

Increasing the role of reimbursement for specific costs and income losses would be cheaper, if it can be made to work effectively. This is the approach the government has decided to take for losses in SFCs income – albeit with councils bearing the first tranche of losses and sharing a portion of the remaining cost, so that they retain an incentive to generate such income. It is also the approach taken in Wales, where councils submit monthly returns to the Welsh Government where they identify the costs they have incurred as a result of the COVID-19 crisis, which the Welsh Government scrutinises and reimburses them for.

The key challenge with this approach is to put in place clear guidelines and a robust system for verifying claims to ensure that they meet the guidelines. This could include auditing a proportion of claims, as is planned with the SFC safety-net scheme. Some degree of cost-sharing, also part of the SFC safety-net scheme, may also be worth considering to ensure that councils still have an incentive to seek good value from suppliers and otherwise control spending pressures. Even with this, there is the potential for councils to interpret guidance differently, meaning areas facing the same financial pressures could claim for and receive different amounts of support.

It is also worth reiterating an option that we have highlighted previously:[19] a temporary relaxation of rules preventing councils from borrowing to cover day-to-day spending. A process is in place to do this on a case-by-case basis in exceptional

[19] Ogden and Phillips, 2020a; Phillips, 2020.

circumstances: councils can request to 'capitalise' some day-to-day spending and utilise their existing capital borrowing powers to fund it. But a more general relaxing of the rules for a period of a few years may allow councils to draw down more of their reserves if necessary this year, as they would have additional flexibility if further unfunded pressures arise in the next few years. Such powers would also allow those councils that wanted to go further in supporting their local areas through the COVID-19 crisis to do so even if they have limited reserves. Indeed, the OECD has suggested that relaxing borrowing rules for subnational governments such as councils should be considered, to provide additional flexibility and reduce the risk of funding shortfalls necessitating cuts to expenditure.[20]

Of course, borrowing needs to be repaid at some stage. However, the ability to borrow would allow the impacts to be spread over a longer period and the government would have the option of reimbursing at least part of the costs incurred (again, subject to some kind of vetting).

Finally, it is worth noting that these options are not mutually exclusive: they can be used in combination. The government has already made use of both additional formula-based funding and a (partial) reimbursement scheme in the form of the SFC safety net. However, it is important to ensure that the interaction between different approaches is properly considered: that councils are only able to claim for additional pressures not already funded by existing grant funding schemes, for example.

Ultimately, a series of political trade-offs will need to be made: first, between whether to provide additional support and/or financial flexibilities or whether to risk some councils either significantly drawing down reserves or cutting spending in-year; and second, between the extra costs involved in relying on general grant funding and the potential for inconsistent interpretation of reimbursement-type schemes across the country.

[20] OECD, 2020.

Appendix. Data and methods

This appendix lists and describes the data, methodological approach and assumptions we use in this report.

A.1 Description of data

This report uses the following main data sets on COVID-related spending and income pressures and councils' overall spending and income.

- **COVID-19: Local Authority Financial Management Information.** These data contain information on the expected spending and income impacts on councils of the COVID-19 crisis, as well as information on their financial reserves and their use of the additional general grant funding provided to them.
  - For spending and income pressures, councils are asked to estimate impacts for the month in question and the prior month (basing the latter on out-turns data, if possible), as well as for the whole 2020–21 financial year. For certain services, the returns ask for a detailed breakdown of spending pressures; for example, adult social care pressures are broken down into increases in spending as a result of additional demand, increased payment rates and other support for providers, workforce sickness and other pressures, the cost of personal protective equipment and other costs. Similar detailed breakdowns are asked for some income sources such as council tax and business rates. In this report, we focus on the service-level and income-source-level figures, but our next report – on the medium-term outlook – may make use of these more detailed data as certain spending and income pressures are more likely to persist than others.
  - For reserves, councils are asked to identify the proportion of both 'other earmarked' and unallocated reserves that are programmed for use in the next three to four years and which they therefore consider unavailable to help address the pressures resulting from the COVID-19 crisis.

  - The deadline for councils to submit their May return[21] was 15 May 2020. The deadline for the June return[22] was 19 June 2020.
- **Revenue budget (RA) and revenue out-turn (RO) returns.** These data contain budgets and out-turns for councils' spending on services for each financial year. The RA data contain information on expenditure net of income from sales, fees and charges (SFCs) only, whereas RO data contain information on SFCs and hence gross expenditure too.
  - The latest RA data are for 2020–21 but are missing for 23 councils, and a further 33 have incorporated updates to their data to reflect the impact of the COVID-19 crisis.[23] RA data for 2019–20 are available for all councils, however.[24] We use RA data to calculate our measure of net spending by service and adjusted revenue expenditure.
  - The latest RO data are for 2018–19.[25] We use this and earlier years' RO data to project what councils' SFCs income would have been in the absence of the COVID-19 crisis. This is used both to provide a sense of scale to forecast SFCs income pressures and in our modelling of the SFCs safety net.

The source of data on the allocations of grant funding to each council are detailed in Table A.1 later. Section 2.2 of the report also makes use of various socio-economic and geographic characteristics, such as deprivation and population age structure. Further information on these data can be found in the appendix to Ogden and Phillips (2020a).

A.2 Methods and assumptions

Missing data and differences in the assumptions different councils have made when filling in their returns (including what look like mistakes or misinterpretations in some instances) have necessitated several imputations and robustness checks. The following subsections provide additional information to supplement the overview provided in the main text of this report.

[21] MHCLG, 2020a.
[22] MHCLG, 2020b.
[23] MHCLG, 2020c.
[24] MHCLG, 2019a.
[25] MHCLG, 2019b.

Estimating spending and income in the absence of the COVID-19 crisis

In order to provide a sense of scale of pressures both overall and for different services and sources of income, we express them as percentages of:

- an adjusted measure of overall revenue expenditure, measured pre-COVID;
- the spending or income item in question, again measured pre-COVID.

We use an **adjusted measure of revenue expenditure** rather than reported revenue expenditure in order to strip out expenditure on schools, over which councils have very limited control, and to add back in expenditure funded by commercial and investment income. Hence our measure of adjusted revenue expenditure is calculated as:

> adjusted_revenue_expenditure = revenue_expenditure – specific_schools_grants + trading_services_income + investment_and_interest_income

As highlighted above, 23 councils are missing from the 2020–21 RA data, and a further 33 councils incorporated updates to their data to reflect the impact of the COVID-19 crisis. For these councils, we therefore use figures from the 2019–20 RA data, and uprate each element in line with the average change between 2019–20 and 2020–21 for councils of their type that have pre-COVID figures available in the 2020–21 RA data.

Our measure of **spending on each service** is net expenditure. Again, we use figures from the 2020–21 RA data where available, or otherwise uprate figures from the 2019–20 RA data.

Our measure of **income from SFCs** is taken from two sources. First are the figures reported in 2018–19 RO data, uprated in line with the average annual growth by council type between 2015–16 and 2018–19, separately by service. Second, we compute the implied pre-COVID forecast from the cash and percentage reductions in income reported in the May returns[26] as follows:

[26] MHCLG, 2020a.

pre_covid_income_forecast = cash_reduction / percentage_reduction

We then compare the estimates obtained by these two approaches. We use the second approach when the resulting estimate is within 20% of the estimate obtained by the first approach, but otherwise use the estimates from the first approach. We do this because analysis suggests that while some councils correctly interpreted the question on the percentage reduction in income they were facing, many councils incorrectly interpreted it. Our method means we only use the pre-COVID forecasts implied by councils' returns when they are broadly in line with (specifically, within 20% of) what would be implied by uprating their audited 2018–19 out-turns. This means that our figures may not reflect when councils are genuinely forecasting particularly large increases or falls in SFCs income, but we consider this a necessary trade-off to avoid including unreliable or erroneous responses.

Alternative scenarios for spending and income pressures

Differences in councils' forecasts for full-year pressures will reflect genuine differences in the impact of the COVID-19 crisis on their spending and income streams, but also differences in the assumptions councils have made about the degree and speed with which things return to normal. When comparing pressures between individual councils or even groups of councils, we would ideally take full account of the former source of variation but abstract from the latter in order to do a more *like-for-like* comparison.

Unfortunately, the *COVID-19 Local Authority Financial Management Information* returns do not ask councils to state the assumptions they have made, so we cannot do this. However, we can make use of the monthly estimates councils have provided for April, May and June to test the robustness of results based on councils' annual forecasts. In particular, we calculate two variant forecasts for full-year spending and non-tax income pressures.

- Our **alternative** forecast takes each council's estimates for pressures in April, May and June as given. We then calculate, for each council type (shire district, shire county, etc.), the average ratio between forecast full-year pressures and pressures for the April–June quarter (Q1). These average ratios are then applied to each council's Q1 estimates to obtain the alternative full-year forecast for that council. This strips out any differences in assumptions about the extent and pace with which things return to normal. But it also strips out other more ‘genuine’ differences in the timing of pressures, such as differences in contracting arrangements and agreements with suppliers, tenants, etc. This is done for all spending lines and income sources, except for additional spending on public health, where a council’s own annual estimates are used for reasons discussed below.

- Our **pessimistic** forecast again takes each council’s estimates for pressures in April, May and June as given. It then assumes that pressures for each council in each of Q2 to Q4 of the financial year are two-thirds of those faced by the same council in Q1. This retains variation between councils based on differences in their Q1 forecasts, but removes any differences in assumptions about the extent or pace of a return to normal. It also removes any genuine differences in the likely speed of the return to normal between service areas or different types of income. This forecast is included in our analysis to test how sensitive our estimates of funding shortfalls are to pressures abating less quickly (on average) than councils have assumed in their own forecasts.

These alternative forecasts for full-year spending and income pressures have pros and cons relative to the forecasts provided by councils themselves, so neither is our ‘preferred’ forecast. But when findings are consistent across all three sets of forecasts, we can have more confidence in them.

Grant funding

The government has announced a range of additional grants to help councils address the spending and income pressures arising from the COVID-19 crisis. We only include some of this funding in our analysis, where sufficient information is available to estimate how much individual councils have received, and we expect that councils are likely to have included related spending pressures when completing their June returns.[27] Including other funding would lead us to overestimate the value of funding relative to the reported pressures we are able to include.

[27] MHCLG, 2020b.

Notes to Table A.1

[a] MHCLG, 2020d. [b] DHSC, 2020a. [c] MHCLG, 2020e. [d] DHSC, 2020b. [e] DfT, 2020.
[f] Defra, 2020; MHCLG, Defra & DWP, 2020. [g] MHCLG, 2020f. [h] MHCLG, 2020g. [i] MHCLG, 2020h. [j] MHCLG, 2020i and 2020j.

Table A.1. Details of all additional grant funding relating to councils, and the value included in different funding scenarios

	Description	Assumptions	Total value (£m)	(1) Baseline scenario	(2) Generous scenario
A	**General-purpose grant funding**, announced in three tranches: allocations of just under £1.6 billion were announced on 30 March; allocations of the second tranche of just under £1.6 billion were announced on 28 April; and allocations of the final tranche of £0.5 billion were announced on 16 July.[a]	This unringfenced funding is available for councils to address the immediate pressures arising from COVID-19, so the full amount is included in both scenarios.	3,688	3,688	3,688

B	**Infection Control Fund** to support measures to reduce COVID-19 transmission and support workforce resilience in the adult social care sector. This was announced in early June, and allocated to councils based on their number of care home beds, and local wages and prices.[b]	At least 75% of the funding must be used to support care homes, with up to 25% available to support domiciliary care and 'wider workforce resilience'. We count 25% of this funding in the baseline scenario, and 100% in the generous scenario, reflecting the possibility that councils have included funding passed on to providers as a spending pressure.	600	150	600
C	**Local authority council tax hardship fund**, announced on 11 March, with allocations to councils published on 24 March. Councils must use this to provide top-ups to council tax support (i.e. reductions in council tax bills to low-income households) and may also use it to provide other support to households.[c]	The required extensions to council tax support will reduce council tax revenues, which will hit councils' main budgets next year. These losses are excluded from this analysis, so we also exclude this funding.	500	0	0

D	**Local authority Test and Trace service support grant**, announced on 11 June, to cover the public health responsibilities of councils in mitigating against and managing local outbreaks, including developing tailored local plans.[d]	As this funding was associated with new responsibilities, we include this only for the 27 councils that appear to have included these extra pressures when submitting their June returns. See subsection below for further detail.	300	53	53

E	**Active travel fund** to support improvements to cycling and walking facilities, including: • £42 million in emergency funding for the installation of temporary projects for the COVID-19 pandemic, with final allocations published on 2 July; • £180 million for the creation of longer-term projects, for which only indicative allocations have been published.[e]	We include £20 million of the first tranche of funding, which was provided directly to councils. Funding shared between Cornwall and the Isles of Scilly is split between them on a population basis. We exclude £22 million which was instead provided to 10 combined councils, which act as the local transport authority across several individual councils in a number of (mostly urban) parts of the country. We assume that in these areas, individual councils do not have responsibility for activities relating to the funding, and will not have included additional spending on transport funded through the grant in their returns. We also exclude the second tranche of funding (£180 million) as this is designed to fund projects over a longer horizon, and only indicative allocations are available.	222	20	20

F	**Local Authority Emergency Assistance Grant for Food and Essential Supplies**, which is to allow councils to provide support to households struggling to afford food and other essentials. The funding was announced on 11 June, but was only allocated to specific councils in mid July. This was allocated to upper-tier councils based on their populations and level of deprivation, as a proxy for additional need.[f]	As councils did not learn their specific allocations until after the deadline for submitting their June returns to MHCLG, it is unlikely that councils had plans to use this funding or included this additional spending in their estimates. As such, we exclude this funding from our analysis. Councils were asked about their plans for this funding in the subsequent survey round, so it may be possible to say more in future work.	63	0	0
G	**Reopening High Streets Safely Fund**, to fund measures that establish a safe trading environment for businesses and customers, particularly in high streets, to the end of March 2021. This was announced on 24 May, with allocations above a minimum set based on population.[g]	Councils will be able to apply to be reimbursed for the cost of eligible measures, including the development of strategic plans and public information materials, and temporary changes to streets to enable social distancing. We include all of this funding, and so assume all councils are able to make full use of their allocation to fund in-scope activity.	50	50	50

H	**Emergency rough sleeping funding**, announced on 17 March 2020. This was to reimburse councils for the cost of providing accommodation and services to rough sleepers, and others at risk of homelessness, to help them successfully self-isolate. Allocations of this funding have not been published, but councils were notified of the maximum funding they could claim 'which [was] calculated based on the number of rough sleepers reported in the Autumn 2019 snapshot'.[h]	In the absence of published allocations, we have assumed that this funding was shared between all 317 lower-tier councils in proportion to the number of people counted as sleeping rough on a single night in the 2019 MHCLG rough sleeping snapshot.[i]	3	3	3

I	**Interim accommodation and immediate support** to rapidly support those in COVID-19 emergency accommodation. This could include funding interim accommodation, or helping support rough sleepers and those at risk of homelessness to secure tenancies. Total funding of £105 million was confirmed on 24 June (£20 million of this was refocused from existing homelessness funding). In mid July, this was confirmed to be part of the Next Steps Accommodation Programme, which includes a further £161 million in 2020–21 for longer-term move-on accommodation.[j]	Council-level allocations are not available as the fund is bid-based, with councils asked to submit funding proposals to MHCLG by 20 August. As councils were not aware of the funding, never mind whether any proposals of theirs may be successful in securing funding, we do not include any of this funding in this analysis. The first £105 million is revenue funding to be used in 2020–21, so it would have been appropriate to include this if councils had known about this earlier. Of the later £161 million under the Next Steps Accommodation Programme, £130 million is capital funding, so would anyway have been excluded.	105	0	0

After discussions with stakeholders, we have decided to test the robustness of our findings to two different measures of additional grant funding: a baseline scenario, which includes £3,911 million of grant funding, and a generous scenario, which includes a further £450 million.

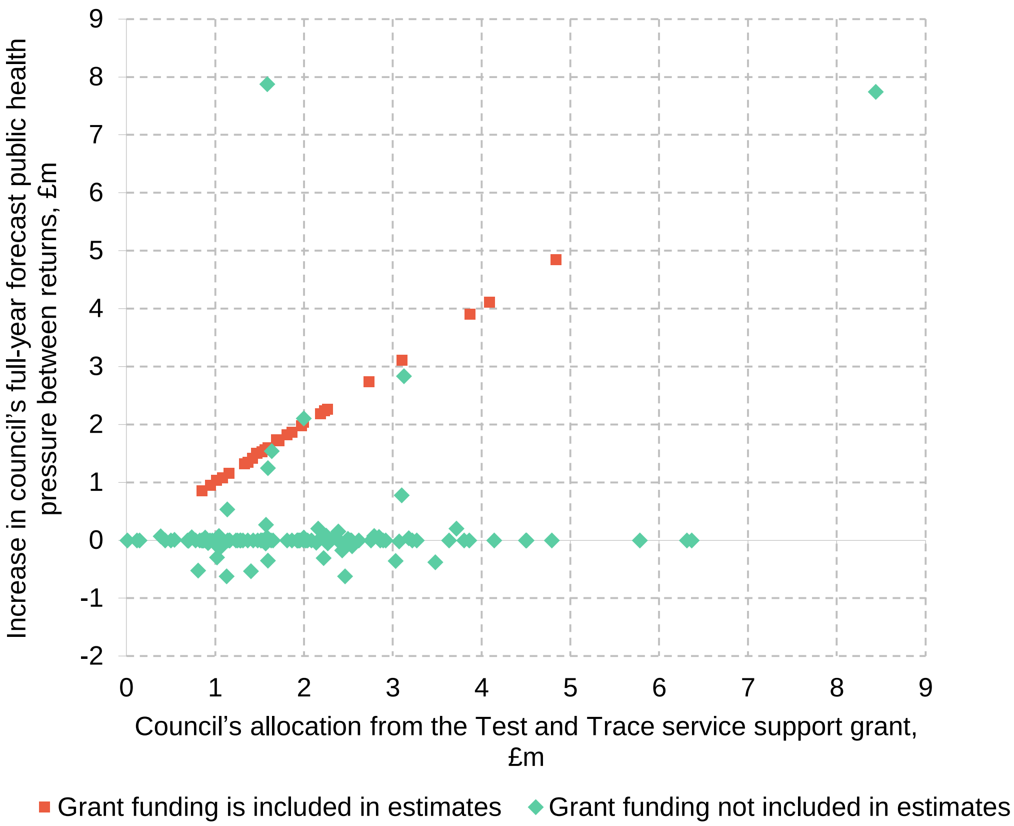
Table A.1 details the different forms of grant funding for councils that government has announced so far in relation to 2020–21. It also describes the assumptions we have made in relation to each grant or fund, and how much funding has been included in our baseline and generous scenarios for funding.

Estimating which councils have included the Test and Trace service support grant when completing their returns

As part of their local public health responsibilities, councils play a key role in the Test and Trace programme. Funding for new responsibilities relating to managing local outbreaks was confirmed on 11 June, just prior to when June *Financial Management Information* returns had to be submitted to MHCLG. Of the 151 upper-tier councils receiving funding through the Test and Trace service support grant, 27 appear to have revised up their forecast annual spending on public health between the May and June returns by an amount very similar to the funding they are set to receive from this grant. Figure A.1 illustrates this, showing the absolute change between May and June in forecast full-year public health spending pressures at the council level for upper-tier councils and, on the horizontal axis, the value of the grant each was allocated. This strongly suggests that these, and only these, 27 councils took these new responsibilities and the associated funding into account when completing their June return.

As discussed in the main text, when analysing the scale of any funding shortfalls, we only want to account for additional funding if the responsibilities that it is targeted at are included in the reported ‘pressures’. Based on the patterns illustrated in Figure A.1, we have decided to include the Test and Trace grant funding only for councils that increased their forecast public health spending pressures between May and June by an amount within 5% of the grant they were allocated. These 27 councils (in orange) are set to receive £53.3 million in Test and Trace grant funding. This means we have not included the Test and Trace funding allocated to the remaining 124 upper-tier councils (green), which totals £247 million.

Figure A.1. Changes in forecast of additional spending on public health in 2020–21 between May and June returns, and Test and Trace support grant funding (£ million)



Source: Authors' calculations based on MHCLG (2020a and 2020b) and DHSC (2020b).

Non-grant support

In addition to extra grant funding, we model three other ways in which central government is helping councils address spending and non-tax income pressures. Assumptions made in relation to these are discussed further below.

Coronavirus Job Retention Scheme

In some cases, councils have been able to furlough workers and claim funding through the Coronavirus Job Retention Scheme (CJRS). The government expects this use to be 'limited to where an employee:

1. Works in an area of the business where services are temporarily not required, and their salary is not covered by public funding

2. Cannot be redeployed elsewhere in the organisation to support the coronavirus response
3. Would otherwise be made redundant or laid off'.[28]

This is most likely to be relevant where councils have more 'arm's-length' organisations or arrangements funded without public money (for example, tourism or leisure companies), with salaries largely funded by sales, fees and charges and where there is a significant reduction in these revenue streams which is not already offset by additional grant funding from central government.

81 councils (24%) reported in June that they were using the scheme, offsetting a total of £27 million in lost SFCs income. We assume that this represents councils' estimate of their full-year benefit from the scheme, and take their estimates at face value in each of our scenarios for funding pressures.

On 8 July 2020, the government announced that employers who continuously employed staff after the end of the scheme would in some circumstances be able to claim a Job Retention Bonus of £1,000 per eligible employee.[29] This was announced after councils submitted their returns, so will not have been included in their estimates. As we do not know how many employees councils have furloughed, or what proportion may be eligible for the bonus, we have not attempted to estimate the value of the bonus for local government, although this is likely to be much lower than £27 million.

Cost-sharing with NHS clinical commissioning groups

The government has allocated £1.3 billion to the NHS through clinical commissioning groups (CCGs) to support COVID discharge arrangements. This will cover the follow-on care costs for adults in social care, or people who need additional support, when they are out of hospital, and extra costs incurred in preventing people having to go or return into hospital. CCGs are expected to reimburse councils for this additional COVID spend, with the details to be agreed between councils and CCGs locally.[30]

[28] As quoted in LGA (2020a).
[29] HMRC, 2020.
[30] LGA, 2020b.

- In their June returns, 103 out of 151 upper-tier councils with responsibility for adult social care reported they had reached agreements with the CCGs in their areas.
- In our baseline funding scenario, we only include transfers for these 103 councils, which amount to £293 million or an average of 23% of these councils' adult social care pressures.
- In our more generous funding scenario, we assume that councils yet to reach agreement with their CCGs reach an agreement to share costs in line with the average in existing agreements for councils of their type.
- In all scenarios, we apply the percentage reimbursement above to a council's own full-year estimates of its additional spending on adult social care, rather than to projected annual additional spending using the alternative or pessimistic methods. This is because we have assumed the agreements councils have reached with CCGs are for specific amounts of funding rather than specific percentages of pressures being met. This means the estimated value of CCG reimbursement of costs does not vary between our different scenarios for spending and income pressures.
- We also assume that shire districts do not benefit at all from CCG reimbursement of any of their adult social care costs. While many have incurred some costs relating to social care services during the pandemic, these are usually the responsibility of shire county councils in two-tier areas.

Sales, fees and charges (SFCs) 'safety net' scheme

On 2 July 2020, the Local Government Secretary announced a 'safety net' for SFCs income, which will provide compensatory payments of 75p for every £1 by which SFCs income falls below 95% of what councils planned to raise prior to the COVID-19 crisis. Full guidance has yet to be published, although the government has outlined a set of principles for what SFCs income will be in the scope of this scheme.[31]

While the details of the scheme are not yet clear, we estimate the value to each council of the scheme as announced as follows:

- **Baseline income.** Pre-COVID forecasts for overall SFCs income in 2020–21, let alone in-scope SFCs income, are not currently available. We project forward

[31] MHCLG, 2020d.

total SFCs income as of 2018–19 using the growth rate for each service and council type between 2015–16 and 2018–19, and use this as our estimate of what councils planned to raise in 2020–21 prior to the COVID-19 crisis. We include SFCs relating to education services, as text comments from councils suggested some had included losses relating to education charges in their estimates of losses, but excluding these SFCs would reduce baseline income and so increase the compensation councils could expect to receive.

- **Lost income.** In the baseline scenario, we take the full-year losses as reported by councils in their June returns. In the alternative and pessimistic scenarios, we adjust these based on their reported losses in Q1, as described above. This means that the SFCs compensation a council is estimated to receive varies between the scenarios.
- **In-scope income.** As noted above, some SFCs losses will be considered out of scope for the scheme in practice, but we cannot estimate this proportion from the data available at present. We use figures from the June returns, but these figures may include some income recorded as SFCs that is actually out of scope (for example, rent on properties held not for investment purposes, but as part of ongoing regeneration schemes), but also exclude some income that has been recorded as commercial income but may be in scope (such as parking, trade waste, or other services that have been organised as trading companies).
- **Compensation.** Councils receive compensation equal to 75% of the extent to which their income falls below 95% of their baseline income. This is done for total SFCs, rather than separately for SFC losses relating to different service areas (for example, culture and transport). If MHCLG instead applied the 95% threshold at the level of each service, this would make the compensation scheme more generous.

  Three councils reported bigger losses in 2020–21 than our estimate of their baseline income. For these councils, we assume that our baseline underestimated their income and we set our baseline equal to their loss. This may mean we slightly underestimate the compensation they would receive.
- **Coronavirus Job Retention Scheme.** We have not modelled any interaction between the SFC safety-net scheme and the CJRS. Councils will only be eligible for compensation for ‘in-scope’ losses after they have netted off any cost-saving measures taken, such as furloughing staff.[32]

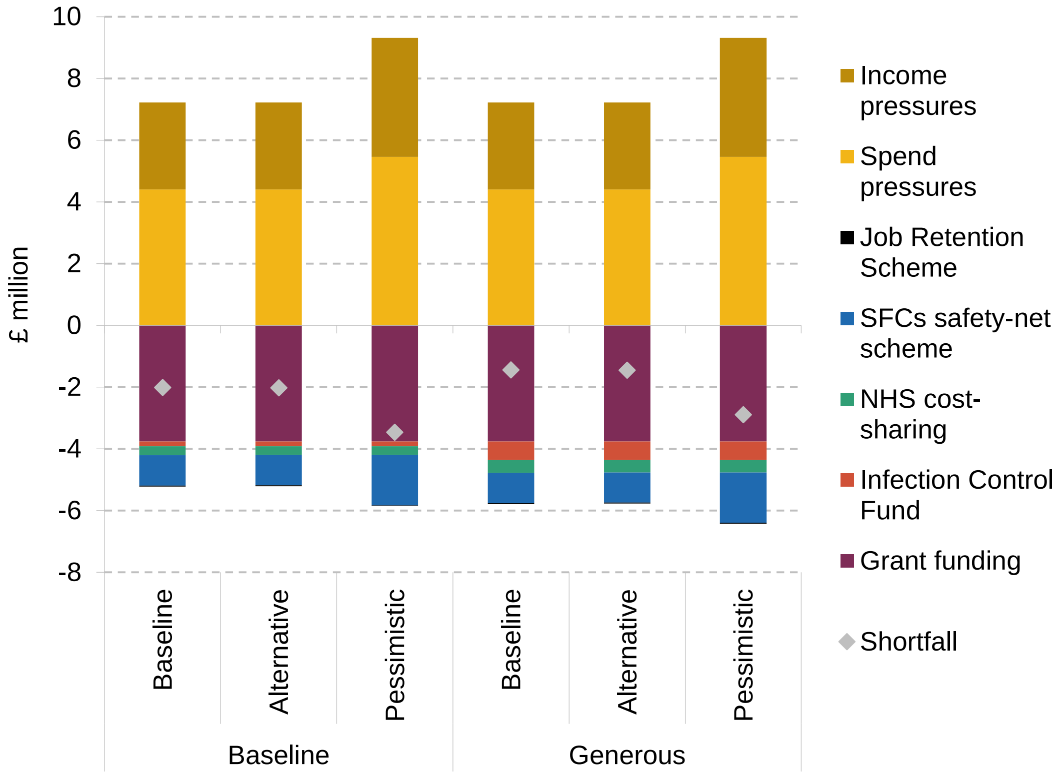
[32] MHCLG, 2020d.

The lack of detail on how the SFCs safety-net scheme will operate and its scope, and the need to estimate pre-COVID expected income, mean our estimates of the compensation councils could receive should be seen as indicative and subject to potentially significant margins of error.

Forecast funding shortfalls under different scenarios

The total funding shortfall under each scenario is indicated by diamonds in Figure A.2, with the bars showing the value of different elements that contribute to this total shortfall. For instance, in the baseline scenario for both pressures and funding, total pressures of £7.2 billion are offset by government support of £5.2 billion, leaving a net shortfall of £2.0 billion.

Figure A.2. Forecast funding shortfalls under different scenarios for spending and income pressures and funding levels: all councils (£ million)



Note: See the note to Table 3.2 and discussion in the main text. Grant funding here includes general-purpose grant funding (£3.6 billion) and other specific grants, excluding the Infection Control Fund.

Source: Authors' calculations based on MHCLG (2020a and 2020b).

Potential recovery of some lost income

This report assumes that none of the income lost by councils is subsequently recovered. Of their total forecast non-tax income losses of £2.8 billion, councils estimated in June that 89% was already known to be immediate and irrecoverable, and so would permanently impact (worsen) their financial position. Thus the maximum amount that councils could potentially recover is £300 million, with the majority (£187 million) from SFCs income (see Table A.2). This rate of recovery is unlikely, and some of the loss may anyway be recovered only in later financial years.

Table A.2. Non-tax income losses, and potential for recovery

	Forecast full-year loss (£m)	Proportion deemed irrecoverable	Potentially recoverable (£m)
All SFCs	1,958	90.4%	187
Commercial	626	85.6%	90
Other	237	90.2%	23
Income excl. CT and BR	2,821	89.3%	300

Note: Forecast losses are as estimated by councils in their June returns, as in the baseline scenario for pressures.

Source: Authors' calculations based on MHCLG (2020b).

We estimate that councils may receive £118 million in compensation from government in relation to lost SFCs income that is potentially recoverable. If councils manage to recover any SFCs income in-year, they will lose out on this compensation. Once this is accounted for, the maximum benefit councils could see from recovering non-tax income losses falls from £300 million to £183 million.

Other assumptions

- **Local lockdowns.** We do not take any account of additional pressures that councils may face in relation to local lockdowns. It is possible some councils may have considered this possibility when forecasting full-year spending estimates, but the high degree of uncertainty around this, and around what a ‘local lockdown’ may mean for a council when the latest returns were submitted, makes this unlikely. The finances of 26 councils may have been directly affected as of 14 August 2020, with some or all of their populations subject to additional local restrictions for at least some part of the period between June and August. This includes Leicester and Luton, as well as councils in Greater Manchester, Lancashire and West Yorkshire.
- **Housing revenue account.** Councils were also asked in their returns to estimate any additional spending pressures or income losses relating to the management of their council’s housing stock due to COVID-19. In total, councils reported that they expected to spend £74.2 million more than forecast and to lose income of £210.9 million, mostly through residential rent arrears (£152.5 million). This impacts councils’ housing revenue accounts (HRA), which are ring-fenced from the rest of a council’s activities and managed using separate HRA reserves. We do not include any pressures coming through the HRA in this report.
- **Missing or erroneous figures in COVID-19 returns.** We do not have May data from *COVID-19 Local Authority Financial Management Information* returns for a single council. For this council, we have imputed figures relating to spending pressures and income losses arising in April using its estimates for May and the average relationship between April and May figures for other councils of the same type. For a further four councils, some figures in May returns relating to April were large and negative. We deemed that these had likely been entered in error, and replaced these using the same method.
- **Planned movements in reserves.** Before the COVID-19 crisis, some councils will have been planning to make withdrawals from or payments into their reserves over the course of 2020–21. These represent the difference between their planned in-year spending and income. To understand the reserves position that councils may be in at the end of this financial year, we should take into account these planned movements, as well as the impact of COVID-19 pressures and government support. For most councils, we use the difference between planned reserves at the start and end of 2020–21 in their 2020–21 RA data. For the 23 councils that are missing from the 2020–21 RA data, and the 33

councils that incorporated updates to their data to reflect the impact of the COVID-19 crisis, we do not attempt to estimate their planned reserves movements based on historic data. We instead assume they were not planning any movements into or out of their reserves over the course of 2020–21.

- **Business rates, Section 31 grants and the General Fund.** Business rate losses accrue to the Collection Fund this year, and so do not impact the General Fund until 2021–22. Like council tax losses, these have been excluded from this analysis and will be considered in a later report on the medium-term outlook for local government spending and revenues. However, Section 31 grants paid by government to compensate councils for business rate reliefs will accrue immediately to councils' General Funds accounts. This includes the expanded retail discount for businesses in the retail, hospitality and leisure sectors, which is expected to cost over £10 billion[33] and result in Section 31 grants of approximately £6.0 billion[34] to compensate councils for their share of this. This may mean councils' reserves appear to increase in-year, but this effect is somewhat artificial as this funding will be needed to address the concomitant reductions in business rates revenues when they are transferred to the General Fund next year. As such, we exclude the impact of business rates (both reductions in revenue and Section 31 grants) from our analysis in this report.

[33] Ogden and Phillips, 2020b.
[34] Gerraghty, 2020.

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