

REVIEW OF RESERVES

Head of Service:	Lee Duffy, Chief Finance Officer
Wards affected:	(All Wards);
Urgent Decision?	No
If yes, reason urgent decision required:	N/A
Appendices (attached):	1 – Reserve policies and recommended minimum balances

Summary

This report presents a review of the Council's reserves and financial standing.

Recommendation (s)

The Panel is asked to:

- (1) Consider and review whether the overall level of reserves and contingencies are appropriate for the sound management of the Council's finances;**
- (2) Review the individual reserve and contingency balances and consider whether to support the recommended minimum balances in the report;**
- (3) Support the transfer of the uncommitted balance on the Interest Equalisation Reserve back to the Corporate Projects Reserve.**

1 Reason for Recommendations

- 1.1 The recommendations will ensure that the Council maintains an appropriate level of reserves for the sound management of the Council's finances.

2 Background

- 2.1 The Medium Term Financial Plan 2020-24 (MTFP), including the Medium Term Financial Strategy (MTFS), was approved by Full Council in February 2020 following a review of the Council's financial standing.
- 2.2 The MTFS includes the following objectives for budgets, revenue reserves and investment:

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- 2.2.1 Produce a balanced revenue budget each year;
 - 2.2.2 Maintain a prudent level of strategic reserves and a minimum balance of £1m in the corporate projects reserve;
 - 2.2.3 Utilise reserves proactively to manage major risks to the Council's finances;
 - 2.2.4 Maintain a minimum working balance of £2.5m at 31 March 2024.
 - 2.2.5 Maintain a minimum uncommitted level of capital reserves of £1m at 31 March 2024.
- 2.3 The MTFP presented a trend analysis of the Council's revenue and capital reserves from 2012 to 2019 and an overview of reserves held at March 2019.
- 2.4 Since the MTFP was approved in February 2020, the Council's finances have been subjected to an unprecedented level of uncertainty due to Covid-19 and other external factors. These pressures have increased the level of financial risk faced by the Council. It is therefore more important than ever to understand the level of reserves held, as reserves are increasingly likely to be required in the coming years.
- 2.5 The purpose of this report is to review the current level of reserves; to understand the known risks facing the Council; and to recommend a minimum level of reserves to be held.

3 Reserves

- 3.1 In local government, reserves play a crucial role in sound financial management. They typically exist to enable Councils to invest in service transformation for the future, or to respond to unexpected events or emerging needs.
- 3.2 Reserves have been built up by EEBC over a number of years, mainly either through accumulated surplus of income over expenditure or one off grants.
- 3.3 Reserves held by EEBC are distinguished between general fund and capital; there is clear guidance and statutory rules for how these two different types of reserves can be applied.
- 1. General Fund Revenue Reserves
- 3.4 The Council's general fund accounts for the day to day running of Council services. General fund reserves can be applied to fund revenue expenditure and can also be used to fund capital expenditure.

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- 3.5 However, these reserves should not be utilised as a source of long term funding for revenue expenditure on an ongoing basis; this would be unsustainable as the reserves would eventually deplete.
- 3.6 General fund reserves are split between the working balance (which is unearmarked) and strategic reserves (which are earmarked for specific purposes).

1A. General Fund Working Balance (Unearmarked reserve)

- 3.7 The working balance accounts for the day to day running of Council services and is maintained to safeguard the Council against potential financial risks beyond those for which specific earmarked reserves have been created.
- 3.8 The 'normal' level of un-earmarked reserves should reflect the long term needs of the Council and be based on ongoing operational requirements. This will include a number of factors, the main ones being the gross annual expenditure and the extent to which long term service contracts reduce the Council's flexibility to respond to financial shocks. Previously the Audit Commission had suggested that a yardstick for normal unearmarked reserves is somewhere between 5% and 100% of net operating expenditure.
- 3.9 The working balance currently stands at £3.38m, however latest projections at Quarter 1 show this is forecast to reduce to £2.5m by the end of 2021/22, which is the minimum balance targeted by the MTFS.
- 3.10 At between £2.5m-£3.38m, the balance on this fund would represent between 29% to 39% of the council's net operating expenditure budget of £8.61m for 2021/22.
- 3.11 Given that the working balance is within the Audit Commission's previous recommended range, and is around the average for district councils of a comparable size, the current working balance level is considered appropriate for this Council.

1B. Strategic General Fund Reserves (Earmarked reserves)

- 3.12 Strategic reserves, also known as earmarked reserves, are amounts set aside for specific policy purposes or for general contingencies and cash flow management. For each strategic reserve, the purpose and usage should be clearly defined.

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- 3.13 The Council has managed to increase the level of strategic reserves significantly over the last 10 years. This increase has been necessary to reflect and manage the corresponding increased risks around the present funding sources for services. In particular, compared to 2010 the Council is more reliant now on higher risk income from investment properties and fees and charges to fund services. These higher risk income streams have replaced previously 'guaranteed/lower risk' grant funding from Central Government, which was cut significantly across the 2010's.
- 3.14 The pandemic has also created a significant demand on strategic reserves to fund recent losses of income from services and assets. For 2021/22 the Council expects to transfer c£0.5m from strategic reserves to cover the revenue budget deficit. Furthermore, across 2022/23 and 2023/24, the Council will be required to fund the c£7m collection fund deficit that arose during 2020/21.
- 3.15 This report categorises the strategic reserves across three types;
- 3.15.1 Contingencies that are unavailable for general use
 - 3.15.2 Ringfenced grants or funds that are available only for specific uses
 - 3.15.3 Un-ringfenced grants or funds that are available for general use
- 3.16 The following table shows a breakdown of the strategic revenue reserves totalling £25m at 31 March 2021.

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General Fund Revenue Reserves	Balance at 31 March 2021	Forecast transfers	Uncommitted Balance
	£'000	£'000	£'000
General Fund Working Balance	3,383	-883	2,500
Strategic Earmarked Reserves			
Repairs and Renewals	390	69	459
Insurance	443	-25	418
Property Maintenance	548	-134	414
VAT Reserve	199	0	199
Business Rates Equalisation Reserve	9,306	-7,421	1,885
Commuted Sums	1,447	0	1,447
Property Income Equalisation Reserve	5,495	14	5,509
Subtotal - Contingencies unavailable for general use	17,828	-7,497	10,331
Residential Property Acquisition Fund	1,066	-280	786
Community Safety	108	-1	107
Sports & Leisure Development Projects Fund	87	-5	82
Housing & Planning Delivery Grant	88	-88	0
Personalisation, Prevention & Partnership	73	0	73
Partnerships	28	0	28
Flexible Housing Support Grant	385	-385	0
Homelessness Reduction Act	19	0	19
HIA Hardship Fund	125	-35	90
Mortgage Rescue/Arrears Funding DCLG	9	0	9
Surrey Homeless Alliance Funding DCLG	1	0	1
Basic Payments Scheme	141	0	141
Covid Grants Reserve	121	-121	0
Subtotal - Ringfenced funds for specific use	2,251	-915	1,336
Corporate Project Reserve	4,673	-2,068	2,605
Interest Equalisation	400	0	400
Subtotal - Unringfenced funds available for general use	5,073	-2,068	3,005
Total Strategic Earmarked Reserves	25,152	-10,480	14,672
Total Revenue Reserves	28,535	-11,363	17,172

2. Capital Reserves

- 3.17 Capital receipts reserves are only available to finance future capital expenditure. The Panel will consider capital reserves separately after the Capital Member Group has prepared the draft 2022/23 capital programme. The capital reserves are used to invest in services and are monitored closely along with other funding sources such as community infrastructure levy (CIL) and section 106 planning funds.

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4 Committed Use of Revenue Reserves

4.1 Of the Council's revenue reserves, the Council has already committed the need to use £10m of strategic reserves as well as a projected £883,000 of general fund working balances, as set-out in the following table:

Description	Date agreed/reported	£'000	Funded from
Unfunded Forecast Deficit on General Fund 2021/22	Quarter 2 Budget Monitoring	329	Corporate Projects Reserve
Additional Planning resources	July 2021	190	Corporate Projects Reserve
Deficit on Business Rates 2020/21	July 2021	6,600	Business Rates Equalisation Reserve
Covid-19 Grants	July 2021	121	Covid Grants Reserve
Additional resources for Local Plan	March 2021	742	Corporate Projects Reserve
Feasibility Studies for property and investment opportunities	March 2021 & October 2020	160	Corporate Projects Reserve
South Street	March 2021	280	Residential Property Acquisition Fund
Support increased numbers of homelessness	February 2021	385	Flexible Housing Support Grant
Deficit on Business Rates	February 2021	808	Business Rates Equalisation Reserve
Funding for impact of Covid	February 2021	306	Corporate Projects Reserve
2021/22 Property Maintenance Programme	January 2021	105	Property Maintenance Reserve
Planning Appeals	December 2020	96	Corporate Projects Reserve
Housing and Planning Delivery Grant for Local Plan	July 2019	88	Housing and Planning Delivery Grant
Other smaller committed sums		270	
Subtotal – Committed Use of Strategic Reserves		10,480	Strategic Reserves
Projected Use of General Fund Working Balance		883	General Fund Working Balance
Total Committed/Projected Use of General Fund Reserves		11,363	GF Reserves

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5 Review of Strategic (Earmarked) Reserves

- 5.1 The Council recently underwent a Local Government Association (LGA) Finance Peer Review. The LGA Peers' report made specific reference to the Council's state of reserves, as follows:
- 5.2 *"The Council's track record for financial management and a healthy overall level of revenue reserves, the Council also demonstrates a positive overview from the CIPFA resilience index for 2019/20.*
- 5.3 *Arriving into this COVID period in a healthy financial position has helped the Council significantly. Thanks to the way in which the Council has managed its finances over a number of years, this reserves position has also afforded the Council an opportunity to take a considered, strategic approach to recovery/renewal. The time afforded to the Council from this reserves position is limited as it is made possible only through the use of reserves to support revenue expenditure, which the Council recognises can be used only once."*
- 5.4 This feedback from the LGA Peers provides a positive context for the present review of reserves.
- 5.5 An assessment of each reserve is made in Appendix 1 showing:-
- 5.5.1 The policy for each reserve
 - 5.5.2 The objective of each reserve
 - 5.5.3 The recommended minimum balance
- 5.6 Each reserve has a clearly specified and defined use either as a contingency, as part of the council's financial risk management, or to meet specific funding commitments in future years.
- 5.7 As previously stated at 3.15, strategic reserves are split between three categories. The following section reviews each category in turn and considers the scope for releasing funds or the need to strengthen individual reserves with a balance of over £200,000.
- I. Strategic Reserves - Unringfenced funds available for general use
- 5.8 These reserves can be used to fund most types of expenditure and are presently relied upon to support the Council in managing its way out of the pandemic and to address impending changes in government funding arising from the Fair Funding Review. The following reserves are included within this category.
- Corporate Projects Reserve
- 5.9 This reserve was established to provide revenue funding for projects that fall outside of the day-to-day delivery of services, such as:

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- 5.9.1 Spend to save one-off costs - some of the Council's spend to save initiatives involve one-off pump priming costs which cannot be contained within the base budget.
- 5.9.2 Funding for one-off corporate priority projects
- 5.9.3 Partnership funding - grants of contributions for schemes that cover a number of years can be held in this fund until expenditure is incurred (for example, government new burdens grants).
- 5.10 The balance on the Corporate projects reserve at 31 March 2021 was £4,673,000.
- 5.11 The Council is expected to drawdown £2 million from this reserve in the next couple of years, which reduces the uncommitted balance to around £2.6m.
- 5.12 The opportunities replenish funds into this reserve have significantly reduced in recent years, due to reductions in funding from new homes bonus grant, which has been the main source of funding for this reserve in the past.
- 5.13 The Council's MTFS recommends a minimum balance of £1m is held in this reserve to enable the Council to continue to invest in projects as set out above.**

Residential Property Acquisition Fund

- 5.14 This fund was created in 2016/17, mainly from new homes bonus funding. The fund has been used to purchase residential properties to support the council's housing activities. The remaining fund balance at 31 March 2021 was £1,066,000, with £280,000 of this balance committed to fund works to the Council's property on South Street.
- 5.15 As no new properties have been identified for acquisition since 2018/19, it is proposed that the criteria for using this fund should be reviewed to ensure it continues to effectively assist the Council to manage homelessness and reduce operational costs.**

II. Strategic Reserves - Ringfenced funds/grants for specific use

- 5.16 The Council holds a number of funds to deal with specific policy areas, risks or liabilities, which typically have conditions attached to the funding. The ability to redeploy these funds for alternative use is restricted due to the conditions attached; the funds are therefore only available for specific uses, and not for general use. The total of these types of reserves at 31 March 2021 is £1.1m, broken down as follows;

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- 5.17 As these reserves/balances can only be used for specific activities and are limited in their application, it is recommended that no transfers are made from these to other reserves, nor would it be appropriate to set individual minimum balances.

III. Strategic Reserves – Contingencies unavailable for general use

- 5.18 The final category of strategic reserves is those classed as contingencies, which are funds set aside to allow the Council to respond to particular circumstances. If these resources were unavailable to mitigate potential losses/costs, then the Council would be required to find alternative funding from cuts to services within the general fund.
- 5.19 These reserves make up the largest proportion of our uncommitted strategic earmarked reserves (£11m) and are reviewed individually as follows.

Property Income Equalisation Reserve

- 5.20 Nearly half of the £11m uncommitted balances is held within the Property Income Equalisation Reserve. The reserve aims to hold sufficient funds to mitigate the risks associated with future rental income streams from investment properties purchased in previous years with the support of external borrowing. The reserve's target is to hold sufficient funds to cover the potential loss of 1 years rental income for each property acquired in this way, which totals £5.5m
- 5.21 Following contributions made in 2020/21, the reserve's target balance of £5.5m has now been attained.
- 5.22 It is anticipated in the coming years that the Council is likely to experience pressure on this reserve, as changes in tenant demands as a result of the pandemic may adversely impact the income the Council is able to generate from its investment properties.
- 5.23 As such, it is recommended that the Council continues to maintain a minimum target balance on this reserve equating to one year's rental income from properties financed with the use of external borrowing.**

Business Rates Equalisation Reserve

- 5.24 This reserve was established back in 2013 to mitigate new risks associated with the introduction of the current redistribution mechanism of retained business rates. It was created to manage variations to estimates of retained business rate income.
- 5.25 The reserve balance at 31 March 2021 is £9.3 million. However, due to the statutory mechanism for redistributing collection fund deficits, this reserve will be required to fund the c£7m collection fund deficit that arose during 2020/21, bringing the Business Rates Equalisation Reserve uncommitted balance down to £1.9 million.

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5.26 The current financial plan anticipates a further £0.5m use from this reserve over the next three financial years, to offset expected business rate reductions in funding over this period that may arise from the Fair Funding and Business Rate Retention Reviews.

5.27 In the context of potential future cuts to the Council's business rates funding, it is considered prudent to maintain a minimum balance on this reserve to compensate for at least two years' of business rates retained income falling below the funding baseline. On this basis, it is recommended that a minimum balance of £1m is set for this reserve.

Recreation Commuted Sums

5.28 This reserve holds down payments of £1.4m which the Council received upon the historic transfer of land. The funds must be used to fund future maintenance of specific open spaces. As such, the funds are held within the Council's treasury investment portfolio and the interest earned is credited to the Community and Wellbeing Committee's open spaces budget to fund on-going grounds maintenance costs. **As the funds are contractually restricted in this way, no changes are recommended to balances currently held.**

Repairs and Renewals Fund

5.29 This reserve holds funds set-aside in previous years for the replacement or repair of plant, equipment and vehicles owned by the council.

5.30 The level of reserve reflects past contributions to the fund from service budgets, less spending authorised. It is not based on a detailed assessment or forward plan of items that will need replacement or repair. This provides greater flexibility for managers to review their assets outside of the normal budget process. It also enables them to make a case to fund one-off items for which there is a service requirement that cannot otherwise be met within the constraints of revenue budgets or funded from capital. Since most vehicles are covered by a separate maintenance contract, recently funded items have mainly been plant and equipment.

5.31 The balance on the reserve at 31 March 2021 was £390,000.

5.32 The 2021/22 budget includes contributions of £69,000 into the reserve. As the reserve is funded by budgeted contributions from service budgets, **no minimum balance is recommended for this reserve.**

Interest Equalisation Reserve

5.33 The Council's revenue budget currently relies on a budgeted £115,000 of interest being generated by the Council's treasury investment. Returns on investments are subject to external economic factors, and the Interest Equalisation Reserve has previously allowed the Council to manage fluctuations in the interest earned.

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The £115,000 budgeted interest income is low by historical standards, and as such, the associated financial risks to the Council of underachieving this budget are limited. **As such, it is considered that the Interest Equalisation Reserve balance of £400,000 could be transferred to the Corporate Projects Reserve, to be available for funding corporate initiatives.**

Insurance Reserve

- 5.34 The Council maintains this reserve as a provision for any uninsured losses (e.g. sums below the council's insurance excess limits) on all unsettled claims, which can go back several years. The reserve is reviewed annually based on broker assessments of potential liabilities and the current balance of £443,000 is sufficient to meet the forecast of outstanding liabilities based on the most recent March 2021 assessment.
- 5.35 The Council's base budget requires an ongoing contribution from this reserve at £25,000 per annum to fund the increase costs of insurance, therefore to ensure at least the next four years are covered, **a £100,000 minimum balance is recommended for this reserve.**

Property Maintenance Reserve

- 5.36 This reserve was established to provide additional resources to deal with backlog repairs to council property.
- 5.37 The Council now has a base budget of £205,000 per annum for prioritised repairs to buildings and other assets such as hard surfaces. This budget is additional to the programmed and reactive maintenance works that are covered under the facilities management contract. Work is prioritised by the Council's Senior Surveyor in consultation with the Head of Property and Regeneration, and the programme is reported annually to Strategy and Resources Committee. Part of the budget is left uncommitted at the start of the year, to finance any unforeseen urgent unplanned works.
- 5.38 Any unspent maintenance budget is transferred at year end to the Property Maintenance Reserve, so the funds are set-aside to finance completion of the maintenance programme in the following year(s).
- 5.39 The uncommitted balance on this reserve is £414,000. **It is recommended that the Council maintains a minimum balance on this reserve of £250,000, to provide sufficient cover for unforeseen works.** The recommended minimum balance equates to just over one year of the annual maintenance budget.

6 Proposals

- 6.1 It is proposed that the Panel:

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- 6.1.1 Consider and review whether the overall level of reserves and contingencies are appropriate for the sound management of the Council's finances;
- 6.1.2 Review the individual reserve and contingency balances and consider whether to support the recommended minimum balances in the report;
- 6.1.3 Support the transfer of the uncommitted balances on the Residential Property Acquisition Fund and Interest Equalisation Reserve back to the Corporate Projects Reserve.

7 Risk Assessment

Legal or other duties

7.1 Impact Assessment

- 7.1.1 The Council holds reserves both as a contingency against unforeseen expenditure and as provisions for known, future expenditure. The Council's reserves are actively managed as part of the MTFS. Any significant reduction in the level of reserves would naturally carry the risk of reducing the Council's financial resilience and the ability to deal with unforeseen circumstances.
- 7.1.2 The level of reserves has enabled the Council to manage the financial impact of Covid-19 in a planned and structured way. The prospect of further funding cuts through central government's Fair Funding and Retained Business Rates Reviews means that the retention and ability to use strategic reserves to smooth out any funding reductions changes has become even more critical as reductions to the net budget become harder to deliver.
- 7.1.3 This report does not cover the Council's long-term liabilities. The Council has long term debt of £90.3m (£64.4m of which is externalised with the Public Works Loan Board), acquired when purchasing commercial properties. This debt must be repaid within the next 50 years alongside interest which is payable annually. The Council has made provision within the revenue budget to fund the necessary interest and debt repayments.
- 7.1.4 The Council also has a pension fund liability (£46.2m at 31 March 2021 on an IAS19 basis) which is managed through the payment of additional monetary contributions each year. The pension scheme is managed by Surrey County Council as part of the Surrey Pension Fund. The next triennial valuation of the pension fund will be at 31 March 2022 - this valuation will determine the additional monetary contributions payable from 2023/24 onwards.

7.2 Crime & Disorder

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7.2.1 None arising directly from the contents of this report.

7.3 Safeguarding

7.3.1 None arising directly from the contents of this report.

7.4 Dependencies

7.4.1 None arising directly from the contents of this report.

7.5 Other

7.5.1 None arising directly from the contents of this report.

8 Financial Implications

8.1 Financial implications are set-out in the body of the report.

8.2 **Section 151 Officer's comments:** Although the Council has a healthy level of reserves and balances, over the next couple of years these are expected to be utilised to fund services at unprecedented levels in recent memory.

8.3 The uncertainty caused by the pandemic and the outcome of the Fair Funding Review poses greater risk to the Council's finances. However, by agreeing to maintain a minimum level of reserves for specific funds this provides the Council with greater resilience to mitigate any further unplanned costs/losses.

8.4 This report should be read in conjunction with the financial planning report also included on the agenda for this meeting.

9 Legal Implications

9.1 None arising from the contents of this report.

9.2 **Monitoring Officer's comments:** None arising from the contents of this report.

10 Policies, Plans & Partnerships

10.1 **Council's Key Priorities:** The following Key Priorities are engaged: Effective Council.

10.2 **Service Plans:** The matter is included within the current Service Delivery Plan.

10.3 **Climate & Environmental Impact of recommendations:** None arising from the contents of this report.

10.4 **Sustainability Policy & Community Safety Implications:** None arising from the contents of this report.

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10.5 **Partnerships:** None arising from the contents of this report.

11 Background papers

11.1 The documents referred to in compiling this report are as follows:

Previous reports:

- 2021/22 Budget Report to Full Council, 16 February 2021
- Review of Reserves Report to Financial Policy Panel, 10 September 2019.

Other papers:

- None.