

## REVIEW OF RESERVES

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

### Summary

This report presents a review of reserves and recommends minimum reserve balances to ensure sound management of the Council's finances.

### 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.**

## 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:
  - 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;

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- 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 initially due to Covid-19 and subsequently due to other external economic factors including the elevated inflation/interest rate environment. These pressures have increased the level of financial risk faced by the Council. It is therefore important 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.
- 3.5 However, these reserves should not be utilised as a source of long-term funding for day-to-day revenue expenditure on an ongoing basis; this would be unsustainable as the reserves would eventually deplete.
- 3.6 General fund reserves can be split into three sub-categories:

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3.6.1 Reserves available for use;

3.6.2 Contingencies unavailable for general use;

3.6.3 Ringfenced funds/grants for specific purposes.

### 1A. Reserves Available for Use

- 3.7 This category includes the working balance, which accounts for the day to day running of Council services and is maintained to safeguard against potential financial risks beyond those for which specific contingencies have been created.
- 3.8 The corporate projects reserve is also available to fund one-off corporate priority projects.
- 3.9 These reserves can be used to fund most types of expenditure and are presently relied upon to support the Council in managing its way to delivering a sustainable annual revenue budget that requires no underlying use of reserves to balance.

### 1B. Contingencies Unavailable for General Use

- 3.10 Contingencies unavailable for general use are amounts set aside to manage key material risks faced by the Council. For each contingency, the purpose and usage is clearly defined.
- 3.11 Contingencies are necessary to manage elevated risks around the present funding sources for services, compared to pre-2010. In particular, compared to 2010 the Council is now far more reliant on higher risk income from investment properties and fees and charges to fund services. These higher risk income streams replaced previously 'guaranteed/lower risk' grant funding from central government, which was cut significantly across the 2010's.
- 3.12 The pandemic and current economic environment have also created a significant demand on reserves to fund permanently reduced income from some services and assets (such as car parks), as identified in the budget re-basing exercise reported to S&R in July 2022. For 2023/24 the Council expects to transfer c£0.5m from 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.

### 1C. Ringfenced Funds/Grants for Specific Use

- 3.13 Ringfenced funds are reserves that the Council has previously agreed to set aside for a specific policy purpose, for example the Residential Property Acquisition Fund. Where it is a local decision to ringfence funds, Council can decide to un-ringfence funds if the specific policy purpose is no longer a priority or has been achieved.

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3.14 This category also includes specific external grants, which were received with conditions attached requiring them to be used for a specific purpose/service.

3.15 The following table shows a breakdown of all general fund revenue reserves which hold a forecast balance of £15.7m after taking existing commitments into account.

General Fund Revenue Reserves	Balance at 31 March 2021	Balance at 31 March 2022	Commitment & Forecast Transfers	Forecast Balance
	£'000	£'000	£'000	£'000
General Fund Working Balance	3,383	2,853	243	3,096
Corporate Projects Reserve	5,073	4,130	(1,972)	2,158
<b>Sub-Total - Reserves available for general use</b>	<b>8,456</b>	<b>6,983</b>	<b>(1,729)</b>	<b>5,254</b>
Repairs and Renewals	390	456	(59)	397
Insurance	443	434	(20)	414
Property Maintenance	548	689	(186)	503
VAT Reserve	199	206	0	206
Collection Fund Equalisation Reserve	9,306	5,158	(4,356)	802
Commuted Sums	1,447	1,439	0	1,439
Property Income Equalisation Reserve	5,495	8,459	(3,541)	4,918
<b>Sub-Total - Contingencies unavailable for general use</b>	<b>17,828</b>	<b>16,841</b>	<b>(8,162)</b>	<b>8,679</b>
Residential Property Acquisition Fund	1,066	1,017	0	1,017
Community Safety	108	104	0	104
Sports & Leisure Development Projects Fund	87	76	0	76
Place Development Grants	88	225	(225)	0
Personalisation, Prevention & Partnership	73	73	0	73
Housing/Homelessness Support Grants	404	332	(104)	228
HIA Hardship Fund	124	124	0	124
Basic Payments Scheme	142	142	0	142
Covid Grants Reserve	121	163	(140)	23
Other smaller grants	38	28	0	28
<b>Sub-Total - Ringfenced funds/grants for specific use</b>	<b>2,251</b>	<b>2,284</b>	<b>(469)</b>	<b>1,815</b>
<b>Total Revenue Reserves</b>	<b>28,535</b>	<b>26,108</b>	<b>(10,360)</b>	<b>15,748</b>

3.16 Of the revenue reserves, the Council has forecast commitments to use £10.4m, commitments over £40k are summarised in the following table:

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Description	Date agreed/reported	Commitment £'000	Funded from
Forecast Underspend on General Fund 2022/23	Quarter 2 Budget Monitoring - Audit & Scrutiny, November 2022	-243	General Fund Working Balance
Funding the revenue budget 2022/23 to 2024/25	2022/23 - Full Council, February 2022 2023/24 to 2024/25 - S&R, January 2023	694	Corporate Projects Reserve
Building Control service changes	S&R, September 2021 and July 2022	45	Corporate Projects Reserve
Interim Chief Executive support	S&R, July 2022	50	Corporate Projects Reserve
Additional planning resources and appeals budget	S&R, July 2021 and January 2022	213	Corporate Projects Reserve
Income Generation Opportunity	S&R, November 2022	40	Corporate Projects Reserve
Resources for Local Plan	S&R, March 2021 (and earlier committees)	764	Corporate Projects Reserve
Feasibility Studies for property and investment opportunities	S&R, March 2021 & October 2020	128	Corporate Projects Reserve
Other smaller committed sums - corporate projects reserve	S&R, Financial Outturn report July 2022	38	Corporate Projects Reserve
Deficit on business rates 2021/22 and 2022/23; forecast budget contributions to 2025/26	Full Council, February 2022 Full Council, February 2023	4,356	Collection Fund Equalisation Reserve
Dilapidations receipt for commercial property	S&R, May 2022	1,700	Property Income Equalisation Reserve
Contributions to offset reduced property rental income	Full Council, February 2022 Full Council, February 2023	1,841	Property Income Equalisation Reserve
Place Development Grants	LPPC, May 2022	225	Place Development Grants
Household Support Fund and £150 Energy Rebate Administration	Government grants to deliver support schemes in 2022/23	140	Covid Grants Reserve
Support increased numbers of homelessness	Full Council, February 2022	104	Homeless Reduction Grants
2022/23 Property Maintenance Programme	S&R, January 2022	186	Property Maintenance Reserve
Other smaller committed sums		79	Repairs & Renewals and Insurance Reserves
<b>Total – Committed Use of Revenue Reserves</b>		<b>10,360</b>	<b>Revenue Reserves</b>

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### 2. Capital Reserves

- 3.17 Capital receipts reserves are only available to finance future capital expenditure.
- 3.18 Capital reserves are used to invest in services/assets and are monitored closely along with other funding sources, such as community infrastructure levy (CIL) and section 106 planning funds, in quarterly reports to Audit & Scrutiny Committee.

## 4 Review of Revenue Reserves

- 4.1 The Council underwent a Local Government Association (LGA) Finance Peer Review 2021. The peers' report in May 2021 made specific reference to the Council's reserves position, as follows:
  - 4.2 *"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.*
  - 4.3 *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."*
- 4.4 This feedback from the LGA Peers provides a positive context for the present review of reserves.
- 4.5 An assessment of each reserve is made in Appendix 1 showing:-
  - 4.5.1 The policy & objective for each reserve;
  - 4.5.2 The recommended minimum balance where applicable.
- 4.6 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.
- 4.7 As previously stated, revenue 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. Reserves Available for General Use

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- 4.8 These reserves can be used to fund most types of expenditure and are presently relied upon to support the Council in managing its way to delivering a sustainable annual revenue budget that requires no underlying use of reserves to balance.
- 4.9 Available reserve balances total £4.9m but taking into account combined recommended minimum balances of £3.5m (set out in the following paragraphs), **the Council holds just £1.4m of revenue reserves available for investment.**
- 4.10 The following reserves are included within this category.

### General Fund Working Balance

- 4.11 The working balance accounts for the day-to-day running of Council services and is maintained to safeguard against potential financial risks beyond those for which specific contingencies have been created.
- 4.12 The 'normal' level of un-earmarked reserves should reflect the Council's long-term needs 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.
- 4.13 The working balance currently stands at £2.85m, however latest projections at Quarter 2 show this is forecast to increase to £3.1m by the end of 2022/23, which is just above the minimum balance of £2.5m targeted by the MTFS.
- 4.14 At between £2.5m-£3.1m, the balance would represent between 29% to 36% of the Council's net operating expenditure budget of £8.63m for 2022/23.
- 4.15 **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 recommended minimum working balance of £2.5m is considered appropriate for this Council.**

### Corporate Projects Reserve

- 4.16 This reserve was established to provide revenue funding for projects that fall outside of the day-to-day delivery of services, such as:
- 4.16.1 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;
- 4.16.2 Funding for one-off corporate priority projects;

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4.16.3 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).

- 4.17 The balance on the corporate projects reserve at 31 March 2022 was £4.1m. The Council is expected to drawdown £2.3m from this reserve in the next couple of years, which reduces the uncommitted balance to around £1.8m.
- 4.18 The opportunities to replenish this reserve have significantly reduced in recent years, due to reductions in funding from new homes bonus grant, which had been the main source of funding for this reserve in the past.
- 4.19 It is recommended that future spend-to-save projects, funded from this reserve, should plan to make a contribution back to the reserve to ensure funds remain available to progress future investment opportunities.
- 4.20 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.**

### II. Contingencies Unavailable for General Use

- 4.21 A second category of revenue reserves are contingencies, which are funds set-aside to allow the Council to respond to particular risks and circumstances. If these resources were not set-aside to mitigate potential losses/costs, then the Council would be required to find alternative funding potentially from cuts to services within the general fund.

These reserves make up the largest proportion of forecast revenue reserves (£9.6m) and are reviewed individually as follows.

#### Property Income Equalisation Reserve

- 4.22 Around half of the £9.6m 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 year's rental income for each property acquired in this way, which currently totals £5.6m.
- 4.23 Following receipt of one-off sums including the dilapidations settlement at Parkside House, compensation for the early lease surrender at 70 East Street, and one-off back rent at industrial estates, the reserve's target balance has been attained and temporarily exceeded.



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- 4.24 However, it is anticipated the Council is likely to experience pressure on this reserve in forthcoming periods. The reserve will enable the Council to temporarily endure the loss of two key tenants, by replacing the c.£1.3m net lost annual rental income at Parkside House and 70 East Street, without having to make short-term cuts to services while new tenants are sought and/or transformation plans are progressed. The reserve may also be used to fund necessary works to the properties to secure new tenants and/or progress transformation plans.
- 4.25 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.**
- 4.26 It is also recommended that the current balance be retained but should be reviewed again once the two vacant investment properties become re-let or alternative transformation plans are agreed.**

### Collection Fund Equalisation Reserve

- 4.27 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.
- 4.28 The forecast reserve balance is £1.8 million, as due to the statutory mechanism for redistributing collection fund deficits, this reserve will be required to fund the c£3m collection fund deficit that arose during 2021/22.
- 4.29 The current financial plan anticipates a further £1.2m use from this reserve over the next three financial years, to offset the collection fund deficit for 2022/23 of £1.1m and to partially mitigate expected business rate reductions in funding over this period that may arise from the Fair Funding and Business Rate Retention Reviews.
- 4.30 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 £0.5m is set for this reserve.**

### Recreation Commuted Sums

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- 4.31 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

- 4.32 This reserve holds funds set-aside in previous years for the replacement or repair of plant, equipment and vehicles owned by the council.
- 4.33 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.
- 4.34 The forecast balance on the reserve is £0.4m.
- 4.35 As the reserve is funded by budgeted contributions from service budgets, **no minimum balance is recommended for this reserve.**

### Insurance Reserve

- 4.36 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 forecast balance of £0.4m is sufficient to meet the forecast of outstanding liabilities based on the most recent March 2022 assessment.
- 4.37 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, in addition to the potential liabilities detailed at Appendix 1, **a £300,000 minimum balance is recommended for this reserve.**

### Property Maintenance Reserve

- 4.38 This reserve was established to provide additional resources to deal with backlog repairs to council property.

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- 4.39 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.
- 4.40 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).
- 4.41 The uncommitted balance on this reserve is £0.5m. **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.

### III. Strategic Reserves - Ringfenced funds/grants for specific use

- 4.42 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 2022 is £1.8m, with the largest balance held within the Residential Property Acquisition Fund.

#### Residential Property Acquisition Fund

- 4.43 This fund was created in 2016/17, mainly from new homes bonus. The fund has been used to purchase residential properties to support the Council's housing activities. The remaining fund balance at 31 March 2022 was £1.07m.
- 4.44 **It is expected that further opportunities to utilise the fund may arise in coming years, particularly with official forecasts predicting residential property value depreciation from 2023.**
- 4.45 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.

## 5 Proposals

- 5.1 It is proposed that the Panel:

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- 5.1.1 Consider and review whether the overall level of reserves and contingencies are appropriate for the sound management of the Council's finances;
- 5.1.2 Review the individual reserve and contingency balances and consider whether to support the recommended minimum balances in the report;

## 6 Risk Assessment

Legal or other duties

### 6.1 Impact Assessment

- 6.1.1 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.
- 6.1.2 The level of reserves has enabled the Council to manage the financial impact of Covid-19, and the loss of commercial property tenants, 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.
- 6.1.3 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, which total circa £2.6m per annum.
- 6.1.4 The Council also has a pension fund liability (£36m at 31 March 2022 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.

### 6.2 Crime & Disorder

- 6.2.1 None arising directly from the contents of this report.

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### 6.3 Safeguarding

6.3.1 None arising directly from the contents of this report.

### 6.4 Dependencies

6.4.1 None arising directly from the contents of this report.

### 6.5 Other

6.5.1 None arising directly from the contents of this report.

## 7 Financial Implications

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

7.2 **Section 151 Officer's comments:** The Council maintains a reasonable level of reserves and balances to help manage the risks faced. However, over the next couple of years these reserves are expected to come under further pressure to help fund services as the Council tries to transition to a sustainable revenue budget that requires no use of reserves to balance.

7.3 Factors such as uncertainty caused by elevated inflation and the cost of living crisis, the outcome of the Fair Funding Review, and the Council's reliance on higher risk income streams (such as from commercial property), all pose 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.

7.4 This report should be read in conjunction with the budget report also included on the agenda for this meeting.

7.5 Interest generated from reserves and balances held by the Council provide a significant level of funding for its services, with £720,000 planned income for 2023/24 and there is no requirement for the Council to apply interest to individual balances held such as CIL and S106.

## 8 Legal Implications

8.1 None arising from the contents of this report.

8.2 **Legal Officer's comments:** None arising from the contents of this report.

## 9 Policies, Plans & Partnerships

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

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

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

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

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

### 10 Background papers

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

#### **Previous reports:**

- 2022/23 Budget Report to Full Council, February 2022
- Review of Reserves Report to Financial Policy Panel, November 2021.

#### **Other papers:**

- None.