Reserves Strategy

1. Introduction

1.1 The level and use of local authority reserves has been a regular media topic over a number of years, often fuelled by comments from the Government that these reserves should be used to significantly lessen the impact of the measures to reduce the deficit that have seen a greater impact on local government than any other sector.

1.2 The County Council has continually explained that reserves are kept for many different purposes and that simply trying to bridge the requirement for long term recurring savings through the use of reserves only serves to use up those reserves very quickly (meaning that they are not available for any other purposes), and merely delays the point at which the recurring savings are required.

1.3 Six out of ten respondents (61%) to the County Council's public consultation called *Serving Hampshire – Balancing the Budget,* which ran for six weeks from 5 June to the 17 July 2019, agreed with the position that reserves should not be used to plug the budget gap.

1.4 In some respects, the Covid-19 pandemic has tested in real terms the financial resilience and stability within the local government sector. For Hampshire, the decision was taken very early on that any financial response to the pandemic could not be at the expense of the existing medium term financial strategy and the need to continue to provide resources for the challenges that existed prior to Covid-19. Therefore, a financial response package was developed by the County Council that looked at what reserves and other funding could be applied to offset the impact of the pandemic. This demonstrated very clearly the value of our reserves and shows that the level of reserves held by the County Council provides options and flexibility in addressing financial challenges, including those created by such an exceptional event as the Covid-19 crisis, which are not available to other authorities.

1.5 At the end of the 2019/20 financial year the total reserves held by the County Council together with the general fund balance stood at more than £643.1m a decrease of more than £26.3m on the previous year. The decrease in reserves is largely due to the use of departmental Cost of Change reserves as planned draws have been made in 2019/20 to fund transformation and cash flow safe delivery of Transformation to 2019 (Tt2019) savings over an extended time frame.

1.6 This is in line with the Medium Term Financial Strategy (MTFS) and reflects the continued strategy of achieving savings early and then using those savings to fund the next phase of savings delivery. However, this decrease in reserves was offset in part by a contribution to the Budget Bridging Reserve (BBR) of £11.9m at the end of the financial year. This contribution was possible due to savings in non-cash limited budgets and was approved in preparation for any future draw required beyond 2020 as set out in the MTFS.

1.7 In addition, in view of the impact of the Covid-19 crisis on the County Council's financial position it was judged to be even more important that we continued to make contributions to reserves as in the short term, in the absence at that time of definite commitments from the Government, the County Council needed to ensure that existing reserves would be available to meet any potentially unfunded costs.

1.8 This Appendix sets out in more detail what those reserves are for and outlines the strategy that the County Council has adopted.

2. Reserves Position 31 March 2020

2.1 Current earmarked reserves together with the General Fund Balance totalled £643.1m at the end of the 2019/20 financial year. The table overleaf summarises by purpose the total level of reserves and balances that the County Council holds and compares this to the position reported at the end of 2018/19.

2.2 The narrative beneath the table explains in more detail the purpose for which the reserves are held and in particular why the majority of these reserves cannot be used for other reasons.

	Balance 31/03/2019 £'000	Balance 31/03/2020 £'000	% of Total %
General Fund Balance	21,398	22,298	3.5
<u>Fully Committed to Existing Spend Programmes</u>			
Revenue Grants Unapplied	14,251	38,112	5.9
General Capital Reserve	120,428	112,357	17.4
Street Lighting Reserve	27,006	27,527	4.3
Public Health Reserve	7,535	5,480	0.9
Other Reserves	937	1,070	0.2
	170,157	**184,546**	**28.7**
<u>Departmental / Trading Reserves</u>			
Trading Accounts	9,218	6,725	1.0
Departmental Cost of Change Reserve	118,895	85,492	13.3
	128,113	**92,217**	**14.3**
<u>Risk Reserves</u>			
Insurance Reserve	35,860	40,955	6.3
Investment Risk Reserve	2,957	4,958	0.8
	38,817	**45,913**	**7.1**
<u>Corporate Reserves</u>			
Budget Bridging Reserve	65,001	78,509	12.2
Invest to Save	29,201	22,290	3.5
Corporate Policy Reserve	6,397	6,852	1.1
Organisational Change Reserve	3,626	3,442	0.5
	104,225	**111,093**	**17.3**
HCC Earmarked Reserves	**441,312**	**433,769**	**67.4**
EM3 LEP Reserve	4,657	5,081	0.8
DSG Deficit Reserve	(13,746)	(22,754)	(3.5)
Schools’ Reserves	40,614	38,109	5.9
Total Revenue Reserves & Balances	**494,235**	**476,503**	**74.1**
Total Capital Reserves & Balances	**175,228**	**166,637**	**25.9**
Total Reserves and Balances	**669,463**	**643,140**	**100.0**

General Fund Balance

2.3 The General Fund Balance is the only reserve that is in effect not earmarked for a specific purpose. It is set at a level recommended by the Chief Financial Officer

(CFO) of around 2.5% of the net budget requirement and it represents a working balance of resources that could be used at very short notice in the event of a major financial issue.

2.4 The balance at the end of the 2019/20 financial year stood at £22.3m which was 2.8% of net expenditure at the beginning of 2020/21; as projected in the budget setting report approved in February 2020, and this is broadly in line with the current policy.

Fully Committed to Existing Spend Programmes

2.5 By far the biggest proportion of revenue reserves are those that are fully committed to existing spend programmes and more than £112.4m of this funding is required to meet commitments in the Capital Programme. These reserves really represent the extent to which resources, in the form of government grants or revenue contributions to capital, are received or generated in advance of the actual spend on projects.

2.6 These reserves increased significantly in recent years following a change to International Financial Reporting Standards which required unapplied government grants to be shown as earmarked reserves, and due to the fact that significant revenue contributions were made to fund future capital investment using the surplus funds generated from the early achievement in savings (a deliberate strategy that is explained in more detail later in this Appendix).

2.7 Specifically, the Street Lighting Reserve represents the anticipated surplus generated by the financial model for this Public Finance Initiative scheme that is invested up front and then applied to the contract payments in future years, and the Public Health reserve represents the balance of the ring-fenced government grant carried forward for future public health expenditure.

2.8 These reserves do not therefore represent 'spare' resources in any way and are being utilised as planned in the coming years, as evidenced by the draw of approaching £15.3m in 2019/20, once the receipt of almost £29.7m of emergency Covid-19 government funding allocated in March 2020 is taken into account.

Departmental / Trading Reserves

2.9 Trading services within the County Council operate as semi-commercial organisations and as such they do not receive specific support from the County Council in respect of capital investment or annual pressures arising from spending or income fluctuations.

2.10 Given this position, any surpluses generated by the trading services are earmarked for their use to apply for example to equipment renewal, service expansion, service improvement, innovation and marketing. They are also used to smooth cash flows between years if deficits are made due to the loss of the customer base and to provide the time and flexibility to generate new revenues to balance the bottom line in future years.

2.11 Departmental reserves are generated through under spends in annual revenue expenditure and Council policy was changed in 2010 to allow departments to retain all of their under spends in order to provide resources to:

- Meet potential over spends / pressures in future years without the need to call on corporate resources.
- Manage cash flow funding issues between years where specific projects may have been started but not fully completed within one financial year.
- Meet the cost of significant change programmes.
- Meet the cost of standard redundancy and pension payments arising from the downsizing of the work force.
- Invest in new technology and other service improvements, for example the IT enabling activity associated with the Tt2019 and Transformation to 2021 (Tt2021) Programmes.
- Undertake capital repairs or improvements to assets that are not funded through the existing Capital Programme where this is essential to maintain service provision or maximise income generation.

2.12 Utilising reserves in this way and allowing departments and trading services to retain under spends or surpluses, encourages prudent financial management as managers are able to ensure that money can be re-invested in service provision without the need to look to the corporate centre to provide funding. This fosters robust financial management across the County Council and is evidenced by the strong financial position that the County Council has maintained to date.

2.13 All departments will be utilising their reserves to fund the activity to deliver the remaining elements of the Tt2019 and Tt2021 Programmes and to fully cash flow the later delivery of savings if needed, alongside corporate cash flow support, provision for which has made within the MTFS. These reserves will also be used to manage in year pressures and to provide investment needed to underpin the development of the successor Savings Programme to take us to 2023.

Risk Reserves

2.14 The Council holds specific reserves to mitigate risks that it faces. The County Council self-insures against certain types of risks and the level of the Insurance Reserve is based on an independent valuation of past claims experience and the level and nature of current outstanding claims.

2.15 Each year the County Council sets aside an insurance provision to meet claims resulting from incidents that have occurred during the year, along with reserves to cover potential claims arising from incidents in that year but where the claims are received in the future.

2.16 Regular actuarial reviews on the overall Insurance Fund have provided assurance that the County Council has been setting aside appropriate levels of funding against future liabilities to date. However, the conclusions of the previous review were that there was a need to adopt a long term approach to increasing that fund going forward, and the intention was to regularly review the Insurance Reserve and to make year end contributions that move the County Council towards the level outlined in the latest actuarial assessment.

2.17 To begin this, in 2017/18 £6.25m was added to the Insurance Reserve resulting in a net increase of £5m after the provision for that year, totalling £1.25m, was set aside and in 2018/19 the provision reduced and there was a resulting net increase in the reserve of almost £10.3m. In 2019/20 the net increase in the Insurance Reserve was a further £5.1m, again due to changes in the provision required and therefore in light of this, and the fact that a further actuarial review had been commissioned, no additions to the Insurance Reserve were made in 2019/20. This position will be reviewed at the end of 2020/21.

2.18 The Investment Risk Reserve was established in 2014/15 to mitigate the slight additional risk associated with the revised approved investment strategy as a prudent response to targeting investments with higher returns. Following changes to the accounting treatment of some investments going forward it has been approved that we will make additional contributions to this reserve with the longer term aim of increasing it to 2.5% of the total higher yielding investment portfolio. The potential to make a contribution in 2020/21 will be reviewed at the end of the year.

Corporate Reserves

2.19 The above paragraphs have explained that most reserves are set aside for specific purposes and are not available in general terms to support the revenue budget or for other purposes.

2.20 This leaves other available earmarked reserves that are under the control of the County Council and totalled almost £111.1m at the end of last financial year. Whilst it is true to say that these reserves could be used to mitigate the loss of government grant, the County Council has decided to take a more sophisticated long term approach to the use of these reserves, that brings many different benefits both directly and indirectly to the County Council and the residents of Hampshire. In addition, the availability of these reserves has been critical to the ability of the County Council to develop a financial response package to manage the impact of the Covid-19 pandemic, thereby avoiding some of the immediate issues facing other local authorities and the possibility of a Section 114 Notice. These reserves are broken down into four main areas:

2.21 **Budget Bridging Reserve (BBR)** – This reserve, previously named the Grant Equalisation Reserve (GER), was set up many years ago to deal with changes in government grant that often came about due to changes in distribution methodology that had an adverse impact on Hampshire compared to other parts of the country.

2.22 In 2010/11, the County Council recognised that significant reductions in local government spending were expected and built in contributions as part of the MTFS over the Comprehensive Spending Review (CSR) 2010 period from the GER to smooth the impact of the grant reductions.

2.23 It has become clear that the period of tight financial control will continue and the County Council continues to take every opportunity to increase the reserve to be able to continue the sensible policy of smoothing the impact of funding reductions and service and inflationary pressures without the need to make ‘knee jerk’ reactions to deliver a balanced budget.

2.24 The net impact of the changes in the revenue account during 2019/20 mean that the BBR stood at just over £78.5m at the end of the 2019/20 financial year. This is in line with the financial strategy of supporting the revenue position as savings are developed and delivered on a two year cycle; or longer where appropriate.

2.25 It has been agreed that where possible, the County Council will continue to direct spare one-off funding into the BBR to maintain what is part of this successful strategy which has served it very well to date. Consequently, as part of budget setting in February 2020, a number of additions were approved, notably following the savings resulting from both the favourable 2019 Pension Fund revaluation (which saw the eradication of the deficit and the removal of the need for the past service payments that we were making and assumed would be needed in the future), and also the pre-payment of pension contributions to the Pension Fund.

2.26 Building the provision within the BBR will support the revenue position in future years, as set out in the MTFS, in order to give the County Council the time and capacity to implement the Tt2021 Programme and to develop the successor Savings Programme through a two year savings cycle which enables safe delivery of change in the medium term.

2.27 Further additions have been included as part of developing the budget for 2021/22 and the table below summarises the latest forecast position for the BBR taking into account these additions and the requirement to balance the budget in the interim year of 2022/23 and to begin to make provision for the period beyond, particularly as we have no confident visibility of the financial landscape until the CSR later in the year:

	£'000
Balance at 31 March 2020	**78,509**
MRP Holiday	10,500
Remaining Cash Flow for Tt2019	(16,000)
Cash Flow for Tt2021	(32,000)
Interim Year 2020/21	(28,400)
Additions from valuation saving (3 Years)	45,000
Additions from pension pre-payment (3 Years)	9,000
Additions from 2020/21 Budget Setting	6,995
Additions from 2021/22 Budget Setting	3,396
Interim Year 2022/23	(40,200)
Forecast Balance 31 March 2023	**36,800**
Interim Year 2024/25	(44,100)
Forecast Deficit 31 March 2025	**(7,300)**

2.28 This position does not include the impact of the Covid-19 pandemic as the County Council's approved strategy is to deal with this as a separate one-off event in order to leave the County Council in the same position it would otherwise have been to tackle the next savings programme after Tt2021.

2.29 The forecast balance at 31 March 2023 begins to make provision for the medium term as part of the County Council's overall longer term risk mitigation strategy. Whilst this amount is not insignificant it must be considered in the context of the size and complexity of the County Council's activities and both the level of uncertainty associated with the financial position beyond 2020 and scale of the complex and challenging transformation activity that is still to be implemented in full.

2.30 It is important to note that the table includes no allowance for IT investment or cash flow funding for the Savings Programme for 2023, hence the focus on leveraging the benefits from the investment made to date and on ensuring delivery by 1 April 2023. Despite this a deficit is forecast and further contributions will therefore need to be made.

2.31 I**nvest to Save** – This reserve is earmarked to provide funding to help transform services to make further revenue savings in the future. Rather than just prop up the budget on a short term basis, the County Council feels it is a far more sensible policy to use available reserves to generate efficiencies and improve services over the longer term, by re-designing services and investing in technology and other solutions that make services more modern and efficient.

2.32 **Corporate Policy Reserve** – This small reserve is available to fund new budget initiatives that are agreed as part of the overall budget. It offers the opportunity to introduce specific service initiatives that might not have otherwise gained funding and are designed to have a high impact on service users or locations where they are applied.

2.33 **Organisational Change Reserve** – The County Council is one of the largest employers in Hampshire and inevitably reductions in government funding, leading to reduced budgets, alongside the need to deal with service and inflationary pressures means that there is an impact on the number of staff employed in the future.

2.34 The County Council, as a good employer, has attempted to manage the reduction in staff numbers as sensitively and openly as possible and introduced an enhanced voluntary redundancy scheme back in 2011. The scheme offered an enhanced redundancy rate for people who elected to take voluntary redundancy. This has been a highly successful way of managing the reductions in staff numbers, whilst maintaining morale within the rest of the workforce who are not required to go through the stress and uncertainty of facing compulsory redundancy and since the scheme was introduced, voluntary redundancies account for the vast majority of the total number of staff that have left the organisation because of specific restructures and service re-design.

2.35 A scheme is in place, albeit adapted since first introduced, to enable the continued reduction and transformation of the workforce required to deliver the significant savings needed in the medium term with the aim of minimising compulsory redundancies.

2.36 Departments are still responsible for meeting the ‘standard’ element of any redundancy package, but the Organisational Change Reserve was put in place to meet the ‘enhanced’ element of the payment. The reserve has been reviewed in the context of the new scheme and the requirement for future organisational change and this will be revisited periodically in line with the implementation of the Authority’s change programmes and the consequent requirement for future organisational change.

2.37 This reserve also funds aspects of management development approved under the Workforce Development Strategy to support a range of middle and senior management developmental work which has been critical to the delivery of transformation and has also been a key factor in the County Council's ability to recruit and retain the best senior staff.

2.38 It should be highlighted that the total 'Corporate Reserves' outlined above accounted for approximately 17.3% of the total reserves and balances that the County Council held at the end of the 2019/20 financial year, and these have largely been set aside as part of a longer term strategy for dealing with the significant financial challenges that have been imposed on the County Council. In addition, the BBR which comprises the majority of these 'available' Corporate Reserves, standing at more than £78.5m at the end of 2019/20, is in reality committed to balance the budget in the medium term, as set out in paragraph 2.27, as well as providing crucial cash flow support as part of the Covid-19 response package.

2.39 The reserves detailed above represent the total revenue reserves of the County Council and amounted to £476.5m at the end of the 2019/20 financial year, as shown in the table on the second page of this Appendix. Within this amount, the County Council is required to show other reserves as part of its accounts which are outlined below.

Enterprise M3 Local Enterprise Partnership (EM3 LEP) Reserve

2.40 The County Council is the Accountable Body for the funding of the EM3 LEP and has therefore included the EM3 LEP's income, expenditure, assets and liabilities, (including reserves) in its accounts. Prior to 2015/16 the County Council did not include transactions relating to the EM3 LEP in its accounts.

2.41 The County Council does not control the level or use of the EM3 LEP Reserve.

Schools' Reserves

2.42 Schools' reserves accounted for more than £38.1m or 5.9% of total reserves and balances at the end of the 2019/20 financial year.

2.43 These reserves must be reported as part of the County Council's accounts, but since funds are delegated to schools any surplus is retained by them for future use by the individual school concerned. Similarly, schools are responsible for any deficits in their budgets and they maintain reserves in a similar way to the County Council to smooth fluctuations in cash flow over several years.

2.44 The County Council has no control at all over the level or use of schools' reserves.

Dedicated Schools Grant (DSG) Deficit Reserve

2.45 Schools are facing increasing financial pressure, in particular relating to high needs for children with special educational needs and or disabilities (SEND), both at an individual school level and within the overall schools' budget. These pressures are outside the County Council's core budgets, but the County Council retains an active role and interest as the local education authority. In 2019/20 the overall position was once again balanced through the use of the Dedicated Schools Grant (DSG) Reserve, as allowed by the Department for Education (DfE).

2.46 The resulting DSG deficit of approaching £22.8m (up from £13.7m last year) will be funded from future years DSG funding. A DSG Deficit Recovery Plan was produced last year, at the request of the DfE, and the local authority continues to develop this and implement strategies to reduce the pressure on the High Needs Block.

2.47 The overall cumulative deficit in the DSG Deficit Reserve (which was included within overall schools' reserves for presentational purposes only in 2018/19) is expected to be £36.4m at the end of 2020/21. The Department for Education (DfE) have consulted on changes to the DSG to clarify that it is a ring-fenced specific grant separate from the general funding of local authorities and that any deficit is expected to be carried forward and does not require local authorities to cover it with their general reserves. Therefore, whilst this sum sits as a 'negative reserve' on the County Council's balance sheet, it in effect therefore represents an overdraft for schools which they (and the Government) need to address over the longer term.

Capital Reserves

2.48 The Capital Grants Unapplied Reserve holds capital grants that have been received in advance of the matched spending being incurred. They are not available for revenue purposes.

2.49 A sum of more than £166.6m was held within capital reserves and balances at the end of the 2019/20 financial year, although of this approaching £25.8m related to the EM3 LEP which is included in the annual accounts, as the Council is the Accountable Body. EM3 LEP capital grants unapplied have increased as part of a deliberate strategy to ensure that major projects are approved based on the outcomes they will deliver rather than the speed at which funding provided by the Government can be spent.

3. Reserves Strategy

3.1 The County Council's approach to reserves has been applauded in the past by the Government and the External Auditors as a sensible, prudent approach as part of a wider MTFS. This has enabled the County Council to make savings and changes in service delivery in a planned and controlled way rather than having to make urgent unplanned decisions in order to reduce expenditure.

3.2 This approach is well recognised across local government and a previous article in the Municipal Journal by the Director of Local Government at the Chartered Institute of Public Finance and Accountancy stated

> *"What reserves do allow authorities to do is to take a more medium term view of savings and expenditure and make decisions that give the best value for money. This is better than having to make unnecessary cost reductions in the short term because they do not have the money or funding cushion to allow for real transformation in the way they provide services."*

3.3 We are in an extended period of tight financial control which will last longer than anyone had previously predicted, and the medium term view highlights a continued need for reserves to smooth the impact of reductions in funding and enable time for the planning and implementation of change to safely deliver savings.

3.4 The County Council's strategy for reserves is well established and operates effectively based on a cyclical pattern as follows:

- Planning ahead of time and implementing efficiencies and changes in advance of need.
- Generating surplus funds in the early part of transformation programmes.
- Using these resources to fund investment and transformation in order to achieve the next phase of change.

3.5 This cycle has been clearly evident throughout the decade, with surplus funds generated in advance of need as part of budget setting and then supplemented by further resources released in the year. Achievement in advance of need within departments and efficiencies in contingency amounts due to the successful implementation of change has meant that the Council has been able to provide material funding including the following:

- Departmental reserves to pay for the cost of change associated with their own transformation programmes and to manage service pressures.
- Funding within the Invest to Save Reserve to help support the Tt2019 and Tt2021 Programmes and substantial IT enabling investment that will underpin many aspects of the next phase of transformation and savings.
- Additional funds to help smooth the impact of grant reductions, and safely manage the implementation of change, giving the County Council maximum flexibility in future budget setting processes.

3.6 It is recognised that each successive change programme is becoming harder to deliver and the challenges associated with the Tt2019 and Tt2021 Programmes are well known. The MTFS has made clear that delivery will extend beyond two years and provision has been made to ensure one-off funding is available both corporately and within departments to enable the programmes to be safely delivered. Taking longer to deliver service changes, rather than being driven to deliver within the two year financial target, requires the careful use of reserves as part of our overall financial strategy to allow the time to deliver and also to provide resources to invest in the transformation of services. This further emphasises the value of our Reserves Strategy.

3.7 Beyond 2021 the financial landscape will be significantly different, and the County Council will no doubt face the biggest ever challenge to its overall financial sustainability which on top of both the immediate and longer lasting effects of the Covid-19 pandemic will be impacted one way or another by government policy on fair funding, business rate retention, Brexit and the future for adults' social care and the growing pressure nationally on children's services.

3.8 This increases the potential necessity to use reserves to alleviate the ongoing financial pressures in the coming years and we will continue to review all reserves regularly to ensure that there is sufficient financial capacity to cope with the challenges ahead.

3.9 In addition, while the overall level of reserves currently exceeds £0.6bn, it is also important to consider the level of the available resources in the context of the scale and scope of the County Council's operations, and it is a stark fact that when expressed in terms of the number of days that usable reserves would sustain the authority for, it would now be around 14. This highlights once again that reserves offer no long term solution to the financial challenges we face. Correctly used however, they do provide the time and capacity to properly plan, manage and implement change programmes as the County Council has demonstrated for many years now.

Section 25 Report from Chief Financial Officer

Section 25 of the Local Government Act 2003 requires the Chief Financial Officer (the Deputy Chief Executive and Director of Corporate Resources) to report to the County Council when setting its council tax on:

- the robustness of the estimates included in the budget, and
- the adequacy of the financial reserves in the budget.

The County Council is required to have regard to this report in approving the budget and council tax. It is appropriate for this report to go first to Cabinet and then be made available to the County Council in making its final decision.

Section 25 concentrates primarily on the risk, uncertainty and robustness of the budget for the next financial year rather than the greater uncertainties in future years. Given the significance of the funding reductions announced to the end of the decade and the uncertainty surrounding the outcome of the next Comprehensive Spending Review (CSR), this report considers not only the short term position but also the position beyond 2021/22 in the context of the County Council's current Medium Term Financial Strategy (MTFS) and in light of the impact of the Covid-19 pandemic.

Robustness of Estimates in the Budget

The budget setting process within the County Council has been operating effectively for many years and is based on setting cash limits for departments each year allowing for pay and price inflation and other marginal base changes in levels of service whether these be the increasing cost of social care or the requirement to make savings to balance the budget.

Individual departments are then required to produce detailed estimates for services that come within the cash limits that have been set. More recently, the requirement to make savings has dominated the budget setting process and major transformation programmes have been put in place to effectively and corporately manage the delivery of savings within the required timescales, or as is more recently the case, to provide cash flow funding to support a longer delivery timescale for the more complex elements of the Programme.

Appropriate provisions for pay and price inflation are assessed centrally with departmental input and are allocated to departmental cash limits. Specific inflationary pressures within the financial year are expected to be managed within a department's bottom line budget but contingencies are still held centrally in the event that inflationary pressures have a severe impact in any one area (for example, energy costs).

Separate work is also undertaken to assess the demand led areas of service provision, which mainly relate to:

- Adults' Social Care.
- Children's Social Care.
- Waste Disposal.

Any requirement to increase budgets in these areas is considered corporately and may require additional savings to be made across the board to meet the increased demand. This is seen as a more effective way of managing cost pressures and enables strategic decisions to be made about resource allocation and the impact on service provision, rather than these decisions potentially being made in isolation by each department.

Budget management within the County Council remains strong as demonstrated by the outturn position each year since funding reductions began and as reflected in the annual opinion of the External Auditors who have given an unqualified opinion on the annual accounts and in securing value for money / financial resilience.

A further £80m of savings will be removed from the budget in 2021/22 and whilst some of this is expected to be delivered in later years, supported by corporate cash flow provisions, around £50m of the savings directly impact on the budget for this financial year. The current business as usual (i.e. excluding Covid-19) forecast outturn for 2020/21 as detailed in the main budget report shows that all departments are expected to be able to manage expenditure within the budgets that have been set, with previously agreed corporate support where required. This provides a stable financial base for the further challenges that lie ahead and is a good indicator that the savings that have been put in place to date are working as intended.

Budget 2021/22

The budget for 2021/22 has been produced in line with the process outlined in the section above and therefore I am content that a robust, council wide process has been properly followed and driven through our Finance Business Partners working with the Operational Finance Team. Further oversight is then provided by the Head of Finance and myself, in presenting the final budget and council tax setting report to Cabinet and County Council.

As part of the budget setting process this year a further £80m has been removed from detailed budgets and this is reflected in the departmental summaries contained in Appendix 5. However, it has repeatedly been reported to Cabinet and County Council as part of the MTFS and updates on the Transformation to 2019 (Tt2019) and Transformation to 2021 (Tt2021) Programme that delivery of these savings in some areas will extend beyond this financial year and in some cases on to 2022/23 and 2023/24; before the full value of savings can be achieved.

This reflects the complexity of the savings programmes in the social care services in particular, and the fact that some of the changes will take time to implement and fully bed in and will not start to have a major impact until new cohorts of clients come into the service. Funding to meet the later delivery of these savings must first come from departmental cost of change reserves, but corporate cash flow, supplemented by the Covid-19 response package, has been provided for to support this position.

The overall budget position for 2021/22 was less negative following the announcements made in the one year Spending Review in respect of social care funding and more importantly Covid-19 financial support, albeit that longer term this does not improve the expected two year gap to 2023/24 as a result of the continued growth in both adults' and children's social care services. This was set out in full in the update of the MTFS that was presented to County Council in July and then also in November last year.

Once again, the robustness of the budget is underpinned by adequate contingencies for volatile areas such as social care as well as by the existence of departmental cost of change reserves, which can be used to meet unforeseen costs during the year as well as providing funding for investment to achieve transformational savings.

Risks in the Budget 2021/22

In some respects, the significant changes to local government finance since 2010 have changed the profile of risk faced by most authorities. In reality the biggest financial risks now relate purely to reductions in government funding, changes in government policy and social care demand and cost pressures. These items together with other traditional risks and the impact of Covid-19 are outlined below:

a) **Covid-19 Pandemic** – In some respects the Covid-19 pandemic has tested in real terms the financial resilience and stability within the local government sector. For Hampshire, the decision was taken very early on that any financial response to the pandemic could not be at the expense of the existing medium term financial strategy and the need to continue to provide resources for the challenges that existed prior to Covid-19.

It was therefore agreed to treat the financial impact of Covid-19 as a one-off issue and to draw together a financial response package to deal with the medium term impact of the pandemic. Prior to the Spending Review and provisional Local Government Finance Settlement announcements, it was predicted that medium term unfunded costs and losses would reach £210m.

To counter this, a financial response package was developed by the County Council that looked at what reserves and other contingency funding could be applied to offset the impact of the pandemic. A total of £160m was pulled together, which meant that a minimum of £50m of further Government funding was required to protect the County Council's financial position.

To be clear, this did not represent spare funding, it literally would have stripped out every last bit of financial capacity that the County Council possesses coupled with a reduction in in-year budget contingency levels for three years, leaving the Council extremely vulnerable to any financial shocks in the future.

Following the Government announcements of new funding and the provision of information on council tax and business rates by billing authorities, the forecast of medium term unfunded costs and losses has now reduced to £88.3m, which is clearly 'less negative' than the previous estimate but still does mean that over £88m of County Council resources has needed to be expended on the pandemic response at a time when it still faces significant financial challenges going forward. The package includes the use of contingency budgets in future years which does therefore increase the risks in the budget for those years, albeit efforts will be made to re-instate them.

At the time of writing this report, the country is in another full lockdown and rates of infection are at an all-time peak. Whilst the roll out of the vaccine offers hope in the coming months, further financial impact cannot be ruled out at this stage.

In overall terms, I am content with the County Council's response to the pandemic and its decision to protect existing funding for the Transformation and Savings Programmes currently in train, but the overall outcome is that the underlying financial strength of the County Council is weaker as a result of the pandemic.

b) **Government Funding and Policy** – The expectation within the public sector was that there would be a multi-year Spending Review over the Summer of 2020 that would provide funding announcements to government departments and local government alike.

As a result of the Covid-19 pandemic once again a one year Spending Round was announced. Whilst this has given greater certainty for the 2021/22 budget setting process it still leaves the public sector on a 'cliff edge' in respect of future years and makes the question of longer term financial sustainability difficult to assess.

The provisional Local Government Settlement was announced on 17 December 2020 and broadly confirmed the funding announcements contained in the Spending Review the month before and these are reflected in the budget and council tax decisions contained in the main budget report. Disappointingly, the methodology for distributing social care grant was changed once again and heavily weighted towards those authorities with a low tax base. As a result, only £1.2m of the £300m was received by Hampshire compared to an expectation of around £5m. The continuation of the New Homes Bonus into 2021/22 was welcomed and has enabled the £3m extra investment into the Operation Resilience Programme to continue for another year.

Other significant changes to funding or policy during the year would have to be covered by contingencies or general balances, but generally once grant levels have been set in the final settlement due in January they do not change, although there have been in year changes implemented previously, for example reductions to the Public Health grant. At this stage therefore there is not thought to be any significant risk in this area for 2021/22 but it does have a major impact on future financial sustainability as discussed later in this Appendix.

c) **Social Care Demand Pressures** – By far the biggest impact in recent years has been the accelerating increase in the number and cost of Children Looked After. Despite the Covid-19 pandemic, the Transforming Social Care Programme has still created some positive results and longer term it is still hoped that the delivery of these Tt2019 savings can be achieved, although they do still represent a key risk in the budget.

Similarly, whilst adequate provision has been provided for children's social care growth in 2021/22, the impact of Covid-19 on the overall numbers is not known and could be adversely impacted by the latest lockdown and closure of schools. Furthermore, the medium term position assumes that Covid-19 will create a peak of temporary new cases that will drop out of the system in later years. Should this not prove to be the case then this will add further pressure on the budget in future years.

For adults' social care services, following a long period of relative stability the annual growth figure was increased from £10.0m to £13.5m each year from 2020/21 onwards, reflecting in particular the complexity and needs of clients at the point they present for care.

Whilst there is no evidence to change this assumption at the moment, the impact of Covid-19 on the adults' social care market has obviously been profound as has been the interaction with the NHS on the way in which clients are managed at the point of discharge from hospital.

It is far too early to understand what the forward impact of these changes will be, but at the moment there is still expected to be a worsening of the position for next year as health funded clients revert back to the County Council and there is the potential for 'pent up' demand to be released given the reluctance of people to go into care homes during the pandemic period. This impact is included within the medium term Covid projections and similar to children's services is expected to produce a peak in demand that reduces over time.

Despite the uncertainties presented by Covid-19 I am content that the budget for 2021/22 contains a realistic assessment of the likely growth we will face in the year, backed up by further contingency amounts and reserves if growth should be higher than forecast.

d) **Council Tax** – The ability to increase council tax specifically to fund the growing cost of adults' social care continues to be a key element of the funding package that has been put in place by the Government and includes flexibility to apply an extra 1% in total between the financial years 2021/22 and 2022/23.

The measure of core spending power assumes that local authorities will increase council tax by the maximum permitted by the referendum thresholds and on this basis the recommended increase is 4.99%, of which 3% relates to adults' social care, in line with the thresholds included in the provisional Local Government Finance Settlement released on 17 December last year.

This additional 1% was not included in past forecasts and therefore provides additional funding of £7m towards the increased cost of adults' social care for next financial year, which is positive in terms of our original forecasts.

e) **Pay and Price Risk** – The budget forecast originally contained a 3% allowance for the April 2021 pay award, which was also set to deal with any changes arising from the National Living Wage (NLW).

Following the Government's announcement that there should be a public sector pay freeze next year, with the exception of health workers and an allowance for the low paid, 2% of the allowance has been removed from the budget and directed towards to other pressures and initiatives. The remaining allowance will be used to deal with the award for the low paid and the NLW.

Any deviations from this position will be managed in year and reflected in future forecasts, however the impact of variances in this area now tend to be immaterial compared to the growth in social care costs that we face every year.

Similarly, the impact of price inflation has been considered in setting the budget and it would take a major departure from the Council's assumptions to create a financial problem that we could not deal with.

f) **Treasury Risk** – The County Council has limited exposure to interest rate risk as most long term borrowing is undertaken on a fixed rate. At the present time we are not undertaking any new or replacement long term borrowing due to the significant 'cost of carry' involved and our ability to internally borrow given our high level of reserves and cash balances. However, we do need to be mindful of the fact that we do not want to store up a large value of external borrowing that needs to be taken out in less favourable circumstances as our reserves reduce. Given current predictions on base rate levels and the fact that long term borrowing rates are based on the price of gilts rather than the underlying base rate, this is still considered low risk at this stage.

On the investments side, the absolute value of estimated income for 2021/22 is circa £10m per annum excluding the impact of Covid-19, which is minimal against the County Council's overall budget, however, the change in investment strategy which moved part of the portfolio to medium term investments has increased the risk in the portfolio overall. This has been mitigated by the creation of an Investment Risk Reserve which will deal with any changes in valuations of investment and provide a buffer against any significant drop in returns. Contributions to this reserve are regularly reviewed at year end to ensure adequate provision is made and the medium term aim is to increase the reserve to match 2.5% of the higher yielding investment portfolio.

More recently the market has experienced negative interest rates and the investment strategy has been amended to reduce the likelihood of needing to invest at negative rates, albeit the primary need to protect capital may necessitate this under certain market conditions.

Covid-19 has obviously had a de-stabilising impact on investment markets with a big dip being seen early on in the crisis. Whilst markets have recovered to some extent the latest lockdown and spread of the virus could undermine the recovery during this year.

The loss of investment income resulting from Covid-19 is covered by the medium term financial response package that has been put in place and does not have an impact on the forward budget. However, as with other factors, it is assumed that investment income levels will return to normal over the medium term and if this is not the case then this will impact on the budget going forward. Having said this, as mentioned above, the total level of investment income is relatively small compared to the overall net budget.

The Adequacy of Reserves

The County Council's policy on general balances is to hold a minimum prudent level which based on the previous risk assessment is around 2.5% of net expenditure. The projected level of general fund balances will be 2.8% of net expenditure at the beginning of 2021/22.

Overall, the level of earmarked reserves and balances that the County Council holds stood at £643.1m (including schools and the Enterprise M3 Local Enterprise Partnership Reserve) at the end of March 2020 and these reserves, the majority of which are held for specific purposes as set out in the Reserves Strategy in Appendix 7, underpin the overall MTFS and the Capital Programme.

The Reserves Strategy sets out clearly that the bulk of reserves are earmarked for a specific purpose and are not available to fund other things. This is reflected in the Covid response package which currently anticipates the use of only £18.3m of reserves to meet the £88.3m deficit; and £3m of this amount reflects bringing the General Fund Reserve back to the 2.5% recommended by the CFO.

However, what has been demonstrated throughout the pandemic is that the level of reserves held by the County Council provides options and flexibility in addressing the financial challenges created by Covid-19. For example, at one point the response package included using the General Capital Reserve to help meet the deficit by borrowing to provide replacement funding for the Capital Programme. Whilst this would have had a financial impact in the longer term it did provide a ‘last resort’ option to the County Council which would not have been available to other authorities who do not have the value of reserves that the County Council does.

As mentioned above, the County Council’s strategy for dealing with Covid-19 was to protect resources that have already been set aside to support the various Transformation and Savings Programmes currently in train. In line with that strategy, those reserves remain available to support the ongoing revenue position are used sensibly to manage change and provide the time and capacity to properly implement savings plans that seek to minimise the impact on service users. Cash flow funding to support the Tt2019 and Tt2021 Programme is already included in our financial plans and sufficient funding also exists to meet the ‘interim year’ for 2022/23 as part of the planning for the next Savings Programme to 2023. Whilst this stabilises the position up until 2023/24, it does not provide sufficient firepower to cashflow savings beyond 1 April 2023 and this is reflected in the change from a Transformation to a Savings Programme for 2023 as proposals would need to be fully implemented by that date, since there is no provision made for slippage at this stage.

Whilst the majority of reserves are allocated for a specific purpose, as outlined in the Reserves Strategy, and highlighted by the Covid-19 pandemic, this does still provide flexibility in being able to manage the finances of the County Council going forward, compared to some County Councils whose total reserves stand at less than the BBR which we currently hold. I am therefore satisfied that the level of reserves is adequate to support the agreed financial strategy over the medium term.

CIPFA Financial Resilience Index

Following the events in Northamptonshire and a heightened national focus on the finances of local government more generally, the Chartered Institute of Public Finance and Accountancy (CIPFA) produced a Financial Resilience Index (FRI). The index uses a range of financial information and other factors to generate a series of measures against which all authorities are ‘stress tested’, although clearly Covid-19 has created a very real and more complex stress test than we would ever want to consider in theory.

There is currently no update on the Index for this year as the majority of the datasets in the Resilience Index are based upon the Revenue Outturn (RO) forms that are usually published annually by Ministry for Housing, Communities and Local Government (MHCLG) in November. Due to the coronavirus, the final RO forms for 2019/20 are not now due to be published by MHCLG until the end of January 2021 and therefore the FRI is unlikely to be available until February.

That said, the data used for the Index is not likely to change significantly for Hampshire and it is likely that the same issues will be flagged once again. The summary below indicates the low and high risk areas identified in the Index from last financial year:

Lower Risk Areas:

- The County Council scored well on most indicators relating to reserves, in fact Hampshire has the highest level of reserves of any County Council.
- The rate of use of its reserves and the reserves depletion time also came out as low risk.
- The council tax requirement as a proportion of total funding was also positive meaning that a high proportion of resources was generated locally and was therefore low risk as a continued income source.
- Hampshire has an outstanding children's social care Ofsted judgement and an unqualified External Auditors value for money assessment.

Higher Risk Areas:

- The level of unallocated reserves was flagged as high risk, which reflects the commentary in the Reserves Strategy in Appendix 7 that the majority of our reserves are set aside for a specific purpose. We are fully aware of this fact and the MTFS already provides for specific future funding that is essential to maintain our financial sustainability. The Covid-19 response package also highlighted that there were limited unallocated reserves but as mentioned above the value of Hampshire's reserves provides options and flexibilities that are not open to others.

I do not expect there to be any new issues arising from the FRI once it is published but should information become available before Cabinet or County Council an update will be provided if there are any significance deviations.

<u>CIPFA Financial Management Code</u>

The following statement was issued by CIPFA on the Financial Management Code:

> *"The first full year of compliance with the new Financial Management Code is due for 2021/22. CIPFA recognises that the coronavirus crisis has seen local authorities and their finance teams placed under extreme pressure which is ongoing.*
>
> *CIPFA are considering the potential impact of these additional burdens on authorities and their ability to fully implement the FM Code from 2021/22 and whether 'working towards' full implementation from 2022/23 might be an appropriate response to these resourcing issues (alongside the evident risks and financial challenges in the sector, which arguably make earlier implementation more important).*
>
> *The ultimate decision will rest with MHCLG (as with the Prudential and Treasury Management Codes, CIPFA set the FM code on behalf of MHCLG) and we plan to make an announcement in the new year, following consultation with ALATS."*

The following table outlined the areas where improvements were identified last year together with the latest update (in italics):

Code Section	**Financial Management Standard**	**Hampshire County Council Position**
Section 5: Stakeholder engagement and business plans	L – The authority has engaged where appropriate with key stakeholders in developing its long-term financial strategy, medium term financial plan and annual budget.	Whilst the County Council has regular contact with its key stakeholders in developing service priorities and collaborative working and consults widely in respect of changes to service provision, it is not systematic in engaging stakeholders in respect of strategic financial planning and budget setting and consideration could be given to how this could be improved and incorporated into the financial planning and budget setting cycle if appropriate. *Whilst this has not been progressed during this year, the plan is to engage with stakeholders as part of the development of the updated Medium Term Financial Strategy once a multi-year settlement has been provided by the Government.*
Section 5: Stakeholder engagement and business plans	M – The authority uses an appropriate documented option appraisal methodology to demonstrate the value for money of its decisions.	The County Council's feedback in respect of this Financial Management Standard is that it would not want to dictate a specific documented option appraisal methodology across the whole Council as many of the more theoretical models are not appropriate for some of the decisions that are taken and are often disproportionate in terms of the effort required to complete them. Instead, we ensure that all relevant decisions are supported by a clear business case that should be proportionate to the size and complexity of the matter being considered. *An E-Learning module is being developed for managers to assist them with drawing up business cases and option appraisals on a consistent basis and will be available next financial year.*

Code Section	**Financial Management Standard**	**Hampshire County Council Position**
Section 6: Monitoring financial performance	O – The leadership team monitors the elements of its balance sheet which pose a significant risk to its financial sustainability.	Again, the feedback provided to CIPFA on the Standard was that it was inappropriate to concentrate on the balance sheet as a single issue and that this was not something that generally happened in practice. The draft guidance quoted various specific areas covered by this Standard including: 1. Capital investment and the maintenance of assets. 2. Long and short term investments. 3. Debt collection. 4. Cash flow management. 5. Borrowing. 6. Reserves. The County Council already has appropriate arrangements in place through other means to manage these risks and it is therefore not considered necessary to group them in this way for consideration by the leadership team. A review of the more detailed guidance will be undertaken to ensure that we are not missing anything. *Having reviewed the more detailed guidance the CFO has concluded that the arrangements that we already have in place are sufficient to ensure appropriate focus in these areas and no further action is necessary.*

Budget 2021/22 – Conclusion

Given the details outlined above, provided that the County Council considers the above factors and accepts the budget recommendations, including the level of earmarked reserves and balances, a positive opinion can be given under Section 25 on the robustness of the estimates and level of reserves for 2021/22.

The Position Beyond 2022

The latest MTFS was approved by County Council in July and updated in November last year and extended the planning horizon to 2023/24. After the announcement of another one year spending round for 2021/22, the next Comprehensive Spending

Review (CSR) is due to take place this year and will set the framework for public spending; hopefully over the next four years.

Reference has already been made about the anticipated medium term impact of Covid-19 and how this is being dealt with as a separate, one-off issue in order to leave other resources intact to support existing and future Transformation and Savings Programmes. Given this approach it is not anticipated that Covid-19 will have a major impact on future medium term forecasts and the budget setting process.

The delay in the CSR and the postponement of the Fair Funding Review and the extension of Business Rate Retention, mean that there is very little information on which to base forecasts beyond the next financial year. This is further exacerbated by the fact that both the economy and public finances at a national level have been so heavily impacted by Covid-19 which has seen government debt levels rise well above those that followed the economic crash in 2008, which triggered a pro-longed period of austerity.

It is therefore difficult at this stage to predict what the financial landscape will look like for the County Council after 2021/22, and in reality, we will probably need to wait until December 2021 before we are in a position to understand our longer term financial prospects, but it is clear we cannot wait to progress with the next savings programme and that this must be delivered in full by April 2023. Work has therefore already started on delivering the Savings Programme for 2023 based on the past forecasts of a £40m per annum deficit each year after allowing for a 3.99% council tax increase.

Clearly trying to make further savings on top of the £560m that will have been removed from the budget by April 2021 will be extremely challenging particularly as there is no flexibility on the delivery timescales, however our tried and tested approach will mean that proposals will be considered in good time for implementation by April 2023 and our forecasting approach means that there may be some additional grant funding that could be applied to savings targets in Adults' Health and Care and Children's Services.

The MTFS has highlighted for many years the fact that over the medium term, without a significant change in the way in which growth in adults' and children's social care is funded, the County Council is unlikely to be financially sustainable, since it is not possible to continually cut some services to fund growth in others.

At this stage however, in the absence of the outcome of the CSR and other changes to the local government finance regime, the County Council must focus on delivery of the remaining Tt2019 and Tt2021 Programme the development of the Savings Programme for 2023 and I believe it is well placed to do that underpinned by departmental reserves and the corporate funding that is already in place.

Carolyn Williamson

Deputy Chief Executive and Director of Corporate Resources

27 January 2021