

## 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 fueled 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 At the end of the 2020/21 financial year the total reserves held by the County Council together with the general fund balance stood at almost £754.8m an increase of nearly £89m on the previous year. This is primarily as a result of savings in Departmental expenditure due to reduced activity and additional NHS funding for adults' social care, together with net savings in schools spending during the pandemic.
- 1.4 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 2021

- 2.1 Current earmarked reserves together with the General Fund Balance totalled £754.8m at the end of the 2020/21 financial year. The table below 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 2019/20.
- 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.

	<b>Balance 31/03/2020 £'000</b>	<b>Balance 31/03/2021 £'000</b>	<b>% of Total %</b>
General Fund Balance	<b>22,298</b>	<b>23,198</b>	<b>3.1</b>
<b><u>Fully Committed to Existing Spend Programmes</u></b>			
Revenue Grants Unapplied	38,111	18,969	2.5
General Capital Reserve	112,357	148,963	19.7
Street Lighting Reserve	27,527	27,228	3.6
Public Health Reserve	5,480	5,758	0.8
Other Reserves	1,071	1,198	0.2
	<b>184,546</b>	<b>202,116</b>	<b>26.8</b>

	<b>Balance 31/03/2020 £'000</b>	<b>Balance 31/03/2021 £'000</b>	<b>% of Total %</b>
<b><u>Departmental / Trading Reserves</u></b>			
Trading Accounts	6,725	8,800	1.2
Departmental Cost of Change Reserve	85,492	140,690	18.6
	<b>92,217</b>	<b>149,490</b>	<b>19.8</b>
<b><u>Risk Reserves</u></b>			
Insurance Reserve	40,955	39,589	5.2
Investment Risk Reserve	4,958	6,250	0.8
	<b>45,913</b>	<b>45,839</b>	<b>6.1</b>
<b><u>Corporate Reserves</u></b>			
Budget Bridging Reserve	78,509	68,170	9.0
Invest to Save	22,290	17,215	2.3
Corporate Policy Reserve	6,852	7,300	1.0
Organisational Change Reserve	3,442	3,422	0.5
	<b>111,093</b>	<b>96,107</b>	<b>12.7</b>
<b><u>HCC Earmarked Reserves</u></b>			
EM3 LEP Reserve	5,081	4,760	0.6
Schools' Reserves	38,109	66,667	8.8
	<b>433,769</b>	<b>493,552</b>	<b>65.4</b>
<b>Total Revenue Reserves &amp; Balances</b>	<b>499,257</b>	<b>588,177</b>	<b>77.9</b>
<b>Total Capital Reserves &amp; Balances</b>	<b>166,637</b>	<b>166,672</b>	<b>22.1</b>
<b>Total Reserves and Balances</b>	<b>665,894</b>	<b>754,849</b>	<b>100.0</b>
DSG Deficit Reserve	(22,754)	(35,444)	
<b>Net total</b>	<b>643,140</b>	<b>719,405</b>	

### **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.

### **Fully Committed to Existing Spend Programmes**

- 2.4 By far the biggest proportion of revenue reserves are those that are fully committed to existing spend programmes and around £149m 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.
- 2.5 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.
- 2.6 These reserves do not therefore represent 'spare' resources in any way and are being utilised as planned in the coming years.

### **Departmental / Trading Reserves**

- 2.7 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.
- 2.8 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.
- 2.9 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 implement changes associated with savings proposals and to manage the cash flow impact of later delivery of savings and in year budget pressures.
- 2.10 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.
- 2.11 All departments will be utilising their reserves to fund the activity to deliver the Tt2021 and SP2023 Programmes and to fully cash flow the later delivery of savings if needed. The exceptions to this are Children's Services, ETE and Adults' Health and Care who will require some additional corporate and/or Covid based support based on the current forecast of savings delivery across the transformation programmes, provision for which has made within the latest MTFs.

### Risk Reserves

- 2.12 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.
- 2.13 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.
- 2.14 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.
- 2.15 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 the reserve has been increased to the equivalent of 2.5% of the total higher yielding investment portfolio.

### Corporate Reserves

- 2.16 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.
- 2.17 This leaves other available earmarked reserves that are under the control of the County Council and totalled more than £96.1m 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. These reserves are broken down into four main areas:
- 2.18 **Budget Bridging Reserve (BBR)** – This reserve 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.
- 2.19 More latterly the reserve has been used to fund budget deficits in the ‘interim’ year of the two year savings cycle and to provide any corporate cash flow support needed for the planned later delivery of savings.
- 2.20 The increased deficit in the 2022/23 ‘interim’ year and the additional deficit over and above the £80m predicted to 2023/24 will need to be met from the BBR and have been factored into the updated MTFS set out in the main body of the report.
- 2.21 However, beyond this date, the County Council does not have the firepower to meet the predicted deficit in 2024/25 and therefore a revised approach to balancing future years budgets beyond 2023/24 needs to be developed.
- 2.22 **Invest 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.

- 2.23 **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.
- 2.24 **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.
- 2.25 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. This has been changed and adapted over the years with a revised voluntary redundancy scheme now in place that is used on a targeted basis. Departments continue to pick up the compulsory costs of any redundancy and this reserve funds the enhanced element where applicable.
- 2.26 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.
- 2.27 It should be highlighted that the total 'Corporate Reserves' outlined above accounted for only 12.7% of the total reserves and balances that the County Council held at the end of the 2020/21 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.
- 2.28 The reserves detailed above represent the total revenue reserves of the County Council and amounted to £588.2m at the end of the 2020/21 financial year, as shown in the table above. 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**

- 2.29 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.
- 2.30 The County Council does not control the level or use of the EM3 LEP Reserve.

### **Schools' Reserves**

- 2.31 Schools' reserves accounted for almost £66.7m or 8.8% of total reserves and balances at the end of the 2020/21 financial year. The deficit on the Dedicated Schools Grant (DSG) is now shown as a separate item at the foot of the balances table following changes to Government guidance.

- 2.32 Schools 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.
- 2.33 The County Council has no control at all over the level or use of schools' reserves.
- 2.34 The overall schools' budget is currently in deficit and this deficit will increase again this financial year with School's Forum agreeing for this to be carried forward and be funded from future years DSG allocations. The overall cumulative deficit in the DSG Deficit Reserve at the end of 2020/21 is £35.4m and as yet there is no financial solution to this growing problem, which is of significant concern as the 'statutory override' currently in place to separate this deficit from the local authority reserves ends after next financial year.

### **Capital Reserves**

- 2.35 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.
- 2.36 A sum of more than £166.7m was held within capital reserves and balances at the end of the 2020/21 financial year, although of this £22.5m 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, albeit the approach for 2024/25 onwards need to be re-considered.

- 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 and savings 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 since 2010, 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 and savings programmes and to manage service pressures.
  - Funding within the Invest to Save Reserve to help support digital and other IT improvements.
  - Additional funds to help smooth the impact of our two year savings cycle, 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 with significant elements of Tt2019, Tt2021 and the SP2023 Programmes still to be delivered over the next 13 months, before we begin to address the challenges ahead.
- 3.7 The strategy will be to use reserves to fund the additional deficits in both 2022/23 and 2023/24 to give the County Council the maximum time and flexibility to address the financial challenges from 2024/25 onwards, but it is clear that it cannot do this alone and we will continue to lobby the Government to provide additional financial support and financial flexibilities going forward.
- 3.8 In addition, while the overall level of reserves currently exceeds £0.75bn, 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. 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.

