BCP Council

9 February 2022

RESERVES (s25 Report)

Background

A local authority must decide the level of general reserves it wishes to maintain before it can decide the level of the council tax it sets. The purpose of general reserves is to manage the risk to the council's financial standing from the impact of excesses to the budget provision and unforeseen events.

In setting the budget the Director of Finance as the Councils section 151 (s151) officer is required under section 25 of the Local Government Act 2003 to report on **the robustness of the budget** and the **adequacy of reserves** supporting the budget. The requirement on the s151 officer is to ensure that the **annual budget recommended to council is balanced** (i.e. expenditure matches income), is robust and therefore deliverable and has an adequate level of reserves. The s151 officer is required to ensure that the council's approved budget addresses these three issues.

Ultimately, Council will determine the level of reserves and balances formally in setting the annual budget. The advice of the Chief Finance Officer must be formally recorded.

Guidelines

There is no set formula for deciding what level of reserves is adequate. Councils are free to determine the reserves they hold. Councillors are responsible for ensuring that the reserves are appropriate to local circumstances and are accountable to taxpayers for the decisions they make.

It should be stressed that there is no theoretically "correct" level of reserves because the issues that affect an authority's need for reserves will vary over time and between authorities. Reserves should not be seen in a short-term context. They should be placed in the context of the ongoing uncertainty caused by the global public health emergency, long-term government funding reductions since 2010, the uncertainty caused by the lack of a three-year government spending review, and service delivery problems within its Children's Directorate. It is however legitimate for the council to call on reserves to mitigate short term pressures, smooth out the impact of extraordinary one-off demands and/or otherwise meet the costs of unforeseen events

Of relevance to this annual report will be the bold and ambitious agenda which underpins both the councils Big Plan and the proposals set out in the 2022/23 budget. Increasing levels of risk with reducing levels of overall reserves will be a key subject for reflection as will be the adoption of several non-traditional approaches to the balancing that proposed budget.

It should be emphasised that councils can and do experience significant financial difficulties as recent high-profile cases such as those at Northamptonshire County Council, Croydon Council, Slough Borough Council, and Nottingham City Council demonstrates.

Types of Reserves

Councils generally hold two main forms of reserves.

a) **Unearmarked Reserves:** are set aside to help manage the risk to the council's financial standing in the event of extraordinary or otherwise unforeseen events and to mitigate the underlying operational risk associated with the operation of the council and the management of service expenditure, income and the council's funding.

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b) **Earmarked Reserves:** are set aside for specific purposes including those held in support of various partnerships where the council is the accountable body, reserves designed to help deliver the challenges in the Medium-Term Financial Plan, key major projects of the council, reserves held on behalf of third parties and several reserves the council is required to hold in line with statute or its own governance requirements.

Comparative information

The Chartered Institute of Public Finance and Accountancy (CIPFA) have previously carried out some benchmarking on the level of reserves held by most unitary authorities and identified that they tend to maintain ***unearmarked reserves*** between 5% and 10% of net revenue expenditure. For BCP this would mean maintaining such reserves at between £14.1 million and £28.2 million.

(Net revenue expenditure (NRE) = £281.922 million, which is our 2021/22 projected net revenue expenditure before reserve movements, revenue support grant, business rates and collection fund surpluses / deficits).

Attached at appendix 3a is comparative information on **unearmarked reserves** against all upper tier authorities including unitary, county, and metropolitan authorities. This demonstrates that at a level of £15.3m the councils unearmarked reserves would be on the lower side of the median when presented as a proportion of NRE (5.4%).

CIPFA Financial Resilience Index

In 2019 the Chartered Institute of Public Finance and Accountancy (CIPFA) first published what they refer to as the CIPFA Financial Resilience Index. Its aim is to promote good standards of governance and financial management across the sector. The index shows the council's position on a range of measures associated with financial risk. It is a comparative analytical tool which builds a picture of the council's financial resilience by comparing one financial year with another and by comparing BCP Council with similar and other unitary councils.

The index uses a combination of financial outturn and budget data for the specific financial years in question. As year-on-year data is only now beginning to emerge for BCP Council the index usefulness is only now beginning to emerge.

That said, the approach of using benchmarking information to influence and shape the financial strategy and medium-term financial plan is fundamental to the council's budget process. This was demonstrated by the approach set out in the June 2021 MTFP Update report to Cabinet which proposed adjustments to the Councils self-imposed levels of debt as set out by the Capital Financing Requirement (CFR) and the year on year increases to the level of unearmarked reserves to recognise the higher level of risk associated with a higher debt position. The Council has also undertaken taken two separate pieces of work with the Local Government Association around Adult Social Care and Children's Services which included a review of the robustness of the council financial planning and monitoring processes and benchmarking to confirm if the base budget levels are appropriate to the size of the authority and suggest ways of reducing the councils cost base.

For information and transparency Appendix 3b provides a summary of the latest published CIPFA Financial Resilience Index. The key matters highlighted by this document include.

a) Comparative information is currently only available for 2019/20.

b) BCP Council has submitted its data for 2020/21 which is still subject to DLUHC data validation processes.

c) Comparative benchmarking information with other unitary councils will not be available until later in the financial year. Nevertheless our 2020/21 data has been shown on the appendix along with a direction of travel.

d) Benchmarking information for 2020/21 is likely to be significantly caveated due to the impact of covid19 and the government's response. A good example will be the level of reserves with BCP having, as just one example, to hold £40.4m of Government compensation for the reliefs given to business in 2020/21, in our reserves on 31 March 2021 on the basis that the cash transaction is processed within 2021/22.

Local Government Peer Review

In line with the statutory requirement to continually improve the council was reviewed by a team of Local Government Association peers in the week commencing the 19th November 2021. The standard scope of such reviews besides, local priorities and outcomes, organisational and place leadership, governance and culture, and capacity for improvement includes financial planning and management.

This financial element was led by Duncan Whitfield the Strategic Director of Finance and Governance at Southwark Council. Early observations included that BCP had a professional and experienced finance team who had enabled the council to have a solid financial base having successfully navigated the creation of a new unitary authority following the most complicated local government review process since 1974, a global pandemic and the delivery of services with over £100m less in annual Revenue Support Grant from Government compared to 2010. They also reflected that the council had a reasonable level of reserves. The council has not received the final report but in respect of areas to consider relevant to this report, it is expected they will recommend that council.

- notes that the accumulated DSG high needs deficit is close to creating an overall negative reserve position.
- continually assess the risks created by the overarching and ambitious programmes of regeneration and transformation and the potential to impact the resources necessary to support statutory and priority services.
- Ensures the affordability of new initiatives within the context of the MTFP timeline.
- Considers increasing unearmarked reserves beyond the current MTFP target to mitigate strategic and operational risks from ambitious programmes.

Chief Financial Officer advice

Reserves are an essential part of good financial management. They help councils to cope with unpredictable financial pressures and plan for their future spending commitments. The level, purpose and planned use of reserves are important factors for elected members and council officers to consider in developing medium term financial plans and setting annual budgets. Having the right level of reserves is incredibly important. Where councils hold very low reserves there may be little resilience to financial shocks and sustained financial challenges, where reserves are high then councils may be holding more than they need.

In advising councillors on the appropriate level of reserves there is a need to consider the potential financial impact of all strategic, operational, and financial risks facing the authority, together with the current overall financial standing of the council including any third-party assessments of this position. The management of reserves will be fundamental to ensuring BCP has a sound financial base on which to deliver its ambitions moving forward.

Organisational and change risk associated with the council's ambitions also need to be seen in the context of local authorities continuing to face some of the most significant financial challenges for a generation. These included the almost complete removal of government's un-ringfenced core funding to the relevant councils, constrained council tax increases, a decline in other sources of income, rising costs, and growing demand for many services the consequences of which will test the council's financial management and resilience well into the future. All these at the time of an ongoing global public health emergency and its legacy impact.

Summary Reserves Position

	Balance 31/3/21 £m	Balance 31/3/22 £m	Balance 31/3/23 £m	Balance 31/3/24 £m	Balance 31/3/25 £m	Balance 31/3/26 £m	Balance 31/3/27 £m
Un-earmarked Reserves	15.3	15.3	16.0	16.7	17.4	18.1	18.8
Earmarked Reserves	153.8	57.3	15.3	12.1	10.1	10.2	10.4
Total General Fund Reserves	**169.1**	**72.6**	**31.3**	**28.8**	**27.5**	**28.3**	**29.2**
Dedicated Schools Grant (1)	(7.8)	(20.7)	(37.4)	(62.6)	(99.9)	(150.3)	(216.1)
Dedicated Schools Grant (2)	**(7.8)**	**(20.7)**	**(37.4)**	**(58.0)**	**(80.6)**	**(102.7)**	**(122.1)**

The position as set out above recognises.

(a) **Unearmarked Reserves**. As a matter of prudence, the agreed strategy is to increase the level of unearmarked reserves from their current level of 5.4% of the council's net revenue expenditure to 6.1% over the five years of the MTFP. At £18.8m this will position these reserves at the mid-point when compared to all upper tier authorities including unitary, county, and metropolitan authorities. This approach is coterminous with the council taking the opportunity to support its big plan ambitions afforded by low levels of borrowing compared to similar size local authorities.

(b) **Earmarked Reserves.** Balance as at the 31 March 2021 includes both £59m of covid related government grants, and £30m of capital financing which was specifically set aside to support the 2021/22 revenue budget.

(c) **Earmarked Reserves**. Balance as at the 31 March 2022 includes.
- £20.7m being set aside to be used in 2022/23 to support the delivery of the revenue budget as proposed via the release of the remaining financial resilience earmarked reserve balance.
- £3.3m being the forecast 2021/22 financial outturn which will be set aside in earmarked reserves and released to support the 2022/23 budget.
- £12.2m being set aside to be used in 2022/23 to support the delivery of the revenue budget as proposed via the release of the transformation mitigation earmarked reserve.

The total General Fund Reserves balance excludes the accumulating deficit (negative reserve) on the **dedicated school's grant**.

(d) Line (1) represents how it would grow based on the current pattern of provision and growth, with no new state funded places being created beyond the 17 planned for September 2022 and further 60 from September 2023, and no actions to educate a greater proportion of pupils in mainstream schools

(e) Line (2) assumes that an additional 56 special school and resource-based places will be created in each of the 3 years following, starting from September 2024, that the growth in EHCPs will reduce from 10% per annum in 2021/22 to 5% from 2026/27, and the proportion of the growth in pupils educated in mainstream schools will increase from the current 10% to 50% in 5 years.

In both lines the same predictions for DSG funding growth have been used with the DfE providing the assumptions of 5% in 2023/24 and 3% for each year thereafter.

Robustness of the Budget - Assumption that £61m of capital receipts will be generated to fund the council's £67.9m transformation investment programme.

In the context of the council's overall financial position and its financial sustainability, a critical issue is the assumption that the council will generate £61.1m in capital receipts to finance its £67.9m transformation programme over the period to 31 March 2025. As indicated the council is proposing to redirect, to finance the 2022/23 proposed revenue budget, the residual £12.2m transformation mitigation earmarked reserve which would have supported any timing, by financial year, differences between when the transformation investment expenditure is planned to be incurred and when the actual capital receipts to fund it by, are received.

The assumed £61.1m in capital receipts break down into three component parts.

a) £5.5m of capital receipts already achieved as of 30 November 2021.

b) £13.4m of estimated but not yet delivered capital receipts assumed to be realisable before the 31 March 2025 from longstanding traditional asset sales.

c) This leaves a balance of £42.2m in net capital receipt from the securitisation of a future income stream assumed to be realisable in 2022/23.

The key risk to the council is in respect of any expenditure which it intends to incur before the actual capital receipts required to fund it are delivered. Before 31 March 2023 the council intends to spend £34.3m of transformation expenditure which it plans to finance from capital receipts. On the basis that £5.5m of receipts have already been received (a), the council therefore needs to deliver £28.8m in either this financial year (2021/22) or next (2022/23) to ensure it can meet it spending plans as set out. It estimates that £11.8m will be delivered from traditional asset sales over this period leaving **£17m** as a target to be delivered from the securitisation of a future income stream in 2022/23. Our work with KPMG suggests that the timelines in relation to the securitisation of an income stream are well within those required to mitigate this risk.

Council will need to monitor the achievement of capital receipts very carefully. Should the council fail to deliver the assumed amounts then it will not be easy to reprofile the expenditure to match. The current expenditure profile is key to delivering the £8.7m of annual transformation savings now being assumed for 2022/23 and the accumulated savings profile of £18.7m for 2023/24 onwards. Such a situation would lead to a formal assessment as to whether the council can continue to balance its budget for the year and the likelihood, failing any alternatives, of in-year service reductions to ensure the council can manage within the parameters of its financial resources.

Robustness of the Budget – Revenue expenditure transferred to Transformation.

In establishing a transformation investment programme at £67.9m, the budget as proposed increases the scale of the commitment to transformation related expenditure by £22.9m. This increase reflects.

a) The inclusion of £6.7m per year for 3 years of the costs of employees working on the programme who are not available to support day to day or statutory improvement duties. To be clear this is a transfer of £6.7m of annual costs, currently charged to the day-to-day revenue budget, to the transformation investment programme which is separately funded by the application of capital receipts.

b) Investment in the data and insight capability.

c) Increase in the programme contingency.

In respect of the first of these changes the council has engaged with both CIPFA Consultancy and the External Auditor to provide assurance that they accord with the current regulations which determine expenditure that can be legitimately financed by the flexible use of capital receipts. Key to these requirements is that any costs associated with the programme can be directly related to the savings workstreams and staff need to ensure evidence is available to justify any charges so made.

Robustness of the Budget – Flexible Use of Capital Receipts Regulations Extension

An associated risk to the ability to fund revenue transformation expenditure from the application of capital receipts is that it is only permissible via the governments Flexible Use of Capital Receipts (FUCR) regulations. These regulations are scheduled to cease on 31 March 2022 however in February 2021 the government set out their intention to extend these regulations to 31 March 2025. From discussion with government, they continue to provide assurance that the extension will be enacted however they also suggest that there will be some changes to the guidance. The 2022/23 budget has been prepared on the basis that these regulations will be laid before and agreed by parliament and that they will be materially consistent with the current regulations. Again, council will potentially need to formally review the 2022/23 budget to confirm it is still deliverable once the regulations that permit the extension of the FUCR regulations are published.

Robustness of the Budget – Unitemised Transformation Savings

From a good financial management perspective having unitemised savings in a budget are considered a sign of weakness. Both Northamptonshire and Croydon were criticised for having budgets built on this basis.

The BCP Council budget for 2022/23 as proposed includes £4m of unitemised savings associated with the transformation programme. However, it is a key priority work stream for the council with significant activity providing reassurance that the saving for 2022/23 is achievable. This includes work with the councils Strategic Implementation Partner and a revised business case presented by the Corporate Director for Transformation to the Transformation Programme Board at its January 2022 meeting.

Robustness of the Budget – Refinancing of Regeneration Expenditure

Council have had an ongoing programme of considering the extent to which costs charged to the revenue account can instead be transferred to capital where they can be considered part of the cost in creating an asset and financed as per the specific project. This means that where the project is being financed by borrowing over the life of the asset council taxpayers benefitting from the investment will be the ones paying for it.

In this regard the council has been reflecting on its 2021/22 budget which decided to fund our Urban Regeneration Company (URC) (BCP FuturePlaces) via ongoing contractual payments allowed for as part of the revenue account. Following a review of similar practice elsewhere, an alternative mechanism is being proposed whereby payment to the URC is based on the successful outcomes of the development advice received. This new approach from 1 April 2022, means BCP FuturePlaces would require a working capital loan from the council in the first instance to cashflow their activity prior to presenting successful business cases to Cabinet, and potentially Council, which include provision for an appropriate professional fee.

The approach will increase the operational risk to the URC which will need to ensure that both the cost of their day business activity and costs incurred in bringing projects forward are covered by the professional fee on these projects and any other income they are able to achieve. Ultimately this risk is retained by the council to the extent to which it is providing an £8m working capital loan facility to the company.

This proposal requires council to formally approve a revised business plan and operating model for the BCP FuturePlaces, including business cases for individual schemes as they come forward. Should council not endorse the approach then the 2022/23 budget as proposed will need to be significantly revised to ensure the budget can continue to be balanced.

Adequacy of reserves consideration - Accumulating deficit on the Dedicated Schools Grant (DSG) with specific reference to the High Needs Budget.

Another critical issue for the Council. In the private sector an organisation which has negative reserves, is likely to fail the "going concern" accounting concept. In local government a material uncertainty related to "going concern" is unlikely to exist as the financial reporting framework assumes the council's services, at least its statutory services, will continue to be delivered in all scenarios. In local government the most likely scenario is the councils Section 151 Officer is likely to have to contact DLUHC to advise them of their financial concerns and possibility of issuing what is referred to as a s114 report. A section 114 notice would result in an immediate and severe curtailing of activity to the provision of non-statutory services. Even statutory services may be subject to a reduction in frequency or quality.

As demonstrated by the summary reserves table the council is forecast to move into this position in the 2022/23 financial year.

To mitigate this situation the council and its partners, particularly the DfE and local schools, need to demonstrate leadership and decisive action in the recovery of the High Needs Budget position. This leadership is being led by a council High Needs Recovery Board which is chaired by the Chief Executive and includes, amongst others, the Leader, relevant Portfolio Holders, and the chair of the Schools Forum.

Part of this leadership is focused on conversations with government, supported by the Local Government Association and other local authorities, around the possibility of an extension to a current DfE statutory instrument which became law at the end of November 2020. These regulations currently mean the council cannot contribute to the deficit, cannot hold a reserve to act as a counterweight and has been required to move the deficit to an unusable reserve where it will sit as though it did not exist. It does though mean that the council is required to cash flow the deficit and continue to prioritise the work needed to reduce the deficit.

The statutory instrument, which comes to an end on the 31 March 2023, reads as follows.

Where a local authority has a deficit in respect of its school's budget for a financial year beginning on 1st April 2020, 1st April 2021 or 1st April 2022, the authority—

(a) must not charge to a revenue account an amount in respect of that deficit; and

(b) must charge the amount of the deficit to an account established, charged and used solely for the purpose of recognising deficits in respect of its school's budget.

Through the various conversations with civil servants and ministers, they continue to acknowledge the impact of the growing DSG deficit will have on BCP and many other local authorities. However as at the time of authoring this report (January 2022) no specific indication has been received that the statutory instrument will be extended.

Adequacy of reserves consideration – Recognition of funding gap for 2023/24

In considering the adequacy of reserves councillors are advised to take a forward look at the position for 2023/24. As it stands there is a revenue funding gap of £28.2m for 2023/24, This is in addition to delivering.

i. £18.7m of annual savings from the transformation programme now being assumed from that financial year onwards

ii. £7.8m of specific savings and efficiencies in Adults and Children's Services due to the inclusion, as a matter of policy, of a 2.99% restriction on the growth allowable in both these service areas ignoring any contribution towards the already assumed transformation savings. As part of this approach Portfolio Holders and officers will need to deliver a range of proposals for consideration in advance of the formal budget setting for 2023/24.

iii. As a matter of policy, an increase on all local fees and charges in line with inflation

Councillors need to acknowledge that unless significant additional revenue receipts from new commercial models can be delivered the council will have to make significant cuts to service levels from 1 April 2023 onwards. Both these eventualities will need to be planned for during the first 6 months of the new financial year. It should also be borne in mind that the council will approach this task with no financial resilience earmarked reserves available to fund the exit costs associated with any a reduction in service levels.

Looking even further forward councillors need to recognise the positive impact that the assumption of a 2.99% restriction of growth in Adults and Children's services and the £7.2m further saving in net FTE reductions following transformation (2025/26) are having on the MTFP. Without these assumptions the funding gap over the five years would amount to £53.8m. In addition, it should be borne in mind that the council is using the higher end FTE reductions and consequent savings that have been independently assessed as deliverable for each element and for the overall transformation programme.

Adequacy of reserves consideration – Reducing Level of Total General Fund Reserves

Another salient matter is that the council's financial sustainability is being reduced by the use of reserves to support budget proposals. £30m of one-off resources were used to support the 2021/22 budget of the council, principally created from refinancing of the capital programme and from a review of inherited resources. £36.2m of one-off resources are being used to support the 2022/23 proposed budget. Reserves can only be used once, therefore note should be taken that over the last two years the council will have materially reduced its earmarked reserves. The use of reserves will reduce the future financial flexibility and resilience of the council.

S25 Report - Conclusions

In respect of 2022/23 budget, the budget is balanced, and the CFO considers that there is sufficient evidence to support the estimates being used to prepare the budget and that they provide a reasonable and robust basis upon which to derive such forecasts. That said councillors need to fully acknowledge that the future financial sustainability of the council is dependent upon delivering the recurring savings through the transformation programme as it is currently living beyond its means (expenditure greater than the permanent sources of income). Councillors should also acknowledge the following risks being taken in drawing a budget based on the assumptions.

a) Council will deliver at least a £43m capital receipt in 2022/23 from the securitisation of an income stream which will need to obtain subsequent Council approval.

b) Council will agree to the refinancing of its Urban Regeneration Company (BCP FuturePlaces) and a £8m working capital loan facility within the context of a new Business Plan.

c) Council will deliver at least a £3.3m surplus in the 2021/22 financial year.

d) Council will deliver the £4m in unitemised transformation savings in 2022/23.

e) Council will be able to generate significant additional revenue receipts from new commercial models to avoid the service cuts that would otherwise be needed for 2023/24 and to avoid the need for the council to establish new or reprioritise current earmarked reserves to facilitate this process.

f) Council will be able to deliver the government's announced social care reforms within the resources they have announced as available

g) The pay and grading project can be delivered within a cost neutral framework in respect of the project's delivery before 1 April 2024 as provision for cost increases have only been recognised from this date onwards. No specific provision is made for any associated claims.

h) Government will formally confirm the extension of the flexible use of capital receipts regulations, as they have previously indicated, and that they will remain materially the same as the current regulations.

By way of mitigation, the approach of increasing the level of unearmarked reserves over the lifetime of the MTFP by £3.5m to cover the increasing day-to-day operational risks faced by the council is commendable. As is the holding of a base revenue budget contingency of £2.2m. It should be noted that £0.2m of this contingency is held subject to due diligence in respect of a proposal around Giant Gallery.

It does not though require any professional judgement from the Chief Financial Officer (CFO) to assess that the council's reserves cannot be considered adequate based on the potential crystallization of the DSG accumulating deficit. However, as legislation prevents the council from making provision to offset the deficit in 2022/23 it appears there is no other option than to accept the position. Councillors do need to recognise that this legislation will not, as it stands, be applicable for the financial year 2023/24 and in the absence of movement by government the council will have reached a tipping point and severe and drastic action will be required to manage the council's financial position.

The Chief Finance Officer in his statutory s151 officer role would also request that councillors carefully reflect that.

a) the transformation of the council and the savings being assumed from its delivery must happen if the council is going to have a financially sustainable future. The inherent risk must be acknowledged in using one off resources to support the proposed budget for 2022/23. £30m of one-off resources were used to support the 2021/22 budget, principally created from refinancing of the capital programme and from a review of inherited resources. £36.2m of one-off resources are being used to support the 2022/23 proposed budget. Reserves can only be used once therefore note should be taken that over the last two years the council will have materially reduced its earmarked reserves. The use of reserves will reduce the future financial flexibility and resilience of the council.

b) the current £28.2m funding gap that is forecast for 2023/24 (excluding the impact of the 2.99% restriction on the proposed growth Adults and Children's services) and assure themselves before investing further in services in 2022/23 even if they are deemed one-off in nature.

c) acknowledging the administrations confidence in new commercial models, give serious consideration as to whether increasing Council Tax by the full 5.99% permissible, not investing further in services at this time, and only committing to further borrowing if it is self-financing, would better preserve statutory services into the future. Any proposals to use complex capital transaction as a mechanism for balancing the 2023/24 budget needs to be treated with a high degree of caution.

Continual careful and diligent management of the council's financial resources will be required to ensure the council is not required to undertake the severe forms of actions that an increasing number of councils are having to resort to in order to balance their budgets.