APPENDIX 3

Reserves Strategy - Budget 2023/24

1 Background

1.1 Reserves are an essential part of good financial management. They help the Council to cope with unpredictable financial pressures and plan for future spending commitments. The level, purpose and planned use of reserves are important factors for the Council to consider in developing the Medium-Term Financial Strategy (MTFS) and setting the annual budget.

1.2 In setting the budget, the Council decides what it will spend and how much income it needs from fees, charges and council tax to supplement government funding. The Council may choose to fund some of its spending from its reserves or set aside some of its income to increase reserves for future spending.

1.3 Having the right level of reserves is important. If reserves are too low, there may be little resilience to financial shocks and sustained financial challenges.

1.4 Councils are free to determine the reserves they hold. Members are responsible for ensuring that the Council's reserves are part of the MTFS and need to be appropriate for circumstances. The Chief Finance Officer has a duty to provide members with advice on the level of reserves.

1.5 Councils face significant financial challenges, especially given the cost of living crisis and subsequent high inflation which has increased cost dramatically. The unprecedented reduction in government funding since 2010/11, a decline in other income, rising costs and growing demand for many services are all testing the Council's financial management and resilience. Many of these challenges are likely to continue through to the end of the decade and potentially beyond.

1.6 The Government has postponed the review of local government finances and the reset of business rates to 2025/26 and this uncertainty could create additional risk.

1.7 Current and future financial challenges pose significant, and increasing, pressures and risks for the Council. The Council may consider using reserves to balance competing pressures for example:

- Using reserves to offset funding reductions and protect services – although this can only be a short-term strategy as reserves are a one-off resource.
- Invest in making operational changes with the objective of reducing future costs of providing services.
- Increasing reserves to strengthen resilience against future, uncertain cost pressures. A feature of the 2023/24 budget strategy and for future MTFS years 2024/25 and 2025/26 has been that reserves will be used to support the budget. It is also used to fund investment in delivering savings through transformation and improving services supporting the new 15 minute neighbourhood corporate strategy.

2 The approach to setting the Reserves Strategy

2.1 The Reserves Strategy is integral to the MTFS and the annual budget setting process. Therefore, the MTFS includes:

- ➢ Information showing the current level of reserves and how reserves have changed over time.
- ➢ Consideration of the forward strategy for reserves needed to support the Council's MTFS.
- ➢ A summary of the financial risks facing the Council, how it will mitigate these risks, and the minimum and maximum level of residual risk for which the council may need to hold funds in its reserves.
- ➢ An explanation of the purpose and level of any earmarked reserves.
- ➢ Details of the plans for reserves within the published budget.

2.2 Reserves will be monitored throughout the year as part of the routine financial monitoring and the level of reserves reported as part of the year-end accounting processes.

3 Why the Council holds reserves

3.1 We use different terms to refer to the reserves depending on why they are held. Terms we use in this report have the following meanings:

- Available earmarked reserves – funds we choose to set aside to meet known or predicted future spending or ring-fenced by previous Council decisions.
- Working balances (unallocated reserves) to manage cash flows, funds to protect annual budgets against multiple, less predictable, costs and uncommitted accumulated surpluses.
- Other reserves - the Council holds but which are not available to fund their general spending: schools' reserves held by the Council; some reserves with statutory restrictions on how they can be spent, such as capital receipts or Housing Revenue Account reserves; and non-cash-backed reserves that councils hold to comply with accounting practice, such as pension reserves.
- Total reserves – the sum of earmarked reserves and working balances.

3.2 Available earmarked reserves include funds for contingent spending that is hard to predict (risk-based reserves) – for example reserves to cover shortfalls in investment income.

3.3 Reserves are distinct from contingency funds and provisions. Contingency funds are held within the annual revenue budget and are set aside mainly to meet ongoing costs such as pay and price pressures and provide a degree of flexibility around spending. Provisions are funds set aside for one-off probable future liabilities where the timing and amounts are uncertain.

Ring-fenced income

3.4 The Council must spend some of its income on specific purposes, for example, ring-fenced grants, or property developers' contributions for local environmental improvements. Spending ring-fenced income before the end of a financial year is not always possible or desirable. The Council will carry forward unspent ring-fenced income from one financial year to the next in its reserves.

Delivering a balanced budget

3.5 The Council, in common with other organisations, needs financial reserves to help manage unforeseen circumstances and to smooth the impact of known spending requirements over time. The Council will use reserves for such purposes to enable it to manage variations between its planned and actual budgets that result from unpredictable spending and income. Reserves will also be used by the Council to plan its finances strategically to support activities over the medium and long term.

3.6 The budget takes a prudent approach by retaining an equalisation reserve to mitigate future year increases in the NLWA Levy that are anticipated as the authority (along with its North London partner authorities) progresses towards its replacement of facilities at Edmonton. This effectively reduces budgetary shocks from large annual increases and allows the Council to plan more effectively.

3.7 The Local Government Finance Act 1992 requires the Council to calculate its expected outgoings and income for the year – including any additions to or use of reserves. The difference between expected outgoings and expected income is the authority's council tax requirement for that year.

3.8 If unplanned costs are incurred during the year that are not funded externally (for example, by a grant from government or an insurance policy) or the Council experiences a shortfall in expected income, there will be few options if it is to deliver to budget. Raising extra income or making in-year savings may have an unacceptable impact on service users. Therefore, the Council may want to consider using reserves to balance spending and income. The current MTFS has provided to set aside surpluses from the Council Tax and Business Rates Collection Fund to mitigate against any adverse movement in the tax base compared with the assumed growth that has been built into the financial plan. For 2023/24, there will be a drawdown from this reserve to offset a reduction in the Business Rates from the fallout of the pandemic.

3.9 The current MTFS is forecasting a funding gap in 2024/25 and 2025/26, and reserves could be required to manage some of this gap whilst longer-term solutions are identified. However, there is a lot of uncertainty about government funding from 2025/26 onwards and this position must continually be kept under review.

4 Reserves and the management of risks

4.1 With regard to the Council's financial stability, reserves are used to manage risks. There are certain earmarked reserves that have been set aside for specific risks, for example: the collection fund and budget pressures. These reserves and the potential pressures that need to be managed are reviewed as part of the budget setting process. The last review recommended that the management of major corporate risks largely be consolidated into the Budget Strategy Reserve.

4.2 The Council also manages unforeseen financial shocks by maintaining a Working Balance in its General Fund. The Council's agreed policy is to maintain working balances at between £10 million and £15 million. Some councils set a minimum desired percentage and although the Council has not done this the policy would maintain general balances at approximately 4% to 5% of the net budget. This level of working balance is kept under review and the Chief Finance Officer has expressed a view that the level is reasonable as part of the budget setting process. The recent CIPFA resilience index also indicated that the level of reserves the Council keeps is sufficient to mitigate financial shocks over the horizon of the medium-term financial strategy.

Increasing Financial Risks

4.3 The risk environment for local government funding has significantly increased. This strategy identifies the following issues that have increased risk during MTFS period to the end of the decade:

- The Cost of Living Crisis, increases in interest rates and the subsequent high inflation, meaning all costs are increasing at unprecedented levels
- The continuing impact of Covid-19 on the future of local government finances
- Impact of the Fair Funding Review and late notification of changes reduces timescales to plan and manage risk from reduced resources.
- Localisation of business rates or other reforms could present a collection rate risk, an economic downturn risk, and a risk in respect of backdated appeals.
- Economic stability generally resulting from the war in Ukraine or wider economic environment.
- The government could decide to transfer further services/responsibilities to local authorities, and these may not be adequately funded.
- Significant movement and growth in the resident population numbers brings pressures to a range of services and requires more investment in schools, housing and social infrastructure.
- Potential liabilities due to schools running deficit budgets ahead of converting to Academies.

On-going risks in the current strategy.

4.4 In addition to the new risks there are still the risks that are normally managed within the MTFS:

- The implementation of the budget savings programme
- Service budgetary control.
- Support for Asylum Seekers and No Recourse to Public Funds cases.
- Homelessness – increasing numbers coming into the area due to rising rents in other parts of the capital.
- Service spending pressures, e.g. unavoidable demand in social care services.
- Exceptional inflation beyond that provided for within the annual budget.
- Council Tax base may not grow at the assumed rate of some 2000 additional properties per annum due to market rates and/or difficult economic conditions such as high inflation on construction costs and a depressed housing market.

4.5 The prospect of further grant reductions means that it is prudent to retain sufficient reserves so that any future spending reductions may be implemented in a planned and efficient fashion. Whilst the current level of reserves is considered to be robust, consideration should be given to increasing reserves should the opportunity arise, in order to facilitate budget strategy management.

5 Budgeted Reserves

5.1 The forecast Earmarked Reserves assumed as part of the budget strategy are included at Appendix 4.

5.2 The forecast value of General Fund Reserves as at 31 March 2023 is £65.7m, a decrease £12.6m on the balance as at 31 March 2022 with a decrease of £15.8m projected in 2023/24, leaving a balance of £49.8m as at 31 March 2024. The decreases are primarily from using the Budget Strategy Reserve, the collection fund reserve and the Investment Reserve to invest in service improvements, future savings projects and manage the delay to the Business Rates Reset.

5.3 These reserves are earmarked for specific purposes and do not include the £14.9 million Working Balance that is held to protect the Council’s budget from unexpected risks.

5.4 The table below summarises the General Fund Reserves:

Forecast General Fund Earmarked Balances and Reserves

Reserves	31 March 2022	31 March 2023	31-Mar-24
	est. £'000	est. £'000	est. £'000
Capital programme related	2,153	2,153	2,456
Contingencies for known risks / Committed revenue	20,788	15,705	13,573
To Support the Budget Strategy	16,792	17,891	12,409
Technical Reserves	32,053	25,246	18,676
Operational Reserves	5,593	3,823	2,248
Statutory Accounts	944	849	475
External Income Related	8	8	0
Total	**78,330**	**65,674**	**49,837**

5.5 **Capital Related Reserves** link to the current capital programme or provide resources are used support capital schemes.

5.6 **Contingencies for Known Risks / Committed revenue** provide funds to meet potential expenditure not provided for within the base budget. The largest item is a reserve set aside to meet any loss of Housing Benefit Admin Grant Forecast at £10.1m for March 2023. The level will be reviewed as the benefits service changes in response to the welfare reforms and will also be used to manage the reduction of grant when it occurs. Committed revenue relate to plans agreed in the past where the expenditure will be required at some time in the future and based on business cases. They mainly relate to PFI projects.

5.7 A balance of £14.5m million is forecast to be carried forward into 2023/24 to **support the budget strategy.** This can be used to balance the budget and manage service budgetary risks, including the forecast rises in the waste levy. The Investment BSR stands at £3.4m (the majority of which has been allocated) to support investment in service change and savings relating to the Council priorities.

5.8 The **Technical Reserve** are earmarked funds to manage the risk within the Council collection fund and major levies which the authority has little or no control over. The main reserve within this grouping is the Tax Base Fluctuation Reserve (£9.3m estimated at the end of March 2024), which is being held to manage the risks from major fluctuations in the collection fund and the delay in the new local government funding regime changes from 2021/22 to 2025/26. The other reserves include Levies equalisation reserve to manage the North London Waste Authority levies.

5.9 The **Operational Reserves** are earmarked funds for service activities. In many cases they will have been committed to spending plans and in others they are funds that have been carried over from previous service underspends. Included in this category is the Hardship Fund of £750,000 which is used to support Council Tax Support cases.

5.10 The reserves held in respect of **statutory accounts** result from surpluses that can only be used for statutory purposes or over time should be balanced.

5.11 The **reserves in respect of income** relate to external income which has been received to provide a specific service, in this case funds for William Morris Gallery.

5.12 The table and paragraphs above only cover the General Fund earmarked reserves. There are other revenue balances held by the Council for specific purposes including (projected 31 March 2023): HRA Reserves £368k, Schools Balances £8m, Grant Related £15m (earmarked for the purpose that the grant was received), Provisions £10.8m (set aside for known liabilities) and Working Fund balances of £14.9 million for the General Fund and £5 million for the HRA.