

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, and more recently the Government has reiterated the view that reserves should feature more significantly in plans to reduce the impact of current financial pressures. Whilst helpful in the short term, as demonstrated by the County Council's use of its Budget Bridging Reserve, in the medium term however, one-off reserve funding does not provide a sustainable solution to on-going financial pressure.
- 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 with even less time to seek and implement any further savings that can be found.
- 1.3 The County Council's published balance sheet as at 31 March 2023 shows that reserves held by the County Council, including the general fund balance and individual schools' balances, but excluding the ring-fenced DSG deficit, total £845m. This is £38m lower than the year before and represents the 'tipping point' anticipated in the MTFs as reserves are used as intended to support transformation and to cash flow budget gaps until permanent savings are fully implemented.
- 1.4 This Appendix sets out in more detail what those reserves are for and outlines the strategy that the County Council has adopted. During 2023/24, further draws from reserves have been made in line with the strategy and any early achievement of SP2025 savings will be transferred into the Budget Bridging Reserve. The net movement is expected to result in a further reduction in total reserves and this will be reported as part of the outturn position.

2. Reserves Position 31 March 2023

- 2.1 Current earmarked reserves together with the General Fund Balance totalled £845m at the end of the 2022/23 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 2021/22. It also shows the reserve transfers agreed by County Council in July 2023 and the revised total of £817.3m.
- 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.

Appendix 5

	Balance 31/03/2022 £'000	Balance 31/03/2023 £'000	Post Transfers 20/07/2023 £'000	% of Total %
General Fund Balance	24,098	24,998	24,998	3.1
<u>Fully Committed to Existing Spend Programmes</u>				
Revenue Grants Unapplied	8,438	9,590	7,190	0.9
General Capital Reserve	167,414	172,441	110,741	13.6
Street Lighting Reserve	26,835	26,953	26,953	3.3
Public Health Reserve	8,869	10,768	10,768	1.3
Other Reserves	1,361	1,513	1,513	0.2
	212,917	221,265	157,165	19.2
<u>Directorate / Trading Reserves</u>				
Trading Accounts	11,038	10,238	10,238	1.3
Directorate Cost of Change Reserve	175,079	141,801	141,801	17.4
	186,117	152,039	152,039	18.6
<u>Risk Reserves</u>				
Insurance Reserve	43,684	47,529	47,529	5.8
Investment Risk Reserve	6,250	6,250	6,250	0.8
	49,934	53,779	53,779	6.6
<u>Corporate Reserves</u>				
Budget Bridging Reserve	98,971	73,111	134,371	16.4
Invest to Save	15,581	16,462	2,362	0.3
Corporate Policy Reserve	8,107	9,158	1,361	0.2
Organisational Change Reserve	3,163	3,003	0	0.0
	125,822	101,734	138,094	16.9
HCC Earmarked Reserves	574,790	528,816	501,076	61.3
EM3 LEP Reserve	3,741	3,572	3,572	0.4
Schools' Reserves	83,903	81,323	81,323	10.0
Total Revenue Reserves & Balances	686,533	638,710	610,970	74.8
Capital Grants Unapplied	196,447	206,292	206,292	25.2
Total Reserves and Balances	882,980	845,002	817,342	100.0

	Balance 31/03/2022 £'000	Balance 31/03/2023 £'000	Post Transfers 20/07/2023 £'000	% of Total %
Transferred to the revenue budget:				
Highways maintenance			22,500	
Analogue to digital networks			5,240	
Total			845,002	

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 currently 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. This will be kept under review and is likely to need to increase as the total of earmarked reserves falls.

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 £111m 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 A planned review of the capital programme to identify options to reduce scope, stop or not start approved projects or seek alternative funding sources will commence shortly. However, given that 80% of the capital programme is funded by grants and contributions that cannot always be re-purposed, the scope for releasing significant reserve funding may be limited.
- 2.6 The Street Lighting Reserve is used to manage the cash profile of the financial model for this Public Finance Initiative scheme whereby surplus cash 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.
- 2.7 Based on current plans, these reserves are fully committed to be spent in the coming years and do not therefore represent 'spare' resources. However, the County Council could potentially re-consider some of the planned expenditure in order to repurpose some of this reserve funding for higher priority one-off spend.

Directorate / Trading Reserves

- 2.8 Trading services within the County Council operate as semi-commercial organisations and as such they do not receive a budget allocation from the

County Council in respect of capital investment or annual pressures arising from spending or income fluctuations.

- 2.9 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.
- 2.10 Directorate reserves are generated through budget savings in annual revenue expenditure and Council policy was changed in 2010 to allow directorates to retain budget savings 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.
- 2.11 Utilising reserves in this way and allowing directorates and trading services to retain surpluses has encouraged prudent financial management as managers have been able to ensure that money can be re-invested in service provision without the need to look to the corporate centre to provide funding.
- 2.12 However, given the significant financial challenges which the Council currently faces, it is no longer possible to allow directorates to retain savings delivered in the interim years of two year savings programmes. All planned savings delivered from 2023/24 agreed as part of the SP2025 Programme will be transferred to the Budget Bridging Reserve at the end of each financial year (see paras 2.21 – 2.23) to contribute towards meeting the budget gap on an interim basis.
- 2.13 It is acknowledged that this will lead to a decline in directorate reserves over time as existing balances are put to use as planned by directorates. Consequently, a more corporate approach to manage these reserves will be required to ensure that these reducing funds are used for the highest priority purposes. In addition, any additional enabling investment required to facilitate savings delivery will be considered and managed corporately through the Invest to Save Reserve (see para 2.24).

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, current risks 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.

- 2.17 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. The original aim was to hold a minimum risk reserve of 2.5% of the total higher yielding investment portfolio and a reserve balance of £6.25m was established in 2021 representing 2.5% of the then earmarked investment. This is being reviewed in the light of changing conditions in financial markets over recent quarters and the fact that the statutory override on accounting for gains and losses on pooled investment funds ends on the 31 March 2025.
- 2.18 As reported to Cabinet in October 2023, the investment risk reserve will be increased by the £3.9m net capital gain crystallised from the disinvestment of £68m pooled investment funds. This will take the total investment risk reserve to £10.15m, which is an appropriate level based on the current market value of the remaining pooled fund investments including the remaining pooled fund property investments and the potential for having to account for any unrealised losses from after 31 March 2025 under the new accounting requirements. This takes the investment reserve to 2% of current total investments, which is reasonable minimum basis for the level of the reserve moving forward.

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 nearly £102m at the end of last financial year. Whilst it is true to say that these reserves could be used to mitigate budget pressures resulting from increasing demand and inflation, 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:
- 2.21 **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.
- 2.22 More recently 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.
- 2.23 The increased deficit over and above the £80m savings accounted for in the 2023/24 budget and the predicted deficit in the 2024/25 'interim' year will need to be met from the BBR. A review of the Council's reserve balances was undertaken in July 2023 resulting in the repurposing and transfer of £61.26m from other corporate and earmarked reserves into the BBR to contribute to bridging the budget gap for 2024/25. This is in addition to a significant shortfall of £56.9m in 2025/26, after accounting for the profile of identified SP2025 savings.

- 2.24 **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.
- 2.25 An allocation of £5m from the reserve will be made available to fund major change initiatives to support delivery of the Savings Programme to 2025, supplementing available directorate resources as these are depleted following the change in policy as set out in para 2.12. Requests from directorates to access the funding will be considered by the Corporate Management Team on a case by case basis and approved under the recommended delegation.
- 2.26 **Corporate Policy Reserve** – This small reserve is available to fund new one off 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.
- 2.27 **Organisational Change Reserve** – The reserve was formally used to meet the additional costs of the Council’s enhanced voluntary redundancy (EVR) scheme, introduced in 2011, associated with large scale organisational change programmes. In recent years, following changes to the EVR scheme, all redundancy costs have been fully met Directorates and this will continue to be the case for any future change programmes. The balance of the reserve was therefore repurposed in July 2023 and was transferred to the BBR to contribute towards bridging the budget gap for 2024/25.
- 2.28 It should be highlighted that even after increasing the BBR to cover the anticipated budget gaps this year and next, the total ‘Corporate Reserves’ outlined above accounted for only 16.9% of the total reserves and balances that the County Council holds, 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.
- 2.29 The reserves detailed above represent the total revenue reserves available to the County Council and amount to £501,076m as shown in the table above. In addition, 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

- 2.30 The County Council is currently 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. The County Council does not currently control the level or use of the EM3 LEP Reserve, however, following the Government’s announcement of the transfer of LEP functions to upper tier authorities from April 2024, the County Council is working with the LEPs on the transfer of any assets or liabilities to relevant authorities to enable continued delivery of programmes and functions from 1 April 2024.

Schools' Reserves

- 2.31 Schools' reserves accounted for over £81m or 10% of total reserves and balances. 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.
- 2.32 The County Council has no control at all over the level or use of schools' reserves.
- 2.33 In line with statutory reporting requirements, the table of earmarked reserves excludes the cumulative deficit against the Dedicated Schools Grant (DSG) which was just over £86m at the end of 2022/23. This deficit is forecast to increase to £130m by the end of the 2023/24 financial year with School's Forum agreeing for this to be carried forward and be funded from future years DSG allocations. The statutory override which keeps the DSG deficit separate on the Council's balance sheet is due to end in 2026/27. The DSG deficit is projected to reach almost £250m by the end of 2025/26, and even if the override is extended for a third time, the deficit will have significant implications for the Council's cashflow position. This also impacts the revenue budget by limiting the cash available to the Council for investment. Any suggestion that ongoing in year deficits or the cumulative deficit must be made good by the local authority will put the Council in the position of issuing a Section 114 notice and starting discussions with Government.

Capital Reserves

- 2.34 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.
- 2.35 A sum of more than £206m was held within capital reserves and balances at the end of the 2022/23 financial year, although of this £18.9m related to the EM3 LEP which is being reviewed as part of the LEP transition to upper tier authorities from 1 April 2024.

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 While the overall level of reserves currently exceeds £0.81bn, it is 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.
- 3.4 The County Council’s strategy for reserves is well established and has operated 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 directorates 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:
- Directorate 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 However, the Council has now reached a financial tipping point beyond which it is unable to balance its budget through savings alone and is reliant on annual reserve draws to bridge the remaining shortfalls. This position has been reached following more than a decade of national austerity, continued underfunding of local services by central government and surging demand and inflationary pressures.
- 3.7 Whilst the Council will continue to implement efficiencies and changes at the soonest possible opportunity and ensure that funding continues to be prioritised for invest to save purposes, it is no longer possible to deliver sufficient savings in advance of need to allow these to be retained and reinvested by directorates. The Council’s reserves strategy will therefore focus on increasing the level of the BBR whenever possible, including through

transferring all savings delivered from directorate budgets at the end of each financial year.

- 3.8 This will lead to a decline in directorate reserves over time as existing balances are put to use as planned by directorates. In the short term, these resources can be supplemented by additional funding from the corporate Invest to Save Reserve, providing the enabling investment required to facilitate delivery of the Savings Programme to 2025. However, given the limited corporate funding available, a successor arrangement will be required with appropriate governance to support prioritisation of the remaining resources between directorates.
- 3.9 The Council will use reserves to fund the additional budget deficits in both 2023/24 and 2024/25 to give the maximum time and flexibility to address the financial challenges from 2025/26 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.
- 3.10 Beyond 2024/25, the Council will need to continue to repurpose its earmarked reserves, simply to balance the budget one year at a time. However, given the current funding constraints that the Council faces, it is unlikely that those reserves can be replenished at a rate which is sufficient to deliver the planned service investment, which is essential to maintain delivery of statutory services. Therefore, without swift and fundamental change to the way local government is funded, the County Council does not have a sustainable financial strategy beyond 2024/25.