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 has recently entered the public eye in relation to the local government response to the pandemic and how this should be funded. MHCLG have stated that the use of reserves is an "appropriate way of helping to manage the impact of the pandemic on local government finance", however this position does not take account of the potential for longer term spending pressures on council budgets as a result of the pandemic, or the historic underfunding of the sector which has impacted councils' financial resilience.

1.2 The County Council has continually explained that reserves are held 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 Almost half of respondents (48%) to the County Council's 2021 public consultation '*Serving Hampshire – Balancing the Budget'*, agreed with the position that reserves should not be used to plug the budget gap, compared to 42% who disagreed. This figure has fallen in recent years, reflecting residents' increasing concerns about the implications of further reductions to council services.

1.4 The Covid-19 pandemic has presented a practical test of the financial resilience and stability within the local government sector. Hampshire County Council took the early decision that the financial response to the pandemic should not compromise the existing Medium Term Financial Strategy and the requirement to continue to provide resources to address challenges that existed prior to Covid-19. The financial response package developed therefore took account of the reserves and other funding that could be applied to offset spending pressures resulting from the pandemic. This clearly demonstrated the value of the Council's reserves and showed that the level of reserves held provides options and flexibility in addressing financial challenges which are not available to other authorities.

1.5 At the end of the 2020/21 financial year the total reserves held by the County Council together with the general fund balance stand at more than £754.8m, an increase of £111.7m on the previous year. The increase in reserves is largely due to:

- an increase in Schools Reserves of £28.6m, reflecting a reduction in day to day spending as a result of school closures throughout much of 2020/21 due to the pandemic.
- the new requirement from 1 April 2020 to exclude the brought forward DSG deficit balance (£22.8m) and
- an increase in Departmental Cost of Change Reserves of £55.2m, reflecting the 2020/21 underspend on service provision. This was principally due to additional financial support from NHS England and Hampshire CCG to

facilitate hospital discharge, reduced demand for social care, family support and transport services.

1.6 In line with the Medium Term Financial Strategy (MTFS), it also reflects the continued strategy of achieving savings early and then using those savings to fund the next phase of savings delivery. However, this increase in reserves was offset in part by a planned draw from the Budget Bridging Reserve (BBR), to enable the County Council to continue its financial strategy, and to allow delivery of the more complex changes to be achieved safely within the Transformation to 2021 (Tt2021) Programme over a longer time period.

1.7 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 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 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.

	Balance 31/03/2020 £'000	Balance 31/03/2021 £'000	% of Total %
General Fund Balance	**22,298**	**23,198**	**3.1**
Fully Committed to Existing Spend Programmes			
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	1,197	0.2
	184,546	**202,115**	**26.8**
Departmental / Trading Reserves			
Trading Accounts	6,725	8,800	1.2
Departmental Cost of Change Reserve	85,492	140,690	18.6
	92,217	**149,490**	**19.8**
Risk Reserves			
Insurance Reserve	40,955	39,589	5.2
Investment Risk Reserve	4,958	6,250	0.8
	45,913	**45,839**	**6.1**
Corporate Reserves			
Budget Bridging Reserve	78,509	68,170	9.0

	Balance 31/03/2020 £'000	Balance 31/03/2021 £'000	% of Total %
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
	111,093	**96,107**	**12.7**
HCC Earmarked Reserves	**433,769**	**493,552**	**65.4**
EM3 LEP Reserve	5,081	4,760	0.6
Schools' Reserves	38,109	66,667	8.8
Total Revenue Reserves & Balances	**499,257**	**588,177**	**77.9**
Total Capital Reserves & Balances	**166,637**	**166,672**	**22.1**
Total Reserves and Balances	**665,894**	**754,849**	**100.0**
DSG Deficit Reserve	(22,754)	(35,444)	
Net total	**643,140**	**719,405**	

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) at 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 current balance stands at £23.2m which was 2.9% of net expenditure at the beginning of 2021/22; as projected in the budget setting report approved in February 2021, which is broadly in line with the current policy. This balance includes a planned annual contribution of £0.9m in 2020/21 to maintain the general fund balance as a proportion of net budget requirement, reflecting the increasing financial risk in cash terms as spending increases.

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 £148.9m 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 the project.

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. These reserves do not therefore represent 'spare' resources in any way and are being utilised as planned in the coming years, as evidenced by a budgeted net draw of £10.1m in 2021/22.

Departmental / Trading Reserves

2.8 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.

2.9 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 suffered due to losses in customer base, and to provide the time and flexibility to generate new revenues to balance the bottom line in future years.

2.10 Departmental reserves are generated through underspends in annual revenue expenditure. Council policy was changed in 2010 to allow departments to retain all of their underspends in order to provide resources to:

- Meet potential overspends / 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 Tt2021 and SP2023 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.

2.11 Utilising reserves in this way and allowing departments and trading areas to retain underspends 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.

2.12 All departments will be utilising their reserves to fund the activity to deliver the Tt2021 Programme and to fully cash flow the later delivery of savings if needed. Additionally, AH&C, ETE and CCBS are expecting to invest a total of £11.2m over three years in SP2023 enabling projects.

Risk Reserves

2.13 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.

2.14 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.

2.15 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.

2.16 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. Therefore, no further additions to the Insurance Reserve were made in 2019/20 or 2020/21.

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. Following changes to the accounting treatment of some investments, it has been decided that we will make additional contributions to this reserve to achieve a reserve equal to 2.5% of the total higher yielding investment portfolio. This target reserve level was reached in 2020/21 when £1.29m was added to the Investment Risk Reserve, increasing the balance to £6.25m.

Corporate Reserves

2.18 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.

2.19 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 reduce the immediate requirement to make savings, 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 pandemic, thereby avoiding the immediate financial issues facing some other local authorities. These reserves are broken down into four main areas:

2.20 **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.

2.21 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.

2.22 It is clear that the fiscal restraint exercised by government over the past decade following the 2008 banking crisis is set to continue, given the record levels of government borrowing necessitated by the national response to the Covid pandemic. The council therefore expects to continue with its disciplined approach to budget planning which involves cash flowing successive savings programmes through carefully releasing targeted resources in advance of need. The BBR allows the council to operate on a two year cycle of delivering savings by providing resources to bridge the interim year, providing time for changes to be properly planned, developed and safely implemented.

2.23 The County Council therefore continues to take every opportunity to increase the reserve to be able to continue the sensible policy of smoothing the impact of funding changes 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 2020/21 mean that the BBR stands at just over £68m, which 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. Provision is being made for draws in 2021/22 and 2022/23 in order to give the County Council the time and capacity to implement the Tt2021 and SP2023 Programmes and to cash flow the safe delivery of change.

2.25 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 next phase of savings to take us to 2023/24.

2.26 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 a successful strategy which has served it very well to date. Consequently, as part of budget setting in February, a number of additions totalling £8.1m were approved to begin to make provision for the period beyond 2021 to support the two year savings cycle and to provide cash flow support to the SP2023 Programme.

2.27 The table below summarises the forecast position for the BBR taking into account the requirement to balance the budget in 2022/23 and to provide corporate funding to cash flow the next stage of transformation:

	£'000
Balance at 31/03/2020	78,509
2020/21 Original Draw Planned	(28,400)
Contingency for Tt2019	15,100
Pension deficit saving & MRP Holiday	28,500
Addition Outturn 2020/21	5,560
Balance at 31/03/2021	**68,169**
Additions Approved February 2021	8,058
Pension deficit saving and pre-payments	36,000
Planned use:	
Cash Flow Tt2021	(32,000)
Interim Year 2022/23	(40,200)
Unallocated Balance	**40,027**

2.28 This will significantly deplete the BBR and therefore, where possible, the County Council must continue to direct spare one-off funding into the reserve as part of its overall longer term risk mitigation strategy.

2.29 It should be noted that this position does not include the financial impacts of the pandemic as the County Council's approved strategy is to treat these as a separate one-off event in order to maintain a provision to support future savings programmes.

2.30 **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.

2.31 **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.

2.32 **Organisational Change Reserve** – The County Council is one of the largest employers in Hampshire and inevitably, due to rapidly increasing demand and inflationary pressures continuing to outstrip available funding, there is an impact on the numbers of staff employed in the future.

2.33 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.

2.34 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.

2.35 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.

2.36 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 HCC’s ability to recruit and retain the best senior staff.

2.37 It should be highlighted that the total ‘Corporate Reserves’ outlined above account for approximately 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; including a £28m net reduction in the BBR to 2022/23 as set out in section 2.27. The BBR is in reality fully committed to balancing the budget over the medium term, as well as providing crucial cashflow support as part of the Covid-19 response package.

2.38 The reserves detailed above represent the total revenue reserves of the County Council and amount to £493.6m as shown in the table on second page of this Appendix. 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

2.39 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.

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

Schools’ Reserves

2.41 Schools’ reserves accounted for £66.7m or 8.8% of total reserves and balances at the end of the 2020/21 financial year. Schools have seen their reserves increase significantly during the pandemic due to a number of factors including the deferral or avoidance of costs due to lockdown measures.

2.42 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 schools 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.

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

Dedicated Schools Grant (DSG) Deficit Reserve

2.44 Schools are facing increasing financial pressure, in particular relating to higher 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 Council retains an active role and interest as the local education authority. In 2020/21 the overall position was once again balanced through the use of the Dedicated Schools Grants (DSG) Reserves, as permitted by the Department for Education (DfE).

2.45 The resulting DSG deficit of over £35.4m (up from £22.8m last year) is ringfenced, with the carried forward balance being met from future years' DSG funding; the view of Government and the sector being that this should not place a pressure on resources required by other essential services funded from the Council's General Fund. Therefore, whilst this sum sits as a 'negative reserve' on the County Council's balance sheet, it in effect represents an overdraft for schools which they (and the Government) will need to address over the longer term.

2.46 A DSG Deficit Recovery Plan was produced in 2019/20, 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. The overall cumulative deficit in the DSG Deficit Reserve (which has been included within overall schools' reserves for presentational purposes since 2018/19) is expected to reach almost £50m by the end of 2021/22.

Capital Reserves

2.47 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.

2.48 A sum of £166.7m was held within capital reserves and balances at the end of the 2020/21 financial year, although almost £22.5m of this relates to the EM3 LEP which is included in the annual accounts, as the Council is the Accountable Body. The EM3 LEP pursues a deliberate strategy to increase unapplied capital grants where possible 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 The funding environment in which local authorities operate will continue to remain challenging due to ongoing spending pressures from the pandemic, increasing demand for services and the need for a further period of fiscal restraint to manage down government debt accrued during the pandemic. Reserves will therefore continue to play a vital role in smoothing the impact of changes to finance settlements and enable time for the planning and careful implementation of 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 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 throughout the past 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 support IT enabling projects underpinning delivery of the Tt2019 and Tt2021 Programmes.
- Additional funds to help smooth the impact of grant changes, 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 savings programme is becoming more difficult to deliver and the challenges associated with the Tt2019 and Tt2021 Programmes, which have been exacerbated as a result of the pandemic, are well known. The MTFS has made clear that deliver will extend beyond two years and provisions have 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 careful use of reserves as part of our overall financial strategy to provide departments with the time and capacity to properly implement savings and also to provide resources to invest in enabling measures. This further emphasises the value of our Reserves Strategy.

3.7 The County Council is still in the position of having no visibility of its financial prospects beyond 2022, which clearly makes any accurate financial planning difficult to achieve. The Fair Funding Review and increased local retention of business rates, which were due to be introduced next year, have been set back further due to the pandemic. There also remain significant uncertainties as to the latent impacts of the pandemic on demand-led services, particularly Children's Social Care, where the Council is beginning to see an increase in caseloads following the ending of lockdown restrictions.

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 on an ongoing basis 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 £0.7bn, 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. 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 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.