

## **Appendix 4 - Reserves Strategy**

### **Introduction**

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 as part of the Medium Term Financial Strategy (MTFS).
2. 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.
3. Lancaster City Council, in common with most local authorities, face significant financial challenges. The unprecedented reduction in government funding from 2010/11 to 2019/20 and continuing uncertainties with respect to funding as well as, rising costs and growing demand for many services are all testing the Councils' financial management and resilience.
4. The introduction of local business rates retention in particular has created additional risks to all Councils' finances and particularly for Lancaster as it is one of a handful of authorities which has a nuclear power station within its area. The Council, therefore, bears a significant risk of a temporary or permanent shut down at the power station which would immediately and significantly reduce funding from business rates. The magnitude of such a financial shock is sufficient that the Council must hold a reserve to provide resilience in the event that this happens.
5. Current and future financial challenges pose significant risks for the Council. The Council will continue to use 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 funding resource
  - Investing in making changes that reduce the cost of providing services in the longer-term.
  - Increasing reserves to strengthen resilience against future, uncertain cost pressures.

### **The approach to setting the Reserves Strategy.**

6. The Reserves Strategy covers the following aspects:
  - Information showing the current level of reserves, individually and in aggregate and an assessment of the adequacy of reserve levels
  - 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, particularly its General Fund and HRA reserves
  - Consideration of the forward strategy for reserves needed to support the Medium Term Financial Strategy
  - Summary of each individual reserve covering its purpose and governance arrangements for its use
7. Reserves will be monitored throughout the year as part of the quarterly financial monitoring and the level of reserves reported as part of the year-end accounting processes.

### **Level of reserves and principles to assess adequacy**

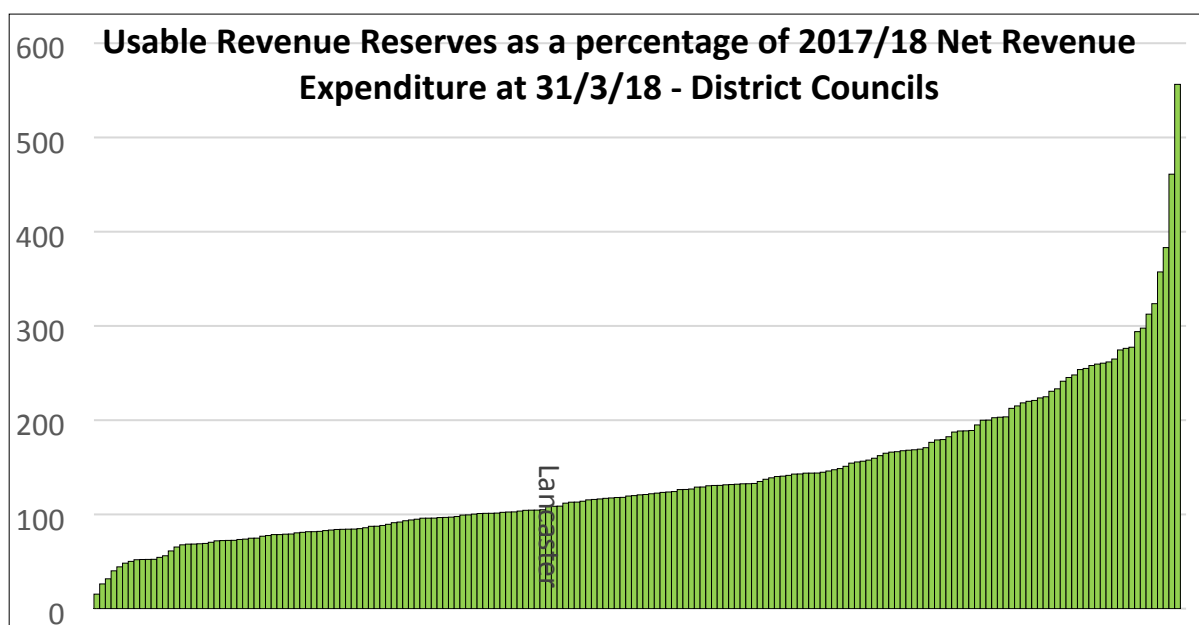
8. Within the existing statutory and regulatory framework, it is the responsibility of the Chief Financial Officer (at Lancaster this is the Financial Services Manager who is the Section

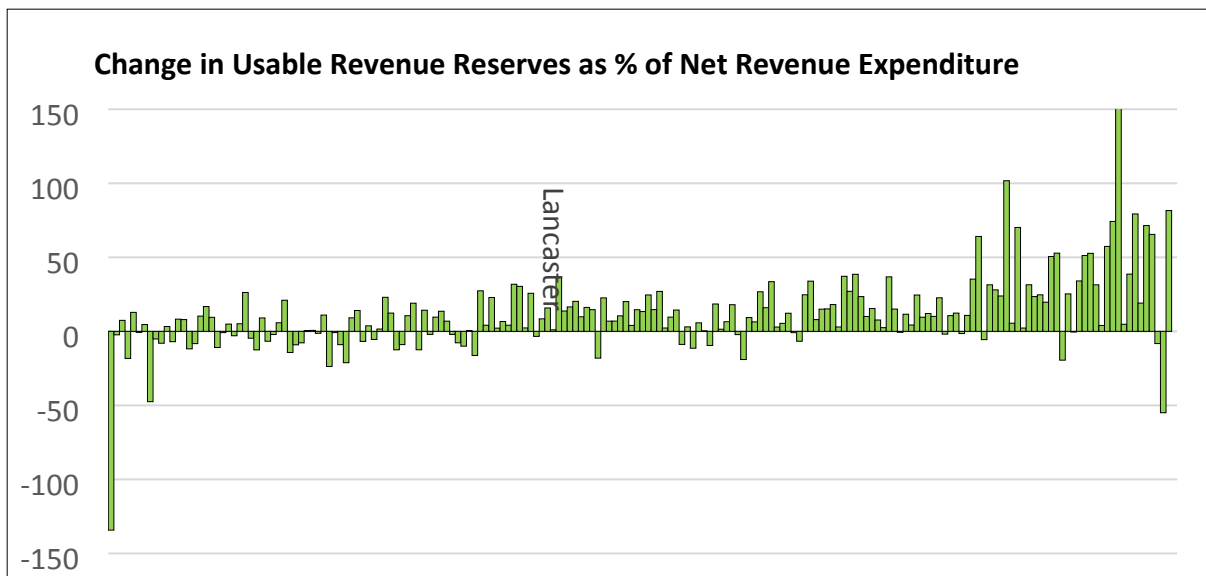
151 Officer) to advise local authorities about the level of reserves that they should hold and to ensure that there are clear protocols for their establishment and use.

9. For clarity, within the legislation the minimum level of any reserve is not quantified, and it is not considered appropriate or practical for the Chartered Institute of Public Finance and Accountancy (CIPFA), or other external agencies, to give prescriptive guidance on the minimum, or maximum, level of reserves required either as an absolute amount or a percentage of the budget.
10. At the end of the 2017/18 financial year, Lancaster City Council had levels of usable reserves as set out in the table below.

	2016/17 £000s	2017/18 £000s	Change £000
General Fund Reserve	4,725	5,067	342
Earmarked Revenue Reserves	6,510	11,869	5,359
Usable Capital Receipts	0	0	0
Capital Grants Unapplied	103	103	0
<b>Total General Fund Reserves</b>	<b>11,338</b>	<b>17,039</b>	<b>5,701</b>
HRA balance	1,937	2,017	80
Earmarked HRA Reserves	10,709	10,561	(148)
<b>Total HRA Reserves</b>	<b>12,646</b>	<b>12,578</b>	<b>(68)</b>

11. The table shows that reserves increased significantly during 2017/18. This was mainly due to an increase in the Business Rates Reserve from the Council's share of retained rates associated with business rates growth in the district. The increase in reserves is a significant boost to the Council's financial resilience.
12. Media focus on reserves has tended to focus on General Fund revenue reserves as it is these which provide the financial resilience to guard against unanticipated increases in expenditure or reductions in income.
13. The graph below shows the level of reserves at Lancaster City Council expressed as a percentage of net revenue expenditure compared with all other district councils.





14. Lancaster City Council has the equivalent of about one year's net revenue expenditure held in usable revenue reserves. In general terms, reserve levels should be adequate to meet any short term unanticipated financial shock.
15. In specific terms, it is important to assess the adequacy of reserves taking account of the financial assumptions underpinning the budget alongside a consideration of the authority's financial management arrangements. These include:

*Budget Assumptions*

- The treatment of inflation and interest rates
- Estimates of the level and timing of capital receipts
- The treatment of demand led pressures
- The treatment of planned efficiency savings/gains
- The financial risks inherent in any significant new funding partnerships, major outsourcing arrangements or major capital developments
- The availability of other funds to deal with major contingencies and the adequacy of provisions

*Financial Standing and Management*

- The overall financial standing of the authority (level of borrowing, debt outstanding, council tax collection rates, etc.)
- The authority's track record in budget and financial management including the robustness of the medium term financial plans
- The authority's capacity to manage in-year budget pressures
- The strength of the financial information and reporting arrangements
- The adequacy of the authority's insurance arrangements to cover major unforeseen risks.

## General Fund Balance

16. The General Fund balance is an unearmarked revenue reserve and as such should be sufficient to cover all unanticipated expenditures or reductions in income that may arise so that the authority has sufficient balances to meet these in the medium term.
17. In calculating the minimum level of General Fund balance, an assessment of the risks that give rise to unanticipated expenditure or loss of income has been made and these are shown in the table below. The analysis shows that in the unlikely event of a 'perfect storm' of risks happening all within the next year then there are sufficient balances to meet all these risks which would give the Council time to adapt to such risks in the medium term.

Risk	Symptom of risk	Balance required £000
Increased demand for services	3% increase in net revenue expenditure	500
Recession results in reduced fees and charges income	10% reduction in major fees and charges income	657
Recession results in reduced council tax collection rates	3% reduction in collection rate	282
New Homes Bonus Scrapped	Significant reduction in funding income	1,242
Next year's budget savings not achieved	Significant overspend	1,083
Natural disaster such as flood	Additional unanticipated expenditure	500
Uncertainty with respect to Brexit	Additional unanticipated expenditure	500
Aggregate overspend if all above risks were to happen		4,764
General Fund Balance as at 31/03/18		5,069

**Given the increase in uncertainty set out above, particularly with respect to the Fair Funding review, the Section 151 Officer's advice is that the minimum level of balances held in the General Fund should be set at £2m, an increase of £0.5m**

## **HRA Balance**

18. The HRA balance and earmarked reserves are considered each year in conjunction with the annual budget at update of the 30 year business plan.

## **Review of Earmarked Reserves**

19. The Council holds a number of earmarked reserves, which the Council has chosen to set aside for one of the following purposes:
- To manage fluctuations in income or funding
  - To provide for some future anticipated expenditure for identified projects
  - To provide up-front costs which specifically result in future efficiencies, cost savings or increased income
  - To hold funding from other bodies, mainly Government, for specified purposes

A schedule of earmarked reserves is included at the end of this document with details of the reserve balance, the purpose of the reserve and governance arrangements. Specific issues arising from the annual review of earmarked reserves are detailed below.

### ***General***

The Council has strengthened its focus on providing business cases for all new projects and areas of spend. This discipline should be extended to the use of reserves with any such use supported by a case outlining the need for reserve funding and providing a summary of measurable outcomes and impacts arising from the use of reserves.

The schedule of earmarked reserves shows, for each reserve, how the reserve will be used and the authorisation requirements for use. Any use of reserves which exceeds £50k would have to be supported by a Council or Cabinet decision.

### ***Business Rates Reserve***

This reserve was set up to manage fluctuations in business rates income and ensure that risks attributable to business rates appeals and the potential shutdown of Heysham Power Station. However, in six years these risks have not been realised and the Council has been able to accrue the rewards from good levels of business rates growth in the Lancaster district. Going forward, the risks persists but as part of the MTFS, an assessment of the exposure to those risks has been undertaken and it is possible to calculate that there are surplus funds in the business rates reserve over and above those which are required to protect business rates income over the medium term. As the surplus funds are effectively attributable to economic growth it seems appropriate that these are now used for future corporate priority initiatives.

It is therefore recommended that following the year end, the balance on the Business Rates Reserve is reviewed and any surplus funds, over and above those required to provide funding certainty, are redesignated towards the delivery of corporate priorities as set out in the Council Plan or accompanying strategic documents as and when revised by the new Council.

### ***Budget Support***

The Budget Support Reserve purpose should be extended to include any upfront costs which are attributable to work undertaken in respect of Funding the Future. Any such bid to the reserve should be accompanied with a business case showing the need for intervention and outcomes and impact arising from the use of the reserve.

### ***Restructure***

All three Directorates created under the recent reorganisation will commence structural reviews during 2019/20. There may be a significant call upon this reserve for costs relating to redundancy and pension strain but any call on the reserve should be accompanied by a payback calculation which compares the upfront cost with ongoing savings.

## **Schedule of Earmarked Reserves**

20. A schedule of reserves is shown below. The schedule sets out for each reserve, its purpose, how and when it will be used, management and control processes and timescale for review.
21. Any use of reserves at a level over £50k should be supported by a Council or Cabinet decision.
22. To aid transparency, as part of the Council's quarterly monitoring a statement on the movement of reserves and provisions, including key transactions, will be reported.