

Reserves Strategy

Report by Gary Fairley, Head of Finance and Integrated Service Support

1 Introduction

The purpose of this report is to update Council on the useable reserves and set out a Reserves Strategy for Council's consideration.

2 Background

Section 93 of the Local Government (Scotland) Act 1973 stipulated that in addition to a General Fund, Council may hold three other Funds, namely a Capital Fund, a Repairs and Renewal Fund and an Insurance Fund.

In addition to a General Fund, the Council has previously established a Capital Financial and Repair and Renewal Reserve.

The Capital Fund can be credited with the disposal proceeds of assets and any other sums the Council determines. It can only be utilised for financing capital expenditure or the repayment of loans fund principal.

The Repairs and Renewal Reserve may be credited with any sums the Council determines. It can be used to finance repairs, maintenance, replacement and renewal of fixed assets.

The Housing (Scotland) Act 1987 makes specific provision for Councils' to keep a Housing Revenue Account (HRA) and separately account for HRA income and expenditure. As a consequence the accumulated surplus on the HRA account is held as the HRA balance.

The actual useable reserves position as at 1 April 2016 and projected position for 31 March 2017 is as follows:

Table 1: Useable Reserves – actual 1 April 2016 projected 31 March 2017

	1 April 2016 £m	31 March 2017 £m
General Fund	24.625	14.810
Capital Fund	15.378	22.695
Repairs and Renewal Reserve	3.607	4.140
HRA Balance	24.913	28.917
	<u>£68.523</u>	<u>£70.562</u>

3 General Fund

Included in the projection is £2.177 million of commitments as follows:

Table 2: General Fund Commitments as at 27 September 2016

	£m
Resources earmarked for Council Transformation	2.150
Borders Rail Economic Development	0.027
	<u>£2.177</u>

The remaining £12.633 million is uncommitted and is available to meet unplanned or unforeseen costs.

Council, on 4 February 2014, agreed that a prudent level of General Reserve be around £8.000 million or 4% of net expenditure. This decision took cognisance of the challenging financial outlook and the financial and service risks faced by the Council.

Given the continuing challenging financial outlook, the uncertainty associated with future years grant settlements, pay awards and the economic impact of Brexit and also the potential costs to come from the historic child abuse enquiry, it is recommended that Council retains the contingency level at £8.000 million, approximately 4% of net expenditure.

Subject to this recommendation the 'available' General Fund reserves would therefore be £4.633 million.

As previously reported the financial outlook for 2017/18 and beyond will continue to be challenging both in terms of the financial pressures faced by the Council and also the continued uncertainty on key aspects of the budget, particularly government grant settlements.

Given the continued cost and service pressures and reducing grant support it is clear that the Council will need to implement significant service changes over the coming years. Experience shows that such significant change will take time to implement and may also require an initial investment to secure the necessary changes. In addition it is inevitable that the Council will require to further reduce staffing levels in certain areas and this in turn will incur one off costs associated with this.

Accordingly, it is considered prudent to set aside further resources to support change and in this respect Council is recommended to earmark a total of £4.000 million, approximately 2% of net expenditure, to support change and incorporate the current £2.150 million set aside for Council Transformation within this.

Approval of commitments from this Change Fund would continue to rest with Business Transformation Board and be based on the criteria that are currently used. For severance costs these will continue to require approval by Chief

Executive, Head of Finance and Integrated Service Support and relevant Director.

4 Capital Fund

It is recommended that the current policy of crediting all capital receipts for the disposal of assets to the Capital Fund continues. This strategy provides greater flexibility compared with the alternative of utilising receipts to fund capital expenditure particularly given the historically low cost of borrowing at the current time.

Currently £12.000 million of the Capital Fund is earmarked for Edinburgh and South East Scotland City Region Deal. The remainder is retained to provide for unforeseen capital expenditure and to provide flexibility between financial years.

As reported elsewhere on today's agenda, as part of the General Services Capital Plan report there are significant capital investment requirements over the coming years, some of which have still to be fully developed and the cost implications fully assessed.

The General Services Capital Plan report also highlights the restricted scope for additional capital investment to be made while remaining within the revised borrowing cap of £124 million. As such capital investment above the £124 million level would require to be funded by utilising the available balance in the Capital Fund and or by increased borrowing cap. The latter option would in turn increase the financial costs borne by the revenue budget so increasing the revenue budget shortfalls set out in the Financial Strategy report. Given the position the utilisation of the Capital Fund will be kept under review as part of the reassessment of the General Service Capital Plan.

5 Repairs and Renewal Reserve

Whilst the Repairs and Renewal Reserve is classified as a useable reserve, the projected balance of £4.140 million reflects the use of the Repairs and Renewal Reserve to properly account for the Council's two PPP contracts in accordance with the Accounting Code of Practice.

The balance represents payments made to the contractors which will be utilised to fund lifecycle asset replacement costs. As such the balance on the reserve is in itself not useable.

6 HRA Reserve

The HRA Reserve represents the accumulate surplus of income, principally rents, over expenditure.

The rents strategies adopted by this and previous councils has been to utilise income generated by rent increases to support significant investment in new social housing.

Based on the programme for Phase 3 Social Housing, it is projected that the HRA Reserve will peak in 2018/19 at £35.426 million and then reduces over the next 13 years as the reserve is utilised to defray the impact of the borrowing cost associated with the capital investment.

This leaves a contingent balance on the HRA Reserve of £2.114 million to meet unforeseen costs etc.

7 Investment of Reserves

The Council's Treasury Management and Investment Strategy sets out the governance arrangements and strategy for the investment of reserve balances.

The current approach is to 'cash back' the reserves and so seek appropriate investment opportunities in line with the Treasury Management and Investment Strategy.

8 Summary

Reflecting the recommendations set out above the projected position with useable reserves at 31 March 2017 would be as follows.

Table 3: Projected Useable Reserves – 31 March 2017

	Total £m	Committed £m	Contingency £m	Available £m
General Fund	14.810	4.027	8.000	2.783
Capital Fund	22.695	12.000	-	10.695
Repairs & Renewal Reserve	4.140	4.140	-	-
HRA Reserve	28.917	26.803	2.114	-
	£70.562	£46.970	£10.114	£13.478

The available balance on the General Fund would be available to support any additional cost pressures and supplementary estimates which arise in the current financial year and or budget pressures in future years.

The available balance on the Capital Fund would be available to support any additional or unforeseen capital expenditure pressures.

9 Report Implications

9.1 Resource

Whilst this report deals with financial issues there are no financial implications arising directly from it.

9.2 Risk

The Council faces significant financial and service risks, particularly those associated with continuing expenditure pressures, reducing resources coupled with uncertainties on future years grant settlements.

The recommendations in this report ensure that the Council maintains adequate reserves to help mitigate these risks and also secures resources to achieve the change necessary to ensure continued financial sustainability.

9.3 Single Midlothian Plan and Business Transformation

Themes addressed in this report:

- ☐ Community safety
- ☐ Adult health, care and housing
- ☐ Getting it right for every Midlothian child
- ☐ Improving opportunities in Midlothian
- ☒ Sustainable growth
- ☒ Business transformation and Best Value
- ☐ None of the above

9.4 Impact on Performance and Outcomes

Whilst there is no direct impact, the Reserves Strategy and utilisation of reserves is a key component of the Council's Financial Strategy which in turn is central to the way Council allocates and uses its limited resources.

9.5 Adopting a Preventative Approach

Whilst the proposal in this report do not directly impact on the adoption of a preventative approach, an effective Reserves Strategy as part of the overall financial strategy in turn allows resources to be prioritised for support prevention.

9.6 Involving Communities and Other Stakeholders

The Corporate Management Team has been consulted on the proposed Reserves Strategy.

9.7 Ensuring Equalities

There are no equality implications arising directly from this report.

9.8 Supporting Sustainable Development

There are no implications arising directly from this report.

9.9 IT Issues

There are no implications arising directly from this report.

10 Recommendations

Council is recommended to:

- a) Retain the General Fund contingency level at £8.000 million which is approximately 4% of net expenditure;
- b) Earmark a total of £4.000 million to support change, which will incorporate the current sums set aside for Council Transformation;
- c) Note that subject to recommendations (a) and (b) £2.783 million of General Fund Reserves would be available to utilise;
- d) Maintain the current arrangements for capital receipts and the Capital Fund; and
- e) Otherwise note the Reserves Strategy set out in the report.

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Report Contact:

Gary Fairley Tel No: 0131 271 3110

gary.fairley@midlothian.gov.uk

Background Papers: