TITLE	**Medium Term Financial Plan 2024-27 - Reserves**
FOR CONSIDERATION BY	Community and Corporate Overview and Scrutiny Committee on 2nd October 2023
WARD	None Specific;
LEAD OFFICER	Deputy Chief Executive - Graham Ebers

OUTCOME / BENEFITS TO THE COMMUNITY

To deliver on the priorities within the Council's Corporate Plan whilst maintaining a financially viable Council.

RECOMMENDATION

The committee are asked to:

1. note the reserves position in the context of setting the Medium-Term Financial Plan for 2024/2025 mindful of the strategic approach.

2. note the table of reserves, which enhances the annual disclosure in the MTFP.

3. seek assurance of the sufficiency of reserves in setting a safe budget for 2024/25.

INTRODUCTION

The purpose of this report is to provide the Community and Corporate Overview and Scrutiny Committee with information regarding the Councils financial reserves.

The term "reserves" applies to both the General Fund reserve and earmarked reserves. Earmarked reserves are reserves allocated to ensure that there are sufficient funds available to cover specific risks. In some cases, these reserves will be built up over a period to cover a specific expenditure the Council expects in future years, in order to smooth the revenue impact. The General Fund reserve is to cover more general risks that may be faced across the council. The Housing Revenue Account has its own separate reserves. There are also reserves associated with the Dedicated Schools Grant.

It is part of the role of the Chief Finance Officer to assess whether the level of reserves is adequate, which they will do in conjunction with relevant lead officers. The Chief Finance Officer has a statutory duty to ensure the council's finances are fit for purpose under Section 151 of the Local Government Act 1974.

SUMMARY OF REPORT

Financial reserves should be set in the context of the authority's risk register and medium-term plans and should not focus exclusively on short-term considerations. Balancing the annual budget by drawing on general reserves may be viewed as a legitimate short-term option. However, it is not prudent for reserves to be deployed to finance recurrent expenditure. CIPFA has commented that councils should be particularly wary about using reserves to deal with shortfalls in current funding. Where such action is to be taken, this should be made explicit, and an explanation given as to how such expenditure will be funded in the medium to long term. Advice should be given on the adequacy of reserves over the lifetime of the medium-term financial plan and should also take account of the expected need for reserves in the longer term.

The CFO has a duty to report on robustness of estimates and adequacy of reserves (under Section 25 of the Local Government Act 2003) when the authority is considering its budget requirement. Section 28 of the Act also requires budget monitoring 'from time to time' and take action to deal with any deterioration. As part of the medium-term financial plan, section 2 sets out the reserves and balances, providing details regarding the use of the reserve and estimated balances. A further breakdown of the reserves is provided in the table later in this report.

These requirements are reinforced by Section 114 of the Local Government Finance Act 1988 which requires the chief finance officer in England and Wales to report to all the authority's councillors if there is or is likely to be unlawful expenditure or an unbalanced budget. This would include situations where reserves have become seriously depleted and it is forecast that the authority will not have the resources to meet its expenditure in a particular financial year.

The report details the overall position and considerations taken in respect of reserves and how the financial values required are set strategically to balance the level of risk from across the organisation's operations and approach to investment.

Like most local authorities across the Country, Wokingham have faced and will continue to face significant financial challenges and risks. Some of these risks are within the control of the Council and therefore action can be taken to mitigate against risks however a number remain outside the Councils control (e.g. future local government funding settlement, inflation, interest rates, demand for statutory services such as adults and Childrens social care) and require prudent financial management to protect against these risks. Where strong financial management fails, Councils can have little choice other than to restrict non-essential spending which can lead to significant impacts for the residents and businesses in those areas.

The Council have embarked and delivered on an ambitious capital programme including regenerating Wokingham town centre, delivering much need housing through our strategic development locations, invested in commercial assets, care homes and affordable housing working with our subsidiary companies and future investment planned in solar farms. As expected, there are risks associated with all of these areas, some risks are higher than others and some risks will reduce over time. The Council have taken a careful approach to ensure appropriate levels of reserves are held to protect against these risks. Over a number of years Wokingham have maintained a responsible level of reserves whilst still protecting services to residents.

Background

The requirement for financial reserves is acknowledged in statute. Sections 31A, 32, 42A and 43 of the Local Government Finance Act 1992 require billing and precepting authorities in England and Wales to have regard to the level of reserves needed for meeting estimated future expenditure when calculating the budget requirement.

There are also a range of safeguards in place that help to prevent local authorities over committing themselves financially. These include:

- Setting a balanced budget (Sections 31A, 42A of the Local Government Finance Act 1992, as amended)
- Chief finance officers' duty to report on robustness of estimates and adequacy of reserves (under Section 25 of the Local Government Act 2003) when the authority is considering its budget requirement (England and Wales); Section 28 of the Act also requires budget monitoring 'from time to time' and take action to deal with any deterioration.
- The legislative requirement for each local authority to make arrangements for the proper administration of their financial affairs and that the chief finance officer/proper officer has responsibility for the administration of those affairs, Section 151 of the Local Government Act 1972.

The Council are required under the Local Government Finance Act 1992, to have regard to the level of reserves needed for meeting estimated future expenditure when calculating the budget requirement. The legislative requirement for each local authority to make arrangements for the proper administration of their financial affairs and that the Chief Finance Officer has responsibility for the administration of those affairs, Section 151 of the Local Government Act 1972.

While it is primarily the responsibility of the local authority and its chief finance officer to maintain a sound financial position, external auditors will confirm that there are no material uncertainties about going concern. It is not an auditor's responsibility to prescribe the optimum or minimum level of reserves for individual authorities or authorities in general.

The Chief Finance Officer (CFO) is a critical member of the leadership team, helping it to develop and implement strategy and to resource and deliver the organisation's strategic objectives sustainably and in the public interest. The CFO role is one of 3 statutory roles which together oversee the finances and governance of the council, the other two being the Chief Executive and the Monitoring Officer. The CFO must be actively involved in, and able to bring influence to bear on, all material business decisions to ensure immediate and longer-term implications, opportunities and risks are fully considered, and alignment with the organisation's financial strategy. The CFO must lead the promotion and delivery by the whole organisation of good financial management so that public money is safeguarded at all times and used appropriately, economically, efficiently and effectively.

CIPFA's Prudential Code requires chief finance officers in local authorities to have full regard to affordability when making recommendations about the local authority's future capital programme. Such consideration includes the level of long-term revenue commitments. Indeed, in considering the affordability of its capital plans, the authority is required to consider all the resources available to it estimated for the future, together with the totality of its capital plans and revenue forecasts for the forthcoming year and the following two years.

Impact on Cash Management and Borrowing

Holding usable reserves allows the Council to invest cash to generate investment returns or avoid the need to externally borrow thus reducing interest payments.

As highlighted in the treasury management outturn report presented to Executive on 28th September, the Councils borrowing requirement (known as Capital Financing Requirement (CFR)) is £453m at 31st March 2023, £371m for the general fund and £82m for the Housing Revenue Account (HRA). Due to strong cash balances (reserves + working capital), the Council are able to support this borrowing requirement through internal borrowing and limiting external borrowing to £182m. This helps minimise external interest costs which is important at a time when interest rates are high and very volatile. Interest rates on external borrowing costs will always be higher than interest rates achieved on investments.

It is important that the Council maintain strong cash balances to support the total borrowing requirement (CFR). As set out in the treasury management strategy, the Councils CFR is prudent and affordable however does come with financial risk with regards to interest rates and repaying down the CFR. An important mitigation to this risk is maintaining reserves which can support the need to limit external borrowing. The current CFR is expected to reduce each year through debt repayments such as capital receipts, income generation, developer contributions, subsidiary loan repayments and minimum revenue provision (MRP) payments.

Types of Reserves

There are a variety of different reserves which consist of;

- General Fund Balance Reserve (GFB) – held to provide a general contingency to offset any impact from unexpected events or emergencies. In addition, it provides some stability to support longer term planning.

- Earmarked Reserves – unringfenced and held for specific purposes such as developer funding for future maintenance of assets, grants received in advance and equalisation funds to smooth annual changes on demand led areas such as waste and recycling. Other reserves include interest equalisation and forward funding which are linked to the capital programme where infrastructure is delivered ahead of receipt of developer funding.

- Housing Revenue Account Reserve – similar to the general fund reserve however ringfenced for the housing revenue account.

- Schools & Dedicated Schools Grant Reserves* - ringfenced reserves relating to schools funding for investment in future expenditure within schools. The DSG deficit reserve is required to be treated as an unusable reserve under accounting requirements, currently until 31st March 2026. This does not remove the financial risk / impact of having a reserve in a deficit position and the uncertainty of what will be required post March 2026.

In addition, the Council will hold reserves that are held and restricted for capital purposes, these include the capital receipts reserve, capital grants reserve and major repairs reserve (ringfenced for the HRA)

Earmarked Reserves

When reviewing medium-term financial plans and preparing annual budgets local authorities should consider the establishment of earmarked reserves. These will be held for a number of purposes:

- a contingency to cushion the impact of unexpected events or emergencies
- a means of building up funds to meet known or predicted requirements.
- a working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing.

There are a number of budget assumptions which can have an impact on need for earmarked reserves, these include;

- Volatility in 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/productivity gains.
- The financial risks inherent in any significant new funding partnerships, major outsourcing arrangements or major capital developments.
- The availability of reserves, government grants and other funds to deal with major contingencies and the adequacy of provisions.
- The general financial climate to which the authority is subject (local government finance settlement, government spending reviews).
- Reductions of income.
- New service demands and responsibilities (e.g. demographic changes, accommodating refugees)

It is possible and allowable within the overall balance of earmarked reserves to have some individual reserves that hold debit balances. For example, equalisation reserves where costs outweigh income in the early years of an asset operational life and over time, income exceeds costs, and the deficit reserve is brought into balance.

Part of the risk management process involves taking appropriate action to mitigate or remove risks, where this is possible. This in turn may lead to a lower level of reserves being required, and it would be appropriate to consider reducing the level of balances held where appropriate action to mitigate or remove risks has been successfully undertaken. A balance will need to be found between maintaining adequate levels of reserves and investing in risk reduction measures.

Wokingham's Strategic Approach

The overall relatively high level of Reserves is consistent with a relatively high CFR. This is because the higher CFR has been required to fund the Council's strong Capital investment ambition over many years, including: Wokingham Town Centre Regeneration, Strategic Development Locations, and Affordable Housing delivered through its companies. Such an ambition clearly exposes the Council to greater financial risk, requiring stronger financial safeguards and required funding mechanisms through its Reserves. This is one of the key contextual considerations taken by the CFO in determining a safe and required level of overall reserves for the Council.

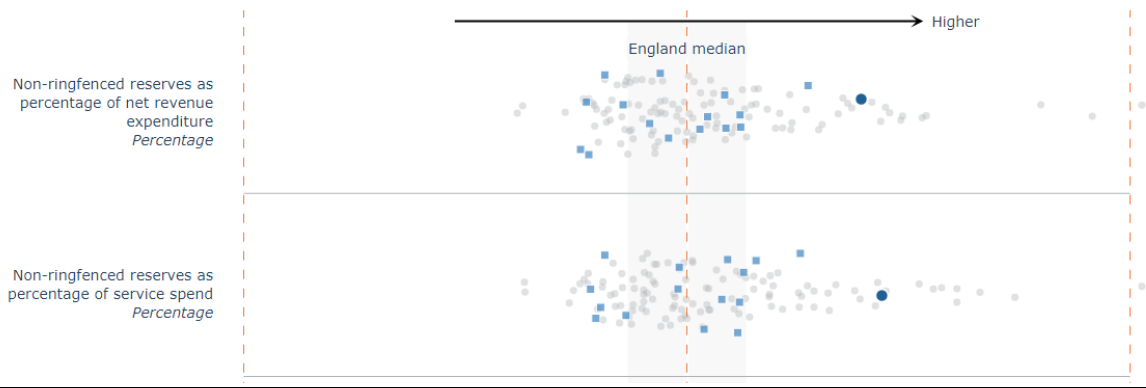
A further strategic context is that the current and potentially future nature of the Local Government Finance Settlement leaves the Authority particularly exposed to potential drastic detrimental movements in funding and/or significantly underfunded transfers in responsibilities that may result from any changes to the methodology for calculating perceived need and subsequent allocation of resources across Local Authorities.

A final consideration on Wokingham's strategic approach is the overall reserve balance position in the context of deficit balances, in particular, the Dedicated Schools Grant. The financial reserves are monitored closely and considered against the financial risks the Council face. The level and types of risks will change over time with new emerging risks arising. Holding a prudent level of reserves provides the Council the ability to review and adapt the reserves it holds which is a vital strategic financial control.

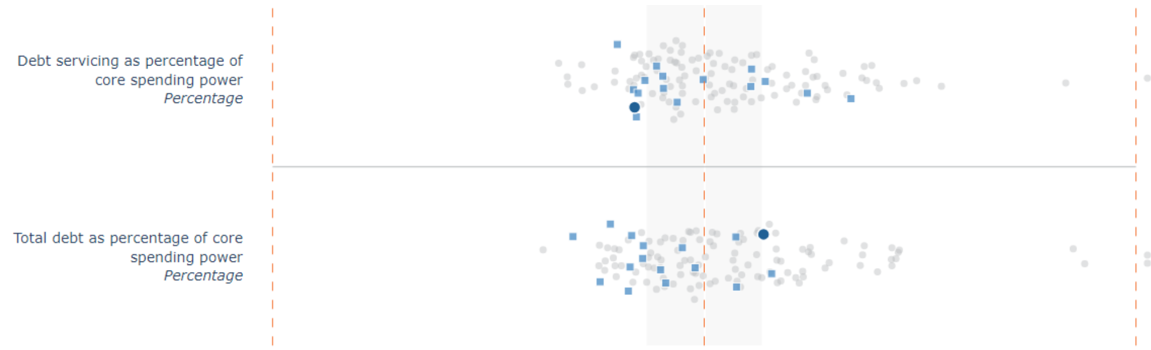
A recent data analysis tool has been made available by the Office for Local Government (Oflog) providing a number of metrics across a subset of service areas, including finance (the data is drawn from the latest Revenue Outturn returns made by all local authorities). These show clearly how the Council is currently balancing its level of debt and the repayment of that debt with a level of reserves.

The tables below compare Wokingham (round mark) with it local neighbours/similar authorities (square mark) and all other authorities.

The first two tables show how Wokingham's non-ringfenced reserves compare and show a high level against most other local authorities



The next two tables show how the comparatively higher level of reserves are being used to manage the risk from the current strategy of lower debt servicing and relatively high level of debt compared to other Councils. i.e. the relatively higher level of reserves balances the level of risk the Council faces from its relatively higher level of debt and lower level of debt servicing



Association of Local Authority Treasurers Societies (ALATS) Review

Earlier in the year, ALATs led an analysis of local authority reserves across all forms of local government in response to DLUHC comments about the levels held and the purposes. Some of the key outcomes highlighted from ALATs is set out below.

Reserves must always be a matter for the Section 151 Officer's professional judgement as set out in Statute that it is for the s151 Officer to advise their respective council. Where these are deemed insufficient then there are further statutory duties to take action under s114. As such as part of s25 duties all s151 officers carry out regular reviews of the level and use of their reserves.

Broadly the data, received from 144 authorities (just under 50% of all local authorities), shows some consistency of trends and patterns across all types of authorities. The data is also consistent with Revenue Out-turn (RO) returns, Revenue Budget (RA) returns, and Accounts produced. This data identifies that those surveyed have a level of reserves greater than one year savings but that these are declining and over a longer period this is not sustainable. In such cases without significant financial restructure this will quickly lead to risk of a S114 notice where reserves can no longer support the annual revenue gap.

It should be noted that cash reserves are invested under CIPFA's Treasury Management code and forms a key part of all council's income streams. Any use of these to fund settlement shortfalls simply adds to pressures from a loss of investment income.

Table of Reserves

Earmarked Reserves are unringfenced however are held for specific purposes and to mitigate future risks. These can be broken down as follows;

Earmarked Reserve Type	Justification for Reserve	Estimated Balance 31st March 2024	Financial Risk / Exposure
Insurance	Required to fund insurance claims below excess limits in insurance policies. Higher excess limits reduce annual premiums payable by the Council however means WBC must absorb more costs when claims are made.	£2,680,000	£250k - £300k drawdown per annum expected based on claims history and excess limits. Council insures c£1billion of assets.

			In additional, unforeseen historic specific claims
Renewals Funds	Required to ensure future funds available to fund the anticipated replacement cost of the items over their expected life. The need for these sinking funds (e.g. 3G pitches / tennis courts) are often required under the conditions of certain grant funding.	£1,220,000	Future replacements costs in excess of £2m + conditions of grant funding
Equalisation Funds	Required to smooth the annual impact on the revenue budget and avoid fluctuations each year on key areas which are subject to market conditions and have deficits in early years which are repaid once assets operational and generating income. Examples include Solar Farm, Leisure Contract	£2,540,000 Deficit	Deficits will increase in short term as planned and then return to balanced / surplus position subject to income levels, etc.
Waste Equalisation Fund	Required to smooth the annual impact on the revenue budget and avoid fluctuation each year across all waste and recycling activities which are subject to external factors such as recycling rates, levels of waste, etc. The reserve is also held to mitigate risks from future implications of the waste PFI arrangement which expires in 2031/32.	£1,990,000	Waste PFI contract ends 2031, high risk as costs unknown, contract arrangements unknown, WBC have no land asset. c£15m-£20m estimated as WBCs share (37%) of original capital costs. Dilapidations & Capital costs likely to be required at contract renewal.
Interest and Debt Repayment	Required to mitigate the impact on the revenue budget where fluctuations in market conditions may have an adverse impact on interest costs on new borrowing and refinancing of existing borrowing when historic loans mature. Reserve is also required to help offset any impact from changes in government policy around debt repayment (e.g. minimum revenue provision).	£12,820,000	A 1% impact from long term higher interests against the general fund capital financing requirement of £276m (at March 2023, excluding town centre) could equate up to £2.76m per annum in additional interest costs (depending on timing on borrowing / level of cash balances, etc). Impact from new MRP guidelines alone are expected to be £1m to £2m per annum equating to £5m to £10m over 5 years.

Pension Contributions	Required to mitigate the annual impact on the revenue budget when the pension contributions are set every three years by the Berkshire Pension Fund including an annual contribution to reduce the pension deficit. Contributions currently agreed up to 31/03/26.	£6,240,000	Annual deficit payments will vary however are in the region of c£3m - £4m (£3.42m 23/24, £3.56m 24/25, £3.7m 25/26) . A base budget is in place however variances against this budget will be covered through this reserve. Overall pension liability is £120m at 31/03/23.
Town Centre Regeneration	Required to mitigate the annual impact on the revenue budget where fluctuations in market conditions may have an adverse impact on annual rental income (e.g. long term covid impact, national / local economy, etc). Reserve is also required to mitigate risks associated with the long-term capital financing costs of the regeneration (interest and debt repayments).	£9,350,000	Debt position at 31/03/23 was c£95m. Rental income required to fund interest costs and debt repayment costs. Overall position to be reviewed upon completion.
Fairer Funding Review	Required to mitigate unknown risks from future local government finance settlements including removal of new homes bonus, impact from levelling up agenda, reduction in core spending power, risk of negative revenue support grant, etc.	£19,920,000	New Homes Bonus - Currently £2.2m assumed in base budget. Allocation for 23/24 only £1.9m. High risk scheme will end meaning c£2m shortfall per annum or £10m over 5 years. Core Spending Power (including Council Tax) is £161.9m for 2023/24. If the government reduce this and / or increases are behind inflation, a 3% impact would equate to c£5m per year, or £25m over 5 years. Total potential impact of the above over 5 years is £35m.
Commuted Sums	These are amounts received from developers for the maintenance of open spaces, parks and natural greenspaces (SANGs). These are secured through the planning process to ensure long term funding for the maintenance of these areas. Also includes section 38/278 highways agreements.	£24,360,000	This is for infrastructure and will be draw down annually over long term into revenue budget. During 2023/24, c£1m expected to be drawdown into revenue.
Forward Funding	Required to offset capital financing financial impact where there are timing differences between capital investment costs and receipt of developer contributions.	£22,410,000	Forward funding debt at 31/03/23 was c£30m. Based on 5.5% interest, c£1.7m drawdown per

			annum until developer funding received. Furthermore, there is potential shortfall in capital funding over the medium-term capital programme.
Other	Various smaller reserves held across departments to support ongoing projects, efficiency and improvement works over medium-term plan.	£1,360,000	Required to support specific service pressures (such as winter maintenance) and supporting efficiency and transformation programmes.
Children Services	Held to support current and future risks around children services, demand management, transformation and efficiency programmes.	£1,080,000	Children Services facing significant pressures in current year.
Building Control	Building control service is required to operate an independent trading account which is ringfenced. Reserve is held to support investment in building control service and ensure trading account holds a rolling three-year break-even position required under the CIPFA regulations	£230,000	Required to support building control to ensure trading accounts operates a three-year rolling break even position.
Adult Social Care	Held to support current and future risks around adult social care, supporting the market and providers, development of WBC care company, impact of national living wage, demand management.	£3,590,000	Required to support delivery of savings and efficiencies. Financial Impact and timing from longer term care reforms
Property portfolio	Required to mitigate the annual impact on the revenue budget where fluctuations in market conditions may have an adverse impact on annual rental income (e.g. long term covid impact, national / local economy, etc).	£1,000,000	Rental income c£5m per annum (excluding town centre regeneration).
Business rates	A CIPFA recommended held reserve required to mitigate number of risks associated with business rates from changes in collection rates, level of appeals and bad debt, changes in government policy on rates payable. Reserve also required to offset annual fluctuations created from complex statutory collection fund accounting for business rates.	£5,020,000 (net of collection fund deficit)	Level of retention (currently 49%), tariff payment payable by the Council. c£62m collected during 2022/23, a 2% impact would equate to c£1.25m per annum. Central government only protect 92.5% of retained business rates (known as safety net), remaining 7.5% required to be funded by WBC if NNDR income falls below government set target. Equates to £960k per annum.

Revenue Grants	Relate to a number of revenue grants received across all services which are planned to be spent in short / medium term in line with grant requirements. These includes areas such as Ukraine Funding, new burdens funding, homelessness, school improvements, council tax support schemes, etc.	£3,480,000	Individual services will plan to utilise 2024 to 2027.
Public Health Grant	Ringfenced grant held to support public health objectives and initiatives in line with requirements of annual grant funding	£780,000	24/25 grant allocation confirmed with only 1% inflation uplift on current level. Reserves to cover the shortfall from this increase for the continuation of the public health statutory services
Carry Forwards	Required to fund and deliver the carry forwards agreed by Executive previously as part of revenue monitoring outturn reports.	£2,300,000	
DSG Deficit	Statutory account required to account for the deficits created where ringfenced expenditure is greater than ringfenced income across maintained schools, early years, and high needs services.	£21,000,000 deficit after £8m government contribution	Deficit forecast expected to increase to almost £50m over 5 years before safety value contribution.
DSG Equalisation Fund	1% Council Tax contribution each year from 2023/24 to contribute to deficit and fund safety value programmes	£300,000	Reserve to be monitored and reviewed alongside safety value programme

The appropriate level of all reserves is monitored continually, and a full review is undertaken as part of the develop of the Medium-Term Financial Plan that will be put before council in February 2024

Risk of Depleted Reserves

More recently, an increasing number of local authorities have raised warnings about their financial health and sustainability. Some Councils have already issued a section 114 notice meaning the local authority are unable to balance its budget and are effectively bankrupt. These include;

- Birmingham City Council (September 2023)
- Woking (June 2023)
- Thurrock (December 2022)
- Croydon (November 2022)
- Slough (July 2021)
- Northamptonshire (February 2018)

Nb, the most recent example prior to Northamptonshire was London Borough of Hackney in 2000

More recently, there are councils who are publicly issuing warnings that they face the real risk of needing to issue a section 114 notice on almost a weekly basis.

There are a number of reasons those authorities have found themselves in that position, including non-delivery of efficiency savings, poorly delivering investments and increased demand/costs (with Childrens social care most frequently cited). However they have all found themselves in a position where they do not have sufficient reserves to balance the budget whilst they resolve any ongoing revenue pressures/gaps. The need therefore for sufficient and robust reserves at this incredibly difficult financial time is absolutely critical to manage the short, medium and longer-term position.

FINANCIAL IMPLICATIONS OF THE RECOMMENDATION

The Council continues to face severe financial challenges over the coming years as a result of reductions to public sector funding and growing pressures in our statutory services. It is estimated that Wokingham Borough Council will be required to make budget reductions of approximately £20m over the next three years and all Executive decisions should be made in this context

	How much will it Cost/ (Save)	Is there sufficient funding – if not quantify the Shortfall	Revenue or Capital?
Current Financial Year (Year 1)	See other financial implications	Y	Both
Next Financial Year (Year 2)	See other financial implications	Y	Both
Following Financial Year (Year 3)	See other financial implications	Y	Both

Other financial information relevant to the Recommendation/Decision
There are no financial implications associated with the scrutiny process, however, the full MTFP, when submitted to Council in February 2024, will have to represent a balanced budget.

Cross-Council Implications
This is in respect of budgets across all Council services.

Public Sector Equality Duty
Not at this stage of consideration but equality impact statements will be required before specific proposals are agreed and implemented.

List of Background Papers
None

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