LGFUTURES

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APPENDIX ONE

Strategic Assessment of Reserves

South Ribble Borough Council

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LGFUTURES

Contents

Executive Summary

Introduction

I. LG Futures was commissioned by South Ribble Borough Council in April 2016 to undertake a strategic assessment of the current level of reserves, which could then be used to assist with the planning for future levels of reserves across the council in its Medium Term Financial Plan (MTFP).

II. The strategic assessment was specifically intended to review the following:

- The current approach to reserves in the council's MTFP and the main financial risks to the authority;
- The link between the budgeted assumptions and the levels of reserves set aside, including balances on Collection Funds;
- Comparative analysis across the sector on the levels of reserves and comparison to professional guidance; in particular, LAAP 99;
- Future gearing of sources of income (e.g. from council tax, business rates, government grant and fees and charges) and the implications for future levels of reserves.

III. This strategic assessment is not intended to advise the council on what an appropriate level of reserves would be for the authority.

IV. There is no 'best practice' for the specific minimum or maximum levels of reserves that should be held at any given time, either now or for future years. Instead, the levels of reserves that a s151 officer recommends should be held is a professional judgement that has to be made based on local knowledge including the circumstances relating to an individual authority, the risks it currently faces and the potential risks that could materialise in the future. It is a critical feature of setting a balanced budget and in producing a robust medium term financial plan, one that both plans to support the continued effective delivery of services and ensures the future financial sustainability of the authority.

V. There are a number of different reserves that a local authority might have at any one time. Those that have been reviewed as part of the strategic assessment are:

- General reserves: representing a working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing and / or to cushion the impact of unexpected events or emergencies;
- Earmarked reserves: these can represent a building up of funds to meet known or predicted requirements.

VI. The level of reserves held by South Ribble was compared against two comparator groups:

- Lancashire Districts: all other district councils across the County including an average for all the districts inclusive of South Ribble;
- Nearest Neighbours: a group of district councils from across England with similar characteristics. The group was based on a list provided by the council.

VII. In addition the analysis undertaken and report written was derived after meeting with council officers, reviewing local budget papers and identifying recommended professional practice.

Main findings

General Reserves

VIII. The levels of general reserves are broadly consistent with comparisons undertaken with other councils. The council is not consistently at one extreme or another in the benchmarks we analysed. Our findings included:

- The comparative position on budgeted general reserves is higher relative to others than the comparative position for actual levels of reserves;
- In four of the five indicators reviewed the council is below the national average for district councils.

IX. The council better estimates the future levels of general reserves that it will have compared to many other councils with average variances of the actual to budget below that in comparative councils. This substantiates the positive Audit Findings for South Ribble Borough Council published by Grant Thornton in September 2015 which stated that “the Council has robust systems and processes to manage effectively financial risks and opportunities”.

X. The council is already planning for a reduction to the average level of reserves it budgets for between 2016/17 and 2018/19 of 22%. This reduction is driven by the pension deficit recovery payment of £2.1m planned for March 2017. If the past and future pension deficit reduction plan is excluded from the analysis of general reserves, the average level of general reserves remain constant for the periods

XI. However the pension deficit reduction plan is currently an integral part of the general reserves. Therefore the average reduction of 22% represents an additional level of risk to the authority of a lower level of general reserves created by the current rolling pension deficit reduction plan.

XII. There are significant additional future financial risks for the council to manage in its MTFP for the period leading up to and beyond 2019/20. These additional risks include:

- By 2018/19, the level of reliance on business rates as a source of revenue as a proportion of the total revenue shown grows from 19% to 31%. This source of revenue is potentially more variable and more difficult to predict than other sources of revenue. Therefore, the forward projections of income for the council are potentially more uncertain.
- As a result of the move to 100% of business rates by the end of the current Parliament there will be a number of major reforms to local government finance and each could have a significant financial impact for local government generally and South Ribble BC specifically. As a result there will be significant additional uncertainty to the levels of future resources the council can expect from 2019/20; and there will be continued revenue variability for the period 2019/20 and beyond. This adds to the degree of financial risk that the authority faces.
- The reset of the business rates baseline could have the impact of reducing income from business rates for those local authorities currently retaining business rates income at above

their business rates baseline. South Ribble is currently retaining business rates at above their baseline and they could potentially lose from 2019/20. Current projections provided by LG Futures provided within the MTRR is for a reduction in revenue from business rates of £1m from 2019/20.

- The potential financial impact of a future recession. Whilst it may not be possible for the council to readily model the potential financial consequence of recession locally, it is a new additional financial risk to income received by a local authority from both council tax and business rates.

Earmarked Reserves

XIII. The council already has plans to reduce all but two of the categories of earmarked reserves over the period of current MTFP, by between 11% and 70%.

XIV. The benchmarking against other councils showed the levels of earmarked reserves differed in a number of ways with comparators. Our findings included:

- The council had a high budgeted level of earmarked reserves at 2015/16 compared to other councils. However other authorities are under-budgeting for the actual levels of earmarked reserves compared to South Ribble BC;
- The council has increased both its budgeted and actual levels of reserves between 2011/12 and 2015/16 by less than other councils;
- The council did not have a substantially higher level of actual earmarked reserves at 2014/15 compared to other councils.

XV. The lower level of variance between actual and budgeted levels of earmarked reserves substantiates the positive Audit Findings for South Ribble Borough Council published by Grant Thornton in September 2015 which stated that “the Council has robust systems and processes to manage effectively financial risks and opportunities”.

XVI. The ICT reserve has increased by £0.509m (35%) over the period 2011/12 to 2015/16. The balance at the beginning of the period in March 2011 of £1.468m represented the equivalent of 7.4 years of spending at the average spend of the last five years.

XVII. There is still an active resourcing requirement, with spend in the last two years averaging £0.225m per annum which is 24% higher than the average spend for the previous three years of £0.181m.

XVIII. The current plan is to reduce the balance on this reserve to £0.643m by March 2017, rising to £1.091m by March 2019. The lower point represents the equivalent of 3.2 years of spending at the average spend of the last five years, which is less than half the comparable level at March 2011.

XIX. There has been a minimal decline (£10,000) in the size of the Asset Management reserve over the period 2011/12 to 2015/16, because contributions from revenue have almost matched the capital financing commitments.

XX. There is still an active resourcing requirement, with spend in the last two years averaging £0.336m per annum; however the average spend of the last two years was a decline of 45% on the average for the previous three years of £0.613m.

XXI. The balance in March 2011 was worth 3.6 years of the annual contributions of the period 2011/12 to 2013/14; the balance at March 2016 is worth 6.2 years of the annual contributions of the period 2014/15 to 2015/16.

XXII. The current plan is to reduce the balance on the Asset Management reserve to £0.830m by March 2018, which is the equivalent of 2.5 years of the average capital financing costs of 2014/15 to 2015/16. This is a decline of one third on the comparable level at March 2011.

XXIII. The Borough Investment Account, which represents a new reserve from 2016/17 and at £3.7m is the highest single earmarked reserve in 2016/17. The Borough Investment Account has been created through reductions to other reserves and has not been set at a level commensurate with meeting a specific objective or managing a specific risk.

XXIV. The need to have a robust equalisation reserve to manage a higher level of future risk to the level of business rates income being collected and to manage the financial impact of a transition to a revised business rates baseline makes it prudent to maintain this reserve and at a level the council believes to be robust.

XXV. The plan for using the reserve for Public Open Space Commuted Sums at a gradual reduction in the level of this reserve of approximately £60,000 per annum would reduce this reserve to a nil balance over 23 years after March 2016.

XXVI. The council currently projects that the balance on its capital reserves will fall from £2.001m at March 2016 to £0.562m at March 2020, a fall of £1.439m or 72%. Within this there is a reduction to the earmarked capital reserve from £0.397m to £0.067m a fall of £0.330m or 83%. The reduced balance will have implications for the future funding of the council's capital programme.

Main recommendations

XXVII. The strategy for setting levels of general reserves will need to be mindful of the additional financial risk it will be facing in future years and in particular from 2019/20 and beyond from the major reforms to local government finance; the reset of business rates and the potential impact of a future recession on levels of revenue.

XXVIII. The council should consider modelling and / or estimating the potential impact on its level of income of the various future changes highlighted and review the impact for the levels of reserves it might require at 2019/20 and in the intervening years.

XXIX. This planned review of ICT should consider the reserve and its current balance and clarify the following:

- Given contributions have exceeded spending over the last five years but a decline is budgeted for to March 2019, what is the purpose of the balance on this reserve? Is it to provide for:

- A future large increase in spend that won't be covered by annual contributions; and /or
- Future years when revenue contributions may not be possible?

- If the reserve is to cover a large increase in future spend, what is this spend and when is it anticipated to arise?
- If the reserve is to cover for the eventuality of reduced or nil revenue contributions in future years, how many years of such reduction does the council wish the reserve to protect against?

XXX. This review of Asset Management should consider the reserve and its current balance and clarify the following:

- Given contributions have been made to cover expenditure over the period 2011/12 to 2015/16, what is a balance required on this reserve? What purpose is it intended to serve? Is it to provide for;

  a) A future large increase in spend that won't be covered by annual contributions; and /or

  b) Future years when revenue contributions may not be possible?

- If the reserve is to cover a large increase in future spend, what is this spend and when is it anticipated to arise?
- If the reserve is to cover for the eventuality of reduced or nil revenue contributions in future years, how many years of such reduction does the council wish the reserve to protect against?

XXXI. The council should maintain an equalisation reserve for business rates. It is recommended that a robust balance should be maintained on this reserve given the inherent volatility of business rates income, the major changes planned for business rates and the potential future risks to an increasingly material part of the council total source of income.

XXXII. A clear strategy for the operation of a Borough Investment Account should be developed in recognition of professional guidance on the management of earmarked reserves and this should include establishing clear objectives; clarity as to how and when this reserve can be used; procedures for the management and control of the reserve and establishing a process and timescale for a review of its continuing relevance and adequacy.

XXXIII. The council reviews the need to maintain the reserve for Public Open Space Commuted Sums given that at the current rate of usage it will be reduced to nil only by 2032.

XXXIV. The council should consider if it should rebuild some of its capital reserves or identify what the alternatives it will turn to for the future funding of the capital programme.

1. Introduction

1.1. LG Futures was commissioned by South Ribble Borough Council in April 2016 to undertake a strategic assessment of the current level of reserves, which could then be used to assist with the planning for future levels of reserves across the council in its Medium Term Financial Plan (MTFP).

1.2. The strategic assessment was specifically intended to review the following:

- The current approach to reserves in the council's MTFP and the main financial risks to the authority;
- The link between the budgeted assumptions and the levels of reserves set aside, including balances on Collection Funds;
- Comparative analysis across the sector on the levels of reserves and comparison to professional guidance; in particular, LAAP 99;
- Future gearing of sources of income (e.g. from council tax, business rates, government grant and fees and charges) and the implications for future levels of reserves.

1.3. It was agreed that the strategic assessment would be split into three parts:

- A review of external benchmarks;
- An assessment of existing plans for levels of general reserves to 2019/20;
- An assessment of existing plans for levels of earmarked reserves to 2019/20.

1.4. In carrying out the strategic assessment LG Futures:

- Met with council's officers to discuss the current plans and the assumptions underlying these;
- Reviewed the existing plans including the council's Budget Report; the Treasury Management Strategy Report, produced in February 2016; and the most recent External Audit Report, published in September 2015;
- Researched the current professional guidance, specifically LAAP 99 on Local Authority Reserves and Balances which was produced by the Chartered Institute of Public Finance and Accountancy (CIPFA) in July 2014; and the CIPFA briefing on English Local Authority Reserves produced in June 2015;
- Assessed the current and historic levels of reserves held by South Ribble BC in comparison with a number of all other agreed authorities, including other district councils across Lancashire and those identified as nearest neighbours - a group of district councils from across England with similar characteristics. The group was based on a list provided by the council.

1.5. This strategic assessment is not intended to advise the council on what an appropriate level of reserves would be for the authority.

1.6. There is no 'best practice' for the specific minimum or maximum levels of reserves that should be held at any given time, either now or for future years.

1.7. Instead the levels of reserves that a s151 officer recommends should be held is a professional judgement that has to be made based on local knowledge including the circumstances relating to an individual authority, the risks it currently faces and the potential risks that could materialise in the future. It is a critical feature of setting a balanced budget and in producing a robust medium term financial plan, one that both plans to support the continued effective delivery of services and ensures the future financial sustainability of the authority.

1.8. There are a number of different reserves that a local authority might have at any one time. They include:

i. General reserves: representing a working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing and / or to cushion the impact of unexpected events or emergencies;

ii. Earmarked reserves: these can represent a building up of funds to meet known or predicted requirements;

iii. Unusable reserves: these arise out of legislation interacting with proper accounting practice to store revaluation gains or to form adjustment accounts. These are not resource backed and cannot be used for any other purpose. Examples include the Revaluation Reserve, Pensions Reserve and Capital Adjustment Account.

1.9. This strategic review is looking at the first two of these three types of reserve identified only.

1.10. This report is split into:

- Section 2: An assessment of existing plans for levels of general reserves to 2019/20;
- Section 3: An assessment of existing plans for levels of earmarked reserves to 2019/20;
- Section 4: Conclusions and recommendations.

2. General Reserves

Introduction

2.1. The budgeted level of general reserves for the period 2016 to 2019 was identified in the council's Revenue and Capital Budget, which was agreed in February 2016. Table 1 below shows the levels of general reserves budgeted for.

Table 1: Budgeted levels of general reserves 2016 to 2019

	31 March 2016 £'000	31 March 2017 £'000	31 March 2018 £'000	31 March 2019 £'000
General Reserves	4,059	1,874	2,574	3,274

2.2. There is a decline of £2.185m in the projected level of general reserves between March 2016 and March 2017 and then a steady increase in each of the following two years. The council has explained that this is in part due to the recovery plan for the pensions deficit. A pensions deficit recovery contribution is made in advance for a triennial period. This reduces the level of general reserves and then a payment is made into the reserve in each of the three subsequent years. The payment of £2.100m budgeted to be made in March 2017 is subsequently repaid in the following three years at £0.700m per annum.

2.3. In addition, in 2016/17 there is a contribution into the general reserves of £0.515m as repayment for the pension deficit reduction payment of £1.778m made in March 2014 and there is a contribution of £0.600m to the Borough Investment Account.

Comparison with external benchmarks

2.4. Benchmarking analysis was undertaken of the past levels of general reserves held compared to the district council average, other district councils in Lancashire and to a group of 'Nearest Neighbours' with South Ribble BC. The levels of general reserves for the council the period analysed are shown in table 2.

Table 2: Budgeted and actual level of general reserves 2011/12 to 2015/16

	2011/12 £'000	2012/13 £'000	2013/14 £'000	2014/15 £'000	2015/16 £'000
Budgeted	2,887	3,272	3,772	2,876	3,607
Actuals	4,170	4,891	4,092	3,449	N/A

2.5. The purpose of this analysis of external benchmarks is to provide both an initial comparator of the size of general reserves and the change of these levels over time; and to establish if the levels of, and variations to the levels of, general reserves is unusual at South Ribble BC.

2.6. The benchmarking carried out compares the level of general reserve as a proportion of the Total Service Expenditure (TSE) of an authority each year. This shows the size of the level reserves as a proportion of service expenditure to provide a comparable like-for-like percentage analysis across councils.

2.7. Analysis was undertaken across three main categories of benchmark:

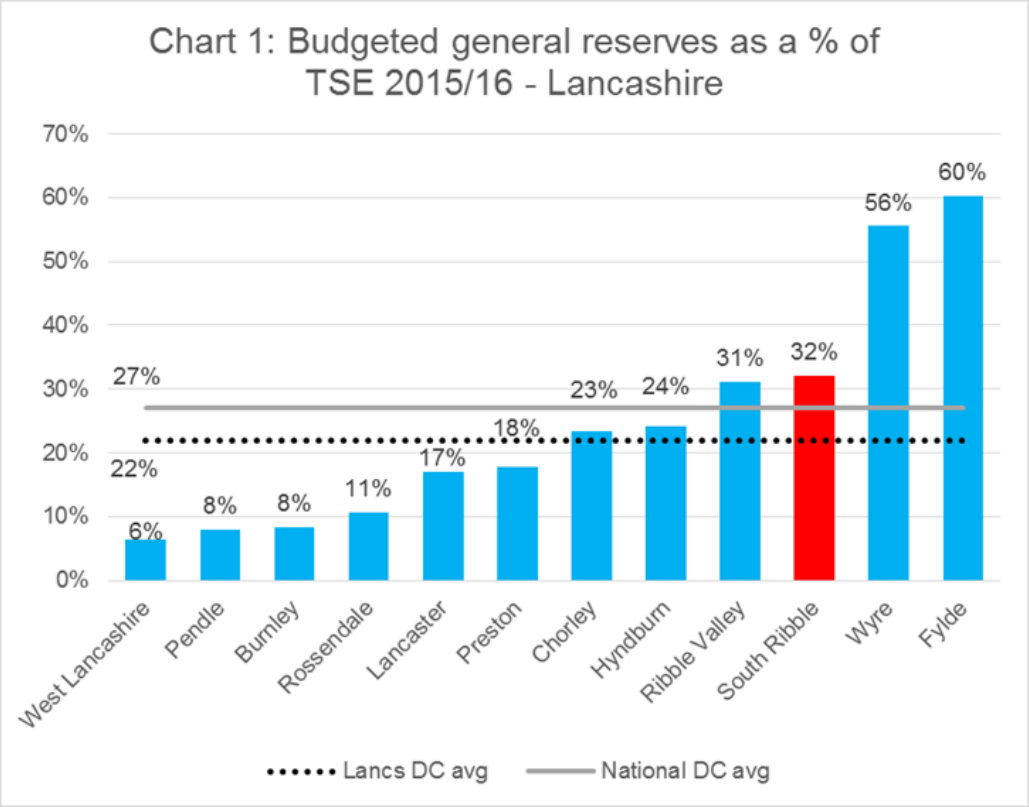
i. Budgeted levels of general reserves as a percentage of TSE in 2015/16 and the level of change in budgeted levels of reserves between 2011/12 and 2015/16;

ii. Actual levels of general reserves as a percentage of TSE in 2014/15 and the level of change in actual levels of reserves between 2011/12 and 2014/15;

iii. A comparison of the difference between the budgeted and actual level of reserves between 2011/12 and 2014/15.

2.8. The benchmarking analysis has generated 10 charts. Chart 1 below shows the levels of budgeted general reserve as a percentage of TSE in 2015/16 against other Lancashire districts and the national district council average.

Chart 1: Budgeted general reserves as a % of TSE 2015/16 (Lancashire)



2.9. Chart 1 shows that compared to other district councils across Lancashire, South Ribble BC had the third highest level of budgeted levels of general reserves as a % of TSE in 2015/16 at 32%. This exceeded the average by 10% across Lancashire (22%) and 5% across England (27%).

2.10. Table 3 below shows the comparative position of South Ribble BC across all 10 charts created against other Lancashire and Nearest Neighbour district councils. The charts are available at Appendix One (a) to this report.

Table 3: Summary of benchmarking analysis of general reserves

Chart title	South Ribble placement (from 12) 1 = highest	South Ribble variance to group average	South Ribble variance to national DC average
Budgeted general reserves as a % of TSE 2015/16 – Lancashire (as per Chart 1 above)	3rd	+10%	+5%
Budgeted general reserves as a % of TSE 2015/16 – Nearest Neighbour	4th	+9%	+5%
Percent change in budgeted level of reserves 2011/12 to 2015/16 – Lancashire	5th	-8%	-6%
Percent change in budgeted level of reserves 2011/12 to 2015/16 – Nearest Neighbour	6th	+1%	-6%
Actual general reserves as % of TSE 2014/15 – Lancashire	7th	+3%	-4%
Actual general reserves as % of TSE 2014/15 – Nearest Neighbour	6th	+1%	-4%
Percent change in actual general reserves 2011/12 to 2014/15 – Lancashire	11th	-31%	-23%
Percent change in actual general reserves 2011/12 to 2014/15 – Nearest Neighbour	11th	-37%	-23%
Average variance of actual to budgeted levels of general reserves 2011/12 to 2014/15 – Lancashire	6th	+13%	-6%
Average variance of actual to budgeted levels of general reserves 2011/12 to 2014/15 – Nearest Neighbour	7th	+19%	-6%

2.11. The main points arising from the summary analysis of the benchmarking of general reserves for the council:

- The council is neither consistently at one extreme or the other against the two comparator groups of Lancashire and Nearest Neighbour districts councils.
- In four of the five indicators the council is below the national average for district councils.
  - Percent change in budgeted level of reserves 2011/12 to 2015/16;
  - Actual general reserves as % of TSE 2014/15;
  - Percent change in actual general reserves 2011/12 to 2014/15;
  - Average variance of actual to budgeted levels of general reserves 2011/12 to 2014/15.
- It is only above the national average for the benchmark of general reserves as a % of TSE in 2015/16.
- The comparative position on budgeted general reserves is higher relative to others than the comparative position for actual levels of reserves.

2.12. The authority is neither in the upper or lower quartile of its comparator groups in 7 of the 10 comparators in Table 3. It is therefore not consistently setting levels of reserves at one extremity or another.

2.13. The Audit Findings for South Ribble Borough Council published by Grant Thornton in September 2015 stated that “the Council has proper arrangements in place for securing financial resilience - the Council has robust systems and processes to manage effectively financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future”. The comparative benchmarks produced for general reserves would support this audit conclusion.

2.14. Benchmarks are only available up to 2015/16 (budgeted) and 2014/15 (actual). Table 4 below shows the average level of general reserves budgeted for during the period 2011/12 to 2015/16 and the average level currently projected for by the council 2016/17 to 2018/19.

Table 4: Budgeted and actual level of general reserves 2011/12 to 2015/16

	Period average £’000
Budgeted 2011/12 to 2015/16	3,282
Budgeted 2016/17 to 2018/19	2,574

2.15. Table 4 shows that the future average level of budgeted levels of general reserves for 2016/17 to 2018/19 is -£0.708m per annum below the average for the period 2011/12 to 2015/16. Therefore the council is already planning for a reduction to the average level of reserves it budgets for between 2016/17 and 2018/19 of 22%. The significant contributor to this trend is the pensions deficit recovery payment of £2.1m planned for March 2017 which in subsequent years will then be repaid at £0.7m per annum.

2.16. If this reduction of 22% were applied to the comparative analysis for 2014/15 (actuals) and 2015/16 (budgeted), then the impact can be assessed for the four benchmarks shown in Table 5.

Table 5: Updated comparative analysis for the 22% average reduction to general reserves

	South Ribble (table 3 placement) 1=highest	South Ribble revised placement 1 = highest	South Ribble variance to group average	South Ribble variance to national DC average
Budgeted general reserves as a % of TSE 2015/16 –Lancashire	3rd	4th	+3%	-2%
Budgeted general reserves as a % of TSE 2015/16 – Nearest Neighbour	4th	4th	+3%	-2%
Actual general reserves as % of TSE 2014/15 – Lancashire	5th	6th	-3%	-10%
Actual general reserves as % of TSE 2014/15 – Nearest Neighbour	6th	6th	-5%	-10%

2.17. Table 5 shows that if the average 22% long term reduction in the level of general reserves was applied to 2014/15 (actuals) and 2015/16 (budgeted) then:

- The budgeted levels of reserves as a % of TSE would be reduced to +3% above the group average for Lancashire (previously +10%) and Nearest Neighbours (previously +9%). Against the national average for district councils the council would be -2% below the average (previously +5%);
- The actual levels of reserves as a % of TSE would be reduced to -3% below the group average for Lancashire (previously +3%) and -5% for Nearest Neighbours (previously +1%). Against the national average for district councils the council would be -10% below the average (previously -4%);

2.18. As explained in paragraph 2.2 the level of general reserves includes the annual movements relating to the recovery plan for the pensions deficit. Each year the council adds to general reserves from service revenue accounts as a repayment for a one off payment (once every three years) from general reserves to the pension fund to reduce the pensions deficit. This does of course affect the level of general reserves as a percent of TSE and naturally decreases it over a period of three years whilst the reserve is then added to as a recovery for the sum paid in advance.

2.19. Analysis was undertaken which adjusted the budgeted amounts of general reserve shown in table 2 by the amounts relating to movements for the pension deficit repayment. Once these adjustments were made the average budgeted level of reserves for 2011/12 to 2015/16 was £3.973m and this compared to a revised average for the period 2016/17 to 2018/19 of £3.974m. Therefore if the pension deficit reduction plan was either not being progressed, or was progressed outside of the general reserves, the average level of general reserves for the periods analysed in table 2 remain constant.

2.20. However the pension deficit reduction plan is currently an integral part of the general reserves. Therefore the average reduction of 22% highlighted in paragraph 2.15 effectively represents the additional level of risk to the authority of a lower level of general reserves created by the current rolling pension deficit reduction plan. However, it is understood that the authority chooses to pay its pensions deficit in this way in order to reduce the overall cost to the authority. This approach is used by a number of authorities.

2.21. In 2016/17 the authority is also budgeting to transfer £0.600m from general reserves to the Borough Investment Account. This level of contribution in the absence of any pension deficit reduction plan does not reduce the comparative level of reserves for the periods analysed at paragraph 2.19.

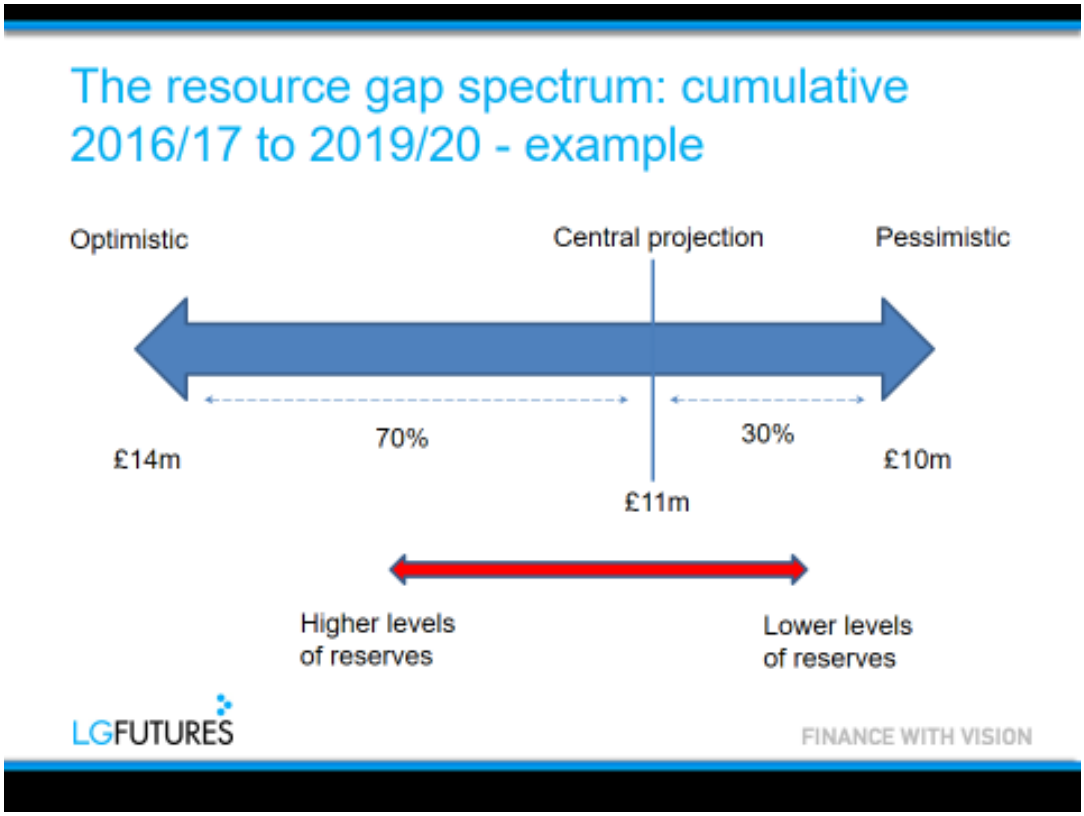
Assumptions made in the medium term financial plan and the potential additional exposure to financial risk from these assumptions

2.22. The MTFP includes a number of key assumptions that underpin the revenue budget up to 2018/19. These assumptions in themselves have an impact upon the level of robustness of the

level of general reserves that have been set for the period, as does the level of earmarked reserves that have been budgeted for (see next section).

2.23. Where the authority is using optimistic forecasts for the future level of income for the authority in the MTFP then the future pressure on general reserves is potentially increased and vice-versa. Diagram 1 below illustrates this principle for an example authority.

Diagram 1: Potential impact of relative optimism/pessimism on level of general reserves



2.24. In the diagram, if the example authority has makes a series of central assumptions in the MTFP that are generally more optimistic than pessimistic, it may wish to consider whether a higher level of general reserves is required to counter balance the optimism.

2.25. The key assumptions identified by South Ribble in its MTFP and underpinning the revenue budget for 2016/17 to 2018/19 were therefore reviewed for whether there was a degree of potential optimism or pessimism bias in the assumptions made. The results of this review are shown in Table 6.

Table 6: Analysis of key revenue budget income assumptions of the council in MTFP

Assumption	Council assumption	National conditions	Conclusion
Settlement Funding Assessment (grant levels)	Grant Levels per Final Local Government Finance Settlement 2016/17	Published with Final Local Government Finance Settlement 2016/17	Neither optimistic or pessimistic
Council tax increases	0% over the three years	Assumed by CLG at an increase of £5 per annum	Lower range assumed. This could provide an additional source of revenue in 2017/18 (£0.2m) and 2018/19 (£0.3m) if the £5 flexibility was utilised (at 2016/17 taxbase).

Assumption	Council assumption	National conditions	Conclusion
Council taxbase increases	Assumed nil	Locally has been an average 1.85% per annum over last 2 years	Lower range assumed. Could provide potential opportunity for additional source revenue in 2017/18 (£0.1m) and 2018/19 (£0.3m) if tax base growth was at the average for the last two years
New Homes Bonus Funding	Reducing over time	Subject to national consultation – results currently unknown	Current MTFP projections in line with some but not all of the potential reductions outlined in the national consultation

2.26. Table 6 shows that the council has not been either optimistic or pessimistic in the levels of grant funding it receives for the grants shown in table 6. However, table 6 does show that the council has been prudent on the level of council tax revenue that could be raised and this arises for two reasons:

- No Council tax increase in line with local policy. If the option to increase council tax in line with the national framework of £5 per annum was adopted, this would provide additional revenue from council tax of £0.2m in 2017/18 and £0.3m in 2018/19.
- No forecast increase in the taxbase. If the council was able to increase its council taxbase at the average for the increase of the last two years this would provide additional revenue from council tax of £0.1m in 2017/18 and £0.3m in 2018/19.

2.27. The analysis in table 6 should be viewed in the context that the council has already identified a budget shortfall in the MTFP, with this forecast budget shortfall in each of the following two years as follows:

- 2017/18 - £0.708m;
- 2018/19 - £2.254m.

Balances on the Collection Fund for council tax and business rates

2.28. In addition to the balances on general fund reserves councils also have a share of the Collection Fund balances at year end. These effectively operate as a further reserve, although a proportion of these balances will already have been estimated at January 2016 and used for the purposes of the 2016/17 budget setting.

2.29. Table 7 shows the year end level of balances on the Collection Funds and the amount of balances assumed for distribution in 2016/17.

Table 7: Collection Fund balances at the end of 2015/16

Collection Fund	Actual year-end balance £'000	Budgeted balance to be used in 2016/17 £'000	Outstanding balance from 2015/16 £'000
Council tax	65	-9	74
Business rates	310	305	5
Total balances	375	296	79

2.30. Table 6 shows that there is only a small total balance outstanding of £0.079m. This represents 2% compared to the projected year-end balance on general reserves of £4.059m. The outstanding balances from the Collection Fund receivable in 2017/18 are therefore only providing a minor additional level of general reserve.

Future gearing of council revenues

2.31. The future balance of funding received by the council from its different sources of revenue will have a significant impact upon the degree of risk that the council will face to its overall level of revenue in future years. Nationally there is an ever decreasing reliance upon grants provided by central government and an increasing reliance upon source of funding raised locally through council tax and business rates and also from fees and charges.

2.32. Each local source of revenue is subject to different degrees of annual volatility and to other additional major one-off variation from significant economic events e.g. a recession. The greater the council dependency upon those sources of revenue that are most subject to variation and subject to major economic shock then the higher the level of risk to the short term future financial sustainability of an authority. It is these variations to which an authority would seek to manage its risk exposure through having a higher level of general reserves.

2.33. Analysis of the councils own MTFP for 2015/16 to 2018/19 provided in table 8 below shows how the gearing of its revenue is projected to change in between 2015/16 and 2018/19.

Table 8: Gearing of sources of revenue shown in council MTFP

Source of Revenue	2015/16 £'000	2018/19 £'000	Change £'000
Government grants	2,749 (22%)	591 (5%)	-2,158 (-17%)
Business rates	2,330 (19%)	3,643 (31%)	1,313 (12%)
Council tax	7,368 (59%)	7,375 (64%)	7 (5%)
Total	12,447 (100%)	11,609 (100%)	-838

2.34. Table 8 shows that, by 2018/19, the level of reliance on business rates as a source of revenue as a proportion of the total revenue shown grows from 19% to 31%.

2.35. National analysis of the degree of variance for the income streams shown in table 8 above between 2011/12 and 2015/16 have shown:

- Government grant consistently declining each year;
- Council tax income consistently increasing each year;
- Business rates net rates payable increasing in three years, but declining in two.

2.36. The potential variance to the level of business rates income is therefore greater than either for government grant and council tax for which movements from year to year are much more predictable. Therefore, the forward projections of income for the council are potentially more uncertain. Given an increasing reliance on a relatively more unstable and variable source of revenue, the strategy for setting levels of general reserves will need to be mindful of this changing financial context to the overall level of general reserves. The CIPFA Briefing in 2015 stated that "transfers of business rates and council tax support into locally financed expenditure have increased local uncertainty".

Emerging financial risks

2.37. In October 2015, the government announced that local government would in future be able to retain 100% of business rates by the end of the current Parliament. This is leading to a number of major reforms to local government finance and each could have a significant financial impact for local government generally and South Ribble BC specifically.

2.38. The three main strands of the changes relating to the move to 100% business rates retention are:

i. In moving to 100% business rates it will be necessary to re-look (and potentially change) some of the decisions made when 50% business rates were introduced. In addition there

will need to be a devolution of new responsibilities to local government which will be funded from 100% business rates;

ii. As announced at the provisional settlement, there will also be a 'Fair Funding Review' of authorities' funding needs;

iii. As part of the move to 100% rates retention it is expected that there will also be a partial or full reset of the business rates baseline.

2.39. Each of these changes, while interconnected, can have differential implications for a local authority. A council could gain from some of the changes, and lose from others. Whilst it is not possible to currently estimate the combined potential impact of these changes two consequences can be forecast:

i. There will be significant additional uncertainty to the levels of future resources the council can expect from 2019/20; and there will be continued revenue variability for the period 2019/20 and beyond. This adds to the degree of financial risk that the authority faces.

ii. The potential reset of the business rates baseline could have the impact of reducing income from business rates for those local authorities currently retaining business rates income at above their business rates baseline. South Ribble is currently retaining business rates at above their baseline and they could potentially lose from 2019/20. Current projections provided by LG Futures provided within the MTRR is for a reduction in revenue from business rates of £1m from 2019/20.

2.40. A further new uncertainty is the potential financial impact of a future recession. In the past, when there has been a recession a local authority may have seen an impact on levels of expenditure and a reduction in income from certain fees and charges. In April 2013 two key changes were made to local government finance:

- Business Rates Retention was introduced: local government was able to retain up to 50% of business rates collected. This means that in future they are directly affected by changes to the levels of business rates collected.
- Localised council tax support replaced council tax benefits. The introduction of a localised scheme of support for council tax to replace council tax benefit meant that for the first time councils are directly affected by changes in the levels of those claiming support for council tax.

2.41. To the best of our knowledge no modelling has been undertaken by individual local authorities to estimate the possible impact of recession on both business rates and council tax income. Whilst it may not be possible for the council to readily model the potential financial consequence of recession locally, it is a new additional financial risk that should influence the level of reserves that an authority would set. From 2019/20, the move to 100% rates retention could potentially double the level of risk that the council faces from a reduction to the level of business rates collected.

2.42. Therefore the council is facing additional uncertainties that may have a significant financial impact on the level of income it receives to fund local services. Although these have not been quantified, it is recommended that in setting future levels of reserves:

- The council should be mindful of the additional financial risk it will be facing in future years and in particular from 2019/20 and beyond;
- The council should consider modelling and /or estimating the potential impact on its level of income of the various future changes highlighted above and review the impact for its levels of reserves it might require at 2019/20 and in the intervening years.

3. Earmarked Reserves

Introduction

3.1. The budgeted level of earmarked reserves for the period 2016 to 2019 was identified in the council's Revenue and Capital Budget which was agreed in February 2016. Table 9 below shows the levels of earmarked reserves budgeted for.

Table 9: Budgeted levels of earmarked reserves 2016 to 2019

	31 March 2016 £'000	31 March 2017 £'000	31 March 2018 £'000	31 March 2019 £'000
Earmarked Reserves	10,792	12,037	11,944	12,560

3.2. Table 9 shows that over the period there is an increase of £1.768m (16%) in the planned level of earmarked reserves.

3.3. A breakdown of the earmarked reserves shows where the main variations over the period arise.

Table 10: Breakdown of changes to earmarked reserves March 2016 to March 2019

Earmarked Reserve	March 2016 £'000	March 2019 £'000	Change £'000 (%)
ICT Strategy	1,868	1,091	-777 (-42%)
Asset Management	2,145	1,180	-965 (-45%)
Public Open Space Commuted Sums	1,594	1,417	-177 (-11%)
Business Rate Equalisation Reserve	2,615	3,807	+1,192 (46%)
Borough Investment Account	0	3,732	+3,732
Organisational Restructure	385	385	0
Various other identified	857	552	-305 (-36%)
Other	1,328	396	-932 (-70%)

3.4. Table 10 shows that:

- All but two of the categories of earmarked reserves existing at March 2016 decline over the period of the current MTFP, by between 11% and 70%;
- The business rates equalisation account increases by £1.2m or 46%;
- A new earmarked reserve is created named the "Borough Investment Account" which will have increase in value of £3.732m over the period. This equates to 30% of the total level

of earmarked reserves in March 2019 and it is the single largest reserve at both March 2017 and March 2018.

3.5. There are therefore three significant changes currently envisaged for the levels of earmarked reserves to March 2019:

- A reduction to all but two of the existing earmarked reserves. In total the reduction across all those earmarked reserves except the business rates equalisation reserve is from £8.177m to £5.021m, a decline of £3.156 or 39% across these reserves over a three year period.
- Adding to the business rates equalisation reserve by £1.2m or 46% over a three year period.
- Creating a new earmarked reserve, called the Borough Investment Account. Valued at £3.732m, by March 2019 this will represent 74% of the value of all other reserves combined excluding the 'Equalisation Reserve'.

Comparison with external benchmarks

3.6. Benchmarking analysis was undertaken of the past levels of earmarked reserves held compared to the district council average, other district councils in Lancashire and to a group of 'Nearest Neighbours' with South Ribble BC. The levels of earmarked reserves for the council the period analysed are shown in table 2.

Table 11: Budgeted and actual level of earmarked reserves 2011/12 to 2015/16

	2011/12 £'000	2012/13 £'000	2013/14 £'000	2014/15 £'000	2015/16 £'000
Budgeted	6,476	7,285	7,715	8,793	9,893
Actuals	7,834	8,494	10,186	8,865	N/A

3.7. The purpose of this review and analysis of external benchmarks is to provide both an initial comparator of the size of earmarked reserves and the change of these levels over time; and to establish if the levels of, and variations to the levels of, earmarked reserves is unusual at South Ribble BC.

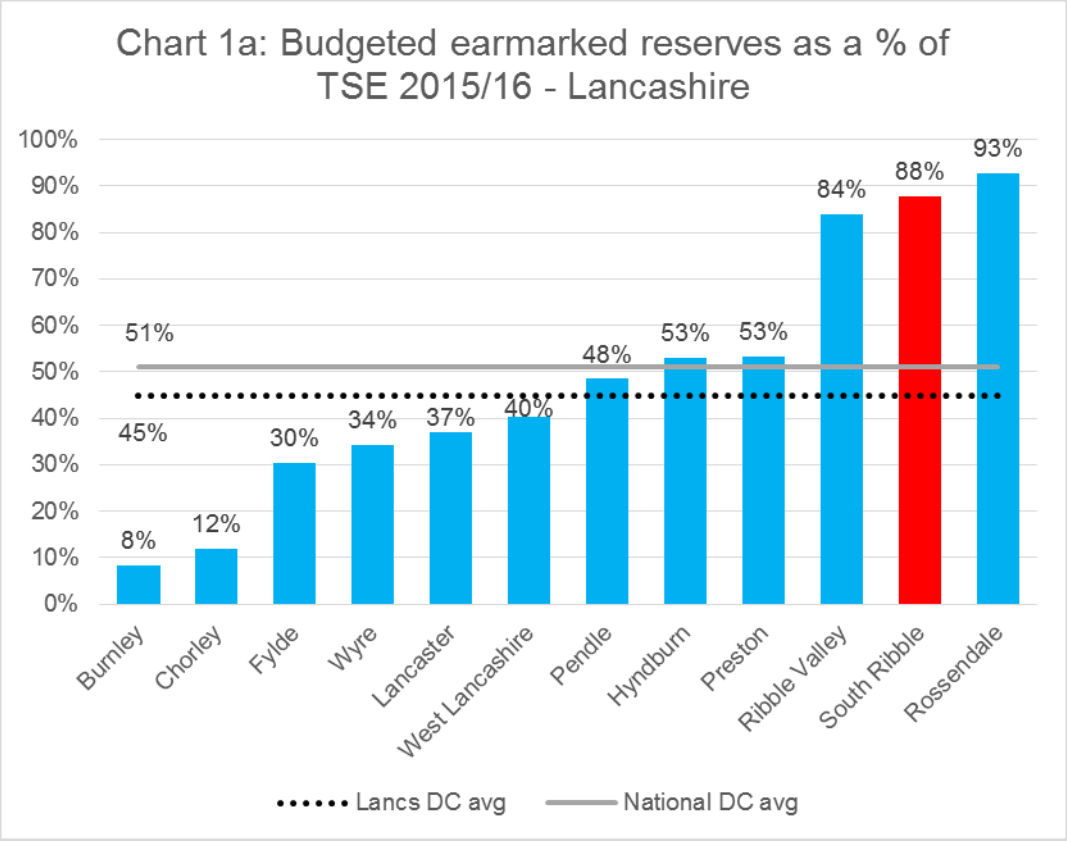
3.8. The benchmarking carried out compares the level of earmarked reserves as a proportion of the TSE of an authority for each year. This shows the size of the level reserves as a proportion of service expenditure to provide a comparable like-for-like percentage across councils.

3.9. Analysis was undertaken across three main categories of benchmark:

- Budgeted levels of earmarked reserves as a percentage of TSE in 2015/16 and the level of change in budgeted levels of reserves between 2011/12 and 2015/16;
- Actual levels of earmarked reserves as a percentage of TSE in 2014/15 and the level of change in actual levels of reserves between 2011/12 and 2014/15;
- A comparison of the difference between the budgeted and actual level of earmarked reserves between 2011/12 and 2014/15.

3.10. The benchmarking analysis has generated a further 10 charts. Chart 1a below shows the levels of budgeted earmarked reserve as a percentage of Total Service Expenditure TSE in 2015/16.

Chart 1a: Budgeted earmarked reserves as a% of TSE 2015/16 (Lancashire)



3.11. Chart 1a shows that compared to other district councils across Lancashire, South Ribble BC had the second highest level of budgeted levels of earmarked reserves as a % of TSE in 2015/16 and was 43% above the average across Lancashire and 37% above the average across England.

3.12. Table 12 below shows the comparative position of South Ribble BC across all 10 charts created against other Lancashire and Nearest Neighbour district councils. The charts are available at Appendix One (b) to this report.

Table 12: Summary of benchmarking analysis of general reserves

Chart title	South Ribble placement (from 12) 1 = highest	South Ribble variance to group average	South Ribble variance to national DC average
Budgeted earmarked reserves as a % of TSE 2015/16 – Lancashire	2nd	+43%	+37%
Budgeted earmarked reserves as a % of TSE 2015/16 – Nearest Neighbour	1st	+40%	+37%
Percent change in budgeted level of reserves 2011/12 to 2015/16 – Lancashire (of 10)	9th	-25%	-26%
Percent change in budgeted level of reserves 2011/12 to 2015/16 – Nearest Neighbour (of 11)	9th	-65%	-26%
Actual earmarked reserves as % of TSE 2014/15 – Lancashire	6th	-2%	-22%
Actual earmarked reserves as % of TSE 2014/15 – Nearest Neighbour	5th	+3%	-22%
Percent change in actual earmarked reserves 2011/12 to 2014/15 – Lancashire	10th	-9%	-28%
Percent change in actual earmarked reserves 2011/12 to 2014/15 – Nearest Neighbour	9th	-28%	-28%
Average variance of actual to budgeted levels of earmarked reserves 2011/12 to 2014/15 – Lancashire	12th	-54%	-36%
Average variance of actual to budgeted levels of earmarked reserves 2011/12 to 2014/15 – Nearest Neighbour	11th	-53%	-36%

3.13. The main points arising from the summary analysis of the benchmarking of earmarked reserves for the council:

- The council had a high budgeted level of earmarked reserves at 2015/16 compared to other councils, being ranked 1st or 2nd of the comparator groups and being significantly

above the average of the comparator groups (+40% and +43%) and the national DC average (+37%).

- However, the council did not have such a high level of actual earmarked reserves at 2014/15 compared to other councils. It was between +3% and -2% different to the average of its comparator groups and was -22% below the national DC average.
- The increase in both budgeted and actual levels of earmarked reserves between 2011/12 and 2014/15 (actual) and 2015/16 (budgeted) was lower than the majority of comparative councils and was below the comparative averages by between -9% and -65% and was below national averages by -26% (budgeted) and -28% (actual)
- The council has a lower comparative variance between the actual and budgeted level of earmarked reserves. The level of variance is 18% which is 36% below the national average level of variance and over 50% below the average level of variance shown across its comparator groups.

3.14. The council has budgeted for higher levels of earmarked reserves but its actuals have varied by only a small amount to the budgeted amounts compared to other authorities. Other authorities are therefore under-budgeting for the actual levels of earmarked reserves they have at year end compared to South Ribble BC.

3.15. The low level of variance between actual and budgeted levels of earmarked reserves is reflected in the Audit Findings for South Ribble Borough Council published by Grant Thornton in September 2015 which stated that “the Council has robust systems and processes to manage effectively financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future”.

3.16. In addition, the council has increased both its budgeted and actual levels of reserves between 2011/12 and 2015/16 by less than other councils.

Review of specific earmarked reserves with large provisions

3.17. As part of the strategic review of reserves it was determined that we would review the most material individual earmarked reserves. These have been identified as the following:

i. The ICT strategy

ii. Asset Management

iii. Public Open Space Commuted Sums

iv. Equalisation Reserve

v. Borough Investment Account

3.18. There were a number of smaller earmarked reserves specifically identified in the MTFP, but all were budgeted under £0.2m by 31 March 2019. In the detailed council list of those earmarked reserves covered as ‘Other’, there was an earmarked reserves for Sports Development Funding

the balance for which was maintained at a level unchanged of £0.341m throughout the period of the MTFP.

3.19. For each of the five earmarked reserves identified in 3.17 four main questions were asked:

- What is the purpose of this reserve?
- What is the method used in determining the level of reserve set?
- Is there a plan to use the reserve and if so, is this in line with the purpose identified?
- What impact would not having the reserve have on the relevant benchmarks for earmarked reserves?

The ICT strategy

3.20. The value of this reserve is currently budgeted to be reduced from £1.868m at March 2016 to £1.091m at March 2019, a reduction of £0.777 or 42%.

3.21. The purpose of this reserve is to provide funds for the renewal of ICT equipment. Each year costs arise through capital financing and each year there are contributions to the reserve from revenue. The movements are summarised in table 13.

Table 13: Summary of movements on ICT reserve

Year	Opening balance £m	Spend £m	Contribution £m	Closing balance £m
2011/12	1.468	(0.054)	0.300	1.715
2012/13	1.715	(0.218)	0.300	1.797
2013/14	1.797	(0.270)	0.600	2.126
2014/15	2.126	(0.263)	0.150	2.013
2015/16	2.013	(0.187)	0.150	1.977
Total	**n/a**	**(0.992)**	**1.500**	**n/a**

3.22. The main points arising in table 13 are:

- There has been a £0.509m (35%) increase in the size of the reserve over the period, because contributions from revenue have exceeded the capital financing commitments;
- There is still an active resourcing requirement, with spend in the last two years averaging £0.225m per annum which is 24% higher than the average spend for the first three years of £0.181m;
- The balance at March 2011 of £1.468m represented the equivalent of 7.4 years of spending at the average spend of the last five years.

3.23. The current plan is to reduce the balance on this reserve to £0.643m by March 2017, rising to £1.091m by March 2019. The lower point represents the equivalent of 3.2 years of spending at the average spend of the last five years, which is less than half the comparable level at March 2011.

3.24. There is no up to date method used to establish what the appropriate level of balance is in this reserve. However there is a pending review on the ICT strategy which should provide clarity on future requirements including levels of funding required.

3.25. Removing this remaining balance is the equivalent of reducing the proportion of budgeted earmarked reserves as a % of TSE from 88% to 78%.

Asset Management

3.26. The value of this reserve is currently budgeted to be reduced from £2.145m at March 2016 to £1.180m at March 2019, a reduction of £0.965 or 45%.

3.27. The purpose of this reserve is to provide funds to support the asset management programme for the authority. Each year costs arise through capital financing and each year there are contributions to the reserve from revenue. The movements are summarised in table 14.

Table 14: Summary of movements on Asset Management reserve

Year	Opening balance £m	Spend £m	Contribution £m	Closing balance £m
2011/12	2.203	(0.667)	0.500	2.036
2012/13	2.036	(0.552)	0.500	1.984
2013/14	1.984	(0.619)	1.000	2.365
2014/15	2.365	(0.388)	0.250	2.227
2015/16	2.227	(0.284)	0.250	2.193
Total	**n/a**	**(2.510)**	**2.500**	**n/a**

3.28. The main points arising in table 14 are:

- There has been a minimal decline (£10,000) in the size of the reserve over the period, because contributions from revenue have almost matched the capital financing commitments;
- There is still an active resourcing requirement, with spend in the last two years averaging £0.336m per annum; however the average spend of the last two years was a decline of 45% on the average for the first three years of £0.613m.

3.29. There is no up to date method used to establish what the appropriate level of balance is in this reserve. However there is a current Asset Management review which should provide clarity on future requirements including levels of funding required.

3.30. The current plan is to reduce the balance on this reserve to £0.830m by March 2018, which is the equivalent of 2.5 years of the average capital financing costs of 2014/15 to 2015/16. This is a decline of one third on the comparable level at March 2011.

3.31. Removing the remaining balance shown at March 2019 is the equivalent of reducing the proportion of budgeted earmarked reserves as a % of TSE from 88% to 77%.

Public Open Space Commuted Sums

3.32. The value of this reserve is currently budgeted to decline between March 2016 and March 2019 from £1.594m to £1.417m a reduction of £0.177m or 11%.

3.33. The purpose of this reserve is to provide for the future cost of maintaining open space areas.

3.34. The plan for using this is to pay for the cost of grounds maintenance in open space areas. There is only a gradual reduction in the level of this reserve of approximately £60,000 per annum. It is already planned to be reduced by £0.177m to March 2019 and will then reduce (on a straight-line basis) to a nil balance over 23 years after March 2016.

3.35. Reducing the balance at March 2019 to nil is the equivalent of reducing the proportion of budgeted earmarked reserves as a % of TSE from 88% to 75%.

3.36. The council may wish to consider whether having a reserve with a balance at March 2016 that it is intends to run down to nil over 26 years is fit for the purpose of its earmarked reserves.

Equalisation Reserve

3.37. The value of this reserve is currently budgeted to increase from £2.615m at March 2016 to £3.807m at March 2019, an increase of £1.192 or 46%.

3.38. The purpose of this reserve is to establish a fund that will enable the council to manage significant future declines in the level of business rates income that might be collected.

3.39. An amount has been built up over time and will be added to in future years through the contribution from the City Deal that has been put in place by the council. The arrangements for the City Deal and contributions to this reserve will be reviewed in 2019/20.

3.40. The plan is to use this reserve to compensate for future downward variations to the level of business rates revenue. There has not been a need to draw down from this reserve to date.

3.41. If the balance on this reserve planned for March 2019 was reduced to nil this would the equivalent of reducing the proportion of budgeted earmarked reserves as a % of TSE from 88% to 55%.

3.42. However, the potential risks to future council revenues identified in section 2 included:

- Increased gearing which makes business rates a larger proportion of future total revenues;
- A reset to the business rates baseline, which is highly likely to cause a material reduction in overall income from business rates;
- The move to 100 rates retention; and
- The potential revenue implications a future recession.

3.43. The need to have the equalisation reserve to manage a higher level of future risk to the level of business rates income being collected and to manage the financial impact of a transition to a

revised business rates baseline makes it prudent to maintain this reserve and at a level the council believes to be robust.

Borough Investment Account

3.44. The purpose of this reserve is to provide funds for investment funds for the purchase of assets which can then provide a revenue return to fund future service delivery. Similar types of reserves were identified in the CIPFA briefing on 'English Local Authority Reserves' (June 2015). This highlighted a district council which had "increased reserves with the specific aim of providing capital funding for schemes which will ultimately have a positive impact on the revenue budget" and a unitary in the North West that is "using its reserves to support debt-free capital investment programme".

3.45. No specific method was used to determine the level of this reserve and its value is the result of reduction in value to other reserves including a £0.600m contribution from general reserves in 20161/7. No plan currently exists for using this reserve over the period of the current MTFP.

3.46. If the balance on this reserve planned for March 2019 was reduced to nil this would the equivalent of reducing the proportion of budgeted earmarked reserves as a % of TSE from 88% to 54%.

Capital Reserves

3.47. The council has also estimated its capital reserves within the MTFP. From a balance of £2.001m at March 2016 this is projected to decline to £0.562m at March 2020, a fall of £1.439m or 72%. Within this there is a reduction to the earmarked capital reserve from £0.397m to £0.067m a fall of £0.330m or 83%.

3.48. The reduced balance will have implications for the future funding of the council's capital programme. The council will wish to consider if it should rebuild some of its capital reserves or what alternatives it will turn to in progressing the future capital programme.

4. Conclusions and Recommendations

Conclusions

4.1. The level of general reserves includes the annual movements relating to the recovery plan for the pensions deficit. This does affect the level of general reserves as a percent of TSE and naturally decreases in the year an advance payment is made and then increases it whilst the reserve is contributed to in subsequent years.

4.2. The council is neither consistently at one extreme or the other against the two comparator groups of Lancashire and Nearest Neighbour districts councils. The comparators are influenced by the operation of the pension deficit reduction plan, which flows through the general reserves.

4.3. In four of the five indicators reviewed the council is below the national average for district councils:

- Percent change in budgeted level of reserves 2011/12 to 2015/16;
- Actual general reserves as % of TSE 2014/15;
- Percent change in actual general reserves 2011/12 to 2014/15;
- Average variance of actual to budgeted levels of general reserves 2011/12 to 2014/15.

4.4. The council is only above the national average for the benchmark of general reserves as a % of TSE in 2015/16.

4.5. The comparative position on budgeted general reserves is higher relative to others than the comparative position for actual levels of reserves. This indicates that the council better estimates the future levels of general reserves that it will have compared to many other councils.

4.6. The future average level of budgeted levels of general reserves for 2016/17 to 2018/19 is £0.708m per annum below the average for the period 2011/12 to 2015/16. Therefore the council is already planning for a reduction to the average level of reserves it budgets for between 2016/17 and 2018/19 of 22%. This is in large part driven by the pension deficit recovery payment of £2.1m planned for March 2017.

4.7. This planned reduction to the underlying level of general reserves for the period 2016/17 to 2018/19 could therefore have the impact of reducing the comparative level of general reserves for the period, depending on the planned changes by comparators.

4.8. If the pension deficit reduction plan was either not being progressed, or was progressed outside of the general reserves, the average level of general reserves for the periods analysed in table 2 remain constant.

4.9. However the pension deficit reduction plan is currently an integral part of the general reserves. Therefore the average reduction of 22% highlighted in paragraph 2.15 effectively represents the additional level of risk to the authority of a lower level of general reserves created by the current rolling pension deficit reduction plan.

4.10. The outstanding balances from the Collection Fund receivable in 2017/18 are only providing a minor (£0.079m) additional level of general reserve.

4.11. The council has not been either optimistic or pessimistic in the levels of grant funding it is budgeting to receive in the MTFP. At the same time the council has been prudent on the level of council tax revenue that could be raised, both in assuming a nil increase in the level of council tax and no increase in the council tax base. Changes to these assumptions could generate additional council tax income of up to £0.6m by 2018/19.

4.12. By 2018/19, the level of reliance on business rates as a source of revenue as a proportion of the total revenue shown grows from 19% to 31%. The potential variance to the level of business rates income is greater than either for government grant and council tax for which movements from year to year are much more predictable. Therefore, the forward projections of income for the council are potentially more uncertain.

4.13. Given an increasing reliance on a relatively more unstable and variable source of revenue, the strategy for setting levels of general reserves will need to be mindful of this changing financial context to the overall level of general reserves. The CIPFA Briefing in 2015 stated that “transfers of business rates and council tax support into locally financed expenditure have increased local uncertainty”.

4.14. In October 2015, the government announced that local government would in future be able to retain 100% of business rates by the end of the current Parliament. This is leading to a number of major reforms to local government finance and each could have a significant financial impact for local government generally and South Ribble BC specifically.

4.15. As a result there will be significant additional uncertainty to the levels of future resources the council can expect from 2019/20; and there will be continued revenue variability for the period 2019/20 and beyond. This adds to the degree of financial risk that the authority faces.

4.16. The potential reset of the business rates baseline could have the impact of reducing income from business rates for those local authorities currently retaining business rates income at above their business rates baseline. South Ribble is currently retaining business rates at above their baseline and they could potentially lose from 2019/20. Current projections provided by LG Futures provided within the MTRR is for a reduction in revenue from business rates of £1m from 2019/20.

4.17. A further new uncertainty is the potential financial impact of a future recession. Whilst it may not be possible for the council to readily model the potential financial consequence of recession locally, it is a new additional financial risk that should influence the level of reserves that an authority would set.

4.18. The council already has plans to reduce all but two of the categories of earmarked reserves over the period of current MTFP, by between 11% and 70%.

4.19. The council had a high budgeted level of earmarked reserves at 2015/16 compared to other councils, being the highest or 2nd highest of comparator groups and being significantly above the average of comparator groups and the national DC average.

4.20. The council did not have such a high level of actual earmarked reserves at 2014/15 compared to other councils. It was between +3% and -2% different to the average of its comparator groups and was -22% below the national DC average.

4.21. The council has increased both its budgeted and actual levels of reserves between 2011/12 and 2015/16 by less than other councils. The increase in earmarked reserves between 2011/12 and 2014/15 (actual) and 2015/16 (budgeted) was lower than the majority of local comparative councils and was below national averages by -26% (budgeted) and -28% (actual).

4.22. The council has a lower comparative variance between the actual and budgeted level of earmarked reserves. The level of variance is 18% which is 36% below the national average level of variance and over 50% below the average level of variance shown across its comparator groups.

4.23. It has budgeted for higher levels of earmarked reserves but its actuals have varied by only a small amount to the budgeted amounts compared to other authorities. Other authorities are therefore under-budgeting for the actual levels of earmarked reserves they have at year end far more than South Ribble BC.

4.24. The low level of variance between actual and budgeted levels of earmarked reserves again reflects the Audit Findings for South Ribble Borough Council published by Grant Thornton in September 2015 which stated that “the Council has robust systems and processes to manage effectively financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future”.

4.25. If the balance on the current budgeted level of an earmarked reserve at March 2019 was reduced to nil, for the specific earmarked reserves reviewed this would the equivalent of reducing the proportion of budgeted earmarked reserves as a % of TSE by the following:

- ICT Strategy - from 88% to 78%.
- Asset Management - from 88% to 77%.
- Equalisation Reserve - from 88% to 55%.
- Borough Investment Account - from 88% to 54%.

4.26. There is still an active resourcing requirement for the ICT reserve, with spend in the last two years averaging £0.225m per annum which is 24% higher than the average spend for the first three years of £0.181m.

4.27. The balance on the ICT reserve at March 2011 of £1.468m represented the equivalent of 7.4 years of spending at the average spend of the last five years. The current plan is to reduce the balance on this reserve to £0.643m by March 2017, rising to £1.091m by March 2019. The lower point represents the equivalent of 3.2 years of spending at the average spend of the last five years, which is less than half the comparable level at March 2011.

4.28. There has been a minimal decline (£10,000) in the size of the Asset Management reserve over the period, because contributions from revenue have almost matched the capital financing commitments.

4.29. There is still an active resourcing requirement for the Asset Management reserve, with spend in the last two years averaging £0.335m per annum; however the average spend of the last two years was a decline of 46% on the average for the first three years of £0.619m.

4.30. The balance in March 2011 was worth 3.6 years of the annual contributions of the period 2011/12 to 2013/14; the balance at March 2016 is worth 6.2 years of the annual contributions of the period 2014/15 to 2015/16.

4.31. The current plan is to reduce the balance on the Asset Management reserve to £0.830m by March 2018, which is the equivalent of 2.5 years of the average capital financing costs of 2014/15 to 2015/16. This is a decline of one third on the comparable level at March 2011.

4.32. The plan for using the reserve for Public Open Space Commuted Sums at a gradual reduction in the level of this reserve of approximately £60,000 per annum would reduce this reserve to a nil balance over 23 years after March 2016.

4.33. The need to have a robust equalisation reserve to manage a higher level of future risk to the level of business rates income being collected and to manage the financial impact of a transition to a revised business rates baseline makes it prudent to maintain this reserve and at a level the council believes to be robust.

4.34. The Borough Investment Account, which represents a new reserve from 2016/17 and at £3.7m is the highest single earmarked reserve in 2016/17, currently lacks specifics that are recommended in professional guidance. It lacks a methodology for generating a specified level of funding and it has no specific plans for how it will be used over time.

4.35. In the detailed council list of those earmarked reserves covered as ‘Other’, there was an earmarked reserves for Sports Development Funding the balance for which was maintained at a level unchanged of £0.341m throughout the period of the MTFP.

4.36. The council currently projects that the balance on its capital reserves will fall from £2.001m at March 2016 to £0.562m at March 2020, a fall of £1.439m or 72%. Within this there is a reduction to the earmarked capital reserve from £0.397m to £0.067m a fall of £0.330m or 83%.

Recommendations

4.37. The strategy for setting levels of general reserves will need to be mindful of the changing balance of funding for the authority between 2016/17 and 2019/20 and the additional risk of added variability to the annual level of revenue.

4.38. The strategy for setting levels of general reserves will need to be mindful of the additional financial risk it will be facing in future years and in particular from 2019/20 and beyond from the major reforms to local government finance and the reset of business rates.

4.39. The council should consider modelling and/or estimating the potential impact on its level of income of the various future changes highlighted above and review the impact for its levels of reserves it might require at 2019/20 and in the intervening years.

4.40. This planned review of ICT should consider the reserve and its current balance and in particular the following questions:

- Given contributions have exceeded spending over the last five years but a decline is budgeted for to March 2019 what is the purpose of the balance on this reserve? Is it to provide for;

    a) A future large increase in spend that won't be covered by annual contributions; and /or

    b) Future years when revenue contributions may not be possible?

- If the reserve is to cover a large increase in future spend, what is this spend and when is it anticipated to arise?

- If the reserve is to cover for the eventuality of reduced or nil revenue contributions in future years, how many years of such reduction does the council wish the reserve to protect against?

4.41. The current review of the Asset Management should consider the reserve and its current balance and in particular the following questions:

- Given contributions have been made to cover expenditure, is a balance required on this reserve? What purpose is it intended to serve? Is it to provide for;

    c) A future large increase in spend that won't be covered by annual contributions; and /or

    d) Future years when revenue contributions may not be possible?

- If the reserve is to cover a large increase in future spend, what is this spend and when is it anticipated to arise?

- If the reserve is to cover for the eventuality of reduced or nil revenue contributions in future years, how many years of such reduction does the council wish the reserve to protect against?

4.42. The council should review the need to maintain the reserve for Public Open Space Commuted Sums given that at the current rate of usage it will be reduced to nil only by 2032.

4.43. The council should review the purpose and level of reserve established for Sports Development Funding.

4.44. The council should maintain an equalisation reserve for business rates. It is recommended that a robust balance should be maintained on this reserve given the inherent volatility of business rates income, the major changes planned for business rates and the potential future risks to an increasingly material part of the council total source of income.

4.45. A clear strategy for the operation of a Borough Investment Account should be developed in recognition of professional guidance on the management of earmarked reserves and this should include establishing clear objectives; clarity as to how and when this reserve can be used; procedures for the management and control of the reserve and establishing a process and timescale for a review of its continuing relevance and adequacy.

4.46. The council should to consider if it should rebuild some of its capital reserves or identify what the alternatives it will turn to for the future funding of the capital programme.