

## London Borough of Hammersmith & Fulham

**Report to: Finance, Commercial Revenue and Contracts Policy and Accountability Committee.**

**Date: 29 January 2020**

**Subject: Reserves Strategy and Action Plan**

**Report of: Cabinet Member for Finance and Commercial Services – Councillor Max Schmid**

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### Summary

- 1.1 This report provides an update on Hammersmith and Fulham's reserves and sets out the strategy for their future use
- 1.2 In light of the uncertainty around future funding from Government, continued action is required to ensure that reserves remain adequate to meet the pressures facing the Council over the medium term and deal with future unexpected events. The reserves strategy acknowledges the challenges facing the Council and, as previously agreed by Strategic Leadership Team, proposes the streamlining of all available corporate and departmental reserves to focus on key priorities. An action plan is proposed to improve the medium term-outlook including actions to identify capital receipts to safeguard reserves.
- 1.3 Hammersmith and Fulham carried forward a general balance of £19.0m and earmarked reserves of £62.3m at the start of 2019/20. This level of balances and reserves is slightly below average for a London Borough and reduced by £32.1m in 2018/19. The most significant movement in 2018/19 was the set aside of £13.6m regarding the historic high needs Dedicated Schools Grant funding deficit. Key council projects were also supported such as the use of £5.5m for managed services implementation and £2.0m for the Civic Campus scheme.
- 1.4 The Council has already committed to use reserves to fund several major initiatives and priorities. It also faces significant current and future financial risks (such as the current year forecast overspend, £9.4m at month 6 after mitigating actions) and potential costs of future service improvements.

### Recommendations

2.1 To review and comment on the reserves strategy and action plan as set out in this report.

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**Wards Affected:** All

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### **H&F Priorities**

Please state how the outcome will contribute to our priorities.

<b>Our Priorities</b>	<b>Summary of how this report aligns to the H&amp;F Priorities</b>
<ul style="list-style-type: none"><li>Being ruthlessly financially efficient</li></ul>	We need to always confirm that spend fits our Council's priorities; challenge how much needs to be spent; and achieve results within agreed budgets. Finance is everyone's business and every penny counts.

### **Financial Impact**

This report is wholly financial in nature and those implications are contained within.

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### **Contact Officer(s):**

Name: Emily Hill  
Position: Assistant Director of Finance  
Telephone: 020 8753 3145  
Email: [Emily.hill@lbhf.gov.uk](mailto:Emily.hill@lbhf.gov.uk)

### **Background Papers Used in Preparing This Report**

None

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### **Detailed Analysis**

- 3.1 Local government reserves play a crucial role in good public financial management. They exist so that a council can make one off investment in service transformation for the future or to respond to one off unexpected events or emerging priorities and needs. They are the foundation for good financial management and resilience. As one-off resources they can only be spent once.
- 3.2 The Chartered Institute of Public Finance & Accountancy (CIPFA) maintains guidance on the establishment and maintenance of local authority reserves and

balances. The guidance identifies that reserves can be held for three main purposes:

- As a working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing – this forms part of general balances
- As a contingency to cushion the impact of unexpected events or emergencies – this also forms part of general balances
- As a means of building up funds to meet known or predicted requirements; these specific reserves are known as earmarked reserves.

3.3. At the start of 2019/20 Hammersmith and Fulham carried forward General Fund reserves and balances of £81.3m. The split, and trend since 2015/16, between the general balance and earmarked reserves is set out in Table 1.

**Table 1 – The general balance and earmarked reserves 2015/16 to 2019/20**

	Opening balance 2015/16	Opening balance 2016/17	Opening balance 2017/18	Opening balance 2018/19	Opening balance 2019/20
General balance	19.0	19.0	19.0	19.0	19.0
Earmarked reserves	89.5	90.0	82.9	94.4	62.3
<b>Total</b>	<b>108.5</b>	<b>109.0</b>	<b>101.9</b>	<b>113.4</b>	<b>81.3</b>

3.4 The Council’s reserves are slightly below average, both in overall value and as a percentage of net revenue expenditure, for a London Borough. A comparison against the average for a London Borough is set out in Table 2.

**Table 2 – Comparison to other London Boroughs**

Measure	Hammersmith and Fulham	Average for London Boroughs	Ranking relative to other London Boroughs (/32)
Total general fund and non-schools earmarked general fund reserves as at 31 March 2019 (£000s)	81,313	106,462	15
General fund and non-schools earmarked general fund reserves as a percentage of net service revenue expenditure (%)	36%	42%	16

3.5 As part of the Audit Findings Report for the year ended 31 March 2019 the Council’s external auditors (Grant Thornton) commented on the level of the Council’s reserves:

*‘The Council’s reserves level is of concern as there doesn’t appear to be sufficient cushion to weather the ongoing financial challenges that the Council will face over the medium term due to reductions in central government funding and forecast pressures of the DSG funding. The Council only has finite reserves available and it is important that you continue to maintain appropriate budgetary control. It cannot*

*be stressed enough how important it is to have a fall back position to address the challenges of the future. We have seen a number of Councils reach the financial precipice and members have a fiduciary duty to ensure the Council retains financial sustainability. We would strongly recommend that use of reserves remains limited in future years other than for specifically earmarked schemes.'*

### **General balance**

- 3.6. Under Section 25 of the Local Government Act 2003, the Strategic Director, Finance and Governance is required to include, in budget reports, his view of the adequacy of the balances and reserves the budget provides for. The level of balances is examined each year, along with the level of reserves, considering the risks facing the authority in the medium term.
- 3.7 Given the on-going scale of change in local government funding, and risks facing the Council, the Strategic Director, Finance and Governance considered, as part of the 2019/20 budget report, that general balances need to be maintained within the range of £14m to £20m.
- 3.8. The current general balance of £19m falls within this range. It represents 3.6% (equivalent to 13 days spend) of the Council's gross budget of £525m.

### **Earmarked reserves**

- 3.9. In accordance with CIPFA guidance, earmarked reserves are held for several purposes:
  - sums set aside for major schemes such as the decant from the Town Hall and extension as part of the Civic Campus scheme
  - insurance reserves
  - service transformation or to meet one-off pressures
  - unspent revenue grants.
- 3.10 Whilst use of accumulated reserves can be part of a plan to ease future budget reductions and to allow longer term savings to come to fruition, it is not a prudent use to draw down reserves with no clear plan on how any budget gap will be bridged once reserves are no longer available.
- 3.11. Some earmarked reserves have restrictions placed on their use. For example, reserves relating to unspent revenue grants may have conditions on their use. The main restricted reserves for Hammersmith and Fulham are set out in Table 2.

**Table 2 – Restricted and earmarked reserves**

	Opening balance 2019/20
	£m
Revenue grants	3.5
Insurance fund	6.3
Developer contributions (section 106 and Community Infrastructure Levy)	6.5
Other	1.2
<b>Total</b>	<b>17.5</b>
Other earmarked reserves	44.8
<b>Total earmarked reserves</b>	<b>62.3</b>

**RESERVES STRATEGY**

3.12 The proposed reserves strategy is based on the following key principles:

- General Balances to be reviewed annually as part of the Council Tax and Budget report. They have remained within the current range of £14m to £20m for the last decade. Over the past year national political and economic risk and uncertainty has increased significantly. In addition, after years of reductions in government funding there is very limited capacity to manage unplanned costs within annual departmental revenue budgets. General balances may need to be revised upwards to mitigate against the potential impact on the Council of an economic slowdown.
- Those reserves no longer required for their intended purpose are identified and made available for other defined priorities.
- The level of reserves and forecast to be re-assessed every 6 months to ensure their adequacy.
- The risk assumptions to be reviewed every 6 months.
- A long-term view will be used when assessing the use of reserves to ensure that existing commitments and agreed priorities can be delivered.
- Being 'ruthlessly financial efficient' will underpin any request for use of reserves. Internal bids for one-off funding will be peer challenged and need to be competitively argued so that using reserves is agreed in exceptional cases. The 'one-off nature' and funding solution/ outcome will be rigorously assessed during the funding term and at the end of life. Use off reserves will only be progressed once agreed with the Strategic Director, Finance and Governance, the Chief Executive and cabinet members.
- Reserves can only be used once and the required future service transformation is significant. In accordance with proper accounting practice, and subject to affordability, the draw down from reserves will be minimised through consideration of government provisions for the flexible use of capital receipts, securing an appropriate contribution from partners and non-General Fund services, revenue contributions and regular balance sheet review..
- When the Council is in receipt of one-off and non-recurrent resources it should aim to utilise them to top up reserves.
- The reserves strategy will be supported by an action plan, that is updated quarterly, that aims to ensure the adequacy of reserves over the medium-term.

## The planned use of reserves

### General balances

- 3.13. In accordance with the agreed 2019/20 budget strategy, general balances will be maintained within the range of £14m to £20m. This falls within the range of 2.5% to 4% of the Council's gross budget of £525m. This sum is reviewed annually, after consideration of the financial risks facing Hammersmith and Fulham, as part of the Council Tax and Budget Report.
- 3.14. General balances cover unforeseen financial risks and provide cover for unexpected or unavoidable additional costs. Should general balances be anticipated to fall below the recommended range then serious concerns would arise regarding the Council's financial resilience and sustainability.
- 3.15 General balances have remained within the current range for a decade. The past year has seen an increase in national political and economic risk and uncertainty. Future finances and demand for services, both at a national and local level, will be affected should such risk result in an economic slowdown. In addition, after years of reductions in government funding there is very limited capacity to manage unplanned costs within annual departmental revenue budgets.

### Unrestricted earmarked reserves

- 3.16 As set out in Table 2 the level of unrestricted earmarked reserves carried forward at the start of 2019/20 was £44.8m. This was split over 37 different reserves. In accordance with the proposed reserves strategy the intended purpose of such reserves has been reviewed and the number of reserves streamlined to 14. These are set out in Table 3.

**Table 3 – Proposed earmarked reserves (unrestricted) as at 1 April 2019**

	£000s
Civic campus	17,610
DSG High Needs deficit reserve	15,000
Demand and pressures	5,598
Facilities management	2,500
Managed services	1,094
Temporary accommodation	900
Unallocated contingency	563
Schools regeneration fund	525
Technology and IT	394
Pensions	372
Contribution to local elections	92
Community safety	70
High speed 2	58
Property	44
<b>Total</b>	<b>44,820</b>

- 3.17 Funding is now set aside for known commitments that deliver agreed priorities. There are risks associated with streamlining reserves and these are summarised in Appendix 1. In some areas, departments had plans to use reserves to offset current spend pressures or bring forward future initiatives. In future any such request will need to be considered on a council wide basis as part of the overall reserves strategy.
- 3.18 Based on the approved commitments, and budgeted contributions, a cash flow forecast of earmarked reserves (unrestricted) has been undertaken to 2023/24 (Appendix 2). The forecast identifies a balance of £38.0m that has yet to be committed.

**Table 4 – Unrestricted earmarked reserves forecast to 2023/24 based on existing commitments**

	£m
<b>Balance at 1 April 2019</b>	<b>44.8</b>
<b>Less existing commitments</b>	<b>(42.9)</b>
Add:	
Revenue contributions	8.1
Business rates (timing adjustment)	7.5
Flexible use of capital receipts/capitalisation	3.5
Civic Campus Joint Venture profit share estimate	11.1
Civic Campus section 106/CIL contributions	5.9
<b>Uncommitted balance</b>	<b>38.0</b>

- 3.17. The forecast assumes a 5-year relocation regarding the Civic Campus. If the break clause was exercised at the earliest opportunity (three and a half years), in line with the current programme, the call on reserves would reduce by £7.7m (of which the General Fund element would be £5.9m).

#### **Reserves adequacy and future risk / priorities**

- 3.18. The Council faces several potential risks whilst indicative plans for further service transformation highlight possible further calls on reserves. These are summarised in Table 5. An action plan has been developed to mitigate against future risk with the expected benefit also summarised in Table 5.

**Table 5 – Future risks / potential call on reserves to 2023/24**

	<b>£m</b>
<b>Uncommitted balance of earmarked reserves</b>	<b>38.0</b>
<b>Funding assumptions:</b>	
Use of the Invest to Save Fund (including the balance of uncommitted capital receipts)	(4.7)
Use of the IT and Technology Fund	(4.0)
<b>Future risks</b>	
Increase in the DSG High Needs cumulative deficit to 2023/24	(15.0)
Essential building maintenance backlog	(2.5)
Current forecast 2019/20 budget overspend (month 6)	(9.5)
Any future in-year overspends	?
<b>Potential future drawdowns</b>	
Resident access (invest to save/ ZBB proposal)	(4.0)
Waste contract procurement	(3.5)
Earls Court CPO strategy	(0.3)
Support for future regeneration initiatives	?
Early Intervention Link Worker Support Service (potential unfunded balance beyond 2020/21)	(0.6)
<b>Confirmed Benefit from the Reserves Action Plan (Table 6)</b>	<b>13.2</b>
<b>Remaining Balance</b>	<b>7.3</b>

3.19 The main assumptions that underpin Table 5 are set out below:

- The potential use of the Invest to Save Fund and Technology and IT reserves is in line with the budgeted revenue contributions to reserves. In line with the proposed reserves strategy any use of these reserves will need to demonstrate that it is being ruthlessly financially efficient with peer challenge by the Chief Executive and Strategic Director of Finance and Governance.
- The DSG High Needs deficit stood at £13.6m at the start of 2019/20 and is forecast to increase (at month 6) by £5.7m in 2019/20. The above forecast assumes that the total increase in the deficit will be £15m over the next 4 years. This takes account of the extra government funding made available in the 2019 Spending Review.
- Following the end of the Amey contract there is a backlog of maintenance works. Subject to the completion and review of building surveys and detailed plan of works an allowance is made for expenditure of £2.5m.
- The current year monitor is forecasting, at month 6, an overspend of £9.5m. This will need to be met from reserves unless the overspend is addressed. Officers are working to reduce this overspend in the second half of the year. No future overspends are assumed in the forecast nor sums required to balance future budgets.
- Several new initiatives are expected to come on stream in the forthcoming months. These include a new resident access programme, procuring a new waste contract and potential funding for the Early Intervention Link Worker support service beyond 2020/21. Indicative funding allocations are included within the reserves forecast.

3.20. **The future risks forecast highlights a risk regarding the adequacy of the Councils reserves, over the medium term, unless action is taken.** An action

plan is set out in Table 6 to mitigate against this risk. This will be updated quarterly. The actions identified to date are estimated to benefit the reserves forecast by £13.2m.

**Table 6 – Reserves action plan**

Ref	Action	Potential Opportunity	Update
1	Relocate back to the new Town Hall Civic Campus at the earliest opportunity and in line with the current programme timetable – this would enable the break clause to be exercised at three and a half years.	£7.7m	
2	Address the forecast 2019/20 overspend through mitigating actions to reduce in-year expenditure and/ or increase income.	£9.5m	-
3	Prepare and agree a programme of asset disposals to deliver capital receipts to fund invest to save and IT investment costs through the flexible use of capital receipts. The regulations require expenditure to be incurred by the end of 2021/22 and £5m is forecast to be spent in these areas during this period.	£5m	-
4	Capitalisation of relevant Civic Campus costs (such as decant accommodation fit-out costs and other programme costs) and funding of these through capital receipts. High level, indicative figures show that the assumed sum that can be capitalised could increase by c£4m. This will reduce the call on reserves <b>only</b> if funded from capital receipts generated as suggested in action above.	£4m	-
5	Capitalisation of relevant Civic Campus programme costs and professional fees where these are in respect of the Town Hall refurbishment and fit out (capital works). The Civic Campus project team is preparing an analysis of costs to more accurately forecast this opportunity.	tbc	-
6	Review of future requests to use reserves, such as the Resident Access programme, to identify potential capitalisation opportunities, only where capital receipts can be identified.	tbc	-
7	Ensure all Council budgets (such as the Housing Revenue Account/ Pension Fund) and partners pay a fair share of costs falling on reserves. Updated figures, that are included in the HRA business plan, suggest the potential HRA contribution could reduce the call on reserves for the new Civic Campus	£2.5m	£6m

Ref	Action	Potential Opportunity	Update
	by £6m over 5 years. The HRA contribution would reduce to £4.2m for a 3.5 years relocation.		
8	Peer Challenge by the Chief Executive and Strategic Director of Finance and Governance of all existing commitments.	tbc	
9	Review the planned maintenance backlog.	tbc	
10	Balance sheet review to establish if further reserves can be freed up. As part of the 2020/21 budget process £3.4m of historic council tax adjustments have been identified as available for release.	tbc	£3.4m
11	Take action to reduce the DSG overspend. Raise concern over funding shortfall and the accounting treatment with government. Use all the £2.4m of additional funding (for the next 3 years) made available through the Spending Round 2019 to reduce the call on reserves. Deliver Phase 2 of the High Needs deficit recovery plan. Demographic pressures and changes in funding allocations for the DSG central block now suggest that a reduction in the forecast DSG overspend is unlikely.	£7.2m	£0m
12	Review external funding opportunities and developer contributions.	tbc	
13	Assess the IT funding requirement over the medium term.	tbc	
14	Review the purpose for which all reserves are held on a twice-yearly basis, including those that are restricted, to ensure they are required for their intended purpose.	tbc	
15	Consider additional contributions to reserves as part of annual revenue budget setting process. The 2020/21 budget includes new contributions of £3.8m from non-recurrent benefits on the collection fund and operation of the 2019/20 business rates pool.	tbc	£3.8m
	<b>Total</b>		<b>£13.2m</b>

### Restricted reserves

3.21 The restricted reserves of £17.5m are forecast to reduce to £9.8m by 2022/23 as they are used for their intended purpose. This takes no account of further contributions that may be received. Such reserves will be reviewed annually to ensure they are still required for their intended purpose.

## Overall cashflow

3.22 A reserves cashflow forecast has been undertaken. This is detailed in Appendix 2 with the assumptions. The forecast is for financial modelling purposes and significant uncertainty remains regarding the timing of expenditure and income flows. A major potential variant is the new Civic Campus. Options have been modelled based on relocating back to the Town Hall at the earliest opportunity (3 and a half years in line with the current programme) or in five years (the life of the leases).

**Table 7 – Cash flow (general balances, earmarked and restricted reserves)**

	2019/20	2020/21	2021/22	2022/23	2023/24
<b>Five-year Civic Campus relocation</b>	£m	£m	£m	£m	£m
<b>Opening balance</b>	<b>81.3</b>	<b>68.9</b>	<b>62.4</b>	<b>54.0</b>	<b>45.6</b>
Forecast movement	-12.5	-6.5	-8.4	-8.5	8.9
<b>Closing balance</b>	<b>68.9</b>	<b>62.4</b>	<b>54.0</b>	<b>45.6</b>	<b>54.4</b>
Risks and other potential uses (Table 5) – cash impact	-15.5	-21.3	-25.9	-29.3	-32.1
Action Plan	0.6	9	10.2	11.4	13.2
<b>Revised balance</b>	<b>53.9</b>	<b>50.1</b>	<b>38.4</b>	<b>27.7</b>	<b>35.5</b>
<b>Three-and-a-half-year Civic Campus relocation</b>					
<b>Opening balance</b>	<b>81.3</b>	<b>68.9</b>	<b>62.4</b>	<b>54.0</b>	<b>63.4</b>
Forecast movement	-12.5	-6.5	-8.4	9.3	-1.2
<b>Closing balance</b>	<b>68.9</b>	<b>62.4</b>	<b>54.0</b>	<b>63.4</b>	<b>62.1</b>
Risks and other potential uses (Table 5) – cash impact	-15.5	-21.3	-25.9	-29.2	-32.1
Action Plan	0.6	9	10.2	11.4	11.4
<b>Revised balance</b>	<b>53.9</b>	<b>50.1</b>	<b>38.4</b>	<b>45.4</b>	<b>41.4</b>

3.23 The cash-flow forecast emphasises the need for regular monitoring of the reserves forecast and implementation of the action plan. Reserves can only be spent once and the forecast to 2023/24 identifies a tightening in the Council's finances that will need careful management and review. Continued focus will be required on keeping spend within budget, avoiding the use of reserves to balance future budgets and on rebuilding reserves to support future investments.

## Appendices

Appendix 1 – General Fund reserves forecast to 2022/23

Appendix 2 – Reserves cashflow forecast