

HAMPSHIRE COUNTY COUNCIL**Decision Report**

Decision Maker:	Cabinet
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Report From:	Director of Corporate Resources – Corporate Services

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1. Executive Summary

- 1.1. The purpose of this report is to update Cabinet on the budget strategy development process for 2014/15 and 2015/16 and to consider the medium term prospects for the County Council's finances to 2017/18.
- 1.2. The County Councils early action in tackling its forecast budget deficit over the current Comprehensive Spending Review period and providing funding in anticipation of the tougher times to come, has placed it in a very strong position to produce a 'steady state' budget for 2014/15 and give itself the time and capacity to develop and implement the next phase of savings by 2015/16.
- 1.3. Cabinet received an initial report on 'Transforming the Council to 2015' in June and further updates will be provided as this programme gathers momentum. This report therefore sets out a proposed approach in respect of the setting of the 2014/15 budget and outlines how the transformation programme will deliver the savings required for 2015/16.
- 1.4. This strong position is testament to the County Council's ability to plan ahead and ensure that it is appropriately placed to deal with the future challenges that lie ahead, at a time when most other authorities in the country will be concentrating on balancing their budgets for 2014/15.
- 1.5. Whilst the County Council remains in a very strong financial position, this report also outlines that with further grant reductions, ongoing social care and inflationary pressures and the national pressure to avoid council tax increases, the financial outlook for 2016/17 and 2017/18 remains challenging and considers the financial strategy that may be developed to tackle this.

2. Contextual information

- 2.1. It is normal practice at this time of the year to provide Cabinet with an update on the Medium Term Financial Strategy (MTFS) in order to inform and direct work on detailed budget setting that will take place over the Summer. This is particularly good timing this year as we already have the grant figures for 2014/15 and the Government announced details of the Comprehensive Spending Review for the standalone year of 2015/16 on 26 June.
- 2.2. It has therefore been possible to produce slightly more detailed financial planning forecasts for the next two years and to confirm that the 'Transforming the Council to 2015' (TtC to 2015) programme will close the budget gap by the 2015/16 financial year.
- 2.3. This report is divided into three main sections :
 - The budget position for 2014/15 and the strategy that will be applied to set a balanced budget
 - A forecast for 2015/16, together with details of how the Transforming the Council to 2015 programme will meet the anticipated gap.
 - Consideration of the medium term position to 2017/18.
- 2.4. By way of background, the next two sections of the report look at the broader economic outlook and outline some of the key issues for Hampshire County Council arising from the Comprehensive Spending Review for 2015/16 which was announced on 26 June.
- 2.5. The penultimate section of the report deals with the County Council's earmarked reserves in the context of the financial challenge that we have already faced and will continue to face in the future. A separate appendix examining a 'reserves strategy' in more detail is also attached.

3. Economic Outlook

- 3.1. At the start of the current Comprehensive Spending Review period, it was clear that any incoming Government would have to tackle the underlying structural deficit and bring down the national debt to GDP ratio.
- 3.2. Headline figures within the CSR 2010 assumed a 28% reduction in local government spending over the four year period. Whilst there has been a small increase in this overall amount, the distribution of the reductions has meant that the County Council has experienced Revenue Support Grant reductions of 43% during this period.
- 3.3. In addition, there were further reductions in specific grants and additional pressure on budgets through the introduction of local Council Tax Support Schemes that widened the budget deficit that the County Council was trying to close.
- 3.4. Despite the impact of these cuts across the public sector it became clear last year that economic growth was slower than expected and that the Government deficit reduction programme had not been as successful as

anticipated and indeed the debt to GDP ratio had actually worsened during the period and was not expected to start improving until 2016.

- 3.5. Early warnings were given that economic growth was likely to remain sluggish for some time and that the period of austerity would last until at least the 2017/18 financial year. This position was further reflected within the Comprehensive Spending Review released on 26 June which is covered in the next section.

4. 2015/16 Comprehensive Spending Review

- 4.1. On 26 June, details of the Comprehensive Spending Review for 2015/16 were published. The headlines in respect of local government that impact directly on our resource levels were :
- A 10% real terms cut in the Departmental Expenditure Limit (DEL) for local government, which equates to a 8.2% cash cut.
 - Provision of a further two years of council tax freeze grant at an equivalent 1% increase level.
 - Extension of existing council tax freeze grants to 2015/16. Additional resources have been made available to extend both the 2011/12 and 2013/14 council tax freeze grants until the 2015/16 financial year. This would equate to an additional one off gain of £18.5M to Hampshire in that year.
 - A 20% reduction in Education Services Grant (the replacement to LACSEG) which is equivalent to around £4M for the County Council.
 - A pooled budget of £3.8bn of Department of Health funding will be made available in 2015/16 for joint commissioning by councils and the NHS of care services for disabled and older people, with the aim of integrating care and reducing hospital stays. £1 billion of this funding will be set aside for payment by results work that prevents people being in hospital unnecessarily.
- 4.2. What was not clear from the original announcements is what the 10% grant reduction applied to, since the changes to local government grants introduced in 2013/14 significantly complicate the overall picture. It has now been clarified that the 10% reduction applies to all funding that was originally included in the Start Up Funding Assessment (SUFA) produced for the 2013/14 settlement.
- 4.3. This means that the reductions apply to virtually all previous funding streams as follows :-
- Early Intervention Grant and Learning Disability and Health Reform Grant
 - Council Tax Support Scheme grant
 - New Homes Bonus
 - Formula grant (RSG and business rates)

- 4.4. Part of the confusion arises from the fact that a large part of local government funding comes from the retained business rate model and the Government is unable to influence the distribution of this without implementing a reset in the system.
- 4.5. This means that if the Government reduces grants by 10% across all of the previous funding sources, it can only implement this by directly reducing Revenue Support Grant. In Hampshire's case, this would equate to an RSG reduction of 17.9% in 2015/16.
- 4.6. Of particular concern is the fact that this grant reduction applies to the funding that was given to support the introduction of local Council Tax Support Schemes. In 2013/14 the County Council was given £43M to compensate for lost council tax income as a result of the new schemes. This already took into account a 10% national cut in funding compared to the previous council tax benefit scheme.
- 4.7. Concerns were raised at the time that this amount might be 'baselined' into general grant and cuts applied to it, but this was denied by the Government. The announcement for 2015/16 means exactly that and means that local Council Tax Support Schemes that were introduced in good faith to fit within the new funding envelopes will no longer be viable and will lead either to more pressure in budgets or to changes in the schemes that will impact on people who currently rely on the scheme. This report recommends that the Leader of the Council write to the Secretary of State highlighting the potential impact of this decision and the fact that previous commitments had been made to protect this funding (as is the case with Police).
- 4.8. The MTFs forecast figures provided later in this report assume a 10% cash cut in all grant funding sources, which is above the Government's figure, however, given that the distribution methodology is likely to see a relatively higher reduction for the County Council it is not proposed to change this at this stage. This has additional implications for Adults and Children's Services as the policy on such funds is that changes to specific grants are passported to Departments, who then make resultant savings through exit strategies in service provision. Although since 2010, this has also been supported through corporate cash flow funding in the first year to ensure a managed delivery of savings. It should be noted that we may not find out the actual level of grant cut until December 2014.
- 4.9. The forecasts and scenarios in this report also assume that the extension of the council tax freeze grant for previous years decisions will be payable to Councils irrespective of the council tax decisions they make in 2014/15 and 2015/16. there is however a risk that more specific criteria could be applied to the receipt of this additional grant.
- 4.10. Whilst these figures provide some indication of the likely grant reductions across the local government sector, they do not provide any detailed figures for individual authorities and therefore in looking at our forward forecasts we must still make assumptions as to the likely level of grant reductions.
- 4.11. The forecasts provided in the rest of this paper assume a 10% per annum reduction in the grant support that we receive. They also assume that the

Government will pass on the benefits of any business rate increases in line with the business rate retention model that was introduced in 2013/14.

5. 2014/15 Budget

- 5.1. The Budget report presented to County Council on 21 February assumed that there would be a forecast deficit on the revenue account of £26.1M by 2014/15.
- 5.2. This position was based on a number of key assumptions :-
 - No council tax increase in 2014/15
 - No additional council tax freeze grant for 2014/15
 - Pay award of 1% in line with the Government's guidelines
 - Social care pressures of £11.5M
 - Achievement of Departmental 2% efficient targets of £9.137M and the release of the £1.5M additional savings target set for Corporate Services
 - Savings in Children's Services of £6.308M to compensate for the loss of Early Intervention Grant (EIG)
 - Delivery of re-phased savings of £3.018M by Adult Services
- 5.3. Since this time and in light of the emerging strategy for TtC to 2015, it is proposed to roll up the 2% Departmental efficiency targets into a single target that must be delivered by 2015/16, although the expectation is that there will be some early delivery of this during the 2014/15 financial year.
- 5.4. In addition, other changes have been assumed in order to produce a 'baseline forecast' for 2014/15 and future years, including :-
 - A 1% council tax freeze grant available for 2014/15 on the assumption that council tax is not increased
 - Use of the New Homes Bonus to support the revenue account from 2014/15 onwards
- 5.5. Appendix 1 to this report summarises the baseline position for 2014/15 and shows that the revised deficit that needs to be addressed (before considering any potential offsetting savings) is £27.381M.
- 5.6. As part of the TtC to 2015 programme there is a housekeeping work stream dealing with inflation / debt and investment management, which has a target of £5M to deliver and it is anticipated that this can be delivered by the 2014/15 financial year. In addition the £1.5M additional target for Corporate Services has already been delivered but was used in 2012/13 and 2013/14 to help support the implementation of the Corporate Services Review, this sum therefore becomes available to be released as savings from 2014/15 onwards.
- 5.7. It is also anticipated that the phased implementation of the TtC to 2015 programme throughout 2014/15 will generate some savings that will be

available to meet the overall deficit and an initial figure of £5M has therefore been assumed for planning purposes. This scenario would require a draw of £15.881M from the Grant Equalisation Reserve in order to balance the budget.

- 5.8. It is worth reflecting at this point that the County Council's original strategy for the CSR 2010 period was to generate 4 years worth of savings over 2 years in order to still achieve a balanced budget by 2014/15. A key assumption at the time was that council tax would increase by 1.9% per annum over the four year period, which would have generated additional ongoing revenue of around £40M over this time.
- 5.9. Whilst Council Tax Freeze Grant was received for these years and has helped in providing resources in the order of £32M, they are fixed amounts that are time limited and based on the previous profile would have all dropped out of the base budget by 2015/16.
- 5.10. The current forecast deficit of £27.381M therefore needs to be viewed in the context that the County Council will have frozen council tax over this entire period and foregone that additional recurring revenue which would have otherwise created a budget surplus in 2014/15 of nearly £13M in line with the original financial strategy.
- 5.11. The early action that the County Council took and the sensible use of the one off council tax freeze grants that have been offered by Government have also allowed the County Council to provide top up funding to the Grant Equalisation Reserve, which can be used over the next few years to soften the landing in respect of further grant reductions.
- 5.12. Taking all of these factors into account, it is therefore envisaged that the budget setting process for 2014/15 can be contained within the parameters set out in this report. However, it must be clearly understood that decisions taken regarding any future council tax freeze grants cannot be viewed on a one year basis, since the impact on future years on a cumulative basis has a significant affect on the County Council's financial stability going forward.
- 5.13. Final decisions on council tax levels and spend will of course be made by County Council in February 2014, but this report sets out a baseline scenario which if approved, can be used as the basis for the detailed budget development.

6. 2015/16 Budget

- 6.1. The baseline forecast for 2015/16 is also set out in Appendix 1 and once again, assumes no council tax increase and allows for normal inflationary increases plus a further £11.5M for social care pressures. There are however other factors which will have a significant impact on the budget deficit in this year, namely :
 - A reduction of 20% on the Education Services Grant
 - Drop out of revenue reserves currently supporting the base budget (£11.6M)

- The continued reduction of Revenue Support Grant (equivalent to a £17.1M reduction)
 - Reductions in former specific grants of £7.4M which it is assumed will be passported to services.
- 6.2. Since the baseline forecast assumes no council tax increase for the whole period, the recent announcement of two further years of council tax freeze grant at the equivalent of 1% has also been added to the forecast and it has been assumed that the grant for 2014/15 will be payable for two years and the grant for 2015/16 will be one off.
- 6.3. Following the announcement of the extension of previous council tax freeze grants, the drop out of £18.460M of grant has been pushed back to 2016/17.
- 6.4. The Appendix shows that taking all of these factors into account produces a cumulative budget deficit of £84.7M for the year and takes into account the addition of further Revenue Support Grant reductions and the proposal to roll up the 2% Annual Efficiency Target for 2014/15 into the overall target for 2015/16.
- 6.5. Whilst this figure represents a significant challenge for the Authority, initial preparatory work on the Transforming the Council to 2015 programme began as early as last year and Cabinet received a confidential report on 24 June setting out the indicative targets for the new corporate workstreams that will deliver the bulk of the savings required by the 2015/16 financial year. Appendix 2 sets out the indicative targets that have been set for the work streams.
- 6.6. Whilst the work streams are a key strand to the transformation programme, each Department retains responsibility for achieving its Departmental savings target. For 2015/16 a target of 12% of net spend has been set for each Department, with the exception of Corporate Services which has a target of 10% plus the additional 4% that was required to be delivered within the 2012/13 financial year. The calculation of the targets is shown in the table below :

	Adults	Children's	ETE	CCBS	Corporate Services	P&R Other	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
2013/14 Cash Limits	313,732	160,916	109,946	42,350	46,599	43,892	717,435
Savings target 2015/16	(37,648)	(19,310)	(13,194)	(5,082)	(4,660)	(5,267)	(85,161)
Corporate Services additional 4%					(1,500)		(1,500)
Total Target	(37,648)	(19,310)	(13,194)	(5,082)	(6,160)	(5,267)	(86,661)

- 6.7. In addition to these Departmental targets, there is also a separate Housekeeping work stream in respect of inflation / debt and investment

management which is targeted to achieve £5M and an assumed contribution to overheads from trading services (which fall outside of the cash limits) of £1.5M. This gives a total value of savings of £93.2M to set against the baseline forecast deficit of £84.7M and if these were achieved in full would produce a budget surplus of £8.5M in the year, consistent with the reserves strategy set out in Appendix 3. It may however be necessary to offer some cashflow funding to Adults and Children's Services during 2015/16 in order to give them time to consider how to appropriately deal with the reductions in former specific grants.

- 6.8. Furthermore, in order to assist Department's and Work Stream leads in delivering savings, a sum of £5M has been earmarked within the Invest to Save reserve as part of the outturn approved by Cabinet on 24 June and delegated authority has been given to the Chief Executive and Director of Corporate Resources in consultation with the Leader and Executive Member for Income and Capital Resources to approve expenditure from the reserve in order to help fast track the delivery of savings within the programme.
- 6.9. Once again this demonstrates that the County Council's forward thinking and prudent financial management has provided funding to build capacity and support transformation in a way that few other authorities could achieve. Amounts committed against this sum will be reported to Cabinet as part of the regular updates planned for the Transforming the Council to 2015 programme.

7. Medium Term Forecast

- 7.1. In looking at forecasts over the medium term, there are mainly only four key factors that need to be taken into account :-
 1. The extent of any further grant reductions
 2. Allowances for inflation and known base changes
 3. Additional resources for increasing complexity and demography in Adults and Children's social care
 4. Assumptions on council tax increases
- 7.2. In addition to these items, in 2016/17 changes to national pension arrangements means that those public sector employers who currently opt out of SERPS will no longer receive a reduced employers National Insurance rate, which is estimated will add £6M to the County Council's pay bill. The Government have already indicated that they do not intend to fund this additional burden and it is recommended that the Leader write to the Secretary of State setting out the impact of this decision on the County Council and previous commitments of the Government to fund new burdens placed on local government.
- 7.3. Looking at the high level forecasts for both years taking into account the items set out in paragraph 7.1, indicates that the current trend of having to reduce expenditure in line with reductions in Government grant and normal cost pressures, will continue into this period. The reductions could be,

subject to different planning assumptions, of a similar order to 2013 and 2015

- 7.4. A significant factor in the likely financial forecasts for these two years is the extent of any council tax increases during the 4 year period from 2014/15 to 2017/18. The timing of any increases is also important due to the cumulative impact of the income that is generated over the whole period.
- 7.5. Final decisions on Council Tax will obviously be made in each of the relevant years and will be dependant on a number of other factors, but it is important that the Council understands the importance of council tax decisions on the longer term forecasts of the County Council.
- 7.6. After allowing for any council tax increases, any remaining deficit in funding would clearly need to be bridged by further savings or income generation, supported by the reserves strategy as outlined in Appendix 3.

8. Reserves Strategy

- 8.1. The level of reserves held by local authorities has been a regular media topic over a number of years often fuelled by comments from Government that these reserves should be used to significantly lessen the impact of the austerity measures that have seen a greater impact on local government than any other sector.
- 8.2. The County Council has continually explained that reserves are kept for many different purposes and that simply trying to bridge the requirement for long term recurring savings through the use of reserves only seeks to use up those reserves very quickly (and mean that they are not available for any other purposes) and merely delays the point at which the recurring savings are required.
- 8.3. At the end of the 2012/13 financial year the County Council's earmarked reserves together with the general fund balance stood at nearly £419M. Appendix 3 sets out in more detail what those reserves are for and explains that in reality only 19.1% of these reserves are actually freely available to support the revenue budget and that the County Council's approach has been to use these funds for investment to help transform services and drive out efficiency savings rather than just prop up the revenue budget for a short period of time.
- 8.4. In fact, the County Council's strategy has deliberately been and will continue to be the opposite to how the Government thinks reserves should be used. The County Council's strategy works on a cyclical basis as follows :
 - Planning ahead of time and Implementing efficiencies and savings in advance of need
 - Generating surplus funds in the early part of the programme
 - Using these resources (often 'one off') to fund investment and transformation in order to achieve the next phase of savings.

- 8.5. This cycle is evident within the 2012/13 outturn position that was reported to Cabinet in June. Savings in advance of need within Departments and savings in contingency amounts due to the successful implementation of the full early savings programme meant that the Council was able to provide :
- Departmental reserves to pay for the cost of change associated with their own transformation programmes
 - Top up funding to the organisational change reserve to provide resources to continue the very successful voluntary redundancy programme as a means of releasing staff in a sensitive and controlled manner that has helped maintain morale across the Council
 - An additional £5M within the Invest to Save Reserve to help with the Transforming the Council to 2015 programme that will deliver the next phase of savings to 2015/16.
 - Additional funds for the Grant Equalisation Reserve to help smooth the impact of grant reductions and give the County Council maximum flexibility in future budget setting processes
- 8.6. The expectation is that the Transforming the Council to 2015 programme will also generate early savings that may increase the level of balances in the future albeit there will be planned reductions and use of reserves that are not necessarily evident within the bottom line numbers. Appendix 3 provides some examples of the movements in reserves that demonstrate this point.
- 8.7. The strategy that the County Council has adopted means that if we are in a position that reserves begin to decrease, it may be a sign that there is something wrong within the programme that might therefore need to be addressed. In any event, it needs to be highlighted that the strong financial position that the County Council finds itself in is not an accident and is one about which we should be proud. For the foreseeable future this twin approach: planning for delivering efficiencies and lower costs plus using balances to improve capacity and to lower costs will be at the heart of our strategy.

9. Capital Investment

- 9.1. Although the Council's strategy of delivering early savings has provided past opportunity for increasing the capital programme, there is limited scope outside of traditional capital funding sources to significantly grow the programme any further. However the existing approved programme still stands at well over £500M and represents a significant investment in the County's infrastructure and economy.
- 9.2. The Cabinet Member for Income and Capital Resources has therefore proposed that a review be undertaken of the current capital programme to ensure that it still reflects the policy priorities of the County Council and to establish whether there is some scope for re-prioritisation or opportunities for new funding sources. The results of the review will be reported to Cabinet in the Autumn.

- 9.3. This does not however exclude other innovative options for capital investment that could be undertaken on a self financing basis where there is a robust business case and where this fits with the policy priorities of the County Council. There may also be other policy priorities that the County Council may wish to pursue to improve the quality of life of the residents of Hampshire.

10. Recommendation(s)

It is recommended that Cabinet :

- 10.1. Approves the proposal to roll up the 2% efficiency targets set for 2014/15 into a total 12% target to be delivered by 2015/16.
- 10.2. Approves the Departmental savings targets for 2015/16 as set out in paragraph 6.6
- 10.3. Approves the high level strategy proposed for balancing the budget in 2014/15 and 2015/16.
- 10.4. Notes the prospects for 2016/17 and 2017/18.
- 10.5. Requests the Leader of the Council to write to the Secretary of State in respect of reductions to grant levels and national insurance changes that will impact significantly on the financial stability of the County Council.

BASELINE FORECAST – NO COUNCIL TAX INCREASE

	2014/15	2015/16
	£'000	£'000
Grant Changes		
Reduction in EIG / LD & Health Reform Grant		7,419
Revenue Support Grant Reduction	17,671	17,100
	17,671	24,519
Departmental Savings		
Passport Decrease in EIG	(6,308)	
Adult Services slipped savings	(3,018)	
Passport decrease in Specific Grants		(7,419)
	(9,326)	(7,419)
Base Expenditure		
Inflation and Base Changes	12,378	19,240
New Homes Bonus	(4,800)	(1,200)
ESG Reduction		4,000
Social Care Complexity and Demography	11,500	11,500
Change in use of Reserves	4,908	11,600
	23,986	45,140
Council Tax		
Council Tax Freeze Grant - 1% 2014/15	(4,950)	
Council Tax Freeze Grant - 1% 2015/16		(4,950)
	(4,950)	(4,950)
Total Budget Gap in Year		
	27,381	57,290
Deficit from Previous Year		27,381
Total to be Balanced	27,381	84,671
Balancing		
Housekeeping Workstream	(5,000)	(5,000)
Corporate Services 4% Release	(1,500)	(1,500)
Early achievement of Departmental Savings	(5,000)	
12% Departmental Targets		(85,161)
Business Strategy Opportunities		(1,500)
Grant Equalisation Reserve	(15,881)	8,490
	(27,381)	(84,671)
Remaining Net (Surplus) / Deficit	0	0
<u>Grant Equalisation Reserve</u>		
Opening Balance	41,452	21,971
Budgeted Draw from previous MTFS	(3,600)	
To Balance Budget	(15,881)	8,490
Closing Balance	21,971	30,461

Transforming the Council to 2015 Workstreams

Workstream	Sub-streams	Indicative Target
Housekeeping	<ol style="list-style-type: none"> 1. Inflation management 2. Debt & investment management 	£5,000,000
External Spend	<ol style="list-style-type: none"> 3. Saving opportunity plan 4. Adults Services 5. Children's Services 6. Waste 7. Highways 8. IT 9. Property 10. Other 11. Spend comparator model 12. Capability improvement plan 	£20,000,000 - £25,000,000
Adult & Children's Social Care (Demand Management)	<ol style="list-style-type: none"> 13. Adult Services sub-streams 14. Adult Services & Children's Services joint sub-streams 15. Children's Services sub-streams 	£30,000,000 - £35,000,000
Further Efficiencies	<ol style="list-style-type: none"> 16. Senior management & other workforce savings 17. Staff overheads & running costs 18. Joint working with health 19. ICT cost reduction 20. Hampshire Workstyle & other asset backed opportunities 21. Integrated Business Centre (IBC) 22. Business Strategy opportunities 	£20,000,000
Strategic Transformation/ Improvement Priorities	<ol style="list-style-type: none"> 23. Approach to enabling/working with communities 24. Organisational development & Learning & Development 25. Growth strategies 26. Customer access/insight 	These workstreams are partly about service improvement consistent with a wider transformation programme.

Reserves Strategy

Introduction

The level and use of local authority reserves has been a regular media topic over a number of years often fuelled by comments from Government that these reserves should be used to significantly lessen the impact of the austerity measures, that have seen a greater impact on local government than any other sector.

The County Council has continually explained that reserves are kept for many different purposes and that simply trying to bridge the requirement for long term recurring savings through the use of reserves only seeks to use up those reserves very quickly (and mean that they are not available for any other purposes) and merely delays the point at which the recurring savings are required.

At the end of the 2012/13 financial year the County Council's earmarked reserves together with the general fund balance stood at nearly £419M. This Appendix sets out in more detail what those reserves are for and outlines the strategy that the County Council has adopted (but perhaps not articulated) in using reserves and more importantly in contributing to them.

Reserves Position 31 March 2013

Current earmarked reserves together with the General Fund balance totalled £418.8M at the end of the 2012/13 financial year. The table below summarises by purpose the total level of reserves and balances that the County Council holds.

The narrative beneath the table explains in more detail the purpose for which the reserves are held and in particular why the majority of these reserves cannot be used for other reasons.

	Balance 31.3.2013 £'000	% of Total %
<u>Fully Committed to Existing Spend Programmes</u>		
Capital Grants Unapplied	74,967	17.9%
Revenue Grants Unapplied	18,448	4.4%
General Capital Reserve	89,316	21.3%
Street Lighting Reserve	2,395	0.6%
Community Transport Reserve / Other	1,550	0.4%
	186,676	44.6%
 <u>Departmental / Trading Reserves</u>		
Trading Accounts	13,780	3.3%
Departmental - Cost of Change Reserve	30,601	7.3%
	44,381	10.6%

	Balance 31.3.2013 £'000	% of Total %
<u>Risk Reserves</u>		
Insurance Reserve	22,043	5.3%
Local Government Resource Review	6,150	1.4%
	28,193	6.7%
<u>'Available' Reserves</u>		
Corporate Policy Reserve	1,979	0.5%
Invest to Save	10,154	2.4%
Corporate Efficiency Reserve	9,235	2.2%
Organisational Change Reserve	10,018	2.4%
Grant Equalisation Reserve	48,460	11.6%
	79,846	19.1%
HCC Earmarked Reserves	339,096	81.0%
Schools Reserves	44,870	10.7%
Total Earmarked Reserves	383,966	91.7%
General Fund Balance	34,795	8.3%
Total Reserves and Balances	418,761	100.0%

Fully Committed to Existing Spend Programmes

These reserves, which account for nearly half of total reserves are already fully committed in the main to existing revenue or capital programmes. They really represent the extent to which resources, in the form of government grants or revenue contributions to capital, are received or generated in advance of the actual spend on the project.

Specifically, the street lighting reserve represents the anticipated surplus generated by the financial model for this PFI scheme that is invested up front and then applied to the contract payments in future years.

These reserves have increased significantly in recent years following a change to International Financial Reporting Standards which required unapplied government grants to be shown as earmarked reserves and due to the fact that significant revenue contributions have been made to fund future capital investment using the surplus funds generated from the early achievement in savings (a deliberate strategy that is explained in more detail later in this paper).

These reserves do not therefore represent 'spare' resources in any way.

Departmental / Trading Reserves

Trading services within the County Council operate as semi-commercial organisations and as such they do not receive specific support from the County Council in respect of capital investment or annual pressures arising from spending or income fluctuations.

Given this position, any surpluses generated by the trading services are earmarked for their use to apply for example to equipment renewal, service expansion, service improvement, innovation and marketing. They are also used to smooth cash flows between years if deficits are made due to the loss of the customer base and provide the time and flexibility to generate new revenues to balance the bottom line in future years.

Departmental reserves are generated through under spends in annual revenue expenditure and Council policy was changed a few years ago to allow Departments to retain all of their under spends in order to provide resources to :-

- Meet any potential overspends in future years without the need to call on corporate resources
- Manage cash flow funding issues between years where specific projects may have been started but not fully completed within one financial year.
- Meet the cost of standard redundancy and pension payments arising from the down sizing of the work force
- Invest in new technology and other service improvements, for example the new Children's Services integrated system
- Undertake capital repairs or improvements to assets that are not funded through the existing capital programme where this is essential to maintain service provision or maximise income generation.
- Meet the cost of significant change programmes and restructures such as the Corporate Services Review implementation, which is being fully funded from planned savings within the Corporate Services Department.

By utilising reserves in this way, and allowing Departments and Trading areas to retain under spends or surpluses it encourages prudent financial management as managers are able to ensure that money can be re-invested in service provision without the need to look to the corporate centre to provide funding. This fosters strong financial management across the County Council and is evidenced by the strong financial position that the County Council is in at this point in time.

Risk Reserves

The Council holds specific reserves to mitigate risks that it faces. The County Council self insures against certain types of risks and the level of the insurance reserve is based on an independent valuation of past claims experience and the level and nature of current outstanding claims.

On 1st April 2013, the Government introduced two new schemes that have an impact on the financial stability of local government. Business rates retention transferred both risk and potential reward to local authorities in that a proportion of locally generated business rates is now retained by local councils and fire

authorities. Whilst this does introduce the potential for this income base to grow if there is economic growth, it also means that there is the potential for lost income should the business rate base decline.

In addition, local Council Tax Support Schemes were introduced on 1st April and replaced the national scheme for council tax benefits. The national funds were distributed amongst authorities to compensate for the loss of council tax income, but these were reduced by 10%. On top of this reduction in funding, Councils face further risk in the form of increasing numbers of claimants due to economic factors or due to the increased publicity around the schemes. If claimant numbers increase, the Government does not provide any additional funding and therefore the costs of this fall on the local authorities.

Both of these changes represent a significant risk transfer from central to local government and therefore a separate risk reserve has been created to mitigate potential losses arising from these sources in order to soften the impact on the budget setting process in any one year.

'Available' Reserves

The above paragraphs have explained that the majority of reserves are set aside for specific purposes and are not available in general terms to support the revenue budget or for other purposes.

This leaves other available earmarked reserves that are under the control of the County Council and total nearly £80M at the end of last financial year. Whilst it is true to say that these reserves could be used to mitigate the loss of Government grant reductions, the County Council has decided to take a more sophisticated long term approach to the use of these reserves, that brings many different benefits both directly and indirectly to the County Council and residents of Hampshire. They are broken down into four main areas :-

Corporate Policy Reserve – This small reserve is available to fund new budget initiatives that are agreed as part of the overall budget. It offers the opportunity to introduce specific service initiatives that might not have otherwise gained funding and are designed to have a high impact on service users or locations where they are applied. Past initiatives have included :

- Targeted speech and language therapy
- Apprenticeship and graduate placement schemes
- Funding for rural grants
- Funding for troubled families programme
- Olympic legacy
- The 'Have Your Say' community bidding budget

Invest to Save / Corporate Efficiency Reserve – These reserves are earmarked to provide funding to help transform services in order to make further revenue savings in the future. Rather than just prop up the budget on a short term basis, the County Council feels it is a far more sensible policy to use available reserves to generate savings and improve services over the longer term, by re-designing

services and investing in technology and other solutions that make services more modern and efficient.

Organisational Change Reserve – The County Council is one of the largest employers in Hampshire and inevitably, large reductions in Government grant leading to reduced budgets means that there is a significant impact on the numbers of staff that are employed in the future.

The County Council as a good employer has attempted to manage the reduction in staff numbers as sensitively and openly as possible and introduced a voluntary redundancy scheme back in 2011. The scheme offers an enhanced redundancy rate for people who elect to take voluntary redundancy and this has been a highly successful way of managing the reductions in staff numbers, whilst maintaining morale within the rest of the workforce who are not required to go through the stress and uncertainty of facing compulsory redundancies.

In fact, since the scheme was introduced, voluntary redundancies account for around 98% of the total number of staff that have left the organisation as a result of specific restructures and service re-design.

As explained above, Departments are still responsible for meeting the ‘standard’ element of any redundancy package, but the Organisational Change Reserve was put in place to meet the ‘enhanced’ element of the payment. The reserve was recently topped back up to provide funding to continue the voluntary redundancy scheme as part of the TtC to 2015 programme.

Further information on the use of this reserve has been provided in the next section of this Appendix.

Grant Equalisation Reserve – This reserve was set up many years ago to deal with changes in Government grant that often came about due to changes in distribution methodology that had an adverse impact on Hampshire compared to other parts of the country.

In 2010/11, the County Council recognised that significant reductions in local government spending were expected and built in contributions as part of the Medium Term Financial Strategy over the CSR 2010 period from the Grant Equalisation Reserve in order to smooth the impact of the grant reductions.

Over the last few years, it has become clear that the period of austerity will continue for much longer than planned and therefore the County Council has taken the opportunity to increase the reserve in order to be able to continue the sensible policy of smoothing the impact of grant reductions without the need to make ‘knee jerk’ reactions to offset large decreases in grant

Further information on the use of this reserve has been provided in the next section of this Appendix.

It should be highlighted that the total ‘Available Reserves’ outlined above account for only 19.1% of total reserves and balances that the County Council holds and of these, 7.5% have been set aside as part of a longer term strategy for dealing with the significant financial challenges that have been imposed on the County Council.

Schools Reserves

Schools reserves account for nearly £45M or 10.7% of total reserves and balances. These reserves must be reported as part of the County Council's accounts, but since funds are delegated to schools any surplus is retained by them for future use by the individual school concerned. Similarly, schools are responsible for any deficits in their budgets and they maintain reserves in a similar way to the County Council in order to smooth fluctuations in cash flow over several years.

The County Council has no control at all over the level or use of school reserves.

General Fund Balance

The General Fund Balance is the only reserve that is in effect not earmarked for a specific purpose. It is set at a level recommended by the Chief Financial Officer at around 2.5% of the budget requirement and in effect it represents a working balance of resources that could be used at very short notice in the event of a major financial issue.

The current balance stands at £34.8M, which includes £16M carried forward from the 2012/13 financial year that will be used to provide planned contingency support of £8M per year in the budget during 2013/14 and 2014/15. After this planned usage, the balance will return back to the recommended minimum of 2.5% of the budget requirement (£18.8M).

Use of Reserves

The absolute level of County Council reserves have continued to increase over the last few years as part of a deliberate strategy for dealing with the extended period of austerity. This strategy is explained in more detail in the next section, but the purpose of this section is to highlight the fact, through a couple of real examples, that whilst the absolute level of reserves continues to increase, this masks the fact that reserves are being used constantly to manage the finances of the County Council.

The tables below show for the Organisational Change Reserve and the Grant Equalisation Reserve, the movements that have taken place since 2010/11 and the planned use of the reserves over the next few years.

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Organisational Change Reserve	£'000	£'000	£'000	£'000	£'000	£'000
Opening Balance		3,511	8,119	10,018	9,018	3,018
Planned Use	(6,489)	(1,738)	(618)	(1,000)	(6,000)	(3,018)
Planned Contribution in Year	10,000	6,346				
Additional Contribution in Year			2,517			
Closing Balance	3,511	8,119	10,018	9,018	3,018	0

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Grant Equalisation Reserve	£'000	£'000	£'000	£'000	£'000	£'000
Opening Balance	22,415	18,680	32,180	48,460	41,452	21,971
Planned Use (2011/12 MTFS)	(3,735)	(4,500)	(4,500)	(4,200)	(3,600)	
Planned Use (2014/15 MTFS)				(2,808)	(15,881)	
Planned Contribution in Year			8,190			8,490
Additional Contribution in Year		18,000	12,590			
Closing Balance	18,680	32,180	48,460	41,452	21,971	30,461

These examples show that for many of the reserves that the County Council holds, the movements are a combination of draws from and contributions to the reserve in line with the financial strategy that the County Council has put in place and it is therefore important to look in more detail at the use of reserves rather than just concentrate on the absolute level contained in the annual accounts.

Reserves Strategy

The County Council's approach to reserves has been applauded in the past by the Government and the External Auditors as a sensible, prudent approach as part of a wider Medium Term Financial Strategy. This has enabled the County Council to make savings and changes in service delivery in a planned and controlled way rather than having to make urgent unplanned decisions in order to reduce expenditure.

This approach is well recognised across local government and a recent article in the Municipal Journal by the Director of Local Government at the Chartered Institute of Public Finance and Accountancy stated :

"What reserves do allow authorities to do is to take a more medium term view of savings and expenditure and make decisions that give the best value for money. This is better than having to make unnecessary cost reductions in the short term because they do not have the money or funding cushion to allow for real transformation in the way they provide services."

It is now clear that the period of austerity will last longer than anyone had previously predicted and therefore it is possible that the County Council will have to take a longer term view of its financial strategy than the traditional 3 to 4 years that it has used in the past. A core strand of this strategy going forward will be the continued use and replenishment of reserves in line with the strategy and ensuring that there is sufficient financial capacity to cope with the challenges ahead, possibly up to 2020.

The County Council's strategy for reserves is already well established and is based on a cyclical pattern as follows :

- Planning ahead of time and implementing efficiencies and savings in advance of need
- Generating surplus funds in the early part of the programme

- Using these resources to fund investment and transformation in order to achieve the next phase of savings.

This cycle was clearly evident during 2011/12 and again within the 2012/13 outturn position that was reported to Cabinet in June. Savings in advance of need within Departments and savings in contingency amounts due to the successful implementation of the full early savings programme meant that the Council was able to provide :

- Departmental reserves to pay for the cost of change associated with their own transformation programmes
- Top up funding to the organisational change reserve to provide resources to continue the very successful voluntary redundancy programme as a means of releasing staff in a sensitive and controlled manner that has helped maintain morale across the Council
- An additional £5M within the Invest to Save Reserve to help with the Transforming the Council to 2015 programme that will deliver the next phase of savings to 2015/16.
- Additional funds for the Grant Equalisation Reserve to help smooth the impact of grant reductions and give the County Council maximum flexibility in future budget setting processes

The expectation is that the Transforming the Council to 2015 programme will also generate early savings that will increase the level of balances in the future albeit there will be planned reductions and use of reserves as outlined in this paper.

Looking further ahead, a similar strategy can be applied in looking to make savings up to 2017/18, allowing planned reductions to be made and providing resources to support the next transformation programme.

It is important to highlight that the strategy the County Council has adopted means that if we are in a position that reserves begin to decrease, it may be a sign that there is something wrong within the savings programme or financial strategy that might therefore need to be addressed. In any event, it needs to be stressed that the strong financial position that the County Council finds itself in is not an accident and is one about which we should be proud.

CORPORATE OR LEGAL INFORMATION:

Links to the Corporate Strategy

Hampshire safer and more secure for all:	yes
Corporate Improvement plan link number (if appropriate):	
Maximising well-being:	yes
Corporate Improvement plan link number (if appropriate):	
Enhancing our quality of place:	yes
Corporate Improvement plan link number (if appropriate):	

Section 100 D - Local Government Act 1972 - background documents

The following documents discuss facts or matters on which this report, or an important part of it, is based and have been relied upon to a material extent in the preparation of this report. (NB: the list excludes published works and any documents which disclose exempt or confidential information as defined in the Act.)

Document

Location

None

IMPACT ASSESSMENTS:

1. Equalities Impact Assessment:

- 1.1. Equality objectives are not considered to be adversely affected by the proposals in this report but the Council's budget and the services that it provides are delivered in a way that ensures that any impact on equalities issues are fully taken into account.

2. Impact on Crime and Disorder:

- 2.1. The proposals in this report are not considered to have any direct impact on the prevention of crime, but the County Council through the services that it provides through the revenue budget and capital programme ensures that prevention of crime and disorder is a key factor in shaping the delivery of a service / project.

3. Climate Change:

- 3.1. How does what is being proposed impact on our carbon footprint / energy consumption?

The revenue budget and capital programme contain measures that will assist in reducing our carbon footprint and changes to services are designed in such a way to also achieve this objective.

- 3.2. How does what is being proposed consider the need to adapt to climate change, and be resilient to its longer term impacts

The County Council in designing and transforming its services will ensure that climate change issues are taken into account.