

Reserves Strategy

Background

1. The requirement for a local authority to maintain financial reserves is acknowledged in legislation; the Local Government Act 1992 requires billing and precepting authorities to have regard to the level of reserves needed for meeting estimated future expenditure when calculating the budget requirement.
2. In addition to holding financial reserves, there are a number of safeguards in place that mitigate against local authorities over committing themselves financially:
 - There is a legal requirement to set a balanced budget;
 - In accordance with the 1988 Local Government Finance Act the Chief Finance Officer (Section 151 Officer - which is the Treasurer) must report if there is or is likely to be unlawful expenditure or an unbalanced budget. This would include situations where reserves have become seriously depleted and it is forecast that expenditure will exceed resources;
 - The external auditor's responsibility to review and report on financial standing.
3. While it is primarily the responsibility of Members and the Treasurer to maintain a sound financial position, external auditors have a responsibility to review the arrangements in place to ensure that financial standing is soundly based. The work undertaken by external auditors will include a review of the level of reserves and the advice given to Members by the Treasurer.
4. The Government consultation on the Fire and Rescue National Framework, published in December 2017, makes reference to reserves and the need for a policy on reserves. In particular, the consultation recommends that:
 - Fire authorities should establish a policy on reserves in consultation with their Treasurer
 - Fire authorities should publish their Reserves Strategy, including details of the current and future planned levels, the purpose for which each reserve is held and how each reserve supports the medium term financial plan.

Determining the level of reserves

5. In accordance with the Authority's Financial Regulations, the Authority holds reserves which fall into two distinct categories:
 - General Reserves: these are necessary to fund any day to day cash flow requirements and also to provide a contingency in the event of any unexpected events or emergencies; and

- Earmarked Reserves: these have been created for specific purposes and involve funds being set aside to meet known or predicted future liabilities. By establishing such reserves it will smooth the expenditure profile and avoid liabilities being met from Council Tax or Grant in the year that payments are made.
6. There is not a standard recognised formula for determining the level of reserves that each local authority should maintain. It is up to each authority to consider the local circumstances and the potential issues/risks that may occur across the medium term. In determining an appropriate level of reserves for the Authority the risks and issues that should be taken into account will include the following:
- The possibility of savings not being delivered: as austerity levels of funding continue, the need for annual reductions in spending is expected to increase in magnitude. This is likely to mean the identification of savings proposals that carry a potentially greater risk of not being delivered;
 - To provide cover for extraordinary or unforeseen events occurring: given that the purpose of the fire & rescue service is to respond to emergency situations, there is always the potential for additional, unexpected and unbudgeted expenditure to occur;
 - The level of self insurance that we provide to minimise our insurance premiums: potential insurance liabilities can vary significantly across financial years. The levels of liabilities are difficult to accurately forecast and it would not be appropriate nor affordable to budget for peak levels of expenditure. Any costs that fall above a baseline should be met from general reserves
 - Any additional delivery costs, or time lags in the implementation of savings, associated with collaboration initiatives such as the blue light collaboration and the multi force shared service arrangements.
 - The level of financial contingencies that may be held within the budget: the proposed savings for 2018/19 will, if approved, result in the complete removal of any further contingencies from the revenue budget.
 - The commitments falling on future years as a result of capital plans and proposals to improve/develop the asset base. Having reserves would mitigate the impact on the revenue budget of borrowing and/or revenue contributions to capital and would support projects/programmes that will generate revenue efficiencies.
 - The risk on inflation, especially pay. In the 2016 Autumn Statement the Chancellor forecast that price inflation would be around 2% from 2017 to 2021. With inflation currently running at about 3% there is likely to be continued upward pressure on pay inflation.

Earmarked Reserves

7. The Authority has a number of earmarked reserves. These have been set aside to support capital and revenue expenditure in future years. Details of the forecast levels of earmarked reserve are set out in Annex A. The forecast levels reflect the planned usage of reserves to meet anticipated expenditure. There may be further use of such reserves which have not, as yet, been submitted to Members. The main earmarked reserves are explained below.

IRMP Reserve

8. The purpose of this reserve is to meet the needs placed upon the Authority in meeting delivery programmes falling out of an IRMP and associated annual actions plans). One such activity is the Emergency Response Programme (ERP), which includes the construction of new fire stations and a safety centre. Government grant was secured to part-fund this and existing reserves set aside for capital are also being utilised. The balance was funded from the IRMP reserve.
9. Although this reserve mostly supports capital expenditure, it also finances the revenue implications from delivering the ERP: e.g. costs of the training and upskilling of firefighters, pay protection for firefighters moving from one shift system to another, relocation expenses, training new on call cohorts and running over-establishment in order to avoid redundancies.

Capital Reserve

10. The Government have ceased the practice of providing Capital Grants to local authorities although occasionally there are national initiatives announced that involve consideration of bids from local authorities in furtherance of Government priorities. The present strategy for funding capital is that the Authority will fund capital from existing reserves or from the revenue budget. As the Authority reviews its MTFP and Treasury Management Strategy, this funding strategy will also be reviewed. The Authority has a sizeable capital programme that involves contribution from capital reserves, which will result in a diminishing level of reserves going forward. As part of this strategy it is proposed that other reserves be used to support capital expenditure and to ensure that the capital reserve is not depleted entirely.

Resource Centre Reserve

11. There are amounts that are devolved to Resource Centre Managers for use in delivering activity in 2018/19 and future years. These amounts have built up from underspends in previous years and are mostly to smooth out the impact of additional one-off expenditure and to mitigate against peaks and troughs in revenue expenditure. During 2018/19 the Treasurer intends to review the rationale behind these reserves and to challenge the purpose for their existence and level of each amount. The amounts are attributable to the following issues/risks:

- Staff related: there are a number of staff related issues including pension costs and future recruitment costs.
- Legal and insurance: there are potential future prosecution and enforcement costs associated with the work of the Protection Team, as well as self insurance risk related costs;
- ICT and Systems Development: The Authority undertook a Programme of Change to upgrade its ICT infrastructure during 2012 and 2013. However the nature of ICT is that developments are constant, and the Authority holds ICT reserves which are designed to fund ICT developments.
- Equipment and uniforms: there are costs associated with the purchase of new and improved personal protective equipment, the purchase of high cost equipment (such as cutting equipment) and the development of the Incident Command Training Suite.
- Collaborations and partnerships/Blue Light Collaboration: there is a statutory duty to collaborate. The Authority currently collaborates on the North West Fire Control; a training partnership at Manchester Airport as well as the Bluelight Collaboration programme and the Multi Force Shared Service arrangements.

General Reserve

12. At a national level there has been considerable debate about the level of general reserves that are being held by local authorities. Whilst there is no specified minimum general reserve level, a broad rule of thumb adopted by most Chief Finance Officers in Local Government has been that an appropriate and prudent level is one that is equivalent to 5% of the budget. This has been recommended in the past in Audit Commission reports and has been included in recent comments by Government ministers as being an accepted “reasonable level” of general reserve.
13. The December 2017 consultation on the Fire and Rescue National Framework includes statements that a Reserves Strategy should explain how the “level of general reserve has been set” and should include “justification for holding a general reserve larger than 5% of the budget”. This therefore, adds weight to the adoption of 5% of the budget as an appropriate calculation of the required level of general reserve.
14. At the present time, the level of General Reserve is forecast to be £6.4m by 31st March 2018, subject to the outturn position for 2017/18. This is well above 5% of the revenue budget. However, there are significant potential capital costs that are likely to face the Authority in future financial years and which, without the use of reserves, would involve additional borrowing which would add to the revenue resources gap thereby requiring further savings. It is therefore forecast, as part of this Reserves Strategy, that the General Reserve be maintained at a level equivalent to 5% of budget and that the remainder of the reserve be used to support capital expenditure.

15. This Strategy will be kept under review as the position regarding capital spending proposals becomes clearer and the level of reserves is adjusted to reflect the actual position at the year end. The table set out in the Annex A shows the level of reserves available across the medium term after contributions to support the capital programme.

FORECAST LEVEL OF RESERVES TO MARCH 2022

	Forecast 1 Apr 18 £000	Forecast 1 Apr 19 £000	Forecast 1 Apr 20 £000	Forecast 1 Apr 21 £000
IRMP	8,221	3,076	2,031	2,031
Capital Reserve	2,766	1,645	1,044	1,084
Resource Centre	4,496	4,686	4,434	4,034
Community Risk	430	430	430	430
UPG	372	122	122	122
TOTAL EARMARKED	16,285	9,959	8,061	7,701
General Reserve	6,467	2,200	2,200	2,200
TOTAL RESERVES	22,752	12,159	10,261	9,901

Assumptions

The main assumption is that Reserves will be used in preference to borrowing to support capital expenditure. If capital spending proposals at the level forecast were to take place, further contributions from Reserves may be necessary to ensure a balanced funding position or additional borrowing.