Birmingham City Council
Resources Overview and Scrutiny Committee
27 April 2023

Subject:	Reserves review
Report of:	Fiona Greenway, Acting Section 151 officer
Report author:	Peter Sebastian, Interim Head of Financial Planning

1 Purpose

1.1 At the previous meeting of this committee, during a review of the Period 10 Monitoring Report for 2022/23, a paper was requested to assess whether the level of corporate reserves held by the Council is sufficient. This paper covers this review and looks at General Fund revenue reserves.

2 Recommendations

2.1 Note the points made in Section 3 below, including the fact that, at present, the Council holds sufficient revenue reserves to cover expected risks.

2.2 Note that the reserves position will be further updated, as part of the Long Term Financial Plan (LTFP) refresh that is due to come to Cabinet this summer (as part of the normal course of business)

3 Review of Council reserves

3.1 Every year, the finance team carries out regular reviews of reserves. This takes place as follows:

3.1.1 Budget-setting for the next financial year – this is based on the reserves forecast at the end of Month 9 (i.e. end of December)

3.1.2 Outturn reporting – once the financial year ends, the corporate outturn report shows the final positions on reserves. This report also seeks approval from members for reserve drawdowns and contributions to top up reserves

3.1.3 LTFP refresh – this usually takes place in the summer (planned for July 2023) in which the Financial Plan is reviewed and future spending risks and proposals are challenged. This will also result in an up-to-date reserve picture

3.2 For the 2022/23 financial year, this process has taken place as usual. At Month 10 (end of January 2023; the final monthly monitoring report before the end of the financial year), it was forecast that total corporate General Fund revenue reserves would be £664.6m at the end of the 2022/23 financial year:

Table 1 Forecast Reserves uses and contributions

	A	B	C	D	E	F	G	H
	Balance as at 31st March 2022	Original Budgeted (Use) / Contribution	Change approved in March and at Outtum 2021/22	Original Budgeted Use / (Contribution) not to be processed	Other forecast (Use) / Contribution	(Release) of Reserves	Total Forecast (Use/Release) /Contribution	Forecast Outturn Balance at 31st March 2023
Reserves	£m	£m	£m	£m	£m	£m	£m	£m
Corporate General Fund Balance	38.382	0.000	0.000	0.000	0.000	0.000	0.000	38.382
Delivery Plan Reserve	66.196	(15.118)	(3.600)	0.000	(2.503)	0.000	(21.221)	44.975
Financial Resilience Reserve Gross	*146.962*	*(29.956)*	*(1.300)*	*0.000*	*(42.478)*	*0.000*	*(73.734)*	73.228
Net Borrowing from Financial Resilience Reserve	*(21.480)*	*(0.912)*	*0.000*	*0.000*	*0.000*	*0.000*	*(0.912)*	(22.392)
Financial Resilience Reserve Net	125.482	(30.868)	(1.300)	0.000	(42.478)	0.000	(74.646)	50.836
General Reserves and Balances	**230.060**	**(45.986)**	**(4.900)**	**0.000**	**(44.981)**	**0.000**	**(95.867)**	**134.193**
Other Corporate Reserves	323.087	(212.965)	(1.000)	(0.779)	(20.637)	(11.185)	(246.566)	76.520
Grant	340.609	(23.727)	0.000	0.000	(4.684)	(20.120)	(48.531)	292.079
Earmarked	82.049	(0.498)	0.000	0.000	(9.800)	(5.792)	(16.090)	65.960
Schools	79.888	0.000	0.000	0.000	0.000	0.000	0.000	79.888
Non Schools DSG	15.989	0.000	0.000	0.000	0.000	0.000	0.000	15.989
Subtotal Other Reserves	**841.623**	**(237.190)**	**(1.000)**	**(0.779)**	**(35.121)**	**(37.097)**	**(311.187)**	**530.436**
Grand total	**1071.683**	**(283.176)**	**(5.900)**	**(0.779)**	**(80.102)**	**(37.097)**	**(407.054)**	**664.630**

3.3 These above reserves are held for a range of reasons, which are:

Reserve	**Purpose held**	**Type: General / earmarked (note 1)**
Corporate General Fund balance	For unplanned and unforeseen circumstances	General
Delivery Plan Reserve	The Delivery Plan Reserve (DPR) has been established to enable the necessary investment required by the Council's Delivery Plan	General
Financial Resilience Reserve	This is a reserve created in 2017/18 from the backdated application of a consistent Minimum Revenue Provision (MRP) policy of 2007/08 (Note 2) • The change in policy has created additional revenue costs. The Council plans to release some of this reserve in line with the Council Plan and Budget 2018+ to phase in the ability to meet the additional costs. The balance of this reserve is to provide contingency fund in case the Council faces financial difficulties in the future	General
Other Corporate reserves	These include reserves for Budget Smoothing (i.e. if the delivery of savings is delayed), Capital Fund (to enable flexibility around the future revenue financing costs for the capital programme), Business Rates Volatility (a contingency if business rates income falls below forecast levels), Cyclical Maintenance (to cover upgrades to council buildings, such as libraries) and Insurance	Earmarked
Grant	These reserves relate to the unused element of grant support for which the conditions of the grant are expected to be met. The reserves will be used to meet	Earmarked

	future years' expenditure for the service for which the grant was awarded. These reserves are managed by the Directorates. The reserves will only be released following the Directorate requests being approved by the Section 151 Officer to use funding in line with grant conditions The Council holds various Section 106 reserves which were contributed by private companies to improve the local community. The fund must be used for the specific scheme and within the agreed timescale. If funds are not used, they need to be returned back to the contributors. In addition, the Council also received Highways Public Finance Initiative (PFI) grant in advance of required payments. These funds are taken to reserves to be utilised in years when annual maintenance expenditure exceeds the annual Government grant income, in line with the PFI model.	
Earmarked	There are some reserves which cover a wide range of services that have been set aside to support future years' service delivery. These reserves are monitored at Directorate level and can only be used for a particular purpose. During the annual review if it is determined earmarking is no longer necessary the reserves will be allocated to general reserves.	Earmarked
Schools	The reserves are the net cumulative balances held by Council maintained schools. Under national school funding regulations, the schools are entitled to retain these balances for unexpected commitments and/or for planned school curriculum/infrastructure improvements and investment.	Earmarked
Non-schools DSG (Dedicated Schools Grant)	These are the balance unused element of the DSG that is held by the Council as opposed to Schools	Earmarked

Note 1: General reserves are those held for unforeseen future financial pressures. Earmarked reserves are those held to either: 1) meet known future liabilities (e.g. future debt repayments; in some cases these are held for legal reasons and cannot be liquidated); or 2) to pay for future policy initiatives (which could be liquidated, noting the impact on the policy, if needed to cover future council overspends).

Note 2: Minimum Revenue Provision (MRP) is the revenue costs set aside to pay off capital borrowing. This is separate from the interest costs on borrowing; this is the amount to pay off the principal sum. The amount set aside depends on the length of the loan (i.e. a 20 year loan is usually repaid in 20 equal instalments).

3.4 The following tests are carried out to ensure that the Council holds sufficient reserves:

3.4.1 General Fund balances as a percentage of net budget – this will be £38.4m on 1 April 2023. This represents around 4.5% of the Council's net General Fund budget in line with the Cabinet decision of 10 November 2020. There is no planned use of the General Fund Balance in 2023/24.

3.4.2 Financial Resilience Reserve risk assessment – within the 2023 Financial Plan, a full risk analysis was carried out to assess the full range of potential risks to the Council over the next four financial years. Each risk was quantified by likelihood of impact – for example a £10m risk with 20% probability would be assessed as a £2m weighted probability of potential impact. A total of £144m of risks (weighted probability) were identified. A 70% deflator was then applied to reflect the likelihood that not all risks will happen at the same time, leading to a total assessed risk of £42m. This is then compared to the General Fund balances (£38m as forecast for 31 March 2023, at the point the 2023/24 budget was set) and the Financial Resilience Reserve (£52.9m as forecast for 31 March 2023, at the point the 2023/24 budget was set). Further details are included in **Appendix A**.

3.5 However, whilst reserve levels are considered adequate, they require continuous monitoring. The Council cannot be complacent and must continue to maintain financial rigour, particularly with regard to delivering planned savings, accumulated debt and associated financing costs and financial income collection

3.6 Reserves are continuously reviewed. In 2022/23, the Council has been able to identify certain reserves that are no longer required, which has mitigated overspends on a one-off basis. These releases and other expected uses have been reported to Cabinet in monitoring reports over the year.

3.7 The forecast Reserves were reviewed by the Section 151 Officer and other senior finance officers as part of the compilation of the Financial Plan agreed in February 2023.

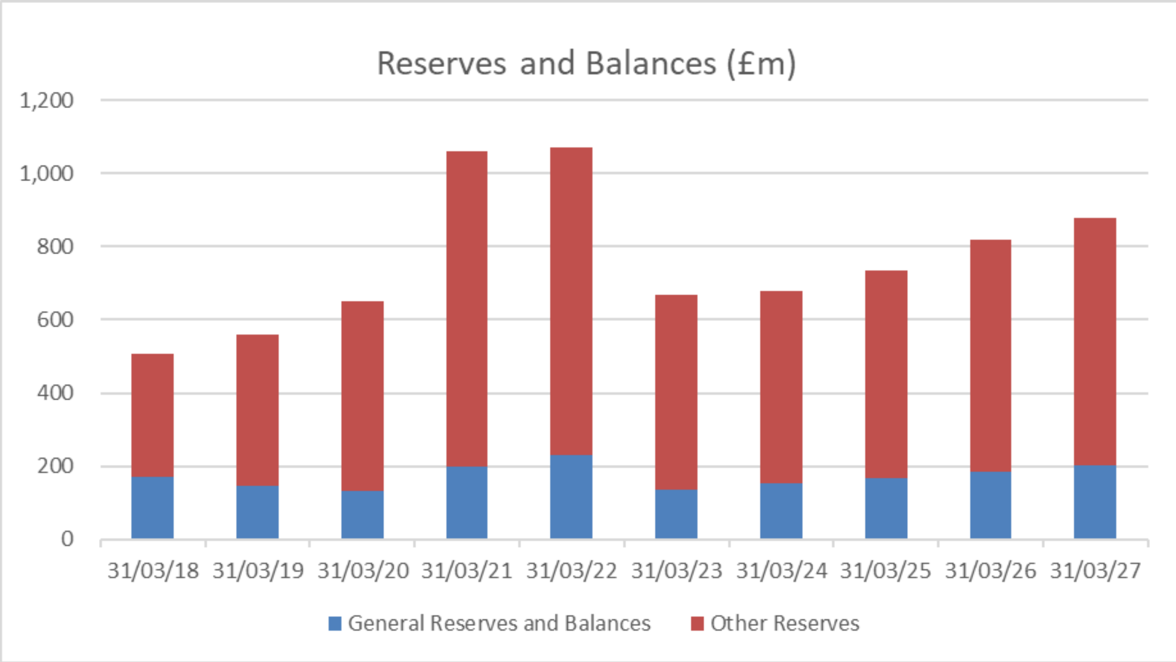
3.8 It is worth noting that the forecast reserve position in Table 1 was made at the end of January. The final reserve position will be confirmed as part of the corporate outturn report and will depend on the final level of council overspend or underspend. It is assumed that any overspends, if they materialise, would be taken from the Financial Resilience Reserve (just as any underspends or contributions not needed would be added to this reserve).

Plan to rebuild reserves in future years

3.9 There are two other factors that are worth highlighting:

3.9.1 Reserve balances at the start of the 2022/23 financial year were unusually high (see Table 2). The main reasons for this relates to COVID support from central government. At the end of the 2020/21 financial year, the Council contributed a total of £371m to reserves, the largest single contribution being £178m compensation for lost business rates income. In addition, there was around £30m compensation for lost Council Tax income and £14m of unspent COVID grants brought forward. There were also significant underspends of £79m, mainly as a result of government compensation for staff costs for those officers redeployed for COVID-related work. Since then, these costs have been used to cover remaining COVID costs and, in the case of income compensation, been used to cover additional shortfalls.

Table 2 – Reserves and balances (taken from the 2023 Financial Plan)



3.9.2 Over the next four financial years, the Council has approved a plan to increase reserve balances over the 2023/24 financial year and the next four financial years thereafter. This is mainly due to increased contributions to the Financial Resilience Reserve and the Budget Smoothing Reserve.

3.10 It is worth noting that the final accounts for the 2020/21 and 2021/22 financial years have not been formally signed by the auditors. If additional adjustments need to be made, this will mean that the brought forward reserve balances may need to change.

4 Any Finance Implications

4.1 Financial implications are included in the body of this report.

5 Any Legal Implications

5.1 It should be noted that the Section 151 officer has responsibility for ensuring that the Council holds sufficient reserves. The Financial Plan for 2023/24 includes a Section 25 report that assesses the robustness of estimates and adequacy of reserves. The assessment that reserves are adequate remains robust, based on present forecasts. These will be reviewed and updated as part of the Long Term Financial Plan refresh, due to Cabinet this summer.

6 Any Equalities Implications

6.1 All equalities implications have been considered when writing this report.

7 Appendices

7.1 **Appendix A –** Assessment of financial risks and adequacy of reserves (taken from the 2023 Financial Plan)

Appendix A – Assessment of financial risks and adequacy of reserves (taken from the 2023 Financial Plan)

Risk	Mitigation	Existing Reserve/Provision £m	Residual Risk	Maximum Impact over Medium Term Financial Plan £m	Likelihood	Probability weighted medium term potential impact £m
Business Rates income reduced by re-set, non-payment, impact of recession or appeals	The Council has employed a company to identify business rates income not being recorded	20	Company actively identifying companies not recorded on the list and therefore not in current baseline. However, pandemic has caused a backlog to accrue at VAO delaying growth to baseline. Risk will always remain in the current system. Government has announced it will freeze the business states multiplier for 2023/24. Any changes of significant scale would affect the whole of local government and would be highly likely to require government support. Currently government has delayed any change for the near future.	880	2%	18

Risk	Mitigation	Existing Reserve/Provision £m	Residual Risk	Maximum Impact over Medium Term Financial Plan £m	Likelihood	Probability weighted medium term potential impact £m
Council Tax growth and collection rates	Council Tax growth forecasts are based on the Council's approved housing forecasts and plan. Growth has been lowered to reflect the impact of COVID. Assumption that collection rates will climb back up to pre-pandemic rates		Cost of Living Crisis and recession may impact of building and collection rates	21	10%	2
Council Tax collection falls below budgeted levels producing a deficit on the Collection Fund and impact on the following years budget.	The 2022/23 budget includes an increase in collection from 96.6% in 2021/22 to 96.85% in 2022/23. Pre pandemic collection rates were set at 97.1%. So while collection rates are not yet back to pre-pandemic rates they are gradually increasing.		There remains uncertainty around collection in 2022/23.	10	20%	2

Risk	Mitigation	Existing Reserve/Provision £m	Residual Risk	Maximum Impact over Medium Term Financial Plan £m	Likelihood	Probability weighted medium term potential impact £m
Outcome of the Government Spending Review and Relevant Needs and Resources Review	The Government has announced that there will be no spending review in 2022		Risk has been pushed out beyond 2022/23 based on government announcements during 2021, settlement maybe at assumed inflation rate of 3.3%, which would be a real terms cut in funding	51	20%	10
Inflation increases at a greater rate than planned.	Generally provided for 5% inflation increase in 2023/24 within the budget on expenditure items. Contracts that run at a higher rate than the general assumption have been provided for separately in MTFP		Risk that inflation is higher than budgeted for and will therefore need to call on the Financial Resilience Reserve for funding.	20	25%	5
There is a risk that short-term and long-term interest rates rise above budgeted forecast	The Council has taken a more prudent view than various commentators over the medium term		If rates (long and short) rise higher than current market forecasts by 1% (100bp)	19	40%	8

Risk	Mitigation	Existing Reserve/Provision £m	Residual Risk	Maximum Impact over Medium Term Financial Plan £m	Likelihood	Probability weighted medium term potential impact £m
The Government has deferred making any decision on the Fair Funding Review and is now considering Local government Funding in a larger context. There remains a risk that the outcome could reduce resources available to Birmingham City Council	The Council has taken a more prudent view and reduced resources from 2025/26		The longer that Government defer the decision, the less likely that there is a residual impact as the time value of money reduces the impact	9	25%	2
There is a risk that the new PWLB lending rules exclude BCC from accessing PWLB borrowing, and BCC will have to borrow from the market at a higher rate	Capital programme investments have been reviewed to ensure they are not primarily for yield. The Financial Plan sets out clearly a policy of not investing primarily for yield. Any acquisitions will be reviewed against PWLB guidance for compliance		Nil	0		0
There is a risk that invested treasury monies are unable to be returned e.g. Icelandic Banks/BCCI	Adoption of up to date treasury management practices, regular monitoring and advice from external advisors		Low risk as continuously monitored. The Treasury Management Strategy and Policy sets limits on deposits with any single counter party	80	5%	4

Risk	Mitigation	Existing Reserve/Provision £m	Residual Risk	Maximum Impact over Medium Term Financial Plan £m	Likelihood	Probability weighted medium term potential impact £m
There is a risk of capital commitments being entered into with revenue implications that are not reflected in the Budget	All capital commitments must go through existing Council governance processes. Due diligence strengthened		These decisions could be agreed without full implications	100	5%	5
There is a risk in not achieving budgeted capital grants or capital receipts to fund commitment capital schemes which results in increased prudential borrowing	Property are required to provide a schedule of disposals and regular updates on progress. A prudent assessment of likely disposals is always assumed		Disposals for 2023/24 may not be achieved either at all or when expected as the market could be flooded with properties listed for sale or recession impacting on sales or market values achievable	40	30%	12
There is a risk that the Capital programme overspends in any one year and additional prudential borrowing is required in the short term	Regular capital monitoring is undertaken, robust budget setting and robust business cases supported by good project delivery.		Due to a history of slippage this risk has a very low likelihood.	20	5%	1
There is a risk of a Cyber-attack that severely disrupts operations or holds the Council to ransom	Investment and resources put into dealing with the cyber threat		The risk remains and other Councils have suffered attacks and financial consequences	40	20%	8

Risk	Mitigation	Existing Reserve/Provision £m	Residual Risk	Maximum Impact over Medium Term Financial Plan £m	Likelihood	Probability weighted medium term potential impact £m
Delivering the savings programme	A fundamental review of all savings proposals has been undertaken, there are some ambitious plans that need to be in place for the 1st April 2022		Not all listed savings will deliver a full year impact in 2022/23, resulting in a need to utilise some of the budget smoothing reserve	30	20%	6
There is a risk of demand pressures in Adult Social Care causing an overspend	Annual demography is built into the budget plus additional social care market inflation. Monthly budget monitoring would identify at an early stage any overspend, and mitigations would be expected		There is a residual risk of an Adults overspend not being contained in one year, although in recent years the service has underspent and delivered its savings target. The ongoing long term impact of Covid on the service is still unknown	80	10%	8
There is a risk of demand pressures in Children's Social Care causing an overspend in the contract payments to BCT as we see a rising number of complex cases	Annual demography is built into the budget plus additional baseline budget sufficiency sum reflected in 22/23 budget refresh. Monthly budget monitoring would identify at an early stage any overspend, and mitigations would be expected		There is a residual risk of a BCT contractual overspend not being contained in one year	20	20%	4

Risk	Mitigation	Existing Reserve/Provision £m	Residual Risk	Maximum Impact over Medium Term Financial Plan £m	Likelihood	Probability weighted medium term potential impact £m
There is a risk that SEND and Travel Assist continue to overspend	Work is underway with a CIPFA review to understand the budget in greater detail, with growth of over £19m built into the budget for 2022/23		Given the ongoing budget review work and demand in this service there is a risk that the growth built into the budget is not enough	20	20%	4
There is a risk based on recent history of City Operations Department not spending within its annual budget	Monthly budget monitoring would identify any overspend and mitigation would be expected.		Given its history of overspending there remains a residual risk in this Directorate.	15	20%	3
There is a risk of Property Services not delivering its income levels budgeted for	The MTFP and Financial Plan have been developed in line with service projections. Monthly budget monitoring would identify any overspend and mitigation would be expected		However, in the current environment income levels could remain difficult to achieve	20	10%	2

Risk	Mitigation	Existing Reserve/Provision £m	Residual Risk	Maximum Impact over Medium Term Financial Plan £m	Likelihood	Probability weighted medium term potential impact £m
There is a risk that the Highways PFI alternative arrangement will cost significantly more than the current budget provision	Re procurement is taking place now and soft market testing is underway. The service is intending to re-procure within existing external funding	200	However there remains a residual risk that the Council could be required to provide additional funding	50	50%	25
Increased Pension Contributions required	The Council agreed a three-year payment plan with the pension fund to repay the pension deficit, beginning 2020/21. Any movements would be incremental from the current agreed recovery plan.			20	25%	5

Risk	Mitigation	Existing Reserve/Provision £m	Residual Risk	Maximum Impact over Medium Term Financial Plan £m	Likelihood	Probability weighted medium term potential impact £m
Impact of COVID 19 - potential additional cost implications	Currently no Government funding for 2022/23 identified. The last Government funding as tranche 5 allocated in early 2022/23. Any unspent monies will be ring fenced and carried forwards to 2022/23	17.5	Costs exceed the remaining funding and fall on the Council's overall budget.	10	10%	1
Impact of Brexit – potential loss of grant income	There still remains some uncertainty over the Governments replacement of European Grant funding.			5	40%	2
Industrial disputes	Continuing discussions through ACAS			6	25%	2
Exceeding the 5% VAT Partial Exemption limit	Appropriate taxation advice is taken before each decision is taken		Appropriate tax advice is not taken at the outset of projects to minimise tax risks and partial exemption limits	40	10%	4

Risk	Mitigation	Existing Reserve/Provision £m	Residual Risk	Maximum Impact over Medium Term Financial Plan £m	Likelihood	Probability weighted medium term potential impact £m
Major Contract disputes	Ensure contracts are operated in accordance with the agreed Terms and Conditions. Earmarked reserves in place to mitigate impacts.			10	10%	1
Successful Equal Pay disputes	Provision has been set aside for outstanding Equal Pay claims.	270		0	0%	0
Total Risk						**144**

70% deflator to reflect not all risks will happen at same time	**43.2**
General Fund Reserve	**38.4**

Risk	Mitigation	Existing Reserve/Provision £m	Residual Risk	Maximum Impact over Medium Term Financial Plan £m	Likelihood	Probability weighted medium term potential impact £m
			.		**Estimated Financial Resilience Reserve balance at 31 March 2023**	**52.9**