

RESERVES & BALANCES

General Reserves

- 1.1 Local authorities are legally required to set a balanced budget and the chief finance officer has responsibility to report should serious problems arise (including in relation to the adequacy of reserves). External auditors are responsible for reviewing and reporting on financial standing but are not responsible for recommending a minimum level of reserves.
- 1.2 Under provisions introduced by the Local Government Act 2003, the level and use of reserves must be formally determined by the Council, informed by the judgement and advice of the chief finance officer. When calculating the budget requirement, the chief finance officer must report to Members on the adequacy of reserves. There are also now reserve powers for the Secretary of State to set a minimum level of reserves.
- 1.3 The Council needs to consider the establishment and maintenance of reserves as an integral part of its medium term financial planning. Reserves are 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 a general reserve.
 - To hold funds for specific purposes or to meet known or predicted liabilities – these are generally known as earmarked reserves. Schools' balances and insurance reserves are examples of these.
 - As a contingency to cushion the impact of unexpected events or emergencies, including budget overspends – this also forms part of a general reserve.
- 1.4 In order to assess the adequacy of general reserves, account needs to be taken of the strategic, operational and financial risks facing the authority. The level of general reserves is also just one of several related decisions in the formation of a medium term financial strategy and the budget for a particular year. Factors affecting judgements about reserves include the key financial assumptions underpinning the budget and an assessment of the Council's financial health, including:-
 - Overall financial standing (level of borrowing, Council Tax collection rates, auditors' judgements, etc.)
 - The track record in budget management.
 - Capacity to manage in-year budget pressures.
 - The strength of financial information and reporting arrangements.

RESERVES & BALANCES

- The external financial outlook.
- 1.5 There is therefore no 'correct' level of reserves. Furthermore a particular level of reserves is not a reliable guide to the Council's financial health. It is quite possible for reserves to increase but for financial health to deteriorate, if for example, the authority's risk profile has changed.
 - 1.6 Financial reserves also have an important part to play in the overall management of risk. Councils with adequate reserves and sound financial health can embark on more innovative programmes or approaches to service delivery, knowing that if the associated risks do materialise the Council has sufficient financial capacity to manage the impact. Conversely, Councils with inadequate reserves can either find it more difficult to introduce change, or in extreme cases can be forced to develop very high-risk service strategies simply in order to restore their financial health.
 - 1.7 General reserves are projected to stand at £24.5m as at 31st March 2010.
 - 1.8 The authority is currently projecting an over spend of approximately £2m in 2009/10. There are currently projected overspends in service budgets in five out of the six Directorates, with only the Adults, Health & Wellbeing currently projecting a break-even position. These overspends can probably be attributed in part to the general tightening of the Council's resources and this in turn increases the risk that unforeseen pressures may cause more temporary over spends in future years.
 - 1.9 The Council continues to face a range of uncertainties which carry attendant financial risks.
 - 1.10 Economic risk has increased substantially since the Three Year Budget was set. The UK economy has been in recession during 2009 and the public finances are now severely in deficit as a consequence of the cost of extra public borrowing to stimulate the banking sector and reductions in tax income. This has a number of potential effects for the Council;
 - The Pre Budget Report confirms that the squeeze on public spending which will be needed to part fund the public spending deficit will begin in earnest in 2011/12. Pledges by the current Government to protect spending in schools, health and international development seem certain to result in deeper cuts in other services, among them those run by local authorities. This impact is likely to last for several years, well into the next decade.
 - The general economic downturn may place extra demands on some services putting upward pressure on costs.
 - Economic downturn is leading to a reduction in income from charges that are linked to economic activity, such as planning and building

RESERVES & BALANCES

control fees and land charges, as well as capital receipts. The general economic conditions could also make other debts harder to collect.

- In a bid to stimulate credit, the Bank of England has drastically reduced interest rates. The Council has around £100m invested at any one time and reductions in interest rates impact directly upon income to the Council. Interest rates are expected to stay low or recover only gradually during 2010/11.

All of these factors tend to increase risk to the authority and should be taken into account in setting the level of reserves for 2010/11 and the medium term.

- 1.11 The Council remains highly dependent upon Government grant and therefore has a high exposure to Formula Grant settlements, changes in specific grant regimes, and tightening public finances. With 2010/11 being the last year of the current three year settlement and a General Election pending before the next settlement is announced, there is greater uncertainty over Council funding than at any time in the last fifteen years. With Tower Hamlets likely to remain at the grant floor, however, Formula Grant settlements below inflation are anticipated until around 2015/16. Since the population of the authority is expected to grow substantially in that period, any additional costs arising will need to be met from savings. A healthy level of reserves would enable the Council to plan for these savings and increase the chances that they can be met from efficiencies, avoiding sudden cuts in spending.
- 1.12 As with Formula Grant, no announcements have been made of Area Based Grant or any specific grants beyond 2010/11. Many specific grants and capital allocations continue to be announced on a year-by-year basis. The Medium Term Plan and the level of reserves needs to set so as to avoid over-dependence on income streams that could be temporary.
- 1.13 The Council continues to have an ambitious improvement programme, and a number of major and interdependent projects, with significant financial implications, which will come to fruition in similar timescales over the next few years. These factors point to the need for a solid financial position to underpin the risks involved.
- 1.14 Against this background, the chief financial officer has considered whether to change the current advice to the Council that reserves need to be maintained at between 5- 7.5% of budget requirement. On balance this does not seem necessary, although it would seem prudent to maintain reserves in the mid to upper end of this range for the time being.

Insurance Reserve

- 1.15 The Financial Outlook and Review identified continuing pressure on insurance costs to meet both higher numbers of claims payments and higher

RESERVES & BALANCES

external insurance premiums. The Council self-insures a substantial proportion of its insurable risks and an external actuarial review of the level of internal insurance reserves is commissioned at regular intervals.

- 1.16 Contributions to the insurance reserve are made by all Directorates from their budgets based on their relative size, risk profile, and level of claims, representing the equivalent of a 'premium'.
- 1.17. The value of the Council's insurance reserves and provisions was £31.0m at the end of 2008/09. A contribution of £500,000 to the Insurance Reserve is recommended for 2010/11.

Decent Homes Reserve

- 1.18. The functions of the Housing Revenue Account are supported corporately by the Council's support services. There are also a number of front line services, especially environmental services, which provide support to Council tenants and therefore charge costs to the HRA.
- 1.19. The achievement of the Decent Homes standard will involve an ongoing review of housing management service costs to ensure that resources for front-line delivery are optimised. This is likely to affect those General Fund support services which support front-line housing management activity. The majority of the costs of these services would need to be saved, although any costs associated with downsizing these services would need to be borne by the General Fund. Any ongoing costs which could not be saved would need to be met on an ongoing basis by the Council.
- 1.20 The General Fund Decent Homes Reserve is expected to stand at £8.5m by the end of this year and this is currently considered to be sufficient to address the risks set out above.

Efficiency Reserve

- 1.21 On 6th December 2000, PIC (the former Policy Implementation Committee) provided £2.7m for the Public Service Strategy/E-Government in 2001/2002 on a one-off basis. These proposals entailed the temporary application of reserves and their eventual repayment with interest on the principle of Invest to Save. The repayments were agreed to be made from savings at a rate of £0.65m 2002/2003 and £0.689m each year from 2003/2004 onwards. The initial investment has now been paid off and annual contributions of £0.689m are now being paid into an Efficiency Reserve to contribute towards the costs of schemes to deliver efficiency savings towards the Council's savings target.

Parking Control Reserve

- 1.22 The Parking Control Account (PCA) is ringfenced. The surplus can only be used for reinvestment within the service and for highways and transport

RESERVES & BALANCES

initiatives. Tower Hamlets uses the surplus for a variety of measures relating to street works and transportation including to part fund the cost of the concessionary fares scheme which forms part of the Communities, Localities and Culture Directorate budget.

- 1.23. The Parking Control Account has now largely recovered from the deficit incurred in 2006/07 and through a series of policy measures and management interventions, income has increased to the point at which the account can contribute more significantly to General Fund expenditure. However, the account remains subject to the buoyancy of income collection from parking and is kept under constant review.

Schools' Reserves

- 1.24 Schools' reserves represent unapplied revenue resources accumulated by schools with delegated spending authority. These totalled £20.5m at 31st March 2009. Schools' reserves are technically earmarked reserves of the Council but are controlled by schools and are not available to the Council for other purposes.

Capital Programme

- 1.25 The Council's Local Priorities Capital Programme is dependent largely upon the sale of large scale assets. Such sales are subject to risk, arising from the tendering process and contract negotiation and market factors. In addition, the economic slowdown has reduced demand for land and buildings and depressed prices. In view of this, officers advice to Members in setting the capital programme is not to project capital receipts which have not already been received or are receivable under contract.
- 1.26. The Council receives monies under agreements entered into under Section 106 of the Town and Country Planning Act 1990. These agreements specify the purposes to which the monies can be applied. Unapplied sums are held in reserve until such time as they are applied.

Service Specific Earmarked Reserves

- 1.27 A number of earmarked reserves are held to meet specific service objectives or fund potential liabilities which do not qualify as provisions for accounting purposes. The principal ones provide for:-
- One-off costs relating to the organisational changes required to ensure the delivery of decent homes.
 - The carry-over of budgetary underspends from one financial year to the next.

RESERVES & BALANCES

Use of these reserves is subject to specific Cabinet approval. The nature of these reserves means they are not generally available to support the Council's medium term financial strategy.

Sensitivity Analysis

The following table shows how assumptions made in this budget process would affect the budget if they proved to be incorrect. This gives a guide to the kind of risks which need to be allowed for in considering the level of reserves or contingencies made available as part of this exercise.

Scenario	2010/11	2011/12	2012/13
	Estimated financial impact	Estimated financial impact	Estimated financial impact
	(% age of estimated balances) £000s (£24.5m)	(% age of estimated balances) £000s (£24.5m)	(% age of estimated balances) £000s (£24.5m)
Inflation – cost of an additional 0.5% pay rise for all staff	718 (2.9%)	730 (3.0%)	740 (3.0%)
Inflation – price inflation 0.5% higher than forecast.	661 (2.7%)	677 (2.8%)	694 (2.8%)
Committed growth 10% higher than forecast	790 (3.2%)	781 (3.2%)	1,064 (4.3%)
Interest rates – average investment rate in 2010/11 is 1% less than estimate.	Not considered a major risk in light of historic low levels of rates		
10% Of projected savings not delivered	782 (3.2%)	1,838 (7.5%)	1,862 (7.6%)
Budget requirement overspent by 1%	3,104 (12.7%)	3,057 (12.5%)	3,049 (12.4%)

Opportunity Costs

When a decision is made to set resources aside against risks, it is important to consider the opportunities that are foregone and to balance this against the risk. Each £1million set aside in reserves adds to the amount invested by the authority, and currently this generates around £15,000 a year in investment income, or reduces the Council's need to borrow by a similar amount. However, the allocation of resources to reserves does temporarily deny the authority the opportunity to

RESERVES & BALANCES

spend this money. However, the ability to set money aside in reserves allows the authority to plan with more certainty and thus to take more short term risks than it would do if, for example, it had no balances or reserves to fall back on.

It is therefore important that reserves are held at a level that takes account of risks and that the reserves strategy is neither reckless nor risk averse.