Section Three – Robustness of Estimates and Adequacy of Reserves

Background

1. As part of its budget setting processes, the council has a duty to consider the adequacy of its reserves and working balances. Under Section 25 of the Local Government Act 2003 the Section 151 Officer is required to state in the budget report their view on the robustness of estimates for the coming year, the medium term financial strategy and the adequacy of proposed reserves and balances.

2. This report provides a summary of the review of reserves and working balances undertaken this year which will form part of the considerations around budget setting for 2019/20.

Reserves Policy

3. The council has developed a Reserves Policy which documents how the council will manage and utilise its financial reserves in meeting the financial challenges it faces over the medium term. This can be found at Appendix 4a.

Principles to assess risk in relation to the Adequacy of Usable Reserves

4. In order to assess the adequacy of usable reserves when setting the budget for the Housing Revenue Account (HRA), the Director (Corporate Services) has considered the strategic, operational and financial risks facing the Housing Revenue Account and future investment requirements in capital and other projects. Advice from professional bodies and reserve practices of other like authorities has then been considered to derive the recommended level of working balances and reserves for the 2019-20 financial year.

Assessing the risks

5. A risk assessment has been undertaken which attempts to quantify the risks to the Council's financial position in the forthcoming financial year for the Housing Revenue Account. The outcomes of this assessment can be found at Appendix 4b.

Professional advice

6. Guidance received from the Audit Commission in 2012 indicated that, in the Commission's view, a prudent level of working balances was to retain an amount equivalent to three months net revenue spending requirement. For the HRA, three months net spending would equate to approximately £5.5 million.

7. The Financial Resilience Review 2015 conducted by Grant Thornton recognises the importance of working balances and earmarked reserves as a means of providing a buffer against unplanned financial shocks and to invest in capital and other projects, including the funding of transformation. This view was shared by CIPFA in their briefing on English local authority reserves published in June 2015 and the more recently published Financial Resilience Index, which contains indicators relating to the level of reserves an authority holds and the extent to which reserve are being utilised.

Benchmarking

8. Benchmarking was undertaken to consider the relative positions of the minimum working balances retained by the authorities in England assessed as being the most similar to Gravesham Borough Council and other Kent stock holding authorities. This identified that the level of minimum level of working balances retained by this authority (at £3m), is higher than most. It is important to note, however, that Gravesham has a larger housing stock than all other comparators, with Gravesham's housing stock at 31 March 2018 standing at 5,686 and the average stock of the comparator authorities being 3,962. The review also recognises that each authority will structure their reserve arrangements differently and will be affected to a greater or lesser relative degree by the risks outlined in the risk assessment at Appendix 4b, as well as differing net revenue budget requirements and policies around how they establish contingency amounts.

Assessing the appropriateness of Working Balances and Reserves

9. The introduction of self-financing to the Housing Revenue Account (HRA) in April 2012 fundamentally changed the way that local authority housing is funded. All rental income is retained locally in return for the authority taking on a level of debt representative of the value of the stock. The level of debt taken on by Gravesham Borough Council amounted to £106 million, and at the end of 2018-19 will stand at £93m.

10. Business planning is central to a self-financed HRA to inform financial and service planning and managing risk. The business plan shows how over 30 years the rental and other income will fund all the investment needs of the stock, servicing of the debt and day-to-day management and repair requirements. It is the main tool for the financial management of the HRA and has a substantial impact on the asset management plans.

11. However, with 30 year business planning and the undertaking of £106 million of long-term debt/financing comes an increased risk to the authority of being unable to meet annual debt repayment obligations and the demands of managing around 5,700 Council Homes. The roll out of the Full Service for Universal Credit commenced in May 2018 and, based on areas where this has already taken place, is likely to lead to further financial pressures for the council, and to residents in receipt of benefits.

12. After considering the risks set out at appendix 4b to this report, professional advice and reserve practice of other comparator authorities it is the opinion of the Director (Corporate Services), that the minimum level of working balances be retained at £3 million. It is also considered that no changes are required to HRA reserves. The Housing Revenue Account continues to maintain adequate reserves and working balances and that the budget proposals recommended to Cabinet are robust and sustainable. The risk assessment conducted does, however, set out a number of areas of risk or uncertainty and for this reason, the reserves and working balances maintained for the Housing Revenue Account will be kept under review.

Opportunity Cost of holding reserves

13. Having set minimum levels, the opportunity cost of holding reserves needs to be considered. All balances are used to either reduce temporary borrowing or are invested subject to other cash flows. Therefore in measuring any opportunity cost of holding these reserves, account needs to be taken of the interest saving. The opportunity cost of holding the reserves is therefore a judgment whether the ‘worth’ of expenditure foregone is more than the income generated. Given the current economic climate and prevailing uncertainty over future grant funding it is considered that the risks the authority is exposed to exceed the opportunity cost of holding reserves.