To:
All members of the Corporate Policy and Resources Committee

Please reply to:
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Date: 11 January 2023

Supplementary Agenda

Corporate Policy and Resources Committee - Monday, 16 January 2023

Dear Councillor

I enclose the following items which were marked 'to follow' on the agenda for the Corporate Policy and Resources Committee meeting to be held on Monday, 16 January 2023:

Reason for exemption
This report contains exempt information within the meaning of Part 1 of Schedule 12A to the Local Government Act 1972, as amended by the Local Government (Access to Information) Act 1985 and by the Local Government (Access to information) (Variation) Order 2006:

Paragraph 3 – Information relating to the financial or business affairs of any particular person (including the authority holding that information) and in all the circumstances of the case, the public interest in maintaining the exemption outweighs the public interest in disclosing the information because, disclosure to the public would prejudice the financial position of the authority in the bidding process for the site/services by allowing other bidders to know the position of the Council. This in turn prejudices the Council by (i) distorting the bids process and (ii) prejudicing the opportunity for the Council to acquire a site/services in order to enable regeneration in the Borough.

Yours sincerely

Karen Wyeth
Corporate Governance

To the members of the Corporate Policy and Resources Committee

Councillors:

J.R. Boughtflower (Chairman)	R.O. Barratt	L. E. Nichols
A.J. Mitchell (Vice-Chairman)	J.T.F. Doran	R.J. Noble
M.M. Attewell	S.A. Dunn	O. Rybinski
I.J. Beardsmore	T. Fidler	J.R. Sexton
M. Beecher	S.C. Mooney	V. Siva

Substitute Members: Councillors: C. Bateson, C.F. Barnard, S. Buttar, J. Button, N.J. Gething, M. Gibson, H. Harvey, T. Lagden, D. Saliagopoulos, J. Vinson and S.J Whitmore

By virtue of paragraph(s) 3 of Part 1 of Schedule 12A
of the Local Government Act 1972.

Agenda Item 8

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Corporate Policy & Resources Committee

16 January 2023

Title	**Outline Budget Report 2023-24 to 2026-27**
Purpose of the report	To note and make a decision
Report Author	*Paul Taylor Chief Accountant*
Ward(s) Affected	All Wards
Exempt	No
Corporate Priority	Community Affordable housing Recovery Environment Service delivery
Recommendations	**Committee is asked to:** *To note the current projected Budget gaps set out in 1.20.* *To recommend:* *That the Council seeks to protect its council tax base over the four-year outline budget period by increasing the council tax by the maximum allowed by the Government limits.* *That Council utilise the Sinking fund Reserves to maintain the £10.8m income support for frontline services, affordable housing & regeneration programme.* *That the Council uses all of the initiatives in section 1.7 to 1.19, to close the forecast budget gaps for the years 2024-25 to 2026-27, as set out in the Medium Term Financial Strategy (MTFS).*
Reason for Recommendation	*Councils have a statutory duty to balance their budgets. It is important that we take a medium-term approach in ensuring that we can take action sufficiently early to ensure the Revenue Budget remains financially sustainable.*

1. Summary of the report

1.1 Please note that this report is normally dealt with by this Committee in November prior to the council meeting in February, however, due to workload pressure this was deferred to this meeting.

1.2 Having emerged from the worst economic downturn in over 350 years, caused by COVID-19, the Council and the Borough will be coming to terms with the impact of the Pandemic, with many issues from the last thirty months remaining unresolved for a few years to come.

1.3 Unfortunately, global events over the last twelve months, including the Russian invasion of Ukraine, Brexit and more recently the ongoing Cost of Living Crisis present major ramifications for the Borough exacerbated by these global factors, and is likely to have a more significant impact on the Council's finances in years to come, than the global COVID-19 pandemic. For the Council's budget position, the inflationary pressures associated with supply side issues of coming out of the pandemic are having a particularly significant impact on the Council's budget position over the Outline Budget period.

1.4 The existing issues mentioned below, are now further exacerbated by what has been labelled the cost-of-living crisis.

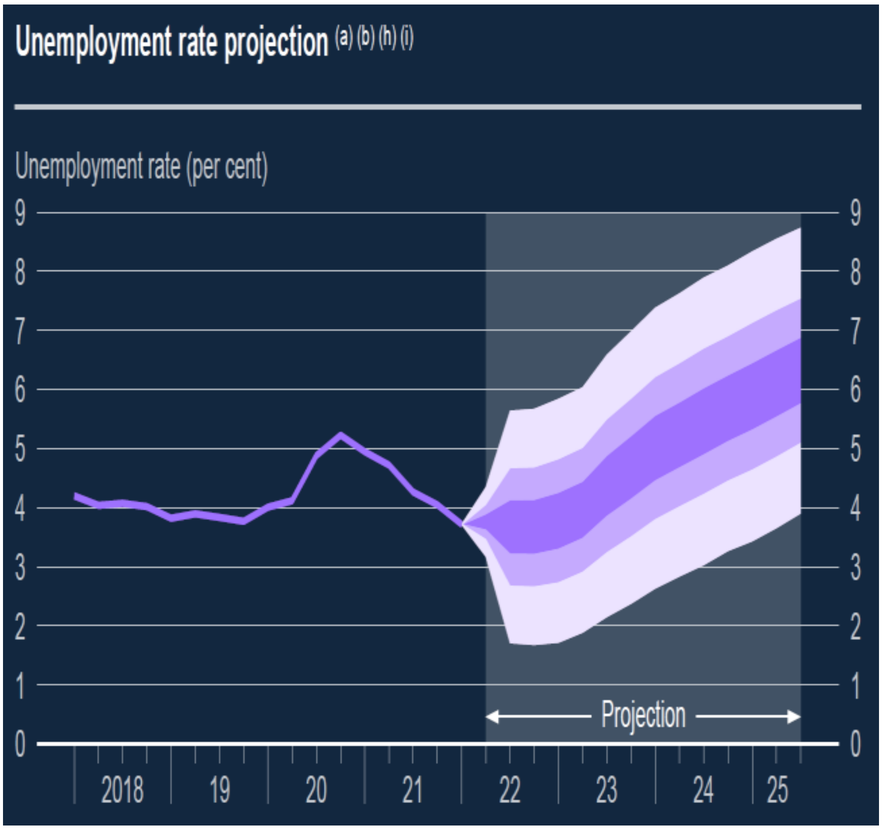
1.5 This means that the Council must have regard to these issues from a post COVID-19 recovery perspective and pending recessionary influences that will curtail recovery, increase costs, reduce income and therefore, where possible strong strategic policies to deal with these issues, must be implemented.

1.6 The vast range of issues to be considered include:

(a) The extent to which services' income such as car parking charges return to pre-pandemic levels, considering we are seeing changes to people's behaviour, for example, increased home working and online shopping. Have they permanently changed, and do they impact on the time any recovery may take?

(b) What will the impact be on our local economy in terms of jobs? Will the green shoots of a post pandemic recovery, as seen with the recent rise in recruitment numbers at Heathrow Airport, be slowed down or will the growth prospects for the Borough be reversed.

ArlingClose, the Council's Treasury Management advisors provided the Bank of England's unemployment projections that forecast a sharp rise in unemployment over the next three years, as shown in the table below.



(c) The labour market is expected to tighten further into 2023 from continued elevated recruitment difficulties due to the fall in size of the labour force before the slowdown in demand leads to a rise in unemployment and excess supply over the rest of the projection

(d) Whilst the furlough scheme assisted residents to pay their bills as and when they fell due, during the pandemic, given the Cost of Living Crisis, particularly around food, electricity and gas prices, the Council should be prepared to see a reduction in council tax collection rates and increased demand for some services such as Housing Benefits or Housing Options. This will create a dual challenge of reduced revenues and increased costs, as residents struggle to balance their budgets and pay their bills on time.

(e) Officers are not proposing any amendments to the current level of localised council tax support for our residents struggling to pay council tax.

(f) Officers believe that the Council may see a rise in numbers of residents presenting themselves for Housing Options support.

(g) The projected Council delays in developing our residential property schemes, continue to adversely impact on the Council's finances. The Council is currently incurring £170k per month in both revenue and capital costs and following the recent Bank of England Monetary Policy decision to increase the current Bank Base rate to 3%, Officers are forecasting that this will rise to £200k a month from January 2023. It could rise further still in April 2023 to £250k (£3m per annum), as the Council replaces short term (six to twelve months) borrowing agreed in December 2021 when the previous loans at rates agreed up to 12 months ago, when the base rate was

0.1%. **It is therefore particularly important that the Council maintains momentum in its affordable housing residential delivery programme and advances schemes through Planning.**

Officers are constantly reviewing our policy of capitalising borrowing costs in the light of these delays and section 4.8 of the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Local Authority Accounting in respect of borrowing costs, which could result in an additional £3.0m+ capital costs being written off to revenue costs. This is the equivalent of running our day centres for over six years and would greatly increase the Revenue Budget gap that council would need to close.

(h) During the Pandemic, Officers assumed that the council tax collection rates for the previous years would be 97% and managed to achieve an improved performance of 98.5%, which as mentioned above, was greatly assisted by the furlough scheme. However, as the Country heads towards recession, based on the Bank of England and Office for Budget Responsibilities and erring on the prudent side it is recommended that the Council should adopt a 97% collection rate for 2023/24 and this should be monitored closely.

(i) Whilst the Council welcomes the £1.48m 3% Core Spending Power grant, announced on 21 December, it has been allocated, together with the £1.2m for the following year 2024/25. This essentially just offsets the impact of the reduction in the Council's New Homes Bonus grant which dropped from £1.29m for 2021/22 to £101k in 2023/24.

Please note that the Department of Levelling Up., Housing and Communities (DLUHC), which is the central Government department responsible for local government faces the steepest real terms funding reduction of any Government department. Within local government resources will continue to be directed towards upper tier councils with adult care responsibilities, presenting a significant financial challenge for lower tier councils in sustainably delivering services.

(j) Refreshing the Council's annual Reserves Strategy and consideration of some planned short term use of reserves as part of a longer-term strategy to balance our budget and maintain financial stability for the Council. At the end of 2021/22 the Council has £63m in predominantly Earmarked Revenue Reserves (ERR), which can only be used for the purpose council set them up for. This means that it would not be possible for Council to use the environmental Impact Reserve to fund an FTE role in, say, Car Parks.

(k) Following the Council meeting on 20 October 2022, Officers were asked to review the earmarked reserves and provide an additional £200,000 to support key front-line services during the Cost of Living Crisis.

(l) The funds flow from Knowle Green Estates Ltd. (KGE) to the Council has been delayed, as the proposed development at Thameside, Oast House, Victory Place, Ashford Multi Story Car Park, Benwell phase 2 have been delayed.

Further, the reduction from 666 apartments to 564 apartments due to the proposed height reductions, has reduced the potential income available to Spelthorne Borough Council by in excess of £90m, over the next 50 years. This is offset by savings in costs of approximately £23m, over the same period

The recent interest rate movements, which will be touched on further in the report, is forecast to have an adverse impact of over £91m in the next 50 years.

When combined with the additional £33m of costs to construct these developments, KGE is struggling to make these new developments viable and proposals will be presented to the Council for consideration at their Extraordinary Council Meeting in January 2023.

When these items are factored into the MTFS the budget deficit is further increased for future years and Council need to address how they intend to cover this shortfall of income and protect the residents of the Borough.

Pay Awards

i) **2022/23**

The local Unison branch originally formally asked for a 4% pay increase for staff but accepted the Council offer of 2.5% for the lowest five grades and 2% for all other staff. Despite the national employers settling for an agreement for 2022/23 which is more generous (a fixed some of £1,925 per FTE equivalent to an average of 3,7% on Spelthorne grade) local Unison branch have confirmed that they do not expect a further uplift in 2022/23 to bring us in to line with the national settlement.

The 1.25% increase in national insurance employer's contributions which came into effect during 2022/23 (estimated cost to Spelthorne £181k) has been dropped by Government. However, the Other Services grant) from 2023/24 which was designed to partially offset, has been reduced for us to £88k.

2023/24

The local Unison branch have formally requested that the pay award be restricted so that each FTE received the equivalent of £1,925 per annum, which equates to an average aggregate pay award of 3.54%, across the Council.

By structuring the pay award in this manner, the percentage increase is approximately 10% for the lower grade members of staff and just under 2% for our highest-grade members of staff.

(m) **Pensions -** Local Government pensions are subject to a triennial valuation every three years. The latest one reflects the position as at 31 March 2022 and due to the increased number of FTEs joining the scheme, despite the pension fund overall performing well this has increased the Council's employer pensions contributions for the period 2023/24 to 2025/26. The Outline Budget projections has reflected the £500k increase in employer contributions for 2023/24 (previously anticipated this would be an extra £333k per annum), together with the incremental increases for the following three years.

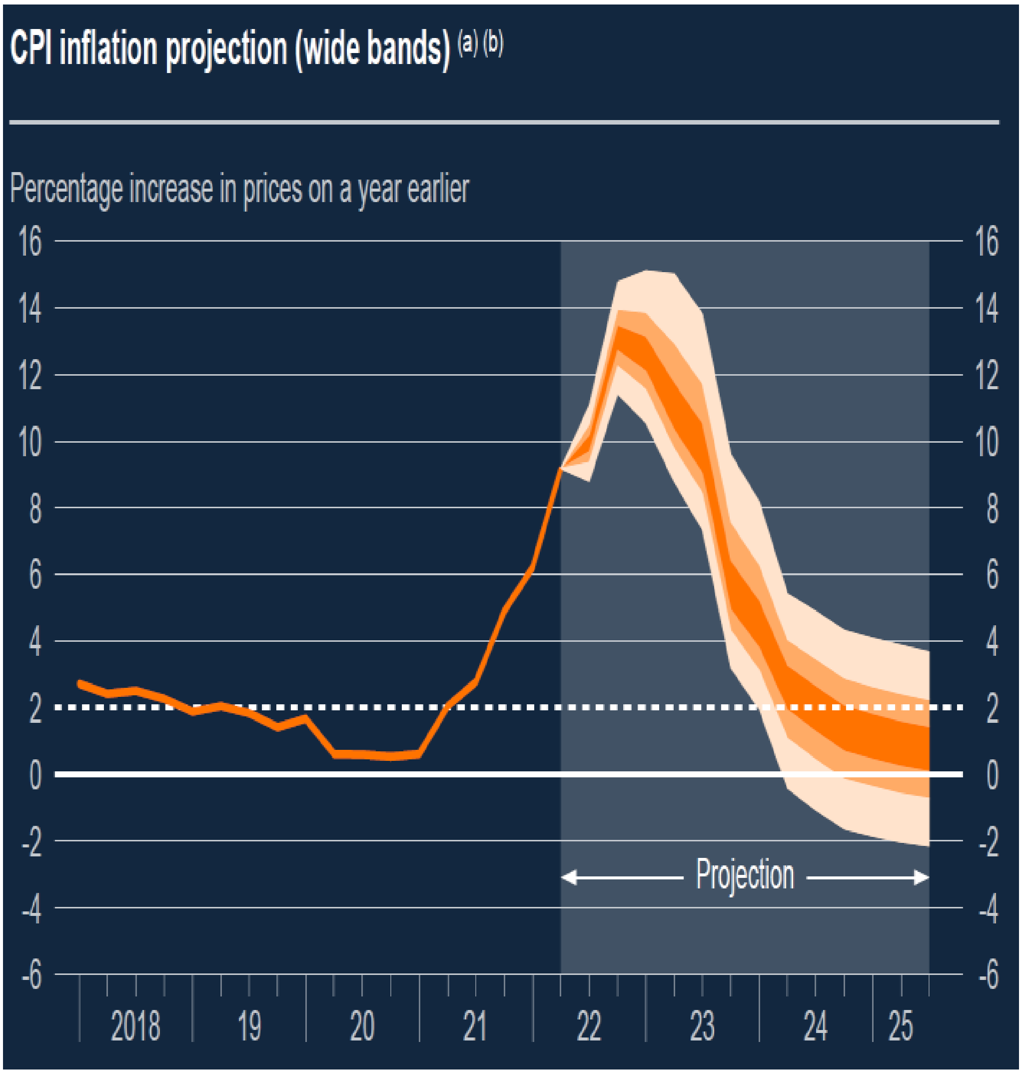
(n) **Full Time Equivalent (FTE) Growth –** Council has been concerned about the growth in FTE roles over the years and is undertaking a route and branch review of the Council's staffing structure and requested that in view of the forecast budget deficit set out in 1.21 below, only growth bids for FTE roles that were either fully funded or statutorily required will be permitted in the Service Plans and Budgets for 2023/24.

(o) **New Spelthorne Leisure Centre** – Again, this has been subject to increased inflationary build costs and once it is constructed is unlikely to fully cover its cost\s once it becomes operational in 2024. This has been reflected in the Outline Budget projections.

(p) **Additional Statutory Duties -** we also need to be mindful of the potential for additional statutory duties and requirements being imposed on Councils during the Outline Budget period, a potential example could be the proposed waste management changes such as universal green waste collection being proposed by DEFRA in a few years' time which could have a significant cost impact on our refuse collection arrangements. The Provisional Funding Settlement and the Statement of Principles issued by the Government has indicated that there will be additional funding for the Extended Producer Responsibility regime for lower tier councils in 2024/25 but at this stage it is unclear what form that funding will take and to what extent that will offset initial additional costs.

(q) **Inflation** – The rapid rise in inflation over the last fourteen months has had a significant impact on the Council's finances, and as can be seen the Bank of England are forecasting a sharp rise ahead, through to mid-year 2023 and then it is anticipated inflation will fall, which is borne out by the Medium Term Financial Strategy in section 1.20 below.

The vast majority of the increase and subsequent fall in CPI inflation reflects the impact of external factors domestic price pressures rise further this year, as wage growth strengthens, and companies increase their selling prices reflecting their sharp rises in costs Inflationary pressures subside in the second half of the forecast period, as the increasing degree of economic slack and lower headline inflation also reduce the pressure on wage growth



(r) The above list is not exhaustive.

1.7 **Opportunities**

Not only will there be challenges, but there will also be opportunities including:

1.8 **Partnering** – Over the last few years, SBC have been partnering with other councils to ensure that the emphasis is on service delivery, rather than additional administration or supervision. These include:

(a) Counter Fraud – with Reigate & Banstead Council

(b) Spelthorne Personal Alarm Network – with Mole Valley District Council

(c) Family Support - with Elmbridge and Epsom and Ewell Borough Councils and Surrey County Council

(d) Insurance – Sutton LBC early indications are that a potential £50k cashable saving per annum will be achievable

These are just a few of the successful partnerships the Council are involved with locally for the benefit of our taxpayers.

Following the recent change of S151 Officer at Mole Valley District Council Officers have recommenced discussions about combining the Finance Teams of the two Councils, to improve resilience, aid recruitment and deliver efficiencies, particularly around Integra. Other services could also be combined, and Officers are considering this as part of a wider project.

Should the Council look to outsource some of its services to other Councils, alternatively, should Spelthorne Borough Council establish itself as an outsourcing shared service? In the context of the financial challenges all councils are facing and uncertainties around the future of local government in Surrey it is particularly timely to look at these opportunities.

1.9 **Investment Properties** – there have been a number of unplanned external challenges that have recently impacted on the Council's income streams, namely the war in Ukraine and the UK Governments decision to freeze all the UK assets of certain Russian nationals, which has resulted in the Council taking action to foreclose on a lease, and as the property will be empty, to take the opportunity to improve the infrastructure within the building to attract a new tenant. The refurbishment costs and the void period will see income from this property fall by just over £4m.

Following extensive negotiations with an existing tenant, at another property, they have finally decided to terminate their lease in December 2022 and whilst there is an option to relet some or all of these units, which will be shortly discussed by Council. Once a decision is known, Officers will reflect that in an updated MTFS forecast.

Until then, Officers are exercising caution and taking a worst case scenario for reduced rental income and landlord costs.

Officers were aware of both of these situations and the likely adverse impact on cash flow in 2022/23 and 2023/24 and recommended that Council, invest an additional £2.5m in the sinking fund to contribute towards the short fall of the above, from the 2021/22 Outturn report, which was approved.

It is also clear that for 2023/24 and 2024/25, based on the worst case scenario, the Council will have to fall back on its sinking fund reserves, due to these unplanned situations, which was why they were established in the first place.

The recent sinking fund review modelled the likely impact on future cashflows and are forecasting that over the next 45 years, the Council will invest a net £3.5m per annum into the Council's sinking fund to cover unplanned emergencies, such as, warfare, together with providing sufficient fund to ensure that the Council still receives a £10m contribution towards front line service delivery, affordable housing and regeneration programmes.

The modelling indicates that in 45 years' time the aggregate sinking fund balance will be in excess of £200m, with the vast majority of loans for investment assets almost paid off.

Noting that the Corporate Policy & Resources Committee will receive an updated Sinking Fund Policy for review on 20 February 2023.

1.10 **Invest to save** – are there any opportunities for Committees and officers to invest in 2023/24 to deliver savings in subsequent years, and MAT has requested that based on the success of home working during the pandemic, Officers look at our long strategy for hybrid working and available technology.

There are several other initiatives that fall under the invest to save category that Officers with be looking to deliver cashable savings of £200k per heading over the next 4 years.

1. Procurement savings
2. Cost savings
3. Business Improvement
4. Green Initiatives.

On the basis that each area delivers the cashable savings expected that equates to £800k, over four years.

1.11 **Digital Transformation -** The Council has a digital transformation programme and has recently appointed a digital transformation programme manager. The Council will explore opportunities to deliver services more efficiently using technology. However, it will ensure that services remain accessible to those who are less digitally literate. The Council will also explore opportunities to reduce the number of software applications it is paying for by seeking to better align and integrate applications and quantify the cashable savings for 2023/24 and beyond.

1.12 **Knowle Green Offices -** Explore how the Council can maximise the opportunities created by the hybrid working era and reduce the overall running costs for the current office.

1.13 **New Corporate Plan** – This will be a key priority for the Council to evolve, post the May elections, the current Corporate Plan to ensure that all cost of services are aligned to deliver the strategy established by Council.

1.14 **Centros (Council financial system) –** Following a smooth transition from Integra our previous Enterprise Resource Planning financial system to Centros in August the Council is beginning to see some of the opportunities materialise, including:

(a) **Budget setting process –** the data is already loaded into Centros and a variety of data sets have been made available to enable Officers to model different scenarios. Based on this approach, once Council agree the final budget in February 2023, the Finance Team will be able to produce all the relevant reports and update the system by the first week of March, saving at least three weeks in the process.

(b) **Business intelligence dashboards** – is an information management tool that analyses information and displays it graphically, which will also assist with data used in Council reports in conveying important messages.

(c) **Application Programme Interface** – enabling us to open our data for the development of apps for our services, Officers are already looking to see how we can establish interfaces with the Assets team to model sinking funds.

(d) **Mapping –** by introducing ‘maps’ for our standard internal external reports, once established, this will reduce the time taken to collate the report by over 95% in respect of Officer time.

1.15 **Empty property premia** – Following last year's Council decision, Officers will be submitting a claim to Surrey County Council (SCC) to make use of their offer to spend their share of this income of related project in our Borough.

1.16 **Affordable Housing Delivery**- as stated above it remains particularly important that the Council maintains momentum of its affordable and keyworker programme otherwise it faces abortive costs which will significantly increase its Revenue Budget gaps. The Council therefore needs to continue to advance its schemes through the Planning process.

1.17 **International Financial Reporting Standard 16 – Accounting for leases** – the Council formally adopted this standard from 1 April 2022, as previously mentioned by Officers, where the Council has a right to use each asset costing over £10k, the Council must capitalise the cost of the asset in its balance sheet and depreciate it over its useful economic life, this will impact on the Estimate Capital Programme, rather than treat the lease payments, as rentals which are then charged to the relevant cost centre. The interest and maintenance element of such an agreement, will continue to be charged to the cost centre. This has no impact on cashflow. Officers estimate that this will save £472k over the two years 2022/23 and 2023/24.

1.18 **Current initiatives**

Officers have several initiatives that they have been working on to drive efficiency, reduce costs or increase income, some have been mentioned separately in this report, particularly around partnering, and also including:

1.19 **An average 2.5% and 5% savings** – In the 2024/25 Budget Setting process, which will begin in June 2023, Group Heads will be asked to review their service plans and identify opportunities for achieving these two levels of savings, to assist with the projected deficits for 2024/25, 2025/26 and 2026/27, noting that some contracts have a few years to run and inflation increases already built in, as highlighted in the next section.

1.20 **Medium Term Financial Strategy (MTFS)**

Continuing to refresh our medium-term financial strategy (MTFS) will help bring together all known factors affecting the Council's financial position and its financial sustainability into one place. This should be as wide ranging as possible and include all the assets and liabilities on an organisation's balance sheet. This is particularly important, and challenging, in the context of the significant additional uncertainties generated by the financial impacts of COVID-19, as mentioned above, some of which have yet to be fully felt. The Council also needs to understand the full impact of the Cost of Living Crisis as it unfolds, and take action, as it has done so, with utilising the Cost of Living and supplementary reserves amounting to £564k. It also allows the Finance team to balance the financial implications of objectives and policies against constraints in resources. This should in turn form the basis for Council's decision making.

A good MTFS should provide a clear and concise view of future sustainability and the decisions that need to be made to address any gaps in long-term financing. It forms the pivotal link to translate the organisation's ambitions and constraints into deliverable options for the future.

1.21 Considering the above Officers are predicting that the Budget deficits for the four years ended 31 March 2027 will be as follows, as shown in Appendix A:

Medium Term Financial Strategy for 2023/24 to 2026/27				
11/01/2023				
	2023/4 £000's	2024-25 £000's	2025-26 £000's	2026/27 £000's
Initial (positive)/negative imbalance before action	574	4,191	5,279	7,453
Opening budget (surplus)/deficit	0	574	4,191	5,279
In year movements (favourable)/adverse	574	3,617	1,088	2,174
Closing budget (surplus)/deficit	574	4,191	5,279	7,453

The current projected deficit of £574k for 2023/24, will need to be resolved and Council presented with a balanced budget at their meeting on 23 February 2023.

The later year gaps are largely due to a combination of inflation pressures, projected impact of Fair Funding Review and Business Rates reset and in 2026/27 further potential increase in employers' pension rates and a reduction in net income of approximately £1.25m from Knowle Green Estates Ltd, following the height restrictions imposed by Council.

2. Financial announcements and implications

2.1 **Council Tax** – In the Autumn Statement, the Chancellor announced that for 2023/24 and 2024/25, lower tier councils can increase their council tax bills by the higher of £5 on band D council tax or 3%. In comparison the maximum for 2021-22 for Spelthorne was £5 or 2.4% i.e., currently we have an additional 0.6% or £53k headroom. For Spelthorne £5 on Band D equates to 2.4% for 2023/24, to 3%, which equates to £6.30 and £6.49 for 2023/24 and 2024/25 respectively. In comparison upper tier councils such as Surrey County Council will be able to increase by 3% plus a further 2% for adult social care.

2.2 This would yield the Council an additional aggregate council tax revenue of £52,716 and £61,330 for 2023/24 and 2024/25 respectively.

2.3 In view of the short term challenges being presented by the Cost of Living Crisis, Officers are recommending that rather than reduce council tax, it charges the maximum and utilises the £264,000 to replace the £562,000 (Cost of Living Reserves) used in 2023/24 to fund and retain our essential services.

2.4 **Provisional Local Government Finance Settlement (PLGFS)** – this was announced on 21 December, this is possibly the latest notification received and Officers have processed and updated the information over the festive break.

The Statement of Principles issued by DLUHC earlier in December made clear that there neither the Fair Funding Review nor any business rates reset will be implemented before the next General Election. This therefore gives Councils at least two years of greater funding certainty. The likelihood is that such funding changes will not be implemented until 2026/27 as any new Government would be required to consult on impacts of funding changes.

Officers are expecting a “roll over” settlement, i.e., do not expect any significant funding methodology changes. It is now anticipated that the Fair Funding Review and Business Rates will slip to at least 2026/27- in the Outline Budget projections Officers have assumed a reduction of a third in the amount of business rates we retain from 2026/27 and the disappearance of New Homes Bonus at the same time. This is a factor as to why the last two years in the outline budget period are particularly challenging.

2.5 As part of the Provisional Funding Settlement the Government has rolled a number of specific grants into the Settlement, this has enabled the Government to ensure that every council now receives at least some Revenue Support Grant (RSG) whereas previously many such as Spelthorne were receiving nil RSG. Our allocation is £91k for 2023/24. The Government is indicating that RSG allocations will be uplifted annually to reflect inflationary pressures. This does mean that for the moment the threat of negative grant for Spelthorne has receded.

2.6 A position aspect of the Provisional Funding settlement was the announcement of a one off specific grant designed to ensure that all councils received at least a 3% increase in their core spending power (core spending power equals grant support plus assumed income raised from council tax). This has resulted in a £1.48m allocation for Spelthorne Borough Council. Whilst very useful this effectively offsets the impact of the Council’s New Homes Bonus allocation dropping from £1.29m in 2022/23 to £144k in 2023/24.

2.7 **Business Rate** – The business multiplier has been frozen for another year. The Business Rates Retention scheme is going to remain unchanged at 50% (this does not mean councils retain 50% of business rates but above a baseline they gain 50%) and that the associated baseline levels will not be reset for councils. There are some indications that the focus on Levelling Up by the Government may cause Government to reflect further on whether it wishes to move to a 75% Business Rates retention scheme. When the business rates baseline is reset, there is a risk for the Surrey councils as when the baseline was set in 2013-14 for the 50% retention system the Surrey Councils did relatively well. Business properties will be revalued every three years from April 2023.

2.8 For 2023/24, the Council is now included in the Surrey Business Rates Retention Pool scheme and potentially will benefit by approximately £450,000 in 2023/24.

2.9 **From 1st April 2023**, across England rateable values have been revalued. The Government will allow reductions to feed through immediately but has a transitional relief scheme to assist those ratepayers whose values and therefore bills are rising. We are working through analysis to understand the impact on the Council’s own properties.

The Government has announced an extension of the 50% discount on business rates for retail, leisure, and hospitality sectors with it providing 75% relief for 2023/24. This is clearly a response to the pressure’s businesses are now facing in light of the Cost of Living Crisis.

2.10 **New Homes Bonus Grant** – The PLGFS has announced that for 2023/24 the Council will receive £101,000 and a further £121,000 in 2024/25.

2.11 **International Financial Report Standard (IFRS) 16 Lease Payments** – as a result of implementing the above, the Council has received a one of revenue windfall adjustment in 2022/23 of approximately £400,000 as a result of capitalising the lease rental costs for our fleet of vehicles. This will be added to by approximately £72,000 in 2023/24, with the aggregate of £472,000 used to fund the budget deficit.

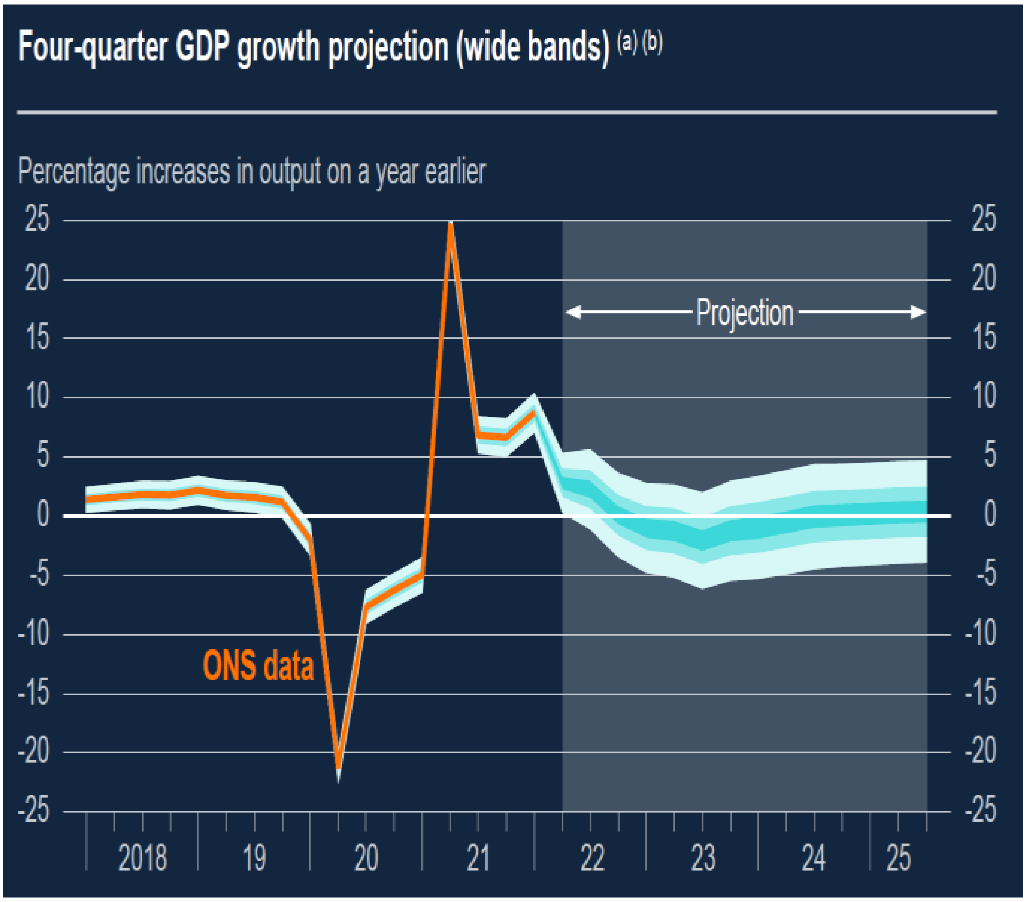
2.12 **Cost of Living Reserve** – as part of the Outturn Report for 2021/22, Council set aside £364,000 toward the cost of Living Crisis, and in October 2022, a further £200,000 was set aside to assist. Council will fully utilise the £564,000 to fund frontline services and provide additional support to our residents during the crisis.

3. Other considerations

3.1 Bank of England

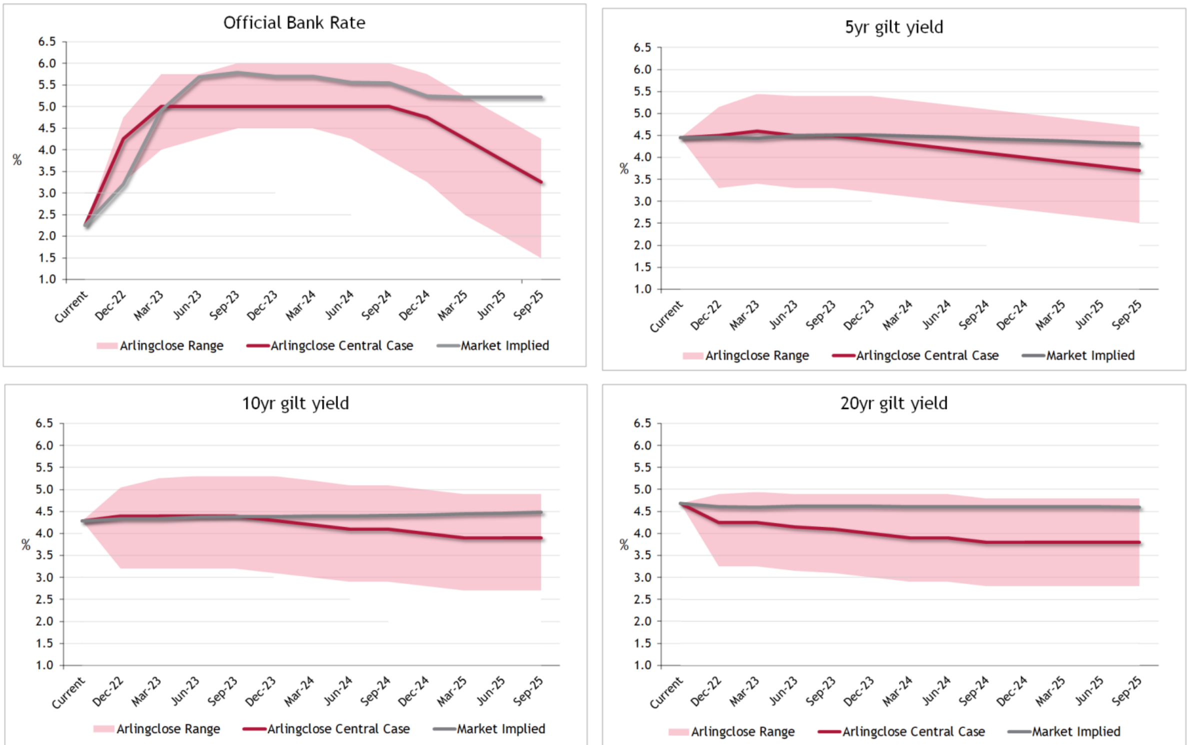
3.2 In addition to the charts above, the Bank of England produces regular updates and forecasts and shown below:

3.3 UK GDP



3.4 Real household post tax income is projected to fall sharply in 2022 and 2023 while consumption growth turns negative The UK economy entered into a recession during the late summer in 2022, and it is predicted that this will continue for the whole of 2023.

3.5 **Interest Rates**



3.6 **Gilts –** the Public Works Loan Board (PWLB) is the Council’s banker, and, unlike personal mortgages which are linked to the Bank of England official base rate, the PWLB interest rate are linked to the 20-year gilt market, which as can be seen from the above forecasts from Arlingclose is less volatile that the base rate.

3.7 Over the last three years, the Council has managed to fix the 50 year PWLB interest rates at an average rate of 2.3%

3.8 Officers in conjunction with our advisors are currently forecasting a 50 year fixed term interest rate of approximately 4.5% and increase of 1.1% on the previous rate for 2024/25 and based on the calculation, many of the affordable housing projects due to be completed and passed to Knowle Green Estates (KGE), will not be able to take place, as this high interest rate, will renders the projects even more unviable for KGE.

3.9 As at 9 January 2023 the PWLB fifty year certainty rate for Council was 4.47%, which confirms the upward pressure on interest rates predicted by our advisors.

3.10 Officers will be monitoring the situation closely.

4. Other considerations

4.1 Based on the current MTFS projections as shown in 1.20 above, Officers are predicting a relatively small deficit budget for 2023/24 and significant deficits for the following three years, therefore, Council will have to plan carefully how it manages the 2023/24 Budget, through the budget setting process to ensure that it can approve a balanced budget for 2023-24 in February and also has regard to medium term actions to address the projected deficits over the Outline Budget period..

4.2 As a result of building cash back Sinking Fund reserves, the Council is benefiting from a one off forecast increase in interest receivable of £500k as a result of the increases in Bank of England Base Rate.

4.3 The implementation of IFRS 16 Accounting for Leases has also provided a one off forecast Revenue saving of £472k.

4.4 The current growth bids for 2023/24 amounting to £868k will need to be carefully considered and by allowing them in 2023/24, this will impact on 2024/25 and beyond, therefore, between now and the first draft of the budget more refinement of these bids will be required, and this should increase the surplus available for Council.

4.5 As mentioned above, Officers have allowed for the maximum increases in Council Tax, based on the Autumn Statement (3% for 2023/24 and 2024/25) should council decide to implement a £5.00 (2.4%) increase, this would reduce the surplus by £53k and £61k for 2023/24 and 2024/25 respectively.

4.6 Alternatively, Council could consider putting these funds into an earmarked reserve to assist with the Cost of Living and inflationary pressures to protect key front line services to our elderly and vulnerable residents.

4.7 Officers have forecast that the Council will draw down the maximum amount from available earmarked reserves (Cost of Living & Sinking Funds) and they may wish to retain the funds in these reserves to deal with future issues.

4.8 The MTFS and assumptions made by Officers, provides Council with some options to consider, taking into account the projected future years deficit beyond 2023/24.

5. Financial implications

5.1 No material implications, other than those discussed above, noting that it is not an exhaustive list.

6. Procurement considerations

6.1 There are none.

7. Risk considerations

7.1 As set out in the report, focusing on opportunities to procure goods and services smarter should generate some opportunities to deliver financial savings.

8. Legal considerations

8.1 Councils have a statutory duty to set a balanced Budget. It is essential that the Council has plans in place to ensure the Council remains financially viable over the next few years.

9. Equality and Diversity

9.1 Any savings proposals impacting on service users will require an Equality Impact Assessment to be undertaken

10. Sustainability

10.1 There is the potential to align climate change objectives with budget sustainability reductions as reductions in energy consumption assist in easing pressures on the Revenue Budget

11. Timetable for implementation

11.1 September to October 2022, Officers present and discuss Service Plans with relevant Committee.

11.2 November 2022 – Officers collate Service Plans and feedback received from Committees and collate Outline Budgets

11.3 December 2022 – draft 2023/24 budget made available to Committees.

11.4 January 2023 – all Committees review and consider their consolidated growth and savings bids and submit list of bids to the Corporate Policy & Resources Committee for final short listing to feed into the final Detailed Budget for 2022-23.

11.5 Late January/early February 2023 - All councillor briefing

11.6 Early February 2023 – informal meeting with CP&R to review options to balance budget.

11.7 20 February 2023 – CP&R to meet to finalise the budget.

11.8 23 February 2023 – Council approves growth and savings bids as part of the 2023/24 annual budget debate.

12. Contact

12.1 P.taylor@spelthorne.gov.uk

Background papers:
Budget Briefing Presentation 21 June & November 2022.
Service plans 2023/24 submitted and discussed with each Committee September and October 2022.
Committee papers for their January meetings

Appendices:
Appendix A – MTFS 2023-24 to 2022-27

Medium Term Financial Strategy for 2023/24 to 2026/27

Appendix 1

11/01/2023

	2023/4 £000's	2024-25 £000's	2025-26 £000's	2026/27 £000's
Funding				
Council Tax	-8,773	-9,172	-9,519	-9,875
Business Rates	-1,929	-1,929	-1,929	-1,200
Business Rates - Economic set aside	0	0	0	0
Core spending powere grants	-1,483	-1,200	0	0
S31 Grants	-800	-800	-800	-800
Other NI	0	0	0	0
Lower Tier Service Grant	-80	-80	-80	-80
New Homes Bonus	-101	-121	0	0
NNDR Pool allocation	-450	0	0	0
Capitalised interest	-1,321	-1,471	-1,621	-671
Empty Property Premia	-500	-500	-500	-500
Other Service Grants	-75	-75	-75	-75
Funding from reserves	-1,263	0	0	0
KGE income	-151	-151	-151	-151
SDS income	-20	-25	-30	-35
RSG	-91	-95	-98	-102
Net Property income	-10,832	-10,847	-10,456	-10,828
Investment Income	-1,838	-1,838	-1,838	-1,838
	-29,707	**-28,305**	**-27,098**	**-26,155**
Spending				
Previous years budget	24,155	25,339	26,773	27,324
In year growth bids	200	200	200	200
Inflation				
Fees and Charges	0	-328	-336	-344
Pay	0	713	612	627
Suppliers	0	772	788	805
Lapsed Growth and Savings Bids	0	-534	-459	-6
Triennial pensions impact	544	61	45	50
Leisure Centre funding	0	750	0	0
IFRS 16 - Accounting for leases	-72	0	0	0
Additional support from reserves to Cost of	-200	0	0	0
Short fall in income - COVID	-100	-200	-300	0
SLM	-300	0	0	0
Lost Taxi fees	50	0	0	0
Lost Car park fees	500	0	0	0
Additional energy costs SLM	126	0	0	0
Growth bids	868	0	0	0
Savings bids	-432	0	0	0
	25,339	26,773	27,324	28,655
Revenue contribution to capital	750	750	750	750
NI increases	-131	0	0	0
Difference on aggregate MRP and Interest	4323	4323	4323	4323
Cashable savings				
Procurement	-25	-50	-50	-75
Costs	-25	-50	-50	-75
Business Improvements	-25	-50	-50	-75
Green Initiatives	-25	-50	-50	-75
Leisure Centre	0	750	0	0
Revised budget	30,181	32,396	32,197	33,428
Collection fund deficit	100	100	180	180
Key issues				
CT arrears	0	0	0	0
NNDR arrears	0	0	0	0
Cost of Living Reserve	0	0	0	0
	30,281	**32,496**	**32,377**	**33,608**
Initial (positive)/negative imbalance before action	574	4,191	5,279	7,453
Opening budget (surplus)/deficit	0	574	4,191	5,279
In year movements (favourable)/adverse	574	3,617	1,088	2,174
Closing budget (surplus)/deficit	574	4,191	5,279	7,453

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Corporate Policy & Resources Committee

16 January 2023

Title	**Capital & Revenue Reserves Strategy** **This report is subject to the final decisions made by the Committee between mid-January and 20 February around finalising the 2023/24 budget and 2022/23 Outturn Report and therefore may be subject to further change.**
Purpose of the report	To note
Report Author	**Paul Taylor Chief Accountant**
Ward(s) Affected	All Wards
Exempt	No
Corporate Priority	Community Affordable Housing Recovery Environment Service Delivery
Recommendations	**Committee is asked to note:** • That by successfully implementing a prudent approach to developing its Sinking Funds, Spelthorne Borough Council has the highest ratio of usable (cash backed) revenue reserves to Net Revenue Expenditure (NRE) of any district or borough Council in England. • That subject to Council approval, the Outline Budget analysis indicate that Council will require net funding of £6,519,900 from the Rent Equalisation Reserve (sinking funds) – (RER) in 2023/24 and £3,125,300 in 2024/25 From 2025/26 the five year planning cycle currently indicated that the Council would return to making net contributions to the RER. • That based on the Medium Term Financial Strategy (MTFS) Council must look to bridge the £1.25m per annum net contribution deficit from Knowle Green Estates caused by the height restrictions, and adverse movements in interest rates & building cost inflation. • The forecast projections for the reserves from 2022/23 to 2024/25, as set out in appendix D below.
Reason for Recommendation	**Effective and sustainable use of reserves is a key element of the Council's Medium Term Financial Strategy**

1. Executive Summary

1.1 The Council's Earmarked Revenue Reserves have been assigned by Council and can only be used for the purpose they were intended, for example, it is not possible to use the Sinking Fund Reserves to fund an FTE role within the Council.

1.2 **Investment Property Sinking Funds**

(a) Council have been advised of a challenging two years ahead for the Sinking Funds based on the five year planning cycle, which was why Council approved a £2.5m one off payment into the Sinking Funds as part of the 2021/22 Outturn Report.

(b) The Ukraine War has impacted on our Sinking Funds by just over £4.1m over 2022/23 and 2023/24 and when combined with a couple of tenant issues, Officers are forecasting a net funding situation of up to £10m from the Sinking Fund between 2023/24 and 2024/25.

(c) From 2025/26 onwards the Council will be making net contributions into the Sinking Funds.

1.3 The current depressed property market makes it extremely difficult for Council to consider selling its assets, as any shortfall between the purchase price and sale price would crystallise a loss that would negatively impact on the revenue budget, and Council's General Fund & Earmarked Revenue Reserves.

1.4 The reduction in height, adverse interest rate movements and increased constructions costs has resulted in Knowle Green Estates Ltd (KGE) business model changing dramatically, so much so, that they will not be able to contribute a net £1.25m per annum to the Council (for the next 50 years) and if this contribution gap is not covered off, it will have an adverse impact on our ERR, as Council will have to cover the shortfall, which in turn, will cause significant issues for our MTFS and long term future viability.

2. Key issues

2.1 The last eight years have seen a strong performance from Council's investment property portfolio, which has allowed the Council to grow its Sinking Fund Reserve to over £33m

2.2 As part of the 2021/22 Outturn report, Council agreed to invest part of the surplus for the year as a one off payment of just over £2.5m into the Sinking Fund Reserves.

2.3 This was based upon Officers' recommendations, as the five year planning cycle was indicating that due to external factors:

(a) The war in Ukraine, there was going to be a rental shortfall at one of the Council's investment properties, because of the Government's compounding of certain Russian Oligarch's UK based assets. In turn, the Assets Team believe that because the building will be vacant, this would be the perfect time to upgrade the property and maintain it to its optimum specification for reletting on medium to long term leases, to maximise rental returns for the Council. The lost rental income and capital expenditure would amount to approximately £4.0m up to 31 March 2024.

(b) Further, there were also some challenging times ahead for tenants at another property, which could impact on 2023/24, after the Holding Company guarantee has been received, anticipated in February/March

2023. Discussions are still ongoing regarding how the property will be relet. In the 2023/24 Budget setting process, and based on the latest information, Officers are forecasting that the property will be relet, and this has been reflected in the 2023/24 Draft Budget (This is subject to final Council approval being received for the proposals).

(c) In October 2022, Council asked Officers to allocate a further £200,000 to support the existing £362,000 set aside by Council for the Cost of Living Reserve, as part of the 2021/22 Outturn report.

2.4 Sinking Fund Policy, this was presented and discussed by Corporate Policy and Resources Committee at their meeting on 28 November and based on the Committee's feedback, will be represented at their meeting on 20 February.

2.5 The purpose of the Sinking Fund is to essentially smooth out and short fall in investment rental income or unexpected costs, caused by external factors.

2.6 In relation to the Council's borrowing of in excess of £1billion (the majority of which currently relates to funding of past acquisitions of investment assets), the current level of Sinking Fund Reserves would be sufficient to cover just over 10 months of loan repayments and the next two years between 2023/24 and 2024/25 will be challenging according to the five year forecasts that supports the Medium Term Finance Strategy (MTFS).

2.7 The Council's approved Earmarked Revenue Reserves (ERR) were £62.3m at 31 March 2022 (31 March 2021: £53.9m). Noting that as advised in last year's report, a further £26.9m, relating to COVID-19 support Government Grants was received before 31 March 2022, that were paid out to business and individuals after 1 April 2022 and therefore, it had artificially inflated the Council's official ERR at the year end. The ERR quoted in this report have had these COVID-19 Grants removed to enable direct comparison.

2.8 This indicates that on a like for like basis, the Council's ERR grew by £8.4m from 2020-21 to 2021-22.

2.9 Approved ERR can only be utilised for the purposes they were established for, for example, revenue grants unapplied, relates to monies received from Central Government and other third parties that must be spent on a specific project, usually with a deadline and after the deadline any unapplied grants for that purpose are returned to the provider and cannot be used, for example, to fund a new FTE post.

2.10 A strong performance from Council's investment property strategy over the last five years, which has generated over £10m per annum to support Council services and assist with the regeneration of communities, is only part of the good news story. Whilst the Council has been put into a strong position, there is no room from complacency over the next five years and Council still needs to have a strong and clear medium term reserves strategy, together with regular monitoring of Council's reserves, as without one, Spelthorne Borough Council could potentially see its reserves, reduce to critical levels in a relatively short number of years, based on the current MTFS projections.

2.11 This is further compounded by a £1.25m reduction in Medium Term Financial Strategy (MTFS) forecast Council income from its subsidiary Knowle Green Estates LTD (KGE), caused by delays in obtaining planning permission, planned height restrictions, rising interest rates and building materials and labour inflation. Without any plans to replace this lost income, Council will have to face up to some extremely difficult decisions around what essential services to cut, reduce or mothball.

2.12 The current market conditions make it difficult to sell the development assets without it adversely impacting on the residents of the Borough, and Officers and the External Auditors are at a critical point, in respect of the development costs that have been capitalised, because any further delays in finalising our development properties, could see an additional £3m added to the budget deficit for 2023/24.

2.13 Officers currently have sufficient cash back reserves to manage the Council's affairs and therefore the Council is a going concern. However, a reuse of reserves, or a large call on our reserves, would cause grave concern for Officers and Council's ability to remain a going concern.

3. Background

3.1 To assist Councillors, there are three appendices attached to the report that cover:

(a) Appendix A - an introduction to reserves.

(b) Appendix B – the background and purpose to Spelthorne Borough Council's reserves

(c) Appendix C – the management of Council's reserves

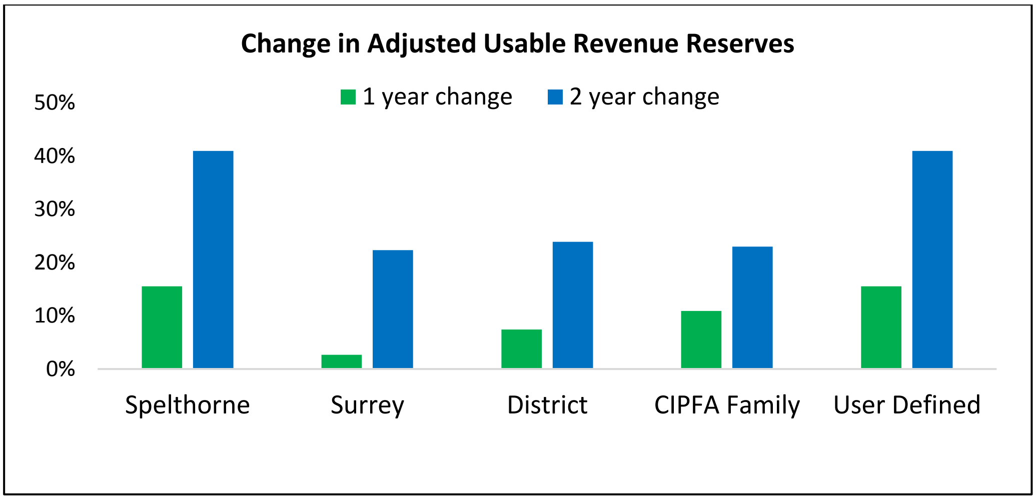
3.2 All figures and charts in this report have been independently prepared by LG Futures as part of their annual benchmarking report.

3.3 Usable Revenue Reserves - 2021/22: Spelthorne

Usable Revenue Reserves at Spelthorne, taken from the annual statement of accounts. The figures for 2020/21 and 2021/22 have been adjusted to reflect the COVID business rates relief funding held in reserves at the end of 2020/21 and 2021/22 (information is taken from national NNDR3 data).

	2017/18	**2018/19**	**2019/20**	**2020/21**	**2021/22**
General Fund Balance	1,000	1,000	1,221	1,352	2,176
Earmarked Reserves	17,802	23,053	43,006	60,364	63,372
Usable Revenue Reserves	18,802	24,053	44,227	61,716	65,548
less s31 grants in 20/21 and 21/22 (RHL and Nursery)				-7,768	-3,213
				£53,948m	£62,335m

3.4

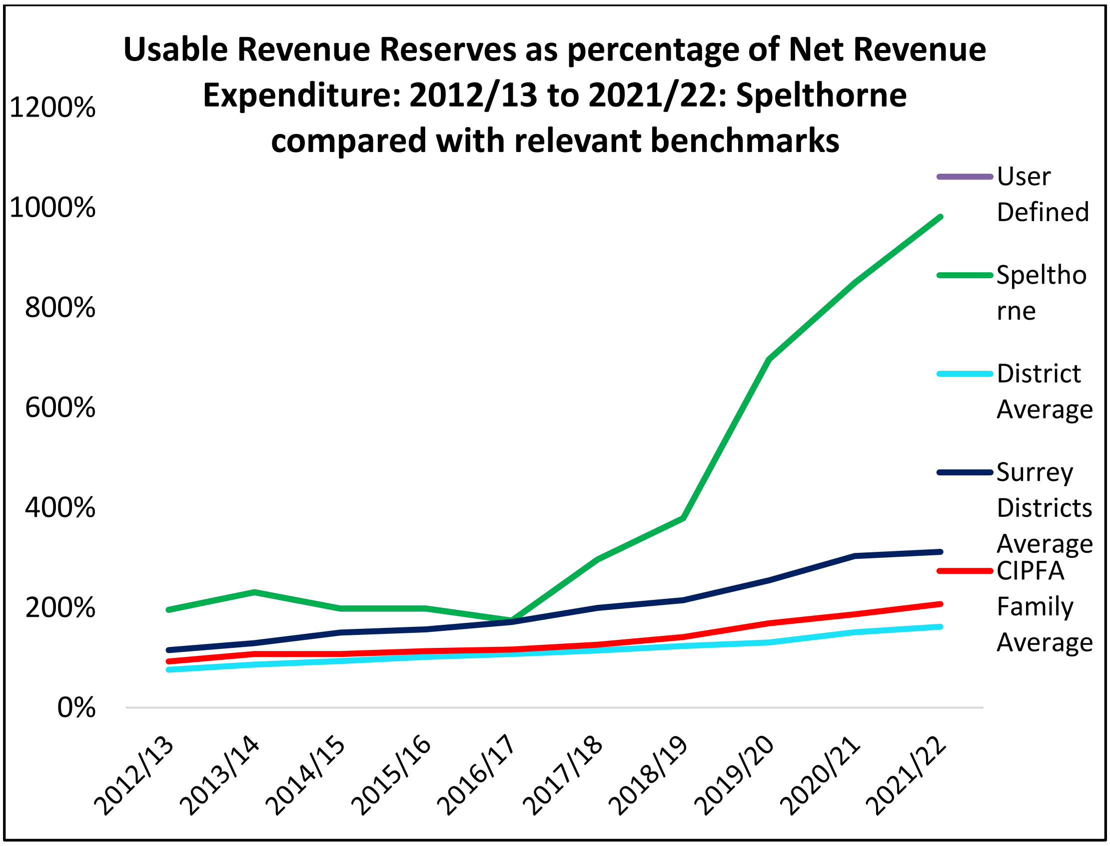


(CIPFA Family – this is a basket of the Districts and Boroughs in England who have borrowed similar amounts to Spelthorne, and forms part of the benchmarking analysis, Officers advised last year, was going to be provided to Council for reference and comparison purposes).

(The user defined bar is Spelthorne and was added by LGFutrues for control purposes).

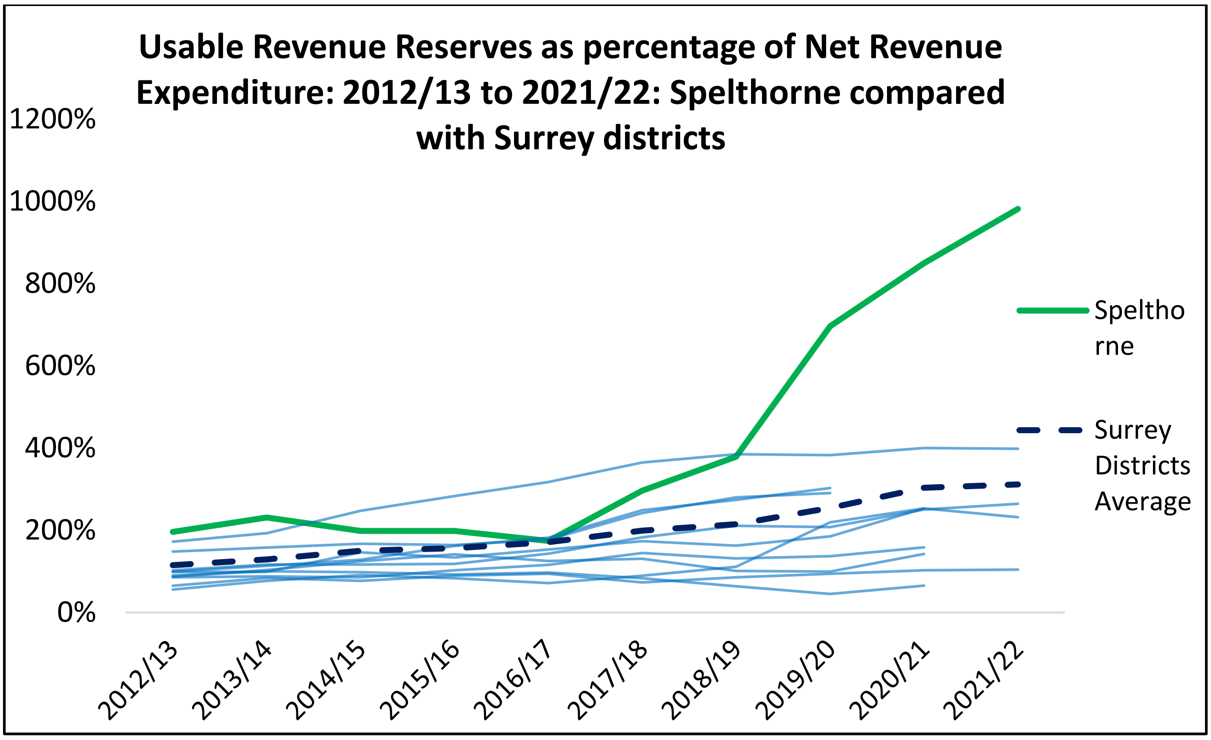
3.5 As can be seen from the above chart, the Investment Portfolio has provided the Council with strong cash backed reserves over the last eight years, and with the Council approved £2.5m used to top up the Sinking Fund in the 2021/22 Outturn Report, has provided additional support, as we enter some challenging times ahead.

3.6



3.7 The chart above shows the comparison between Spelthorne, other Surrey Districts and Boroughs and the CIPFA Family average, over the period 2012/13 to 2021/22. This highlights the prudent approach taken by the Council of providing annual cash backed deposits into our Sinking funds and demonstrates, why the Council is less susceptible to going concerns issues, that have befallen other Council's across the country.

3.8



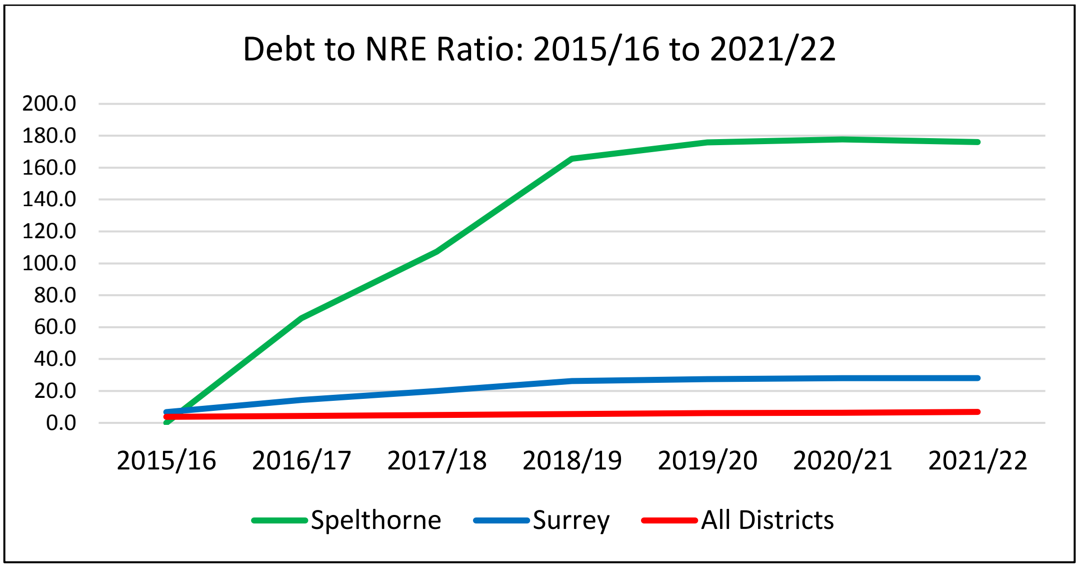
3.9 The chart above shows the comparison between Spelthorne, other Surrey Districts and Boroughs, over the period 2012/13 to 2021/22. This highlights the prudent approach taken by the Council of providing annual cash backed deposits into our Sinking Funds and demonstrates, the Council sound judgement that has set it apart from other similar Council's in the Surrey District.

3.10 **Debt compared to Net Relevant Earnings (NRE)**

3.11 The level of reserves built up over the last eight years has provided a strong cash backed reserves situation for the Council.

3.12 A major risk to the Council is the level of gearing, this is the percentage of aggregate debt to aggregate reserves, and with borrowings exceeding £1bn and reserves of £63m, the Council is highly geared and susceptible to long run market challenges. Over the long term the investment assets debt (the interest rates on which are wholly fixed) will be paid down on a year by year basis, however we have in our programme a further £250m of funding requirement for residential schemes.

3.13



3.14 The chart highlights that the Council has the largest ratio of debt to net relevant earnings of all the district and boroughs in England, and explains why, the Council is being scrutinised.

3.15 This also highlights why Council must focus on increasing its cash backed reserves to protect residents over the coming 15 years, when the trend in borrowing will be downward, resulting in a decrease in the debt to NRE ratio above.

4. Risks

4.1 Many Councillors will have heard of some of the issues facing other Councils in respect of their failure to make adequate provision for Minimum Revenue Provision (MRP). At Spelthorne Borough Council Officers took a prudent approach and ensured that as part of the annual Budget recommendation to Council, that a full provision for MRP, including on investment assets, is charged to revenue expenditure, and as a result, the Council's finances and reserves are not adversely impacted by this issue. The MRP is then applied annually to ensure the Council gradually pay down the debt on a year-by-year basis,.

4.2 Throughout the year, officers in the Finance team, regularly attend external meetings and presentations with the Council's Treasury Management Advisers, Central Government, Local Government Association, Chartered Institute of Public Finance and Accountancy (CIPFA) and LGImprove who benchmark and provide feedback on the Spelthorne Borough Council's performance against other Councils. This benchmarking has highlighted that Spelthorne Borough Council, as part of its risk mitigation strategy for its investment assets, still has the highest ratio of usable revenue reserves to Net Revenue Expenditure (NRE) of any district or borough Council in England.

4.3 Whilst this is good news, and as mentioned above, the Council needs to assess this alongside the aggregate loan liabilities of more than £1bn, making the Council highly geared and vulnerable to fluctuations in the day-to-day course of business, hence why the Council needs to continue to build its earmarked reserves (sinking funds).

4.4 The Council's approved Revenue Reserves, including the Sinking Funds reserves are earmarked and set aside for specific purposes and cannot be used for any other purpose.

4.5 One of the key messages received is that because of a prudent approach by Council over the last few years, it has been possible to grow and build resilience into the useable reserves, which has allowed the Council to generate additional interest income to support the delivery of services and the regeneration programme.

4.6 This is a positive situation. Council can be assured that it is meeting its Value for Money requirement for the external audit review of its arrangements, it is striking a sensible balance between providing support for services (today) and protecting the future (tomorrow) by ensuring that sufficient funds are put away into earmarked reserves for specific future use.

4.7 The next item on the agenda is property valuations, and as Councillors are aware the property market is experiencing short term valuation fluctuations, both upward and downward, because of initially the COVID- 19 pandemic, and now the cost of Living crisis, which means that the Council must take a medium to long term view on its property portfolio, particularly as the current Capital Strategy highlights that the Council has no intention to sell any of the property portfolio, to third parties. (Noting that the Council will transfer residential properties to Knowle Green Estates Ltd., a wholly owned subsidiary at cost).

4.8 The results of the COVID-19 pandemic and the Cost of Living crisis is influencing valuations in several ways:

(a) Tenants financial standing may have changed, positively in the case of IT sector, negatively in others, such as hospitality.

(b) Tenants rightsizing as hybrid working means they no longer require large office premises

(c) Business failures

(d) Incentives provided to new tenants

(e) Approved changes in leases

(f) Uncertainty about the future

4.9 At the 31 March 2022, the Council's property portfolio reduced in value by £23.3m. (31 March 2021: £51m). This represents a paper loss and based on the upward trend in commercial investment properties experienced over the last 300 years, Officers expect to see this upward trend return over the next five to ten years and reverse these short-term paper losses to overall paper gains.

4.10 As well as impacting on the valuation figures, the pandemic and now the Cost of Living Crisis will continue to impact on Council's services, over the next few years, as highlighted during the budget briefing session with Councillors in June and November 2022, the Council is not 'out of the woods' yet and is facing challenges over the next four years around:

(a) Shortage of both labour and materials for the approved capital projects.

(b) Reduced fees and charges, including car parks.

(c) Reduced funding from Business Rates.

(d) Uncertainty due to new COVID-19 variants.

(e) Reduced income from KGE.

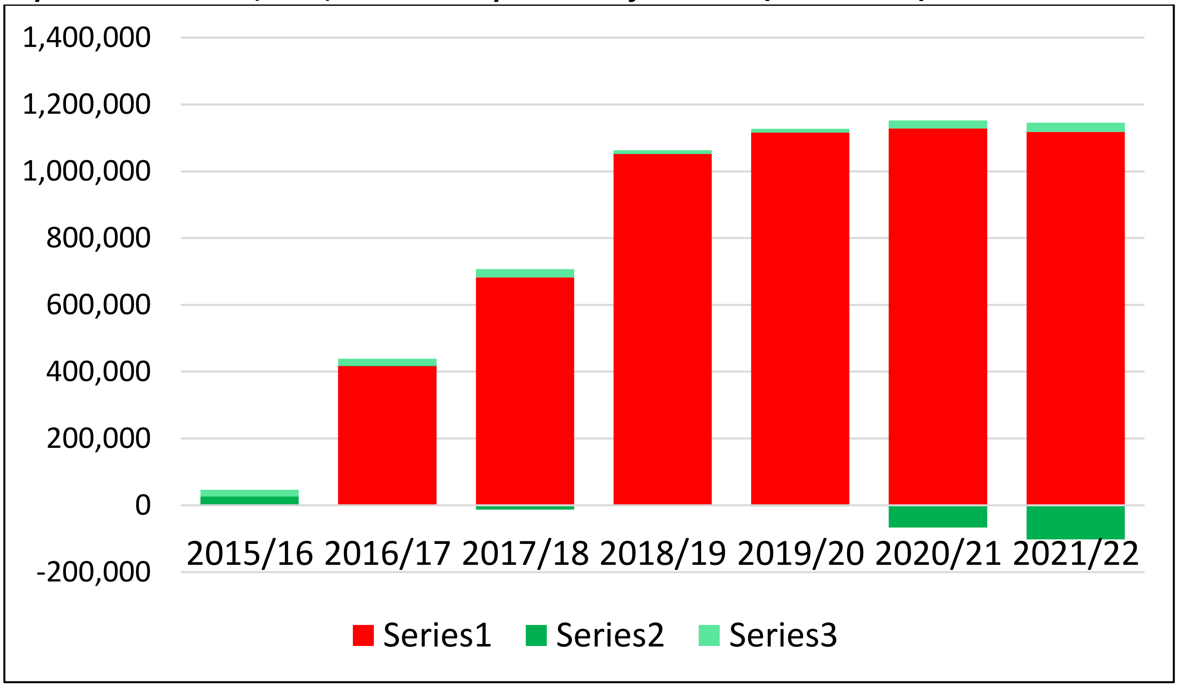
4.11 During 2022, the Council was subject to a Public Interest Report from KPMG and additional scrutiny from the Department for Levelling Up, Housing & Communities (DLUHC), and as can be seen from the benchmarking charts above, Spelthorne Borough Council, is in a much stronger position to deal with any short term fluctuations and maintain a strong going concern model.

4.12 The next area for officers to monitor closely is the Capital Finance Requirement (CFR) because of the aggregate value of the Council's borrowings to the aggregate value of its property portfolio

4.13 The CFR is a measure of the Council's financial health, as shown in the table below which is graphical shown in chart below

£000s	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
Capital Fin. Requirement	0	416,250	681,984	1,051,121	1,116,100	1,128,532	1,117,687
Capital Adjustment Acc.	26,897	2,377	-12,617	871	-2,857	-66,226	-101,825
Revaluation Reserve	20,094	20,538	25,054	10,698	10,754	24,005	27,851
Balance Sheet Capital Assets	46,991	439,165	694,421	1,062,690	1,123,997	1,086,311	1,043,713

Capital Health: CFR, CAA, and RR at Spelthorne from 2015/16 to 2021/22 in £000s



Series 1 = Capital Fin. Requirement
Series 2 = Capital Adjustment Acc.
Series 3 = Revaluation Reserve

4.14 The CFR shows that in 2022/23, because of the paper losses on the property portfolio, the total funding is 107% of the Council's total assets and officers will need to monitor this variable carefully over the next two to ten years and advise Council accordingly.

4.15 What the impact of 107% CFR means is that book value of the Council's properties are lower than the aggregate of the Council's total borrowings and if all the properties were to be sold and achieved the valuations quoted, Council will have an excess of borrowing to repay, therefore it is an important variable to monitor.

4.16 The reality is that Spelthorne Borough Council would be unlikely to sell all its investment properties in one year, going for a planned disposal rather than a forced sale. (The Capital Strategy for 2023/2028 will deal with this in more detail).

4.17 As indicated in the past, the Council is in this for the long term and whilst the net rental income contributions continue to be maintained, the Council will be able to prudently manage its finances over the coming years and at present, Council is on track to deliver its long-term strategy for reserves and sinking funds

4.18 The 2023/24 budget modelling is showing that the net rental income is anticipated to fall by approximately £10m and additional costs of £5m will be incurred, noting the £4m relates to the conflict in the Ukraine war.

4.19 The rent guarantee period negotiated when the Council acquired the Thames Tower, Porter and Charter buildings came to an end in September 2022, and this has had an impact on the forecast revenue, which is one of the main factors in the internal reorganisation, that see the Assets Team responsible for the budgets on rental income and landlord costs, passing the remaining cost responsibility over to the Finance Team, which will enable the Assets Team to put their time into seeking new tenants rather than administration duties.

4.20 Again, the Council cannot take everything for granted following the pandemic and the Cost Of Living Crisis is forecast to put even more financial pressures on businesses, which could lead to an increase in company liquidations and because of this challenge, officers recommend a cautious approach on the use of Council reserves through the next twenty-four months to enable the Council to see clearly the revised financial landscape.

4.21 **Knowle Green Estates Ltd. (KGE),** the Council, as sole shareholder is responsible for agreeing the strategy, which is stalling slightly, due to the imposed hight restrictions, rising interest rates, and building cost inflation

4.22 The current plan was to provide a significant number of affordable and keyworker rental housing, to support the current funding strategy and a notional equity investment £1 and the rest in loan finance, rather than a substantial equity investment and smaller loans, which would reduce the useable earmarked reserves, was actioned.

4.23 Should Council consider changing the balance of units to include Private Rental residential units, the funding model would change significantly, due to having to consider Commercial issues around both State Aid and HMRC Thin Capitalisation Rules (transfer pricing constraints) and therefore this would require a substantial equity investment of several million pounds, to enable KGE to meets its debts as the fall due in the normal course of business.

(Noting that an investment of this type would require the Council to physically transfer the funds in return for equity share capital).

4.24 Based upon the projections prepared for Cabinet and Council in February and March 2021, indications were that KGE could contribute up to £100m towards funding Council services, over the next 50 years.

4.25 Subject to any further planning delays on developing Oast House and Thameside projects in particular, the projections indicated that cash outflows to the Council would be small (tens of thousand) in the first five years and once all the properties had been handed over at 31 March 2026, the cash outflows would rise considerably (hundreds of thousand) each year thereafter. This would be subject to an updated financial strategy.

4.26 Noting that due to the current delays on obtaining planning permission on some of these development properties earmarked for KGE, not only is the Council incurring additional monthly costs of £170k, but it could also reduce the positive aggregate projected cashflow by over 25% and delay the occupancy by between 2 and 5 years, i.e., between 2027/28 and 2030/31.

4.27 This could exasperate the short-term challenges in funding highlighted in the 2023/24 Budget Briefing given to Councillors in June & November 2022, to support services across the Borough, which could lead to increased Council tax, reduced services, redundancies, or a mix of all these options, particularly as the number of apartments to be built has been reduced, from the 663 originally planned for.

4.28 Climate change is another area that is going to create a challenge for the Council, as it explores how to reduce its carbon footprint, it is on track to spend an extra £4m, to be the first Council fully mixed dry and wet leisure centre to be fully compliant with Pasivhaus standards, another first for Spelthorne Borough Council and the UK.

4.29 The successful development of the West Wing at the Council's Knowle Green offices, where an additional 25 new apartments have been made available for key workers, young families, families from the Council's housing lists and some physically impaired residents of the Borough, has provided the Council with the option of moving premises and redeveloping the remaining two wings and generating much needed capital receipts to fund the Council's Capital Programme.

4.30 The final item is that as shown in appendix D – forecast useable reserves to 2024/25, in particular the revenue element, are all approved earmarked reserves, meaning as shown in Appendix A 1.4(b) that these are Council approved reserves, set aside for a specific purpose, i.e., there are currently no unallocated funds for Council to utilise to fund any budget gaps in 2023/24.

4.31 These represent the main challenges and items for Council when considering the reserves and sinking fund strategy for 2023/24 and beyond.

5. Options analysis and proposal

5.1 Officers considered a wide range of proposals for the utilisation of the Council's reserves, and considering the challenges and issues highlighted in section 3 above:

(a) Limited bench marking of like for like Councils

(b) Short term paper fluctuations in property valuations

(c) Higher than expected borrowing to property valuations ratios in the short term

(d) Financial pressure on local businesses due to the continued pandemic and the impact on the Council's rental properties

(e) The requirement for a clear Council led financial strategy for KGE

(f) Apart from the General Fund balance, all revenue reserves are earmarked and cannot be used for any other purpose.

(g) COVID-19

(h) Cost of Living Crisis

(i) Height restrictions placed on the Council's development, which has reduced the income available for KGE by £2m per annum to make available to the Council and the impact on services, and a reductions to the Council's affordable housing and regeneration programme.

5.2 Officers are recommending that Council continue with the current strategy for reserves and sinking funds as shown in the 2023/24 budget.

6. Financial implications

6.1 Appendix D shows the earmarked revenue position: actual as at 31 March 2022; and the forecast position for the three years to 31 March 2025, subject to any changes made during the budgeting process for 2023/24 and 2022/23 Outturn, as approved by Council.

6.2 This indicates that the Council's Earmarked Reserves will reduce by £12.2m by 31 March 2025, noting as mentioned in 2..2 above, Council approved an additional contribution of £2.5m to earmarked reserves, to cover the known challenges that were going to impact on the Council's finances, from Officer's five year financial planning modelling, which means that the real impact on the Council is £9.7m (£11.6m less £2.5m).

6.3 The net impact of £9.7m is broadly made up as follows:

(a) £4.1m due to external uncontrollable factors, the war in Ukraine, as mentioned above

(b) £3.16m due to commercial trading challenges with existing tenants.

(c) £2.5m is due to the year to year movement in Reserves, for example, as we receive or utilise more Contributions from Developments, or in terms of the Green Initiative Fund, pay for an FTE, all of which will be Council approved.

6.4 Please note that the above figures are subject to Council approval of the 2022/23 Outturn report and any recommendations for dealing with any surplus or deficit at the year end and 2023/24 Budget, which is due for approval at the February 2023 Council meeting

6.5 Subject to the finalisation of the 2023/24 Budget Setting process, Council are looking to utilise the earmarked reserves as follows:

(a) £564k to be reallocated to the Cost of Living Reserve.

(b) £103k from the Retained Business Rates (NNDR) Reserve to fund the extension of two temporary posts (Revenue) within the Economic Development Team

(c) £400k from the International Financial Reporting Standard (IFRS) 16 Reserve.

6.6 The Council will implement the new Sinking Fund Policy once approved in February 2023 at the Corporate Policy & Resources meeting.

6.7 The Outline Budget workings indicate that there will be a need to utilise the rent equalisation reserves (sinking funds) for 2023/24 and 2024/25. With the MTFS indicating that from 2025/26 the Council will return to making contributions towards the Rent Equalisation Reserves (sinking funds).

6.8 Once the Sinking Fund Policy has been approved, Officer will revisit the planning for the next five, ten, twenty and fifty year planning horizon and report back to Council in the autumn.

7. Other considerations

7.1 Included in section 2 above.

8. Procurement considerations

8.1 There are none

9. Legal considerations

9.1 There are none

10. Risk considerations

10.1 Addressed in section 3 of the report.

11. Equality and Diversity

11.1 There are none

12. Sustainability/Climate Change Implications

12.1 Included in 2023/24 budget setting proposals.

13. Timetable for implementation

13.1 Implemented as part of the 2023/24 budget setting process.

13.2 Review of sinking funds for the five years to 2028/29 to be carried out as part of the 2023/24 budget setting cycle.

Background papers:
Outline Budget Report 2023/24 and the MTFS Forecasts

Appendices:
Appendix A – Introduction to reserves
Appendix B – Background and purpose to Spelthorne Borough Council's reserves.
Appendix C – Management of Reserves
Appendix D – Earmarked Revenue Reserves (ERR) at 31 March 2022 (Actual) and 2023, 2024 and 2025 (Forecast)

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The forecast below is subject to the following:
2023/24 Budget (February 2023)
2022/23 Outurn Report (May 2023)

Appendix D

Earmarked Reserves £000s	**2021/22 Actual**	**2022/23 Forecast**	**2023/24 Forecast**	**2024/25 Forecast**
Revenue Grants Unapplied	3,688	3,288	2,888	2,488
Capital Fund	1,443	943	343	843
Social Housing and Initiatives	2,136	2,136	2,136	2,136
NSF Revenue	1,221	1,221	1,221	1,221
Rent Equalisation Reserve	37,003	37,003	30,483	27,358
Asset Improvement Reserve	1,814	1,664	1,664	1,664
Interest Equalisation Reserve	493	493	493	243
Environmental Impact Reserve	163	163	163	163
Business Rates Equalisation Reserve	6,057	5,925	5,793	5,661
Contribution from Developers	8,798	8,298	8,498	8,198
Youth Council	20	20	20	20
Cost of Living	362	562	0	0
Green Initiative fund		201	151	101
General Fund	2,176	2,176	2,176	2,176
Reserves per balance sheet at 31 March 2022	65,375	64,094	56,030	52,273

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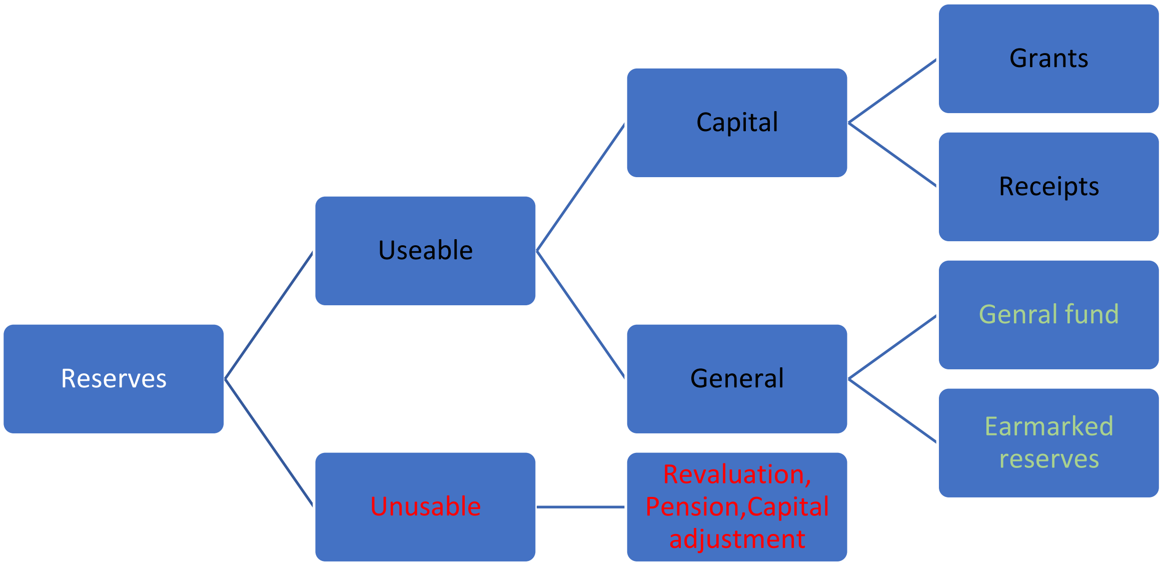
Appendix A – 2023/24 Capital & Revenue Reserves Report – definitions

1. Overview, background, strategic context, purpose and management

1.1 The Council manage its money by dividing it between two types of reserves - useable reserves and unusable reserves (an explanation of these terms can be found below).

1.2 Managing our money in this way means that we can budget successfully for what we need to deliver services now whilst building up funds that will grow over time for a specific purpose or to protect services in the future.

1.3 The chart and explanations below illustrate how those reserves are split.



1.4 **Useable reserves**: This is money that each council has set aside to provide services such as rubbish collection and for its day to day running. Useable reserves are made up of two further pots known as the 'general fund' and 'capital reserves'. These two useable reserves are in turn made up of other pots of money.

(a) **General Fund balance**: This is a contingency fund - money set aside for emergencies or to cover any unexpected costs that may occur during the year, such as unexpected repairs.

(b) **Earmarked reserves**: This is money that has been set aside by Council for a particular purpose, such as buying or repairing equipment or the maintenance of public parks or buildings or equalising over time a particular income stream.

(c) **Capital receipts**: This is the name given to the income received when assets are sold (such as land or buildings) in Spelthorne BC, these receipts will include the monies received from KGE. Capital receipts can only be used to buy or fund capital expenditure. Capital expenditure is the money spent on buying assets that have a lasting value. These assets could be land, buildings or large pieces of equipment such as refuse vehicles.

Appendix A – 2023/24 Capital & Revenue Reserves Report – definitions

(d) **Capital grants:** Capital grants are sums of money given to councils by the government. This money can only be used as capital expenditure, in other words this money can only be used to buy assets of lasting value.

1.5 **Unusable reserves:** The unusable reserves contain funds that cannot be used to provide services or used for day to day running costs. These reserves are required by the accounting and statutory regulations the Council follows and enable proper accounting practice to be applied and then reversed out to ensure no impact on council tax bottom line. The unusable reserves hold funds that have 'unrealised gains or losses'. This means that we have assets such as buildings whose value changes over time. There may also be commitments linked to these assets such as loans or maintenance needs. The funds held in the unusable reserves fund can only be unlocked and turned into usable money if the assets are sold.

1.6 Reserves play an important part in the Council's medium-term financial strategy and are held to create long-term budgetary stability. They enable the Council to manage change without undue impact on the Council Tax and are a key element of its strong financial standing and resilience.

1.7 The Council holds reserves to mitigate future risks, such as increased demand and costs; to help absorb the costs of future liabilities; and to enable the Council to resource policy developments and initiatives without a disruptive impact on Council Tax.

1.8 Capital reserves play a crucial role in funding the Council's Capital Strategy. The Capital Receipts Reserve are used to create capacity to meet future capital investment.

1.9 The Council relies on interest earned through holding reserves to support its general revenue spending plans.

1.10 Reserves are one-off money. The Council aims to avoid using reserves to meet ongoing financial commitments other than as part of a sustainable budget plan.

1.11 The Council has to balance the opportunity cost of holding reserves in terms of Council Tax against the importance of interest earning and long-term future planning.

Appendix B – Background and Purpose to Spelthorne Borough Council's Reserves

1.1 **Background**

(a) Sections 32 and 43 of the Local Government Finance Act 1992 require local authorities to consider the level of reserves when setting a Budget Requirement. Section 25 of the Local Government Act 2003 requires the Chief Financial Officer (Section 151 Officer) to report formally on the adequacy of proposed reserves when setting the Budget Requirement each February.

(b) Reserves are an important part of the Council's financial strategy and are held to create long-term budgetary stability. They enable the Council to manage change without undue impact on the Council Tax and are a key element of its strong financial standing and resilience. The Chartered Institute of Public Finance and Accountancy (CIPFA) monitors trends in movements in reserves as part of its Resilience Index. In recent years the Council has been steadily increasing the level of its reserves, particularly its Sinking Funds. The Council's key sources of funding face an uncertain future and the Council therefore holds earmarked reserves and a working balance in order to mitigate future financial risks.

(c) Earmarked reserves are reviewed annually as part of the budget process, to determine whether the original purpose for the creation of the reserve still exists and whether the reserves should be released in full or in part. Particular attention is paid in the annual review to those reserves whose balances have not moved over a three-year period.

(d) The Council's overall approach to reserves will be defined by the system of internal control. The system of internal control is set out, and its effectiveness reviewed, in the Annual Governance Statement. Key elements of the internal control environment are objective setting and monitoring, policy and decision-making, compliance with statute and procedure rules, risk management, achieving value for money, financial management and performance management.

(e) The Council currently maintains:

i) · a General Fund general reserve.

ii) · various earmarked general reserves.

iii) - a Capital Grants reserve; and

iv) · a Capital Receipts reserve.

(f) Additionally, the Council is required to maintain unusable reserves to comply with accounting requirements although, as the term suggests, these reserves are not available to fund expenditure.

(g) The level of the general reserve is a matter for the Council to determine having had regard to the advice of the Chief Finance (S151) Officer. The level of the reserve will be a matter of judgement which will take account of the specific risks identified through the various corporate processes. It will also take account of the extent to which specific risks are supported through earmarked reserves.

(h) In principle, only the income derived from the investment of reserve funds should be available to support recurring spending.

1.2 **Purpose**

1.3 Reserves are therefore held for the following purposes, some of which may overlap and include:

(a) Providing a working balance i.e. the General Fund general reserves.

(b) Smoothing the impact of uneven expenditure profiles between years e.g. local elections, structural building maintenance and carrying forward expenditure between years.

(c) Holding funds for future spending plans e.g. Capital Expenditure Reserve, and for the renewal of operational assets e.g. repairs and renewal, and Information Technology renewal.

(d) Meeting future costs and liabilities where an accounting 'provision' cannot be justified.

(e) Meeting future costs and liabilities to cushion the effect on services e.g. The Insurance Reserve for self-funded liabilities arising from insurance claims.

(f) To provide resilience against future risks.

(g) To create policy capacity in a context of forecast declining future external resources e.g. COVID-19 Resilience Reserve

1.4 All earmarked reserves are held for a specific purpose. This, together with a summary on the movement on each reserve, is published annually, to accompany the annual Statement of Accounts.

1.5 The use of some reserves is limited by regulation e.g. the Collection Fund balance must be set against Council Tax levels

1.6 As part of the Annual Budget, Treasury Management Strategy and the Capital Strategy setting process, Officers will review the reserves and apply reserves as part of the Capital Financing Requirement (CFR), typically, using Capital Receipts, Capital Grants or contributions from revenue in the first instance. (The CFR is the amount of capital expenditure that has not yet been financed by capital receipts, capital grants or contributions from revenue)

Appendix C – Management of reserves

1.1 All reserves are reviewed as part of the budget preparation, financial management and closing processes. The Council will consider a report from the S151 Officer on the adequacy of the reserves in the annual budget-setting process. The report will contain estimates of reserves where necessary. The Cabinet will consider actual reserves when approving the statement of accounts each year.

1.2 The following matters apply to our major useable reserves as restated:

(a) The General Fund working balance will not fall below £2.176 million without the approval of The Council.

(b) The Asset Improvement Reserve is applied to meet future costs of improving or maintaining our properties.

(c) The Rent Equalisation Reserve (Sinking Funds) is available to cover rent free periods, capital and revenue incentives for incoming tenants, voids, defaults and refurbishment at the end of each lease.

(d) The Business Rates Equalisation Reserve is available to smooth out the irregularity of business rates income retained

(e) The Interest Equalisation Reserve is available to smooth out interest rate fluctuations in volatile market conditions.

(f) There are several minor reserves that are still required going forward, i.e., Youth Council and Social Housing Initiative as they are currently still required.

1.3 During the 2022/23 there were two significant matters that impacted on our earmarked reserves:

(a) IFRS 16 – on 1 April 2022, the Council adopted IFRS 16 and officers are forecasting that a one off reserve of approximately £400,000 will be created, and a further £72,000 will be made available to the reserves in 2023/24.

(b) In October 2022, Council requested that a further £200,000 be added to the Cost of Living Reserve.

Please note that in 2023/24, both these reserves were fully utilised in the budget setting process to reduce the budget deficit of £9m, as highlighted to Council in June and November 2022, during the budget briefing sessions and subsequent reports.

1.4 The Council will review the Reserves Policy on an annual basis as part of the budget setting process and from time to time may restructure its reserves to meet its future needs and plans.

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