Appendix H(i)

Budget risks and adequacy of reserves

When setting the draft budget and MTFP, Corporate Directors have provided their best estimate of their service costs and income based on the information currently available to them. However, there will always be factors outside of the Council's direct control which have the potential to vary the key planning assumptions that underpin those estimates.

There are a number of significant risks that could affect either the level of service demand (and therefore service delivery costs) or its main sources of funding. In addition, there are general economic factors, such as the level of inflation and interest rates that can impact on the net cost of services going forward. Pressures in service demand are demonstrated in children's and adults social care and home to school and special educational needs transport.

Similarly, there are opportunities to either reduce costs or increase income which will not, as yet, be fully factored into the planning assumptions. The main risks and opportunities are summarised below.

Risks

Covid-19 Pandemic

- Public health and wellbeing – both residents and staff
- Increase in service demand – especially mental health, social care, drug and alcohol misuse and domestic abuse
- Increased levels of unemployment and financial hardship, with poverty exacerbating existing inequalities
- Economic impact on Council funding
    - Decreased business rates and council tax income
    - Decreased sales, fees and charges income
    - Decreased treasury investments income due to lower interest rates

Impact of decision to leave European Union (Brexit)

- Potential workforce impact arising from direct or indirect employment of EU nationals.
- Supply chains could be affected by any changes in procurement legislation, and there are potential cost implications associated with currency fluctuations.
- The implications for pension funds are mixed as global investment vehicles have already priced in much of the uncertainty, but valuations on balance sheets and the cost of borrowing may lead to greater vulnerability.
- Commercial strategies may need to take into account the potential for any downturn in demand for properties in their investment portfolios which impact rental income and profitability.

Regulatory Risk

- **Business Rate Reset** – A proposed business rates reset by the Ministry of Housing, Communities and Local Government (MHCLG) means that the baseline level will be raised in 2022-23 to the current level of business rates.

- **Fair Funding Review** - The government has committed to reforming the way local authorities are funded. Its Fair Funding Review aimed to introduce a new funding formula from April 2021, now delayed to at least April 2022. Given the impact of the pandemic, it may bring into question whether the review will happen at all. Nevertheless, the government has said that the Fair Funding Review will: -

    - set new baseline funding allocations for local authorities;
    - deliver an up-to-date assessment of the relative needs of local authorities;
    - examine the relative resources available to local authorities;
    - focus initially on the services currently funded through the local government finance settlement;
    - be developed through close collaboration with local government to seek views on the right approach.

General Economic Factors

- Economic growth slows down or disappears
- A general reduction in debt recovery levels
- Reductions in grant and third party funding
- Reductions in the level of income generated through sales, fees and charges
- Increase in fraud

Increases in Service Demand

- Adult Social Care homecare and residential care services
- Children’s Social Care including an increase in the number of looked after children, unaccompanied asylum seekers or those with no recourse to public funds
- General demographic trends (including a rising and ageing population)
- Impact of unemployment and changes to Welfare Benefits

Efficiencies and Savings Programme

- Slippage in the expected delivery of the savings programme
- Non-delivery of savings remains a risk to the Council and will be monitored during the year

Opportunities

- Growth in local taxbase for both housing and businesses
- Service transformation and redesign including digital services
- Invest to save approach to reduce revenue costs

Adequacy of Reserves

Reviewing the level of reserves the Council holds is an important part of the budget setting process. The review must be balanced and reasonable, factoring in the current financial standing of the Council, the funding outlook into the medium term and beyond, and most importantly, the financial risk environment the Council is operating in. The assessment of reserves is based on factors recommended by the Chartered Institute of Public Finance and Accountancy (CIPFA) as set out below together with an indication of the direction of travel (up arrow represents an improved position i.e. the risk is less than it was last year).

Assumptions for inflation	↑	Inflation has been on a downward trend since its peak of 2.8% in autumn 2017 (barring the occasional seasonal fluctuation). Rates of inflation have fallen sharply during 2020 as a result of the Covid-19 pandemic due to lower indirect taxes and energy prices, as well as significant slack in the economy. Office for Budget Responsibility (OBR) forecasts are for inflation to remain below the 2% target until the end of 2024
Estimates of the level and timing of capital receipts	↓	The Council uses receipts as part of the funding for the capital programme. The Council has not applied the flexible use of capital receipts to fund revenue costs since the 2018-19 budget and does not propose to use the extension to 2021-22. Delivery of receipts against the target has fallen behind in recent years necessitating additional short-term borrowing/use of reserves. Performance in the current year has been sluggish due to the economic turbulence and although there is a reasonable pipeline of assets for disposal the risk profile for potential delays remains high.
Capacity to manage in-year budget pressures and strategy for dealing with demand and service delivery in the longer term	⟺	2020-21 has been a highly unusual year due to the Covid-19 pandemic. The pandemic has placed substantial additional spending pressures and income losses on the Council. The latest forecast is that additional un-ringfenced and specific grants are broadly sufficient to cover the impact in year for 2020-21, although forecasts do not fully reflect the impact of the second wave of infections, the additional restrictions imposed in

		November/December and the latest national lockdown. The sustained period of lockdown and subsequent restrictions have also resulted in significant in year underspends against the base budget for some services. Although the local government finance settlement is better than expected for 2021-22 it is still insufficient to fully fund additional spending growth and relies heavily on council tax increases. The Council has taken a new approach to funding demographic pressures for 2021-22 and budgets will only be adjusted as and when demand growth has actually led to additional spending, with an expectation that services will manage demand pressures more effectively. To mitigate this risk the Council's general reserves have been increased.
Strength of financial reporting and ability to activate contingency plans if planned savings cannot be achieved	↔	There continues to be a reasonable degree of confidence in the validity of financial reporting despite the uncertainties caused by the pandemic and economic turbulence. Reporting has been enhanced to include separate analysis of budget variances for business as usual activities and the impact of Covid-19. Most of the attention has focussed on capturing the Covid-19 impact although it is not always possible to completely separate out the core service and Covid-19 impacts. Some areas of spending can still be changed at short notice if required as a contingency response if planned savings cannot be achieved (or there are unexpected changes in spending). However, there is also a plan to increase general reserves as part of 2021-22 budget strategy. This is in response to heightened risks and therefore does not improve the direction of travel.
Risks inherent in any new partnerships, major outsourcing arrangements and major capital developments	↓	The Covid-19 pandemic has seen improved partnership working with NHS and districts. However, further sustained improvements are still needed to change the direction of travel. Trading conditions for Council owned companies have been incredibly challenging and earlier in the year one company suffered from a cyber breach which affected several systems. A number of outsourced contracts are due for retender and although provision for revised tender costs have been made in the budget the Council is still vulnerable to price changes due to market

		conditions. The ability to sustain the capital programme remains a significant challenge. The programme focuses on securing the Council's statutory responsibilities although there are still shortfalls in funding for some elements of the programme. The Council has recognised that increasing borrowing to unsustainable levels to fund infrastructure is not an option and this is being addressed as part of the further work to develop the council's ten-year capital strategy and programme.
Financial standing of the Authority (level of borrowing, debt outstanding, use of reserves, etc.)	⟺	The Council has included additional contributions to general reserves in the 2021-22 budget in response to increased risks and to improve resilience. The Council has also undertaken a comprehensive review of its existing reserves and established new reserves to meet the cost of ICT investments required to deliver the council's Strategic Reset Programme objectives and to cover feasibility work undertaken to support capital programme planning and delivery. The levels of legacy borrowing remain relatively high with 88% of debt not due to mature within the next 5 years. The debt includes loans taken out under the previous supported borrowing regime and more recent loans taken out under the prudential regime. Just over 10% of debt is in long term Lender Option Borrower Option Loans which can only be redeemed without significant penalties at the lender's discretion. In recent years the Council has adopted a policy of funding additional borrowing requirements from reserves rather than additional external borrowing. Whilst this remains sustainable for the next 2 to 3 years without impacting on long term investments it needs to be kept under review.
The Authority's record of budget and financial management including robustness of medium-term plans	⟺	The Council continues to have a sound record of effective financial management delivering the outturn within budget and with a small underspend in each of the last 20 years up to 2019-20. Due to uncertainty over future government settlements the Council did not formally publish a medium term financial plan for 2020-23. However senior leadership were provided with a number of potential medium to longer term scenarios in advance of agreeing 2020-21 budget. The forecast impact of the Covid-19 pandemic

		required the Council to consider a formal amendment to the 2020-21 budget in September 2020 to ensure that budget plans continued to balance. This amendment included an additional £12.8m of savings and income. A medium term plan outlook for 2021-2024 has been produced.
Virement and year-end procedures in relation to under and overspends	⟺	The Council continues to adhere to sound financial governance and virement procedures set out in its financial regulations. As for all councils, the Covid-19 pandemic impacted on the Council's ability to close the 2019-20 accounts. The draft outturn was reported to Cabinet on 22nd June outlining the main overspends and underspends together with roll-forward requests. A net underspend of £6.2m was reported which included £3.1m roll forward requests. The draft accounts were approved in October 2020 and signed off in November 2020.
The availability of reserves and government grants/other funds to deal with major unforeseen events	↓	The Council continues to have adequate reserves although some significant risks remain unresolved which could impact on reserves if a solution is not found. The most significant risk at the start of 2020-21 was the continuing underlying deficit and accumulated debt on the High Needs Block of Dedicated Schools Grant (DSG). This relates to spending to support children and young people with Special Educational Needs and Disabilities (SEND). Since the introduction of the Children and Families Act 2014, the Council has seen an unprecedented rise in the number of children and young people assessed for Education and Health Care Plans (EHCPs). The high needs funding within the DSG has not kept pace resulting in in-year overspends and an accumulated deficit on the unallocated DSG reserve. This is a national problem but has been particularly acute in Kent and a number of other councils. To date the government has not provided councils with sufficient funding and has not introduced structural reforms to eliminate the overspends or repay the deficits. Whilst the government has confirmed that DSG deficits do not have to be covered from the General Fund, the level of debt remains unsustainable posing a considerable risk in the absence of funding and structural reforms. The Council is updating its DSG deficit recovery plan in light of further projected overspends during 2020-21.

		In previous years the Council has had to use reserves to fund shortfalls in grant from Home Office to support unaccompanied asylum seeking children and care leavers. Whilst the Council has had some success in negotiating sufficient grant for the current year, the Council is continuing to lobby for compensation for the impact of previous shortfalls on the Council's reserves. Another concern is the grant funding made available to prepare for EU transition or to deal with significant disruption. Whilst additional funding has been allocated to councils, with extra funding for councils with major ports, this has not been sufficient for the Council to cover additional costs and without further funding these costs will need to be met from the Council's reserves. At this stage the additional funding for the Covid-19 pandemic has ensured there is no forecast material impact on reserves in the current year but the full impact remains highly uncertain.
The general financial climate including future expected levels of funding	↓	Spending Review 2020 only covers 2021-22. There are no specific departmental spending plans beyond the provisional local government settlement for 2021-22. Added to the lack of indicative funding settlement is a worsening of the ability to forecast additional spending demands and council tax/business rates funding following the pandemic and subsequent economic recession. Furthermore the anticipated reforms to business rate retention and fair funding review have been further delayed by the pandemic. The combination of these makes medium term financial planning highly uncertain. Plans can only be prepared based on a range of potential scenarios. This is consistent with the scenario approach adopted by the Office for Budget Responsibility (OBR) in the national economic and fiscal outlook.
The adequacy of insurance arrangements	↔	The Council's insurance policies were reviewed in January 2016, insuring the same levels of risk as previously, at a higher premium. Since then the Council's exposure to risk and levels of insurance reserves have been reassessed and a higher level of excess has been accepted on some policies in return for a lower premium. Evidence to date is that this has reduced the net cost to the Council.

Of the eleven factors used to assess risk and the adequacy of reserves, one has shown an improvement from twelve months ago, six are relatively unchanged, and four have deteriorated. No weighting has been applied to the individual factors, but the general financial risk to the Council should now be regarded as increased compared with a year ago, which in turn, was increased from the year before.

The review of existing reserves is being finalised. All reserves have been reviewed to ensure the Council enhances compliance with Local Authority Accounting Panel (LAAP) Bulletin 99. This bulletin set out the recommendations on the purposes for holding reserves. Reserves are split between general reserves (working balance to help cushion the impact of uneven cashflows/avoiding unnecessary temporary borrowing and contingency to cushion the impact of unexpected events/emergencies) and earmarked reserves to build up funds for known/predicted specific events. The review includes the closure of reserves where the original predicted events are now unlikely and the establishments of new reserves.

The budget proposals for 2021-22 include a net drawdown to reserves of £5.2m.