

WEST OF ENGLAND COMBINED AUTHORITY

FINANCIAL RESERVES STRATEGY – DECEMBER 2021

High Level Objectives:

- (a) Strive to achieve, and maintain, a Combined Authority, unearmarked, General Fund Reserve of at least 5% of net annual revenue spend;
- (b) Strive to achieve, and maintain, a Treasury Management Reserve of at least £2m to account for financial provisions that might have to be made in relation to any notional loss in value of our pooled fund holdings;
- (c) Maintain a West of England 'Transport Smoothing Reserve' to manage the peaks and troughs of operational transport demand and/or costs against the annual levy. This reserve should aim to be in excess of 5% of annual spend;
- (d) Maintain a Local Enterprise Partnership (LEP) Reserve at the equivalent sum of the annual government LEP Capacity Grant (£500k);
- (e) The appropriateness and adequacy of earmarked reserves, (to cover known and estimated future costs and liabilities), will be reviewed annually by the Combined Authority's Section 73 Officer.

General Fund Reserve:

1. Unlike a single-tier or District Council, the Combined Authority, (CA), delivers very few front-line services and hence, with the exception of operational transport, does not maintain earmarked service risk reserves required to manage demand and/or cost volatility.
2. The main focus for managing financial risk, through a 'General Combined Authority Reserve' is with regard to the volatility of revenue which is used to fund the core staff and operating costs of the CA. The following funding streams are within the CA base budget, but only approved on a rolling annual basis:
 - Mayoral Capacity Fund £1.0m;
 - 100% Business Rates Retention Pilot £1.2m;
 - Housing Capacity Fund £1.0m

3. These funding streams, along with income achieved through the investment of cash balances, (Treasury Management), fund the vast majority of operating activities and costs of running the CA.
4. There is an approved Committee decision to fund the running of the Mayoral office, alongside the costs of facilitating four yearly Mayoral Elections, from the Investment Fund at circa £660k per annum. But there are no other approvals in place from the Investment Fund should any of the above funding items discontinue.
5. The Housing Capacity Fund was a time limited deal of £3m over three years which expires in 2021/22 leaving unfunded revenue staff costs for 2022/23 and beyond.
6. The holding of General, unearmarked, reserves is forecast to be £1.9m at the end of the 2021/22 financial year which represents 3.3% of the Combined Authority net annual revenue budget of £56.7m. There are no 'hard and fast' rules to determine the exact level of reserves that should be retained by public sector bodies, but accepted practice indicates that this should be upwards of 5% (which is a reserves figure exceeded by the West of England Unitary Authorities)
7. Given the uncertainty of future revenue funding for Combined Authorities we are setting a high-level objective of ***striving to achieve and maintain a unearmarked General Fund Reserve of at least 5% of net annual revenue spend.***

Treasury Management Reserve:

8. Revenue returns through cash balances invested, in compliance with our Treasury Management Strategy, has been a much-needed regular source of revenue income since the Combined Authority formed in 2017.
9. For 2021/22 an income budget of £800k was set in relation to financial returns achievable. Despite maintaining reasonably high cash balances, it has become increasingly difficult to achieve rates of return in the current climate with interest rates for 12-month fixed investments being as low as 0.1%.
10. The CA Treasury Management Strategy enables the authority to place a proportion of its investments in long term 'pooled' funds such as property, equity and multi asset funds. We have utilised this flexibility and, as at November 2021, have circa £37m of our overall investment portfolio secured in pooled funds. Such funds are providing consistent revenue returns of between 3.5% and 4% per annum which clearly helps the CA achieve its overall revenue income targets.
11. Pooled funds are deemed as being long terms investments. The price of the funds at the point of acquisition is variable and, as such, could go down in value as well as up over time (often depending on economic factors and the condition of financial markets). To date, Local Authorities do not have to formally account for any

fluctuation in prices of pooled funds held and would only have to do so in the event of selling a particular fund. However, there is a risk that legislation could change at the end of March 2023 which might require public sector bodies to make annual provision in their accounts for any notional losses incurred, through price fluctuation of funds held, over the 12-month accounting period.

12. The Combined Authority, like other public bodies who hold pooled funds, need to start planning for the eventuality of this legislative change now. The largest 'swing' in financial markets in recent years occurred at the beginning of the Covid pandemic in March / April 2020. Throughout these early months, the notional loss in value of the CA pooled fund holdings was circa £2m (which has subsequently recovered in line with corresponding market increases)
13. It is therefore recommended that ***we strive to achieve, and maintain, a Treasury Management Reserve of at least £2m to account for financial provisions that might have to be made in relation to any notional loss in value of our pooled fund holdings.***

Transport Smoothing Reserve:

14. The cost of running the region's operational transport activities is circa £21m per annum which is funded through a transport levy provided by the region's three constituent authorities along with a recharge from North Somerset Council.
15. A Transport Smoothing Reserve was created in 2020/21 to account for any regional variances in cost and / or service demand. Such variances are particularly volatile in areas such as commissioned bus services, concessionary fares and support for Community Transport. Previous practice would have required an end of year adjustment to the levy for each specific authority with the reserve now enabling a more holistic and pragmatic approach to budget management.
16. Throughout 2021/22 we have continued payments to bus operators at pre-Covid levels, to maintain stability of the provider base, with the support of 'bus operating services grant' from government. This grant was withdrawn in October 2021 and the future impact of the viability of existing bus routes needs to be kept under regular review accounting for reduced patronage, and associated lost income, since the pandemic outbreak. Bus operator costs have also risen over recent years which will put added pressure on budgets when retendering existing networks and routes across the region.
17. With volatility on future operational transports costs and demand, it would be prudent to maintain a 'Transport Smoothing Reserve' of at least 5% of the net annual cost of service delivery with the income to be generated through the levy system being reviewed on an annual basis through the budget setting process.

Local Enterprise Partnership (LEP) Reserve:

18. The operating costs of Local Enterprise Partnership, (LEP), activities are circa £1.1m per annum funded through:

- LEP Capacity Fund £0.5m;
- Unitary Authority match funding for LEP Capacity £0.6m

19. It is a requirement of the LEP Capacity Grant to attract relevant match funding from the four regional Unitary Councils (including North Somerset). Similar to the Mayoral Capacity Fund, the future of the LEP Capacity Fund beyond 2021/22 is very uncertain. The £1.1m operating costs primarily relate to the staffing establishment that support LEP activity hence withdrawal of the fund would result in significant cuts and potential redundancy costs.

20. It is therefore recommended that, at any time, a LEP General Reserve of at least £500k is maintained to smooth over, and manage, any potential transitional period in the event of the LEP Capacity Fund being withdrawn.

Earmarked Reserves:

21. At any point in time, the CA will retain a number of specific earmarked reserves to cover known or estimated future costs and liabilities. In several cases such reserves relate to the receipt of grant funding in advance of profiled spend over a defined period. The appropriateness, and adequacy, of such reserves will be reviewed annually by the CA Section 73 (Statutory Finance) Officer as part of the annual budget setting process.

22. Such reserves include an 'Elections Reserve', with annual contributions of circa £400k made to fund the estimated £1.6m costs of the four yearly Combined Authority Elections and a Business Rates Retention Reserve to manage the fluctuation of funding received and liabilities due through the region's 100% Business Rates (Growth) retention pilot.

23. An earmarked reserve will also be maintained for the Adult Education Budget service which will manage the timing between receipt of government grant and commissioning and spend of subsequent service delivery.