Appendix E2: Balance Sheet Analysis

1. Synopsis

1.1. The balance sheet provides a snapshot of the council's financial position detailing assets, liabilities, and reserves. The balance sheet shows the complex and closely interlinked relationship between revenue, capital, borrowing and other existing and emerging risks. Analysing the council's balance sheet on a regular and ongoing basis (and not just at financial year-end) is key to understanding the underlying financial position of the council. Effective balance sheet analysis is very useful as a measure to indicate whether or not a local authority is showing signs of financial stress currently and over time within an overall direction of travel.

1.2. To be effective, balance sheet analysis needs to look at a wide range of measures to enhance overall understanding of financial resilience and direction of travel. A number of key measures which are set out below, with an analysis of Islington's comparative position to benchmark authorities.

1.3. Summary of key points:

- Islington council has been able to build reserves, and therefore financial resilience, over the previous 6 years. This was partly due to transitory, additional income received during the COVID-19 pandemic (which is now largely reversed out), but also because of a deliberate medium-term financial strategy to bolster the council's overall reserves position. However, the recent significant decrease in reserves demonstrates the importance of strengthening and maintaining sufficient levels of reserves when the council is able to do so. (**Section 2**)
- The council has strengthened its long-term financial sustainability by increasing the value of its net assets. (**Section 3**)
- The council has deterred external borrowing, despite the increasing need to borrow, by using its own resources to finance capital expenditure. (**Section 4**)
- However, if reserves continue to decline and the need to borrow continues to increase, the council will be required to externally borrow and will risk paying high interest rates. (**Section 4**)
- Investment properties make up only a small part of the council's assets and the council is not dependent on investment income to provide vital services. (**Section 4**)

2. Reserves

2.1. Councils hold reserves to manage risk and set aside funding for future expenditure. There is no specified minimum level of reserves for a council to hold as it depends on its particular risks and planned future expenditure.

2.2. Previous audits of the council's financial position have noted the comparatively low level of reserves. The council currently has had a target to increase general fund balances to £40m over the medium term to build financial resilience.

2.3. Declining reserve balances are a sign of financial stress as reserves will eventually deplete to an unsustainable level. Furthermore, recurrent drawdowns from reserves due to budget overspends could suggest that structural issues exist within the authority, putting an unsustainable strain on the council's reserves position over the longer term.

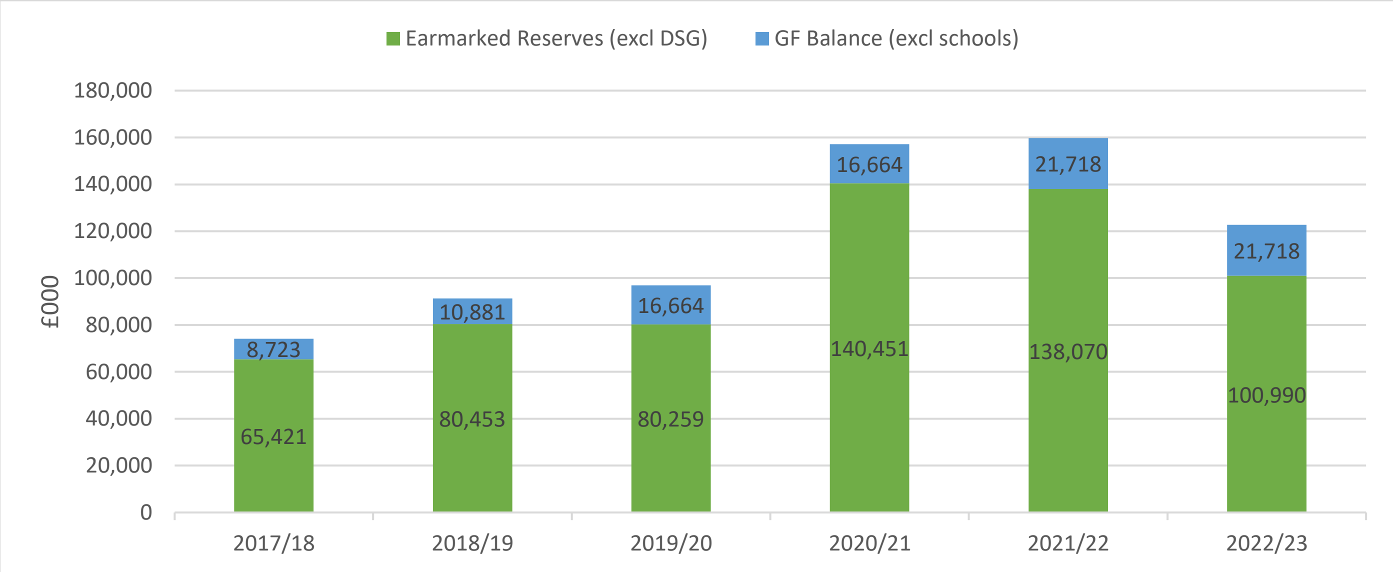
2.4. Council reserves can be split into unusable and useable reserves. Unusable reserves are used to hold unrealised gains or losses for assets not yet disposed of and accounting adjustments which are required by statute. Unlike useable reserves, unusable reserves cannot be used to fund capital or revenue expenditure. Hence key financial indicators focus on the level of useable revenue reserves to demonstrate the level of financial health.

2.5. Useable revenue reserves can be split into ‘Earmarked’ and ‘General’. Earmarked reserves are reserves which have been set aside for the specific purpose. The specific purpose is sometime set by statute e.g. Public Health reserves can only be spent on public health activities. The specific purpose can also be set by the council. For instance, Islington Council has a ‘Business Continuity’ reserve to mitigate the risk of disruption to key council services and systems, including cyber security risks.

2.6. General Fund balances are reserves which have not been set aside for a specific purpose and are used to mitigate the risks of unexpected events and emergencies.

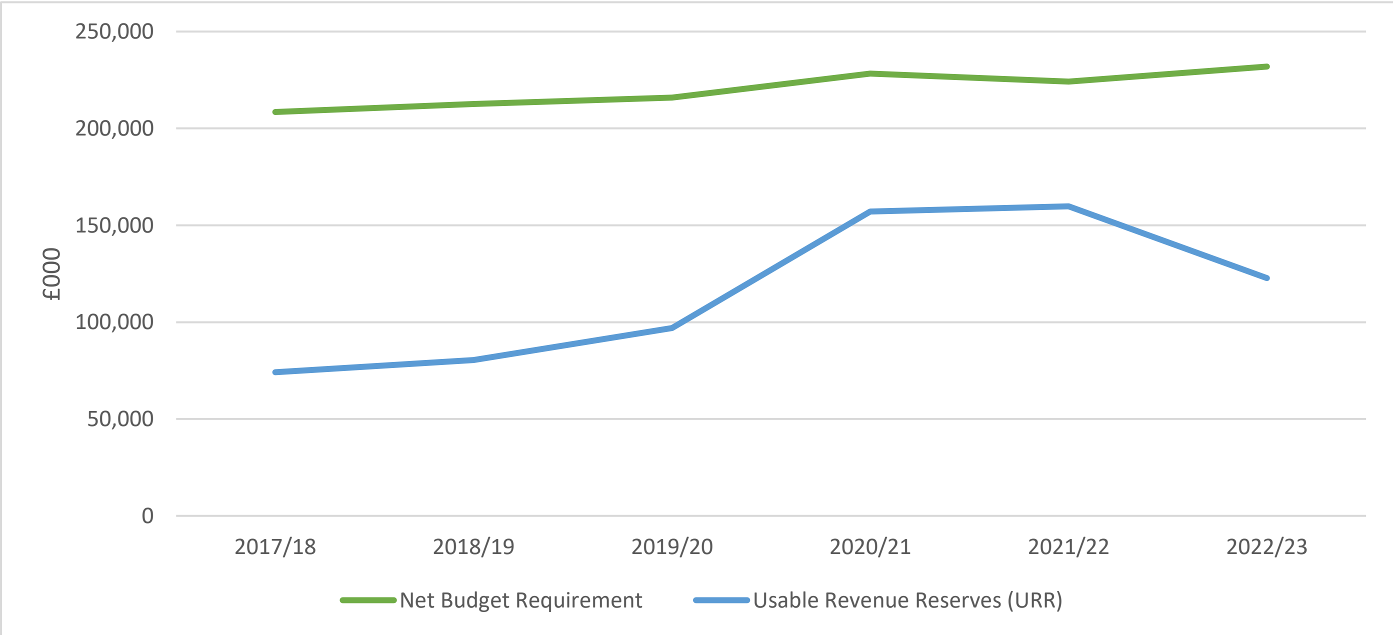
2.7. The figures below analyse the balance of useable revenue reserves over the period from 2017/18 to 2022/23.

Figure 1: Useable Revenue Reserves (Earmarked & General) 2017/18 to 2022/23



2.8. As shown in **Figure 1**, in 2022/23 Islington had £100.990m earmarked reserves representing a 54% increase over the 6-year period. The council had £21.718m of General Fund reserves which is a 149% increase since 2017/18.

Figure 2: Useable Revenue Reserves and Net Budget Requirement 2017/18 to 2022/23



2.9. As shown in **Figure 2**, at 31 March 2023 useable revenue reserves were 53% of the council's 2022/23 net budget requirement. This is a decrease from 2021/22 where useable revenue reserves were the equivalent of 71% of the net budget requirement.

2.10. The council experienced a recent drop in useable earmarked reserves from 2021/22 to 2022/23. Useable earmarked reserves fell by 27% (£37.08m). This is predominantly due to a collection fund related transfer from reserves of £23.800m that will be replenished in 2023/24 and 2024/25, but also due to a greater budget demands in-year – a trend that has continued into 2023/24.

2.11. The above indicators suggest that the council has been able to build financial resilience by contributing to reserves between 2017/18 to 2021/22. Additionally, the council has successfully built-up General Fund balances to £21.718m which will provide more resilience in the case of unexpected events or emergencies.

2.12. However, it should be noted that the council received transitory, additional government funding in the years from 2020/21 to 2021/22 due to the impact of the COVID-19 pandemic. Although this led to an uptick in reserves in the short term, it should be noted that since 2021/22, the council has not received additional funding for COVID-19 pressures but significant additional cost and demand pressures have continued.

2.13. **The recent decline in reserves demonstrates the importance of maintaining (as a minimum) and enhancing levels of reserves (as a preferred strategy) when the council is able to do so, to mitigate the impact of drawdowns when financial circumstances dictate this.**

2.14. Decreasing reserve levels are a key indicator of financial distress in councils. It is important that the medium-term budget makes provision to sustain reserve levels. As recommended in the 2024/25 Budget Report, an absolute Minimum GF Earmarked Reserves Level is set at £60m (combined with the proposed £20m General Balances minimum level).

3. Assets and Liabilities

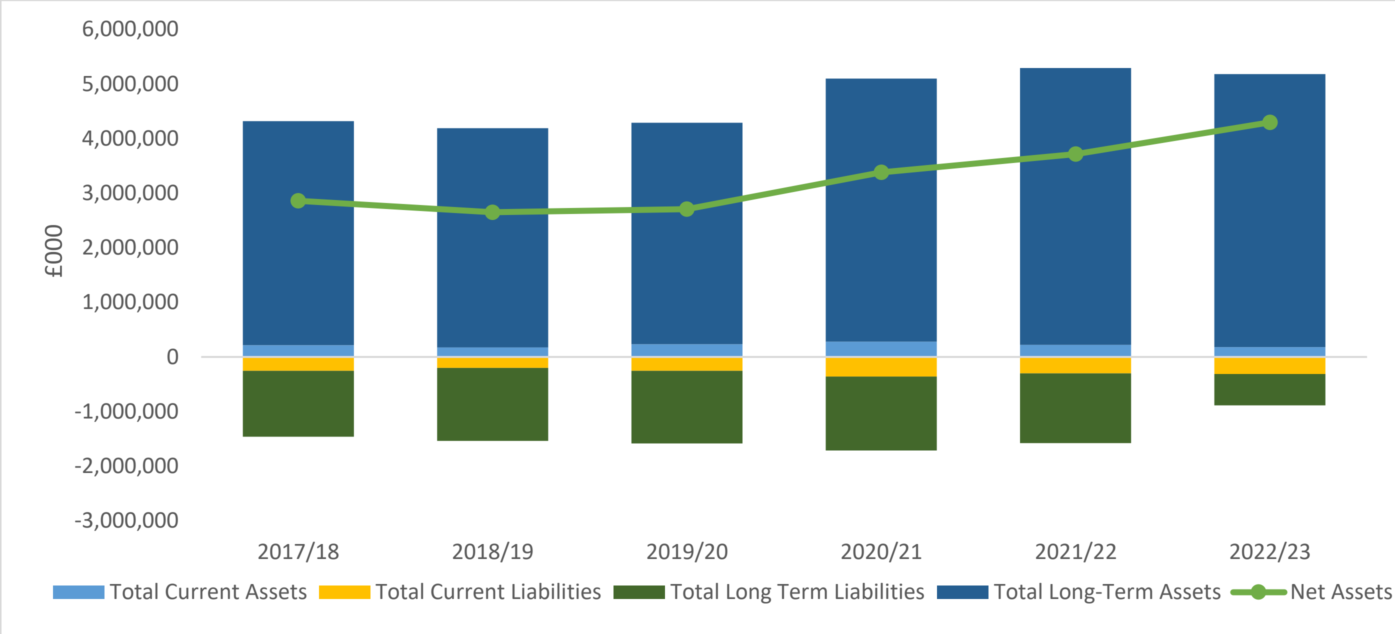
3.1. Assets and liabilities provide information on how financially resilient the council may be in the longer term. Councils tend to have more assets than liabilities due to the prevalence of fixed assets (e.g. buildings) which appreciate in value over time. However, council assets are not always easy to liquidate as public assets (e.g. roads, parks) are seldom sold. Surplus assets have the potential to generate income. For example, investment property is an asset held for this purpose.

3.2. Liabilities on the other hand represent a cost to the council. For example, interest to finance debt will need to be paid off. Therefore, high levels of liabilities imply a future revenue cost.

3.3. The liability related to the defined benefit pensions scheme is usually the most significant liability for the council. The liability predominantly relates to pension owing to past employees. However, pension liabilities change depending upon the latest assumptions on the value of the fund's asset and liabilities. The Pension Fund is set to continue its trajectory of an improving funding level for the 2025 triennial valuation. As a result, there are no anticipated additional pressures in future years resulting from the Pension Fund deficit recovery plan. There could be a small benefit to the MTFS position in 2026/27, but currently this is uncertain.

3.4. Net assets measure an organisation's assets minus its liabilities which includes both long-term and short-term assets and liabilities.

<u>Figure 3: Total Assets and Liabilities 2017/18 to 2022/23</u>



3.5. **Figure 3** shows that the value of Net Assets has increased by 62% over a 6-year period. The liability related to defined benefit pension scheme fell by 76% from 2021/22 to 2022/23. This is predominantly due to an actuarial gain from changes in financial assumptions.

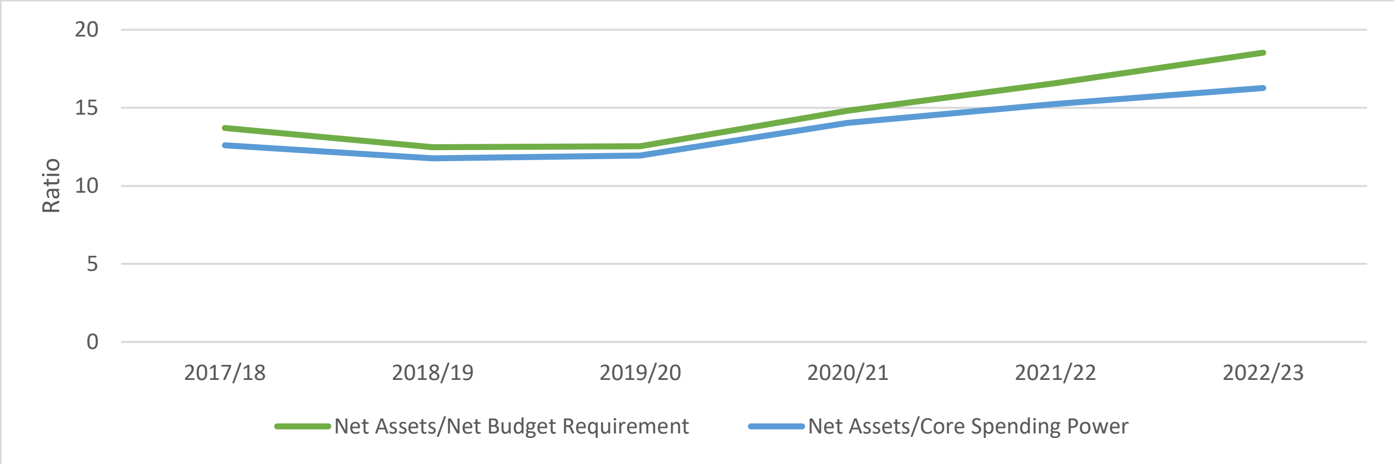
3.6. Assets and liabilities can be split into 'current' (short-term) or 'non-current' (long-term). Consequently, they can provide different information on the short-term and longer-term financial health of an organisation. **Table 1** and **Figure 4** below assess the short-term and long-term sustainability of the council's finances.

<u>Table 1: Current Ratio for 2017/18 to 2022/23</u>

Financial Year	**2017/18**	**2018/19**	**2019/20**	**2020/21**	**2021/22**	**2022/23**
Current Ratio	0.86	0.87	0.90	0.78	0.73	0.58

3.7. Current assets and liabilities can provide insight into the liquidity position of the council. The current ratio of less than 1 could suggest the council will struggle to meet current obligations from its current assets. The ratio of current assets to current liabilities (current ratio) is consistently less than 1 and has declined in the last 4 years. External analysis suggests that the 2022/23 Inner London borough average is 1.22. This is partly linked to the council deferring external borrowing by using cash resources to finance capital expenditure.

Figure 4: Ratio of Net Assets to Net Budget Requirement and Core Spending Power



3.8. The Net Assets to Net Budget Requirement and the Net Assets to Core Spending Power indicators provide insight into the longer-term financial sustainability of an organisation, as they show the number of times the budget and available revenue can be funded though the council's net assets or vice versa.

3.9. The ratio of Net Assets to Net Budget Requirement for 2022/23 is 18.53 compared to 16.57 in 2021/22. This has consistently increased over 5-year period. The ratio of Net Assets to Core Spending Power is 16.27 for 2022/23, an increase from 15.25 in 2021/22.

3.10. Overall, **Figure 3** and **Figure 4** suggest that the council has been able to increase the value of its net assets over the 6-year period, which will support its longer-term financial sustainability. Islington council has seen an increase in the value of its long-term assets, particularly investment properties and property, plant, and equipment, and a decrease in its largest long-term liability in the defined benefit pension liability. If this trend continues, this will help to strengthen the council's longer-term financial sustainability and support its ability to provide vital services.

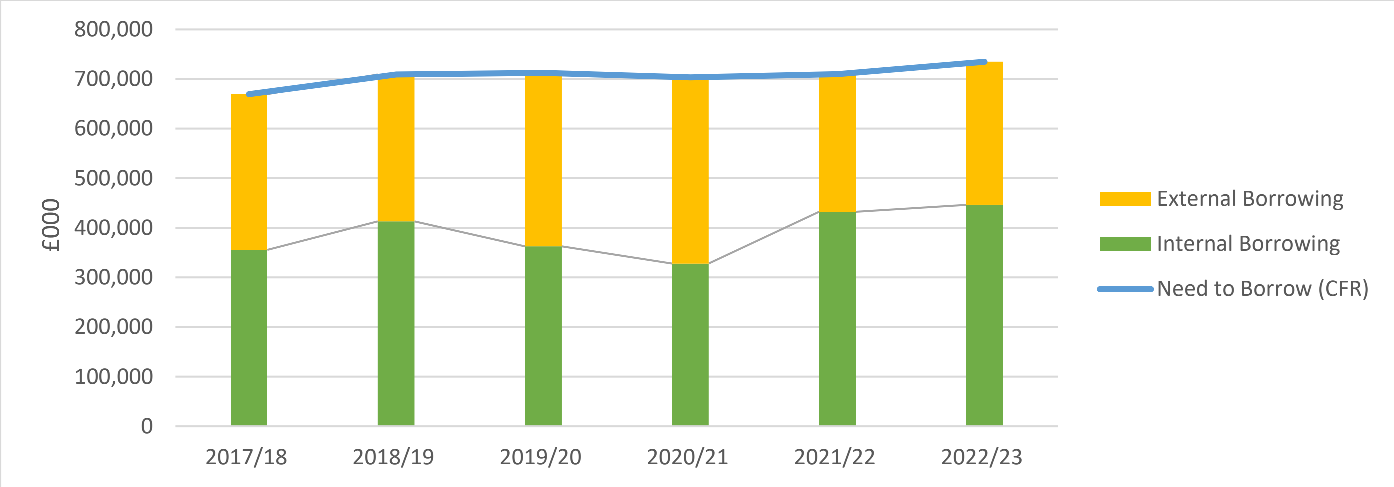
3.11. **Table 1** demonstrates that Islington council consistently has a current ratio of less than 1, and this ratio has been declining over a 4-year period. **If this trend continues, the council may need to borrow to manage its cash position which will expose it to high interest rates. This is a risk going forwards.**

4. Borrowing and other long-term borrowing

4.1. Councils can borrow to finance capital expenditure which is vital to the provision of services such as schools, roads, libraries, and leisure centres. The level of borrowing that a council has depends upon many individual funding decisions taken in previous financial years.

4.2. The capital financing requirement (CFR) measures the historic capital expenditure incurred by the council which has yet to be financed. It represents the council's underlying need to borrow. However, councils can delay external borrowing by temporarily using their own resources to finance the capital expenditure (known as internal borrowing).

Figure 5: Capital Financing Requirement Funded by Internal and External Borrowing



4.3. The CFR has increased by 10% over 6-year period and the extent of internal borrowing has risen by 25% over 6-year period. Internal borrowing as a proportion of CFR in 2022/23 is 61%. External modelling suggests that the Inner London average is 63%.

4.4. Debt gearing is an indicator which represents the council's ability to support the CFR. High debt gearing implies that a council may have difficulty supporting their borrowing. Moreover, high levels of debt have been seen in several councils which have issued S114 notices, notably Woking and Thurrock. **Table 2** shows the debt gearing of Islington council for 2017/18 to 2022/23

Table 2: Debt Gearing from 2017/18 to 2022/23

Financial Year	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
Debt Gearing	16.43%	17.74%	17.61%	14.64%	14.03%	14.73%

4.5. External analysis indicates that the Inner London borough average debt gearing in 2022/23 is 20%.

4.6. Overall, the analysis above demonstrates that the council has been able to delay external borrowing despite the increase in CFR. This is partly due to the council utilising internal borrowing to fund the unfinanced capital expenditure. **However, if the CFR continues to increase combined with declining reserve balances (described in Section 3), the council will be required to externally borrow a greater proportion. This is a significant risk as interest rates are currently at a historic high.**

5. Investments and Investment Property

5.1. Councils typically invest for three reasons:

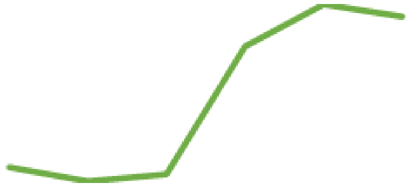
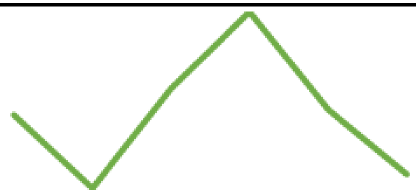
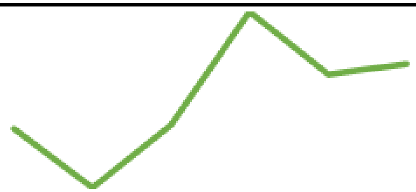
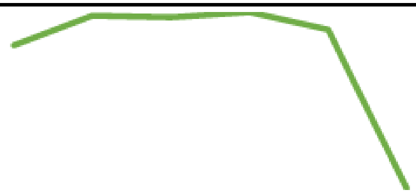
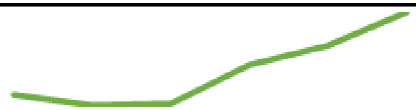
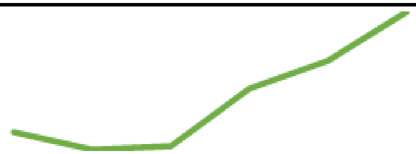
- Investing surplus cash to earn a return and manage the council's cash balance (e.g. when income is received in advance of expenditure)
- Investing to support local services (e.g. local businesses, charities, loans to employees)
- Investing to earn investment income (e.g. purchasing shops or office space which generate rental income, also known as investment property)

5.2. Councils investing in investment property can allow them to generate income from a range of sources. A higher total value of investment property indicates more opportunity to raise income. However, return on investment can vary depending on the type of investment and an investment strategy.

5.3. A number of councils that have issued S114 notices after over-borrowing to fund investment properties or after making risky commercial investments, notably Woking, Thurrock, Slough and Croydon. Hence, analysing the investment activities of a council can provide insight into the financial position and potential risks facing the council.

5.4. Islington council has seen a 40% increase in the value of investment properties over the 6-year period from 2017/18 to 2022/23. However, this increase is mostly due to the increase in the value of currently owned properties rather than the purchasing of new investment properties. The council has not purchased new commercial properties, nor does it plan to in the medium term. **Furthermore, investment properties accounted for only 0.87% of Islington's long-term assets in 2022/23 and generated approximately £1.7m in rental income in 2022/23, demonstrating that investment income only accounts for a small part of Islington's revenue income.**

6. Data

	17/18 £000	18/19 £000	19/20 £000	20/21 £000	21/22 £000	22/23 £000	6-year Trend
Balance Sheet Data							
Property, Plant & Equipment	4,044,359	3,965,375	4,012,229	4,773,583	5,019,139	4,941,918	
Heritage Assets	487	487	487	487	487	487	
Investment Property	31,227	32,675	33,178	32,633	39,259	43,641	
Long Term Investments	10,696	10,752	5,843	813	10,794	10,749	
Long Term Debtors & Prepayments	16,433	8,687	8,498	12,582	6,724	6,158	
Total Long-Term Assets	**4,103,202**	**4,017,976**	**4,060,235**	**4,820,098**	**5,076,403**	**5,002,953**	
Short Term Investments	122,695	85,482	90,452	152,097	95,661	30,676	
Short Term Assets Held for Sale	-	-	-	281	476	1,439	
Inventories	760	1,118	2,183	1,295	1,201	1,769	
Short Term Debtors	76,321	65,737	84,723	116,941	107,147	133,894	
Cash and Cash Equivalents	16,663	20,791	54,206	6,889	14,713	13,651	
Total Current Assets	**216,439**	**173,128**	**231,564**	**277,503**	**219,198**	**181,429**	
Short Term Creditors	142,346	119,530	126,274	184,948	202,727	196,767	
Short Term Borrowing	67,347	30,375	72,888	112,246	31,803	46,006	
Cash and Bank Overdrawn	22,458	24,523	26,474	-	-	26,615	
Short Term Provisions	8,114	12,058	12,452	26,216	27,341	21,439	
Short Term Grants Receipts in Advance	12,185	12,682	18,135	34,175	39,666	19,879	
Total Current Liabilities	**252,450**	**199,169**	**256,224**	**357,586**	**301,538**	**310,707**	
Long Term Provisions	12,119	20,341	21,020	13,001	12,154	19,549	
Long Term Borrowing	246,222	266,109	276,609	263,275	245,604	242,481	
Liability Related to Defined Benefit Pensions Scheme	802,883	916,402	911,488	973,521	916,793	219,084	
Other Long Term Liabilities	123,899	111,188	96,041	82,988	81,841	74,591	
Long Term Grants Receipts in Advance	23,875	26,650	24,218	22,978	23,292	20,643	
Total Long Term Liabilities	**1,208,998**	**1,340,690**	**1,329,376**	**1,355,763**	**1,279,684**	**576,348**	
Net Assets	**2,858,193**	**2,651,245**	**2,706,199**	**3,384,252**	**3,714,379**	**4,297,327**	
Usable Reserves	285,035	284,991	281,145	303,595	313,903	258,824	
Unusable Reserves	2,573,158	2,366,254	2,425,054	3,080,657	3,400,476	4,038,503	
Total Reserves	**2,858,193**	**2,651,245**	**2,706,199**	**3,384,252**	**3,714,379**	**4,297,327**	

***Typically, an upwards trend in long-term assets and reserves and a downwards trend long-term liabilities can be interpreted as the council strengthening its financial position, especially as demand for council services and service costs continue to rise. However, it is worth noting that significantly high levels of reserves could indicate that a council is not effectively using taxpayer's money to provide services and taxpayers are not getting value for money. A balance needs to be struck between providing value for money to current service users and ensuring services can continue to be provided for future service users.**

Other Data	2017/18 £000	2018/19 £000	2019/20 £000	2020/21 £000	2021/22 £000	2022/23 £000
Net Revenue Requirement (Budget Reports)	208,481	212,546	215,839	228,303	224,096	231,923
Current Resources	284,659	287,370	284,329	272,580	290,690	263,894
Core Spending Power (CSP)	226,982	225,420	226,734	241,173	243,547	264,182
Need to Borrow (CFR)	669,593	709,315	712,411	703,721	709,796	734,849
Capital Equity	3,406,480	3,289,222	3,333,483	4,103,263	4,349,565	4,252,636
External Borrowing	313,569	296,484	349,497	375,521	277,407	288,487
Internal Borrowing	356,024	412,831	362,914	328,200	432,389	446,362
Indicators	**2017/18**	**2018/19**	**2019/20**	**2020/21**	**2021/22**	**2022/23**
Internal Borrowing % of Need to Borrow (CFR)	53.17%	58.20%	50.94%	46.64%	60.92%	60.74%
Internal Borrowing/Current Resources	125.07%	143.66%	127.64%	120.41%	148.75%	169.14%
Debt Gearing	16.43%	17.74%	17.61%	14.64%	14.03%	14.73%
CFR/CSP	295.00%	314.66%	314.21%	291.79%	291.44%	278.16%
CFR/Current Resources	2.35	2.47	2.51	2.58	2.44	2.78
Net Assets/CSP	12.59	11.76	11.94	14.03	15.25	16.27
Current Resources/CSP	1.25	1.27	1.25	1.13	1.19	1.00
Earmarked reserves (GF)/Net Budget Requirement	31.38%	32.73%	37.18%	61.52%	61.61%	43.54%
URR/Net Budget Requirement	35.56%	37.85%	44.91%	68.82%	71.30%	52.91%
URR/CSP	32.67%	35.69%	42.75%	65.15%	65.61%	46.45%
Current Ratio (Current Assets/Current Liabilities)	0.86	0.87	0.90	0.78	0.73	0.58
Net Assets/Net Budget Requirement	13.71	12.47	12.54	14.82	16.57	18.53

7. Glossary

Indicator	Calculation	Definition
Current Resources	Total Useable Reserves (MIRS) - Collection Fund Adjustment (Unusable Reserves Note) + Financial Instruments RR (Unusable Reserves Note) - Accumulated Absences Account (Unusable Reserves Note)	Current Resources measures the useable revenue and capital reserves, and the reserves balances for collection fund
Useable Revenue Reserves (URR)	General Fund balances + Earmarked General Fund Reserves - Dedicated School Grant Reserve	Reserves which can be used to fund future revenue expenditure
Unusable Reserves	Unusable Reserves	Unusable Reserves are used to hold unrealised gains or losses for assets not yet disposed of and accounting adjustments, which are required by statute. These reserves cannot be used to fund capital or revenue expenditure.
Core Spending Power (CSP)	Derived from Local Government Finance Settlement	CSP is the government's measure of a local authority's resources available to fund service delivery. It mainly consists of income from retained business rates, grants, and council tax (assuming that council tax is increased by the maximum allowed without a referendum).
Capital Financing Requirement (CFR)	Derived from Capital Expenditure and Capital Financing note in accounts	This is a measure of the capital expenditure incurred historically by the council which has yet to be financed. This can give an indication of the underlying need to borrow.
Capital Equity	Property, Plant, & Equipment + Heritage Assets + Investment Property + Short term Assets held for sale	The value of fixed assets
Net Budget Requirement	Derived from budget reports	The amount of expenditure which needs to be funded from council tax and general support from central government
External Borrowing	Short Term borrowing + Long term borrowing	The value of short-term and long-term borrowing at 31st March
Internal Borrowing	Capital Financing Requirement - External Borrowing	Internal borrowing arises when the council delays borrowing externally by temporarily using cash it holds for other purpose e.g., earmarked reserves
Internal Borrowing % of Need to Borrow (CFR)	(Internal Borrowing/Capital Financing Requirement) x 100	Shows the proportion of the capital financing requirement which is being financed from internal resources. A high proportion indicates that the council has been able to deter external borrowing.

Indicator	Calculation	Definition
Internal Borrowing/Current Resources	(Internal Borrowing/Current Resources) x 100	Measures the ability of the council to fund internal borrowing from the useable revenue and capital reserves. A higher percentage indicates that the council has fewer resources to enable internal borrowing and may indicate a greater need to externally borrow.
Debt Gearing	(Capital Financing Requirement/Capital Equity) x 100	Compares the underlying need to borrow against the value of fixed assets. A higher percentage indicates a high level of potential borrowing which needs to be supported.
CFR/CSP	(Capital Financing Requirement/Core Spending Power) x 100	Compares the underlying need to borrow against the core revenue funding available to the council. A higher percentage indicates a that there is less revenue available to support the capital expenditure.
CFR/Current Resources	Capital Financing Requirement/Current Resources	Compares the underlying need to borrow against the useable revenue and capital reserves. A higher percentage indicates that there are fewer resources available to support the capital expenditure.
Net Assets/CSP	Net Assets/Core Spending Power	Counts the number of times net assets can be funded by the core revenue funding made available to the council, or vice versa. This can be used to indicate the long-term financial health.
Current Resources/CSP	Current Resources/Core Spending Power	Compares the useable revenue and capital reserves to the core revenue funding made available to the council. A higher ratio indicates that there are more resources available to cover the available revenue.
Earmarked reserves (GF)/Net Budget Requirement	[(Earmarked GF Reserves - Dedicated School Grant Reserve)/Net Budget requirement] x 100	Shows how much of the net budget requirement can be covered by the earmarked general fund reserves. A higher percentage indicates that the council has a greater ability to cover budget shortfalls.
URR/Net Budget Requirement	(Useable Revenue Reserves/Net Budget Requirement) x 100	Compares the useable revenue reserves to the expenditure needed to be funded from council tax and general government support. A higher percentage indicates a greater ability to cover budget shortfalls.
URR/CSP	(Useable Revenue Reserves/Core Spending Power) x 100	Compares the useable revenue reserves to the core revenue funding made available to the council. A higher percentage indicates a greater ability to cover budget shortfalls
Current Ratio	Current Assets/Current Liabilities	The current ratio can be used to measure an organisation's ability to meet its short-term obligations from its current assets. A higher ratio indicates a greater ability to meet short-term obligations.
Net Assets/Net Budget Requirement	Net Assets/Net Budget Requirement	Counts the number of times net assets can be funded by the amount of funding provided by council tax and general government support, or vice versa. This can be used to indicate the long-term financial health.