

**Manchester City Council  
Report for Resolution**

**Report to:** Executive - 15 February 2012

**Subject:** Housing Revenue Account Self Financing and The Housing Revenue Account Budget 2012/13 to 2014/15.

**Report of:** The Director of Strategic Housing and the City Treasurer

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**Summary**

This report presents members with details on the proposed changes to the financing arrangements within the Housing Revenue Account (HRA), together with details of the specific issues for Manchester including the proposed debt settlement.

It seeks approval for the HRA budget for 2012/13 and the proposed average rent increase of 6.48%, which is in line with the requirements to ensure we have reached rent convergence by 2015/16.

The report also details the proposed changes to the tenant heating charges. It is proposed that the City Council reduces by up to 10% the charge to tenants who receive their heating supply under the commercial contract and the charges remain unchanged for tenants who are part of the domestic contract arrangements.

**Recommendations:**

The Executive is requested to:

- a) Note the implications of the move to a self financing HRA from 1<sup>st</sup> April 2012 following the cessation of the current subsidy system.
- b) Note the final determination of the housing debt settlement payment to the City Council from the Department for Communities and Local Government (DCLG) of £294.3m and the associated treasury management issues. A report regarding the Treasury Management arrangements for the debt settlement is on Part B of the Agenda.
- c) Note that the final debt settlement was issued by DCLG on 1 February 2012 and delegate to the City Treasurer, in consultation with the Executive Member for Finance and Human Resources, the authority to make the necessary arrangements for the repayment of PWLB debt on 28<sup>th</sup> March 2012 and relevant market debt including any premia payments on, or near to, 28<sup>th</sup> March 2012 dependent upon the prevailing market conditions.
- d) Approve the 2012/13 HRA budget as presented in Appendix 1.
- e) Approve the proposed average increase in rental and associated charges of 6.48%, and delegate the setting of individual property rents, to the Director of

Strategic Housing and the City Treasurer, in consultation with the Executive Member for Neighbourhood Services and the Executive Member for Finance and Human Resources.

- f) Approve the proposed changes to tenants heating charges in accordance with paragraph 5.12, ie a reduction of up to 10% for those tenants who receive their gas through the commercial contract and no price change for those tenants on the domestic contract where charges will remain as at April 2011.

**Wards Affected:** Charlestown, Cheetham, Crumpsall, Harphurhey, Higher Blackley, Moston, parts of Ancoats and Clayton, Ardwick, Bradford and Miles Platting and Newton Heath

Community Strategy Spine	Summary of the contribution to the strategy
Performance of the economy of the region and sub region	Local control of Housing resources will enable the Council and its managing agents to prioritise delivering local services to standards supported by Council tenants which contribute to the overall objectives of the City Council and its Partners.
Reaching full potential in education and employment	
Individual and collective self esteem – mutual respect	
Neighbourhoods of Choice	The Council and its Partners will ensure that a self financing Housing Revenue Account will continue to promote neighbourhoods of choice whilst delivering value for money.

**Full details are in the body of the report, along with any implications for:**

- Equal Opportunities Policy
- Risk Management
- Legal Considerations

### **Financial Consequences – Revenue**

The HRA is a ring-fenced budget. Implications on the General Fund as a result of the changes are currently being assessed. The HRA has downsized significantly over recent years with the transfer of Council housing stock and functions to Registered Social Landlords and the ALMO (Northwards). As a result a full review of City Council recharges to the HRA is currently underway and it is anticipated that certain costs will no longer be chargeable to the HRA and will fall against the General Fund. This will be accounted for in the Council's main 2012/13 business planning process but, until settled, are not yet accounted for in the HRA budget.

## **Financial Consequences – Capital**

Within the proposed HRA budget the charge for depreciation is subsequently credited to the Major Repairs Reserve and this can be used to either fund capital expenditure or pay down any housing debt. In 2012/13 this has been determined in line with the uplifted major repairs allowance which is in accordance with guidance from DCLG. This results in a charge of £12.766m to the HRA in 2012/13 which will be transferred to the Major Repairs Reserve.

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### **Background documents (available for public inspection):**

Budget guidelines issued by the City Treasurer  
DCLG The Housing Revenue Account Self-financing Determinations – 1<sup>st</sup> February 2012  
DCLG HRA Self Financing Determination Consultation – 21<sup>st</sup> November 2011  
Various DCLG Circulars on HRA Self Financing  
Executive, 16<sup>th</sup> February 2011 – Housing Revenue Account Budget 2011/12 – 2013/14.

## **1 Introduction – the move to a Self Financing Housing Revenue Account**

- 1.1 From 1 April 2012 there will be a new financing regime for the Housing Revenue Account (HRA) which will fundamentally change how local authority housing is to be funded. The current subsidy system will be abolished and replaced with a new self-financing system from 1<sup>st</sup> April 2012. The subsidy system has been in place since 1989, but it is now widely acknowledged that it is no longer fit for purpose; it lacks transparency, does not support medium to long term financial planning and can underfund basic management and maintenance of housing stock.
- 1.2 Essentially under self-financing local authorities will retain all their housing rental income and then assume responsibility for financing the management and maintenance of their stock. It is expected that all authorities will have a sustainable business plan going forward, that allows them to maintain the standards of their homes under these arrangements.
- 1.3 The new self-financing system will be created by a once and for all debt settlement between Central Government and Local Authorities based on the level of debt that is deemed affordable from within the retained housing rental income. The majority of stock owning councils will be taking on a proportion of the national housing debt, whilst others such as Manchester City Council, will be receiving a payment from the Department for Communities and Local Government (DCLG) for their housing debt.
- 1.4 As part of the reforms the current HRA ring-fencing arrangements will be retained and all HRA expenditure must be in relation to the Council's housing stock and its management, or for the direct benefit of its tenants and future tenants.
- 1.5 The Council will continue to own around 17,000 properties within the HRA, these are managed under various arrangements, including PFI and stock managed by other Housing providers or the ALMO.

## **2 Self Financing – Debt Settlement**

- 2.1 DCLG have recently issued a draft determination regarding the debt position for the Authority. It set out details of the current subsidy capital financing requirement for Housing of £449.7m, and the initial valuation of the level of debt that is deemed affordable under the new self financing proposals, £155.4m. On this basis the City Council are set to receive a debt settlement of £294.3m on the 28<sup>th</sup> March 2012. This excludes any potential further adjustment for proposed stock transfers prior to 31<sup>st</sup> March 2012 which are yet to receive Secretary of State approval
- 2.2 In order to control the public sector borrowing levels, the Government has set a limit on the amount of borrowing that Councils can undertake for HRA purposes. The City Council's level of indebtedness (debt cap) will be set at £169.4m, this is made up of the initial valuation of £155.4m plus £14m in respect of previously approved LA new build.

- 2.3 The actual housing debt at 28<sup>th</sup> March 2012 will be around £122.3m (including £14m LA new build). However, there are further adjustments to be made to the debt figure in respect of capital expenditure that is financed by credit arrangements such as PFIs which will impact on our position against the debt cap. DCLG will write separately to each Local Authority regarding this issue in the near future.
- 2.4 Of the potential £294.3m debt settlement around £200m is Public Works Loan Board (PWLB) debt which can be settled relatively easily, the remainder is market debt which will require the negotiation of redemption arrangements with lenders, on or shortly after, the settlement date of 28<sup>th</sup> March 2012. The latter will also attract a premia payment for early repayment of borrowing which will be funded by Government. However, the funding for the premia is restricted by a cap imposed by DCLG.
- 2.5 Discussions regarding the payment arrangements for the debt settlement are ongoing between the City Treasurer and DCLG. Further information is contained within the Treasury Management report on Part B of this Agenda.
- 2.6 There will be a separate loans fund to hold the HRA debt, which will have its own Treasury Management Strategy.

### **3 Statutory Duties in Determining the HRA Budget Strategy**

- 3.1 The rules governing the maintenance of the HRA were established pursuant to the Local Government and Housing Act 1989 and provide that:
- The Council must formulate proposals in respect of HRA income and expenditure for the financial year which, on the best assumptions and estimates that the Council is able to make at the time, ensure that the HRA does not show a debit balance.
  - The Council is required to keep a Housing Revenue Account in accordance with proper practice. The Council has the responsibility to determine a strategy that is designed to ensure that the HRA is in balance taking one year with another
  - The HRA continues to be a ring-fenced account, this means that it must, in general, balance on a year-to-year basis, so that the costs of running the Housing Service, which include debt charges, administration costs and maintenance expenditure must be met from HRA income.
- 3.2 The Localism Act 2011 does not affect the detailed operation of the HRA and it will remain largely unchanged, but the Act does allow the Secretary of State to make settlement payments to authorities, and these will be accounted for within the HRA. It also allows for any future reopening of the settlement and also limits the amount of borrowing that can be undertaken by the HRA.

#### **4 Budget Strategy 2011/12**

- 4.1 The 2011/12 budget was set based on an average rental increase of 6.6% which was in line with the Government's assumed increase in the guideline rent, and still ensured that Manchester would achieve the Government's rent convergence target of 2015/16.
- 4.2 The 2011/12 budget strategy also sought to ensure that the HRA was sustainable going forward, and there were savings of £3.347m approved as part of the budget setting process, with a further £3.010m to be delivered in 2012/13. The savings in 2011/12 have been achieved through a combination of redesigning the existing housing function, reviewing how things are undertaken and revising, where necessary, and also requiring Northwards to deliver efficiencies, by reducing the level of funding provided.
- 4.3 The 2011/12 budget anticipated the transfer of the remaining miscellaneous stock. An update on the progress of this will be reported separately. It is still anticipated to happen prior to 31<sup>st</sup> March 2012.
- 4.4 The latest forecast is that the HRA will record an in year shortfall of £452k in 2011/12 against the anticipated budget surplus of £4.2m, but this is only achieved after including anticipated VAT shelter credits of £5.5m. These receipts are time limited, and are set aside to meet any future environmental liabilities which may arise out of the transfer programme. It is not sustainable to use these to support ongoing revenue costs in the longer term.
- 4.5 The Brunswick PFI was anticipated to come on stream during the final quarter of 2011/12 but this has been delayed and is now expected to commence in the first quarter of 2013/14.

#### **5 Budget Strategy 2012/13 – 2014/15**

- 5.1 The proposed HRA budget is shown at Appendix 1; this has been prepared in line with the assumptions set out in the following paragraphs and in accordance with the requirements of the new self financing regime. The HRA budget shows statutory compliance in that a surplus is forecast at the end of each year within the Budget Strategy period, and any surplus will be credited to the HRA reserves.
- 5.2 Reserves are necessary in order to protect the Council from any future risk e.g. increased costs above those assumed, or any unforeseen costs. This will become even more important under self financing, because specific risks around inflation/interest rates have previously been allowed within the subsidy system.
- 5.3 This budget has been prepared incorporating the financial impact of both the existing Private Finance Initiative (PFI) schemes, and the Brunswick scheme which is not expected to come on stream until 2013/14. Costs of repairs and maintenance have been included in the budget in respect of the Brunswick properties in 2012/13.

5.4 The overall reserves include earmarked PFI reserves which are set aside to meet future liabilities. In the early years of PFI schemes the funding received is greater than the annual payments, and the reserves will increase accordingly each year, but in later years the annual grant will be less than annual repayments and the shortfall will be funded from the reserves. A review of the existing PFIs is currently underway to assess future resource requirements against the original plans.

5.5 The key budget assumptions used in preparing the HRA budget are as follows:-

### **Rent Levels**

5.6 The rent levels are set within the boundaries of the HRA rent restructuring which aims to achieve social rent reform and rent convergence by 2015/16. The proposed rent increase for next year is an average 6.48%, in line with the Government's assumed increase in the guideline rent. This increase will enable Manchester to achieve the convergence date.

5.7 It is also proposed to apply the 6.48% increase to all other charges associated with rent i.e. garage, and service charges.

5.8 The above rent increase has been assumed in the budget presented at Appendix 1.

### **PFI Allowances**

5.9 Brunswick PFI is anticipated to commence from April 2013. The HRA budget includes an annual contribution equivalent to the management and maintenance allowances that would have previously been credited to the PFI reserve to ensure that the scheme is affordable. In 2013/14 there is a contribution of £3.9m, this increases to £5.5m in 2014/15, and then rises in line with inflation.

5.10 As well as the above contributions, the PFI agreement is based on the fact that the City Council will have previously been receiving major repairs allowances for these properties, and the PFI grant will be reduced accordingly. This equates to a cost of £764k per annum and the budget has been adjusted from 2013/14 onwards.

5.11 Within the self-financing regime Local Authorities will continue to receive PFI funding in the form of a grant, which will then be used to contribute towards the annual costs of the PFI's.

### **Communal Heating**

5.12 The City Council has now fixed the future gas prices, in respect of both the Industrial and Commercial Contract (I&C), and the domestic gas contract. Members will recall that tenants on the I&C contract were subjected to a mid year

increase around October 2011, due to a higher than anticipated increase in the 12 month contract from April 2011. The most recent negotiations in respect of gas contracts have now concluded, and the following is proposed;-

- Tenants on the commercial contract (I&C), which includes sheltered accommodation, are to receive up to a 10% reduction in their heating bills. The commercial contract was subject to a mid year increase in October 2011, to reflect the City Council's increased costs because of prevailing world events. The proposed increase was in line with other market providers, and reflected the changes to wholesale gas prices. However the recently negotiated I&C contract has resulted in reduced costs to the Council.
- Tenants on the domestic contract will see their charge remain as at previous levels (April 2011). The charges to tenants compare favourably with other providers in the domestic market.

### **Depreciation**

- 5.13 Depreciation is a measure of the economic benefit of the assets that have been consumed.
- 5.14 The Chartered Institute of Public Finance and Accountancy (CIPFA) have consulted on the proposed methodology for the calculation of depreciation within the new self-financing HRA arrangements. However, it is still unclear what the financial impact will be particularly when considering the proposed change on the treatment of impairment. Accordingly there will be a five year transition period before authorities are required to fully implement the necessary changes in respect of depreciation and further guidance is expected in early February 2012.
- 5.15 Until the treatment of depreciation in the accounts is clarified the proposed budget includes depreciation costs calculated on the basis of the uplifted rate for the Major Repairs Allowance (MRA).

### **Borrowing Costs**

- 5.16 The borrowing costs have been calculated based on the initial opening debt (see paragraph 2.3 earlier) and the application of a prudent average loan rate of 4.98%. This may change dependant on the outcome of negotiations around the settling of market debt.

### **Cost of Pay Award**

- 5.17 The Inflationary allowance in respect of pay and prices over 2013-15 has been allowed at 1%, which is in line with City Council's overall budget strategy. The rents have been calculated allowing for inflation and the Government's rent convergence policy.



## **Bad Debts**

- 5.18 Due to the anticipated welfare reform changes from 2013/14 and the payment of Housing Benefit direct to tenants, rather than the current arrangement whereby a payment is made directly to the landlord, there is an increased potential for non payment of rent. It is, therefore, deemed prudent to increase the level of bad debt provision from 1% to 3% of budgeted rental income. This will remain under review and the actual provision required will be finalised as part of the annual closure of accounts.

## **6 Budget Sensitivity**

- 6.1 The budget has been developed taking in to account the above assumptions. Work is ongoing to undertake further sensitivity analysis in respect of the assumptions within the business plan, but the key risks are:
- The assumed interest rates within the PFI reserve calculations are not in line with those currently available on balances in year.
  - The collection rates in respect of rental income are not achieved, due to the current economic climate, or change to the housing benefit rules as part of the welfare reform proposals.
  - Right to buy rates increase, particularly following the new enhanced Right to Buy scheme out to consultation (see paragraph 8 below), and therefore reduce the numbers of properties within the HRA and the level of rental income
  - Interest rates increase significantly, therefore increasing the costs of borrowing – this has traditionally been mitigated within the subsidy system

These issues/risks will be identified within a HRA risk log, together with mitigating actions. They will need to be monitored and reported to management on a regular basis, and managed within the restraints of the HRA.

- 6.2 If there are any changes to the resources required, due to either increased costs through unforeseen events, or reduced income based on the projections then the HRA will need to fund these costs from within the HRA, through the identification of further savings proposals, or the use of reserves.
- 6.3 Interest rates have shown a recent significant reduction during the current economic down-turn. The budget for both interest payable and receivable has been set to reflect this. The assumption is that the low rates currently being experienced will slowly begin to rise as the economy generally improves.
- 6.4 The Budget Strategy makes several assumptions with regard to the rental income. The income figures also take in to account a level of RTBs, and the Government has made assumptions in the debt settlement regarding future RTB numbers. The recent announcement to enhance current discount rates has not been factored into the calculations yet, but will be monitored once guidance is issued.

## **7 Investment Proposals**

7.1 A number of options can be considered by the Council should it decide to use any of the headroom or surpluses generated within the HRA. Options put forward need to take in to account the benefits of the proposed spend for housing tenants and include:

- Build new Council housing.
- Make contributions to fill the gap in the PFI reserves which are set aside to pay for work during future years of the contracts.
- Contribute to the Council's Climate Change Delivery Plan (PV, insulation, smart meters for communal heating, individual boilers to replace communal heating).
- Environmental improvements across Northwards estates. Funding for this would have been provided by Government in 2009/10 as part of the ALMO's capital programme but was cut by the coalition Government as part of the comprehensive spending review.

7.2 It is proposed that no decisions are made on the use of any headroom or surpluses during the first 6-12 months of the new self-financing regime. This will enable the City Treasurer and Director of Housing to assess the risks and issues that are likely to materialise as a result of this major change. A report will be brought back to members once the options have been reviewed.

## **8 Right To Buy (RTB)**

8.1 The numbers of Right To Buy sales in 2011/12 currently total 32 and there is an estimate of 37 per annum going forward.

8.2 The prediction for future years RTB numbers will be affected by the consultation document "*Reinvigorating Right to Buy and one for one replacement*" issued by DCLG on 22<sup>nd</sup> December 2011. The consultation sets out Government proposals to:

- Increase the caps on RTB discounts, to encourage greater take up of RTB
- Ensure the receipts on every additional home sold under RTB are used to fund replacement, on a one for one basis, with a new home for Affordable Rent.

DCLG are seeking views on the draft Impact Assessment of the proposed changes. The consultation will last for six weeks ending 2<sup>nd</sup> February 2012.

## **9 Impact on General Fund**

9.1 Work is being undertaken to identify the potential effect on General Fund resources of changes to the HRA, including a review of corporate recharges to the HRA. As part of the Council's main budget setting process £1.5m has

been set aside within the General Fund to mitigate any impact. The effect of any reductions in charges to the HRA is not yet reflected within the budget shown at Appendix 1.

## **10 Conclusion**

- 10.1 This report outlines the financial implications for the City Council of moving to the new self-financing regime for funding social housing from 1<sup>st</sup> April 2012.
- 10.2 The report recognises that there are still a number of issues that remain under discussion with regard to the treasury management arrangements of the final settlement and the treatment of depreciation and impairment within the accounts.
- 10.3 Work is ongoing regarding the potential housing investment programme following the introduction of self financing and a separate report will be presented to members as soon as the Authority has confirmation of the available resources, particularly the headroom.
- 10.4 The proposals contained in this report will seek to ensure that the HRA business plan provides housing with a sound basis of managing the existing stock, whilst also identifying the potential risks that need to be monitored on an ongoing basis.
- 10.5 The budget proposals will allow for continued service delivery and investment within the stock, within the confines of the available resources.
- 10.6 Under the provisions of the Local Government and Housing Act 1989, the Authority must ensure that the HRA does not result in a debit balance. The proposed budget for 2012/13, together with the indicative budget for the following two years, is attached at Appendix 1 and shows this provision being met.
- 10.7 To meet rent convergence in 2015/16 the proposed rent increase is 6.48%.
- 10.8 It is proposed that tenants on the commercial contract (which includes sheltered accommodation) will receive up to a 10% reduction in their heating bills. Tenants on the domestic contract will see their charges unchanged from April 2011.

## **11 Contributing to the Community Strategy**

### **(a) Performance of the economy of the region and sub region**

A healthy and fit for purpose housing market is essential for the economic growth of the City. People living in energy efficient housing in good repair are more likely to stay in good health and so be able to obtain employment and to stay in employment. Setting rents at an appropriate, affordable level will assist in this.

### **(b) Reaching full potential in education and employment**

Appropriate housing is vital to ensuring that residents achieve their full potential. Children living in energy efficient housing in good repair and of adequate size are more likely to stay in good health and have suitable conditions and space for studying. Setting rents at an appropriate, affordable level will enable tenants to live in locations which meet their aspirations in terms of education and employment.

**(c) Individual and collective self esteem – mutual respect**

Quality housing is intrinsically linked to residents' health, well being and feeling about their community. Setting rents at an appropriate, affordable level will assist in this.

**(d) Neighbourhoods of Choice**

Improving the quality and management of the housing offer is fundamental to creating neighbourhoods where people choose to live. Setting rents at an appropriate, affordable level will enable tenants to live in locations which meet their aspirations in terms of preferred neighbourhood.

## **12 Key Policies and Considerations**

**(a) Equal Opportunities**

The rents have been set inline with the Governments increased guideline rent, and the Housing Benefit system will provide support to the most needy within the constraints of the proposed Welfare reform.

**(b) Risk Management**

Under the provisions of the Local Government and Housing Act 1989, the Authority must ensure that the Housing Revenue Account does not result in a debit balance. The proposed increase in rents and identification of savings within this report, together with regular budget monitoring will assist in managing this risk.

**(c) Legal Considerations**

The City Solicitor has reviewed this report and provided a commentary which has been incorporated within.

**Appendix 1**

**HRA Forecast Outturn 2011/12 and Budget 2012/13 – 2014/15**

	2011/12 Forecast Outturn £000s	2012/13 Plan £000s	2013/14 Plan £000s	2014/15 Plan £000s
<b>Balance brought forward</b>	-51,773	-55,529	-67,030	-82,685
<b>Income</b>				
Rental Income	-56,256	-57,407	-59,094	-60,945
Other Income – contributions	-1,566	-659	-670	-681
Service Charges	-2,379	-2,008	-2,048	-2,089
Housing Subsidy	-3,420			
PFI Allowances	-15,440	-15,385	-23,390	-23,390
VAT Shelter Credits	-5,509	-6,445	-5,513	-1,030
<b>Total Income</b>	<b>-84,570</b>	<b>-81,904</b>	<b>-90,715</b>	<b>-88,135</b>
<b>Expenditure</b>				
Maintenance and Repairs - Stock Condition Requirements	14,560	12,099	10,955	10,933
Communal Heating	3,284	2,072	2,121	2,172
PFI Contractor Payments	20,210	19,829	25,822	27,760
Supervision and Management	11,943	8,606	8,139	8,330
Supervision and Management - Northwards	7,940	8,039	8,227	8,419
West Gorton Management	294	389	129	130
Council Tax, Chief Rents	150	154	158	162
Contribution to Bad Debts	563	579	1,788	1,845
Depreciation (MRA)	9,736	12,766	12,220	12,491
Debt Management Expenses	16	57	59	60
<b>Total Expenditure</b>	<b>68,696</b>	<b>64,590</b>	<b>69,618</b>	<b>72,302</b>
<b>NET COST OF SERVICE ( - ) = surplus</b>	<b>-15,874</b>	<b>-17,314</b>	<b>-21,097</b>	<b>-15,833</b>
Interest payment and similar charges inc prudential borrowing	13,028	6,088	6,088	6,088
Amortised Premia (net of discount)	-1,110			
HRA Investment Income	-200	-275	-646	-791
<b>Sub-total</b>	<b>11,718</b>	<b>5,813</b>	<b>5,442</b>	<b>5,297</b>
Revenue Contribution to Capital Outlay	400			
<b>Sub-total</b>	<b>400</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>In-year balance ( - ) = surplus</b>	<b>-3,756</b>	<b>-11,501</b>	<b>-15,655</b>	<b>-10,536</b>
<b>CUMULATIVE BALANCE CARRIED FORWARD</b>	<b>-55,529</b>	<b>-67,030</b>	<b>-82,685</b>	<b>-93,221</b>
<b>Analysis of Reserves 2011/12 -2014/15</b>				
	2011/12 £000	2012/13 £000	2013/14 £000	2014/15 £000
General Reserve	272	5,244	10,655	16,529
Residual Liabilities Reserve	21,091	27,536	33,049	34,079
PFI Reserves	34,166	34,250	38,981	42,613
<b>Total Reserves</b>	<b>55,529</b>	<b>67,030</b>	<b>82,685</b>	<b>93,221</b>