AGENDA ITEM

REPORT TO:	**MERSEYSIDE FIRE & RESCUE AUTHORITY BUDGET MEETING**
DATE:	**THURSDAY 16TH FEBRUARY 2012**
REPORT NO.	**CFO/033/12**
REPORTING OFFICER:	**DEPUTY CHIEF EXECUTIVE**
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OFFICERS CONSULTED:	**STRATEGIC MANAGEMENT GROUP**

Merseyside Fire and Rescue Authority Budget and Financial Plan 2012/2013- 2016/2017

Merseyside FIRE & RESCUE SERVICE

Beacon Authority 2004-2005 Services for Older People

Beacon Authority 2006-2007 Early Intervention (Children at Risk)

Beacon Authority 2008-2009 Reducing Health Inequalities

APPENDIX	**1**	**DRAFT REVENUE BUDGET ANALYSIS**
APPENDIX	**2**	**PROPOSED CAPITAL PROGRAMME 2012/13 – 2016/17 SUMMARY**
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APPENDIX	**4**	**TREASURY MANAGEMENT STATEMENT**

ATTACHED – HARD COPIES

***A Glossary of Terms has been listed at the end of this report for your information.**

Purpose of Report

1. To present information to allow Members to set a medium term financial plan – both capital and revenue – that allocates resources in line with the Authority's strategic aims and ensures that the Authority delivers an efficient, value for money service. This will also allow the Authority to determine a budget for 2012/2013 and a precept level in line with statutory requirements.

Recommendation

2. Members consider this report and proposed budget and:-

   (a) Confirm their strategy on balances and the level of balances and reserves they consider appropriate for the forthcoming and future financial years.

   (b) Decide the level of precept they wish to set for 2012/2013 and any strategy for precepts they wish to adopt for future years.

   (c) Choose the growth and savings options they wish to support to deliver a balanced Medium Term Financial Plan.

   (d) Confirm the capital strategy and investment strategy they wish to adopt for 2012/2013 and future years.

   (e) Note the prudential indicators relating to the proposed capital programme and agree the Treasury Management indicators set out in the Treasury Management Strategy for:-

      (i) External Debt
      (ii) Operational Boundary for Debt
      (iii) Upper limits on fixed interest rate exposure
      (iv) Upper limits on variable rate exposure
      (v) Limits on the maturity structure of debt
      (vi) Limits on investments for more than 364 days

(f) Noting that these policies and parameters provide an approved framework within which the Officers undertake the day to day capital and treasury activities (the Authority is recommended to approve each of the key elements contained within this section of the report); and

(g) Approve the statement within this report that sets out the Authority's policy on the Minimum Revenue Payment (MRP) for 2012/13.

Introduction & Background

Information

3. The Authority is required to determine its budget and precept level for 2012/2013 by 1st March 2012.

4. This report will present all the necessary financial information in a single report. This report considers:-

Forecast Revenue Estimates
The Proposed Capital Programme
Savings and Growth Options
The Treasury Management Strategy
The Minimum Revenue Payment Policy for the Authority

5. Considering all the financial issues to be taken into account in a single report ensures that the Authority can:-

(a) Consider the borrowing freedoms available under the prudential code
(b) Reflect best practice
(c) Provide value for money
(d) Focus on the link between capital investment decisions and revenue budgets
(e) Continue developing its strategic financial planning

6. The following report structure will be adopted:-

Section	Focus	Page
A	Executive Summary	4-12
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A) EXECUTIVE SUMMARY

7. The Authority must set a balanced budget and a precept level by 1st March 2012.

8. The budget and financial plan should allocate resources in line with corporate priorities. The key aims of Merseyside Fire and Rescue Authority are set out in its Integrated Risk Management Plan and may be summarised as.

Our Mission;

To Achieve; Safer Stronger Communities - Safe Effective Firefighters

Our Mission;

Excellent Operational Preparedness
Excellent Operational Response
Excellent Prevention and Protection
Excellent People

9. The Authority has agreed a number of Value For Money Principles that have underpinned its approach to budgets and financial plans in recent years. They are:-

Principle 1 – Allocate resources in line with priorities

Principle 2 – Control Council Tax

Principle 3 – Acknowledging budget realities

The Authority will continue to:

i) Acknowledge the challenges it faces:
ii) Acknowledge the reality of its budget and recognise that 80% of its costs are people related.

Principle 4 – The Authority seeks to if possible avoid compulsory redundancy in delivering Value for Money

Principle 5 - The Authority seeks to maintain or improve service levels

Revenue Forecasts

10. As Members are aware the Authority is facing an unprecedented financial challenge over the 2011/2012 – 2014/2015 period.

11. Last year the Authority received the worst grant cut for any fire authority in the country from central government, a reduction of in excess of 13% between 2011/2012 and 2012/2013. The national average cut for this period was about 6.5%. The Government has stated that fire service cuts are "back loaded" with

two thirds of the anticipated reduction in government grant funding still to come in 2013/2014 – 2014/2015. The current approved financial plan has adopted a two phase approach to the cuts that are required with the following strategy:-

- Phase 1; 2011/12 – 2012/13, the Authority approved a saving plan for this period that would balance the budget for these years by making cuts and savings totalling £9.2m.

- Phase 2; 2013/14 – 2014/15, the Authority has adopted a lobbying strategy with a view to minimising the level of grant cuts. Depending on the success of the lobbying the Authority would face a stark choice between substantial service reductions or large-scale local taxation increases.

12. The Government has now given an indication of the 2013/14 and 2014/15 national average grant cuts for directly funded fire and rescue services in England. The average cuts will be 8.5% and 5% respectively. However, it is believed that these grant cuts may be varied further to reflect the Chancellors assumptions of a two year paybill cap for all public sector workers of +1%p.a (after an assumed completion of a two year pay bill freeze). The Chancellor has already reflected this in the overall government spending department totals. Therefore the most likely average cuts appear to be at 9.5% and 6% in 2013/14 and 2014/15 respectively.

13. The Government has also confirmed that Fire and Rescue services will be within the new funding arrangements for all local government with effect from 2013/14 (the Resource Review mechanisms which will localise Business Rates) but that the Government's 2010 Comprehensive Spending Review totals will still be applied to the overall funding allocations, i.e. the cut in Government grant will still be applicable for Phase 2. There is much detail to be worked through to understand the position at an individual fire authority level which will probably not be clear before December 2012.

14. The current financial plan has been adjusted to take into account the latest forecast for **average** Government grant cuts in 2013/14 and 2014/15 of 9.5% and 6% respectively, and the following key assumptions:

- that the Authority will keep to its medium term plan and have the freedom to set Council Tax at 4% per annum
- A paybill freeze for all staff in 2012/2013 (as already assumed in the plan) which will then be followed by pay bill rises returning to be in line with the Treasury medium term inflation targets of +2% per annum (Pay bill includes such costs as pay awards, pension contributions and national insurance.)
- 2% per annum General Price Inflation

A five year financial revenue estimate has been prepared based upon the current approved financial plan, and summarised in the Table A below:-

Table A

2012/13 - 2016/17 Financial Plan	2012/13 £'000	2013/14 £'000	2014/15 £'000	2015/16 £'000	2016/17 £'000
EXPENDITURE					
2011/12 Expenditure Forecast:					
Forecast Expenditure	78,824	80,719	83,219	85,074	86,684
2011/12 Approved Saving Proposals	-8,525	-9,200	-9,200	-9,200	-9,200
Planned Use of Cost Smoothing Reserve	-805	0	0	0	0
MTFP for 2011/12 Budget Report	69,494	71,519	74,019	75,874	77,484
2012/13 - 2016/17 Expenditure Changes:					
Capital Prog MRP/Interest for new year 2016/17					200
Adjust Smoothing Reserve drawdown in 2012/13 to bring net position to balance	254				
Updated Expenditure Forecast	**69,748**	**71,519**	**74,019**	**75,874**	**77,684**
FUNDING					
Government Grant	-40,481				
Forecast Grant:					
a) Reductions in Grant anticipated:					
2012/13 Base less -8.5%		-37,040			
2012/13 Base less -8.5% & - 5.0%			-35,016		
2015/16 +2% of 2014/15 grant				-35,717	
2016/17 +2% of 2015/16 grant					-36,431
2017/18 + 2% of 2016/17 grant					
c) Reductions in Grant due to further Govt spending reductions to cover future pay **(-1.0% & -1.0)**		405	810	826	843
d)2011/12 Council Tax Freeze Grant built into base grant from 2012/13	-681	-681	-681	-681	-695
Total Government Formula Grant Forecast	-41,162	-37,316	-34,887	-35,572	-36,283
Council Tax - 4% increase p.a	-28,481	-29,620	-30,805	-32,037	-33,318
Collection fund deficit / (surplus)	-105				
Anticipated Reduction in Coll Fund rates due to impact of benefit change 13/14		200	200	200	200
Updated Income Forecast	**-69,748**	**-66,736**	**-65,492**	**-67,409**	**-69,401**
Forecast Net Position (surplus) / deficit	**0**	**4,783**	**8,527**	**8,465**	**8,283**

The revenue position is considered in more detail in section G.

Proposed Budget

15. The Government has confirmed the level of grant support for the Authority in 2012/3 of £41.162m, this is consistent with the level anticipated in the current financial plan. The Authority remains on track to deliver the £9.2m of approved saving proposals required in phase 1 of its approved financial strategy, and therefore the Authority currently has a balanced budget proposal for 2012/13. This is on the basis that the Authority increases its Council Tax in 2012/13 by +4%, as outlined it its approved financial plan, and that paybill costs are frozen in 2012/13.

It is the view of the Chief Fire Officer (CFO) that future further significant savings could only be achieved by major reductions in fire cover in Merseyside.

Therefore, the recommendation is that the Authority persists with its strategy for phase 2 and continue the lobbying strategy for 2013/14-2014/15 (in conjunction with other Metropolitan Fire and Rescue Services) with a view to minimising the level of grant cuts. The Authority does recognise that it needs to plan prudently for what it would do if this approach is not successful and therefore the Authority needs to commence work on identifying potential solutions to Phase 2 of the challenge, years 3 and 4 (2013/14 – 2014/15). Officers are therefore proposing the following work programme be undertaken:-

a. Working jointly with the relevant service representative bodies to conclude a fundamental review of fire cover, and
b. To review the standards of fire cover appropriate for the county based upon risk, and
c. Consider what further savings can be delivered from a fundamental review of support services.
d. A review of the Authority's; reserve strategy; debt portfolio, capital programme including any alternative financing methods, to identify any possible savings in the costs of debt servicing for the Authority, and
e. A detailed review of all the "technical" assumptions in the base budget to assist the Authority to consider if there is any flexibility in those assumptions, and
f. Commence a consultation with the community of Merseyside on their view as to the potential consequences on the community of Merseyside of the potential cuts and whether they would be supportive of paying relatively small amounts of additional council tax to safeguard their Fire and rescue service, and
g. Grant delegated power to the CFO to continue to use VER/VS to reduce staff numbers where a business case exists to do so in line with the policies and procedures previously agreed by the Authority, and
h. Review the current HFSC strategy with a view to ensuring the investment offers the best returns in community safety.

Reserves and Balances

16. In the light of the financial risks facing the Authority the Deputy Chief Executive has worked with Officers and Members to increase reserves in recent years. The latest financial review report CFO/132/12 identifies a forecast revenue underspend which will allow the Authority to increase its reserves by a further £0.600m meaning approximately £14.150m of reserves might be seen as available. Whist these levels are relatively high historically they reflect the very high level of risk associated with the current financial plan and the potential speed and severity of cuts that might be imposed on the Authority in phase 2. The Authority needs a buffer to give it time to make changes if required and to avoid compulsory redundancy if possible

17. Assuming Members are minded to endorse the proposed budget in line with their current financial plan the Deputy Chief Executive recommends the following strategy on reserves:-

Strategic Reserve Forecast for 2011/12 to 2016/17

	2011/12 Closing Balance	2012/13 Opening Balance	Planned / Potential Use	Forecast Bal 31.03.13	Est Bal 31.03.14	Est Bal 31.03.15	Est Bal 31.03.16	Est Bal 31.03.17
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Earmarked Reserves								
Cost Smoothing Reserve	2,046	2,046	-553	1,493	1,493	1,241	1,241	1,241
Capital Investment Reserve	3,000	3,000	-500	2,500	2,500	2,200	2,200	2,200
Severance Reserve	2,420	2,420	-1000	1,420	1,420	1,420	1,420	1,420
Inflation Reserve	2,000	2,000		2,000	2,000	2,000	2,000	2,000
Total Earmarked Reserves	**9,466**	**9,466**	**-2,053**	**7,413**	**7,413**	**6,861**	**6,861**	**6,861**
General Revenue Reserve	**4,684**	**4,684**	**0**	**4,684**	**4,684**	**4,684**	**4,684**	**4,684**
Total Reserves	**14,150**	**14,150**	**-2,053**	**12,097**	**12,097**	**11,545**	**11,545**	**11,545**

18. As previously stated this report identifies a number of potential risks in relation to the key assumptions in the medium term financial plan. If any of these assumptions vary then the forecast balanced budget position will be affected. Any resultant material deficit might result in the Authority having difficulty in maintaining its value for money principles and in particular avoiding compulsory redundancies.

19. **Members should bear in mind that reserves and balances and one-off savings should only be used to finance one-off expenditure. If such monies are used to fund ongoing revenue expenditure without taking action to reduce underlying expenditure, the Authority would find itself facing the same deficit in the next and future years but without reserves available to finance it. This is underlined by the District Auditor's 'Golden Rule' - that "one off" revenue reserves should not be used to support 'ongoing' revenue expenditure.**

Council Tax Increase

20. The forecast produced assumes a 4.00% council tax increase in each year in line with the Authority's value for money principles. The Authority may choose to use a further precept increase to bridge the gap, however current legislation requires any increase above a threshold set by the Secretary of State must be subject to a referendum of the electorate of Merseyside. Any vote against such an increase will require a revised budget and incur the expense of re-billing all the districts within Merseyside. For 2012/2013 any proposed increase in excess of 4% will require such a referendum.

21. The ready reckoners below show the impact of potential Council Tax increases.

Council Tax Increase

	0%	1%	4%
Band D Tax	64.77	65.42	67.36
District Precept	£m	£m	£m
LIVERPOOL	8.112	8.194	8.437
WIRRAL	6.869	6.938	7.144
ST.HELENS	3.636	3.672	3.781
SEFTON	6.031	6.092	6.273
KNOWSLEY	2.737	2.764	2.846
	27.385	27.660	28.481

Members must choose a portfolio of savings and growth options, a strategy for reserves (in the light of the advice of the Deputy Chief Executive) and a Council Tax level for 2012/2013 that sets a balanced budget in line with the statutory timetable.

<u>Capital</u>

22. The proposed 5 year capital programme is detailed in section C. The table overleaf summarises the proposed investments which are mainly in the Authority's property, vehicle and ICT assets which total nearly £30million across the life of the programme.

<u>Authority Approved Capital Progamme for 2012/2013 - 2016/2017</u>

Expenditure	Total Cost £	2012/13 £	2013/14 £	2014/15 £	2015/16 £	2016/17 £
Building/Land	**9,601,500**	5,246,500	787,000	1,031,000	1,976,500	560,500
Fire Safety	**8,766,000**	1,752,000	1,752,000	1,754,000	1,754,000	1,754,000
ICT	**3,667,000**	826,000	938,000	700,000	662,000	541,000
Operational Equipment & Hydrants	**1,120,000**	577,000	57,000	77,000	57,000	352,000
Vehicles	**7,117,100**	2,202,800	1,291,100	939,100	1,135,300	1,548,800
TOTAL	**30,271,600**	**10,604,300**	**4,825,100**	**4,501,100**	**5,584,800**	**4,756,300**

Financing Available:	Total	2012/13	2013/14	2014/15	2015/16	2016/17
Capital Receipts						
Sale of old workshop - Q2 reduced by £30,000	**470,000**	470,000				
Toxteth Fire Station (Firefit Hub)	**500,000**		500,000			
Sale of 2 existing N-le-W LLAR properties	**275,000**				275,000	
R.C.C.O.						
CFS general cont (Cap sals)	**5,000,000**	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Grant						
BLD017: My Space Big Lottery Grant	**413,000**	413,000				
Other						
BLD017 Toxteth Hub: LCC contribution	**150,000**	150,000				
Total Non Borrowing	**6,808,000**	**2,033,000**	**1,500,000**	**1,000,000**	**1,275,000**	**1,000,000**
Unsupported Borrowing	**23,463,600**	8,571,300	3,325,100	3,501,100	4,309,800	3,756,300
Total Funding	**30,271,600**	**10,604,300**	**4,825,100**	**4,501,100**	**5,584,800**	**4,756,300**

23. This capital programme has a borrowing requirement of £8.571million in 2012/2013 and £23.464million across the whole life of the plan. The proposed borrowing is unsupported borrowing or prudential as Members will note that the Government no longer allocates any supported borrowing to fire authorities and therefore no longer builds any revenue grant funding support for new borrowing in the formula grant. This means all borrowing is prudential.

24. The Government has announced the Authority will receive a capital grant in 2012/13 but at the time of preparing this report the exact amount has yet to be confirmed and therefore no such grant is assumed in this report.

25. The Authority needs to be mindful of the revenue costs of borrowing.

26. There has been an increase in Authority debt levels in recent years as the service needed significant capital infrastructure investment following a long period of restricted capital spend under previous capital control regimes. Current and future debt servicing costs as a consequence of the proposed capital programme have been built into the proposed financial plan. This report provides members with a number of prudential indicators so they can ensure that this commitment is considered affordable, prudent and sustainable in light of these prudential indicators (Section E).

Treasury Management

27. The Prudential Code requires the Authority to set a Treasury Management Strategy that includes a number of indicators and limits. It sets a framework for the Deputy Chief Executive to manage investments and borrowings within.

28. The proposed strategy is set out in Section F and includes limits for the next three years on:-

Overall Level of External Debt
Operational Boundary for Debt
Upper limits on fixed interest rate exposure
Upper limits on variable rate exposure
Limits on the maturity structure of debt
Limits on investments for more than 364 days

Minimum Revenue Payment (MRP) Statement

29. MRP is the amount of money set aside in the revenue budget by the Authority each year to reduce its overall level of debt. The Authority is required under the new Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 to prepare a statement on its policy for MRP in respect of the forthcoming year. The new regulations require authorities to pay debt at a rate which it considers prudent.

30. The Deputy Chief Executive has reviewed the MRP policy in line with the legislation and the report outlines the proposed MRP policy for 2012/2013 and future years.

31. The overall impact of the new regulations has been to increase the revenue costs relating to asset investment.

B) BACKGROUND INFORMATION

32. This section provides general financial information on the Authority's finances and financial health.

Corporate Strategy

33. If any organisation wants to be successful its budget setting and medium term financial plan must allocate resources to support its key strategic aims and priorities. This is a vital consideration when organisations face periods of severe resource shortages.

34. For many years now the Authority has maintained a comprehensive five year financial plan and capital programme despite facing significant financial challenges as a result of ongoing poor Government grant settlements for the Authority. In 2010 the new Government announced its spending review targets for 2011/12 – 2014/15 in which it stated that fire authorities faced a 25% reduction in government funding (equivalent to a cash reduction of 18%) over this period. The Government stated the reduction will be back loaded for fire authorities, with approximately 1/3rd of the reduction in the first two financial years, (2011/12 – 2012/13) and the remainder in the last two years. The Government has announced the Authority's grant settlement figures for 2011/12 & 2012/13 but not for the final two years, (2013/14 – 2014/15), and therefore a level of uncertainty remains. It has however confirmed the position regarding the national average grant cuts for directly funded fire and rescue services in England for these years. The average cuts will be:-

2013/14	- 8.5%
2014/15	-5.0%

However, it is believed that these cuts may be increased further to reflect an assumption by the Chancellor of a two year public sector paybill limitation at increases of 1% for public services after the completion of the pay freeze. Spending totals for local government have been cut accordingly. Therefore it would seem likely that the Authority might (if it were at the national average) face a grant reduction of -9.5% and 6.0% in the respective years 2013/14 and 2014/15. If the Authority does as badly as it did in the first two years it may be much worse than this. This government announcement does confirm the backloading of fire cuts since the national average cut in years one and two of the spending review was 5.7% and 0.7% respectively.

35. It is quite probable the Authority will face a large financial challenge to deliver the savings required over the spending review period.

36. The Integrated Risk Management Plan (IRMP) is the key driver in the allocation of the Authority's resources in response to the risks facing Merseyside.

37. The Authority's IRMP states the main strategic themes that the Authority has been progressing and its plans for the future. The 2012/2013 IRMP, report CFO/028/12 is also considered as part of the budget meeting and appears

elsewhere on the agenda. The IRMP is a three year plan and 2012/2013 is the first year of the next three year plan.

38. The Authority's key Mission, Aims and Values as set out in the IRMP are set out below. Any financial plan should aim to allocate resources to deliver these key aims.

Our Mission;

To Achieve; Safer Stronger Communities - Safe Effective Firefighters

Our Aims;

Excellent Operational Preparedness

We will provide our firefighters with the training, information, procedures and equipment to ensure they can safely and effectively resolve all emergency incidents.

Excellent Operational Response

To maintain an excellent emergency response to meet risk across Merseyside with safety and effectiveness at its core.

Excellent Prevention and Protection

We will work with our partners and our community to protect the most vulnerable through targeted local risk reduction, health inequality intervention and the robust application of our legal powers.

Excellent People

We will develop and value all our employees, respecting diversity, promoting opportunity and equality for all.

Our Core Values;

Make a positive difference to our community

We will build upon our unique position of trust and respect within the community and the professionalism of our staff to tackle the real underlying factors which affect risk.

We will achieve this by seeking partnerships in areas where we believe we can contribute to making communities safer from fire and other emergencies.

Provide an excellent and affordable service

We will manage our emergency response flexibly, with an emphasis on those most at risk.

We will do this by managing the number and type of appliances which are available to respond to emergencies at different locations throughout the day, night and at different times of the year to more accurately reflect the changing level and location of risk.

Everyone matters
We aim to reduce risk in every home on Merseyside to a tolerable level, with no homes being assessed as high risk after we and our partners have offered support to the resident.

To achieve this we will be more sophisticated in the way we commit resources to reduce risk; we will continue to offer free Home Fire Safety Checks to residents in Merseyside as we have done for the past ten years, but our key focus will be to work with our partners to identify and provide assistance to those individuals within the community who are most at risk from fire and other emergencies.

Respect our environment
We will fulfil our responsibilities for protecting the built and natural environment, with support and commitment at the highest level.

We will continue to identify and manage our activities, which have an impact on the environment, without compromising our operational response or our service delivery to the communities of Merseyside.

Our people are the best they can be
We will ensure our workforce has the necessary knowledge, skills and values to make a difference.

We will support them in their role and encourage them to contribute their ideas to continually improve the Service to deliver our mission.

We will ensure our staff receive the training and information they need, in order to deliver our services to a high standard and that they are protected in their work through a comprehensive and robust approach to health & safety.

Is the Overall Strategy Working?

39. The Fire Authority has achieved great success in its aims to make Merseyside a safer community over the last decade. Members receive detail on this excellent performance in a variety of formats but highlights include:-

(a) Becoming the first fire authority in the world to visit 100,000 households in a single year to carry out Home Fire safety Checks(and approximately 700,000 visits in total have been carried out).

(b) Fitting approximately 800,000 free smoke alarms.

(c) Receiving Beacon Status for Early Intervention (Children at Risk), Working with Older People, and for Reducing Health Inequalities.

(d) Reducing fire deaths from an average of 20 in 1999 to 5 in 2010/11 and to just 5 so far this year (year ends March), a 75% reduction.

(e) Reduced the number of fires and their impacts.

40. The table below summarises some key performance statistics over the last 7 years:

Year	Accidental Dwelling Fires	Injuries in Accidental Dwelling Fires	Fatalities in Accidental Dwelling Fires	Anti Social Behaviour Fires
2003-2004	1612	171	9	18984
2004-2005	1470	173	11	12258
2005-2006	1456	155	11	11689
2006-2007	1336	126	8	12721
2007-2008	1286	69	9	10449
2008-2009	1302	107	9	7648
2009-2010	1299	117	8	7384
2010-2011	1199	137	5	6893
2011 – 2012 (qtr 3)	918	105	5	5301
Reduction between 2003/04 t0 2010/11	-25.62%	-19.88%	-44.44%	-63.69%

41. More details of the Authority's performance can be found in:-

(a) The service plan and performance update reports, the most recent of which was CFO/027/12 (IRMP Scrutiny Panel 26th January 2012), http://www.merseyfire.gov.uk/aspx/pages/fire_auth/pdf/DRAFT%20Agenda_IRMP_Scrutiny_Panel_.pdf

(b) The Annual Service Plan 2011/12 can be found on the Authority's web site http://www.merseyfire.gov.uk/aspx/pages/fire_auth/pdf/CFO_029_11_Appendix_A.pdf

Financial Strategy and where are we now?

42. In recent years the Authority has adopted a financial strategy that:-

- Sought to minimise Council Tax increases with a target increase of less than 4% that it has adhered to despite severe financial constraints

- Planned for pay awards and grant increases in line with HM Treasury medium term expectations

- Recruited and trained employees to meet the Authority's high performance standards and budgeted for staff actually in post Sought to generate significant savings through staff reductions whilst avoiding compulsory redundancy

- Made significant investment in Community Fire Safety and preventative work

- Invested to maintain emergency response standards and to modernise working arrangements for dealing with a whole host of emergency incidents

- Developed arrangements for restoration with the private sector and the Fire Support Network

- Made significant investment in IT and computing (including outsourcing)

- Provided further investment in equality and health and safety

- Attempted to plan prudently over the medium term by considering all significant risks to the assumptions in the financial plan and creating specific reserves if deemed necessary

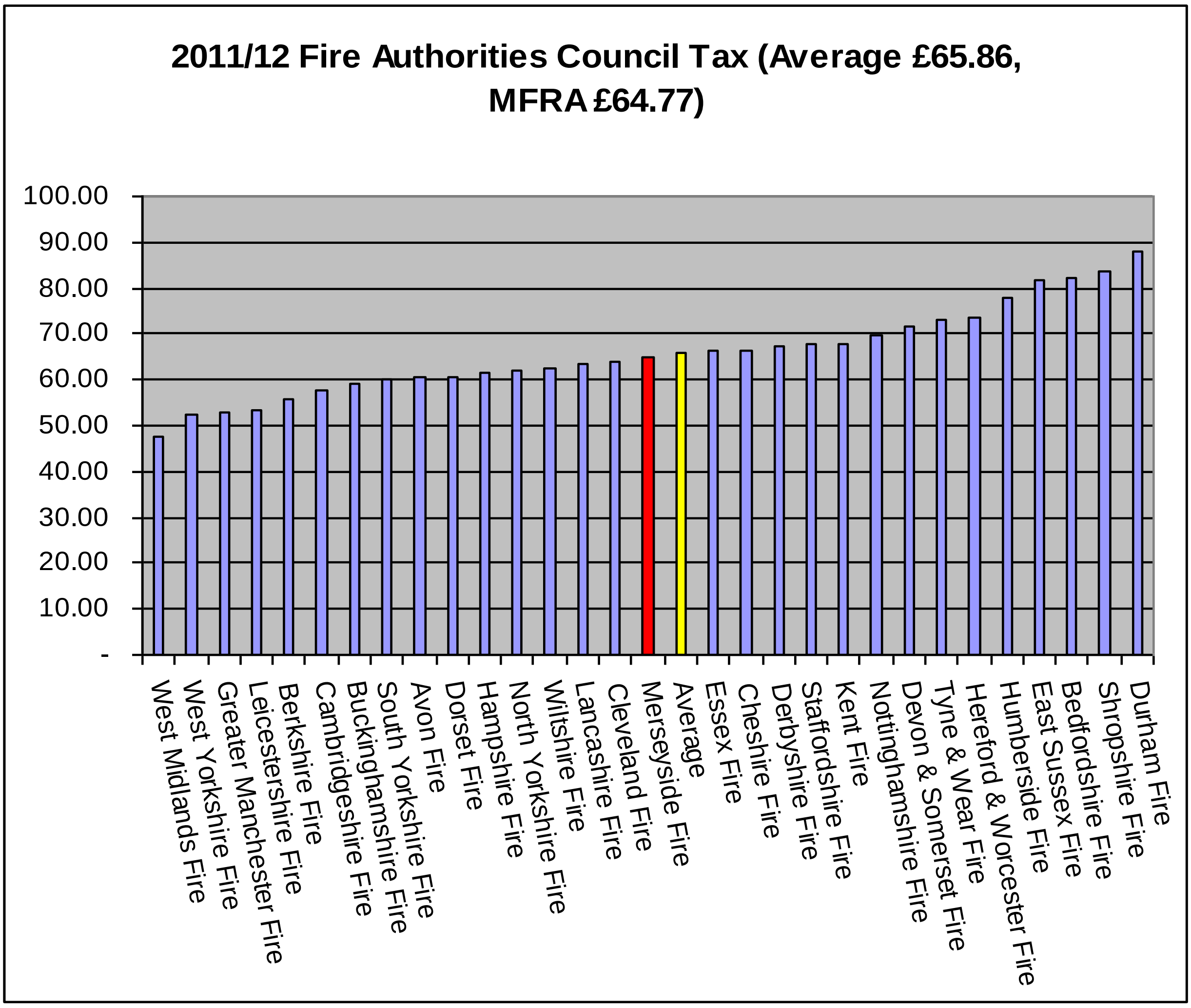
- Maintained a general fund reserve of at least £2m following assessments of risk

- Because of pressures on revenue budget generally avoided funding capital expenditure from revenue through leasing or RCCO

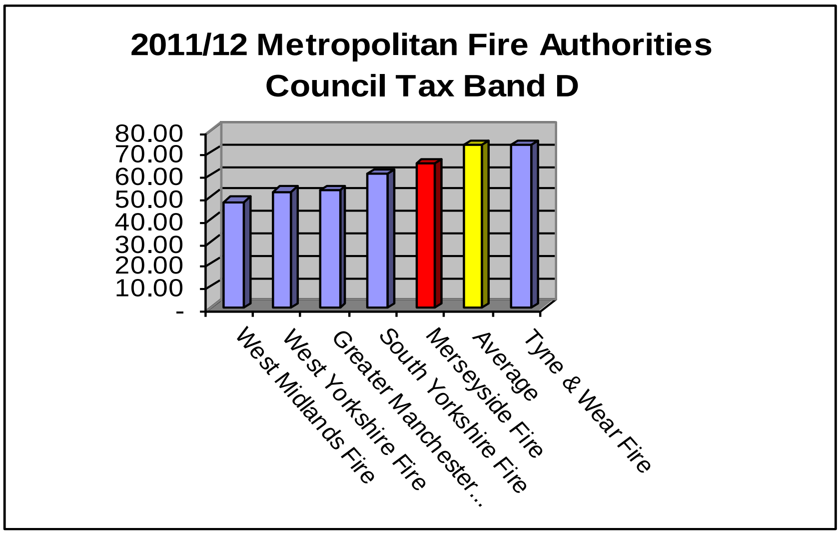
- Invested in the capital infrastructure of the Authority in line with the Asset Management Plan, vehicle replacement strategies and corporate objectives.

These strategies have over recent history allowed the Authority to make significant strides in reducing cost and maintaining relatively low levels of Council Tax increase despite very tight grant settlements.

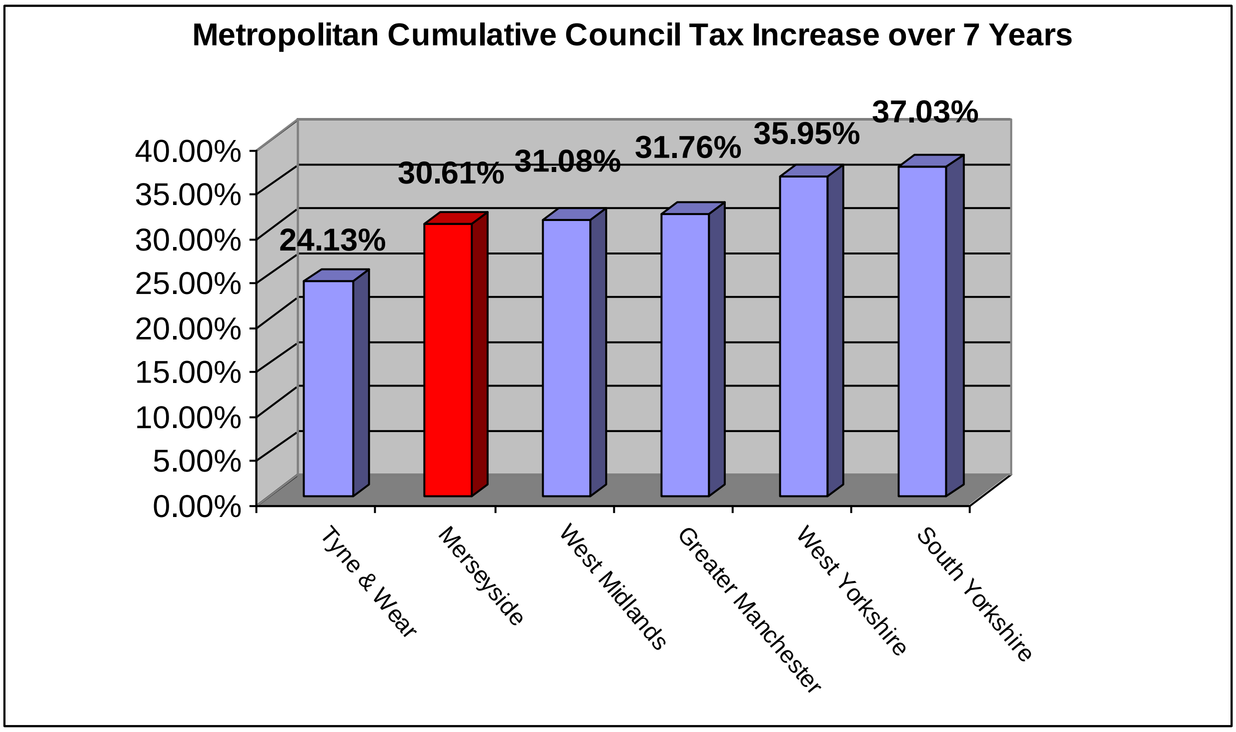
The Authority is below the national average council tax for fire services.



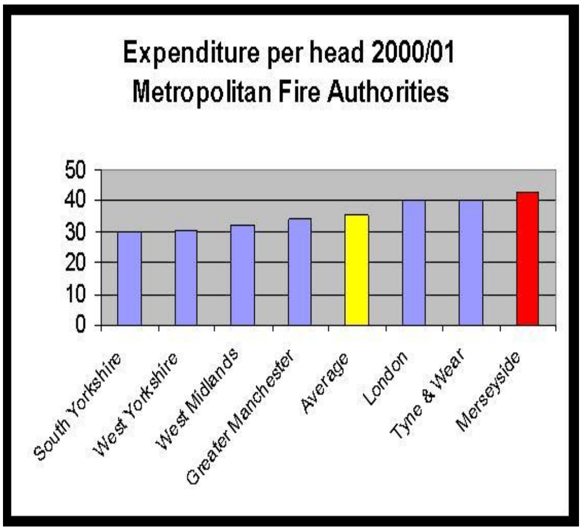
In 1996/97 Merseyside Fire & Civil Defence Authority Council Tax was more than 50% above the average of Metropolitan Fire Authorities. Now it is only 11% above the average:

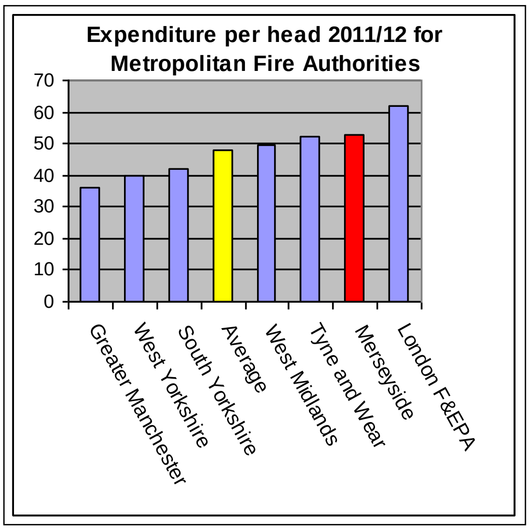


Over the past 7 years when compared to the other Metropolitan Fire Authorities Merseyside has had one of the lowest cumulative council tax increases:

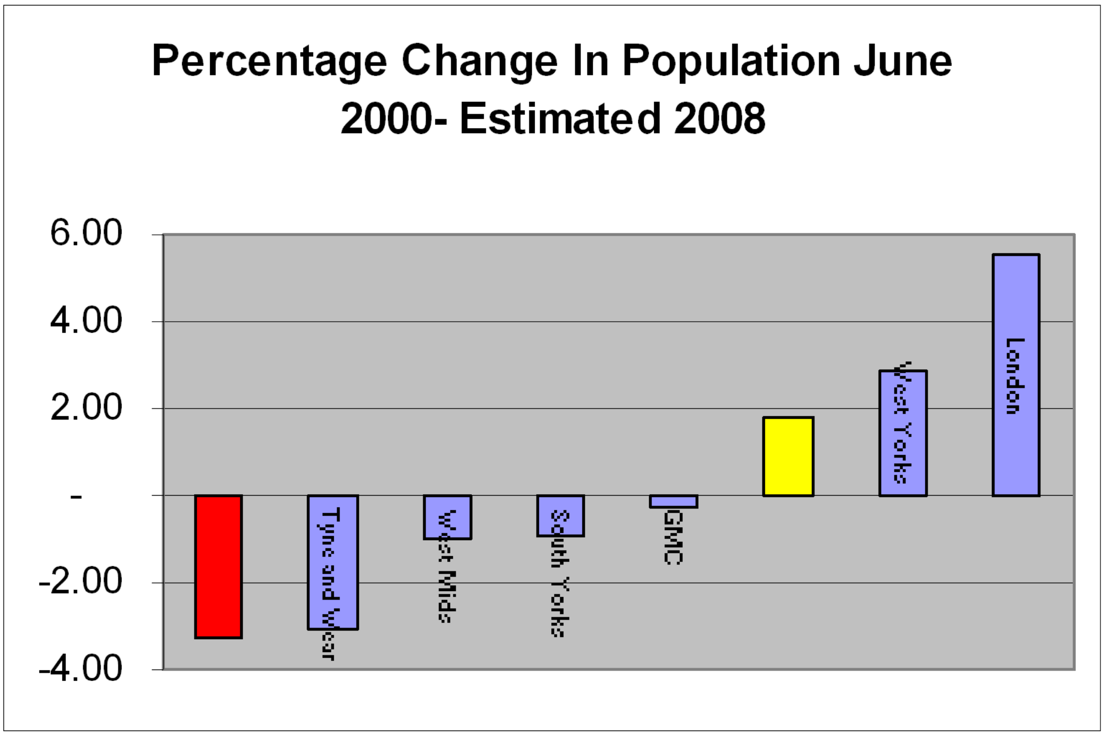


The significant improvements in efficiency by the Fire Authority and a large scale savings plan have meant that from being the most expensive Metropolitan Fire Authority in the country in 2000/01 the Authority has now, at £53 per person, moved closer to the metropolitan fire average (£48).

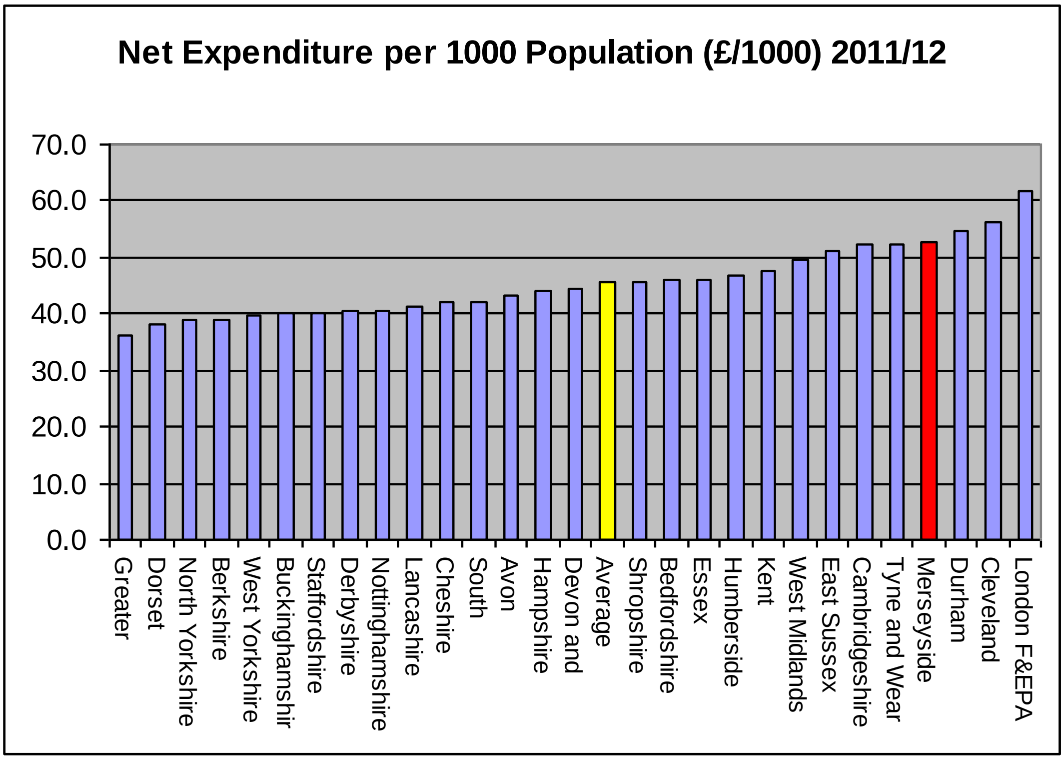




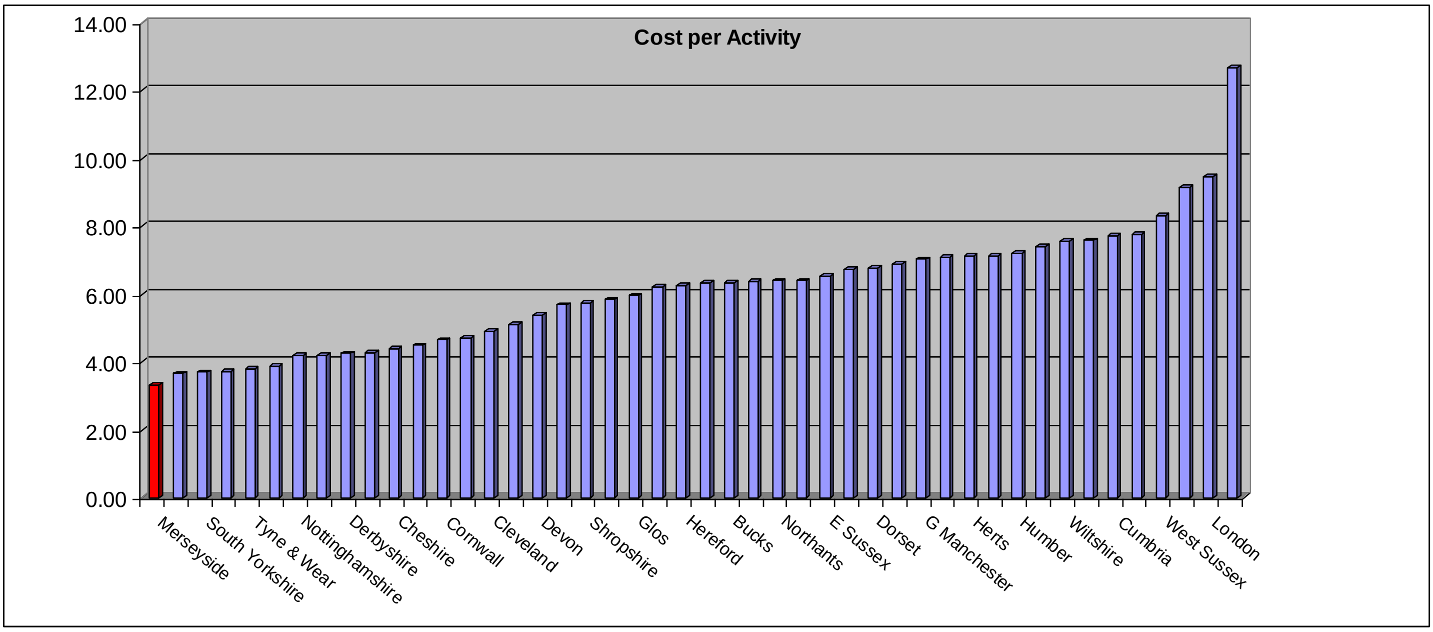
This performance has been especially encouraging when it is considered that across the same time period the population of Merseyside has been reducing significantly whilst other Authorities populations have grown. *If all other things had been equal it might have been expected that Merseyside's position might have worsened on this comparator rather than improved.*



However, despite the recent improvements it should be noted that we remain, in comparison to our peers, a relatively high spending authority on a direct expenditure per head basis.

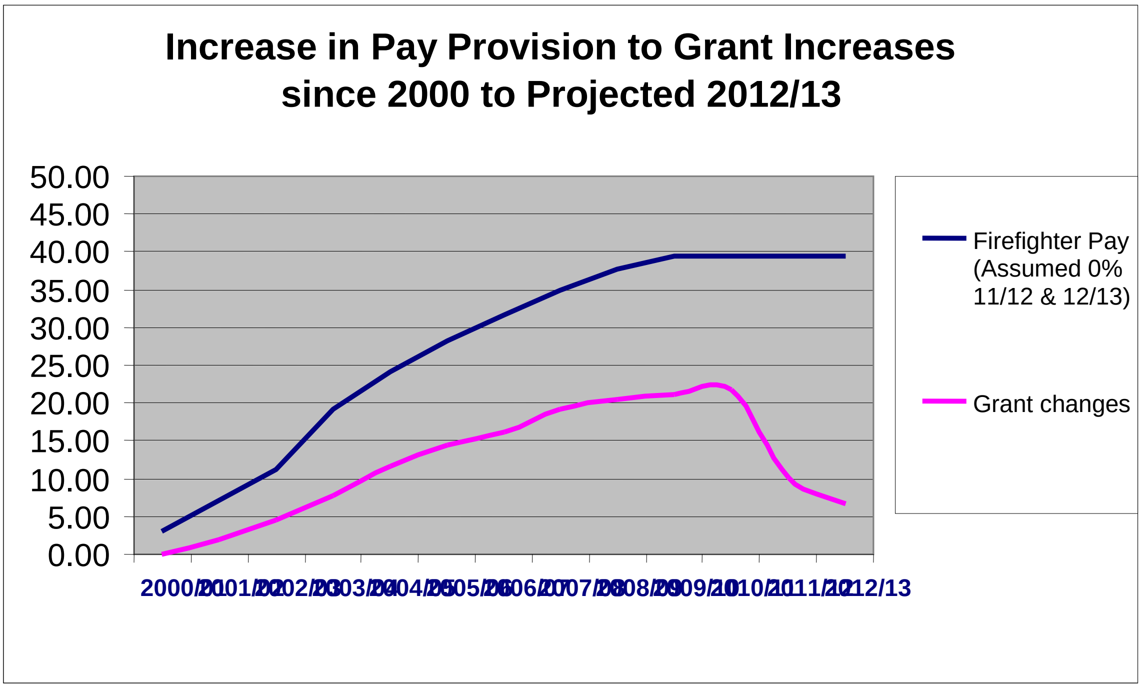


It should be noted that this is only one measure of the relative need to spend (population basis). A comparison of historic net expenditure per activity (including home fire safety checks) over recent years shows a very different picture:



Merseyside continues to invest significantly in community fire safety, approximately £6million in 2011/12.

These improvements in Council Tax level and expenditure have been achieved when the Authority's grant increases have been at the floor (minimum) level for many years whilst inflation including Firefighters' pay awards have been very much higher. The table below highlights cumulative grant increases compared to cumulative pay awards since 2000.



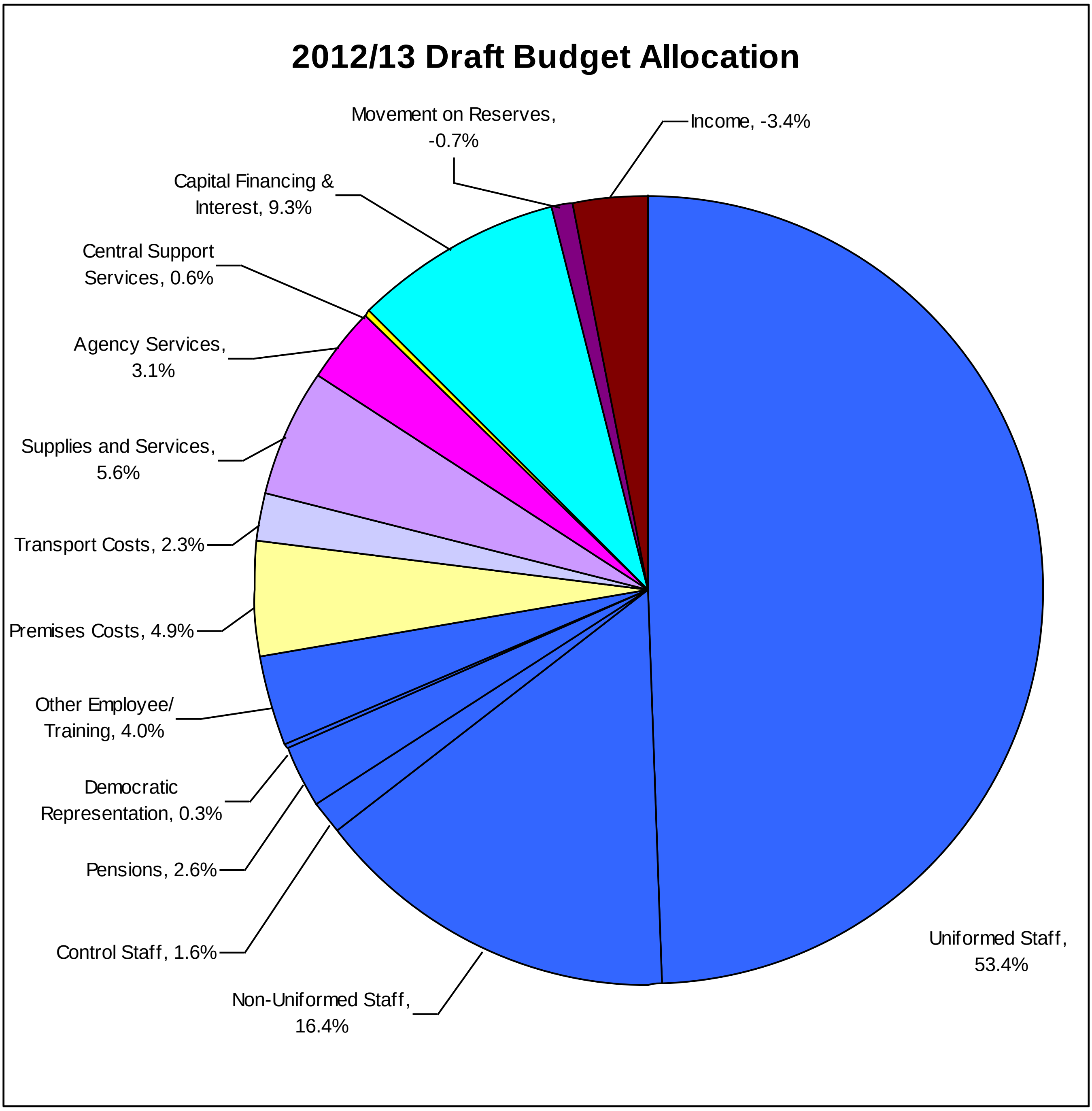
Overall Financial Health

43. The Authority has a proven track record for meeting significant financial challenges in the past and modernising the service to maintain if not improve the service to the community of Merseyside. The Authority, conscious of the pending financial challenge, has built up reserves in recent years as part of a strategy to provide a short term buffer whilst the Authority implements the business re-engineering to deliver the required savings on a permanent basis. The unprecedented reductions in Government funding will require innovative and difficult decisions but the Authority has a proven track record in managing its financial affairs well as can be seen in the following indicators:-

- Authority accounts 2010/2011 audited without qualification once again.
- Annual Audit Letter highlighted general satisfaction with financial corporate governance and reporting arrangements.
- IRMP recognised as innovative.
- The Authority has maintained a general revenue reserve of at least £2.0m (now £4.7m) in recent years.
- Cost centre budgeting now well established along with a culture of financial management.
- Maintained a five year financial plan and capital programme and most importantly a consistent medium term strategy.
- Successfully delivered largescale changes and savings

Current Allocation of Resources

44. Members will be aware that Fire Service expenditure is predominantly employee related costs (approximately 80%) as is shown in the pie chart below. (The blue sections relate to employee costs)

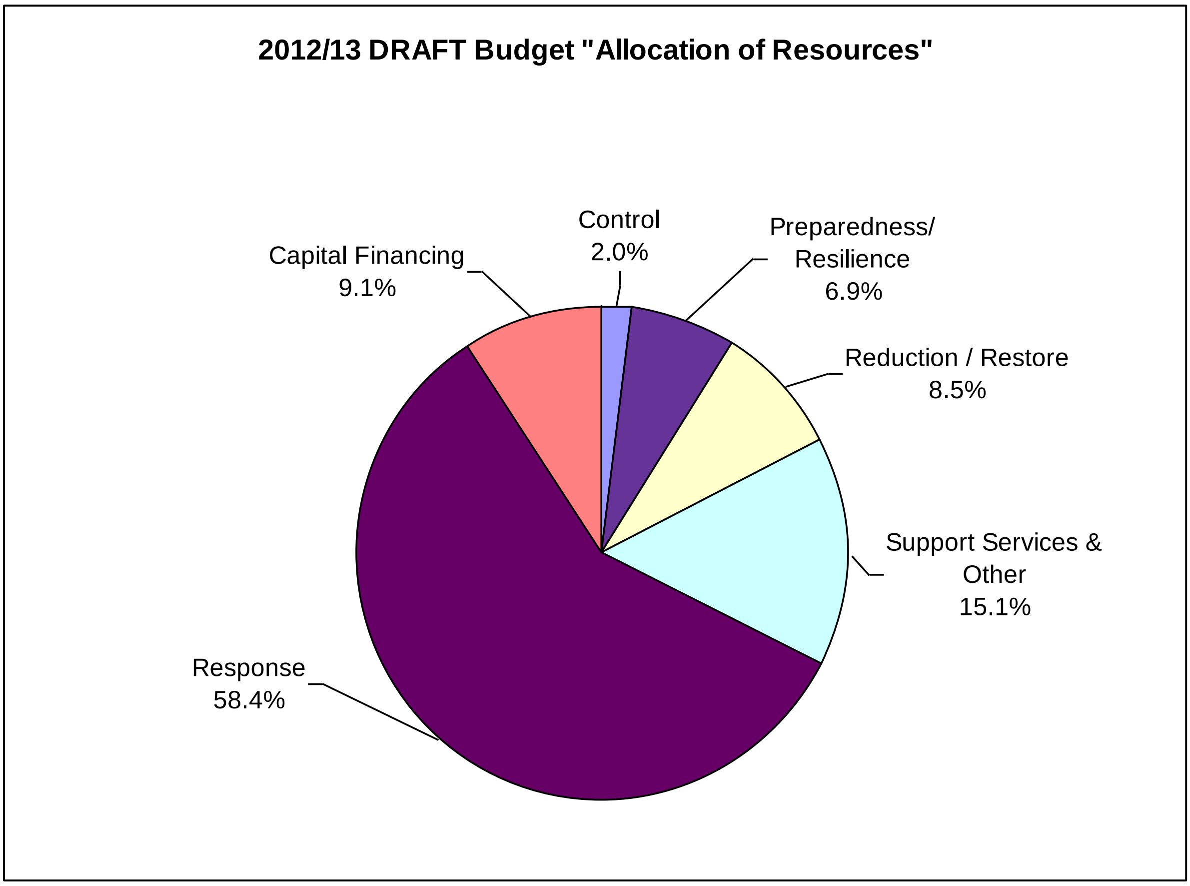


A full subjective analysis of the budget is set out in **Appendix 1**

A subjective analysis is only part of the overall view on spending and in order to assist Members the same data is shown in a “thematic” view overleaf and is based upon the service’s strategic objectives:

Allocation of Resources in line with Corporate Objectives

45. The Authority has an excellent track record of investing in line with its corporate priorities. It can be seen from the pie chart below that 58.4% of gross expenditure, (excluding debt charges) goes on emergency and specialist response, 2.0% on Control Rooms and 6.9% on Preparedness and Resilience and 8.5% on Fire Reduction & Preventative work. 85% of expenditure is on the “front line”-Support costs making up the remaining 15.1%.



Looking in more detail at each area the following investments are included:-

Responding & Control

Investing over £41m

- Service delivery and emergency response through its 26 fire stations (these staff do increasing amounts of preventative work as well).
- Specialist teams like Search and Rescue Team, Targeted Response Group, Hazmats Team and Emergency Response Dogs .
- Invested in staff safety – procured effective fire kit, helmets, boots and appliances.
- Invests in two small fires units, targeting antisocial fires.
- Invests £0.4m on the Incident Management Team.
- Developed the unique Quick Response Motorcycle Unit
- Deliver HFSC programme.
- Investing in new community fire stations.

Prevention & Protection

Investing over £6m p.a in prevention & protection including:

- Legislative Fire Safety Teams (£2.5m)
- Purchase of £0.7m worth of smoke alarms per annum
- Fire Service Direct (£0.2m)
- Employment of specialist Advocates Continuation of the Princes Trust and other Programmes
- Working with young people, including school liaison
- Invested in volunteers with the Fire Support Network (£0.2m)
- Working with the private sector to deliver speedier restoration of property

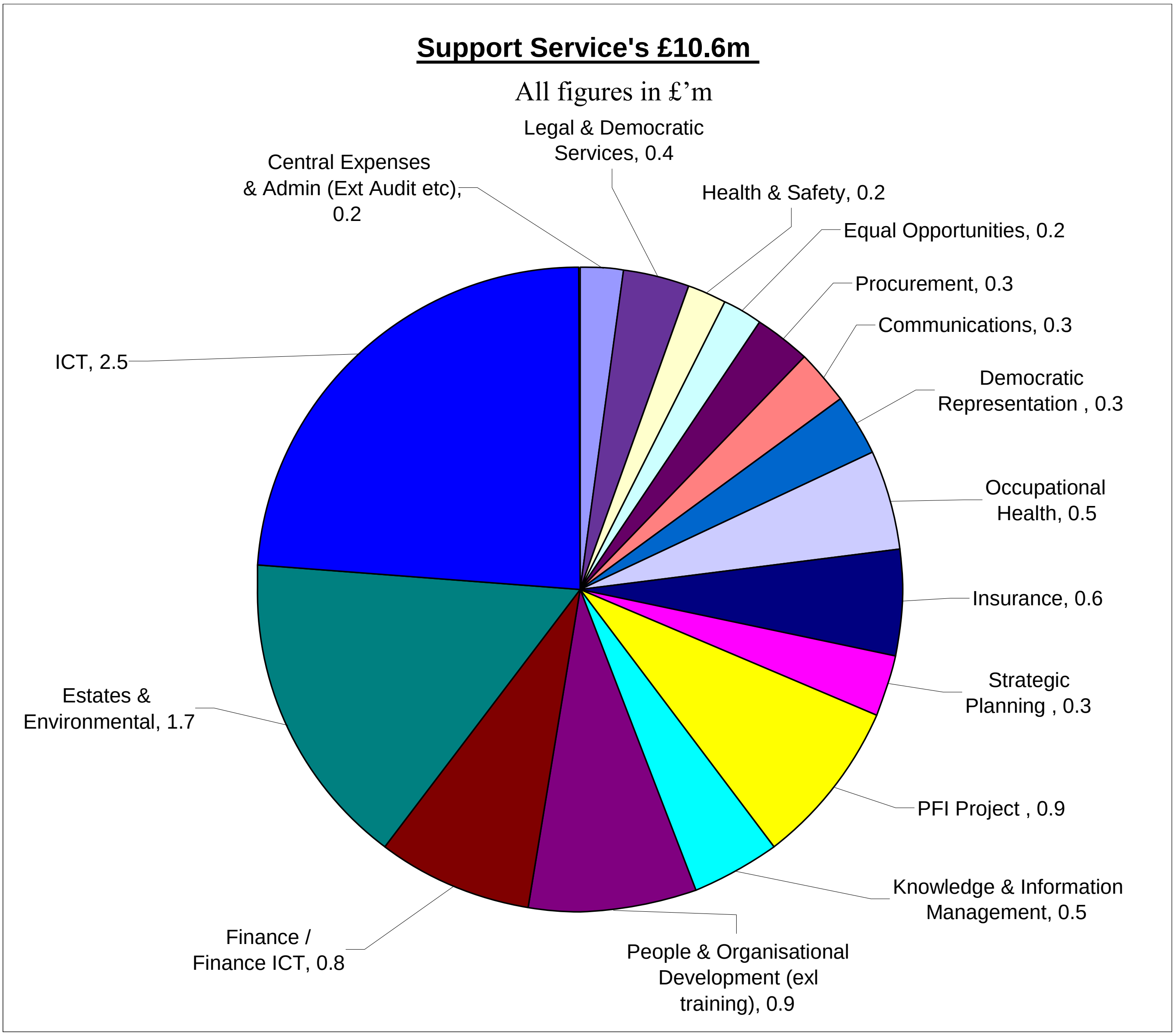
Preparedness & Resilience

The investment of £5m delivers a variety of services which helps prepare for a full range of possible incidents in Merseyside and ensure Firefighter safety.

- Operational Planning and Policy
- Contingency Planning
- New Dimensions to cope with major disasters and terrorist threats
- Operational Equipment Team
- Water Section
- Health and Safety Department
- Transport/Fleet Management – to keep vehicles operating effectively
- Workshops
- Marine Rescue Unit to support the airport and safety on the river
- Standard Operating Procedure Review Team

Support Services & Other

The investment in support services of only £11m (15% of the budget) is analysed overleaf:



It should be noted that many of the services are key "front line" parts of a modern fire and rescue service. For example:-

- People and Organisation Development – includes investment in the Training and Development Academy and costs of training for all staff;
- Estates – includes the running costs of buildings including 26 Community Fire Stations;
- ICT – includes the cost of the Mobilising Communications Centre;

C) CAPITAL PROGRAMME

46. Capital is considered first in this report so that Members can clearly consider the revenue impacts of capital investment and borrowing decisions as part of revenue budget and Council Tax considerations.

Introduction

47. From 1st April 2004, the Local Government Act 2003 replaced the previous regime of capital controls with the Prudential System for Capital Finance. Local authorities are free to decide for themselves how much they can afford to borrow for capital purposes, subject to various safeguards. The Government has reserve powers to limit an authority's borrowing if the Government believes it to be unaffordable, or in times of public spending restraint.

Prudential Code

48. A key part of the revised capital system is the CIPFA "Prudential Code for Local Authority Capital Finance" which provides a framework of decision-making under which authorities will decide their capital investment and financing plans and set limits for borrowing.

49. Authorities will be required to 'have regard to' the Prudential Code when setting their future budgets and Council Tax levels - which in practice means that they would need to have very good reasons not to comply.

50. The over-riding objective of the Prudential Code is to ensure that the capital investment plans of local authorities are **affordable, prudent, sustainable**, and follow good practice.

51. Some of the main features of the Prudential Code are as follows:

- The full Authority must consider and set a number of indicators and limits for its capital plans as part of the annual budget setting process. The limits can be revised during the year but only by the full Authority. The mandatory indicators are shown in Section E.
- The indicators and limits must be monitored during the year and outturn figures reported.
- The Authority must produce and maintain capital and revenue plans for at least three future years including three year estimates of its future Council Tax taking account of the proposed capital programme and other plans.
- The Authority must set an authorised limit for its total debt (including borrowing and long term liabilities) which may not be exceeded.
- Limits relating to treasury management matters must be considered as part of the Annual Treasury Management Strategy Report.

52. Fundamentally, the objective of the Code is that the total of an authority's capital investment remains within sustainable limits, following consideration of the impact on the "bottom line" Council Tax. This is ultimately determined by a judgement about what Members consider is an acceptable level of Council Tax.

Capital Investment Strategy .

53. Each financial year the Authority produces a capital programme to manage major capital schemes. Owing to the nature of capital expenditure a large number of schemes span more than one financial year so the programme is a rolling programme covering five future financial years.

54. The starting point for this programme has been an assessment of the capital investment requirements for the Authority for future years based upon needs identified by the various expert professionals in areas like buildings, vehicles, ICT, and operational equipment. Initial bids were requested and through an iterative process Officers have modified the programme in the light of:-

(a) service requirements, and in particular investments required to support and deliver the IRMP.

(b) the need to adopt a prudential approach to capital borrowing under the new regime, being mindful of affordability, prudence and sustainability and in particular the impact on Council Tax levels.

55. This has produced a total 2012/13 – 2016/17 five-year future capital programme proposal of £30.272m which is set out in the summary table overleaf. This table also identifies funding of the programme and a borrowing requirement of £23.464m to support the proposed capital programme. The full programme is set out in **Appendix 2** (appendix 2A is the updated programme and appendix 2B the new additions to previously agreed programmes).

Proposed Authority Capital Progamme for 2012/2013 - 2016/2017

Expenditure	Total Cost £	2012/13 £	2013/14 £	2014/15 £	2015/16 £	2016/17 £
Building/Land	**9,601,500**	5,246,500	787,000	1,031,000	1,976,500	560,500
Fire Safety	**8,766,000**	1,752,000	1,752,000	1,754,000	1,754,000	1,754,000
ICT	**3,667,000**	826,000	938,000	700,000	662,000	541,000
Operational Equipment & Hydrants	**1,120,000**	577,000	57,000	77,000	57,000	352,000
Vehicles	**7,117,100**	2,202,800	1,291,100	939,100	1,135,300	1,548,800
TOTAL	**30,271,600**	**10,604,300**	**4,825,100**	**4,501,100**	**5,584,800**	**4,756,300**

Financing Available:	Total	2012/13	2013/14	2014/15	2015/16	2016/17
Capital Receipts						
Sale of old workshop	**470,000**	470,000				
Toxteth Fire Station (Firefit Hub)	**500,000**		500,000			
Sale of 2 existing N-le-W LLAR properties	**275,000**				275,000	
R.C.C.O.						
CFS general cont (Cap sals)	**5,000,000**	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Grant						
My Space Big Lottery Grant	**413,000**	413,000				
Other						
Toxteth Hub: LCC contribution	**150,000**	150,000				
Total Non Borrowing	**6,808,000**	**2,033,000**	**1,500,000**	**1,000,000**	**1,275,000**	**1,000,000**
Unsupported Borrowing	**23,463,600**	8,571,300	3,325,100	3,501,100	4,309,800	3,756,300
Total Funding	**30,271,600**	**10,604,300**	**4,825,100**	**4,501,100**	**5,584,800**	**4,756,300**

56. The plan includes some increases , (Appendix 2b), totalling £5.906m. These are:-

(a) The addition of the “extra year” to the programme 2016/17, £4.756m
(b) Additional new schemes for 2012/13 – 2015/16, which total £1.150m.

These projects represent additional investments which are considered as essential and include investments in line with supporting strategies and programmes agreed by the Authority already.

57. Details of the new starts can be found in Appendix 2B attached to this report, and an outline of the scope of each of the main capital programme divisions is presented below. Appendix 2A provides a full analysis of the updated approved 5 year capital programe and also the current financial review (CFO/132/12), elsewhere on the agenda, details the movements on the approved capital plan during the financial year .

58. The key areas of investment (2012/13 -2016/17) are:-

Building Investment Strategy (£9.602m)

59. The estate comprises of 26 fire stations, a training and development academy (TDA), a Mobilising & Communication Centre (MACC), Service Headquarters, Marine Rescue Station and the Engineering Centre. The capital programme reflects the funding required to replace, maintain and enhance the current estate stock, and when possible seeks to attract external funding (PFI) or specific contributions (capital receipts, capital reserves) to reduce the level of borrowing requirement. Estates maintain and revise a 5 year property asset management plan and the proposed capital programme is consistent with the priority areas that are contained within the plan.

PFI

60. The Government has approved a joint project (with Merseyside leading), between Merseyside, Lancashire and Cumbria. In Merseyside there will be seven new stations at:-

(a) Belle Vale
(b) Birkenhead
(c) Bootle/Netherton
(d) Formby
(e) Kirkdale (with Operational Resource Centre (ORC) on same site)
(f) Newton le Willows
(g) Southport (combined Fire and Ambulance Station)

61. Building work for the stations at Bootle/Netherton, Formby, Kirkdale and Newton le Willows is well underway with each expected to be finished and in use by early summer 2012. Work on the stations at Belle Vale, Birkenhead and

Southport will start as the other stations come on line and these should be ready for occupation in mid 2013.

62. The total capital building costs for the North West building stock will be £47.9m and in Merseyside £19.8m. As the capital expenditure will not go through the Authority's Capital Programme this scheme is not included in the current capital programme. Changes to the accounting rules will mean that in the future the PFI assets will be on the Authority's balance sheet and the necessary adjustments will be made to the MRP and prudential indicators (this will simply reflect a technical accounting adjustment).

Non PFI Project Assets

63. For those properties which don't form part of the PFI project investment is proposed in line with the current Asset Management Plan. Notable projects include:-

(a) Refurbishing and essential work at fire stations £5.6m
(b) LLAR accommodation £0.7m
(c) Firefit Hub / New Toxteth Community Fire Station £5.5m

Fire Safety (£8.766m)

64. Smoke alarms and sprinkler systems are being classed as capital expenditure in line with Government guidance. This follows the awarding of historic capital grants by the (then) ODPM towards the purchase cost of such items in financial years 2004/05 through to 2007/08. The estimated investment in alarms for the community over the 2012/13 – 2016/17 period is £0.7m p.a. Current policy is to capitalise the installation costs of smoke alarms estimated at £5.0m over the period, however this expenditure is not funded through borrowing but financed in the year by a revenue contribution to capital.

ICT – Investing in line with the ICT Strategy (£3.667m)

65. In line with the Authority's commitment to using technology to improve the service there is a significant investment in ICT within the programme. The most significant investments are in line with a phased introduction of a controlled planned replacement policy of 5 years in the area of PCs, Servers and Network £1.8m, and software licenses £0.9m.

66. Specific projects include:-

(a) Continued development of the portal, £0.2m,
(b) Computerisation of the HR & training records, £0.2m
(c) Planned replacement of the current Finance, payroll and procurement ICT systems, £0.2m

No specific provision has been made for the implications of the project looking into a new shared control function for Merseyside blue lights services until a fuller business case is developed.

Operational Equipment & Hydrants (£1.120m)

67. Significant provision is also made to ensure that a modern fire and rescue service can be delivered and firefighters kept safe, in particular provision is made for investment in specialist rescue equipment and new breathing apparatus such as :-
    - Hydraulic Rescue equipment, £0.2m
    - Specialist emergency & rescue equipment, £0.3m
    - New hose, £0.1m
    - Installation of new or replacement hydrants in line with our water strategy, £0.2m.

Vehicle Replacement Strategy (£7.117m)

68. The Fleet Manager has identified needs as follows:-

WTL Fire Appliances

69. The Authority has developed an appliance replacement strategy based on the economic life of an appliance. Each appliance has an estimated service life of 12 years on the front line followed by 2 years as a reserve appliance. Significant provision for new appliances has been included in the capital programme – up to 15 new appliances (3 appliances per year) to ensure that the fleet is modern and efficient. .

A Need for Specialist Vehicles

70. There is a need to make provision for the purchase of specialist vehicles to support the IRMP and to support the wider range of roles for the fire service including rescue:

    (a) Rapid Response Motorbikes
    (b) Combined Pump Platform appliances
    (c) Small Fire Unit vehicles
    (d) Prime Movers

Ancillary Vehicles

71. Provision is included for the phased renewal of the ancillary vehicle fleet. These are increasingly important to support the fire safety and prevention work of the Service.

Funding The Programme

Capital Receipts

72. Capital receipts are usually the proceeds from the sale of assets. Any such receipts can be applied either to reduce an Authority's outstanding debt or to be reinvested in the capital infrastructure.

73. The Authority has (when available) used capital receipts as a source of funding for new capital investment with little, if any, being used for debt repayment – unless regulations require a proportion of the receipts to be used specifically to repay debt. However, under the new regime the Authority needs to consider if a proportion of any future receipts should be used for debt repayment as part of its overall strategy.

74. The proposed capital programme anticipates capital receipts from the following site sales: -

Old Workshop site	£0.470m	(2012/13)
Toxteth Fire Station	£0.500m	(2013/14)
Existing LLAR Houses Newton-le-Willows	£0.275m	(2015/16)

75. It assumes that this income will be used to reinvest in the capital infrastructure and support the capital programme. Members should note that the valuations are based on recent valuations. Officers are currently undertaking an exercise to update the market sale values of all stations.

Capital Grants

76. As part of the 2010 spending review the Government also made the decision that there will be no supported borrowing allocations for the fire and rescue service in the spending review period. Government capital support will be given in the form of capital grant only. The Government have announced that the Authority would receive a £1.736m capital grant in 2011/12 and an equivalent grant in 2012/13. Ministers have also said that further grant funding may be available in 2013/14 & 2014/15 but this is likely to be allocated via a bidding process. These grants have not been taken into account in the current capital programme. The Deputy Chief executive is reviewing the programme funding overall with a view to identifying savings.

Alternative to Operating Leasing

77. Under the previous system of capital controls, investment that was funded by operating leases did not count as either capital expenditure or the financing as a credit arrangement. Therefore, in common with most other local authorities, operating leasing has been a source of funding for some limited eligible assets (e.g. vehicles, plant and machinery, and computer equipment) although the Authority generally avoided this because of the impact on the revenue account. However, whilst operating leasing as a source of funding remains outside of the Prudential Capital System, no leasing is assumed in this programme. The Deputy Chief Executive will monitor the suitability of alternative methods of finance.

Borrowing

78. Under the Prudential capital system Local Authorities are now able to determine their level of borrowing. However, the Government has retained reserve powers to limit an authority's borrowing if the Government believes an authority's proposals to be "unaffordable" or in times of national public spending constraint.

79. In the past Government provided support for the Authority's capital spending through **supported** capital expenditure. The revenue costs associated with supported borrowing was funded through the revenue formula grant. As part of the CSR2010, the Government made the decision that no new supported borrowing allocations will be made to the Fire and Rescue Service in the Spending Review period. This will impact on revenue support grant allocations. Whilst there will be no new allocations after 2010/11, the level of assumed outstanding historic debt still forms part of the Formula Grant calculation and hence the Authority still receives some grant funding. **All** borrowing from 2011/12 is therefore effectively now unsupported or prudential borrowing.

80. The proposed capital programme represents an overall expenditure increase of £5.906m reflecting the proposed "new starts" expenditure (of which £4.756m relates to the addition of 2016/17). Appendix 2B sets out the new start schemes.

81. The impact of the additions to the programme on the Authority's borrowing is a net increase of £4.906m, (mainly in 2016/17):

	£m
Increase in expenditure, new starts	5.9
Increase in Non Borrowing Funding Sources:	
• RCCO (HFSC installation costs)	-1.0
Required Increase in Borrowing	4.9

The level of prudential "unsupported" borrowing therefore will increase by £4.906m to £23.464m.

Impacts on Revenue Budget and Financial Plan

82. When the Authority borrows money it has to factor the debt repayment and interest costs into its financial plans. The minimum revenue provision (MRP) methodology calculates how much debt repayment is required each year. Following the new Capital Regulations announced in 2008 the Authority must approve an MRP Statement each year that sets out the policy on MRP. Section D of this report outlines for Members the proposed MRP policy for 2012/13 – 2016/17 and the methodology for calculating the MRP. The additional borrowing and proposed MRP policy require an increase to the 2011/12 base figure for MRP and Interest of:-

	Estimate 20012/13	Estimate 20013/14	Estimate 20014/15	Estimate 2015/16	Estimate 2016/17
	£'m	£'m	£'m	£'m	£'m
Increase in MRP / Interest	**0.911**	**1.369**	**2.269**	**2.624**	**2.934**

83. A significant factor in the large increase in the budget requirement is down to the Government's decision to factor in no new supported borrowing in the 2011/12 or future years grant settlement and the capital regulations requiring all non-supported borrowing to be repaid over the relevant asset life. This has

meant a four or five fold increase in MRP calculations for assets with a short asset life that previously had MRP calculated over a twenty-five year period.

84. The Government also announced in 2010/11 an increase interest charge of nearly +1% on all Public Works Loans Board debt. This has resulted in an increase in interest payments.

85. The required increase in MRP and Interest has been built into the proposed financial plan for 2012/13 – 2016/17. To give Members an indication of the impact of the proposals, for each £1M reduction in borrowing it would reduce the associated revenue cost by potentially £0.050m - £0.100m (depends on the relevant asset life), the council tax equivalent reduction would be 0.2% - 0.4% or £0.12 to £0.24.

More information on the impact on the Capital Programme is shown in the section on Prudential Indicators (Section E).

(D) <u>MINIMUM REVENUE PROVISION STATEMENT</u>

86. Under the Local Authorities and Accounting Regulations the Authority is required to set aside a sum of money each year to reduce the overall level of debt, this sum is known as the Minimum Revenue Provision (MRP). The 2003 regulations set a minimum annual amount to be charged to revenue based on the Authority's Capital Financing Requirement (CFR) which is an amount broadly equivalent to the Authority's outstanding debt. The regulations have been updated in 2008 and now require each authority to repay debt at a rate it considers **prudent** and to set out in an annual statement the Authority's policy on making MRP in respect of the forthcoming year.

87. The new regulations guidance interprets MRP may be deemed to be prudent if it is either:

    - Based over a period that is reasonably commensurate with that over which the capital expenditure / asset provides benefits (asset life), or

    - For the element of expenditure met from borrowing supported by Government Revenue Support Grant (RSG), a period reasonably commensurate with the period in the determination of that grant (this in reality would equate to the current 4% MRP methodology).

88. The regulations guidelines set out four options for calculating MRP, however as the Government are issuing no new supported borrowing only 2 of the 4 options are applicable for new borrowing:

- **Asset Life Method** – MRP is determined by reference to the life of the asset and the amount is either based on equal instalments over the period or on an annuity method based on assumed principal repayments. This option is available to both supported and unsupported borrowing in determining the MRP requirement.

- **Depreciation Method -** MRP is to be equal to the provision required in accordance with depreciation accounting in respect of the asset on which expenditure has been financed by borrowing. This option is available to both supported and unsupported borrowing in determining the MRP requirement

<u>2012/13 MRP:</u>

89. The 2012/13 MRP is determined by the actual level of outstanding debt (CFR) as at the end of 2011/12. Any expenditure funded through borrowing must have the associated MRP requirement determined by either the Asset Life or Depreciation method.

90. For capital expenditure financed by borrowing MRP will be based on the Asset Life equal instalment method. This option meets the requirements to be deemed prudent but also allows certainty and predictability over MRP charges. The financial plan outlined in this report reflects the proposed Authority's policy on prudential MRP.

91. In addition it is proposed that if any approved MRP/Interest budget becomes available due to; capital schemes being re-phased; additional specific non-borrowing funding becoming available; or a reduction on the approved capital programme/ required borrowing, then the Service may choose to make additional MRP payments if the overall financial position of the Authority in that year remains consistent with the approved financial plan.

92. The Authority in the past has determined it can afford and sustain significant prudential borrowing in order to allow the required level of investment in the infrastructure and assets of the Authority to deliver a modern well equipped fire service.

93. Appendix 3 sets out the Authority's proposed MRP policy.

(E) PRUDENTIAL INDICATOR REPORT

94. Having formulated a draft Capital Programme, the Authority, in making final decisions upon that Capital Programme and Revenue Budget 2012/13, will need to consider a report setting out a range of Prudential Indicators aimed at demonstrating the intended Investment Programme's affordability, prudence and impact upon Treasury Management activity and strategy.

95. It should be noted, however, that in order to provide those Indicators, both Capital and Revenue financial plans need to be prepared for each of the next 3 financial years, commencing with 2012/13.

96. The financial plans prepared in respect of the financial years 2013/14 and 2014/15 are not to be mistaken for approved Budgets. They are, at this stage, only a guide for financial planning and as such subject to significant change as a result of decisions made by the Authority. However, such plans are required to be supported by an indication of future Council Tax. At this stage an assumption of Council Tax increases of 4% in all years has been made.

Prudential Indicators

97. The Authority must demonstrate that its spending plans comply with the Prudential Code by the publication of a number of performance indicators, which are known as the Prudential Indicators*. **Details of the prudential indicators for this Authority are provided below.***

98. The purpose of the indicators is to demonstrate that capital investment remains within sustainable limits and that the Authority has considered the impact of the whole plan on future levels of Council Tax. The indicators that will measure this are :-

- Estimates of the ratio of capital financing charges to the net revenue budget
- Estimates of the precept that would result from the three-year capital plan.
- Estimates of the capital financing requirement.

99. The prudential indicators for Merseyside are:-

a) Capital Expenditure

The actual capital expenditure that was incurred in 2010/11 and the estimates of capital expenditure to be incurred for the current and future years that are recommended for approval are:

	Actual 2010/11	Estimate 2011/12	Estimate 2012/13	Estimate 2013/14	Estimate 2014/15	Estimate 2015/16	Estimate 2016/17
	£000,s	£000,s	£000,s	£000,s	£000,s	£000,s	£000,s
Capital Expenditure	**8,603**	**10,622**	**10,617**	**4,825**	**4,501**	**5,585**	**4,756**

Members will note that the increase in expenditure in 2010/11 to 2012/13 reflects the significant investment in fire stations to develop more community based assets and bring the accommodation up-to-date and the continuing investment in the remaining fire appliance fleet to provide modern reliable and safe vehicles. More details on the capital programme are given elsewhere in the report.

(b) Ratio of financing costs to net revenue stream

Estimates of the ratio of financing costs to net revenue stream (amounts met from government grants and local taxpayers) for the current and future years, and the actual figures for 2010/11 are:

	Actual 2010/11	**Estimate 2011/12**	**Estimate 2012/13**	**Estimate 2013/14**	**Estimate 2014/15**	**Estimate 2015/16**	**Estimate 2016/17**
Ratio of Financing costs to Net Revenue Stream	**6.60%**	**7.38%**	**8.65%**	**10.48%**	**11.43%**	**11.75%**	**12.20%**

This shows that forecast debt financing costs will increase from 8.65% in 2012/13 (based on the actual forecast capital spend in 2011/12) to 12.20% by 2016/17. As stated previously the impact of the Government's decision to issue no new supported borrowing for CSR10 has meant all MRP calculations are now based on asset life. This has resulted in a significant rise in MRP over the medium term, but eventually the ratio will fall as historic debt is repaid and all other debt is paid off over the life of the asset. This is also affected by the fact that whilst the Authority's debt is increasing its overall budget is reducing.

(c) Effect on the Precept

The estimate of the incremental impact of capital investment decisions proposed in this budget report, over and above capital investment decisions that have been previously been taken by the Authority are:

	Actual 2010/11	**Estimate 2011/12**	**Estimate 2012/13**	**Estimate 2013/14**	**Estimate 2014/15**	**Estimate 2015/16**	**Estimate 2016/17**
Incremental Impact of Capital Investment Decisions	-£0.29	£0.30	£2.04	-£1.18	-£1.49	-£0.30	£1.65

This indicator compares the capital programme set by the Authority in last year's budget process to the proposed revised capital programme submitted this year. It is intended to show the marginal impact of the overall capital programme, and the decisions being made by the Authority, on the Council Tax levels. The re-phasing of expenditure from 2010/11 into 2011/12, and the relatively lower capital spend in 2013/14 to 2015/16 compared to 2012/13 have resulted in a negative or reduced incremental increases over that period. The new start programme in 2016/17 has resulted in the increase in 2016/17.

Capital Financing Requirement

100. In accordance with best practice, the Authority does not associate borrowing with particular items or types of expenditure. The Authority has an integrated

Treasury Management Strategy and has adopted the CIPFA *Code of Practice for Treasury Management in the Public Services*. The Authority has, at any point in time, a number of cashflows both positive and negative, and manages its Treasury position in terms of its borrowings and investments in accordance with its approved Treasury Management Strategy and practices. In day to day cash management, no distinction can be made between revenue cash and capital cash. External borrowing arises as a consequence of all the financial transactions of the Authority and not simply those arising from capital spending. In contrast, the capital financing requirement reflects the Authority's underlying need to borrow for a capital purpose.

101. Estimates of the end of year capital financing requirement for the Authority for the current and future years and the actual capital financing requirement at 31 March 2011 are:

	Actual 31.3.11	Estimate 31.3.12	Estimate 31.3.13	Estimate 31.3.14	Estimate 31.3.15	Estimate 31.3.16	Estimate 31.3.17
	£000,s	£000,s	£000,s	£000,s	£000,s	£000,s	£000,s
Capital Financing Requirement	**55,066**	**58,014**	**63,543**	**63,137**	**62,560**	**62,491**	**61,531**

102. Members will note that the capital financing requirement (CFR) is a "proxy" for debt outstanding.

103. The Authority's CFR is expected to increase to £61.531m by the end of 2016/17 compared to current levels (end of 2010/11) of £55.066m. This increase is consistent with that anticipated in last year's capital programme.

<u>Net Borrowing and the Capital Financing Requirement</u>

104. CIPFA's *Prudential Code for Capital Finance in Local Authorities* includes the following as a key indicator of prudence:

"In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that net external borrowing does not, except in the short term, exceed the total capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years."

107. The Authority had no difficulty meeting this requirement in 2010/11, nor is any difficulty envisaged for the current or future years. This view takes into account current commitments, existing plans, and the proposals in this budget report.

(F) TREASURY MANAGEMENT STRATEGY STATEMENT 2012/13

INTRODUCTION

108. This report sets out the expected treasury operations for this period, linked to the Authority's Medium Term Financial Plan, Capital Strategy, Asset Management Plan and the Authority's Corporate Plan. It is inextricably linked to delivering the Authority's priorities and strategy. It contains four key legislative requirements:-

(a) The Treasury Management Strategy statement which sets out how the Authority's treasury service supports capital decisions, day to day treasury management and the limitations on activity through treasury prudential indicators. The key indicator is the Authorised Limit required by S3 of the Local Government Act 2003 and is in accordance with the CIPFA (The Chartered Institute of Public Finance & Accountancy) Codes of Practice.

(b) The reporting of the prudential indicators for external debt and the treasury management prudential indicators as required by the CIPFA Treasury Management Code of Practice.

(c) The investment strategy which sets out the Authority's criteria for choosing investment counterparties and limiting exposure to the risk of loss. This strategy is in accordance with the Department for Communities and Local Government (DCLG) Guidance on Local Government Investments updated in 2010. It is proposed to reduce the Authority's minimum long term credit rating requirement from A to A- to enable investment with a wider group of counterparties whose credit standing has not changed but whose ratings are lower because more stringent tests are now applied by credit rating agencies.

(d) The Authority's Minimum Revenue Provision (MRP) Policy, which sets out how the Authority will pay for capital assets through revenue each year as required by Local Authorities (Capital Finance and Accounting) Regulations 2008.

109. Revised editions of the CIPFA Prudential Code for Capital Finance in Local Authorities and CIPFA Treasury Management Code of Practice were published in November 2011. The changes are largely regulatory updates and there is little material change affecting the Authority. The Authority has adopted the codes and the Treasury Management Strategy Statement 2012/13 reflects the updated codes.

110. One element of the revised Treasury Management Code is that the wording of the Treasury Policy Statement must be amended to include the reporting of financial instruments used to manage risks. The revised statement also now includes high level policies for borrowing and investments.

PROPOSED STRATEGY

111. The above policies and parameters provide an approved framework within which the Officers undertake the day to day capital and treasury activities. The Authority is recommended to approve each of the key elements contained within this report, and recommend these to Authority:-

    (a) The Treasury Management Strategy 2012/13.

    (b) The External Debt and Treasury Management Prudential Indicators and Limits for 2012/13 to 2014/15.

    (c) The Investment Strategy 2012/13.

    (d) The revision to the Authority's Treasury Policy statement at Appendix 4 to reflect latest CIPFA guidance.

    (e) The Minimum Revenue Provision (MRP) Statement included in section D and Appendix 3 of this report, and it sets out the Authority's policy on MRP.

TREASURY MANAGEMENT STRATEGY

112. The suggested strategy for 2012/13 in respect of Treasury Management is based upon Treasury Officers' views on interest rates supplemented by leading market forecasts. The strategy covers:-

    (a) prospects for interest rates;
    (b) capital borrowing and debt rescheduling;
    (c) annual investment strategy;
    (d) external debt prudential indicators;
    (e) treasury management prudential indicators;
    (f) performance indicators;
    (g) treasury management advisers.

PROSPECTS FOR INTEREST RATES

113. Short term rates are expected to remain on hold for a considerable time. Growth in the UK economy is expected to be weak in the next two years and there is a risk of a "double-dip" recession. The crisis in the euro-zone, the prospects of tight economic policies at home and weak consumer confidence means that any recovery in the economy is set to be weak and protracted. The Monetary Policy Committee (MPC) is expected to hold bank rates at 0.5% throughout 2012/13.

114. Longer term fixed interest borrowing rates are based on Central Government borrowing costs i.e. UK gilt yields. Gilt yields are currently at historically low levels and will continue to be suppressed by investor concerns over Eurozone sovereign debt, decelerating activity and demand for safe haven instruments. However, a very heavy programme of gilt issuance is required to fund the

government deficit which could push gilt yields higher. Whilst very difficult to predict, the effect would be upward pressure on long term rates and longer-term Public Works Loans Board (PWLB) rates could rise by around 0.50% in 2012/13.

115. The overall structure of interest rates is expected to remain the same and short term rates will continue to be lower than long term rates and are likely to remain so throughout 2012/13. In this scenario, the strategy will be to reduce investments and borrow for short periods and possibly at variable rates when required.

CAPITAL BORROWING AND DEBT RESCHEDULING

116. The borrowing requirement comprises the expected movements in the Capital Financing Requirement and reserves plus any maturing debt which will need to be re-financed. The Authority does not envisage that any new long term borrowing will be required in 2012/13. Given the likely structure of interest rates described above, it is envisaged that any borrowing to meet short term cash flow shortages will be for very short periods. Against this background, Treasury Officers will monitor the interest rate market and adopt a pragmatic approach to any changing circumstances.

117. Rescheduling of debt is the early repayment of loans and replacement by loans for different periods and at different interest rates. It can be used to enhance the balance of the long term portfolio, by for example, amending the maturity profile or changing volatility levels and may on occasion generate cash savings. Debt rescheduling becomes more beneficial when the relationship between short and long term rates moves appreciably.

118. Current PWLB lending terms have severely constrained the option to generate savings via debt rescheduling. A significant rise in long term interest rates is required before rescheduling of debt is viable. However, interest rate structures will be continually monitored for opportunities to generate savings from debt rescheduling. Any rescheduling that takes place will be reported to Members in monitoring reports.

ANNUAL INVESTMENT STRATEGY

119. The primary purpose of the Annual Investment Strategy is to set out the policies for managing investments giving priority to the security and liquidity of the Authority's investments. It also contains the policy on the use of credit ratings and credit ratings agencies, procedures for determining and limiting the use of higher risk investments and the use of external advisors.

120. The Authority's investment priorities are (a) the security of capital and (b) liquidity of its investments. The Authority will aim to achieve the optimum return on its investments commensurate with the proper levels of security and liquidity. All investments will be in sterling. All cash balances will be invested in accordance with the Code of Practice and with regard to the statutory guidance.

121. A counterparty list of institutions with which the Authority will invest shall be maintained by reference to the criteria set out below for the different categories of institution and their credit rating. Regardless of these criteria, the money market will be closely monitored and any institution will be suspended from the counterparty lending list should any doubts arise concerning its financial standing. Under the guidance, investments fall into two separate categories, either specified or non-specified investments.

Specified Investments

122. Specified investments offer high security and high liquidity and satisfy the conditions set out below:-

(a) The investment is denominated in sterling and any payments or repayments in respect of the investment are payable in sterling only.
(b) The investment is not a long-term investment (has a maturity of less than one year).
(e) The investment does not involve the acquisition of share capital or loan capital in any body corporate.
(f) The investment is made with a body or in an investment scheme which has been awarded a high credit rating by a credit rating agency, or with the UK Government or a local Authority or a parish or community Authority.

Specified investments will comprise the following institutions: -

- The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
- Supranational bonds of less than one year's duration*.
- UK Local Authorities.
- Money Market Funds.
- UK Banks.
- Foreign banks registered in the UK.
- Building Societies.

**(Supranational bonds represent the debt of international organizations such as the World Bank, the International Monetary Fund, regional multilateral development banks and others)*

Credit Rating Criteria

123. The Authority will invest with UK institutions or non-UK institutions that are domiciled in a country which has a minimum Sovereign long term rating of "AA". The institution must have a high credit rating assigned by any of the three credit ratings agencies (Fitch, Moodys and Standard & Poors). To be deemed highly rated the institution must satisfy at least the minimum of the following Fitch (or equivalent) criteria:

Long term credit rating A-

If any of the agencies assigns a rating lower than the Fitch minimum (or equivalent) to an institution then the Authority will not invest with that institution.

124. In addition, the Authority will use institutions that are part nationalised UK banks.

125. Regardless of the credit rating assigned to an institution or whether it is covered by a guarantee, if any doubt over its financial standing exists then that institution is removed immediately from the counterparty lending list.

Investment Limits

126. The credit ratings and individual limits for each institution within the categories of investments to be used by the Authority in 2012/13 are as follows:

UK Government (including gilts and the DMADF)	Unlimited
UK Local Authorities (each)	Unlimited
Part Nationalised UK banks	£4m
Money Market Funds (AAA rated)	£3m
UK Banks and Building Societies (A- or higher rated)	£2m
Foreign banks registered in the UK (A or higher rated)	£2m

127. No limits on investments with the UK Government and Local Authorities have been set because they are considered to be of the highest credit quality and are essentially risk free. The limits placed on other categories reflect some uncertainty and marginally higher risk profile of the institutions within those categories. The status of part nationalized banks is unlikely to change for at least 5 and probably 10 years but there is an element of uncertainty about their status. Money Market Funds although AAA rated, invest in a diverse portfolio so are not completely risk free and have been assigned a lower limit. There is a slightly higher risk for A- rated banks as described in paragraph 137 below and so these institutions have the lowest limit.

128. The maximum that may be invested with different banks that are part of the same conglomerate shall not exceed the maximum of the highest rated bank within the group. The limits may be exceeded for short periods when there are adverse conditions in the money market with the agreement of the Deputy Chief Executive or Treasury Manager.

Non-Specified Investments

129. Non-specified investments do not, by definition, meet the requirements of a specified investment. The Department of Communities & Local Government (CLG) guidance requires that greater detail is provided of the intended use of non-specified investments due to greater potential risk. The following types of non-specified investments may be used.

130. Deposits with the Authority’s own banker shall be unlimited for transactional purposes and to allow for unusual cash flow circumstances.

131. Deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment) with any bank or building society that meets the credit rating criteria above.

132. Building societies which do not meet the normal credit criteria but are one of the top ten building societies, determined by asset size. Those societies that are within the top ten but do not have an agency determined credit rating shall have an individual limit of £1m. Building Society rankings are checked annually with the Building Societies Association.

Risk Management of Investment Counterparties

133. Bank and Money Market Fund ratings are checked daily. The Authority is alerted by e-mail when there is an amendment by any of the agencies to the credit rating of an institution. If an amendment means an institution no longer meets the Authority's minimum requirement, or any doubt over its financial standing exists, then that institution is removed immediately from the counterparty lending list. Conversely, an institution may be added to the list should it achieve the minimum rating.

134. Credit ratings are only the starting point when considering credit risk. The Code of Practice requires the Authority to supplement credit rating information with additional operational market information which will be applied before making any specific investment decision from the agreed pool of counterparties. Credit Default Swaps and negative rating watches/outlooks are examined and the financial press, internet and financial information systems are monitored for market information regarding its counterparties. It also receives daily e-mails from various market participants that could identify potential problems. Any information that casts doubt on an institution's creditworthiness is acted on by suspending investment with that institution.

Liquidity of Investments

135. Each investment decision is made with regard to cash flow requirements resulting in a range of maturity periods within the investment portfolio. Investments are normally short term having a maturity of less than one year. The Prudential Code does allow longer term investments and under certain money market conditions it may be prudent to invest for up to three years dependent on cash flow forecasts

Risk Benchmarking

136. The CIPFA Codes and the CLG Investment Guidance recommend the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Security and liquidity benchmarks are new requirements although the application of these is more subjective in nature. The benchmarks are simple guides to maximum risk and so may be breached from time to time depending on movements in interest rates and counterparty criteria. The purpose of them is for officers to monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

137. Security: - Security is currently evidenced by the application of minimum credit quality criteria to investment counterparties, primarily through the use of credit ratings. A method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Authority's investment strategy. The Authority's minimum credit rating criteria is "A-". The average expectation of default for a one year investment in a counterparty with an "A-" long term rating is 0.08% of the total investment e.g. for a £1m investment the average loss would be £800. This is only an average and any specific counterparty loss is likely to be higher but these figures do act as a proxy benchmark for risk across the portfolio. The Authority's maximum security risk benchmark of 0.08% is embodied in the criteria for selecting cash investment counterparties and will be monitored and reported to Members.

138. Liquidity: - The Authority seeks to maintain liquid short term deposits of at least £1 million available daily.

139. Yield: - The Authority's benchmark for investment returns is the 7 day LIBID rate.

Reporting Arrangements

140. The Investments Strategy forms part of the Treasury Management Strategy which is referred to the Audit and Value For Money Scrutiny Panel for monitoring. An interim report is produced during the year and a final annual report by 30th September following the end of a financial year.

EXTERNAL DEBT PRUDENTIAL INDICATORS:

141. The Prudential Code requires the following external debt indicators of prudence:
   - Authorised limit for external debt
   - Operational boundary for external debt

Authorised Limit

142. The Authorised Limit for Debt represents the maximum level of debt which the Authority may have during the year. The Authority has no powers to exceed this unless a further report with revised prudential indicators is approved by the full Authority. The limit therefore makes appropriate allowance for the risks and uncertainties which affect day-to-day debt levels, and the ups and downs of short term cash flow.

143. The authorised limits reflect the Authority's Capital Financing Requirement, identified in its capital expenditure and financing plans. They are consistent with the Treasury Management Policy Statement and Practices. The limit will ensure that total **net** debt does not exceed the total of the CFR in the preceding, current or following two financial years. The Authority is asked to approve the limits below and to delegate authority to the Deputy Chief Executive, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities. In order to ensure the Authority's debt interest payments are as minimal as possible the Deputy Chief Executive is looking at options for

rescheduling current debt. This may require the need to borrow at low interest rates in advance of the repayment of higher interest rate loans. To allow scope for this potential temporary increase in debt, in advance of the planned loan repayments, an additional £20m to £23m has been included in the Authorised Limit totals. However the “true” net figure is within the reported CFR figure (£63m to £64m).

Authorised Limit for External Debt		**2012/13**	**2013/14**	**2014/15**
		£’000	**£’000**	**£’000**
Borrowing		80,000	85,000	85,000
Other Long Term Liabilities		2,000	2,000	2,000
TOTAL		**82,000**	**87,000**	**87,000**

Members should note that these levels have been set to allow “headroom” for refinancing opportunities that may arise where borrowing might precede repayment.

Operational Boundary

144. The Operational Boundary indicator represents the expected maximum debt position during each year. It takes into account projections of borrowing requirement and repayments in future years. It may be different from the year end position as it reflects cash flows within each year. The Authority is asked to approve the limits and to delegate authority to the Deputy Chief Executive, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities.

Operational Boundary for External Debt		**2012/13**	**2013/14**	**2014/15**
		£’000	**£’000**	**£’000**
Borrowing		48,000	53,000	53,000
Other Long Term Liabilities		2,000	2,000	2,000
TOTAL		**50,000**	**55,000**	**55,000**

Actual External Debt

145. The prudential indicator for actual external debt considers a single point in time and hence is only directly comparable to the authorised limit and operational boundary at that point in time. Actual external debt is monitored during the year against the limits. It is forecast to be £46.1 million at 31st March 2012.

TREASURY MANAGEMENT INDICATORS:

146. The Treasury Management Code requires the following Treasury Management indicators of prudence:

Upper limit on fixed interest rate exposures;
Upper limit on variable interest rate exposures;
Upper and lower limits for the maturity structure of borrowing;
Total principal sums invested for periods longer than 364 days.

Interest Rate Exposures

147. It is recommended that the Authority sets upper limits on its fixed and variable interest rate exposures as a percentage of its net outstanding principal sums as follows: -

Upper Limits on Interest Rate Exposures		**2012/13**	**2013/14**	**2014/15**
		%	**%**	**%**
Fixed		100	100	100
Variable		50	50	50

148. This means that the Deputy Chief Executive will manage fixed interest rate exposures within the range 50% to 100% and variable interest rate exposures within the range 0% to 50% for 2012/13.

Maturity Structure of Borrowing

149. It is recommended that the Authority sets upper and lower percentage limits for the maturity structure of its borrowings as follows. Percentage of projected fixed rate borrowing that is maturing in each period:

	Upper Limit	**Lower Limit**
Under 12 months	80%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	50%	0%
10 years and above	80%	0%

Total Principal Sums Invested For Periods Longer Than 364 Days

150. It is recommended that the limit for investments of longer than 364 days be set at £2million for each of the years 2012/13, 2013/14 and 2014/15.

PERFORMANCE INDICATORS

151. The Code of Practice on Treasury Management requires the Authority to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking.

152. The Authority will maintain performance indicators for both borrowing and investment though it must be stressed that the pursuit of higher performance shall not be at the expense of taking undue risks. The indicators for the treasury function are:

Borrowing - Average rate of borrowing for the year compared to average available.

Investments – Internal returns compared to the 7 day LIBID rate.

The results of these indicators will be reported in the Treasury Management Monitoring and Annual Reports.

TREASURY MANAGEMENT ADVISERS

153. The Treasury Management service is provided to the Authority by Liverpool City Council. The terms of the service are set out in an agreed Service Level Agreement. The Council employs treasury management advisers appointed under a competitive procurement exercise who provide a range of services which include: -

- Technical support on treasury matters, capital finance issues.
- Economic and interest rate analysis.
- Debt services which includes advice on the timing of borrowing.
- Debt rescheduling advice surrounding the existing portfolio.
- Generic investment advice on interest rates, timing and investment instruments.
- Credit ratings/market information service comprising the three main credit rating agencies.

154. Whilst Liverpool City Council and its advisors provide the treasury function, the responsibility for any decision on treasury matters remains with the Authority.

(G) REVENUE FORECASTS

155. The Authority has in recent years maintained robust medium term financial plans.

156. This plan is fully reviewed on an annual basis and monitored quarterly. This section of the report will develop a financial forecast for the Authority based upon the latest information. It will:-

- Make underlying assumptions to support the forecast,
- Discuss the key pressures that contribute to forecast deficits.

Members will recall that in the past few years the Authority's budget forecasts have dealt with significant financial challenges because of government decisions about the funding of Firefighters pensions and the poor outcomes of the Comprehensive Spending Review 2007. The Authority has made innovative changes and efficiencies to tackle the deficits, totalling nearly £11m over the 2006/07 – 2010/11 period. These savings all have been fully implemented.

157. The Authority did very badly in terms of the CSR2010 and received in excess of 13% cut in its grant over 2011/12 and 2012/13 requiring £9m of savings to balance the budget for this period (subject to key budget assumptions remaining valid). However, the Government had advised fire authorities that the largest cut- back in grant would be backloaded into 2013/14 & 2014/15, and potentially be double the level in the first two years of the CSR2010 period.

158. A two phase approach was approved by the Authority which adopted the following structure:-

(a) 2011 – 2013 – Years 1 &2
Implement a £9m robust savings plan for 2011/12 and 2012/13 which would balance the budget, subject to key budget assumptions remaining consistent with the plan, and

(b) 2013-2015 - Years 3 & 4
Adopt a lobbying strategy for 2013/14-2014/15 (in conjunction with other Metropolitan Fire and Rescue Services) with a view to minimising the level of grant cuts. Depending upon the success of that lobby the Authority would face a stark choice between severe service reduction or largescale local taxation increases. The Authority would have to (in conjunction with the community) choose its strategy between taxation and cuts.

159. Therefore this report has been prepared with a proposed budget based upon the plan already approved by the Authority. In relation to the 2012/13 budget only variations to the approved plan need to be considered as part of this 2012/13 report.

160. The remaining paragraphs in this section of the report will consider the progress in delivering the phase 1 budget savings of £9m, and the validity of the current budget assumptions in the approved financial plan.

Phase 1 Saving Options – Is the Service on Target?

161. As the table below shows the Authority has made good progress in delivering its Phase one budget and is on target to deliver the required savings. However it should be noted that:-

- Savings in firefighter costs are only delivered at the rate of natural turnover through retirement and will not be fully achieved until the end of next financial year.
- The main risk around assumptions already made is in relation to the 2012/13 pay bill freeze (the third year pay bill freeze). Pay negotiations are conducted nationally;

Progress in allocating out 2011/12 Approved Saving Options				
	2011/12	**2012/13**	**2013/14**	**Future Years**
	£'000	**£'000**	**£'000**	**£'000**
2011/12 Approved Savings:	**-5,500**	**-8,525**	**-9,200**	**-9,200**
Complete:				
Assume Pay Bill Freeze 2010/11	-1,000	-1,000	-1,000	-1,000
Assume Pay Bill Freeze 2011/12	-1,000	-1,000	-1,000	-1,000
Reduction in Support Service Costs	-900	-1,300	-1,300	-1,300
Review of Capital Programme Financing	-400	-400	-400	-400
Rephasing of Vehicles Capital Programme		-100	-100	-100
Manage dynamic reserve more effectively	-1,800	-2,300	-2,950	-2,950
Reduce Senior Management Costs	-200	-400	-400	-400
	-5,300	-6,500	-7,150	-7,150
Approved Saving Options yet to be finalised:				
Assume Pay Bill Freeze 2012/13		-1,000	-1,000	-1,000
Outsource Estates function		-250	-250	-250
MACC Review	-200	-400	-400	-400
Flexible Shift Patterns at Whiston		-300	-300	-300
Flexible Shift Patterns at Marine 1		-75	-100	-100
	-200	-2,025	-2,050	-2,050
TOTAL	-5,500	-8,525	-9,200	-9,200

Note: The approved plan has earmarked the use of reserves to offset the fact that the full savings required for Phase 1 (2011/12 – 2012/13) will not be fully delivered until 2013/14 as they reflect the expected retirement profile of firefighter posts that will be deleted. This has enabled the Authority to adhere to its policy of seeking to avoid compulsory redundancies in Phase 1.

162. Therefore subject to any variation in the assumptions around costs or funding in the current financial plan, the Authority did establish a balanced budget for 2012/13 in its approved 2011/12 financial plan.

Budget Assumptions

163. The key technical and policy assumptions in the current and proposed updated financial plan are:-

Inflation & Pay Changes

164. The forecast plan currently includes a contingency for pay awards and price increases in each year. This has been prepared using the following assumptions –

- **A paybill freeze, (this includes provision for pay rises, employer pension increases and employers national insurance), for 2010/11 to 2012/13 (3 years), and**
- **With effect from 2013/14 an annual increase in the paybill of 2% - It is assumed that long term pay awards will fall in line with HMT expectations of inflation**
- **All Other Price Inflation 2% p.a.**

165. As an indicator to Members and a guide in assessing the volatility of inflation estimates - a movement of 1% in paybill inflation equates to approximately £0.55m in a full year. A 2% budgetary inflationary provision equates to approximately £1.1m in a full year for pay, and about £0.4m for price costs per annum

166. Members will recall that the Government has repeatedly emphasised the need in the current economic climate to manage public sector pay expectations and has announced that it has assumed a two year pay freeze in public sector pay from 2011 and a 1% pay cap for the following two years.

167. There has been no pay offer from employers to staff in 2010/11 and 2011/12.

168. The Government is also concerned about the cost of public pensions and is currently finalising the proposed changes to firefighter and local government pension schemes. At this time it is not clear what the impact of the fundamental pension changes will be on the employer's pension costs.

169. The plan assumes that the employer's contribution to all pension schemes will continue at current rates.

Cost of Capital Borrowing

170. The revenue impacts of capital investment decisions and the agreed 2012/13 – 2016/17 capital programme are included within forecasts. This includes additional new start schemes of £5.906m (predominantly being the additional year of 2016/17 added to the plans). The plan also takes into account the proposed MRP policy discussed previously in section D.

171. Overall spending on debt servicing is forecast to be about £6.4m in 2012/13 rising to £8.4m by 2016/17.

Resources Available

172. The two main sources of Authority funding are Council Tax Precept (41%) and Government Formula Grant (59%);

(a) Council Tax /Precept;

The forecast budget assumes council tax increases at the Authority's medium term planning level of 4.00% in 2012/13 and 4% per annum thereafter.

The localism bill has been introduced which limits the level of council tax increases at a figure set by the Secretary of State. For 2012/13 this has been set at 4%. No indication of the limit beyond 2012/13 has been made at this point.

2011/12 Council Tax freeze grant, £0.681m

Central Government offered all authorities a grant if they agreed to freeze the council tax in 2011/12. This was initially offered by the Government for the full CSR2010 period (2011/12 – 2014/15), as a specific grant and therefore outside the formula grant total. As the Authority approved a Council Tax freeze in 2011/12 it was therefore entitled to this specific grant. The Government has now advised that this grant is to be built into the base formula grant with effect from 2012/13. Therefore for 2012/13 the formula grant has been revised from £40.481m to £41.162m, reflecting the incorporation of the £0.681m specific 2011/12 Council Tax freeze grant.

2012/13 Council Tax freeze grant, Potential £0.816m

The Government have announced the availability of a 2012/13 Council Tax freeze grant if authorities agree to freeze their Council Tax for 2012/13 at 2011/12 levels. However, unlike the 2011/12 grant this would only be available for a single year in 2012/13.

The financial plan **assumes** the precept will increase by 4% in 2012/13. If, however, the Authority decided to freeze the council tax and accept the one off grant it would make the financial forecast worse than that set out in this report by:-

- 2012/13, a net loss of funding in 2012/13 of £0.279m, (4% Council Tax increase = £1.095m less council tax freeze grant of £0.816m),
- Future Years, a £1.1m additional permanent savings required in future years.

Council Tax Benefit Subsidy Localisation

The government has also announced the localising of council tax benefit subsidy along with a cut in the overall budget available for council tax benefit subsidy. The districts of Merseyside are considering how they will apply the new arrangements across the county but initial analysis suggest that the overall outcome will mean trying to collect more cash from relatively low income individuals. This is likely to impact upon collection rates and a 1% long term reduction has been assumed at this stage

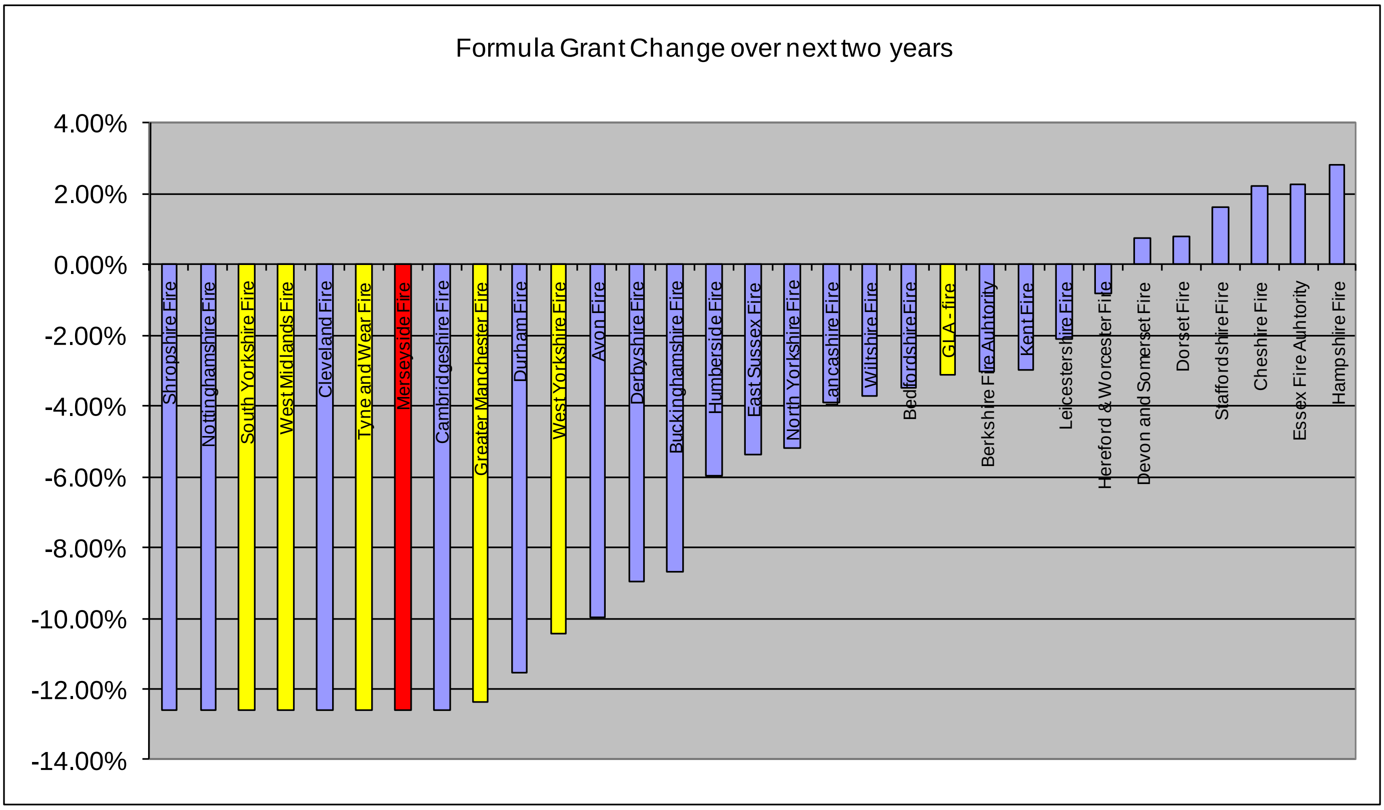
(b) <u>Government Formula Grant;</u>
Central Government's has previously announced that fire authorities face a 25% reduction in Government funding (equivalent to a cash reduction on the 2010/11 figure of 18%) over the 2011/12 – 2014/15 period.

The Government have stated the reduction will be back loaded for fire, with approximately 1/3rd of the reduction being phased in the first 2 financial years, (2011/12 – 2012/13) and the remainder in the last 2 years.

The Government has only announced detailed local authority's grant settlement figures for 2011/12 & 2012/13 but not for the final 2 years 2013/14 – 2014/15, and therefore a level of uncertainty remains over those years. However it is clear the Authority is likely to face an unprecedented challenge to deliver the savings required over this period.

The Authority has received a cash reduction in its grant of in excess of 13% (£7.7m) in 2011/12 – 2012/13 alone.

There is significant variation between Authorities in how the cuts have been allocated across the first two years. Merseyside has done 2.2 times as badly as the national average grant cut of 6%. Some Authorities have in fact received a grant increase**.**



Although the Authority does not know the level of Government funding it will receive in 2013/14 & 2014/15, the Government has confirmed the position regarding the national average grant cuts for directly funded fire and rescue services in England. The average cuts will be;

- 2013/14 -8.5%
- 2014/15 -5.0%

However, it is believed that these cuts will be increased further to reflect the Chancellors assumptions of a two year paybill cap of 1%p.a on public sector pay awards after the completion of the pay freeze and he has cut spending totals for local government accordingly.

The Government has also confirmed that Fire and Rescue services will be within the new funding arrangements for local government (the resource review) but that the spending review totals will be maintained for years 3 and 4 of the spending review period. It is unlikely that the Authority will be formally advised of its formula grant / base grant funding before December 2012.

The proposed financial plan has assumed Government funding reductions in 2013/14 & 2014/15 will be close to the national average figures ;

- **2013/14**: -8.5%, plus -1.0% (to reflect Chancellor pay assumptions) = **-9.5%**
- **2014/15**: -5.0%, plus -1.0% (to reflect Chancellor pay assumptions) = **-6.0%**

If the Authority's Government funding reflected the above adjustments it would result in a further £6.5m grant reduction. However, if the Authority does as badly in comparison to the national reduction as it did in 2011/12 – 2012/13, it may well be double this reduction.

The forecast of future Government grant funding assumes that the "floors" in the current grant allocation system that protect the Authority from the full grant cutback associated with the allocation formula, will remain in place for the foreseeable future.

The grant forecasts assume that any data updates used in the formula to allocate grant funding will not impact on the Authority's allocation.

Other Assumptions

173. The Medium Term Financial Plan assumes that:-

Investment Income

174. It has been assumed that interest rates will remain at current levels until the end of 2012 and will then gradually move upwards. Investment income therefore remains significantly lower than in previous years. The investment income forecast for 2012/13 is £0.232m rising to £0.323m in future years.

New Shared Control Facility and Firelink

175. This forecast does not assume any investment requirement or savings arising from a joint blue light control room in Merseyside currently under consideration. The feasibility study is expected to report in spring this year.

176. The Authority will receive a specific grant from the Government of £0.2m for the Firelink system. This forecast assumes this grant together with the resources set aside by the Authority can contain the future costs of this initiative in the future.

New Dimensions Grant

177. The Authority received a grant of £0.9m in each year for crewing New Dimensions Vehicles from CLG. The financial plan assumes this grant will continue in 2012/13 – 2016/17.

Taxbase Collection Fund changes

Council Taxbase

178. The Districts of Merseyside have set their taxbases 2012/13 and they are shown in the table below:-

District	2011/2012 Council Tax Taxbase	2012/2013 Council Tax Taxbase	Variance	
	£	£	£	%
LIVERPOOL	124,396.00	125,249.00	853.00	0.69%
WIRRAL	104,879.00	106,058.00	1,179.00	1.12%
ST.HELENS	56,110.00	56,135.00	25.00	0.04%
SEFTON	93,075.91	93,119.58	43.67	0.05%
KNOWSLEY	42,134.00	42,253.00	119.00	0.28%
	420,594.91	422,814.58	2,219.67	0.53%
2011/12 Band D Tax Leve	64.77	64.77		
Total Income £	27,241,932	27,385,700	143,768	0.53%

179. The total taxbase for the Authority has increased by 0.53% this means that each £1 of Council Tax the level of income will be slightly higher than that generated in 2011/2012 by £2,219.67. The result of this is that the income from the current level of Council Tax is anticipated to increase by £143,768 without any increase being applied (this is assumed to be a permanent increase).

180. This means that the income forecast from a 1% increase in Council Tax in 2012/2013 is now £0.277m.

Surplus and Deficit on Collection Funds

181. The Districts of Merseyside have reviewed their collection funds and identified the proportion of any surplus or deficit attributable to the Authority. The results are set out in the table below and show a net surplus of £104,737. This impact is a one-off.

District	**2011/2012** Coll fund deficit
	£
LIVERPOOL	-55,427
WIRRAL	-75,140
ST.HELENS	5,702
SEFTON	21,808
KNOWSLEY	-1,680
	-104,737

The overall forecast of the deficit based upon these assumptions is shown in the table overleaf:

DRAFT UPDATE FOR 2011/12 - 2016/17 MTFP	2011/12 £'000	2012/13 £'000	2013/14 £'000	2014/15 £'000	2015/16 £'000	2016/17 £'000
EXPENDITURE						
2011/12 Expenditure Forecast:						
Forecast Expenditure	76,738	78,824	80,719	83,219	85,074	86,684
2011/121 Approved Saving Proposals	-5,500	-8,525	-9,200	-9,200	-9,200	-9,200
Planned Use of Cost Smoothing Reserve	-1,457	-805	0	0	0	0
MTFP for 2011/12 Budget Report	**69,781**	**69,494**	**71,519**	**74,019**	**75,874**	**77,484**
2012/13 - 2016/17 Expenditure Changes:						
Capital Prog increase in MRP to reflect new year 2016/17						200
Adjust Smoothing Reserve drawdown in 2012/13 to bring net position to balance		254				
Updated Expenditure Forecast	69,781	69,748	71,519	74,019	75,874	77,684
FUNDING						
Government Grant	-41,906	-40,481				
Forecast Grant:						
a) Reductions in Grant = **original national figs (-8.5 & -5.0)**						
2012/13 Base less -8.5%			-37,040			
2012/13 Base less -8.5% & - 5.0%				-35,016		
2015/16 +2% of 2014/15 grant					-35,717	
2016/17 +2% of 2015/16 grant						-36,431
2017/18 + 2% of 2016/17 grant						
c) Reductions in Grant due to further Govt spending reductions to cover future pay **(-1.0% & -1.0)**			405	810	826	843
d)2011/12 Ctax Freeze Grant built into base grant from 2012/13		-681	-681	-681	-681	-695
Total Government Formula Grant Forecast	-41,906	-41,162	-37,316	-34,887	-35,572	-36,283
Council Tax Freeze grant 2011/2	-681					
Council Tax - **4% increase p.a**	-27,242	-28,481	-29,620	-30,805	-32,037	-33,318
Collection fund deficit / (surplus)	48	-105				
Anticipated Reduction in Coll Fund rates due to impact of benefit change 13/14			200	200	200	200
Updated Income Forecast	-69,781	-69,748	-66,736	-65,492	-67,409	-69,401
Forecast Net Position (surplus) / deficit	**0**	**0**	**4,783**	**8,527**	**8,465**	**8,283**

The current budget therefore indicates a balanced position for 2012/13 based upon an assumed 4% council tax increase and the other assumptions set out in this report.

Longer term (based on the current information) the likeliest best case scenario is that the Authority will require savings of at least £8.5m if its lobbying campaign is not successful.

(H) Options for facing a Financial Challenge

182. The Authority has agreed a number of Value For Money Principles that have underpinned its approach to budgets and financial plans in recent years. They are broadly:-

Principle 1 – Allocate resources In line with priorities
Principle 2 – Control Council Tax
Principle 3 – Acknowledging budget realities

The Authority will continue to:
i) Acknowledge the challenges it faces:
ii) Acknowledge the reality of its budget and recognise that 80% of its costs are people related.

Principle 4 – The Authority seeks to avoid compulsory redundancy in delivering Value for Money if possible

Principle 5 - The Authority seeks to maintain or improve service levels

183. In applying those principles the Authority has already made largescale budgetary changes and savings. As it faces up to its biggest ever financial challenge the Authority has very limited room for manoeuvre and these principles will be difficult to maintain.

2012/2013 Budget:

184. In considering the financial position the Authority will note that it has already approved a balanced financial plan for 2011/12 – 2012/13, ("Phase 1").

185. Therefore the Authority already has a budget for 2012/13 based on current assumptions. But this does rely upon **;**

- **Full delivery of Phase 1 Approved Savings**;
  It is imperative that the Service deliver on the £9.2m of approved permanent savings. This means that the savings that have yet to be formally implemented must be achieved as per the financial plan:

	2011/12	2012/13	2013/14	Future Years
	£'000	**£'000**	**£'000**	**£'000**
Assume Pay Bill Freeze 2012/13		-1,000	-1,000	-1,000
Outsource Estates function		-250	-250	-250
MACC Review	-200	-400	-400	-400
Flexible Shift Patterns at Whiston		-300	-300	-300
Flexible Shift Patterns at Marine 1		-75	-100	-100
TOTAL	-200	-2,025	-2,050	-2,050

The outstanding saving option that is the most at risk relates to the assumption around the paybill freeze in 2012/13, as this is not something that the Authority has direct control over. Pay negotiations are at a national level and pension and tax changes are controlled by government.

- **All other budget assumptions remaining valid for 2011/12 – 2012/13**: The key budget assumptions are:

  a. **A paybill freeze 2011/12 & 2012/13**, this includes not only pay rises but employer pension and national insurance contributions, and
  b. **A Council Tax increase of 4%** in 2012/13.

  Any pay bill increase in 2011/12 or 2012/13 would require additional permanent savings in the long term, and potentially require a drawdown from the inflation reserve if off-setting saving could not be identified in the relevant year. As an indicator to Members and a guide in assessing the volatility of inflation estimates - a movement of 1% in paybill inflation equates to approximately £0.55m in a full year.

  This forecast has been prepared on the basis that the Authority carries on with its medium term financial plan and sets council tax at 4% increases in each year.

  The Government has indicated that for those local Authorities that freeze their council tax for 2012/13 (zero increase) then a grant will be available equivalent to the income from a 3.0% council tax increase, £0.816m. The Government have stated that this grant will be available for 2012/13 only. If Members were minded to move away from their long term Council Tax strategy and accept the offer of the Council Tax freeze grant then additional savings of £0.279m in 2012/13 and £1.1m in future years must be identified.

  The Localism Act 2011 has been introduced which limits the level of council tax increases at a figure set by the Secretary of State. For 2012/13 this has been set at 4%. No indication of the limit beyond 2012/13 has been made at this point.

  If Members were looking to increase the Council Tax above 4% (or whatever figure is set in future years) then the Government has established procedures that the service must follow to get such a proposal ratified. If the Authority wished to exceed the “limit” in any year then it might approach the Secretary of State who has powers to ‘not apply’ the limit to specific authorities where an Authority can show;

  a) It is unable to discharge its functions in an effective manner
  b) Be unable to meet its financial obligations

  If it did not get the Secretary of State’s approval then the Authority must ask the District Councils to hold a referendum (local vote on its proposals). There are a number of practical issues relating to a potential referendum that would make it a risky proposition;

i) The Authority has to meet the costs of the referendum (Estimate £1-2m),
ii) The Authority would have to meet the cost of rebilling if it were not successful (forecast at £2m) and would still have to find the required savings to balance the budget,
iii) The limitations on council tax benefit subsidy grant in Merseyside where a large proportion of the population receive such benefit would mean that the net income from an increase might only be 60% of the gross amount
iv) There are administrative limitations on the process and campaigning around any referendum

If the Authority chooses to stick to its financial plan at a 4% increase it will not increase the savings target for the Authority and it would be consistent with Its medium term financial plan.

2013/14 – 2014/15 “Phase 2” Financial Plan

186. The Authority has a two phased strategy for dealing with the financial challenges following the unprecedented Government grant reductions expected in CSR2010, 2011/12 – 2014/15. This section of the report considers what changes, if any, are required to the proposed phase two approach approved in the last financial plan to tackle the financial challenges expected in 2013/14 – 2014/15.

187. In the last financial plan the potential additional savings above the £9.2 identified in phase one, ranged from an additional £7.0m (£16.2m annual saving target by 2014/15) to £13.3m (£22.5m annual saving target by 2014/15). The reason for such a wide range in the future saving target was due to the significant uncertainty over the future Government grant support in phase two.

Phase 2 Strategy;

188. The approved policy was to adopt a lobbying strategy for 2013/14-2014/15 (in conjunction with other Metropolitan Fire and Rescue Services) with a view to minimising the level of grant cuts. Depending upon the success of that lobby the Authority would face a stark choice between severe service reduction or large scale local taxation increases.

The concern is that Phase two of the cuts might be so severe that public safety may be compromised and that a legislative review of the impacts may be required.

The Authority agreed that, in conjunction with the community of Merseyside, it would choose its strategy regarding the balance between taxation and cuts for Phase 2.

189. Based on the best current information and the assumptions set out in this report the 'best case' most likely scenario for Merseyside is set out in the table below

DRAFT UPDATE FOR 2011/12 - 2016/17 MTFP						
	2011/12 £'000	**2012/13** £'000	**2013/14** £'000	**2014/15** £'000	**2015/16** £'000	**2016/17** £'000
Updated Expenditure Forecast	69,781	69,748	71,519	74,019	75,874	77,684
Government Formula Grant Forecast	-41,906	-41,162	-37,316	-34,887	-35,572	-36,283
Council Tax Freeze grant 2011/2	-681					
Council Tax - 4% increase p.a	-27,242	-28,481	-29,620	-30,805	-32,037	-33,318
Collection fund deficit / (surplus)	48	-105				
Anticipated Reduction in Coll Fund rates due to impact of benefit change 13/14			200	200	200	200
Forecast Net Position (surplus) / deficit	**0**	**0**	**4,783**	**8,527**	**8,465**	**8,283**

190. It is the Chief Fire Officer's (CFO) view that the Service should continue with the Phase 2 strategy of strong and direct lobbying aimed at minimising the level of grant cuts, but that the Service also needs to plan prudently for what it would do if that approach is not successful. The CFO is therefore proposing to commence work on establishing saving proposals to balance the financial plan in 2013/14 – 2014/15 by:-

i. Working jointly with the relevant service representative bodies to conclude a fundamental review of fire cover, and
j. To review the standards of fire cover appropriate for the county based upon risk, and
k. Consider what further savings can be delivered from a fundamental review of support services.
l. A review of the Authority's; reserve strategy; debt portfolio, capital programme including any alternative financing methods, to identify any possible savings in the costs of debt servicing for the Authority, and
m. A detailed review of all the "technical" assumptions in the base budget to assist the Authority to consider if there is any flexibility in those assumptions, and
n. Commence a consultation with the community of Merseyside on their view as to the potential consequences on the community of Merseyside of the potential cuts and whether they would be supportive of paying relatively small amounts of additional council tax to safeguard their Fire and rescue service, and
o. Grant delegated power to the CFO to continue to use VER/VS to reduce staff numbers where a business case exists to do so in line with the policies and procedures previously agreed by the Authority, and
p. Review the current HFSC strategy with a view to ensuring the investment offers the best returns in community safety.

The outcome of the above reviews will be reported back to Members as and when the relevant pieces of work have been completed, and will be fed into the budget making process as the Authority considers its strategy for the 2013/14 budget.

(I) ADEQUACY OF RESERVES AND BALANCES

Responsibilities of Chief Finance Officers

191. Under Part 2 of the Local Government Act 2003, the Chief Finance Officer of an Authority is now required to comment on the following matters:

- the robustness of the estimates made for the purposes of determining its Budget Requirement for the forthcoming year;
- the adequacy of the proposed financial reserves.

192. There is then a requirement for the Authority to have regard to the report of the Chief Finance Officer when making decisions on its Budget Requirement and level of financial reserves.

193. In the Fire Authority the Chief Finance Officer is the Deputy Chief Executive – Kieran Timmins. For the purposes of the Act the "financial reserves" of the Authority would incorporate Earmarked Reserves and Working Balances.

194. To make a final judgement on these issues it will be necessary to consider the proposed budget decisions of the Authority in the light of this budget report.

Robustness of Estimate

195. To fully satisfy the Chief Finance Officer any proposed Budget or amendment should therefore:-

- Be fully based upon the advice of Service Officers (supported by Finance Officers) – or based upon or supported by information the Chief Finance Officer considers reasonable to accept.
- Provide only for Budget proposals that are fully costed to service level and where the implications – both financial and upon service performance – are estimated and identified.
- Provide for all known future developments either through direct service Budget allocations or the establishment of specific reserves for such purposes.
- Provide for an adequate level of Balances and Reserves consistent with the requirements of any Regulation that may be earmarked and/or the Authority's own risk assessment.
- Provide for the full revenue implications of the Capital Programme.
- Establish clear targets for income collection in respect of key income streams.
- Ensure there are no unidentified savings targets.

- Where appropriate ensure that the consequences of current over and under spendings have been taken into account.

<u>Adequacy of proposed Financial Reserves</u>

196. Under the 2003 Local Government Act the Secretary of State may enact Regulations that define certain types of “controlled reserves” and the minimum level for those Reserves. At the time of preparing this report the Secretary of State has not enacted any such Regulations.

197. However, the 2003 Act still places a requirement upon the Chief Finance Officer to report if the level of reserves is likely to be inadequate. That report should contain comment upon:

  - the reasons for that situation
  - the actions, if any, considered appropriate to prevent the situation arising.

198. There is then a requirement for the Authority to respond to the report when making decisions on its future financial reserves.

199. In recent years the Authority has maintained a general revenue reserve of, in excess, of £2m and also maintained a number of earmarked reserves.

200. A pilot Comprehensive Performance Assessment (CPA) performance indicator relating to the level of general fund reserves indicated that;

  - *an appropriate level of was 5% of the forecast Net Operating Expenditure….* **Or;**
  - *that the organisation had a financial risk management process operating which justified a lower level of reserves….”.*

  This is for ‘normal’ rule for multi-service local authorities.

201. For this Authority a 5% forecast Net Operating Expenditure equates to approximately £3.5 million.

  However:-

  (a) The Authority’s risk management arrangements have improved. As part of this budget process the Deputy Chief Executive has prepared *a financial risk management matrix* and also assessed the year on year variation in risk facing the Authority. This takes account of the corporate risk register.

  (b) The Authority has previously maintained a number of specific earmarked reserves against risk.

  (c) The Authority is single purpose and does not face as full a range of risks to manage as a multi-purpose authority.

  (d) The Authority is unlikely to face significant increases in cost because of uncontrollable demand issues (unlike for example Social Services care for the elderly).

(e) Members will note that the Authority's revenue reserves have not generally been consumed during the year by overspendings but have been maintained throughout the year.

Current Reserves

202. In the latest financial review it has been identified that the Authority maintains the following key reserves:-

General Revenue Reserve	£4.684m
Other Earmarked Reserves	
Cost Smoothing	£2.046m
Capital / Investment	£2.400m
Early Retirement/Severance Costs	£2.420m
Inflation	£2.000m
	£8.866m

203. In addition the current 2011/12 financial position is healthy and savings are being delivered in line with the Authority's strategy, identifying an underspending of £0.600m (See separate report on this agenda for details). The proposal is to use this to increase the Capital / Investment to £3.000m

204. In total there are resources of £14m that might be used as part of an earmarked reserves strategy:

Strategic Reserve Forecast for 2011/12 to 2016/17

	2011/12 Closing Balance	2012/13 Opening Balance	Planned / Potential Use	Forecast Bal 31.03.13	Est Bal 31.03.14	Est Bal 31.03.15	Est Bal 31.03.16	Est Bal 31.03.17
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Earmarked Reserves								
Cost Smoothing Reserve	2,046	2,046	-553	1,493	1,493	1,241	1,241	1,241
Capital Investment Reserve	3,000	3,000	-500	2,500	2,500	2,200	2,200	2,200
Severance Reserve	2,420	2,420	-1000	1,420	1,420	1,420	1,420	1,420
Inflation Reserve	2,000	2,000		2,000	2,000	2,000	2,000	2,000
Total Earmarked Reserves	**9,466**	**9,466**	**-2,053**	**7,413**	**7,413**	**6,861**	**6,861**	**6,861**
General Revenue Reserve	**4,684**	**4,684**	**0**	**4,684**	**4,684**	**4,684**	**4,684**	**4,684**
Total Reserves	**14,150**	**14,150**	**-2,053**	**12,097**	**12,097**	**11,545**	**11,545**	**11,545**

Proposed Strategy

205. Having reviewed the Authority Risk Register and prepared a detailed costing of financial risks, the Deputy Chief Executive recommends that in the light of all risks facing the Authority that it **should aim to maintain a general revenue reserve of at least the current level of £2.5m.**

206. It should, however, be noted that as part of the risk assessment process, four potential major risks have been identified for future years of the financial plan, these are set out in the table below.

207. These risks have been assessed upon the assumption that the Authority adopts the financial savings set out in this report:-

RISK / ASSUMPTION	**RECCOMENDATION**
<u>Pay Freeze/Inflation</u> **If the Authority assumes a multi-year pay freeze within its financial plan whilst this is probably already achieved for 2010/11 & 2011/12 there remain risks for 2012/13 Since pay bargaining is at a national level and the financial position and appetite/attitude toward pay freezes may be very different in better off fire and rescue services.** **In addition any employer pension contribution changes might increase the pay bill.** **General inflation particularly for fuel, food and other commodities remains well above 2%.**	**Maintain a £2m Inflation reserve to allow time to make additional savings if pay freezes/inflation not controlled**
<u>Cost Smoothing Reserve</u> **As identified above it will take time to deliver cash savings up to the finally anticipated level particularly from Firefighter roles where savings are expected to be delivered from retirements that will take three years to complete.** **Reserves will be required to balance the budget until cash savings are delivered.** **The Authority should seek to increase this reserve whenever possible over the next two years because of the financial challenge in future years (Phase 2)**	**Maintain a cost smoothing reserve of £2m and increase if possible**
<u>Severance</u> **The budget savings options identify a large number of post reductions. It is hoped these can be achieved by voluntary means but voluntary severance and /or early release of pensions comes at an additional cost. It is recommended to maintain a reserve which will cover the cost of such upfront investment that delivers longer term savings**	**Maintain a reserve of £2.4m to meet the costs of severance and/or early retirement costs (£0.6m has been used in the year to date)**

<u>Capital/PFI</u> **The overall financial plan contains a number of largescale capital investment projects which represent both a risk and opportunities for the Authority . It is appropriate to maintain a reserve equivalent to about 10% of the total value of the capital investment underway.**	**Maintain a capital Investment Reserve of at least £2m**

<u>Members should bear in mind that reserves and balances should only be used to finance one-off expenditure. If such monies are used to fund ongoing revenue expenditure without taking action to reduce underlying expenditure, the Authority would find itself facing the same deficit in the next and future years but without reserves available to finance it. This is underlined by the District Auditor's 'Golden Rule' - that "one off" revenue reserves should not be used to support 'ongoing' revenue expenditure.</u>

<u>Review of Reserves and Balances</u>

208. Members need to consider their strategy on reserves and balances in the light of the guidance from the Deputy Chief Executive.

<u>Consultation</u>

209. The Authority has consulted on its budget decision in a variety of ways and in particular:-.

(1) <u>IRMP Consultation</u>
As part of the IRMP consultation, some respondents commented on the level of Council Tax. The key message was that – whilst recognising that planning for 4% might seem reasonable, this is still twice the rate of inflation and will cause problems for pensioners and those on low incomes.

(2) <u>Consultation with Unions/Staff</u>
Trade Unions were invited to, and attended, the recent Budget Seminar and contributed to the debate around suitable options.

<u>Budget Timetable</u>

210. There is a legal requirement for the Authority to set a balanced budget and decide its level of precept **before** 1st March 2012.

<u>Equality & Diversity Implications</u>

211. The financial plan makes provision for the required investment to ensure the Authority meets and exceeds its Equality and Diversity requirements in addition to work carried out by all staff and teams.

212. All strategic saving options will have an Equality Impact Assessment undertaken before they are brought to members for ratification and approval.

No new saving options for 2012/13 have proposed above and beyond those approved in the last financial review.

Staff Implications

213. The **'Phase 1'**, 2011/12 to 2012/13, approved saving options proposed a reduction in the Service establishment of approximately -174 whole time equivalent posts, split -82 support & management roles, (-21% of the total support & management structure), and -92 firefighter posts (-10% of the firefighter establishment).

214. While the Service will aim to adhere to its VFM Principle 4, *the Authority seeks to avoid compulsory redundancy in delivering Value for Money* **, given the severity of the financial challenge ahead, this may become more challenging**

Legal Implications

215. The Authority must set a balanced budget and decide its level of precept **before** 1st March 2012.

Financial Implications & Value for Money

216. See Executive Summary.

Health & Safety and Environmental Implications

217. The budget and capital investment programme make largescale investments in staff Health and Safety.

Contribution to Achieving the Mission

218. To Achieve; Safer Stronger Communities - Safe Effective Firefighters. The proposed financial plan considers how best to allocate resources and deliver a balanced budget in light of the approved mission of the service and service priorities.

BACKGROUND PAPERS

Report CFO/016/11 “Merseyside Fire & Rescue Authority Budget & Financial Plan 2011/2012 – 2015/2016” Authority 17 February 2011.

Report CFO/132/12 “Financial Review Report 2011/121 April to December Review” Authority 16 February 2012

Report CFO/028/12 “2012/2013 IRMP” Budget Authority meeting 16 February 2012

Glossary of Terms

CFR – **Capital Financing Requirement** – measures the amount of capital spending that has not yet been financed by capital receipts, capital grants or contributions from revenue income. It measures the underlying need to borrow for capital purpose, although this borrowing may not necessarily take place externally (use of available cash etc).

CFS – Community Fire Safety

CSR07 – Government comprehensive spending review to identify support for the public sector over 2 to 3 year period

CSR10 – Government comprehensive spending review to identify support for the public sector over 2011/12 – 2014/15 period

DCLG – Department Communities and Local Government

HFSC – Home Fire Safety Check

LLAR – Low Level Activity Risk

MRP - MINIMUM REVENUE PROVISION - An amount set aside from revenue towards the repayment of loan debt.

MTFP – Medium Term Financial Plan

ODPM – Office of Deputy Prime Minister

PFI - PRIVATE FINANCE INITIATIVE – a Central Government initiative which aims to increase the level of funding available for public services by attracting private sources of finance. The PFI is supported by a number of incentives to encourage authorities’ participation.

RESERVES -Amounts set aside to meet future contingencies but whose use does not affect the Authority’s net expenditure in a given year. Appropriations to and from reserves may not be made directly from the revenue account.

RSG – Government grant support towards the revenue budget

Supported Borrowing – Borrowing to fund capital expenditure that through the Revenue Support Grant receives grant support to cover the revenue costs associated with borrowing (interest / debt repayment)

Unsupported Borrowing – No Revenue Support Grant to cover the costs associated with borrowing and the Authority must earmark revenue funds to cover these costs.