MERSEYSIDE FIRE AND RESCUE AUTHORITY			
MEETING OF THE:	AUTHORITY		
DATE:	14 DECEMBER 2017	REPORT NO:	CFO/076/17
PRESENTING OFFICER	CHIEF FIRE OFFICER		
RESPONSIBLE OFFICER:	IAN CUMMINS	REPORT AUTHOR:	IAN CUMMINS
OFFICERS CONSULTED:	STRATEGIC MANAGEMENT GROUP		
TITLE OF REPORT:	FINANCIAL REVIEW 2017/18 - APRIL TO SEPTEMBER		

APPENDICES:	APPENDIX A1:	REVENUE BUDGET MOVEMENTS SUMMARY
	APPENDIX A2:	FIRE AND RESCUE SERVICE REVENUE BUDGET MOVEMENTS
	APPENDIX A3:	CORPORATE SERVICE REVENUE BUDGET MOVEMENTS
	APPENDIX A4:	BUDGET MOVEMENTS ON RESERVES
	APPENDIX B:	CAPITAL PROGRAMME 2017/18
	APPENDIX C:	APPROVED AUTHORITY CAPITAL PROGRAMME 2017/18 – 2021/22

Purpose of Report

1. To review the financial position, revenue and capital, for the Authority for 2017/18. The Authority receives regular comprehensive financial reviews during the year which provide a full health check on the Authority's finances. This report covers the period April to September 2017.

Recommendation

2. That Members;
   a) Note the potential £0.900m favourable revenue position identified within this report,
   b) Approve the utilisation of the £0.900m favourable revenue position to increase the Smoothing Reserve in order to enable the Authority to have the time to identify permanent additional savings should future pay awards exceed the assumption in the current financial plan, and
   c) Instruct the Treasurer to continue to work with budget managers to maximise savings in 2017/18.

Executive Summary

Revenue:

The Authority has a detailed medium-term financial plan. The key elements of this are :-

- To control Council Tax
- To continue with its modernisation programme and deliver the Authority's Mission of achieving Safer Stronger Communities – Safe Effective Firefighters
- To deliver the required savings through efficiencies, most of which are employee related, whilst minimising the impact of the cuts.

The Authority is on target to deliver the approved 2017/18 budget savings and is progressing well with the required structural changes in its workforce in order to maintain the required savings on a permanent basis. The Authority has a strategy of maximising savings and delivering its savings plan as early as possible in order to increase reserves as a hedge against future financial challenges. Overall this report has identified that in cash terms the Authority is £0.900m ahead of its saving plan target. Members are asked to approve utilising this saving to fund an increase in the smoothing reserve in light of the current national debate around lifting the 1% cap on public sector workers annual pay increases and the risk that the current 1% pay award assumption in the financial plan (up to and including 2019/20) proves to be inadequate. The smoothing reserve would allow the Authority time to react to any change in the plan's pay assumption in order to identify and implement the required savings to maintain a balanced financial position. Officers will continue to work through the remainder of the year to maximise any savings in order to increase reserves.

The total budget requirement remains at the original budget level of £59.490m. Appendix A1 – A4 outline in detail all the revenue budget and reserve movements between April and September 2017.

Capital:

The capital programme planned spend has increased by £0.386m and is fully funded from specific resources. The revised Capital Programme is outlined in Appendix B and C.

Reserves & Balances:

The general balance remains unchanged at £2.000m. All movements in earmarked reserves are outlined in Appendix A4.

Treasury Management:

No new long term borrowing has been arranged and the Authority has continued its policy of reducing investments and only taking short term borrowing to cover cash flow requirements.

Introduction and Background

3. The purpose of this report is to enable the Authority to monitor its income and expenditure levels against its budget on a regular basis throughout the year to ensure effective financial management.

4. This report is the review of the Authority's position up to the end of September of the financial year 2017/18 (April – September 2017).

5. In order to ensure that the financial reviews provide a regular and effective financial health check on all aspects of the Authority's finances the following structure has been adopted.

Financial Review Structure

Section	Content
A	Current Financial Year Review (Revenue Budget, Capital Programme and movement on Reserves)
B	Treasury Management Review

(A) Current Financial Year – 2017/18

6. The purpose of the financial review report is to provide Members with an assurance that the approved budget remains robust and that the current forecast of expenditure can be contained within the available resources. If actual expenditure or income for the year is inconsistent with the current budget then the report will, if necessary, identify the appropriate corrective action.

Revenue Position:

7. Budget Movements: The attached Appendix A1 – A4 to this report summarises the movements in the revenue budget. The net budget requirement remains at £59.490m which is consistent with the original budget.

8. There have been a number of budget adjustments in the quarter but they have had no impact on the "bottom-line" as they are either self-balancing virements within department budgets or budget adjustments financed by reserves in line with previously agreed Authority decisions. The net contribution to reserves for the period was £3.880m, of which £4.028m was due to the re-phasing of spend on Saughall Massie and St Helens new fire stations from 2017/18 into 2018/19 and the consequential "repayment" of previously drawn down reserve back into the capital reserve.

9. Update on Budget Savings Implementation:
Pre 2016/17 Budget - the Authority had approved savings in total of £25.597m as part of the medium term financial plans. These savings had been forecast to be fully delivered by 2017 due to the savings being achieved by natural firefighter retirement rates. The savings are on target to be delivered as expected by the

end of calendar year. However the required structural changes will not be formally implemented until the required new fire stations being built as part of the station merger initiative are completed. However, the full saving target will be delivered in cash terms as long as the firefighter retirement rate remains consistent with the current expectation.

10. **The Authority approved 2016/17 & 2017/18 Budget** savings of £11.597m to be delivered in full by 2021/22. The saving plan included;

- efficiency savings of £8.256m by reducing management and support services costs,
- a known or anticipated £1.441m increase in the council tax base that the plan assumed is permanent.

Despite identifying efficiencies of £9.697m the Authority had to approve an unavoidable reduction of £1.900m from operational response in order to balance the financial plan by 2021/22. The operational saving has been phased so it can be achieved by anticipated firefighter retirement rates.

All saving options assumed in 2017/18 have been successfully implemented.

The non-firefighter pay award for 2017/18 has been settled at the assumed budget target of 1%, but the 2017/18 firefighter pay award remains to be agreed. An employers' offer of 2% with a potential further 3% in April 2018 has been rejected by the FBU. Any settlement above the 1% assumed in 2017/18 will require permanent additional savings to be identified (approximately £0.3m for each additional 1%). The Authority has established an inflation reserve of £0.5m that may be able to cover any increase in 2017/18, but Members will need to consider the consequences of any agreed 2017/18 pay award above the assumed 1% during the 2018/19 budget making process. As most non-employee and technical savings have been exhausted it is likely that any pay award above the 1% assumed in 2017/18 or change in the 1% assumed for 2018/19 & 2019/20 (2% assumed thereafter) will have to be met from a reduction in the employee establishment. To assist Members as an example each additional 1% may require the loss of up to 10 firefighter posts. The issue over future pay award increases will be considered as part of the 2018/19 budget process.

11. <u>Actual expenditure in comparison to Revenue Budget</u>**:** The Authority is concerned that any future Government may continue to reduce the level of Government support in real terms post 2019/20. It therefore has directed the Chief Fire Officer to maximise savings in the year to contribute towards the building up of reserves. Such reserves can then be used as part of an implementation and risk management strategy to deliver savings.

Employee Costs;

Employee costs make-up approximately 75% of the Authority's revenue budget and is the most risk critical area of the financial plan. As a result these costs are monitored extremely closely.

Firefighter retirements are slightly ahead of the forecast profile adopted for the financial strategy and a small favourable variance of £0.335m is anticipated. Non-firefighter employee costs are forecast to be £0.250m below budget due to temporary vacancies and not all employees being at the budgeted top of the grade. At this point employee costs are expected to be £0.585m under budget.

Contingency for 2017/18 Pay & Price Increases;

As stated already Members will recall that the budget assumed a 1% pay bill increase in 2017/18 and up to 2019/20. The non-firefighter staff have accepted a 2017/18 1% pay award but significant risk exists around the firefighter's award. In addition the current plan's assumption of a 1% pay award in 2018/19 and 2019/20 is at risk with the possible removal of the public sector 1% pay cap. Each additional 1% award would require additional permanent savings of +£0.400m (£0.300m for firefighters and £0.100m for non-operational staff). A review of the current financial plan's assumptions will form part of the 2018/19 budget process. Officers are continuing to control the allocation of non-employee inflation. In the first instance any inflationary pressure is expected to be absorbed from within the relevant budget line, the current expectation is that this strategy will result in a £0.250m saving.

Other Non-Employee Revenue Costs;

Additional one-off savings of £0.065m have been identified within the Premises, Supplies and Services budgets due to savings on premises maintenance, professional fees and subsistence expenses. The Treasurer is continuing to work with budget holders to maximise savings in 2017/18.

The Treasurer will continue to monitor actual staff numbers during the year to ensure the Service continues to deliver in "cash" terms the required saving target and report back as the year progresses.

12. Debtor accounts under £5,000 may be written off by the Treasurer. Following advice from legal services (one account was raised in error and the other was questionable over whether it was a chargeable service), two debtor accounts have been approved for write-off under delegated powers in the second quarter totalling £835.20:-

Invoice Date	Invoice Number	Line Description	Write Off Reason	Original Invoice Value		
				Nett Value	VAT Value	Gross Value
11/04/17	I0019560	SPECIAL SERVICE CALL	LITIGATION ADVICE	348.00	69.60	417.60
28/04/17	I0019602	SPECIAL SERVICE CALL	LITIGATION ADVICE	348.00	69.60	417.60
				696.00	139.20	835.20

13. Summary of Revenue Forecast Position: The Authority has made good progress in implementing the approved budget saving options and required organisational structure changes.

As expected the implementation of all of the approved station merger proposals have yet to be formally concluded, therefore the required budgetary structural changes remain outstanding. As Firefighter retirements are slightly ahead of the planned schedule the Service continues to deliver in "cash" terms the required saving target. The quarter 2 forecast has identified a revenue saving of £0.900m. Members are asked to approve the utilisation of this saving to fund an increase in the smoothing reserve in light of the uncertainty that exists over future pay award increases and the potential that they may exceed the 1% assumed in the current plan for 2017/18 – 2019/20. The Table below summarises the revenue year-end forecast position based on spend to the end of September 2017:

	FIRE SERVICE BUDGET	Fire Authority	NRAT	TOTAL BUDGET	ACTUAL as at 30.09.17	FORE-CAST	VARI-ANCE
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Expenditure							
Employee Costs	48,784	403	1,762	50,949	25,942	50,364	-585
Premises Costs	2,691	0		2,691	1,136	2,666	-25
Transport Costs	1,514	0	254	1,768	859	1,768	0
Supplies and Services	3,130	34	1,305	4,469	1,300	4,429	-40
Agency Services	5,800	0	780	6,580	2,628	6,580	0
Central Support Services	433	92	215	740	317	740	0
Capital Financing	10,948	0	5	10,953	0	10,953	0
Income	-7,282	0	-4,321	-11,603	-6,635	-11,603	0
Net Expenditure	66,018	529	0	66,547	25,547	65,897	-650
Contingency Pay&Prices	1,069			1,069	0	819	-250
Cost of Services	67,087	529	0	67,616	25,547	66,716	-900
Interest on Balances	-172			-172	-9	-172	0
Movement on Reserves	-7,954			-7,954	0	-7,954	0
Total Operating Cost	58,961	529	0	59,490	25,538	58,590	**-900**

The Treasurer is continuing to work with budget holders to maximise savings in 2017/18.

Capital Programme Position:

14. The last financial review report (CFO/054/17) approved a 5 year capital programme worth £43.060m. This has now been updated for scheme additions

and changes during quarter 2 of £0.386m which are summarised in the table below:

Movement in the 5 Year Capital Programme						
	Total Cost	**2017/18**	**2018/19**	**2019/20**	**2020/21**	**2021/22**
Expenditure	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Amendments to Approved Schemes;						
2017/18 re-phasing	0.0	-7,584.3	7,972.7	-305.8	-73.7	-8.9
Saving - Realignment of Vehicles & HFSA	-86.4	-71.4	-15.0			
New ICT Projects funded from Grant/Revenue	332.4	332.4				
New PPE and Energy schemes funded by Reserves/Revenue	140.0	140.0				
	386.0	**-7,183.3**	**7,957.7**	**-305.8**	**-73.7**	**-8.9**
Funding						
Borrowing:						
Rephasing of approved schemes from 2017/18	0.0	-834.3	1,222.7	-305.8	-73.7	-8.9
Savings on Vehicles	-56.4	-56.4				
Reserves						
Saughall Massie FS New Build- **rephased**	0.0	-1,564.0	1,564.0			
St Helens FS New Build- **rephased**	0.0	-2,464.0	2,464.0			
Gas Tight Suits Other PPE - **new**	108.0	108.0				
Fire Helments - new	32.0	32.0				
Revenue Contribution to Capital Outlay(RCCO)						
New ICT equipment	8.4	8.4				
Reduction in HFSA scheme	-30.0	-15.0	-15.0			
Capital Grant						
New ESMCP Project schemes	324.0	324.0				
Transformation Grant -**rephased**	0.0	-2,722.0	2,722.0			
	386.0	**-7,183.3**	**7,957.7**	**-305.8**	**-73.7**	**-8.9**

15. Although the level of planned expenditure has increased, the level of required borrowing has actually reduced as the additional expenditure is funded by non-borrowing resources. Details of the planned changes in quarter 2 are outlined below:

- Following a review of the current programme a number of schemes have been re-phased into future years. The most significant adjustment, a £6.750m re-phasing into 2018/19, is for the new St Helens and Saughall Massie fire stations as construction work is not expected to commence until 2018.
- The replacement of the national Airwaves emergency communications system with a new Emergency Services Mobile Communications Programme alternative, ESMCP, requires up-front investment in the control room and a new scheme for £0.324m funded by Home Office grant monies has been added to the current programme.

- Members approved report CFO/056/17 at the Community Safety and Protection Committee on 5th September 2017, and agreed to drawdown £0.108m from the clothing reserve to contribute towards the replacement of fire helmets. This provision has now been built into the operational PPE scheme.
- A number of small changes to the ICT, Building and Vehicle programmes have been built into the latest capital budget and are being funded from revenue and reserve contributions or have offered up a small saving on planned spend that was funded through borrowing.

16. Overall the revised capital programme has increased by £0.386m. The revised detailed capital programme is attached as Appendix B (2017/18 Capital Programme) and Appendix C (2017/18–2021/22 Capital Programme) to this report for Members information.

Use of Reserves:

17. The analysis in Appendix A4 outlines a £3.880m movement from the revenue budget back to reserves in quarter 2. Of this £4.028m is as a result of the re-phasing of the Saughall Massie and St Helens new fire station schemes from 2017/18 into 2018/19. As a result the earmarked reserve monies have now been credited back into the capital reserve. Also, £0.148m of earmarked reserves was as planned drawn down to fund changes to the capital programme or to cover the PFI unitary charge payments. The general revenue reserve has remained unchanged at £2.000m.

18. As outlined previously in this report the Authority faces a significant degree of uncertainty over the future annual pay award increases. The current financial plan assumes 1% awards up to 2019/20 and 2% thereafter. This report is recommending that the report's forecast revenue underspend of £0.900m be used to increase the existing smoothing reserve which currently has an uncommitted reserve of £0.500m (current balance of £0.906m less £0.406m committed to funding planned spend in 2018/19). This would enable the Authority to have the time to identify permanent additional savings should future pay awards exceed the 1% assumption in the financial plan.

(B) Treasury Management

19. The Authority continues to "buy in" Treasury Management from Liverpool City Council. The following paragraphs reflect Treasury Management activities in the period April to September 2017.

20. **Prospects for Interest Rates;**
Economic growth in 2017 has been disappointingly weak, recording growth of just 0.3% in quarter 1 and 2. The main reason for this has been a sharp increase in inflation, caused by the devaluation of sterling after the Brexit referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy has seen weak growth as consumers cut back on their expenditure.

The September Monetary Policy Committee (MPC) surprised markets and forecasters by suddenly switching to a much more aggressive tone in terms of warning that the Bank Rate will need to rise. Whilst CPI inflation is now expected to peak at over 3% the banks focus is on an emerging view that with unemployment falling to only 4.3%, its lowest since 1975, and improvements in productivity being so weak, that the amount of spare capacity in the economy was significantly diminishing towards a point at which they now needed to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of increasing globalisation. However, the bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a decrease in such globalisation pressures in the UK, and so would be inflationary over the next few years.

The MPC increased the Bank Rate by 0.25% to 0.5% in November. Some forecasters are predicting growth to improve significantly into 2018 and for inflation to fall bringing an end to the negative impact upon consumer spending power while a strong export performance will compensate for weak service sector growth. In this scenario the MPC would have added reason to embark upon a series of slow but gradual increases in Bank Rate during 2018. While there is so much uncertainty around Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two years will pan out.

PWLB rates and gilt yields remain volatile and difficult to predict given the on-going economic and geo-political situation. Whilst this volatility is likely to endure the overall longer run trend is for gilt yields and PWLB rates to rise from historically low levels. Long term PWLB rates rose by 0.15% during the first half of the financial year.

The strategy indicated that the overall structure of interest rates whereby short term rates are lower than long term rates was expected to remain throughout 2017/18. In this scenario, the strategy would be to reduce investments and borrow for short periods and possibly at variable rates when required.

21. **Capital Borrowings and the Portfolio Strategy;**
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 2017/18. Current market conditions continue to be unfavourable for any debt rescheduling.

22. **Annual Investment Strategy;**
The investment strategy for 2017/18 set out the priorities as the security of capital and liquidity of investments. Investments are made in accordance with DCLG Guidance and CIPFA Code of Practice. Investments are made in sterling with an institution on the counterparty list.

Extreme caution has been taken in placing investments to ensure security of funds rather than rate of return. The use of deposit accounts with highly rated or nationalised banks and AAA rated money market funds has enabled reasonable returns in a low interest rate environment. In the period 1st April to 30th September 2017 the average rate of return achieved on average principal available was 0.52%. This compares with an average seven day deposit (7 day libid) rate of 0.11%.

The credit ratings and individual limits for each institution within the categories of investments to be used by the Authority in 2017/18 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
Enhanced Money Market (Cash) 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

The Authority had investments of £39.8m as at 30th September 2017 (this included a £28.7m firefighters' pension grant received in July that will be utilised in the year):

ANALYSIS OF INVESTMENTS END OF QUARTER 2 2017/18

Institution	Credit Rating	MM Fund*	Bank / Other	Building Society
		£	£	£
Aberdeen Liquidity Fund	AAA	400,000		
Deutsche/DGLS/State Street	AAA	1,600,000		
Blackrock	AAA	3,000,000		
Federated Investors	AAA	3,000,000		
Fidelity	AAA	700,000		
Goldman Sachs	AAA	2,100,000		
LGIM (Legal & General)	AAA	3,000,000		
Morgan Stanley	AAA	3,000,000		
Standard Life Investors (Ignis)	AAA	3,000,000		
Close Brothers	A		2,000,000	
Goldman Sachs	A		2,000,000	
Handelsbanken	A		2,000,000	
HBOS FTD	A		2,000,000	
HBOS FTD	A		2,000,000	
Santander UK	A		2,000,000	
Cumberland BS	Unrated			1,000,000
Nationwide B Soc	A			2,000,000
Newcastle B Soc	Unrated			1,000,000
Nottingham B Soc	Unrated			1,000,000
Principality B Soc	Unrated			1,000,000
Skipton B Soc	Unrated			1,000,000
West Bromwich B Soc	Unrated			1,000,000
Totals		**19,800,000**	**12,000,000**	**8,000,000**
Total Current Investments				**39,800,000**

**MM Fund - Money Market Funds -these are funds that spread the risk associated with investments over a wide range of credit worthy institutions.*

23. **External Debt Prudential Indicators;**
The external debt indicators of prudence for 2017/18 required by the Prudential Code were set in the strategy as follows:

Authorised limit for external debt: £77 million
Operational boundary for external debt: £59 million

Against these limits, the maximum amount of debt reached at any time in the first half of the financial year 2017/18 was £39.1 million.

24. **Treasury Management Prudential Indicators;**
The treasury management indicators of prudence for 2017/18 required by the Prudential Code were set in the strategy as follows:

a) Interest Rate Exposures

Upper limit on fixed interest rate exposures: 100%
Upper limit on variable interest rate exposures: 50%

The maximum that was reached in the first half of the financial year 2017/18 was as follows:

Upper limit on fixed interest rate exposures: 100%
Upper limit on variable interest rate exposures: 0%

b) Maturity Structure of Borrowing

Upper and lower limits for the maturity structure of borrowing were set and the maximum and minimum that was reached for each limit in the half quarter of the financial year 2017/18 was as follows:

Maturity Period	Upper Limit	Lower Limit	Maximum	Minimum
Under 12 months	50%	0%	3%	0%
12 months and within 24 months	50%	0%	2%	1%
24 months and within 5 years	50%	0%	10%	9%
5 years and within 10 years	50%	0%	0%	0%
10 years and above	90%	0%	89%	86%

c) Total principal sums invested for periods longer than 364 days.

The limit for investments of longer than 364 days was set at £2 million for 2017/18. No such investments have been placed during 2017/18.

Equality and Diversity Implications

25. There are no equality and diversity implications contained within this report.

Staff Implications

26. There are no staff implications contained within this report.

Legal Implications

27. There are no legal implications directly related to this report.

Financial Implications & Value for Money

28. See Executive Summary.

Risk Management, Health & Safety, and Environmental Implications

29. There are no Risk Management, Health & Safety and Environmental implications directly related to this report.

Contribution to Our Mission: *Safer Stronger Communities* – *Safe Effective Firefighters*

30. The achievement of actual expenditure within the approved financial plan and delivery of the expected service outcomes is essential if the Service is to achieve the Authority's Mission.

BACKGROUND PAPERS

CFO/015/17 "MFRA Budget and Financial Plan 2017/2018-2021/2022" Authority 23rd February 2017.

CFO/054/17 "Financial Review 2017/18 – April June" Audit and Scrutiny Sub Committee 21st September 2017.

GLOSSARY OF TERMS