

MERSEYSIDE FIRE AND RESCUE AUTHORITY

MEETING OF THE:	POLICY AND RESOURCES COMMITTEE		
DATE:	10 DECEMBER 2020	REPORT NO:	CFO/058/20
PRESENTING OFFICER	IAN CUMMINS		
RESPONSIBLE OFFICER:	IAN CUMMINS	REPORT AUTHOR:	IAN CUMMINS
OFFICERS CONSULTED:	STRATEGIC LEADERSHIP TEAM		
TITLE OF REPORT:	FINANCIAL REVIEW 2020/21 - JULY TO SEPTEMBER		

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Purpose of Report

1. To review the financial position, revenue and capital, for the Authority for 2020/21. 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 July to September 2020.

Recommendation

2. That Members;
 - a) note the contents of the report, and
 - b) approve the proposed revenue, capital and reserve budget alignments, and
 - c) approve the use of the £4.440m favourable revenue variance identified within this report to increase the capital investment reserve in order to contribute towards the cost of a new TDA development.
 - d) instruct the Director of Finance to continue to work with budget managers to maximise savings in 2020/21.

Executive Summary

Revenue:

The Authority approved a five-year medium-term financial plan (MTFP) at the Budget Authority meeting on 27 February 2020. The approved MTFP delivers a balanced budget for 2020/21 based on key budget assumptions around costs, in particular pay. A small financial challenge of £0.760m was forecast in 2021/22 rising to £1.490m by 2024/25. However, as Government grant support beyond 2020/21 is unknown the current MTFP strategy is to deal only the known financial challenges at this point and consider any future challenge once it is known or is more certain. This report updates members on the 2020/21 budget position and any issues arising in the year that may impact on the future years' financial position.

The Authority has a strategy of maximising any savings in the year in order to fund increases in reserves or additional debt payments that may free up future budgets to act as a hedge against future financial challenges or fund infrastructure investment.

This report identifies a favourable variance of £4.440m, mainly as the result of reducing planned debt payments to the minimum required (resulting in a £3.069m variance).

Members are asked to approve the use of this favourable variance to increase the capital investment reserve in order to contribute towards the cost of a new TDA development.

The total budget requirement remains at the original budget level of £61.961m. Appendix A1 – A4 outline in detail all the revenue budget and reserve movements since the last financial review report and September 2020.

Capital:

The capital programme planned spend has increased by £0.014m as the result of an increase in ICT spend funded via a revenue contribution. The revised Capital Programme is outlined in Appendix B and C.

Reserves & Balances:

The general balance remains unchanged at £3.000m. All movements in committed 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 2020/21 (April – September 2020).
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.

<u>Financial Review Structure</u>	
<u>Section</u>	<u>Content</u>
A	Current Financial Year Review:- <ul style="list-style-type: none">• Revenue Budget,• Capital Programme, and• Movement on Reserves
B	Treasury Management Review

(A) Current Financial Year – 2020/21

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: there have been a number of budget adjustments with no net impact because they are either self-balancing virements within department budgets or budget increases financed by reserves in line with previously agreed Authority decisions. The budget adjustments in quarter 2 included: -
 - A net contribution to reserves of £0.112m to reflect a required adjustment to the PFI reserve and a repayment back to the energy saving reserve. A breakdown of the reserve movements are outlined in Appendix A4.
 - A £0.511m drawdown from the inflation provision to cover the green book staff annual pay award (2.75%) and other price increases.
 - Self-balancing virements to cover small adjustments within non-employee budget lines.
8. **The net budget requirement remains at £61.961m which is consistent with the original budget.**

9. Update on Budget Assumptions and actual expenditure:

McCloud remedy –

- The Government introduced changes to all public pensions in 2014 and 2015. These changes were challenged in the courts by the Fire Brigades Union (FBU) and Judges representatives as the transitional protections given to some scheme members as part of public service pensions reform was deemed discriminatory. This challenge is often referred to as the “McCloud” case. On 20th December 2018 the Court of Appeal found that these protections were unlawful on the grounds of age discrimination and could not be justified. On 27th June 2019 the Supreme Court refused the Government the right to appeal against this decision and therefore compensation and remedy is required to redress the situation.
- On 16th July 2020 the Government issued its proposed remedy for consultation (ending 11th October 2020), once the Government finalises the remedy proposals they are likely to be subject to the introduction of future legislation, so potentially the remedy may not be fully “signed-off” until 2021/22 at the earliest. The remedy is likely to offer all public pension scheme members who were in service on or before 31st March 2012 and in service on or after 1st April 2015 the choice of either staying in the new scheme or moving back into their original scheme. However, all staff will move into the new scheme from April 2022.
- The Home Office issued informal guidance on 21st August 2020, informing fire and rescue authorities that members of the FPS facing immediate detriment (individuals approaching retirement) should be given the option to choose between their old scheme and the 2015 scheme. This HO guidance also stipulated that any retrospective employer and employee contributions would have to be made good.
- The 2020/21 Budget assumed any proposed remedy / compensation would not impact on the 2020/21 year as employer costs associated with the impact of the remedy would be taken into account in the 2020 FPS Actuarial review. This review will determine the FPS employer rates from 2023/24.
- Direction on the status of the HO immediate detriment informal guidance is being sought by FRS’s via the LGA, and a number of clarifications on the process are required before the informal guidance can be considered. However, HO finance officers have confirmed that any required retrospective employer contributions will not have to be made good by the employer and the cost will be recovered via the 2020 FPS actuarial review and amended employer rates from 2023/24.
- The Authority has been advised that any compensation payments will be passed to the employer as and when they are actioned.
- In order to manage any risk from the McCloud case the Authority identified the Smoothing Reserve, currently £2m, as an in-year source of funding if

any current McCloud assumptions do not hold true. The Director of Finance believes the Smoothing reserve can cover any costs associated with McCloud and the remedy in 2020/21, but the future funding of such costs will be considered as part of the 2021/22 and future budget processes.

Unplanned growth – The budget assumes all spending requirements can be met from the approved budget. The spread of **COVID-19** has created unprecedented circumstances within which the Authority has had to respond. The following points summarise the potential financial impact of COVID-19; -

- The anticipated financial impact in 2020/2021 is expected to be limited to a loss of commercial and other income (£0.5m) and additional expenditure on protective equipment, cleaning, ICT and other costs (£0.9m). To date the Government has awarded the Authority £1.419m to cover the impact of the virus, and MHCLG have made available funds to cover 95% of lost fees and charges income. Subject to the implications of any future wave(s), these grants should be sufficient to cover the loss of income and additional costs up to the end of 2020/2021.
- The 2020/2021 budget anticipates a level of Council Tax and Business Rate income based on the collection rates assumed by the five Merseyside local authorities. COVID-19 may impact adversely on the assumed collection rates and this will be reflected in the collection fund financial position to be taken into account during the 2021/22 budget process. The Government has announced it will allow any deficit on the Collection Fund to be spread over the 2021/22 – 2023/2024 period.
- Any permanent impact on the Authority's MTFP beyond 2020/2021 is difficult to determine at this point, as the impact of the virus on future local government funding is unknown.
- In addition, the Government have announced that the planned reforms to the Fairer Funding Formula and Business Rates Retention scheme that were expected to impact on the Local Government Settlement for 2021/22 will now be delayed.

Actual expenditure in comparison to Revenue Budget:

10. After reviewing spend and income up to the end of September 2020 officers have identified the following 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 retirement numbers are slightly ahead of the expected forecast profile adopted for the financial strategy resulting in a forecast £0.125m or 0.3% favourable variance against the £35.753m budget.

Non-firefighter employee costs - vacancies arising from staff turnover in the year and a refund of LGPS surplus funds (£0.157m) has resulted in a forecast £0.382m or 3.3% saving on the £11.689m budget.

Other Employee costs – The risks associated with COVID-19 has resulted in a number of training courses being deferred and an anticipated saving on the training budget of £0.100m.

Other Non-Employee Revenue Costs;

The service over-achieved in delivering the £0.426m 2019/20 support savings by £0.099m resulting in a favourable variance in this year and future years. In addition, following a review of various historical technical amendments and non-employee budgets a number of permanent saving have been identified; employer national insurance rate and superannuation rate changes £0.160m; premises utility and rates costs £0.100m; computer and communications supplies £0.070m; various supplies and services £0.086m. In total all these variances provide for a permanent £0.515m annual saving, and this will be taken into account during the 2021/2022 budget process. One-off savings of £0.065m have been identified in the quarter. Most of this is down to the 2020/2021 £0.045m Marine 1 growth option not being required as Merseytravel have agreed to continue with their support in 2020/2021.

Capital Financing;

The current debt repayment strategy (minimum revenue provision, MRP) is to use any additional savings to increase the planned MRP payment so that future debt servicing budget may be freed-up to fund additional investment in frontline services approved by the Authority. This strategy has been in place now for a number of years. In addition, current interest rates are such that the strategy is to reduce investments and borrow for short periods rather than take out new long term borrowing to fund capital investment over the short term. The combined strategy of making additional MRP payments and avoiding new borrowing has meant that if the Authority makes only the statutory MRP payment in 2020/2021 the MRP and interest payments will result in a favourable £3.069m variance this year.

Income;

The Authority receives a s31 grant as compensation for loss of Small Business Rates income lost as a result of Government policy on restricting annual rate increases. The current budget income for this grant is £1.007m, however the latest forecast is for a grant of £1.111m, an additional £0.104m.

Contingency for 2020/21 Pay & Price Increases;

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 latest forecast has identified a one-off savings on non-employee lines of £0.100m.

11. Overall the latest forecast has identified a favourable revenue variance of £4.440m, the table below summarises the year-end forecast position based on spend to the end of September 2020:

Anticipated Year-End Revenue Position							
	FIRE SERVICE BUDGET	Fire Authority	NRAT	TOTAL BUDGET	ACTUAL as at 30.09.20	FORECAST	VARIANCE
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Expenditure							
Employee Costs	50,047	353	1,872	52,272	25,137	51,665	-607
Premises Costs	3,042			3,042	1,237	3,042	0
Transport Costs	1,251		6,242	7,493	3,471	7,493	0
Supplies and Services	3,448	101	1,639	5,188	1,991	4,628	-560
Agency Services	6,309		644	6,953	2,830	6,953	0
Central Support Services	434	45	167	646	395	646	0
Capital Financing	8,940		3	8,943	0	5,874	-3,069
Income	-10,404		-10,567	-20,971	-20,311	-21,075	-104
Net Expenditure	63,067	499	0	63,566	14,750	59,226	-4,340
Contingency Pay&Prices	904			904	0	804	-100
Cost of Services	63,971	499	0	64,470	14,750	60,030	-4,440
Interest on Balances	-172			-172	-61	-172	0
Movement on Reserves	-2,337			-2,337	0	-2,337	0
Total Operating Cost	61,462	499	0	61,961	14,689	57,521	-4,440

12. Members considered a report on the development of a new TDA at the Authority meeting on 15 October 2020, and approved that the CFO should look at the option of building a new TDA rather than refurbish the current site, subject to a full business case coming back to Members' for approval. A new development is likely to cost in excess of £20m to £25m and in order to manage any new borrowing requirement Members' are asked to approve the use of the identified £4.440m favourable variance to increase the capital investment reserve in order to contribute towards the cost of a new TDA development.
13. The Director of Finance will continue to monitor the position during the year to ensure the Service continues to deliver the required savings target and report back as the year progresses.
14. Debtor accounts under £5,000 may be written off by the Director of Finance. No account was written-off under delegated powers in the second quarter.

Capital Programme Position:

15. The last financial review report (CFO/045/20) approved a 5-year capital programme worth £37.153m. This has now been updated for one new ICT hardware scheme for £0.014m funded from revenue.
16. The revised detailed capital programme is attached as Appendix B (2020/21 Capital Programme) and Appendix C (2020/21–2024/25 Capital Programme) to this report.

Use of Reserves:

17. The analysis in Appendix A4 outlines a £0.112m contribution to reserves during the second quarter of 2020/21, as a result of: -
 - A £0.095m adjustment to the PFI annuity reserve to reflect the planned drawdown over the life of the PFI initiative, and
 - A £0.017m planned repayment back to the energy saving reserve from savings made from previous investments (Salix Energy Efficiency Loan Scheme).

In light of the need to fund a new TDA development the CFO and Director of Finance have reviewed the current reserves and this report proposes to re-align £0.700m of reserves to increase the Capital Investment Reserve by;

- Reducing the £3.000m Recruitment Reserve by £0.500m in light of the fact the cost of recruiting firefighters in advance of existing staff retirements has been funded from within the overall employee budget to date and it is felt a reduced reserve of £2.500m is sufficient to meet any future challenges, and
- A reduction in the Inflation Reserve from £0.700m to £0.500m which equates to 1% of the pay budget, and this would provide a short term funding solution IF annual pay awards exceeded the current MTFP 2.5% assumption by up to 1%, and this is deemed prudent.

Subject to Members' approval, the quarter 2 report proposal would increase the Capital Investment reserve by £4.440m.

The general revenue reserve has remained unchanged at £3.000m.

(B) Treasury Management

18. 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 2020.

19. Prospects for Interest Rates;

The medium-term global economic outlook remains weak. The second waves of Covid cases have prompted more restrictive measures on a regional and national basis. This ebb and flow of restrictions on normal activity will continue for the

foreseeable future, at least until an effective vaccine is produced and distributed.

The global central bank and government responses have been significant and are in many cases on-going, maintaining more stable financial, economic and social conditions than otherwise might be the case.

The scale of the economic shock to demand, on-going social distancing measures, regional lock downs and reduced fiscal support will mean that the subsequent pace of recovery is limited. Early signs of this are already evident in the UK monthly GDP and PMI data, even before the latest restrictions.

This situation will result in central banks maintaining low interest rates for the medium term. In the UK, Brexit is a further complication. Bank Base Rate is therefore likely to remain at low levels for a very long time, with a distinct possibility of being cut to zero. Money markets have already priced in a chance of a negative Bank Rate.

Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations of potentially even lower rates and insipid inflation expectations. There is a chance yields may follow a slightly different path in the medium-term, depending on investor perceptions of growth and inflation, or if the UK leaves the EU without a deal.

The Bank of England Base Rate is expected to remain at the current level of 0.10%. We can expect additional monetary loosening in the future, most likely through further financial asset purchases. Whilst the central case for Bank Rate is no change, further cuts to zero, or perhaps even into negative territory, cannot be completely ruled out.

The PWLB certainty rate for borrowing is linked to Gilt yield plus 1.80%. Gilt yields will remain very low in the medium-term. Shorter term gilt yields are currently negative and will remain around zero or below until either the Bank expressly rules out a negative Bank Rate or growth/inflation prospects improve. PWLB rates for longer term loans have risen slightly, by 0.06% since the start of the financial year, to 2.60% by the end of the second quarter.

The current environment remains consistent with the strategy that indicated that the overall structure of interest rates whereby short term rates would be lower than long term rates was expected to remain throughout 2020/21. In this scenario, the strategy was to reduce investments and borrow for short periods and possibly at variable rates when required.

20. **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 2020/21. Current market conditions continue to be unfavourable for any debt rescheduling.

21. **Annual Investment Strategy;**

The investment strategy for 2020/21 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 July to 30 Sept 2020 the average rate of return achieved on average principal available was 0.50%. This compares with an average seven-day deposit (7 day libor) rate of 0.06%.

The credit ratings and individual limits for each institution within the categories of investments to be used by the Authority in 2020/21 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
Ultra-Short Duration Bond 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

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 Authority had investments of £48.2m as at 30th September 2020, (this included a £25.8m firefighters' pension grant received in July that will be utilised in the year):

ANALYSIS OF INVESTMENTS END OF QUARTER 2 2020/21

Institution	Credit Rating	MM Fund*	Bank / Other	Building Society	Local Authority	Average Interest
		£	£	£	£	%
Aberdeen Global	AAA	3,000,000				0.70
Federated Investors	AAA	3,000,000				0.69
Fidelity	AAA	3,000,000				0.70
JP Morgan	AAA	3,000,000				0.54
LGIM (Legal & General)	AAA	3,000,000				0.69
Morgan Stanley	AAA	700,000				0.63
Close Brothers	A		2,000,000			0.76
HSBC (MFRS Deposit Account)	A		500,000			0.00
Santander	A		2,000,000			0.58
Coventry BS				1,000,000		0.80
Leeds BS				2,000,000		0.75
Newcastle B Soc				1,000,000		0.75
Nottingham B Soc				2,000,000		0.68
Aberdeen Council					2,000,000	0.58
Blackburn Council					2,000,000	0.63
Blackpool Council					2,000,000	0.61
Broxbourne DC					2,000,000	0.53
Broxtowe BC					2,000,000	0.86
Guildford BC					2,000,000	0.55
Lancashire CC					2,000,000	0.63
PCC Lancashire					2,000,000	0.80
Slough BC					2,000,000	0.79
Tameside MBC					2,000,000	0.71
Thurrock Council					2,000,000	0.86
Totals		15,700,000	4,500,000	6,000,000	22,000,000	0.66
Total Current Investments					48,200,000	

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

22. External Debt Prudential Indicators;

The external debt indicators of prudence for 2020/21 required by the Prudential Code were set in the strategy as follows:

Authorised limit for external debt:	£64 million
Operational boundary for external debt:	£58 million

Against these limits, the maximum amount of debt reached at any time in the period 1 July to 30 Sept 2020 was £37.3 million.

23. Treasury Management Prudential Indicators;

The treasury management indicators of prudence for 2020/21 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 period 1 July to 30 Sept 2020 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 period 1st July to 30 Sept 2020 was as follows: -

Maturity Period	Upper Limit	Lower Limit	Maximum	Minimum
Under 12 months	50%	0%	1%	1%
12 months and within 24 months	50%	0%	8%	8%
24 months and within 5 years	50%	0%	1%	1%
5 years and within 10 years	50%	0%	0%	0%
10 years and above	95%	0%	90%	90%

c) Total principal sums invested for periods longer than 365 days

The limit for investments of longer than 365 days was set at £2 million for 2020/21. One investment of £2 million for 365 days was placed in the second quarter of 2020/21.

Equality and Diversity Implications

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

Staff Implications

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

Legal Implications

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

Financial Implications & Value for Money

27. See Executive Summary.

Risk Management, Health & Safety, and Environmental Implications

28. 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*

29. 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/008/20 "MFRA Budget and Financial Plan 2020/2021-2024/2025" Authority 27th February 2020.

CFO/045/20 "Financial Review 2020/21 – April to June" Audit Committee 24th September 2020.

GLOSSARY OF TERMS
