MERSEYSIDE FIRE AND RESCUE AUTHORITY			
MEETING OF THE:	ANNUAL GENERAL MEETING		
DATE:	26TH JUNE, 2014	REPORT NO:	CFO/077/14
PRESENTING OFFICER	DEPUTY CHIEF EXECUTIVE		
RESPONSIBLE OFFICER:	KIERAN TIMMINS	REPORT AUTHOR:	KIERAN TIMMINS
OFFICERS CONSULTED:			
TITLE OF REPORT:	RESERVE STRATEGY		

APPENDICES:	N/A

Purpose of Report

1. This report considers a potential reserves strategy for the Authority to adopt in light of the Authority debt profile and the need to finance the proposed programme of station mergers without increasing debt costs/burdens.

Recommendation

2. That Members
   a. Note the Authority current debt profile

   b. Approve the proposed reserves strategy

   c. Approve The Chief Fire enter into a dialogue with any firefighters who might wish to be considered for voluntary severance (VS) to see if there are agreements that can be reached that might suit both the individual and the public purse

Executive Summary

MFRA currently has outstanding debt of £42.1m.

This is relatively higher than most FRA's because of:-
- Historical lack of valuable asset sales
- Previous capitalisations of revenue costs
- A large number of assets to support

The Authority should therefore seek to avoid increasing debt if it can as it delivers station mergers.

The Authority has built-up reserves as a hedge against various risks in a very challenging financial position. It is recommended that a large proportion of these reserves are put toward funding the station mergers programme.

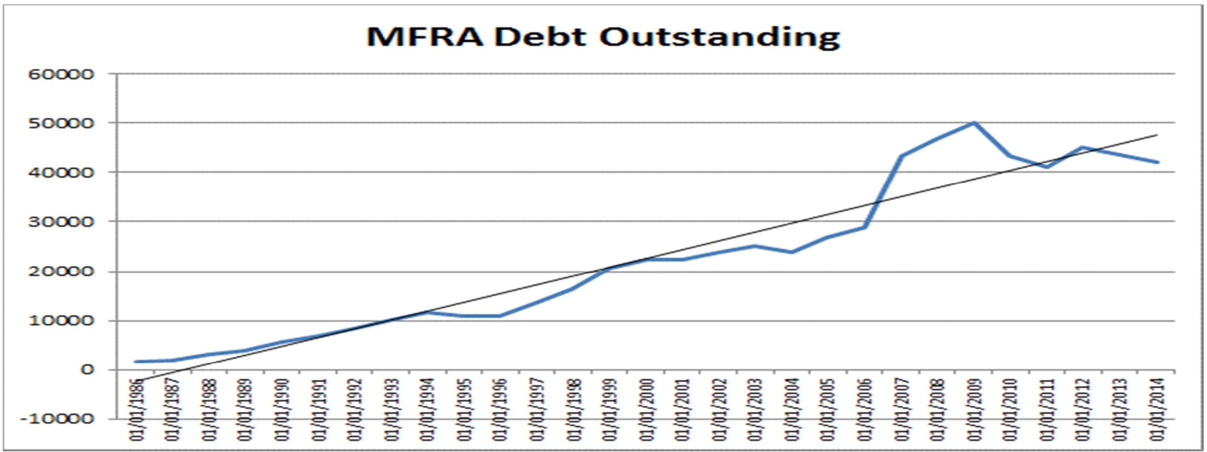
If reserves are lower post 2015/16 and there are ongoing funding cuts and/or other spending pressures it will prove harder to use natural turnover rates to deliver savings and the risk of compulsory redundancy amongst firefighters would be higher.

Because of that issue coupled with the significant change programme for firefighters ways of working it is proposed to explore with firefighters to see if a voluntary severance 'package' can be produced that would be attractive to both firefighters and meet the aims and requirements of the Authority's financial plan.

Introduction and Background

3. Current Debt

The Authority has outstanding loans of £42.1m at the 31 March 2014. The graph below shows total debt outstanding over time since the formation of the Authority.



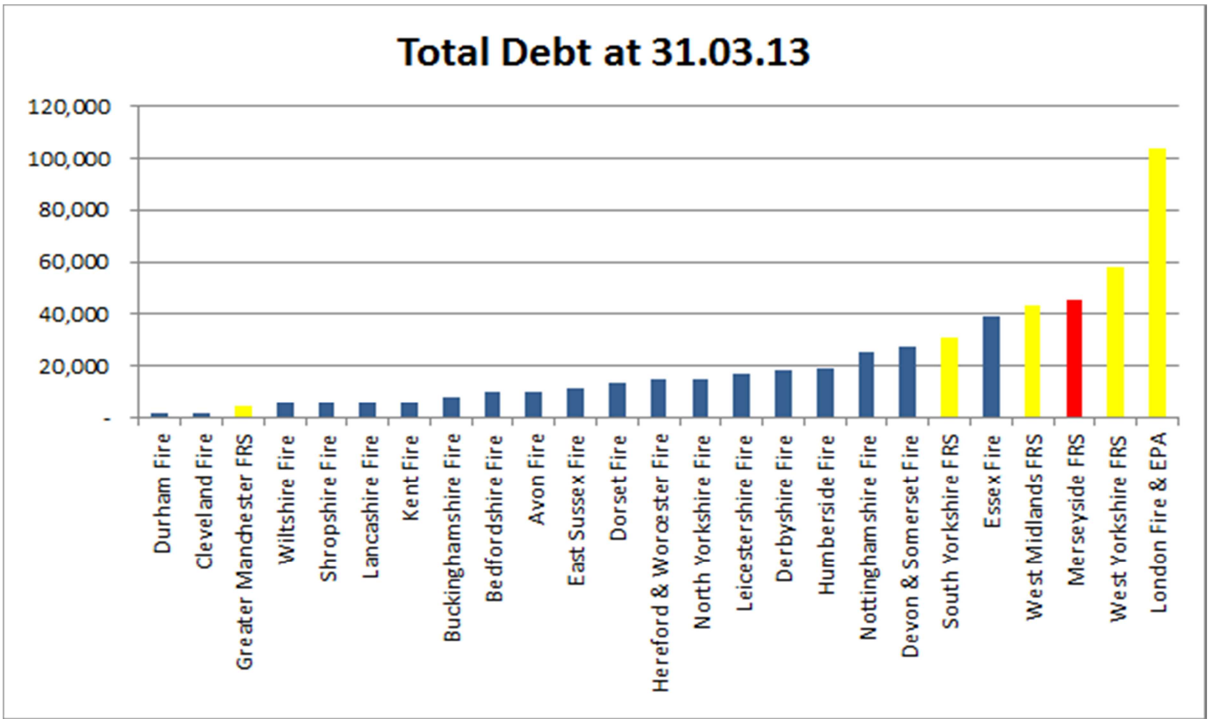
4. In the longer term, any Authority's borrowing is a reflection of the investment funded by borrowing (the capital financing requirement). However, the exact timing of taking out any loans is mainly a function of the cash flow position of the organisation. In recent years Merseyside has had significant financial reserves because of the budgetary risks and challenges it faces, and that

combined with grants being received in advance of payment has meant it has been in a relatively cash rich position and so has avoided borrowing.

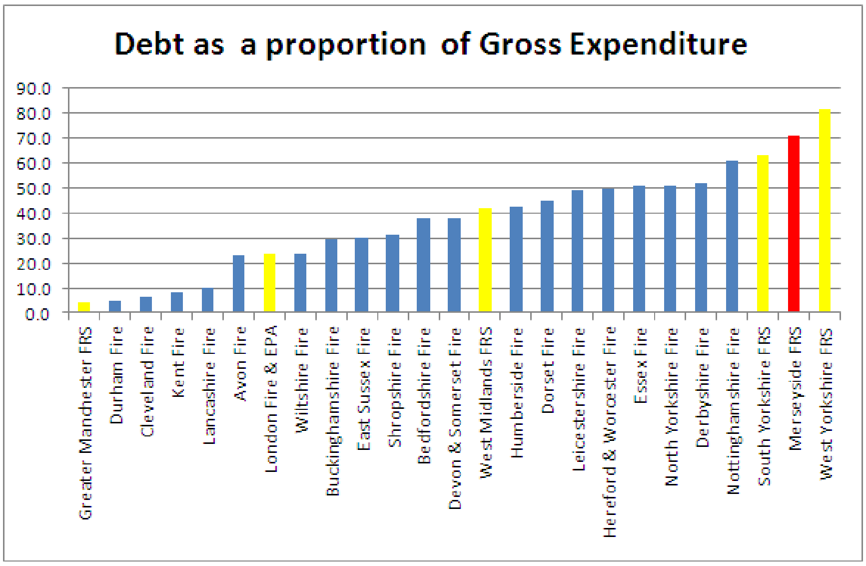
5. The capital financing requirement for the Authority is currently £56m so the Authority is “under borrowed” by some £14m and in the longer term one would expect its actual borrowing to be £56m.

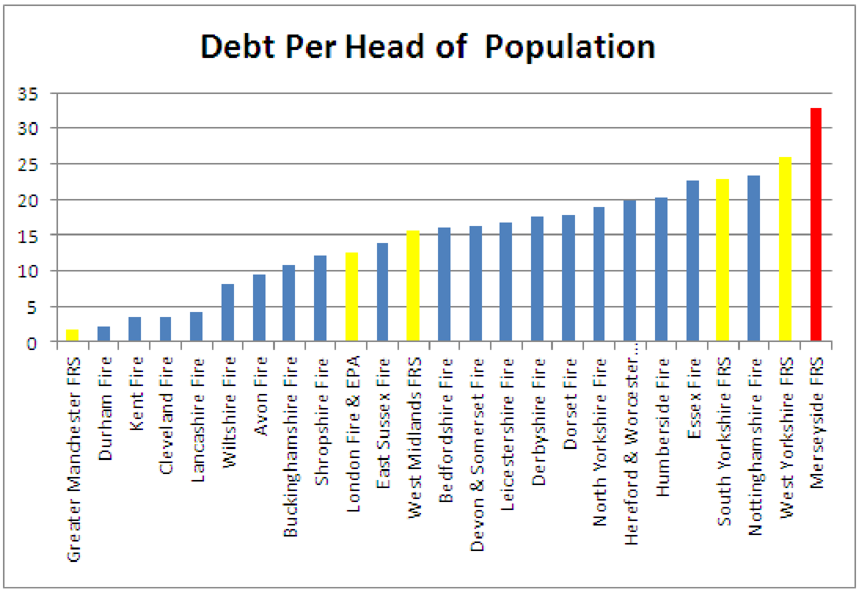
6. <u>Relative Position</u>

The graph below shows all Fire and Rescue Authorities’ absolute debt at 31 March 2013. Merseyside has one of the higher levels of absolute debt of all FRA’s.



7. As a further comparison the tables below show that absolute debt as a proportion of budget and debt per head of population for all FRA’s at the same date.

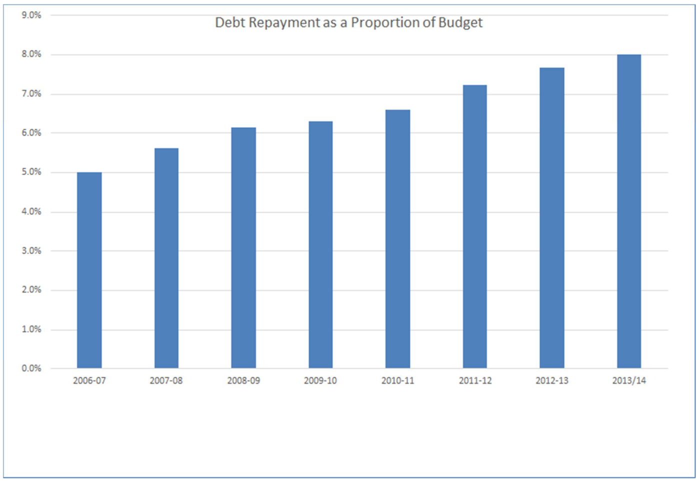




8. In absolute and relative terms Merseyside FRA seems to have high levels of debt compared to most other FRA's, and this comparison would be more acute still if we were fully borrowed up to our capital financing requirement.

9. The cost of repaying debts (Principal and Interest) in 2013/14 was £5.4m or 8% of our budget.

10. In recent years as the budget has been reducing, debt repayments have formed an increasing proportion of the Authority's budget overall as shown in the bar chart below.



11. <u>Reasons for Relatively High Levels of debt</u>

There are three key reasons for the debt levels in Merseyside:-

a) Lack of Capital Receipts
b) Maintaining a relatively large number of assets
c) Capitalising costs to avoid firefighter redundancy

a) <u>Lack of Capital receipts</u>

Merseyside FRA has a relatively unchanged asset base over a long period of time and has sold relatively few sites. Because the property market in Merseyside has never been as buoyant as other cities, the Authority has not been able to generate capital receipts like London, Manchester and West Midlands. For example, London Fire Brigade sold its HQ on the banks of the Thames for £42m in 2008, West Midlands sold its city centre HQ for £11m in 2007.

b) <u>Maintaining a relatively large number of assets</u>

Until very recently Merseyside maintained 42 Fire appliances in 26 Fire stations. Compared to most other Fire and Rescue Services this is a relatively high level of assets per head of population. The long term capital investment in these properties and vehicles is reflected in the relatively high levels of borrowing.

c) <u>Capitalising Costs to Avoid Firefighter Redundancy</u>

The Fire Authority has experienced several ‘shocks’ to its financing because of external factors or decisions. These have left the Authority in the position of having to make fairly radical cost reductions through reductions in the number of firefighters. In order to give time to make savings through natural turnover rates and avoid compulsory redundancy for firefighters, the Authority has in the past sought special permission to capitalise costs. Capitalisation means taking out costs from the revenue budget and treating them as capital expenditure, since capital expenditure is funded by borrowing this means the revenue cost is funded over an extended period of time. Capitalisation usually needs the permission of the Secretary of state.

12. There have been three specific capitalisations:-

- In 1996 MFRA received Secretary of State Permission to capitalise £1.1m of pensions costs.
- In 2006 MFRA faced significant financial difficulties following changes to the way firefighter pensions were funded and it received permission to capitalise £6.1m.
- As a short term measure, from 2006 the salary costs of firefighters installing smoke alarms (which are deemed capital expenditure) were capitalised and funded by borrowing. In total about £3m of costs were financed in this way. Since 2010 the Authority has continued capitalising costs but funds the costs by revenue contribution so there is no long term cost implication.

13. In total about £10m of current borrowing (a quarter) relates to capitalisations.

14. <u>Summary of Debt Position</u>

In overall terms whilst the position is by no means unmanageable, the Authority has relatively higher levels of debt than most FRA's and as the budget is shrinking repaying debt will form a larger proportion of our expenditure.

15. The Authority should seek to control its borrowing as part of any medium term financial strategy.

16. <u>The Need to Borrow</u>

The Authority has already approved a capital programme for the next five years with total borrowing of £18.5m. (A significant portion of which is in 2014/15 relating to the JCC project). That capital programme does not include any provision for the cost or financing of the station mergers programme.

17. Members will be well aware that the Authority is embarking upon a programme of 4 station Mergers. The current forecast costs and funding are set out in the table below:-

		All 4 Mergers £'m
Community Fire Station Build Cost		11.610
Project Management		0.400
Purchase of Land		2.850
Build Cost Total		14.860
Land sale receipts	-	3.950
Grant Confirmed	-	1.770
Grant Bid For	-	4.500
Net Cost to be funded by Merseyside	-	5.640
Total Funding	-	14.860

18. It can be seen that the total estimated cost of the programme will be £14.860m. This will be funded by an anticipated £3.950m of capital receipts, £1.770m of capital grant already received for Prescot. The Authority has bid for £4.5m from the transformation and efficiency fund (£1.500m per station) against national fund of £75m for 46 FRA's.

19. If the grant bid is successful in full the net cost to be funded by MFRA would therefore be £5.640m. If no grant is received this would be £10.140m.

20. <u>Reserves</u>

Members will recall that the Authority has in recent years been building up its financial reserves in preparation for the very difficult financial challenges it is now and will face in the future. The risks it has had to cater for include:-

- Seeking to avoid Firefighter redundancy and using natural retirement rates to deliver cuts.
- Having a hedge against rises in the pay bill from pay awards, pension costs or NI increases.
- Paying for severance and early retirements of non-uniformed staff to avoid compulsory redundancy and deliver savings.
- Risk in major capital projects like the JCC
- Funding invest to save schemes

21. The Deputy Chief Executive has undertaken a review of the available reserves. The table below summarises the current main reserves and identifies what sums might potentially be available to support a capital investment strategy.

	Current 31.3.2014 £'m		Potentially Available £'m	Remaining £'m
Costs Smoothing	6.750	This reserve is used to give time to make savings from firefighter reductions by natural retirements and avoid compulsory redundancy Of this £3.643M is anticipated to be used in 2014/15 and 2015/16 to deliver the current financial plan. Therefore £3.107m will be available. However if it is used for capital investment it means there will be no cost smoothing reserve for 2015/16 and beyond	3.107	3.643
Capital Investment Reserve	0.910	Already available for capital investment	0.910	-
Facing the Future	0.800	Set up in the wake of the Sir Ken Knight review to support modernisation	0.800	-
Inflation reserve	1.500	Currently allows for a 3% rise in the pay bill in a single year (Pay, Pensions and NI). This	1.000	0.500

		might be reduced to 1% (£0.5m). However this would mean that there would be less scope to cope with sudden increases and less time to identify additional permanent savings to cope with cost increases		
Catastrophe	1.000	The Authority maintains a specific fund to cater for the costs it might immediately incur in a very major incident scenario. It is considered that in light of the overall suite of reserves and balances held £0.500m of this might be made available	0.500	0.500
Underspend	1.400	The Final accounts of the Authority are yet to be optimally reported but the Authority has got ahead of target in delivering savings targets by £1.4m in total. This is available to support a reserves strategy	1.400	-
General Reserve	2.894	The Authority has always maintained a general reserve of at least £2m. In recent years it has moved slightly upwards as minor in year underspendings have been reported. In light of the overall balance of reserves and risks and the reducing budget overall it is considered it can be returned to £2m freeing up £0.894m	0.894	2.000
Total	15.254		8.611	6.643

22. It can be seen that £8.611m is available to support the capital investment strategy.

23. Risks

If the Authority uses reserves to avoid borrowing and to fund the station mergers then as the reserves are used up it will reduce the short term flexibility within the financial strategy post 2016/17.

24. If there are large scale cuts in fire service funding and any other short term spending pressures in, for example, the pay bill overall the Authority will in general terms have to reduce its budget to balance the books. In order to do this this almost inevitably means a reduction in staffing and firefighter numbers since those are the biggest areas of spending for the Authority. If the Authority has fewer reserves to act as a buffer against short term shocks post 2016/17 there is a risk that it will be harder to use natural turnover rates to deliver savings from firefighter costs and the risks of compulsory redundancy in this area will increase.

25. Voluntary Severance for Firefighters

The Authority regularly receives queries from firefighters about the potential for early (enhanced) retirement and/or voluntary severance (VS). This has never been progressed in the past because:-

a) There has been a need, since the natural retirement rate of firefighters to deliver savings combined with the use of reserves to avoid redundancy meant it has not been required.

b) There are legal barriers to delivering the same package that can be offered to staff in the LGPS under the rules of the Firefighters pension scheme so early retirement is not an option.

c) Because of the position regarding double accrual for most firefighters it would be expensive to 'buy out' service and to leave them in an uncompromised financial position.

26. The expectations of the Authority in relation to productivity has fundamentally changed over the course of the current spending review. This has been brought about in no small part by the desire of the Authority to attempt to maintain a wholetime crewing model rather than the far more financially efficient retained alternative. This increased expectation has resulted in real tangible change for large numbers of operational staff which for understandable reasons is not always embraced.

27. The reality is however that for the Authority to maintain a wholetime crewing model all operational staff must demonstrate maximum flexibility and fully adapt to and embrace the current and further inevitable change to come, because it is becoming increasingly hard to deliver a reserves strategy that avoids compulsory redundancy (especially post 2015/16).

28. The Chief Fire officer therefore recommends that the Authority should open a dialogue with any firefighters who might wish to be considered for voluntary severance (VS) to see if there are agreements that can be reached that might suit both the individual and the public purse.

29. This does not represent a firm offer of VS, but a proposal to discuss and explore the feasibility for genuinely interested individuals and the Authority.

Equality and Diversity Implications

30. Natural turnover rates have not been sufficient to deliver savings in the non-uniformed workforce and large numbers of staff have been put at risk of redundancy. The Authority has currently used voluntary severance/early retirement with non-uniformed staff to avoid compulsory redundancy. The non-uniformed workforce contains much larger numbers of women, disabled and other minority groups than the firefighting workforce which so far has never faced the threat of redundancy.

Staff Implications

31. Potential to explore voluntary severance or similar for firefighters.

Legal Implications

32. As stated in Paragraph 25(b) it is not possible to approve early retirement for firefighters due to restriction within the Firefighters Pension Schemes. Voluntary severance would therefore be the only option available to the Authority in these circumstances as described above.

Financial Implications & Value for Money

33. As set out in the report there is the potential that the mergers programme will require capital funding of £10.1m if grant bids are unsuccessful. If this were financed by debt the cost of servicing that debt would be about £1m p.a. The strategy proposed is to use reserves to avoid increasing debt levels any further if possible.

Risk Management, Health & Safety, and Environmental Implications

34. Applying all the reserves to the merger programme will reduce flexibility in the budget overall and increase the risk of compulsory redundancy.

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

35. The mergers programme will improve the assets we have for both the community and for firefighters.

36. Using reserves will reduce the long term cost of borrowing allowing scarce resources to be focused on the Authority mission.

BACKGROUND PAPERS

GLOSSARY OF TERMS