NOTTINGHAMSHIRE
Fire & Rescue Service
Creating Safer Communities

Nottinghamshire and City of Nottingham
Fire and Rescue Authority

MEDIUM TERM FINANCIAL STRATEGY 2013/14 TO 2015/16

Report of the Chief Fire Officer

Agenda Item No:

Date: 28 June 2013

Purpose of Report:

To present a Medium Term Financial Strategy to the Fire and Rescue Authority for approval.

CONTACT OFFICER

Name :	Neil Timms Director of Finance and Resources
Tel :	(0115) 967 0880
Email :	neil.timms@notts-fire.gov.uk
Media Enquiries Contact :	(0115) 967 0880

1. BACKGROUND

1.1 The Fire and Rescue Authority has a number of strategies in place for the good financial management and governance of the Authority.

1.2 It is good practice however, to bring these strategies together into a single overarching financial strategy which clearly demonstrates that the finances of the organisation are stable and 'joined up' with other corporate strategies such as the Nottinghamshire Fire and Rescue Service Plan 2010 - 2013, the Workforce Plan and the ICT Strategy, and that the financial platform is sufficient to enable the delivery of the Authority's corporate objectives.

2. REPORT

2.1 The Medium Term Financial Strategy is attached in full to this covering report and therefore no detail is presented here. However the financial strategy includes sections as follows:

- Financial Management
- Context of the Strategy
- Objectives of the Strategy
- Funding Priorities and Service Improvement
- Impact of the UK Economic Downturn
- Medium Term Risks
- Components of the Medium Term Strategy
- Revenue and Capital Budgets
- Fees and Charges
- Treasury Strategy
- External Funding
- Reserves and Provisions
- Working Balances
- The Prudential Code
- Value for Money
- Partnership Working
- The Regional Dimension

2.2 The Strategy also contains appendices on:

- Value for Money Programme
- Treasury Management Strategy
- Use of Balances
- Prudential Code
- Capital Programme 2009/10 – 2011/12
- Revenue Budget 2009/10 – 2011/12
- Sustainable Capital Plans

2.3 It is proposed that the Authority should adopt this Medium Term Financial Strategy and continue to review this annually.

3. FINANCIAL IMPLICATIONS

The financial implications of this report are set out in full within the body of the report.

4. HUMAN RESOURCES AND LEARNING AND DEVELOPMENT IMPLICATIONS

There are no human resources or learning and development implications arising directly from this report.

5. EQUALITIES IMPLICATIONS

An initial equality impact assessment has identified no specific aspects relating to a disproportionate effect in respect of the key equality strands.

6. CRIME AND DISORDER IMPLICATIONS

There are no crime and disorder implications arising from this report.

7. LEGAL IMPLICATIONS

It is a statutory requirement under Section 33 of the Local Government Finance Act 1992 to set a balanced budget. The medium term financial strategy is part of the process designed to assist in delivering the budget requirements and implications for each year.

8. RISK MANAGEMENT IMPLICATIONS

The establishment of a robust framework for financial management and the allocation of resources to corporate priorities will do much to minimise the risks to the achievement of the organisation's objectives.

9. RECOMMENDATIONS

That the Authority adopts this Medium Term Financial Strategy and continues to review this annually.

10. BACKGROUND PAPERS FOR INSPECTION (OTHER THAN PUBLISHED DOCUMENTS)

None.

Frank Swann
CHIEF FIRE OFFICER

Appendix A

NOTTINGHAMSHIRE
Fire & Rescue Service

Medium Term Financial Strategy
2013/14 to 2015/16

Contents

1. Objectives of the Strategy

1.1 The Objectives of the Authority's financial strategy are as follows:

1. To provide a stable financial foundation to assist the decision making process.
2. To be fully cogniscent of other supporting plans and strategies such as the workforce plan, equalities objectives and ICT strategies in order to provide a cohesive framework.
3. To enable the Authority to be proactive rather than reactive in terms of financing
4. To show how resources support the Authority's Service Plan over its full term.
5. To support sustainable service delivery by the use of revenue budgets, reserves and balances.
6. To seek to minimise the impacts on the Council Tax payer of fluctuations in demand for resources.
7. To hold a working balance sufficient to respond to unexpected events and/or opportunities.
8. To be flexible and responsive to changes in needs and legislation
9. To support the continuance of the Authority's core services and strategies.
10. To ensure that the capital base of the Authority can be maintained within affordable and sustainable limits.
11. To provide forward looking indications of Council Tax levels.

Within this overall set of objectives the strategy must seek to find creative ways of using resources to minimise the impact of reducing funding from Central Government.

1.2 A number of principles have been developed to underpin these objectives:

1. Resources will be prioritised to meet the core aims of the Service as set out in the Service Plan and its updates.
2. Priorities will be reviewed in the light of available resources and financial performance
3. Capital Receipts will only be applied to the redemption of debt or the financing of additional capital assets
4. Capital will be financed using the most advantageous method prevailing at the time finance is required within the requirements of the Prudential Code. Full options appraisal will be carried out before financing decisions are taken.
5. Capital development will only be carried out where there is a synergy with existing plans and where the investment fits into the sustainable capital plan.
6. The rate of return on investments will take account of the advice received from the Authority's external advisors
7. Investment decisions will be based on a balance of risk and return, remain biased towards low risk activity and follow the CIPFA principles of Security, Liquidity, and Yield in that order.
8. Council Tax rates will be transparent and sustainable. This means that budgets will not be lowered and supported by balances unless this is part of a long term sustainable strategy and approved by Members.
9. Charging for services will remain sensitive to the needs of communities and their expectations of the service.

10. Sponsorship funding will not be sought to underpin front line or core service delivery unless a long term plan for sustainability has been developed.
11. The Authority will continue to direct resources to the areas of greatest need in our communities and seek to address the wider safety agenda.
12. The Authority will actively seek to work with partner organisations in both setting and delivering priorities.
13. The Authority will apply any year end surpluses to balances and/or reserves notwithstanding the commitment to allow sums to be carried forward until such time as the target level of balances has been achieved.
14. Longer term financial planning will take account of the possible use of reserves and balances to minimise the effect of reductions in funding as a means of transition but not of permanent support.

1.3 There are a number of key outputs which will help to both assure and monitor the effectiveness of this strategy and the underlying principles. The following list is not exhaustive but provides a flavour of the outputs that may be expected:

Production of the three year revenue and capital budgets, including associated briefing papers, consultations and seminars.

The production of longer term procurement strategies for ICT, Transport, Property and Equipment such that financial planning can be carried out both within and beyond the window of the medium terms financial strategy.

Production of quarterly monitoring statements for both Capital and Revenue including project based performance as appropriate.

Supporting information provided to all Council Taxpayers

Prudential Code Monitoring Reports produced quarterly

External Audit Management Letter

Risk based approach to the maintenance of Balances and Reserves

Internal Audit reports reviewed by the Finance and Resources Committee

Grant Claims etc. submitted on time.

Production of the Strategy document dealing specifically with the prospect of significant cuts in central funding in future years.

2. Context of the Strategy

2.1 The primary focus of the organisation is set out in a fundamental strategy document, the Service Plan. This plan fulfils all the requirements of an Integrated Risk Management Plan and sets out the business of the organisation over the next 3 years. This document essentially represents the

Service delivery commitments to the general public and it is therefore essential that resources are effectively managed to achieve the outcomes set out in this plan.

2.2 A plan is in place which takes the organisation forward to April 2014 when a new plan will be published. It is recognised that ideally this Financial Strategy should be aligned with the Service plan and to this end an update will be prepared in 2014 to bring the two plans into line. It is however considered vitally important given the current financial climate that the authority has a viable Medium Term Financial Plan which is in place and takes account of the latest thinking around finances.

2.3 A Medium Term Financial Strategy sets out how finances are to be managed in such a way as to manage levels of Council Tax, Reserves and Balances. In simplistic terms it will set out how a stable and robust financial platform can be created such that developments and improvements in services set out in the Service Plan can both be achieved and sustained over time.

3. Financial Management

3.1 The External Auditors of the Authority have consistently issued unqualified audit reports and positive management letters to the Fire Authority in respect of their audit of accounts. There have been a number of changes in the presentation of the accounts in recent years which primarily relate to the implementation of International Financial Reporting Standards (IFRS) but these changes are now well embedded.

3.2 Following the abolition of the Audit Commission the Authority's external auditors have been changed to KPMG. The staff providing the key roles of Audit Manager and Lead Auditor have however been transferred from the Audit Commission and therefore there is some measure of continuity.

3.3 Although the process of external assessment by the Audit Commission has been discontinued the Service recognises that the high standards achieved as part of this process can be continued and developed. A new process of Peer review has been implemented but it is unclear at present whether similar assessment criteria will be used for the financial elements.

3.4 The prevailing economic climate and changes in national government have caused increased financial pressures to be placed upon all public sector bodies and the Fire Service is no exception. There have been a number of significant changes to the funding mechanism and It is clear that the overall funding position is expected to worsen over the next three years.

3.5 The challenge of the organisation however is not how to survive in this period of austerity but how to continue to both provide and develop high quality services for the communities it serves. Finance is a clear enabler in this context and sound financial management is essential to ensure that maximum value can be achieved with the resources available.

3.6 The organisation will continue to manage its financial resources to the highest professional standards and back this up with a strong governance framework which will include scrutiny by the Finance and Resources Committee (both generally and as an Audit Committee), regular reporting to elected members and the Corporate Management Board. In addition an independent Internal Audit function is maintained to give additional assurances to both Members and Senior Officers.

3.7 The Authority also has the help and advice of an independent Treasurer who works with the Director of Finance to advise the Fire Authority on financial matters and provide an independent source of advice when required. This again strengthens the financial management role.

3.8 The introduction of a new financial accounting system has been completed and is beginning to deliver some of the anticipated benefits. This system was procured and implemented jointly across three services which has not only been cost effective but also presented other opportunities for joint development and the sharing of expertise.

4 Funding Priorities and service improvements

4.1 The challenge for the organisation in times of financial constraint is to find a way to continue to develop and improve the service against this backdrop of uncertainty. This will require both strong leadership and financial stability.

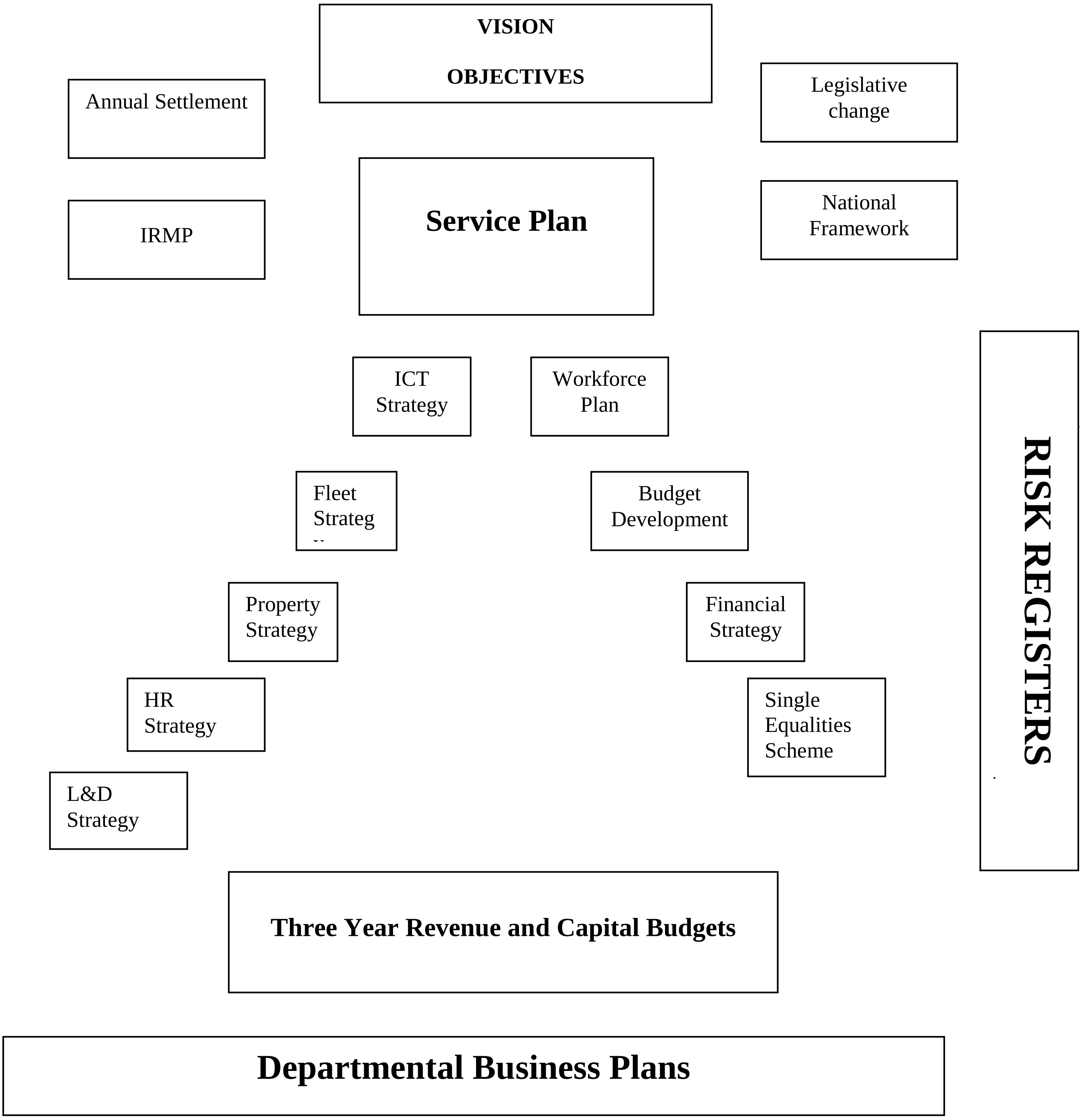
4.2 The funding priorities of the Authority relate entirely to those set out in the Service Plan but primarily relate to the three interrelated service areas of Prevention, Protection and Response. The majority of resources are targeted towards these three objectives.

4.3 This “three pronged” approach to the safety of our communities is mirrored through into the budget and resource planning processes. The detailed working underlying the Authority’s budget proposals for 2013/2014 to 2015/16 shows a clear commitment by both officers and Members not only to the delivery of these broad priorities but also to resourcing the individual projects and activities which will ensure their delivery.

4.4 Underpinning the plan a number of further priorities have been agreed for funding and budget allocation. These include a commitment to financial stability, a commitment to the implementation of the plan and working with partners. The most significant area however remains that of equality. The service recognises that equality objectives will be achieved if given an appropriate level of priority for funding. This is not a simple objective for the achievement of external targets but a recognition that the service will be better and more effective for being more representative of the community it serves and also will be able to access a wider pool of talent which may otherwise go unrecognised.

4.5 It is also important to appreciate that the aspirations of the Authority in respect of equality are not wholly internal. All members of the various communities served by NFRS must be able to access the full range of services in ways appropriate to them.

4.6 Notwithstanding the primacy of the Service Plan there is a framework of interrelated plans and strategies which together provide the basis for the continued provision of and development of the service. This is best illustrated by the following diagram:



4.7 The development of departmental plans and strategies and the alignment of these with other plans, both departmental and corporate, has been improved beyond measure since changes in the internal governance structures have been introduced.

4.8 These changes allow budget holders, service managers, Finance, HR and other support functions to work together to develop plans which consider interdependencies, pressure on both financial and non-financial resources, and relative priority of proposed developments and their relevance to the plan. This process has also “sharpened up” medium term revenue and capital planning.

4.9 Developments in the service will be resourced from a number of sources including:

Recycling resources released by efficiency savings
Reassessment of service priorities
Additional revenue budget allocation where appropriate
Government Grant Funding
Sponsorship (where resources are temporary or not core activity)

4.10 The performance management framework will enable the achievement of service priorities to be monitored and strive to achieve continuous improvement.

4.11 Time limited and specifically targeted government funding will be used to fund specific and non-recurring cost items and fund capacity building around service improvement.

4.12 The operation of the Prudential Code for Local Authorities creates opportunities for capital investment and asset planning which were not possible under the old capital financing regime. This will enable the Authority to make maximum use of capital investment to support the achievement of objectives.

4.13 A pro-active approach to the achievement of Value for Money by seeking to embed VFM principles continues to release resources to improve service delivery.

4.14 The Authority’s Trading Company will continue to operate and seek to broaden its trading base to maximise profits. It is hoped that the dividends arising from these profits may be recycled into community based initiatives in future years.

5 Impact of UK Economic Downturn

5.1 It would be inappropriate to consider a Medium Term Financial Strategy without making some mention of the current economic position in the UK and considering how its effects might be managed and/or mitigated. These are certainly extraordinary times which whilst a proactive response might be desirable a reactive response might be all that is available.

5.2 The financial year 2012/13 has seen little improvement in the prospects for the UK economy which continues to be under threat of a triple dip recession. The legacy of the banking crisis continues to have an impact and the Euro zone is particularly volatile at present.

5.3 Further quantitative easing and consequent low interest rates have reduced the level of investment interest the Authority may expect to receive even though current levels of balances mean that the Authority has more money to invest. Conversely, the Authority may benefit from lower interest rates on borrowing.

5.4 The main focus of investing surplus cash will be to protect the Authority's capital, and higher interest rates will not be taken at the expense of security. Regular risk assessments will continue to take place which will result in regular amendments to the approved counterparty list.

5.5 The falling price of property will also have a significant impact on the Authority's finances as the balance sheet value of properties will fall. This devaluation effect seems to have been slowing down during 2012/2013 and the outlook for 2013/14 and beyond is more positive

5.6 It is a general assumption that Fire and Rescue Services throughout the country may experience increasing demand for their services as the economy shrinks however there is no indication of this so far.

5.7 By far the most significant consideration for the Medium Term Financial Strategy is the general state of Central Government Finances. The UK as a whole is in huge deficit and central government may need to make radical cuts in expenditure and increases in taxation to turn this situation around. The prospect of the Service suffering additional reductions in external funding of 15-20% is by far the greatest issue that this strategy has to face.

6 Medium Term Risks

6.1 The Authority's Strategic Risk register has identified that there are a number of risks over and above budget reductions which can affect this strategy in the medium term, some of which are beyond the direct control of the Authority. The rapidly changing economic climate at the present time, for example, brings with it a number of risks any one of which could significantly impact upon this strategy.

6.2 *Investment Interest Rates.* The Authority has accumulated reserves of cash both in respect of working balances and other reserves. These cash balances are invested to generate income from interest. The outlook for rates is still very low which means that vetting and the choice of borrower is becoming more important. The process for managing these funds is set out in the Treasury Management Strategy document which is approved by the Fire Authority in February of each year.

6.3 *Loan Interest Rates.* As the Authority matures and outstanding debt becomes a more significant burden on the revenue budget there is naturally an increased exposure to movements of interest rates. Although the Authority has adopted a general policy of using fixed interest rate vehicles to minimise this risk in the longer term there is still an exposure from the loan charges on new capital being greater than anticipated. At the present time loan rates are at a low point and therefore the Authority might expect to benefit from this and opportunities to restructure debt will be considered should these arise.

6.4 It is common in the Public Sector to use maturity loans as the most appropriate vehicle for capital financing. These loans do not repay any capital until maturity but interest charges only, and they therefore present a refinancing risk at the end of their term. They are currently the most cost effective way of borrowing but it is considered essential that the Authority has sufficient accumulated cash to repay principal at term. This ensures that the authority retains control of overall debt levels.

6.5 The Authority has adopted a medium term strategy to hold long term debt at low rates but reschedule this at a later date if rates are more advantageous. The overall strategy for borrowing is set out in the Treasury Management Strategy document and in the Prudential Code Report. This strategy needs to "follow through" in terms of eventually seeking to mirror the debt outstanding profile with the profile of asset lives. This will be possible by rescheduling debt again if shorter term interest rates fall in relation to long rates however there is no sign of this at present.

6.6 *Pensions* There are a number of risks associated with pensions:

That employers contributions for non-uniformed personnel will rise significantly.

That employers contributions for uniformed personnel will rise significantly.

That the pattern of early retirements and Ill Health retirements in the service will have a serious impact on budgets if unchecked. The Authority has little control over Ill Health retirements but early retirements for non-uniformed staff can be managed.

That staff in the Retained Service are allowed to enter the 1992 fire fighters scheme with the costs being met locally rather than by Central Government

6.7 In the first scenario, it is likely that employers contributions to the local government pension scheme will continue to rise. However, recent consideration of this issue shows that this is unlikely to be significant unless the Authority's record of low rates of early and ill health retirements worsens. The performance of pension funds had been appalling in recent years but the recent performance by the Stock Market has delivered significantly increased returns. The Nottinghamshire fund shows a bias of fund investments towards equities rather than fixed interest bonds and so has benefitted from this change. Similar overweight exposures to property however are having a negative effect as property values and rental stream values are falling.

6.8 Since the passing of annual pension liabilities for fire fighters to the CLG, employers have been required to make a 21.3% of salary contribution to the scheme for those staff in the old 1992 scheme. For those in the 2006 scheme the contribution is 11%. It seems increasingly unlikely that these levels of contribution can be sustained given recent changes to longevity assumptions and the large increases in commutations recently announced. The current view expressed by the CLG however is that this is offset significantly by the reductions in ill health retirements although recent decisions of the courts may make the incidence of ill health retirements rise. This is not a risk that can be managed although the maintenance of adequate working balances can deal with any temporary fluctuations.

6.9 A big risk in the short and medium term however remains in the area of Ill Health retirement mentioned above. All the costs from such retirements now fall directly on to Authority budgets and costs per early retiree could be as high as £120,000. The Authority continues to maintain a budget for ill health retirements based on historical data and also has set aside a specific reserve to ensure that the volatility of these payments is “smoothed” through to the revenue account in a manageable fashion.

6.10 Proposals for revisions to the Local Government Pension scheme will keep employer contributions steady or may even reduce them over time. Proposed changes to the Fire-fighters scheme may also result in lower costs but it is unclear as to whether Fire Authorities will get the benefit of these changes.

6.11 The issue of RDS employees and former employees being able to enter the firefighters 1992 scheme is still a significant risk.

6.12 Grant Funding. The last Revenue Support Grant settlement in the traditional form was received during 2012/13. For 2013/2014 onwards there has been a radical change both to the amount of grant payable and the way that it is calculated. For the first time, locally collected business rates are retained within local budgets and there is also a requirement for Fire Authorities to pay their share of council tax benefits. The risks are highlighted below.

6.13 Council Tax Support. Prior to 2013/2014 Council Tax Support, or Benefit, was paid out by the billing authorities and funded entirely by government grant. It therefore had no impact on Fire Authorities. This position has changed however and now, whilst Council Tax Benefit continues to be paid by the billing authorities, the funding is drawn from both the billing authorities and the precepting authorities of which Fire is one. In return for this Government have made a grant which is the equivalent of 90% of 2012/2013 spending on council tax benefit to help authorities fund this change. This presents a number of risks:

Authorities may not be able to collected Council Tax from households that have never paid the tax before

Any increase in claimants will need to be funded locally

The amount given by way of grant is absorbed into Revenue Support Grant for 2014/15 and therefore will be reduced in line with other grant reductions even though demand may rise.

6.14 Business Rates. The principle behind the retention of business rates is one that is generally supported, in that it allows Local Authorities to benefit from economic regeneration in their areas. Fire authorities have little or no influence over economic regeneration and therefore via a series of complex calculations are what is known as “top up” authorities. This means that a Fire Authorities business rates will be “topped up” to the amount that they would have received under the old regime. What it doesn’t mean however is that it will always be like this and this situation could change. More fundamentally the old concept of needs driven Revenue Support Grant is essentially over. In future most if not all central government grant will be in the form of business rates and “top up” payments.

6.15 *Long Term Capital Sustainability.* As referred to above the Authority is becoming more mature in terms of the build up of loan debt and leasing to support the capital base of the organisation. It is considered that debt financing costs should not usually consume more than 8% of revenue budgets and this “credit ceiling” for affordable borrowing which is covered within the principles of the Prudential Code, will be more closely matched to the profile of the asset base going forward. This strategy is to ensure that the credit ceiling is not reached before the requirement to undertake major capital schemes is exhausted. The Authority has considered the sustainability of its capital plans in terms of the ICT Strategy, the Fleet Strategy and the Property Strategy and these have been mapped out over a 20 year period to ensure that the revenue budget can continue to support them. The results of this process are shown as an appendix to this report.

6.16 Revenue Budget pressure and the availability of surplus balances has caused the Authority to use surplus revenue budget to fund capital items. This has been expedient in the short term but cannot be continued indefinitely because capital assets which have been purchased from revenue will create an underlying need to borrow for replacement in future years which may cause the 8% ceiling to be breached.

6.17 The Prudential Code requires that capital investment plans, including financing, are affordable, prudent and sustainable. The further use of revenue underspends or balances to fund capital investment will not meet the sustainability requirement so the approach in future will be to ensure that the capital programme contains only “invest to save” or essential projects and to use the cash released from the Minimum Revenue Provision charge to repay loans such that new loans are only required to finance new capital expenditure and not to replace expiring maturity loans.

6.18 In the meantime revenue contributions will be allocated against a range of asset lives thus spreading this risk over a number of years.

7 Components of the Medium Term Strategy

7.1 This section briefly explains some of the processes and key components that underpin the medium term financial strategy.

7.2 *Revenue and Capital Budgets.* The process for the preparation of revenue and capital budgets is now mature but continues to develop each year. There is now positive involvement of business plan owners in the development of the budgets which have been drawn up side by side with business plans. This has continued to be developed still further in the preparation of the Revenue Budget from 2013/14 to 2015/2016 and there is now increased ownership around budget decisions. This has meant that, as planned, budgets were being developed at the operational level from July onwards whilst discussions were taking place over the overall budget strategy. The Finance and Resources Committee had full involvement in the process and made proper recommendations to the Authority.

7.3 The maturity of other plans and strategies has also proven useful in this process as retirement and recruitment profiles from the workforce plan have informed the revenue budget process and the strategies for ICT, Fleet and Property have enabled a cohesive Capital Programme to be developed. It is important to understand that the process of constructing a revenue and capital budget is an iterative one which is driven entirely by organisational priorities. The service’s plans and strategies directly drive the budget and not the other way around. Of course, affordability is a key consideration hence the iterative nature of the process but it is important that when financial constraints are imposed the impacts on service development and/or delivery are fully transparent. Therefore there is a direct relationship between the Fleet Strategy and the Capital Programme because the Capital Programme was developed from that strategy and the two are in complete alignment. The same is true for other strategies also.

7.4 *Council Tax.* As part of the budget setting for 2013/2014 to 2014/2015 the Authority agreed indicative budgets for 2013/14 and 2014/15 of £43,963,813 and £44,272,309 respectively. This would imply a freeze in Council Tax Band D at £69.69 for 2013/14 and 2014/15.

7.5 *Fees and Charges.* The Authority is allowed to make charges for the provision of a range of services to the public and to commerce. It has however been the practice of the Authority to avoid making charges for services which the public have a reasonable expectation of receiving free of charge. For example the Authority could make a charge for pumping out a domestic cellar after a flood but it was decided some years ago that this would not be reasonable. Instead the Authority has concentrated on charging for the more unusual requests often where there is no risk of death or injury, such as filling swimming pools and gaining entry. In addition the Authority makes charges for pollution incidents whenever possible on the principle that the polluter should pay for the damage that they cause.

7.6 *Treasury Strategy*. The Treasury Strategy for the Authority was set out in full in a report to the Fire Authority on 22 February 2013. This strategy complies fully with the Chartered Institute of Public Finance and Accountancy code of practice on Treasury Management which the Authority has adopted. The strategy relies for its success on the appointment of financial advisors who enable the Authority to lend and borrow as prudently as possible. Efforts will continue to be made to ensure a sufficient spread of borrowers to minimise risk exposures.

7.7 *External Funding*. Efforts will continue to be made to secure as much external funding as possible either from Government Grant or from sponsorship and partnerships. These are managed carefully to ensure that the sudden withdrawal of funding does not have a negative impact on revenue budget nor cause the Authority embarrassment from having to close down successful projects due to lack of external funding.

There are no plans at the present time to enter into any Private Finance Initiative (PFI) funding for capital projects unless there is a strong indication that such a vehicle might prove cost effective.

7.8 *Reserves and Provisions.* The Local Government Act 2003 requires that Authorities maintain adequate reserves and provisions to help ensure that the medium term policy programme is sustainable and that it can be delivered. In accordance with good accounting and financial practice, reserves and provisions will always be made in the accounts where appropriate. In simple terms the difference between a reserve and a provision is that a provision is made for a known liability arising from a legal obligation whereas a reserve is created for a discretionary purpose.

7.9 *Working Balances.* In addition to reserves and provisions the Authority is also required to maintain an adequate level of working balances and the Treasurer is required to certify that these are adequate under S25. Local Government Act 2003.

Balances are maintained at an appropriate level by carrying out a risk assessment of financial risk exposures and calculating a value for balances. Accepting that the value of balances may fluctuate to deal with both emergent and changing risk the Authority has decided to target a level of balances of £3.3m. At the end of 2012/13 the level of balances is expected to be of the order of £7.2m although there are planned reductions in balances going forward as they are used to cushion the transition to a tighter financial regime in future years.

7.10 *The Prudential Code.* The freedoms provided by the Prudential Code for Capital Accounting are to be fully used to make the best possible investment decisions in relation to capital spending in order that meaningful choices can be made between borrowing, leasing and the use of capital receipts. Nevertheless it is still considered important that the Authority should not expose itself to unduly high levels of debt. This can be difficult to gauge as the Authority is maturing and therefore levels of debt will be expected to rise each year. However, it is necessary for a view to be taken as to how much debt is sustainable in the longer term. This position has been reviewed and it is clear that given the strategies in place for Fleet and Property over the next 20 years levels of debt can be maintained to a level where the revenue effects of borrowing do not exceed 8% of overall revenue resources available. The risk to this is that as revenue budgets fall this underlying percentage will begin to rise.

7.11 *Value for Money*. The Authority continues to show its commitment to achieving Value for Money although the focus during 2012/2013 has been very much on achieving the significant budget reductions required to deal with grant reductions. Nevertheless value for money activity has continued and a report to the Finance and Resources Committee on 5th April 2013 sets out performance against targets for 2012/2013 and proposals for activity during 2013/2014.

8 Partnership Working

8.1 The Authority is committed to working in partnership to achieve overall outcome objectives and partnerships and collaborations are to be actively encouraged providing that they remain focussed on the delivery of the Authority's objectives. This relies therefore on the identification of shared outcomes with potential partners and the identification of commissioning opportunities with the third sector. Again the common thread of equality can run through some of this partnership work where the Service seeks to build trust and respect amongst disadvantaged groups both for the benefit of service delivery and recruitment.

8.2 The initiative launched in 2007/8 to enable stronger links to be forged with the voluntary sector by sponsoring some voluntary sector led projects in support of our Service Plan objectives continues to gain momentum. This 'On Fire Fund' may require some form of relaunch during 2013/2014.

9 The Regional Dimension

9.1 The Authority remains committed to supporting joint and collaborative working with colleagues across the region and it is considered that the tri-service control centre initiative may encourage further co-operation.

9.2 The commitment to the Tri-Service Control Project remains high on the Authority's priorities as this will provide an efficient method of call handling and mobilisation.

10 Outlook for 2014/15, 2015/16 and beyond

10.1 The Authority set a budget in February 2013 which for 2013/2014 is fairly well balanced but for 2014/2015 is indicating a shortfall of the order of £1.8m. As this rolls forward and if unaddressed it becomes £4.6m by 2015/2016 and may rise beyond this.

10.2 Current predictions of budget requirements as set out on the February budget papers are:

Year	**£'s**	**% Increase**
2013/2014	43,963,813	
2014/2015	44,272,309	0.7
2015/2016	44,808,450	1.2

10.3 Funding Streams however are expected to reduce as follows:

	2013/2014	**2014/2015**	**2015/2016**
	£	£	£
Revenue Support Grant	11,790,301	12,141,024	11,382,210
Council Tax Support	2,104,185	0	0
Freeze Grant 2011/2012	348,180	341,075	0
Total Revenue Support Grant	14,242,666	12,482,099	11,382,210
Formula Funding	7,868,989	9,527,133	8,931,687
Council Tax Support	1,399,856	0	0
Freeze Grant 2011/2012	231,634	238,739	0
Freeze Grant 2013/2014	234,073	234,073	0
Total External Funding	23,977,218	22,482,044	20,313,897
Budget Requirement	43,963,813	44,272,309	44,808,450
Council Tax Yield @ £69.69	19,921,395	19,921,395	19,921,395
Deficit	**65,200**	**1,868,870**	**4,573,158**

10.4 Government have already announced that there may be further reductions on grant of 1% in each of the years 2014/2015 and 2015/2016. This would cause grant to fall as follows:

	2013/2014	2014/2015	2015/2016
	£	£	£
Revenue Support Grant	11,790,301	12,141,024	11,382,210
Formula Funding	7,868,989	9,527,133	8,931,687
Total Grant	19,659,290	21,668,157	20,313,897
Less 1% 2014 on	0	(216,681)	(216,682)
Deficit	65,200	2,085,551	4,789,840

10.5 All of the above problems assume that there will be no Council Tax rises in 2014/2015 nor any further freeze grants.

10.6 There are no indications yet as to whether further reductions in grant are expected beyond 2016. The mini Comprehensive Spending Review currently being undertaken by Government may present further financial challenges but these remain unclear at present.

10.7 There need to be some assumptions with regard to Council Tax for 2014/2015 and 2015/2016 if radical changes to the service are to be avoided but at the same time it is perhaps unrealistic to assume that Council Tax can compensate for all the reductions in grant without reaching the referendum limit.

10.8 It is possible that Council Tax Freeze grant may be offered in 2014/2015 and 2015/2016 and that the level would not exceed 1%. It is equally possible that there may be a capping limit set at 1% thus forcing all authorities to take the freeze grant. In any event it seems unlikely that the capping limit (or referendum limit) will exceed 2%.

10.9 By ignoring any possibility of freeze grant and assuming that Council Tax yield will increases by 1% or 2% in each of the years 2014/2015 and 2015/2016 the above shortfall improves as follows:

	2013/2014	2014/2015	2015/2016
	£	£	£
Revenue Support Grant	11,790,301	12,019,683	11,260,868
Council Tax Support	2,104,185	0	0
Freeze Grant 2011/2012	348,180	341,075	0
Total Revenue Support Grant	14,242,666	12,360,758	11,260,868
Formula Funding	7,868,989	9,431,793	8,836,347
Council Tax Support	1,399,856	0	0
Freeze Grant 2011/2012	231,634	238,739	0
Freeze Grant 2013/2014	234,073	234,073	0
Total External Funding	23,977,218	22,265,363	20,097,215
Budget Requirement	43,963,813	44,272,309	44,808,450
Council Tax Yield 1% Rise	19,921,395	20,120,609	20,321,815
Council Tax Yield 2% Rise	19,921,395	20,319,823	20,726,219
Deficit @ 1%	**65,200**	**1,886,337**	**4,389,420**
Deficit @ 2%	**65,200**	**1,687,123**	**3,985,016**

It should be pointed out that if the deficit of £1.9m in 2014/2015 is resolved then the deficit in 2015/2016 would reduce to £2.5m. Similar calculations for the 2% Council Tax level yield deficits of £1.7m and £2.3m

10.10 What is clear from the tables in 10.4 and 10.9 above is that the figures for budget reductions range from £4.0m to £4.8m whichever combination of freeze grant and/or council tax increase is adopted.

10.11 A reduction in budget requirement of this magnitude will require a percentage reduction between 8.9% and 10.7% over the two years 2014/2015 and 2015/2016. Rises in Council Tax to cover this level of deficit would be 10.5% in 2014/2015 and a further 13.6% in 2015/2016.

10.12 It was reported to Members in October 2012 that the budget profile of the authority shows that the budget is split as:

Uniformed Pay	£29m
Non-Uniformed Pay	£5m
Transport/Premises	£4m
Capital Financing	£4m
Communications/IT	£3m

10.13 The “back office” of the Fire Authority is quite small when compared with the size of the front line service and those areas which are directly public facing. The value of public facing services and unavoidable external costs of capital are probably of the order of £39.5m of the total budget thus leaving £6.5m as the true value of back office services. It is inconceivable that savings of nearly £4m could be made from a £6.5m budget without compromising the Authority’s ability to fulfil its statutory responsibilities.

10.14 The Fire Cover Review offered some alternative options for savings by way of further adjusting how the front line service is delivered but even these measures may be insufficient to meet the required reductions.

10.15 There is no doubt therefore that if a referendum is to be avoided then the service will need to develop options to remove almost £4,000,000 from the base budget over the next two years.

10.16 The potential difficulty with this approach is that to meet statutory requirements it will be necessary to consult the public about any proposed changes via the IRMP process which is due to take place during 2013. Providing that balances can be used to support expenditure in the meantime the IRMP process could begin to consult the public on reductions in service provision to meet the overall budget targets.

Appendix A

Value for Money

Value for Money Programme 2013/14

The organisation has undergone a period of upheaval as a result of the outcomes of the Fire Cover Review and the subsequent restructure. As the Service now looks towards the financial challenges it faces during the next few years it is clear that further significant changes will be needed. While senior managers explore options for future savings and begin to put together a medium term plan, day-to-day work will continue during 2013/14 in order to improve the efficiency of the Service. This will be achieved by improving processes and systems to enable resources to be used more effectively, and seeking procurement savings wherever possible.

The Equipment Section has carried out a risk assessment of gas tight suits and has concluded that the Service can reduce the number of suits it holds. As a result the cost of the replacement programme for 2013/14 and 2014/15 will be reduced by approximately £20k. There will also be annual revenue savings on the maintenance cost. The Equipment Section also intends to save £6k on the servicing of Holmatro kit in 2013/14 by carrying out in-house collections, and is exploring the possibility of training its own technicians to carry out minor repairs to the Holmatro kit. Whilst this would require an initial outlay for training expenses and for setting up a suitable workshop, it is thought that these setup costs would be recouped in a relatively short period of time.

The ICT and Finance Departments have carried out an initial trial on the use of EzeScan software to automate invoice processing. The software uses recognition engines to capture data from scanned invoices. The trial is due to recommence in May 2013. If successful the software can also be used for data processing by other departments such as HR and Procurement. The automation of data processing will free up staff resources and enable departments to work more efficiently.

There are plans to stop the use of fax machines across the Service as staff will be able to scan using the multi-functional printers and then use their PCs to send and receive facsimile mail. This is likely to reduce line rental costs by at least £9k per annum, and will produce savings relating to the purchase and maintenance of fax machines and the purchase of consumables such as paper and toner.

The ICT Department plans to introduce desk-to-desk conferencing facilities using Microsoft Lync software. This will enable people to carry out meetings remotely and so help to reduce the amount of travel expenses claimed. It also means that the time that staff currently spend travelling between sites can be put to better use. A reduction in the number of travel claims will also have a beneficial impact on the workloads of the Finance Team. There are also plans to replace the wide area network (WAN). This will improve both the performance and the resilience of the network. Initial capital expenditure will be required but the ongoing revenue impact is expected to be cost neutral.

The Learning and Development Department has now fully developed an Initial Incident Command Course that allows the Service to train and assess all new operational supervisory managers to gain the Edexcel Level 3 Award in Initial Incident Command. As a result of the ability to provide this training in-house, the requirement for supervisory managers to attend the Fire Service College (FSC) initial incident command course as part of their development has been reviewed. It is intended that, as the internal Initial Incident Command Course has the same externally accredited course outcomes as the FSC equivalent course, our staff will no longer undertake the FSC course. This will generate cost savings of around £20-30k per annum, based on the historic spend on similar courses at the FSC for our supervisory staff. These savings can be re-invested to improve external training provision in other areas.

The Procurement Team will continue to take a pro-active approach to ensure that the Service receives VFM on all items purchased. The tender plan for 2013/14 includes equipment, medical and occupational health services, and a new training management database.

Appendix B

Treasury Management Strategy

THE REVISED CIPFA TREASURY MANAGEMENT CODE OF PRACTICE 2011

It is a requirement of the revised Code that the Authority creates and maintains:

- A treasury management policy statement, which states the policies, objectives and approach to risk management of its treasury management activities.
- Suitable treasury management practices, setting out how the Authority will seek to achieve those policies and objectives and how activities will be controlled and managed.

The revised Code sets out requirements for reporting on treasury management. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

This Authority will adopt the following reporting arrangements in accordance with the requirements of the revised Code:

Area of Responsibility	Committee	Frequency
Treasury Management Policy Statement (revised)	CFA	Initial adoption in 2010
Treasury Management Strategy / MRP policy	CFA	Annually before the start of the year
Treasury Management Strategy / mid year report	CFA	Mid year
Treasury Management Strategy / MRP policy – updates or revisions at other times	CFA	
Annual Treasury Management Outturn Report	CFA	Annually by 30 September after the end of the year
Treasury Management / Prudential Code Monitoring Reports – performance monitoring	Finance & Resources Committee – provide scrutiny	Quarterly
Treasury Management Practices	Finance & Resources Committee – provide scrutiny	Review every two years

TREASURY MANAGEMENT STRATEGY FOR 2013/14

The Local Government Act 2003 (the Act) and supporting regulations requires the Authority to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Authority's capital investment plans are affordable, prudent and sustainable.

The Act therefore requires the Authority to set out its treasury strategy for borrowing and to prepare an annual investment strategy: this sets out the Authority's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The suggested strategy for 2013/14 in respect of the following aspects of the treasury management function is based upon Officers' views on interest rates, supplemented with leading market forecasts provided by the Authority's treasury adviser, Sector Treasury Services.

The strategy covers:

- Prudential and Treasury Indicators
- the borrowing requirement
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy
- creditworthiness policy
- policy on use of external service providers
- the Minimum Revenue Provision policy
- training of Officers and Members

The Authority recognises that whilst there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources, responsibility for treasury management decisions remains with the organisation at all times. The Authority will therefore ensure that undue reliance is not placed upon external service providers.

BALANCED BUDGET REQUIREMENT

It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Authority to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from: -

- increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
- any increases in running costs from new capital projects are limited to a level which is affordable within the projected income of the Authority for the foreseeable future.

ECONOMIC BACKGROUND

The Eurozone debt crisis has continued to affect the world economy and has depressed growth in most countries. This has impacted the UK economy which is unlikely to grow significantly in 2013. Quarter 2 of 2012 was the third quarter of contraction in the economy; this recession is the worst and slowest recovery of any of the five recessions since 1930.

The Eurozone sovereign debt crisis has abated somewhat following the European Central Bank's (ECB) pledge to buy unlimited amounts of bonds of countries which ask for a bailout. Sentiment in financial markets has improved considerably since this ECB action and recent Eurozone renewed commitment to support Greece and to keep the Eurozone intact. However, the foundations to this "solution" to the Eurozone debt crisis are still weak and there is no guarantee that the situation will not worsen in the future.

The Government's austerity measures, aimed at getting the public sector deficit into order over the next four years, now look as if they will fail to achieve their objectives within the original planned timeframe. Achieving this target is dependent on the UK economy growing at a reasonable pace but recession in the Eurozone has depressed growth whilst tax receipts have not kept pace with additional welfare benefit payments. Currently, the UK is enjoying a major financial benefit from some of the lowest sovereign borrowing costs in the world as the UK is seen as a safe haven from Eurozone debt. There is, though, little evidence that consumer confidence levels are recovering nor that the manufacturing sector is picking up. On the positive side, growth in the services sector has rebounded in Q3 and banks have made huge progress since 2008 in shrinking their balance sheets to more manageable levels and also in reducing their dependency on wholesale funding. However, availability of credit remains tight in the economy and the Funding for Lending scheme, which started in August 2012, has not yet had the time to make a significant impact.

This economic outlook has some key treasury management implications:

- Given the weak outlook for economic growth, the prospects for any changes in Bank Rate before 2015 seem limited.
- The longer term prospect is that gilt yields and PWLB rates will rise due to the high volume of gilt issuance in the UK and in other major western countries.
- Investment returns are likely to remain relatively low during 2013/14 and beyond.

Sector Treasury Services has provided a forecast on the bank interest rate, which draws on current City forecasts:

Sector Bank Rate Forecasts	
As at 31 March 2013	0.50%
As at 31 March 2014	0.50%
As at 30 September 2014	0.50%
As at 31 March 2015	0.75%

MANAGEMENT OF CASH RESOURCES

The Authority uses a main current account, an investment account and a number of local petty cash accounts. All of these accounts are held with Barclays Bank PLC and are managed online. This system allows the Authority to make transfers to and from accounts in real time and thus allows the current account balance to be maintained at a minimum level. All surplus funds are held either in the investment account for short periods or are lent to institutional borrowers over longer periods.

The bank overdraft level is £200,000 and this is usually sufficient. There are occasions when the overdraft exceeds £200,000 and temporary arrangements are made with the bank to increase the limit to £500,000. The Prudential Code report included an overdraft limit of £500,000 within the authorised limit to allow for such instances. It is proposed that the overdraft facility remains at a level of £200,000.

A 3 year cash flow projection is prepared together with a 3 month rolling cash flow forecast. The 3 month forecast is updated regularly and this process reveals when cash surpluses are likely to arise.

The current bank account is cleared to zero on a daily basis with the balance being transferred to the investment account (Business Premium Account).

Cash management processes have been examined by internal auditors and have been shown to be robust.

BORROWING STRATEGY

The prudential indicators for borrowing are set out in Appendix B. Background information relating to these indicators is contained within the Prudential Code for Capital Finance 2013/14 report which is elsewhere on this agenda.

The capital financing requirement is the sum of money required from external sources to fund capital expenditure i.e. the Authority's underlying need to borrow or lease. For 2013/14 this figure is estimated at £26,032,000, which is lower than would have been the case if the Authority had not approved the use of revenue reserves to finance future capital expenditure as part of the budget 2011/12 to 2013/14.

The Authority's strategy in the past has been to borrow funds from the Public Works Loan Board (PWLB). The PWLB is an agent of HM Treasury and its function is to lend money from the National Loans Fund to local authorities and other prescribed bodies. Its interest rates are generally favourable compared to those applicable to borrowings from other sources within the marketplace. However, in 2007/08, a £4m loan was borrowed from a bank, with a fixed interest rate which was lower than the equivalent PWLB rate. It is therefore proposed that the Authority continues to borrow primarily from the PWLB, but considers fixed rate market borrowing when market rates are lower than PWLB rates.

The loan of £4m referred to in paragraph 2.19 is structured as a "Lender Option Borrower Option (LOBO)" loan. This means that on 7 March 2013 and on that anniversary every five years, the lender may revise the interest rate, which is currently 4.13%. The Authority may choose to repay the loan without penalty if the amended interest rate is not advantageous. If the lender does exercise the option to revise the interest rate, the strategy will be to either agree to continue the loan with the revised interest rate or to repay the loan and replace it with new, long term debt at a lower rate depending on which is the most advantageous option for the Authority.

Sector's view on future PWLB interest rates is:

	Mar 13	Jun 13	Sep 13	Dec 13	Mar 14	Mar 15	Mar 16
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.75%
5 yr PWLB	1.50%	1.50%	1.60%	1.60%	1.70%	2.20%	2.90%
10 yr PWLB	2.50%	2.50%	2.60%	2.60%	2.70%	3.20%	3.90%
25 yr PWLB	3.80%	3.80%	3.80%	3.80%	3.90%	4.30%	5.00%
50 yr PWLB	4.00%	4.00%	4.00%	4.00%	4.10%	4.50%	5.20%

The table above has been adjusted for the PWLB certainty rate, which is a 20 basis points reduction in the interest rate for Authorities such as this one which have applied for it.

In view of the above forecast the Authority's borrowing strategy will be based upon the following information.

- A combination of revenue reserves, capital grant and internal funds will be used to finance the majority of capital expenditure in 2013/14 and 2014/15.
- Two PWLB loans mature in the short term (September 2013 and September 2014). The first loan will be repaid with a combination of a capital receipt from the expected sale of Dunkirk fire station and cash released from the annual minimum revenue provision charge. The second loan will need to be replaced with new borrowing. The LOBO loan referred to in paragraph 2.20 may be replaced with new borrowing if the lender exercises the option to revise the interest rate and new borrowing can be taken at a lower rate than that offered. The two maturing PWLB loans have a total value of £5m (which is £9m including the LOBO loan) and it is estimated that new borrowing in the period 2013/14 to 2014/15 will be in the region of £3m (or £7m if the LOBO loan is replaced).

- Sector's view is that PWLB rates will remain fairly constant throughout 2013/14 with a small rise in the final quarter, but are likely to rise in 2014/15 and again in 2015/16. It may therefore be advantageous to take out new loans next year before rates increase, as this will have a lesser impact on the revenue budget for the periods of the loans. However if this is in advance of the need to spend, there will be a cost of capital impact as referred to in paragraph 2.25 below.

- PWLB rates on loans of less than ten years duration are expected to be lower than longer term PWLB rates. However, the existing debt maturity profile of the Authority will mean that longer term borrowing at a higher cost is required to give a balanced loans portfolio.

- Consideration will also be given to borrowing fixed rate market loans at 0.25% – 0.50% below the PWLB target rate and to maintaining an appropriate balance between PWLB and market debt in the debt portfolio.

- Consideration will also be given to taking annuity loans rather than maturity loans for new borrowing as this will ensure that over the medium term debt will reduce alongside Capital Financing Requirement (CFR) projections. This will help the Authority to meet the new Prudential indicator which states that gross debt should not exceed the CFR other than in the short term.

In normal circumstances the main sensitivities of the forecast are likely to be the two scenarios noted below. Officers, in conjunction with the treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change in position:

- if it were felt that there was a significant risk of a sharp **fall** in long and short term rates, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- if it were felt that there was a significant risk of a much sharper **rise** in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

The Authority’s gross debt position is projected to be £25.5m by the end of 2012/13, but investments of approximately £10m are expected to be in place at 31 March 2013, giving a net debt position of around £16m. Some of these investments will be used over the year to finance capital expenditure from revenue reserves, which will narrow the gap between gross and net debt. Currently, investment interest rates are substantially lower than debt interest rates so using reserves rather than borrowing to finance capital expenditure will give better value for money in the short term. It must be pointed out though, that with interest rates likely to rise over the medium term, additional longer term costs will be incurred when surplus reserves have been exhausted and there is once more a requirement to borrow at higher rates.

The Authority will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed, although this scenario is unlikely anyway given that current borrowing rates are higher than current investment interest rates, creating a cost of capital impact. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Authority can ensure the security of funds invested. In determining whether borrowing will be undertaken in advance of need the Authority will:

- ensure that borrowing is only undertaken to finance the capital programme approved within the current Medium Term Financial Strategy

- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered

- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow

- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use.

The rescheduling of debt involves the early repayment of existing borrowings and their replacement with new loans. As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, this would indicate a potential to generate savings by switching from long to short term debt. However, a premium would be payable which may negate the savings, and the loan maturity profile of the Authority indicates that this would increase exposure to interest rate risk. It is therefore unlikely that rescheduling of debt will take place in 2013/14 although this will be kept under review should circumstances change. Rescheduling will be considered for the following reasons:

- the generation of cash savings and / or discounted cash flow savings,

- enhancing the balance of the portfolio by amending the maturity profile

- switching from maturity to annuity loans to maintain gross debt below the Capital Financing Requirement in the short / medium term

Any rescheduling of debt will be reported to Members at the earliest meeting following its action.

INVESTMENT STRATEGY

The Authority will have regard to the CLG's Guidance on Local Government Investments ("the Guidance") issued in March 2004, the Audit Commission's report on Icelandic investments and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance. The Authority's investment priorities are:

- (a) the security of capital and
- (b) the liquidity of its investments.

The Authority will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Authority is low in order to give priority to security of its investments. The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Authority will not engage in such activity.

Investment opportunities will arise when there are temporary cash surpluses. In accordance with guidance from CIPFA, and in order to minimise the risk to investments, the Authority sets a minimum acceptable credit quality of counterparties for investment. To determine the institutions with which investments may be placed, the Authority uses the creditworthiness service provided by Sector Treasury Services. This service uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors forming the core element. It is recognised that ratings should not be the sole determinant of the quality of an institution, and Sector's creditworthiness service does not rely solely on the current credit ratings of counterparties but also uses the following as overlays: -

- credit watches and credit outlooks from credit rating agencies

- Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings

- sovereign ratings to select counterparties from only the most creditworthy countries

- information from the financial press and share price information

This modelling approach combines credit ratings, credit watches, credit outlooks and CDS spreads in a weighted scoring system for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Authority to determine both the credit-worthiness of institutions and the duration for investments. It is regarded as an essential tool, which the Authority would not be able to replicate using in house resources.

The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Sector's weekly credit list of potential counterparties. The Authority will therefore use counterparties within the following durational bands:

- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months

Institutions within the "purple band" (24 months), the "yellow band" (5 years) or with no colour band will not be used.

The Authority has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix C. This list will be added to or deducted from by Officers should ratings change in accordance with this policy.

The latest credit list provided by Sector will be made available to Members at the meeting.

In accordance with its low risk appetite, the Authority may undertake the following types of "specified" investments:

- Deposits with the Debt Management Office (Government)
- Term deposits with Banks and Building Societies

- Term Deposits with uncapped English and Welsh local authority bodies
- Triple-A rated Money Market Funds
- UK Treasury Bills

The risks associated with investing will be reduced if investments are spread e.g. over counterparties or over countries. The Authority will therefore aim to limit its investment with any single counterparty to £2m. It is, however, difficult to impose any further spreading requirement due to the relatively small size of the Authority's investments and the fact that investment institutions will often only accept a minimum investment sum, which may render any such policy unworkable. Despite this Officers will, wherever possible, avoid the concentration of investments with one counterparty or group.

The majority of past investments have been for periods of 3 months or less. In the current financial climate no term deposit investments with other counterparties, such as UK semi-nationalised banks and local authorities, will be made for more than 1 year without the prior approval of the Treasurer and the Chair of Finance and Resources Committee. The Authority will avoid locking into longer term deals while investment rates are down at historically low levels unless exceptionally attractive rates are available which make longer term deals worthwhile.

All credit ratings will be monitored via a weekly update from Sector. The Authority is alerted to changes to ratings of all three agencies as and when they occur through its use of the Sector creditworthiness service. If a downgrade results in the counterparty/investment scheme no longer meeting the Authority's minimum criteria, its further use as a new investment will be withdrawn immediately. In addition to the use of Credit Ratings the Authority will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Authority's lending list.

Sole reliance will not be placed on the use of this external service. In addition this Authority will also use market data and market information, information on government support for banks and the credit ratings of that government support.

MINIMUM REVENUE PROVISION POLICY 2013/14

The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 came into force on 31 March 2008. These regulations were an amendment to the 2003 regulations and introduced several changes to the capital finance regime for local authorities (including fire authorities) in England. The most significant of these were new provisions dealing with the calculation of Minimum Revenue Provision (MRP), which is the amount an authority charges to its revenue account in respect of the financing of capital expenditure.

Under the regulations, Authorities must make a “prudent provision” for MRP and guidance is given on the interpretation of this: “provision for the borrowing which financed the acquisition of an asset should be made over a period bearing some relation to that over which the asset continues to provide a service”. This guidance translates into the asset life method. Authorities are permitted to continue charging MRP calculated using the old method for borrowing and credit arrangements which funded capital expenditure incurred before 1 April 2007. This method calculates a charge of 4% of the capital financing requirement each year to revenue.

The following policy on MRP is therefore recommended to members and budgetary provision for MRP has been made on this basis:

- For all borrowing and credit arrangements to fund capital expenditure incurred before or during 2006/07, the minimum revenue provision applied in 2013/14 will continue to be calculated on the basis of the 4% CFR (capital financing requirement) method. This method will continue to be used in future years for capital expenditure incurred during or before 2006/07.

- For all borrowing and credit arrangements to fund capital expenditure incurred from 2007/08 onwards, the minimum revenue provision applied in 2013/14 will be calculated on the basis of the Asset Life method.

TRAINING OF OFFICERS AND MEMBERS

Under the Code, good practice is defined as ensuring that all staff involved in treasury management are appropriately trained and experienced to undertake their duties. Employees within the Finance Department who carry out treasury management activities are suitably trained and experienced and routinely attend at least one treasury management update event each year to ensure that their knowledge keeps pace with changes. It is also suggested that those tasked with treasury management scrutiny responsibilities also have access to suitable training and it is therefore proposed that the Authority arrange a treasury management training seminar during 2013/14 for Members of the Finance and Resources Committee.

Appendix C

Prudential Indicators and Targets

PRUDENTIAL INDICATORS FOR AFFORDABILITY

Estimates of the Ratio of Financing Costs to Net Revenue Stream for 2012/13, 2013/14, 2014/15 and 2015/16 and Actual Ratio of Financing Costs for 2011/12

2011/12 Actual £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's
Ratio of Financing Costs to Net Revenue Stream				
6.3%	6.3%	5.5%	5.6%	5.5%

On 24 October 2008 the Finance and Resources Committee considered a report on Sustainable Capital Plans. This report concluded that in order to meet the Prudential Code requirements of affordability and sustainability, the ratio of financing costs to net revenue stream should not exceed 8%. The table above shows that the use of revenue contributions to finance capital over the past two years has had the effect of reducing this ratio and keeping it within the 8% target.

Estimates of the Incremental Impact of the New Capital Investment Decisions on the Council Tax (Band D) for 2013/14, 2014/15 and 2015/16

2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's
Incremental Impact on Council Tax		
-£1.31	-£0.10	+£0.34

The table above shows that the effect of financing capital expenditure from reserves in 2011/12, 2012/13 and 2013/14 is a reduction in the incremental impact on council tax. Beyond this, there is an incremental increase

PRUDENTIAL INDICATORS FOR PRUDENCE

Gross Borrowing and the Capital Financing Requirement

This indicator has been amended in the 2011 revision to the Prudential Code and the revision takes effect in the 2013/14 financial year. It used to be “Net Borrowing” i.e. borrowing minus investments but is now “Gross Borrowing”. This indicator requires that external borrowing does not, except in the short term, exceed the total of the capital financing requirement estimated up to the end of 2015/16. Performance against this indicator will be monitored throughout the year. For information, at 31 March 2012 (2011/12 financial year), the Capital Financing Requirement was £27,372k, Net Borrowing (total borrowing less investments) was £17,412k and Gross Borrowing was £27,630k. The estimate of the Capital Financing Requirement at the end of 2015/16 is £30,823k. The revision of this prudential indicator may well result in the Authority breaching the indicator in the short term and CIPFA has anticipated that this may be case for some Authorities, who must then explain the reasons for the potential breach. The reason why this Authority may not be able to keep Gross Borrowings below the Capital Financing Requirement in the short term is due to the structure of its borrowings. The majority of Authority loans are now maturity loans for which the principal sums are repaid at the end of the term and the decision to take out maturity loans has been based on advantageous interest rates at the time. The Authority has also made past decisions to gain longer term certainty by locking in lower interest rates on longer term loans. With the change in this indicator, the Authority will not be able to take account of cash set aside to repay loans on maturity and there may be some years when Gross Borrowing does exceed the Capital Financing Requirement. At the end of 2015/16, Gross Borrowings are expected to be in the region of £25.5m, with the Capital Financing Requirement estimated at £30.8m so although in the short term there may be a breach, in the medium term this indicator will be met. The Treasury Management Strategy 2013/14, which is elsewhere on this agenda, will further address this issue.

<u>Treasury Management</u>

As required by this indicator, the Authority has adopted the CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes.

PRUDENTIAL INDICATORS FOR CAPITAL EXPENDITURE AND EXTERNAL DEBT

<u>Estimate of Total Capital Expenditure to be Incurred in 2012/13, 2013/14, 2014/15 and 2015/16 and Actual Capital Expenditure for 2011/12</u>

2011/12 Actual £000's	2012/13 Estimate £000's	2013/14 Estimate £000's	2014/15 Estimate £000's	2015/16 Estimate £000's
Capital Expenditure Total				
2,879	4,634	5,762	4,164	4,880
Capital Expenditure – Financed by Borrowing / Finance Lease				
0	0	0	1,771	3,020
Capital Expenditure – Financed by Revenue Contributions				
1,368	2,200	2,000	0	0
Capital Expenditure – Financed by Internal Funds				
25	948	567	1,305	1,360
Capital Expenditure – Financed by Capital Grant				
1,486	1,486	1,088	1,088	500
Capital Expenditure – Financed by Capital Receipt				
0	0	2,107	0	0

The estimates for 2013/14 to 2015/16 are submitted to the Fire Authority for approval elsewhere on this agenda. The capital expenditure estimate for 2013/14 shown in the above table includes assumed slippage from 2012/13. The final capital expenditure for each year may be different from the figures shown above but overall should be similar. Various financing methods have been assumed for the future years but in reality, decisions relating to financing methods will be taken as part of options analyses which will consider the best long term options for the Authority. These options need to be assessed at the time of financing. The table above assumes that in 2012/13 and 2013/14 a total of £4,200k of reserves will be used to finance capital expenditure. “Internal funds” in the above table refers to the use of cash available within budgeted resources generated by the minimum revenue provision charge, which is a non-cash transaction. Unused cash from this source is assumed to be carried forward for use in future years.

Estimate of Capital Financing Requirement as at the end of 2012/13, 2013/14, 2014/15 and 2015/16 and Actual Capital Financing Requirement as at 31/03/12

2011/12 Actual £000’s	2012/13 Estimate £000’s	2013/14 Estimate £000’s	2014/15 Estimate £000’s	2015/16 Estimate £000’s
Capital Financing Requirement				
27,372	24,645	26,032	27,803	30,823

The Capital Financing Requirement is the sum of money required from external sources to fund Capital Expenditure, and represents the Authority’s underlying need to borrow for capital purposes. It will therefore be the aggregate of all capital expenditure, less any revenue contributions, capital grants or capital receipts. The above table shows that the Capital Financing Requirement reduces overall between 2011/12 and 2013/14 mainly due to the effect of revenue financing.

The Sustainable Capital Plans report referred to in paragraph 2.1 also concluded that in order to meet the Prudential Code requirements of affordability and sustainability, the capital financing requirement in future years should not exceed £40m.

Operational Boundary and Authorised Limit for External Debt

The Operational Boundary is the Authority’s estimate of its total external debt, net of investments but including other long-term liabilities which are separately identified. This is to reflect the most likely scenario and not the worst case. It is possible for the operational boundary to be temporarily breached to take account of unusual movements in cash flow but this should not be a regular occurrence. A variation from the operational boundary is permissible, but will be reported to the Fire Authority.

The Authorised Limit is essentially the same as the Operational Boundary but allows headroom over and above it to take account of unusual movements in cash flow and therefore should be the maximum amount of external debt that the Authority is exposed to at any given time. Any proposed variation from the Authorised Limit must be authorised by the Fire Authority

Cash flow forecasts have been prepared for 2013/14 to 2015/16 and indicate that there will be no difficulty in maintaining a positive current account balance on a month by month basis and therefore there is no proposal to seek an increase in the Authority’s approved overdraft limit of £200,000. However, previous experience shows that these estimates can sometimes be wrong temporarily due to delays in income receipts and it has proved necessary in the past to negotiate temporary increases in this figure of up to £500,000. It is therefore proposed that this buffer of

£500,000 should be included within both the operational boundary and the authorised limit.

	2013/14 £000's	2014/15 £000's	2015/16 £000's
Operational Boundary			
O.B. for borrowing	27,130	27,130	29,130
O.B. for other long term liabilities	103	36	19
Total - Operational Boundary for External Debt	27,233	27,166	29,149
Authorised Limit			
A.L. for borrowing	29,843	29,843	32,043
A.L. for other long term liabilities	113	39	21
Total - Authorised Limit for External Debt	29,956	29,882	32,064

Actual External Debt as at 31/03/12

	2011/12 £000's
Actual borrowing	27,630
Actual other long term liabilities	483
Total – Actual External Debt	28,113

INDICATORS FOR TREASURY MANAGEMENT

The Service carries out its own treasury management in accordance with the CIPFA Code of Practice for Treasury Management, which was revised in 2011. The Authority has adopted a low risk approach to treasury management, which seeks to ensure that investments are secure and that there is sufficient liquidity of funds to enable the Authority carry out its business.

Gross and Net Debt

The actual amount of external long term debt as at 31/03/12 was £25,540k, with short term debt totalling £2,090k. Other long term liabilities at the same date amounted to £483k. At the same date, the amount of investments was £10,582k, giving a net debt position of £17,531k as at 31/03/12.

The Treasury Management Strategy 2013/14 report, which is elsewhere on this agenda, outlines the proposal to use the Authority's surplus balances to partially finance new capital expenditure by way of revenue contributions. The impact of this will be to reduce ongoing revenue costs in future years. There will still be a need to borrow over the next three years, and the decision about when to borrow and when to use revenue contributions to fund the capital programme will depend upon interest rate forecasts. For the purposes of setting indicators, assumptions have been made about when borrowing may take place – the reality of this will be determined by Officers in conjunction with the Authority's treasury advisers.

Interest Rate Risk Exposure

In terms of borrowing, it has been considered prudent to use Public Works Loans Board (PWLB) fixed interest loans on most occasions. This is because the PWLB generally offers rates which cannot be obtained elsewhere in the marketplace. However the Authority did take out a market loan in 2007/08, benefiting from an advantageous rate. Unlike lending, borrowing is a low risk activity so future borrowing arrangements will be entered into on the basis of what is most advantageous for the Authority at the time. Any proposals to borrow from alternative sources to the PWLB will be discussed and agreed with the Treasurer.

Borrowing in the past has been at fixed interest rates although variable rates are not ruled out. It is therefore considered that up to 30% of borrowing might come from variable rate sources if these are considered financially advantageous at the time of financing. For policy changes beyond this, however, it is suggested that Fire Authority approval should be sought.

The total value of lending is not expected to exceed £17m, which is likely to peak around July 2013 however it is difficult to assess what the likely investment profile might be as this depends upon capital expenditure timings as well as the level of pension top up grant received from the Department for Communities and Local Government. The aim will be to reduce risk by investing funds in more than one institution at any given time. Members should note, however, that it is not feasible to set a maximum limit for investing with any one institution as the numbers of banks which meet our minimum credit rating criteria is now very few and even those on the list will not always accept our investments as the Authority is a "small player". The Authority can also invest in Money Market Funds in line with the Treasury Management Strategy. It is expected that the total amount invested will reduce as the year progresses and capital expenditure is funded by revenue contributions.

It is proposed that the Authority sets the following limits for interest rate exposures:

	Benchmark %	2012/13 £000's	2013/14 £000's	2014/15 £000's	2015/16 £000's
Interest Rate Exposures					
Upper Limit for fixed rate exposures	100%	100%	100%	100%	100%
Upper Limit for variable rate exposures	30%	30%	30%	30%	30%

Loan Maturity

The code of practice and CIPFA guidelines state that there should be no direct linkage between the assets financed and the term of loans taken out. Upper limits in terms of loan maturity are set to ensure that the Authority is not exposed to the risk of having to repay loans and then re-borrow in the short term when interest rates might be high.

It is recommended that the maturity structure limits remain unchanged for 2013/14. Projections of principal repayments for currently held loans show that by March 2015, the total proportion of loans with a repayment profile of above 20 years will be around 43% however the proportion of loans due to be repaid within 2 to 5 years will be around 48%, which will be a breach of the indicator. When borrowing does take place, it should therefore be for a longer term than 15 years to protect the Authority from future interest rate risk.

Limits on the Maturity Structure of Borrowing		
	Upper Limit	Lower Limit
Under 12 months	20%	0%
12 months to 5 years	30%	0%
5 years to 10 years	75%	0%
10 years to 20 years	100%	0%
Over 20 years	100%	30%

Principal Sums Invested for Periods Longer than 364 Days

Investments arising from borrowing to support the capital programme are unlikely to exceed one year in duration, however for surplus cash which supports reserves it may be desirable to invest monies for a slightly longer period to achieve a level of certainty around interest receipts and perhaps beneficial interest rates. Such decisions will be influenced by market conditions at the time and the liquidity of funds will be of paramount importance. It is proposed that Officers should be able to invest monies for longer than a year if this appears to be an advantageous strategy, but that a maximum limit of £2m be applied to any such investments. This will contain the Authority's exposure to the possibility of loss arising from having to seek early repayment of investments.

2013/14 £000's	2014/15 £000's	2015/16 £000's
Prudential Limits for Principal Sums Invested for Periods Longer than 364 Days		
2,000	2,000	2,000

APPENDIX D

Capital Programme for 2013/2014 to 2015/16

	2013/2014 £s	2014/2015 £000's	2015/2016 £000's
Transport			
Rescue Pump Replacement	1,221,600	1,263,200	1,282,400
Special Appliance Replacement	816,250	0	0
Light Vehicles	444,570	350,750	292,430
Total Transport	**2,482,420**	**1,613,950**	**1,574,830**
Equipment			
Replacement Cutting Equipment	0	0	750,000
Total Equipment	**0**	**0**	**750,000**
Property			
Rebuild, Refurb	2,200,000	2,310,000	2,315,500
Total Property	**2,200,000**	**2,310,000**	**2,315,500**
Information Technology			
Replacement HR System	150,000	0	0
Business Continuity	30,000	30,000	30,000
Information systems development	0	100,000	100,000
Business Expansion	25,000	25,000	25,000
Replacement Equipment	85,000	85,000	85,000
Business Process Automation	150,000	0	0
Mobile Data Devices	75,000	0	0
Total Information Technology	**515,000**	**240,000**	**240,000**
Total Programme	**5,197,420**	**4,163,950**	**4,880,330**

Appendix E

Cash Limit

		Opening Budget 2012/13 £000's	Revised Budget 2012/13 £000's	Budget Required 2013/14 £000's	Budget Required 2014/15 £000's	Budget Required 2015/16 £000's
Employees	**Direct Employee Expenses**	33,661	33,401	32,925	33,228	33,634
	Indirect Employee Expenses	563	563	497	499	493
	Pension	740	740	775	779	833
		34,964	**34,704**	**34,197**	**34,506**	**34,959**
Premises-Related Expenditure	**Cleaning and Domestic Supplies**	272	241	295	298	304
	Energy Costs	405	405	373	383	395
	Fixture and Fittings	1	1	1	1	1
	Grounds Maintenance Costs	27	27	24	25	25
	Premises Insurance	27	27	26	26	26
	Rates	615	615	652	712	722
	Refuse Collection	27	27	34	35	36
	Rents	104	104	107	107	107
	Repairs Alterations and Maintenance of Buildings	394	394	488	532	533
	Water	53	53	53	55	57
		1,927	**1,896**	**2,054**	**2,175**	**2,207**
Supplies & Services	**Catering**	56	57	55	55	55
	Clothes Uniforms and Laundry	218	272	328	304	274
	Communications and Computing	1,522	1,670	1,714	1,679	1,705
	Equipment Furniture and Materials	972	827	925	846	826

Appendix E

Cash Limit

		Opening Budget 2012/13 £000's	Revised Budget 2012/13 £000's	Budget Required 2013/14 £000's	Budget Required 2014/15 £000's	Budget Required 2015/16 £000's
	Expenses	33	32	49	49	49
	Grants and Subscriptions	40	40	40	41	41
	Miscellaneous Expenses	275	597	578	579	581
	Printing Stationery and General Office Expenses	106	110	86	86	86
	Services	512	504	484	456	442
		3,733	**4,109**	**4,257**	**4,093**	**4,058**
Transport-Related Expenditure	**Car Allowances**	475	482	420	424	417
	Direct Transport Cost	1,044	1,044	1,082	1,110	1,142
	Public Transport	36	29	26	26	26
	Recharges	213	213	189	171	141
	Transport Insurance	188	188	207	259	259
		1,957	**1,957**	**1,924**	**1,990**	**1,985**
Support Services	**Corporate Services**	43	43	42	43	45
	Finance	172	172	175	183	186
		215	**215**	**218**	**226**	**231**
	Other Local Authorities	147	147	100	102	103
Third Party Payments	**Private Contractors**	23	23	24	24	24
		170	**170**	**124**	**126**	**127**
	Customer and Client Receipts	-436	-522	-664	-694	-699

Appendix E

Cash Limit

		Opening Budget 2012/13 £000's	Revised Budget 2012/13 £000's	Budget Required 2013/14 £000's	Budget Required 2014/15 £000's	Budget Required 2015/16 £000's
Income	**Government Grants**	-196	-196	-222	-250	-283
	Interest	-50	-50	-165	-126	-126
	Other Grants/Reimbursements and Contributions	-1,424	-1,424	-2,169	-1,601	-114
		-2,107	**-2,192**	**-3,220**	**-2,671**	**-1,222**
	Debt Management Expenses	4,543	4,543	3,286	1,305	1,360
Capital Financing Costs	**Interest Payments**	1,092	1,092	1,059	1,030	1,103
		5,636	**5,636**	**4,345**	**2,336**	**2,463**
	Budget	46,494	46,494	43,899	42,781	44,808