Agenda item: 8

NORTH WALES FIRE & RESCUE SERVICE

COMMITTEE:	NORTH WALES FIRE AND RESCUE AUTHORITY
DATE:	19 DECEMBER 2005
REPORT OF:	TREASURER
SUBJECT:	DRAFT BUDGET 2006/2007

1. INTRODUCTION

1.1 This report contains proposals to the Authority in respect of the draft budget for 2006/2007, the forecasts for 2007/2008 and 2008/2009, and the papers attached set out:-

(i) the draft revenue budget (Appendix A),
(ii) the provisional contributions required by the Constituent Authorities (Appendix B),
(iii) a list of prudential indicators as required by the CIPFA Code of Practice on Treasury Management (Appendix C),
(iv) the Treasury Management Strategy and Annual Plan for 2006/2007 (Appendix D) and
(v) the draft capital programme (Appendix E).

1.2 At the outset of this report, it is important to draw Members' attention to a number of key points related to the draft budget for 2006/2007.

(a) When the budget for 2005/2006 was considered, Members agreed to a number of options to reduce the proposed increase of 9.53% to 4.09%, a level more affordable to the Constituent Authorities. The options entailed using Provisions held by the Authority and making efficiency savings, the efficiency savings were identified from the retained pay budget. The options agreed for the 2005/2006 budget have depleted the Provisions held by the Authority and removed the contingency element of the retained budget which in the past had been the main source of any underspends. This means that the starting point for the 2006/2007 budget would already be short by the £781,202 which had been funded from Provisions, with the likelihood that they would not be replenished from large underspends in 2005/2006.

(b) No provision has been made in the draft budget for the rank to role costs as it is expected that, as part of the modernisation agenda, this should be met from efficiencies or relocation of resources arising from the IRMP.

(c) Members should be aware of the provisional Revenue Support Grant Settlement for North Wales Authorities when considering increases to the Fire Authority Budget. The provisional average increase in RSG for North Wales Authorities for 2006/2007 is 4.82%; the all Wales average is 5.1%. This is 'net' of a 1% saving assumed in the Settlement. However, the settlement includes substantial new money for specific areas such as Social Care and when this has been deducted the underlying increase is around 3 to 3.5%.

2. REVENUE BUDGET

2.1. The initial draft budget for 2006/2007 has been calculated at £29.812m, 6.65% above the approved budget for 2005/2006. It takes account of the effect of nationally agreed pay awards and a 3% provision for the firefighters' pay award from July 2006. Other factors, such as general inflation, are also included, as are specific issues such as:

- an increase in pension payments to cover the cost of the increased number of pensioners;
- the cost of fuel increasing at rates well above inflation;
- one off additional costs for IT equipment for the 2006/2007 budget following a review of the current systems;
- additional budget for the Corporate Communications Section;
- a review of the Occupational Health contract, which is out to tender, is expected to lead to significantly increased costs in this area.

Appendix A compares the initial budget for 2006/2007 to actual expenditure for 2004/2005, the original and outturn budgets for 2005/2006 and forecasts for 2007/2008 and 2008/2009.

2.2 The initial budget is approximately 1.8% above the average provisional RSG Settlement for the constituent authorities and options for mitigating the increase need to be considered.

2.3 The table below summarises options for Members to consider. Commentary on each of the lines of the table and the potential risks follow:

Budget 2005/2006

£27,951,864

	Budget 2006/2007 £	**Change from 2005/2006 +/- %**
Proposed Base Budget 2006/2007	29,811,855	+6.65
Revenue Consequences of Capital Expenditure	-50,000	-0.18
No Transfer to Pension Provision from underspend on Commutations in 2005/2006	-100,000	-0.36
Pension Provision	-162,200	-0.58
Underspend 2005/2006	-150,000	-0.53
Revised Base Budget 2006/2007	29,349,655	+5.00

2.4 The table has been compiled on the basis of savings which will recur and one-off savings.

(a) It is possible to reduce the revenue consequences of capital if capital receipts are used to finance capital expenditure in 2005/2006. There are currently capital receipts in 2005/2006 which could be used to produce savings in future years. Previously capital receipts were used to supplement BCA (Basic Credit Approval), however, with the new Prudential Borrowing regime there is more flexibility and less necessity for holding capital receipts. There is little risk associated with this option in terms of revenue and the only downside is a loss of opportunity to use capital receipts to supplement capital expenditure in future years.

(b) A report was submitted to the Fire Authority on 19 September 2005 reviewing the current Pensions Provision and setting out the current position with regards to changes to the firefighters' pension scheme. Since that report there have been no further developments with regard to the consultation process between the Welsh Assembly and the Welsh Fire and Rescue Authorities in Wales. However, current indications are that the Welsh Assembly will mirror the scheme to be introduced in England which involves taking over responsibility for financing the costs of 'normal retirements' with the Fire Authority being responsible for ill-health retirements and injury awards. This could have an effect on the Pension Provision held by the Authority, currently £1.955m, in that it may not be necessary to hold such a large provision.

There are two options available to Members. Firstly, defer transferring the savings on commutations to the Pension Provision in 2005/2006 and secondly, use some of the provision to fund the budget for 2006/2007. The risk of implementing this option is considered to be low as the balance on the provision is healthy and will reduce by less than 10%. The position can always be reviewed once the consultation process has commenced.

(c) The next line in the table refers to an underspend arising in 2005/2006. This is currently estimated to be £205k and the risk is balancing the potential levels of operational activity over the winter against what could be put towards 2006/2007's budget, £150k may be reasonable at present as there is a potential contingency in the existence of the Pension Provision.

The main area of underspend is in the retained pay budget and has arisen from lower than normal levels of operational activity. Other areas that have contributed to the underspend is increased income, in particular interest on balances which is due to the high level of provisions held by the Authority.

2.5 The points outlined above result in an increase in the draft budget of 5%. They are not, however, exhaustive and Members may wish to take further steps to reduce the proposed increase for 2006/2007. As a guide, an amount of £280k would generate 1% saving.

2.6 As previously reported to Members the Fire & Rescue Services Act 2004 contains a provision for Fire Authorities to be able to charge for certain services. The Assembly has yet to make an Order for Wales but has issued a consultation paper on the draft legislation for which responses were requested by 25 November 2005. It is possible that the legislation will come into force by April 2006 and would enable the Authority to charge for certain services as set out in the Order. It will be up to the Members of the Fire Authority to determine the level of charges and this could produce a source of income to mitigate budget increases.

2.7 As mentioned previously, no provision has been made in the budget for the rank to role costs which could be in the region of £225k with an additional amount, as yet undetermined, for back pay to November 2003. This year's budget does not specifically include the '1% efficiency saving' generally expected by the Welsh Assembly Government across all services affected by RSG and included in the RSG settlement for 2006/2007 and, as such, it is considered appropriate that any additional costs incurred by the Authority should be met from efficiency savings as part of the modernisation agenda. It is recommended that when the full cost of rank to role is known the Executive Panel be tasked with determining the savings necessary to cover the cost.

3. ADDITIONAL INFORMATION

3.1 Appendix B sets out the provisional contributions for 2006/2007, whilst Appendix C sets out the prudential indicators required from the CIPFA Code of Practice on Treasury Management. The Treasury Management Strategy and Annual Plan for 2006/2007 is in Appendix D.

4. CAPITAL PROGRAMME

4.1 The draft capital programme for 2006/2007 is set out in Appendix E and amounts to £2.78m. In 2005/2006 the estimated outturn for capital expenditure is £2.76m. It is proposed to finance this by borrowing.

4.2 As part of the management re-structure, the Authority has sold some of the properties in its portfolio and is currently in the process of selling York Road premises. The expected Capital Receipts at the end of 2005/2006 are £479k, these include the sale of assets from previous years and the proceeds from the sale of York Road.

4.3 CIPFA guidance on Capital Expenditure recommends that the Authority sets a de-minimis level for items purchased as part of the capital programme. The recommended de-minimis level for capital expenditure by the Fire Authority is £100.

5. RECOMMENDATION

5.1. It is recommended that:

(i) Members determine the draft budget for 2006/2007 in line with the advice set out in 1.2(c) and the table in paragraph 2.3.

(ii) Constituent Authorities be advised of the provisional contributions required for 2006/2007.

(iii) The Executive Panel be granted delegated power to consider and approve how efficiency savings to cover the costs of rank to role can be determined and implemented for 2006/2007.

(iv) The Prudential Indicators set out in Appendix C be approved.

(v) The Treasury Management Strategy and Annual Plan for 2006/2007 set out in Appendix D be approved.

(vi) The draft capital programme for 2006/2007 and associated methods of financing be approved and the de-minimis level for capital expenditure be set at £100.

(vii) If any changes transpire before 31 January 2006, the powers for altering the budget level be delegated to the Executive Panel or, if any such announcements or savings transpire after this date but before 15 February 2006, that this power be delegated to the Treasurer in consultation with the Chairman, Chief Fire Officer and Clerk.

K W FINCH
Treasurer

30 November 2005

APPENDIX C

PRUDENTIAL INDICATORS FOR NORTH WALES FIRE AUTHORITY

1. The actual capital expenditure that was incurred in 2004-2005 and the estimates of capital expenditure to be incurred for the current and future years that are recommended for approval are:

2004/05 £'000 Actual	**2005/06 £'000 Outturn**	**2006/07 £'000 Estimate**	**2007/08 £'000 Estimate**	**2008/09 £'000 Estimate**
3,941	2,756	2,780	3,599	3,268

2. Estimates of the ratio of financing costs to net revenue stream for the current and future years, and the actual figures for 2004-2005 are:

2004/05 Actual	**2005/06 Outturn**	**2006/07 Estimate**	**2007/08 Estimate**	**2008/09 Estimate**
2.31%	2.73%	3.48%	4.48%	5.47%

The estimates of financing costs include current commitments and the proposals in this budget report.

3. Estimates of the end of year capital financing requirement for the authority for the current and future years and the actual capital financing requirement at 31 March 2005 are:

31/03/05 £'000 Actual	**31/03/06 £'000 Outturn**	**31/03/07 £'000 Estimate**	**31/03/08 £'000 Estimate**	**31/03/09 £'000 Estimate**
6,948	9,307	11,475	14,257	16,450

4. The capital financing requirement measures the authority's underlying need to borrow for a capital purpose. In accordance with best professional practice, North Wales Fire Authority does not associate borrowing with particular items or types of expenditure. North Wales Fire Authority has, at any point in time, a number of cashflows both positive and negative, and manages its treasury position in terms of its borrowings and investments in accordance with its approved treasury management strategy and practices. In day to day cash management, no distinction can be made between revenue cash and capital cash. External borrowing arises as a consequence of all the financial transactions of the authority and not simply those arising from capital spending. In contrast, the capital financing requirement reflects the authority's underlying need to borrow for a capital purpose.

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

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

The Treasurer reports that the authority had no difficulty meeting this requirement in 2004-2005, nor are there any difficulties envisaged for the current or future years. This view takes into account current commitments, existing plans, and the proposals in this budget report.

6. In respect of its external debt, it is recommended that the Fire Authority approves the following authorised limits for its total external debt gross of investments for the next three financial years,

and agrees the continuation of the previously agreed limit for the current year since no change to this is necessary. These limits seperately identify borrowing from other long term liabilities such as finance leases. The Fire Authority is asked to approve these limits and to delegate authority to the Treasurer, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities, in accordance with option appraisal and best value for money for the authority. Any such changes made will be reported to the Fire Authority at its next meeting following the change.

Authorised Limit for External Debt

	2005/06	2006/07	2007/08	2008/09
	£'000	**£'000**	**£'000**	**£'000**
Borrowing	13,074	16,190	18,990	21,195

7. The Treasurer reports that these authorised limits are consistent with the authority's current commitments, existing plans and the proposals in this budget report for capital expenditure and financing, and with its approved treasury management policy statement and practices. The Treasurer confirms that they are based on the estimate of most likely, prudent but not worse case scenario, with in addition sufficient headroom over and above this to allow for operational management, for example unusual cash movements. Risk analysis and risk management strategies have been taken into account; as have plans for capital expenditure, estimates of the capital financing requirement and estimates of cashflow requirements for all purposes.

8. The Fire Authority is also asked to approve the following operational boundary for external debt for the same time period. The proposed operational boundary for external debt is based on the same estimates as the authorised limit but reflects directly the Treasurer's estimate of the most likely, prudent but not worse case scenario, without the additional headroom included within the authorised limit to allow for unusual cash movements, and equates to the maximum of external debt projected by this estimate. The operational boundary represents a key management tool for in year monitoring by the Treasurer. Within the operational boundary, figures for borrowing and other long term liabilities, in a similar fashion to the authorised limit. Any such changes will be reported to the Fire Authority at its next meeting following the change.

Operational Boundary for External Debt

	2005/06	2006/07	2007/08	2008/09
	£'000	**£'000**	**£'000**	**£'000**
Borrowing	11,074	14,190	16,990	19,195

9. The Fire Authority's actual external debt at 31 March 2005 was £7,113,428. It should be noted that actual external debt is not directly comparable to the authorised limit and operational boundary, since the external debt reflects the position at one point in time.

10. In taking its decision on this budget report, the Fire Authority is asked to note that the authorised limit determined for 2006-2007 (see paragraph 6 above) will be the statutory limit determined under section 3(1) of the Local Government Act 2003.

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

The net increase in the contribution from the Constituent Authorities

2006/07	2007/08	2008/09
£62,550	£418,547	£840,585

12. In considering its programme for capital investment, the Fire Authority is required within the Prudential Code to have regard to:

- affordability, e.g. implications for the contributions from the Constituent Authorities
- prudence and sustainability, e.g. implications for external borrowing
- value for money, e.g. option appraisal
- stewardship of assets, e.g. asset management planning
- service objectives, e.g. strategic planning for the authority
- practicality, e.g. achievability of the forward plan.

13. A key measure of affordability is the incremental impact on the contribution from the Constituent Authorities, and the Fire Authority could consider different options for its capital investment programme in relation to their differential impact on the contributions.

APPENDIX D

North Wales Fire Authority's Treasury Management Strategy and Annual Plan for 2006-2007

1. **Introduction**

North Wales Fire Authority adopted the CIPFA Code of Practice on Treasury Management on 15 December 2003. This is a requirement of the Prudential Code, which has been introduced as part of the Local Government Act 2003. The code provides an overall framework for members and officers to reduce the risks associated with the treasury function. The code requires that a report on the strategy to be followed in the forthcoming year be presented to the Fire Authority. The strategy as set out below complies with the code and is submitted as required.

2. **Overview**

The strategy details the likely activities of the Treasury Management staff in 2006-2007. Conwy County Borough Council undertakes the treasury function on behalf of the North Wales Fire Authority as part of the service level agreement. Due to the relatively small amounts of surplus cash held by the Fire Authority some investments are invested under the name of Conwy County Borough Council for simplicity and detailed records of the investments are maintained by the Treasury Management staff. Conwy has appointed Butlers as treasury advisors and the strategy is based on their market forecasts as outlined in their various publications.

The strategy report will cover several areas as follows:

(i) Current position
(ii) Borrowing limits in 2006-2007
(iii) Interest rates in 2006-2007
(iv) Borrowing Strategy
(v) Investment strategy/counterparties

(I) Current Position – 30 November 2005

Fixed Rate Borrowing	PWLB	£7,513,428
Variable Rate Borrowing	PWLB	£0
Cash/Investments		£3,950,000

PWLB – Public Works Loan Board, now part of the UK Debt Management Office, which provides the bulk of local authority capital funding.
Cash/Investments – Surplus cash is invested by Conwy on the money market for less than one year.

(ii) **Borrowing Limits 2006-2007**

In accordance with section 3(1) of the Local Government Act 2003 and the Prudential Code it is a requirement that the authority approve and publish three limits to the various types of borrowing that it undertakes. The first limit is the Capital Financing Requirement, this is a measure of the long term debt needed to support the authority's capital programme. The Operational Boundary is a measure of the possible maximum external debt allowing for peaks and troughs in cashflows. The Authorised Limit is an estimate of the maximum amount the authority could borrow based on an assessment of operational requirements and external risks. The limits for 2006-2007 are as follows:

Capital Financing Requirement	£11,475,000
Operational Boundary	£14,190,000
Authorised Borrowing Limit	£16,190,000

The introduction of the Prudential Code sees the replacement of the s45 limits imposed by the Local Government and Housing Act 1989, with three new prudential indicators relating to interest rate exposure. It is recommended that the Authority approve the following limits:

	% Borrowing
Fixed Interest Rate	55 - 100
Variable Interest Rate	0 - 45

It is recommended that the Authority sets upper and lower limits for the maturity structure of its fixed rate borrowings as follows:

	Upper Limit	**Lower Limit**
Under 12 Months	30%	0%
12 Months and within 24 Months	30%	0%
24 Months and within 5yrs	50%	0%
5 yrs and within 10 yrs	75%	0%
10 yrs and above	90%	20%

(iii) **Interest Rates 2006-2007**

The interest rate outlook for 2006-2007 is produced by the Authority's treasury management consultants (Butlers) and is reproduced below:

Year	**Base Rate**	**5-year Gilt**	**20-yr Gilt**
2005/06	4.6	4.3	4.5
2006/07	4.3	4.4	4.6
2007/08	4.5	4.6	4.7
2008/09	4.8	4.8	4.7

Butlers outlook on the economy and their prediction for interest rates is as follows.
The Monetary Policy Committee announced the long-awaited cut in base rates following its August meeting. However, the downturn in the UK interest rates cycle is expected to be prolonged and shallow with the low point not being too wide of the 4.25% level (currently 4.5%). GDP growth had been substantially weaker than anticipated as the slowdown in house price inflation and higher debt servicing costs combined to undermine consumer spending growth. Activity is expected to remain weak through the balance of 2005 but to stage a recovery in 2006.

The Bank of England believes that the rebound in consumer activity, together with continued strength in public sector spending and a rise in corporate investment, will encourage higher growth in the future. This is open to debate and it is clear that the forecasting of interest rates in the current climate is difficult and a cautious approach is needed in treasury activity.

(iv) **Borrowing Strategy**

The growing uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Authority will take a cautious approach to its treasury strategy.

Long-term fixed interest rates are expected to rise modestly and base rates are expected to fall initially by ¼% before rising again in 2007/08. The Treasurer, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above. It is likely that longer term fixed rates will be considered if borrowing levels remain relatively low.

(v) **Investment Strategy/Counterparties**

All investments will be made as cash deposits to banks, building societies and local authorities. Some loans will be made through one of several broking firms who are used by Conwy and others will be direct with the institution. All investments will be no longer than 364 days and will be made according to the latest market forecasts.

The Fire Authority approved a list of counterparties on 20 December 2004. The Treasury Management staff monitor the credit ratings of the approved counterparties and a counterparty is removed from the list if there is a decline in their credit rating. All the counterparties on the list have previously been approved by the Fire Authority:

Banks £5m limit
Barclays, HSBC, Lloyds TSB, Cheltenham & Gloucester, National Westminister, Royal Bank of Scotland, Abbey, Halifax and the Bank of Scotland, Alliance & Leicester, Bank of Ireland, Allied Irish Bank, Northern Rock, Bradford & Bingley, Anglo Irish Bank, Woolwich, Hbos, Bank of Butterfield, Close Brothers, Co-operative Bank, Credit Suisse, First Boston International, Merrill Lynch International Bank, Standard Life, Bank of New York Europe, Citibank, HFC Bank, Clydesdale, Standard Chartered, N M Rothschild, Schroeders, Singer & Friedlander, Morgan Grenfell, Bristol & West, First Active, Irish Permanent, Depfa Bank, IIB Bank and Ulster Bank.

Central Government £5m limit
Debt management Office

Local Authorities £2m limit
All except those subject to limitation of council tax and precepts under Part 1 of the Local Government Finance Act 1992.

Building Societies £2m limit
Britannia, Chelsea, Cheshire, Derbyshire, Dunfermline, Leeds and Holbeck, Leek United, Nationwide, Norwich and Peterborough, Portman, Skipton, The Principality, Coventry and Yorkshire.