Agenda item: 10

NORTH WALES FIRE & RESCUE SERVICE

COMMITTEE:	NORTH WALES FIRE AUTHORITY
DATE:	15 DECEMBER 2003
REPORT OF:	TREASURER
SUBJECT:	DRAFT BUDGET 2004/2005

1. INTRODUCTION

1.1 This report contains proposals to the Authority in respect of the draft budget for 2004/2005, the forecasts for 2005/2006 and 2006/2007, and the papers attached set out:-

- (i) the draft revenue budget (appendix A),
- (ii) the draft capital programme (appendices Band C),
- (iii) the provisional contributions required by the constituent authorities (appendix D),
- (iv) a statement detailing the budget increases (appendix E),
- (v) a list of prudential indicators as required by the CIPFA Code of Practice on Treasury Management (appendix F) and
- (vi) the Treasury Management Strategy and Annual Plan for 2004/2005 (appendix G).

1.2 At the Fire Authority meeting on 29 September 2003 Members were provided with information on the cost implications of the Pay Agreement as it was known at that time. Stage 2 of the Pay Agreement has now been agreed and that has been included in the calculation of the uniformed pay element of the draft budget.

1.3 The draft budget also incorporates the Fire Authority's proposals in the Integrated Risk Management Plan.

2. REVENUE BUDGET

2.1. The proposed budget for 2004/2005 is set at £28.349m and a comparison to the actual expenditure for 2002/2003, the original outturn budget for 2003/2004, forecasts for 2005/2006 and 2006/2007 and the projected outturn for 2003/2004 is set out in Appendix A. The budget statement is supplied in two formats; one showing income and expenditure in detail and the other in Best Value format.

2.2. The proposed budget is 12.03% above that approved for the current financial year. The major factor for the increase between the 2003/2004 budget and the 2004/2005 budget is the pay award. **Members will be given a number of options later on in the report to reduce the 12.03% increase without affecting service levels.**

2.3. Current projections indicate that the Revenue Budget for 2003/2004 will show an overspend of £216,658. This has been reduced from the previous overspend reported due mainly to a slippage in the capital programme where it has been possible to move the purchase of some water tenders from leasing in this financial year to borrowing in 2004/2005. At the meeting of the Fire Authority on 16 June 2003 it was agreed that the underspend from 2002/2003 of £748,064 be directed to a Provision for the Pay Award.

2.4. It is proposed that £216,658 of this provision be used to fund the projected overspend for 2003/2004 and the remainder be used to offset the budget increase for 2004/2005.

3 CAPITAL PROGRAMME

3.1 The draft capital programme for 2004/2005 is set out in Appendices B,C and D and amounts to £3,281,200, of this amount £2,190,700 is new schemes and £1,090,500 is for schemes that have slipped from the previous year. In 2003/2004 the estimated outturn for capital expenditure (excluding leasing) is £1,038,750. It is proposed to finance this by Basic Credit Approval of £936,000, £59,000 from the Capital Provision and £43,750 from Capital Receipts.

3.2 In 2004/2005 the new Prudential Code will come in to force and the limits on borrowing for capital expenditure will be removed. The key issues when considering the capital investment programme will be affordability; prudence and sustainability; value for money; asset management; service objectives; and practicality. Details of the Prudential Indicators are shown in Appendix F.

3.3 In previous years slippage in the capital programme meant that in order to continue with those schemes in following years it was necessary to have financing in place over and above BCA which was required for new schemes in the new financial year. In previous years the Fire Authority has built up a Capital Provision to fund slippage in the capital programme. However, it has not always been necessary to use the Capital Provision and the balance on the provision is now £481,631. It will be necessary to use £59,000 from the provision to fund capital expenditure in 2003/2004 leaving a balance on the provision of £422,631.

3.4 With the new Prudential Code it will no longer be necessary to hold provisions for capital expenditure so the balance on the provision of £422,631 can be used to offset budgetary pressures for 2004/2005.

4. OPTIONS FOR REDUCING THE 12.03% INCREASE

4.1 Two options have already been outlined in paragraphs 2.4 and 3.4 and further options are set out below.

4.2 Another option to further reduce the increase is to forego the £160,000 contribution to the Pension Provision for 2004/2005 and increase the contribution by £20,000 over the next 8 years. The effects of this proposal on the Pension Provision is detailed in Appendix H.

4.3 The sale of surplus property will offer a potential Capital Receipt of £115,000 and having analysed the budget for 2004/2005 it is possible that £80,000 of revenue expenditure on equipment could be capitalised and funded from the Capital Receipt.

4.4 Table 1 details the effect of the options on the budget in percentage and monetary terms in the order they have been identified in the report. There is little or no risk in taking up the option to use the balance of previous underspends and the balance of the Capital Provision. There is a risk that the Capital Receipt for the surplus property may not actually arise in 2004/2005 and, whilst the option identified in paragraph 4.2 is a departure from previous policy it is more certain than relying on a potential Capital Receipt. If Members wish to see a budgetary increase of less than 8% the 'Pension Option' should be given serious consideration.

Table 1

	Budget Reduction	Total Budget	% Increase 2004/2005	% Increase 2005/2006	% Increase 2006/2007
Current Budget 2004/2005		£28,348,670	12.03	2.95	3.38
Contribution from Pay Provision and Capital Provision	£954,037	£27,394,633	8.26	6.53	3.38
Delay contribution to Pension Provision	£160,000	£27,234,633	7.63	7.16	3.38
Capital Receipt	£80,000	£27,154,633	7.31	7.55	3.38

4.4 Ultimately it is for Members to decide at what level the budget is set taking in to account the needs of this organisation. In doing so it is reasonable to consider funding for future years and the impact on how the Authority would obtain its income. As Table 1 illustrates the proposed draft budget shows an increase of 12.03% over the current year with the subsequent years then showing potential increases of around 3%. If this opportunity is taken to mitigate the increase for 2004/2005, a series of 'Smoother' budgetary increases is possible. The options proposed above do not affect service levels but if further reductions are required then service levels will be affected.

5. RECOMMENDATION

5.1. It is recommended that

(i) The balance of the underspend from previous years and the balance of the Capital Provision be taken to mitigate the budgetary increase for 2004/2005.

(ii) Members determine if any further mitigating steps are to be implemented in respect of 2004/2005 and, therefore the proposed budget for 2004/2005.

(iii) Members decide at what level the budget for 2004/2005 is set.

(iv) Constituent authorities be advised of the provisional contributions as set out in Appendix D, dependant on the decision taken as to what level the budget is set.

(v) The draft capital programme and associated methods of financing be approved.

(vi) The proposals in Appendix F on Prudential Indicators be approved.

(vii) The Treasury Management Strategy and Annual Plan be approved.

K W FINCH
Treasurer

APPENDIX E

Budget Increases for 2004/2005

1. Employees

Chief Officers – the increase is due to the part implementation of the Management Structure review incorporating the post of an Assistant Chief Fire Officer and the transfer from Local Government Services Staff of the Assistant Chief Officer (Corporate Services). This has resulted in the reduction of two Senior Divisional Officers and one Divisional Officer 1 from the wholetime budget, totalling £176,927.

Uniformed Part –time – an increase of 29.6% is due to the pay award, giving parity of hourly rate with Wholetime uniformed staff. An example is the retained firefighters hourly rate increasing from £6.45 to £10.94 an increase of 69.6%; drill fees increasing from £19.07 to £32.82 an increase of 72.1%; and the inclusion of £90,000 for Community Fire Safety as agreed in the IRMP.

2. Premises

The increase is due mainly to the rental costs of the new headquarters being included for 2004/2005.

3. Supplies and Services

Operational Equipment – includes a provision of £24,000 for Young Firefighters Association as included in the IRMP.

Uniform – additional funding for Personal Protective Uniforms and new working rig. This cost is offset by future years savings.

Audit Commission – the increase is due to additional costs in verifying the modernisation agenda.

Committee Services – the proposed introduction of Members allowances will increase the Committee Services budget by £60,000.

APPENDIX F

PRUDENTIAL INDICATORS FOR NORTH WALES FIRE AUTHORITY

1. The actual capital expenditure that was incurred in 2002-2003 and the estimates of capital expenditure to be incurred for the current and future years that are recommended for approval are:

2002/03 £'000 Actual	2003/04 £'000 Outturn	2004/05 £'000 Estimate	2005/06 £'000 Estimate	2006/07 £'000 Estimate
1,678	2,697	3,281	1,873	1,810

2. Estimates of the ratio of financing costs to net revenue stream for the current and future years, and the actual figures for 2002-2003 are:

2002/03 Actual	2003/04 Outturn	2004/05 Estimate	2005/06 Estimate	2006/07 Estimate
1.82%	1.84%	1.76%	2.41%	2.84%

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 2003 are:

31/03/03 £'000 Actual	31/03/04 £'000 Outturn	31/03/05 £'000 Estimate	31/03/06 £'000 Estimate	31/03/07 £'000 Estimate
3,329	3,995	7,081	8,670	10,133

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. A report submitted earlier on the agenda recommends that the authority adopts the Code of Practice for Treasury Management in the Public Services, thus ensuring that the authority has an integrated treasury management strategy. 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 2002-2003, 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 separately 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

	2003/04	**2004/05**	**2005/06**	**2006/07**
	£'000	**£'000**	**£'000**	**£'000**
Borrowing	8,691	11,635	13,668	15,637

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

	2003/04	**2004/05**	**2005/06**	**2006/07**
	£'000	**£'000**	**£'000**	**£'000**
Borrowing	6,691	9,635	11,668	13,637

9. The Fire Authority's actual external debt at 31 March 2003 was £3,348,428. 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 2004-2005 (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

2004/05	**2005/06**	**2006/07**
£85,724	£343,028	£495,918

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 G

North Wales Fire Authority's Treasury Management Strategy and Annual Plan for 2004-2005

1. **Introduction**

A previous report on the agenda has recommended that the Fire Authority adopts the CIPFA Code of Practice for Treasury Management in the Public Services, 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 2004-2005. Conwy County Borough Council undertakes the treasury function on behalf of the North Wales Fire Authority as part of the service level agreement. 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 2004-2005
(iii) Interest rates in 2004-2005
(iv) Borrowing Strategy
(v) Investment strategy/counterparties

(i) **Current Position**

Fixed Rate Borrowing	PWLB	£2,999,428
Variable Rate Borrowing	PWLB	£964,000
Cash/Investments		£3,800,000

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 2004-2005**

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 2004-2005 are as follows:

Capital Financing Requirement	£7,081,000
Operational Boundary	£9,635,000
Authorised Borrowing Limit	£11,635,000

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 - 90
Variable Interest Rate	10 - 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 2004-2005**

The interest rate outlook for 2004-2005 is produced by the Authority's treasury management consultants (Butlers) and is reproduced below:

Year	End of Period	Base Rate	12 Month Libor	10yr Gilt
2003	March	3.75	3.60	4.30
	June	3.75	3.50	4.10
	September	3.50	4.00	4.50
	December	3.75	4.40	4.90
2004	March	4.00	4.60	5.10
	June	4.25	4.90	5.40
	September	4.50	5.10	5.50
	December	4.50	5.10	5.60
2005	March	4.50	5.10	5.60

Butlers outlook on the economy and their prediction for interest rates is as follows.
The record indebtedness of the UK personal sector and the danger that a sharp increase in rates could, through its effect on debt servicing costs, trigger a marked contraction in spending growth, is expected to be a restraining influence on policy tightening in 2004. A deceleration in retail spending is anticipated but this hopefully will be covered by an export led recovery due to the increase in UK competitiveness. The central prediction from Butlers is that the Bank of England will not be under pressure to increase rates dramatically leading to gently rising interest rates to counter inflation pressures.

(iv) **Borrowing Strategy**

The scenario indicated above leads through to the following borrowing strategy:

- borrow a proportion of fixed rate funds early in the year to take advantage of the lower medium term rates
- retain some borrowing capacity in case unexpected economic/political events force rates lower
- consider variable rate loans as it is likely that these rates will remain 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.

A list of suggested counterparties is included below for approval by the Fire Authority:

Banks £5m limit
Barclays, HSBC, Lloyds TSB, National Westminister, Royal Bank of Scotland, Halifax and the Bank of Scotland, Abbey National, Alliance & Leicester, Bank of Ireland, Allied Irish Bank, Northern Rock, Bradford & Bingley, Anglo Irish Bank and the Woolwich.

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 (Assets over £400m) £2m limit
Britannia, Cambridge, Chelsea, Cheshire, Coventry, Cumberland, Darlington, Derbyshire, Dunfermline, Furness, Hinckley & Rugby, Kent Reliance, Lambeth, Leeds and Holbeck, Leek United, National Counties, Nationwide, Newcastle, Norwich and Peterborough, Nottingham, Portman, Progressive, Saffron Waldon, Scarborough, Skipton, Staffordshire, Stroud & Swindon, The Principality, West Bromwich and Yorkshire.