Agenda Item No.

WEST MIDLANDS FIRE AND RESCUE AUTHORITY

14 FEBRUARY 2011

1. BUDGET AND PRECEPT 2011/2012 AND BUDGET FORECAST 2012/2013 TO 2014/2015

Joint Report of the Treasurer and Chief Fire Officer.

RECOMMENDED

1.1 THAT the following be approved:-

1.1.1 The Authority's Revenue Budget for 2011/2012 of £111.502m as set out in Appendix B.

1.1.2 The Authority’s capital programme for 2011/2012 to 2014/2015 as set out in Appendix D.

1.1.3 The Authority’s Treasury Management Strategy set out in Appendix E and Prudential Indicators in Appendix F

1.2 THAT it be noted that the constituent District Councils have formally set their Council Tax bases for the year 2011/2012 in accordance with Regulation 3 of the Local Authorities (Calculation of Council Tax Base) Regulations 1992 made under Section 33(5) of the Local Government Finance Act 1992 as follows:

	Tax Base
Birmingham	298,292.00
Coventry	89,027.30
Dudley	98,313.96
Sandwell	85,772.50
Solihull	79,806.00
Walsall	78,707.79
Wolverhampton	71,023.40
	800,942.95

1.3 THAT the following amounts be now calculated by the Authority for the year 2011/2012 in accordance with Sections 43 to 48 of the Local Government Finance Act 1992:

1.3.1	£115,505,000	being the aggregate of the amounts which the Authority estimates for the items set out in Section 43(2)(a) to (d) of the Act.
1.3.2	£4,003,000	being the aggregate of the amounts which the Authority estimates for the items set out in Section 43(3)(a) to (b) of the Act.
1.3.3	£111,502,000	being the amount by which the aggregate at 1.3.1 above exceeds the aggregate at 1.3.2 above calculated by the Authority in accordance with Section 43(4) of the Act as its budget requirement for the year.
1.3.4	£73,193,000	being the aggregate of the sums which the Authority estimates will be payable for the year into its general fund in respect of formula grant by the aggregate of the sums which the Authority estimates will be received in the year from the constituent District Councils in respect of amounts they have estimated as the surplus on their collection funds for 2010/2011.
1.3.5	£47.83	being the amount at 1.3.3 above less the amount at 1.3.4 above all divided by the total amount at 1.2 above, calculated by the Authority in accordance with Section 44(1) of the Act as the basic amount of its Council Tax for the year.

1.3.6 Valuation Bands

Valuation Bands	£ (to 6 decimals)	£ (rounded to 2 decimals)
A	31.886666	31.89
B	37.201110	37.20
C	42.515554	42.52
D	47.829998	47.83
E	58.458887	58.46
F	69.087775	69.09
G	79.716664	79.72
H	95.659997	95.66

being the amounts given by multiplying the amount at 1.3.5 above by the number which in the proportion set out in Section 5(1) of the Act is applicable to dwellings listed in a particular valuation band divided by the number which in that proportion is applicable to dwellings listed in valuation band D, calculated by the Authority in accordance with Section 47(1) of the Act, as the amounts to be taken into account for the year in respect of categories of dwellings listed in different valuation bands.

1.3.7 Resultant precepts:

	£
Birmingham City Council	14,267,306
Coventry City Council	4,258,176
Dudley MBC	4,702,357
Sandwell MBC	4,102,498
Solihull MBC	3,817,121
Walsall MBC	3,764,593
Wolverhampton City Council	3,397,049
Total	38,309,100

being the amounts given by multiplying the amount at 1.3.5 above by the appropriate tax base at 1.2 above in accordance with section 48(2) of the Act, as the amount of precept payable by each constituent District Council.

1.4 THAT the precept for each District Council as calculated at 1.3.7 above be issued in accordance with Section 40 of the Local Government Finance Act 1992.

2. PURPOSE OF REPORT

The Authority is requested to consider the Capital Programme for 2011/2012 to 2014/2015, the prudential indicators relating to the Authority's capital financing requirements, the Treasury Management Strategy, the Revenue Budget and to approve the consequent precept level and resultant amount for each constituent District Council.

3. BACKGROUND

3.1 The budget setting process is a key part of the Fire Authority's arrangements which establishes the anticipated level of available funding to deliver its key priorities and services. Work has been undertaken throughout the year to determine the Authority's key priorities and strategic objectives which are contained in the 2011/2015 Plan.

3.2 Because a key element of developing the Authority's plans is to seek the opinions of those people that live, work and travel within the West Midlands, a public consultation exercise was undertaken on the organisation's Building upon Success programme during the current financial year. The Building upon Success programme is reviewing the whole organisation with a view to identifying where efficiencies can be realised, ensuring a focus on customer needs and providing the necessary services as effectively and efficiently as possible. A questionnaire was developed and loaded onto the website. In addition hard copies were distributed to the community via station personnel. Consultation was open from 19th July 2010 to 16th August 2010. The questions were based around the value and importance given to the main elements of the services provided.

3.3 The feedback was that the activities of the service were very valuable with Response being seen as the most critical. Concerns were expressed over possible changes and how this may affect fire engine numbers and response times. Prevention work was seen as important but it was emphasised for the need to ensure effective targeting to the most vulnerable members of the community.

3.4 On 20th October 2010 the Chancellor announced the Government's four year spending plans in the Comprehensive Spending Review. For Fire and Rescue Authorities it was indicated that there would be a reduction to its central grant funding of 25% over a four year period and that this would be 'back loaded' meaning that the largest proportion of the reduction would occur in years three and four.

3.5 The Government also announced in the Comprehensive Spending Review that it was making an extra £650 million per annum available for the next four years to help local authorities (including police and fire authorities) deliver a council tax freeze in England in 2011/12. The scheme is voluntary and where an authority does not increase its basic amount of council tax in 2011/12 compared with 2010/11, it is eligible to receive a grant equivalent to a 2.5 per cent increase in its 2010/11 basic amount of Council Tax multiplied by the Authority's tax base for 2011/12.

3.6 On 13th December 2010, the Secretary of State for Communities announced a provisional two year settlement for Local Government covering 2011/12 and 2012/13. The figures for this Authority represented a grant reduction of £7.677m (9.5%) in 2011/12 and a further £2.487m (3.4%) in 2012/13, an overall reduction in grant funding of £10.164m (12.58%) over two years.

3.7 The updated Fire Service budget position was presented at a Policy Planning Seminar on 16th December 2010 and to the West Midlands District Leaders' on 17th December 2010. The District Leaders' paid tribute to the provision of the service provided by the Authority and offered support in challenging the provisional grant settlement proposal from the Government.

3.8 At its meeting on 24th January 2011, the Policy Planning Forum considered the draft revenue budget for 2011/2012. Appendix A summarises how the budget has been determined following a number of adjustments from last year's budget projection.

3.9 On 31st January 2011, Communities and Local Government (CLG) confirmed the Authority's 2011/2012 and provisional 2012/2013 grant figures, with no change to the grant reduction announced in the provisional settlement. However there was some improved clarity with regards to capital funding which is referred to in paragraph 7.4 of this report.

3.10 The projected budget includes a number of efficiency measures and provides the capacity to undertake actions arising out of the Authority's Corporate Risk Register. The Corporate Risk Register has identified a number of major risks that would seriously affect the Authority's ability to carry out its functions. The very nature of the risks have made it extremely difficult to quantify any funding impact that would arise were the risk to materialise and in the short term would result in a demand on the Authority's General Balances, which are identified in Section 6 of this report.

3.11 During the financial year 2010/11 the organisation has undertaken only extremely limited recruitment activity in line with its approach to workforce planning and budgetary management.

3.12 The Service will continue to use its workforce data to plan the levels of recruitment that will be necessary across the organisation. This data will be the basis on which recruitment activity is restricted until the financial position for 2013/14 and 2014/15 has been further clarified.

3.13 Details of the draft base budget are set out in Appendix B, together with revisions to the current year's budget (the 2011/2012 budget is replicated for information in the Best Value Accounting Code of Practice format in Appendix C).

Update of "The Plan"

3.14 During January 2011 a series of workshops were undertaken with Corporate Board and Senior Managers to review and refresh the Authority's Corporate Strategy 'The Plan' for 2011/2012 - 2014/2015. 'The Plan' sets the Authority's strategic direction for the next three to four years and defines the services to be provided against a backdrop of reduced funding and resources. The key information that will form the basis of 'The Plan' is provided as a separate agenda item. In line with the Authority's environmental strategy 'The Plan' will be accessible electronically and as such the current version will be refreshed and updated.

3.15 The Building upon Success programme sets an agenda for change over the next four years against the backdrop of the Comprehensive Spending Review and will heavily inform the direction of the Service and therefore the detail of 'The Plan'. As part of the Building upon Success programme approximately forty work packages were issued at the beginning of December 2010 covering both service support and service delivery areas. Each work package aims to deliver a more efficient and effective delivery of services.

3.16 Workshops undertaken during January 2011 brought together the current, expected and predicted financial planning, workforce planning and business activities to enable a joined up approach in the determination of 'The Plan' and alignment with the setting of the budget. A draft of 'The Plan' and particularly the strategic objectives contained within it is included on the agenda as a separate item.

3.17 'The Plan' will need to be reviewed throughout 2011/2012, not only to ensure that the priorities and objectives for that year are achieved but to consider any changes to service areas from 2012/2013 onwards, given the funding reductions in that and future financial years.

4. PRECEPT 2011/2012

4.1 Under the Council Tax arrangements, the allocation of the total sum required by the Authority between constituent District Councils is based on the relevant tax base for each District.

4.2 All District Councils have now formally set their Council Tax base and have notified the Authority accordingly. The total relevant Council Tax base for the Authority is 800,942.95.

4.3 The appropriate precept has now been calculated for each District and is set out in paragraph 1.3.7 for the Authority's approval.

4.4 The Council Tax at Band D for 2011/2012 is £47.83 which represents a zero percent increase over 2010/2011.

5. FUNDING OF EXPENDITURE 2011/2012

The final figures from external funding sources have now been notified and are included in the table below:-

	£'000
Formula Grant	73,136
Share of Collection Fund Surplus	57
Council Tax (met by Districts)	38,309
	111,502

6. GENERAL BALANCES POSITION

6.1 Based on the current forecast of net expenditure in 2010/2011, the Authority's estimated available General Balances at 1st April 2011 are estimated to be £5.9 million. At this level, the amount of General Balances would equate to approximately 5% of the Authority's 2010/2011 budget.

6.2 The actual level of General Balances at 1st April 2011 will not be determined until the completion of the Authority's 2010/2011 closedown of accounts process.

7. CAPITAL PROGRAMME

7.1 At the Authority meeting on 15th February 2010, consideration and approval was given to the current three year Capital Programme. The Programme has been monitored during the year at Authority meetings.

7.2 It is estimated that commitments and new starts in respect of those projects which make up the proposed capital programme, is as follows:

	£m
2011/2012	3.625
2012/2013	2.490
2013/2014	2.500
2014/2015	1.500

The full list of projects is shown on Appendix D.

7.3 As part of the Spending Review, the Government also made a decision that no new supported borrowing allocations will be made in the Spending Review period. Although there will be no new supported borrowing allocations after 2010/2011, the level of assumed outstanding debt still forms part of the formula grant calculation, as it has in previous years.

7.4 The Government also announced that as part of the Spending Review, capital support will only be given in the form of a capital grant. The National Fire and Rescue Service has been allocated capital grant totalling £70m in 2011/2012 and a further £70m in 2012/2013. When the provisional settlement was announced on 13th December 2010, there was no indication of how this grant would be allocated. The lack of clarity regarding capital funding was a specific issue raised with the Fire Minister on 11th January 2011 as part of this Authority's lobbying activity during the consultation process on the provisional Finance Settlement. When the final finance settlement was confirmed on 31st January 2011, the issue was addressed for 2011/12 and this Authority has been allocated £2.915m although no details of future year allocations are available at this stage.

7.5 A forecast of resources covering the period 2011/2012 to 2014/2015 is shown below. The figures shown for Capital Grant for 2012/13 onwards are for indicative purposes at this stage and are likely to change when the Government determines the actual distribution mechanism.

	2011/12 £m	2012/13 £m	2013/14 £m	2014/15 £m
Supported Capital Expenditure	-	7.990	1.000	-
Capital Receipts	-	1.432	-	-
Capital Grants	2.915	1.500	1.500	1.500
Revenue Funding	710	-	-	-
	3.625	10.922	2.500	1.500

7.6 The table below compares the expenditure on those projects within the capital programme which are committed and the projected resources outlined in paragraph 7.5:

	2011/12 £m	2012/13 £m	2013/14 £m	2014/15 £m
Projected Resources	3.625	10.922	2.500	1.500
Less: Commitments	3.625	2.490	2.500	1.500
Funding Surplus	-	8.432	-	-

The forecast surplus in 2012/2013 is required to enable consideration of issues arising from the outcome of the Building upon Success programme (for example possible new fire stations, Low Risk Flexible Crewing Fire Stations, range and type of vehicles). Because of the overall resource position of the capital programme and the potential scale of expenditure arising out of the reviews being carried out as part of the Building upon Success programme, no new capital schemes are proposed for 2011/2012.

8. TREASURY MANAGEMENT AND THE PRUDENTIAL CODE

8.1 The Fire Authority recognises the importance of Treasury Management to the economy and efficiency of its finances. It also recognises that delivering quality services in this area requires expertise and skills that can best be provided by specialist professions from external organisations.

8.2 West Midlands Fire Service's Treasury Management functions are provided by Sandwell MBC who have, in turn, appointed external advisors to support them. The Fire Authority has also linked its appointment of bankers to that of Sandwell MBC in order to benefit from efficiencies in tendering, cash flow management and investment.

8.3 The Treasury Management Strategy for 2011/2012 – 2013/2014 is set out in Appendix E.

8.4 Under the Local Government Act 2003, credit approvals were abolished and a new prudential capital finance system was introduced from 1st April 2004. CIPFA has prepared a Prudential Code which underpins the system of capital finance. Local authorities are required by Regulation to have regard to the Prudential Code under Part 1 of the Local Government Act 2003.

8.5 The key objectives of the Prudential Code are to ensure that the capital investment plans of the Authority are affordable, prudent and sustainable. A further key objective is to ensure that treasury management decisions are taken in accordance with good professional practice and in a manner that supports prudence, affordability and sustainability.

8.6 To demonstrate that local authorities have fulfilled these objectives, the Prudential Code sets out the indicators that must be used and the factors that must be taken into account. The indicators are designed to support and record local decision making.

8.7 The Prudential Indicators that have been calculated for this Authority are detailed on Appendix F.

9. PLANNING FOR THE 2012/2013, 2013/2014 AND 2014/2015 BUDGET

9.1 In preparing the draft revenue budget for 2011/2012, an expenditure forecast for 2012/2013, 2013/2014 and 2014/2015 has also been undertaken by ‘rolling forward’ the 2011/2012 draft budget; updating for anticipated inflation and pay awards, adding in commitments, reducing for known reductions to formula grant in 2012/2013, etc.

9.2 The forecast does not allow for any essential developments and any other new requirements the Authority may need to respond to. Nor does it allow for any additional efficiencies arising from the Building upon Success programme, increasing vacancy levels, etc.
A forecast of the likely level of resources assuming a cash standstill grant, for 2013/2014 and 2014/2015 based on 2012/2013 indicated levels would result in the following position for 2012/2013, 2013/2014 and 2014/2015:

	2012/13	2013/14	2014/15

	£m	£m	£m
Budget requirement	112,150	113,250	114,750
Resources			
- Grant	70.649	70.649	70,649
- Precept	41.501	42.601	44,101
Supportable expenditure	112.150	113.250	114,750
Precept Increase	8.30%	2.65%	3.50%
Band D Increase (per annum)	£3.99	£1.37	£1.87

Any further efficiencies arising from the Building upon Success programme beyond 2011/2012 have not been reflected in the above table. Further efficiencies would reduce the indicated Council Tax increases.

9.3 However, due to restrictions in public sector expenditure and following the Comprehensive Spending Review on 20th October 2010 there will be further reductions in Government grants and so a number of scenarios have been considered regarding the Authority's overall funding position as shown on Appendix G.

9.4 Further details of the medium term budgets are shown on Appendix H.

10. **ROBUSTNESS OF THE BUDGET PREPARATION AND**

ADEQUACY OF RESERVES

10.1 In accordance with the Local Government Act 2003 (S25-S27) and to comply with CIPFA guidance on local authority reserves and balances, the Treasurer is required to formally report to members on the robustness of the budget and the adequacy of reserves.

10.2 The budget presented to the Authority has been prepared using reasonable and appropriate estimation techniques for both expenditure and income. The budget process is such that all financial pressures faced by the Authority have been considered and resources allocated as appropriate to fulfil the priorities of the Authority. Where resources have not been allocated to identified pressures either; the pressure has been absorbed into the existing budget or the risk associated with not meeting the pressure has been evaluated and appropriate action taken. The robustness of the budget preparation undertaken by the Authority is therefore considered satisfactory.

10.3 The Treasurer assesses and determines the appropriate level of reserves and provisions using a variety of mechanisms, including:-

- Being significantly involved in the budget setting process, the annual financial cycle and engaged in the strategic leadership of the organisation as a statutory officer.

- Liaising closely with the Director of Finance and Procurement on the annual refresh of the Medium Term Financial Strategy (MTFS).

- Challenging the budget at various stages of construction including the reasonableness of the key budget assumptions such as estimates of inflationary and corporate financial pressures, realism of income targets and the extent to which known trends and liabilities are provided for.

- Review of the movements, trends and availability of contingencies, provisions and earmarked reserves to meet anticipated and unforeseen cost pressures in the context of future pressures and issues.

- The use of professional experience and best professional judgement.

- The use of appropriate professional, technical guidance and local frameworks.

- Knowledge of the colleagues involved in the process, particularly finance professionals, including their degree of experience and qualifications.

- Review of the strength of financial management and reporting arrangements including internal control and governance arrangements.

10.4 The Authority's aim is to have a prudent level of general reserves informed by an assessment of potential risks to the organisation. The Authority should establish general reserves of between 3% and 5% of the total net revenue budget, the precise level within this range to be determined by risk assessment and availability of resources. The level of reserves at the end of the financial year 2010/2011 is forecast to be £5.9m and this is approximately 5% of the net budget requirement.

10.5 It was deemed that a prudent level of earmarked reserves were established during the Authority's 2009/2010 closedown exercise. A review of these reserves will be undertaken as part of the Authority's 2010/2011 closedown of accounts process.

Based on known circumstances and financial risk assessment, it is felt that adequate earmarked reserves and provisions have been created to meet legal and expected liabilities. A list of the reserves as at 31st March 2010 is included in Appendix I.

10.6 In recommending an adequate level of reserves, the Treasurer considers and monitors the opportunity costs of maintaining particular levels of reserves and balances and compares these to the benefits accrued from having such reserves. The opportunity cost of maintaining a specific level of reserves is the 'lost' opportunity, for example, of investing elsewhere to generate additional investment income or using the funds to invest in service improvements. In assessing this, it is important to consider that reserves can only be used once and are therefore potentially only 'one-off' sources of funding.

Therefore any use of general reserves above the lower minimum threshold is only ever used on one-off items of expenditure. The level of reserves is also determined by use of a comprehensive risk assessment to ensure they represent an appropriately robust ‘safety net’ which adequately protects against potential unbudgeted costs.

10.7 The current level of reserves is considered to be sufficient in all but the most unusual and serious combination of possible events. In this context it is considered that the current level of reserves presents an optimum balance between risk management and opportunity cost. This maintains a suitable and sustainable level of reserves, which include ensuring sound governance and financial stability in the short and longer term.

10.8 Best endeavours have been made to ensure that the budget and reserves are adequate using the information available at this date. The budget has been constructed with a professional policy led medium term strategic framework using appropriate assumptions, linking investment and spending to key priorities and having undertaken a comprehensive assessment of risk.

11. EQUALITY AND DIVERSITY IMPLICATIONS

In preparing this report an initial Equality Impact Assessment is not required and has not been carried out because the matters contained in this report will not lead to and/or do not relate to a policy change.

12. LEGAL IMPLICATIONS

The course of action recommended in this report does not raise issues which should be drawn to the attention of the Authority's Monitoring Officer.

BACKGROUND PAPERS

CLG Communications
Policy Planning Forum 16th December 2010
District Leaders' Meeting 17th December 2010
Policy Planning Forum 24th January 2011
The Plan 2010 - 2013

VIJ RANDENIYA	S. KELLAS
CHIEF FIRE OFFICER	TREASURER

APPENDIX A

REVISED EXPENDITURE PROJECTION 2011/2012

	£m
Authority Meeting (15th February 2010)	120.300
Budget Reductions	
Salary Costs	-1.270
Borrowing Costs	-0.450
General Inflation	-0.100
Efficiencies	
Support Service Reviews	-2.850
Dual crewing - special appliances	-2.600
Efficiency Target	-0.570
Council Tax Freeze Grant	-0.958
TOTAL	111.502

APPENDIX B

SUMMARY OF 2010/2011 REVISED BUDGET AND 2011/2012 BUDGET

	Original Budget 2010/11	Revised Budget 2010/11	Original Budget 2011/12
Subjective Heading	£000s	£000s	£000s
Employees	99,563	94,034	94,573
Premises	6,250	5,782	5,612
Transport	2,156	2,099	2,099
Supplies & Services	8,432	8,819	7,658
Capital Financing	5,212	9,945	4,391
GROSS EXPENDITURE	121,613	120,679	114,333
Income	(2,414)	(2,752)	(3,805)
NET EXPENDITURE	119,199	117,927	110,528
Appropriations to/(from) Reserves	(119)	1,153	974
TOTAL BUDGET REQUIREMENT	**119,080**	**119,080**	**111,502**

APPENDIX C

SUMMARY OF 2011/2012 BUDGET IN BEST VALUE FORMAT

	Original Budget 2011/12
	£000s
Firefighting & Rescue Operations	109,784
Community Fire Safety	18,497
Corporate and Democratic Core	1,580
Emergency Planning & Civil Defence	315
NET COST OF SERVICES	130,176
Interest payable and similar charges	2,531
Pensions Interest Cost	56,096
Gain in relation to Government Grant payable to Pension Fund	(18,763)
Interest & Investment Income	(420)
NET OPERATING EXPENDITURE	169,620
Contribution from Reserves	(57,160)
Council Tax Freeze Grant	(958)
TOTAL BUDGET REQUIREMENT	**111,502**

APPENDIX D

CAPITAL PROGRAMME 2011/12 TO 2014/15

Scheme	Project Year In 2011/12	2011/12	2012/13	2013/14	2014/15
		£000's	£000's	£000's	£000's
COMMITTED SCHEMES					
Asbestos Removal	Ongoing	23	-	-	-
Solihull Refurbishment	3 of 3	34	-	-	-
Walsall Refurbishment	3 of 3	38	-	-	-
Thermal Image Cameras	4 of 4	201	-	-	-
Drill Towers/Training Facilities Upgrades	8 of 8	220	-	-	-
Boiler Replacement Programme	Ongoing	300	-	-	-
Vehicle Replacement Programme	Ongoing	2,809	2,490	2,500	1,500
GRAND TOTAL		**3,625**	**2,490**	**2,500**	**1,500**
RESOURCES AVAILABLE					
Supported Capital Expenditure		-	7,990	1,000	-
Prudential Borrowing		-	-	-	-
Capital Receipts		-	1,432	-	-
Capital Grants *		2,915	1,500	1,500	1,500
Earmarked Reserves/DRF		710	-	-	-
		3,625	**10,922**	**2,500**	**1,500**
SURPLUS (+)/DEFICIT (-)		**-**	**8,432**	**-**	**-**

* Provisional estimate for 2012/13 onwards pending publication of Fire Service Capital Grant allocations

APPENDIX E

TREASURY MANAGEMENT STRATEGY 2011/12 – 2013/14

1. The Treasury Management Service is an important part of the overall financial management of the Authority's affairs. The prudential indicators in Appendix F consider the affordability and impact of capital expenditure decisions, and set out the Authority's overall capital framework. The Treasury Service considers the effective funding of these decisions. Together they form part of the process which ensures the Authority meets its balanced budget requirement under the Local Government Finance Act 1992.

2. The Authority's Treasury activities undertaken by Sandwell MBC are strictly regulated by statutory requirements and a professional code of practice which has been adopted. (The CIPFA Code of Practice on Treasury Management – revised November 2009).

3. A key requirement of this Strategy report is to explain both the risks, and the management of the risks, associated with the Treasury Service.

4. This strategy covers:

   - the Authority's debt projections;
   - the Authority's limits on future debt levels;
   - the expected movement in interest rates;
   - the borrowing and investment strategies;
   - specific limits on treasury activities; and
   - Treasury performance indicators.

Debt Projections 2011/12 – 2013/14

5. The borrowing requirement comprises the expected movement in the Capital Financing Requirement (CFR) and any maturing debt which will need to be re-financed. Appendix F shows this effect on the Treasury position over the next four years. The expected maximum debt position during each year represents the Operational Boundary Prudential Indicator, and so may be different from the year end position.

Limits to Borrowing Activity

6. Within the prudential indicators there are a number of key indicators to ensure the Authority operates its activities within well defined limits.

7. For the first of these the Authority needs to ensure that its total borrowing net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2011/12 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

8. The Treasurer reports that the Authority complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

9. The Authorised Limit for External Debt – A further key prudential indicator represents a control on the overall level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the Authority. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

10. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all Local Authority plans, or those of a specific Authority, although no control has yet been exercised.

11. The Authority is asked to approve the Authorised Limit detailed in Appendix F.

12. Borrowing in advance of need – The Authority has some flexibility to borrow funds this year for use in future years. The Treasurer may do this under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. Whilst the Treasurer will adopt a cautious approach to any such borrowing, where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities. Borrowing in advance will be made within the constraints that it will be limited to no more than 20% of the expected increase in borrowing need (CFR) over the three year planning period and risks associated with any advance borrowing activity will be subject to appraisal in advance.

Expected Movement in Interest Rates
Medium Term Rate Estimates (averages)

Annual Average %	Bank Rate	Money Rates		PWLB Borrowing Rates		
		3 month	1 year	5 year	25 year	50 year
2010/11	0.5	0.7	1.5	2.6	4.6	4.7
2011/12	0.7	0.9	1.8	3.5	5.3	5.3
2012/13	1.7	1.9	2.8	4.0	5.4	5.4
2013/14	3.1	3.3	3.8	4.8	5.6	5.6
2014/15	4.0	4.2	4.5	5.6	5.6	5.8
2015/16	4.0	4.2	4.2	5.3	5.5	5.5

13. There is significant uncertainty with economic forecasts. Whilst short-term rates are expected to remain on hold through most of 2011, inflationary concerns are increasing. Inflation has been above the 2% target for so long the credibility of the MPC may become a greater focus. This will make the MPC's decisions during 2011 a difficult judgment; control inflation or continue to aid the recovery? The MPC will be particularly concerned that the public's inflation expectations could become unhinged. There is a risk that the MPC may feel they will need to take action earlier than Q4, i.e. Q3, in order to reinforce its credibility.

14. The recovery in the economy is well underway; however, the strong rates of growth we have seen are unlikely to be sustained. The Government's determination to cut the size of the public sector deficit will be a drag upon activity in the medium term. The void left by significant cuts in public spending will need to be filled by a number of alternatives – corporate investment, rising exports (assisted by the fall in the value of sterling) and consumers' expenditure. In terms of sheer magnitude, the latter is the most important and strong growth in this area is by no means certain. The combination of the desire to reduce the level of personal debt, lack of access to credit and continued job uncertainty is likely to weigh heavily upon spending. This will be amplified by fiscal policy tightening, in the Comprehensive Spending Review. Without growth in personal spending remaining robust, any recovery in the economy is set to be weak and protracted.

15. Fiscal support in the US through the extension of tax cuts and monetary support through the extension of quantitative easing (QEII, with the potential for further easing), has had an adverse effect on world bond markets. Following the recent sell off the outlook for long-term interest rates is favourable in the near term, but is set to deteriorate again in the latter part of 2011. The increase in yields will be suppressed by continued investor demand for safe haven instruments following the uncertainties and unfolding tensions within the entire Eurozone. In addition to this, the market has been underpinned by evidence of moderating activity in major economies and the coalition government's determination to deal with the parlous state of public

sector finances. These two factors will restrict any deterioration in longer term fixed interest rates in the near term.

16. However, while the UK's fiscal burden will almost certainly ease, it will be a lengthy process and deficits over the next two to three financial years will still require a very heavy programme of gilt issuance. The latest Bank Inflation Report suggests the market will not be able to rely upon Quantitative Easing indefinitely to alleviate this enormous burden.

17. Eventually, the absence of the Bank of England as a continued buyer of gilts will shift the balance between supply and demand in the gilt-edged market. Other investors will almost certainly require some incentive to continue buying government paper.

18. This incentive will take the form of higher yields. The longer end of the curve will suffer from the lack of support from the major savings institutions – pension funds and insurance companies - who will continue to favour other investment instruments as a source of value and performance.

19. Although the FSA has recently delayed implementation of their liquidity requirements, the regulator will still look to ensure banks have necessary short term liquidity. The front end of the curve will benefit from this and will ensure the steeply-positive incline of the yield curve remains intact.

Borrowing Strategy 2011/12 – 2013/14

20. The uncertainty over future interest rates increases the risks associated with treasury activity. As a result Sandwell MBC on behalf of the Authority will take a cautious approach to its treasury strategy.

21. Long term fixed interest rates are at risk of being higher over the medium term, and short term rates are expected to rise, although more modestly. 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 shorter term fixed rates may provide lower cost opportunities in the short/medium term.

22. With the likelihood of long term rates increasing, debt restructuring is likely to focus on switching from longer term fixed rates to cheaper shorter term debt, although the Treasurer and Treasury Consultants will monitor prevailing rates for any opportunities during the year.

23. Following the Comprehensive Spending Review the PWLB increased borrowing interest rates by approximately 1%, without changing debt redemption interest rates. This will make PWLB debt rescheduling more problematic in the future.

24. The option of postponing borrowing and running down investment balances will also be considered. This would reduce counterparty risk and hedge against the expected fall in investments returns.

Investment Strategy 2011/12 – 2013/14

25. **Key Objectives** – The Authority's investment strategy primary objectives are safeguarding the re-payment of the principal and interest of its investments on time first and ensuring adequate liquidity second – the investment return being a third objective. Following the economic background above, the current investment climate has one over-riding risk consideration that of counterparty security risk. As a result of these underlying concerns Treasury Officers are implementing an operational investment strategy which tightens the controls already in place in the approved investment strategy.

26. **Risk Benchmarking** – A development in the revised Codes and the CLG consultation paper is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are new requirements to the member reporting, although the application of these is more subjective in nature. Additional background in the approach taken is attached at Annex E2.

27. These benchmarks are simple targets (not limits) and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that Treasury Officers will monitor the current and trend position and amend the operational strategy depending on any changes.

28. Security – The Authority's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

- 0.03% historic risk of default when compared to the whole portfolio.

29. Liquidity – In respect of this area Sandwell MBC seeks to maintain:

- Bank overdraft – £2m
- Liquid short term deposits of at least £20m available with a week's notice.
- Weighted Average Life benchmark is expected to be 0.25 years, with a maximum of 1.0 years.

30. Yield – Local measures of yield benchmarks are:

- Investments – Internal returns above the 7 day LIBID rate

31. And in addition that the security benchmark for each individual year is:

	1 year	2 years	3 years	4 years	5 years
Maximum	**0.03**	**0.12**	**0.1**	**0.08**	**0.06**

Note: This benchmark is an average risk of default measure, and would not constitute an expectation of loss against a particular investment.

32. **Investment Counterparty Selection Criteria** – The primary principle governing the Authority's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Authority will ensure:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counter parties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections below.

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Authority's prudential indicators covering the maximum principal sums invested.

33. The Treasurer will maintain a counter party list in compliance with the following criteria and will revise the criteria and submit them to Authority for approval as necessary. This criteria is separate to that which chooses Specified and Non-Specified investments as it selects which counter parties the Authority will choose rather than defining what its investments are.

34. The rating criteria use the **lowest common denominator** method of selecting counterparties and applying limits. This means that the application of the Authority's minimum criteria will apply to the lowest available rating for any institution. For instance if an institution is rated by two agencies, one meets the Authority's criteria, the other does not, the institution will fall outside the lending criteria. This is in compliance with a CIPFA Treasury Management Panel recommendation in March 2009 and the CIPFA Treasury Management Code of Practice.

35. Credit rating information is supplied by Sandwell MBC's Treasury Consultants on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance a negative rating watch applying to a counterparty at the minimum Authority criteria will be suspended from use, with all others being reviewed in light of market conditions.

36. The criteria for providing a pool of high quality investment counterparties (both Specified and Non-Specified investments) is:

- **Banks 1** – the Authority will use banks which have at least the following Fitch, Moody's and Standard and Poor's ratings (where rated):

- Sovereign Rating – the Authority will only use organisations whereby the Sovereign Government has a minimum long term rating of AA+. This provides an additional filter to reduce the pool of counter parties to those domiciled in those countries considered to have an adequate state credit rating.
- Short Term – F1, P-1, A-1 respectively
- Long Term – A, A1 and A respectively
- Individual/Financial Strength – C (Fitch/Moody's only)
- Support – 3 (Fitch only)

- **Banks 2** – In addition, the Authority will use banks whose ratings fall below the criteria specified above if all of the following conditions are met:

  - (a) Wholesale deposits in the bank are covered by a government guarantee;
  - (b) The government providing the guarantee is rated "AAA" by all three major rating agencies (Fitch, Moody's and Standard & Poor's); and
  - (c) The Authority's investments with the bank are limited to amounts and maturities within the terms of the stipulated guarantee.

- **Banks 3** – the organisation is an Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008. This is a facility introduced by the HM Treasury to improve institutions ability to access liquidity. It allows eligible institutions to issue marketable securities with a HM Treasury guarantee. Whilst it does not provide a direct guarantee to Authority deposits, it does provide comfort that the institution has undergone checking to become an eligible institution and that it should have the capacity to access liquid funds if required. Organisations with the following ratings will be used:
  - Short Term – F1, P-1, A-1 respectively
  - Long Term – AA-, Aa3 and AA- respectively
  - Support – 1 (Fitch only)

  This criteria acknowledges the support provided by the HM Treasury scheme, and excludes the Individual/Financial Strength ratings, which have been the main cause of the reduction in available counter parties.

- **Banks 4** – The Authority's own banker if this falls below the above criteria

- Building Societies – the Authority will use all Societies, which meet the ratings for banks outlined above.

- Money Market Funds – AAA rated money market funds.

- UK Government (including gilts and the DMADF).

- Local Authorities, Parish Councils, etc.

- Supranational institutions

37. Due to the uncertainty in the financial markets it is recommended that the Investment Strategy is approved on a similar approach to previous years at Sandwell MBC, which will provide officers with the flexibility to deal with any unexpected occurrences. Officers will restrict the pool of available counter parties from this criteria to safer instruments and institutions. Currently this involves the use of the Debt Management Deposit Account Facility (DMADF), AAA rated Money Market Funds and institutions with higher credit ratings than those outlined in the investment strategy or which are provided support from the Government. Investments are being maintained short term to also improve the security of investments.

38. The time limits for institutions on the Counter party List are as follows (these will cover both Specified and Non-Specified Investments):

	Fitch	**Moody's**	**Standard & Poors**	**Money Limit**	**Time Limit**
Upper Limit Category	AA-	Aa3	AA-	£30m	3yrs
Middle Limit Category	A-	A3	A-	£10m	364 days
Other Institution Limits	-	-	-	£10m	364 days
DMADF				Unlimited	6 months

39. The proposed criteria for Specified and Non-Specified investments are shown in Annex E1 for approval.

40. In the normal course of the Authority's cash flow operations it is expected that both Specified and Non-Specified investments will be utilised for the control of liquidity as both categories allow for short term investments.

41. The use of longer term instruments (greater than one year from inception to repayment) will fall in the Non-Specified investment category. These instruments will only be used where the Authority's liquidity requirements are safeguarded.

42. **Economic Investment Considerations** – Expectations on shorter term interest rates, on which investment decisions are based, show likelihood of the current 0.5% Bank Rate remaining flat but with the possibility of a rise in mid-2011. The Authority's investment decisions are based on comparisons between the rises priced into market rates against the Authority's and Sandwell MBC's advisers own forecasts.

43. There is an operational difficulty arising from the current banking crisis. There is currently little value investing long term unless credit quality is reduced. Whilst some selective options do provide additional yield uncertainty over counterparty creditworthiness suggests shorter dated investments would provide better security.

44. The criteria for choosing counterparties set out above provide a sound approach to investment in “normal” market circumstances. Whilst members are asked to approve this base criteria above, under the exceptional current market conditions the Treasurer may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval. These restrictions will remain in place until the banking system returns to “normal” conditions. Similarly the time periods for investments will be restricted.

45. Examples of these restrictions would be the greater use of the Debt Management Deposit Account Facility (DMADF – a Government body which accepts local authority deposits), Money Market Funds, guaranteed deposit facilities and strongly rated institutions offered support by the UK Government. The credit criteria have been amended to reflect these facilities.

Treasury Management Limits on Activity

46. There are four further Treasury activity limits, which were previously prudential indicators. The purpose of these are to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However if these are set to be too restrictive they will impair the opportunities to reduce costs/improve performance. The indicators are:

- Upper limits on variable interest rate exposure – This identifies a maximum limit for variable interest rates based upon the debt position net of investments

- Upper limits on fixed interest rate exposure – Similar to the previous indicator this covers a maximum limit on fixed interest rates.

- Maturity structures of borrowing – These gross limits are set to reduce the Authority’s exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

- Total principal funds invested for greater than 364 days – These limits are set with regard to the Authority’s liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

47. The Authority is asked to approve the limits:

	2011/12	2012/13	2013/14
Interest rate Exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	160%	160%	160%
Limits on variable interest rates based on net debt	30%	30%	30%
Maximum principal sums invested > 364 days			
Principal sums invested > 364 days	£30m	£30m	£30m

Maturity Structure of fixed interest rate borrowing 2011/12		
	Lower	**Upper**
Under 12 months	0%	20%
12 months to 2 years	0%	20%
2 years to 5 years	0%	25%
5 years to 10 years	0%	50%
10 years and above	10%	90%

Performance Indicators

48. The Code of Practice on Treasury Management requires the Authority to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. Examples of performance indicators often used for the treasury function are:

- Debt – Borrowing – Average rate of borrowing for the year compared to average available
- Debt – Average rate movement year on year
- Investments – Internal returns above the 7 day LIBID rate

Treasury Management Advisers

49. Sandwell MBC uses Sector as its treasury management consultants. The company provides a range of services which include:

- Technical support on Treasury matters, capital finance issues and the drafting of Member reports;
- Economic and interest rate analysis;
- Debt services which includes advice on the timing of borrowing;
- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments;
- Credit ratings/market information service comprising the three main credit rating agencies;

50. Whilst the advisers provide support to the internal Treasury function, under current market rules and the CIPFA Code of Practice the final decision on treasury matters remains with the Treasurer. This service is subject to regular review.

Member and Officer Training

51. The increased Member consideration of Treasury management matters and the need to ensure officers dealing with Treasury management are trained and kept up to date requires a suitable training process for Members and officers. This Authority has addressed this important issue by providing training to the Audit and Performance Management Committee and also ensuring officers attend appropriate training courses and seminars.

TREASURY MANAGEMENT PRACTICE (TMP) 1 (5) – CREDIT AND COUNTER PARTY RISK MANAGEMENT

The CLG issued Investment Guidance in 2010 and this forms the structure of the Authority's policy below. These guidelines do not apply to either trust funds or pension funds, which are under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for Authorities to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Authority to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Authority has adopted the Code and will continue to apply its principles to all investment activity. In accordance with the Code, the Treasurer has produced its treasury management practices. This part, TMP 1(5), covering investment counterpart policy requires approval each year.

Annual Investment Strategy – The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for decision making on investments, particularly Non-Specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments the Authority will use. These are high security (i.e. high credit rating, although this is defined by the Authority, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-Specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

This strategy is to be approved by the Authority. The investment policy proposed for the Authority is:

Strategy Guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

Specified Investments – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Authority has the right to be repaid within 12 months if it wishes. These are low risk assets where the possibility of loss of principal or investment income is small.

These would include investments with:

1. The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).

2. Supranational bonds of less than one year's duration.

3. A local authority, parish council or community council.

4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency.

5. A body that has been awarded a high credit rating by a credit rating agency (such as a bank or building society).

6. A body, which has been provided with a government, issued guarantee for wholesale deposits within specific timeframes. Where these guarantees are in place and the government has an AAA sovereign long term rating these institutions will be included within the Council's criteria temporarily until such time as the ratings improve or the guarantees are withdrawn. Monies will only be deposited within the timeframe of the guarantee.

For category 5 this covers bodies with a minimum long term rating of A (or the equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies. Within these bodies, and in accordance with the Code, the Authority has set additional criteria to set the time and amount of monies which will be invested in these bodies. This criteria is as per the 'Investment Counter party and Liquidity Framework'.

Non-Specified Investments – Non-Specified investments are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below.

	Non-Specified Investment Category	**Limit (£ or %)**
a.	**Supranational Bonds greater than 1 year to maturity** **(a) Multilateral development bank bonds** – These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Investment Bank, etc.). **(b) A financial institution that is guaranteed by the United Kingdom Government** (e.g. The Guaranteed Export Finance Company {GEFCO}) The security of interest and principal on maturity is on a par with the Government and so very secure, and these bonds usually provide returns above equivalent gilt-edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	30%
b.	**Gilt edged securities** with a maturity of greater than one year. These	30%

	are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	
c.	Banks and building societies meeting the criteria for long term ratings of AA- or above.	3 years & £30m

The Monitoring of Investment Counter parties – The credit rating of counter parties will be monitored regularly. Sandwell MBC receives credit rating information from Sector on a daily basis, as and when ratings change, and counter parties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counter party failing to meet the criteria will be removed from the list immediately by the Treasurer, and if required new counter parties which meet the criteria will be added to the list.

Annex E2

SECURITY, LIQUIDITY AND YIELD BENCHMARKING

Benchmarking and Monitoring Security, Liquidity and Yield in the Investment Service – A proposed development for member reporting is the consideration and approval of security and liquidity benchmarks.

These benchmarks are targets and so may be breached from time to time. Any breach will be reported, with supporting reasons in the Annual Treasury Report.

Yield – These benchmarks are currently widely used to assess investment performance. Local measures of yield benchmarks are:

- Investments – Internal returns above the 7 day LIBID rate

Security and liquidity benchmarks are already intrinsic to the approved Treasury Strategy through the counterparty selection criteria and some of the prudential indicators. However they have not previously been separately and explicitly set out for Member consideration. Proposed benchmarks for the cash type investments are below and these will form the basis of future reporting in this area. In the other investment categories appropriate benchmarks will be used where available.

Liquidity – This is defined as “having adequate, though not excessive cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives” (CIPFA Treasury Management Code of Practice). In respect of this area Sandwell MBC seeks to maintain:

- Bank overdraft – £2m
- Liquid short term deposits of at least £20m available with a week’s notice.

The availability of liquidity and the term risk in the portfolio can be benchmarked by the monitoring of the Weighted Average Life (WAL) of the portfolio – shorter WAL would generally embody less risk. In this respect the proposed benchmark is to be used:

- WAL benchmark is expected to be 0.25 years, with a maximum of 1.0 years.

Security of the investments – In context of benchmarking, assessing security is a much more subjective area to assess. Security is currently evidenced by the application of minimum credit quality criteria to investment counterparties, primarily through the use of credit ratings supplied by the three main credit rating agencies (Fitch, Moody’s and Standard and Poors). Whilst this approach embodies security considerations, benchmarking levels of risk is more problematic. One method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the investment strategy.

The table beneath shows average defaults for differing periods of investment grade products for each Fitch long term rating category over the period 1990 to 2007.

Long term rating	1 year	2 years	3 years	4 years	5 years
AAA	0.00%	0.01%	0.05%	0.01%	0.17%
AA	0.03%	0.06%	0.08%	0.14%	0.20%
A	0.08%	0.22%	0.37%	0.52%	0.70%
BBB	0.24%	0.68%	1.19%	1.79%	2.42%

The Authority’s minimum long term rating criteria is currently “A”, meaning the average expectation of default for a one year investment in a counterparty with a “A” long term rating would be 0.08% of the total investment (e.g. for a £1m investment the average loss would be £800). This is only an average – any specific counterparty loss is likely to be higher – but these figures do act as a proxy benchmark for risk across the portfolio.

The Authority’s maximum security risk benchmark for the whole portfolio, when compared to these historic default tables, is:

- 0.03% historic risk of default when compared to the whole portfolio.

And in addition that the security benchmark for each individual year is:

	1 year	2 years	3 years	4 years	5 years
Maximum	0.03	0.12	0.1	0.08	0.06

These benchmarks are embodied in the criteria for selecting cash investment counterparties and these will be monitored and reported to Members in the Annual Treasury Report. As this data is collated, trends and analysis will be collected and reported. Where a counterparty is not credit rated a proxy rating will be applied.

APPENDIX F

PRUDENTIAL INDICATORS

1. The actual capital expenditure that was incurred in 2009/10 and the estimates of capital expenditure to be incurred for the current and future years that are recommended for approval are:

Capital Expenditure					
2009/10 £000 Actual	**2010/11 £000 Estimate**	**2011/12 £000 Estimate**	**2012/13 £000 Estimate**	**2013/14 £000 Estimate**	**2014/15 £000 Estimate**
6,654	5,365	3,625	10,922	2,500	1,500

2. Estimates of the ratio of financing costs to net revenue stream for the current and future years, and the actual figures for 2009/10 are:

Ratio of financing costs to net revenue stream					
2009/10 % Actual	**2010/11 % Estimate**	**2011/12 % Estimate**	**2012/13 % Estimate**	**2013/14 % Estimate**	**2014/15 % Estimate**
3.86	3.48	3.56	3.57	3.91	3.77

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

3. All borrowing forecasts contained within this report relate only to supported capital expenditure, which receives Government grant support. Consequently, the incremental impact of any borrowing arising from new capital investment decisions has been reflected within the overall budget projections, although the impact specifically on the level of precept cannot be quantified.

4. Estimates of the end of year capital financing requirement for the Authority for the current and future years and the actual financing requirements at 31 March 2010 are:

Capital financing requirement					
31/03/10 £000 Actual	**31/03/11 £000 Estimate**	**31/03/12 £000 Estimate**	**31/03/13 £000 Estimate**	**31/03/14 £000 Estimate**	**31/03/15 £000 Estimate**
48,202	46,000	46,000	51,000	51,000	51,000

5. The capital financing requirement measures the Authority's underlying need to borrow for a capital purpose. In accordance with best professional practice, West Midlands Fire & Rescue Authority does not associate borrowing with particular items or types of expenditure. The Authority relies upon Sandwell Metropolitan Borough Council to undertake its treasury management function, which has an integrated treasury management strategy and has adopted the CIPFA Code of Practice for Treasury Management in the Public Service. West Midlands Fire Service has, at any point in time, a number of cashflows both positive and negative, and Sandwell Metropolitan Borough Council 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.

6. 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 next two financial years."

   The Treasurer reports that the Authority had no difficulty meeting this requirement in 2009/10, nor are 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.

7. In respect of its external debt, it is recommended that the 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.

Authorised limit for external debt				
2010/11 £000	**2011/12 £000**	**2012/13 £000**	**2013/14 £000**	**2014/15 £000**
56,000	56,000	62,000	62,000	62,000

8. 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 Sandwell Metropolitan Borough Council's approved treasury management policy statement and practices. The Treasurer confirms that they are based on the estimate of most likely, prudent but not worst 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.

9. The 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 Treasurers estimate of the most likely, prudent but not worst case scenario, without the additional headroom included within the authorised limit to allow for example for unusual cash movement, 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.

Operational boundary for external debt				
2010/11 £000	**2011/12 £000**	**2012/13 £000**	**2013/14 £000**	**2014/15 £000**
51,000	51,000	57,000	57,000	57,000

10. The Authority's actual long term borrowing at 31 March 2010 was £47m. It should be noted that actual long term liabilities is not directly comparable to the authorised limit and operational boundary, since the actual long term liabilities reflects the position at one point in time.

11. In taking its decisions on this budget report, the Authority is asked to note that the authorised limit determined for 2010/11 (see paragraph 7 above) will be the statutory limit determined under section 3(1) of the Local Government Act 2003.

Minimum Revenue Provision (MRP) Statement

12. The Authority is required to pay off an element of the accumulated General Fund capital spend each year through a revenue charge (the Minimum Revenue Provision - MRP), although it is also allowed to undertake additional voluntary payments (VRP).

13. CLG Regulations have been issued which require the Authority to approve an MRP Statement in advance of each year. A variety of options are provided to replace the existing Regulations, so long as there is a prudent provision. The Authority is recommended to approve the following MRP Statement:

14. For capital expenditure incurred before 1 April 2008 or which in the future is Supported Capital Expenditure, the MRP policy will be:

- **Existing practice** - MRP will follow the existing practice outlined in former CLG Regulations (Option 1);

15. From 1 April 2008 for all unsupported borrowing the MRP policy will be:

- **Asset Life Method** – MRP will be based on the estimated life of the assets, in accordance with the proposed regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (Option 3);

APPENDIX G

SCENARIO ANALYSIS

The Comprehensive Spending Review (CSR) announcement on the 20th October 2010 indicated that there would be a 25% reduction in grant funding for the National Fire Service over the 4 years of the CSR period (2011/2012 to 2014/2015) and that this reduction would be rear loaded.

The provisional finance settlement announced on the 13th December 2010 and confirmed on 31st January 2011 results in a national reduction in grant of 6.5% in the first 2 years of the CSR period (2011/2012 and 2012/2013). There was no indication of the scale and phasing of any further reductions in years 3 and 4 of the CSR period (2013/2014 and 2014/2015). This makes long term planning for the service extremely difficult and uncertain because there are so many different funding scenarios that could be considered. In terms of assessing the likely further reduction in national fire service grant, there are two basic views that could be taken:

(a) that the 25% reduction in grant funding is a cash reduction. If this is the case, given that the cash reduction in years 1 and 2 at a national level equates to 6.5%, there is still a further 18.5% cash reduction to come by 2014/15.

(b) that the 25% reduction in grant funding is a real term reduction, which would equate to an 18.5% cash reduction by 2014/2015. If this is the case, given that the cash reduction in years 1 and 2 at a national level equates to 6.5%, there is still a further 12% cash reduction to come by 2014/15.

Furthermore, given that this Fire Authority was allocated a grant reduction of almost double that of the national reduction for 2011/2012 & 2012/2013, if that trend were to continue into years 3 and 4, the reduction for this Authority would be a further 37% if the CSR announcement was based on a cash reduction or 24% if the CSR announcement was based on a real terms reduction.

Using the above data, 4 basic scenarios are highlighted to show what the scale of grant reduction could be for this Fire Authority.

Finance Settlement for 2011/12 & 2012/13

Financial Year	Actual Formula Grant	% Reduction	£ Reduction
2010/11	80,813,000		
2011/12	73,136,000	-9.50%	-7,677,000
2012/13	70,649,000	-3.40%	-2,487,000

Scenarios for a further reduction in 2013/14 & 2014/15 (Years 3 & 4)
Based on the Settlement for 2010/11

	2010/11 Formula Grant	% Reduction	£ Reduction
	80,813,000	-12.00%	-9,697,560
	80,813,000	-18.50%	-14,950,405
	80,813,000	-24.00%	-19,395,120
	80,813,000	-37.00%	-29,900,810

Despite the above, because no clarity at all was given in the Finance Settlement as to what the reductions and phasing of reductions would be in years 3 and 4, it is not possible to say with any certainty what level of grant reduction will apply to this Fire Authority and it is likely to be several months before this clarity is provided. However, what is clear from the CSR announcement is that funding reductions in years 3 and 4 will be more significant than years 1 and 2. From the above table, when considering any of the options shown, there would be major issues for years 3 and 4 that would require either a substantial increase in council tax to compensate for the reduced grant funding and/or significant reductions in service which could not be achieved purely through natural staff turnover.

APPENDIX H1

WEST MIDLANDS FIRE AND RESCUE AUTHORITY

BUDGET FORECAST 2012/2013 TO 2014/2015

	Budget 2012/13	**Budget 2013/14**	**Budget 2014/15**
Subjective Heading	**£000s**	**£000s**	**£000s**
Employees	95,900	96,300	97,500
Premises	5,700	5,800	6,000
Transport	2,100	2,200	2,200
Supplies & Services	7,800	7,900	8,100
Capital Financing	4,400	4,800	4,700
GROSS EXPENDITURE	115,900	117,000	118,500
Income	(3,850)	(3,850)	(3,850)
NET EXPENDITURE	112,050	113,150	114,650
Appropriations to/(from) Reserves	100	100	100
TOTAL BUDGET REQUIREMENT *	**112,150**	**113,250**	**114,750**

* Budget forecast for 2013/2014 and 2014/2015 assumes the same level of grant funding as 2012/2013 and therefore before further reductions.

APPENDIX H2

INFLATION ASSUMPTIONS

Pay Awards:		%
- Uniformed Staff		
	July 11	0.0
	July 12	0.0
	July 13	1.0
	July 14	1.0
- Non-Uniformed Staff		
	April 11	0.0
	April 12	0.0
	April 13	1.0
	April 14	1.0
General Prices:		
	April 11	1.0
	April 12	2.0
	April 13	2.0
	April 14	2.0
Pensions Increase Order:		
	April 11	3.1
	April 12	2.0
	April 13	2.0
	April 14	2.0
Residential Rents:		
	April 11	4.8
	April 12	2.0
	April 13	2.0
	April 14	2.0

APPENDIX H3

SENSITIVITY ANALYSIS

The approximate annual impact of a 1% variation in some of the key assumptions underpinning the budget projections is shown below:

Expenditure		
Uniformed pay awards	£775k	(£580k part year)
Non-uniformed pay award	£150k	
Employers Firefighters Pension Contribution	£535k	
Interest payable	£405k	
General inflation	£130k	
Energy costs	£ 12k	
Fuel	£ 9k	
Income		
Government Grant	£730k	
Council Tax	£380k	
Interest receivable	£230k	

APPENDIX I

EARMARKED RESERVES AS AT 31ST MARCH 2010

	£000s
Insurance	8,226
Capital Works	2,680
Budget Carry Forwards	573
Station Works	343
Firefighting and Rescue Equipment	254
Project Management	180
Training & Development	135
System Enhancements/Upgrades	130
LAA Match Funding	125
Fire Prevention & Education	102
Fire Control Support	39
Total	**12,787**

General Reserves (3.9% of overall budget)	**4,690**