Agenda Item No.

WEST MIDLANDS FIRE AND RESCUE AUTHORITY

15 FEBRUARY 2010

1. BUDGET AND PRECEPT 2010/2011

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 2010/2011 of £119.080m as set out in Appendix B.

1.1.2 The Authority's capital programme for 2010/2011, 2011/2012 and 2012/2013 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

1.1.4 The Authority's Forward Looking 2010/2011 Efficiency Statement, the basis of which is set out in Appendix I.

1.2 THAT it be noted that the constituent District Councils have formally set their Council Tax bases for the year 2010/2011 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	298,709.00
Coventry	88,578.00
Dudley	97,631.53
Sandwell	85,255.70
Solihull	79,518.00
Walsall	78,143.38
Wolverhampton	70,973.60
	798,809.21

1.3 THAT the following amounts be now calculated by the Authority for the year 2010/2011 in accordance with Sections 43 to 48 of the Local Government Finance Act 1992:

1.3.1	£121,863,000	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	£2,783,000	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	£119,080,000	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	£80,813,000	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 2009/2010.
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	31.887464	31.89
B	37.202041	37.20
C	42.516619	42.52
D	47.831196	47.83
E	58.460351	58.46
F	69.089505	69.09
G	79.718660	79.72
H	95.662392	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	14,287,609
Coventry City Council	4,236,792
Dudley Metropolitan Borough Council	4,669,833
Sandwell Metropolitan Borough Council	4,077,882
Solihull Metropolitan Borough Council	3,803,441
Walsall Metropolitan Borough Council	3,737,691
Wolverhampton City Council	3,394,752
Total	38,208,000

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 2010/2011, 2011/2012 and 2012/2013, the prudential indicators relating to the Authority's capital financing requirements, the Treasury Management Strategy, the Revenue Budget and Forward Looking Efficiency Statement for 2010/2011 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 2010/2013 Plan, a draft of which was presented to Members at the Policy Planning Seminar on 14th December 2009.

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 between 15th December 2009 and 31st January 2010 to seek views and opinions with regards to the proposed service priorities and associated budget requirements. This exercise included a number of public meetings at which presentations were made to ensure a more thorough awareness of the current and proposed activity of the Service and the budget proposals for 2010/2011.

3.3 The feedback from the meetings was that the activities of the Fire Service were highly valued. The priorities as set out in the public consultation document were supported and there were no suggestions to alter the proposed budget, although concerns were expressed about the potential future funding reductions and the impact this would have on service delivery.

3.4 The 2010/2013 Plan will need to be reviewed throughout 2010/2011, not only to ensure that the priorities and objectives for that year are achieved but to consider which service areas will need to be reduced or stopped from 2011/2012 onwards, given the anticipated funding reductions in that financial year.

3.5 On 26th November 2009, the Minister of State for Local Government confirmed the third of a three year settlement for Local Government covering 2008/09, 2009/10 and 2010/11 which had been announced on 6th December 2007. On 20th January 2010, Communities and Local Government (CLG) confirmed the Authority's 2010/2011 grant figure.

3.6 The updated Fire Service budget position was presented to the West Midlands District Leaders on 18th December 2009. Leaders paid tribute to the provision of the service provided by the Authority. They also asked if consideration could be given to setting a precept increase of less than 2%.

3.7 At its meeting on 25th January 2010, the Policy Planning Forum considered the draft revenue budget for 2010/2011. Appendix A summarises how the budget has been determined following a number of adjustments from last year's budget projection.

3.8 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.

3.9 During the financial year 2009/10 the organisation significantly reduced and restricted recruitment activity in line with its approach to workforce planning and budgetary management. As part of the implementation of the permanent late shift a workforce plan was devised and used to determine the levels of recruitment necessary in order to implement a sustainable new shift system and deliver efficiencies.

3.10 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 2011/12 has been further clarified.

3.11 To further support this level of workforce planning, revised budgeting arrangements (zero based budgeting) have been put in place in relation to the funding of learning and development activities.

3.12 Details of the draft base budget are set out in Appendix B, together with revisions to the current year's budget (the 2010/2011 budget is replicated for information in the Best Value Accounting Code of Practice format in Appendix C).

4. PRECEPT 2010/2011

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 798,809.21.

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 2010/2011 is £47.83, an increase of £0.93 (1.99%) over 2009/2010.

5. FUNDING OF EXPENDITURE 2010/2011

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

	£'000
Formula Grant	80,813
Share of Collection Fund Deficit	59
Council Tax (met by Districts)	38,208
	119,080

6. GENERAL BALANCES POSITION

6.1 Based on the current forecast of net expenditure in 2009/2010, the Authority's estimated available General Balances at 1st April 2010 are £4.45 million. At this level, the amount of General Balances would equate to approximately 3.7% of the Authority's budget.

6.2 The actual level of General Balances at 1st April 2010 will not be determined until the completion of the Authority's 2009/2010 closedown of accounts process.

7. CAPITAL PROGRAMME

7.1 At the Authority meeting on 9th February 2009, 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
2010/2011	6.718
2011/2012	3.309
2012/2013	2.790

The full list of projects is shown on Appendix D.

7.3 This Authority was notified by the CLG on 7th December 2007 that its Supported Capital Expenditure Allocations would be £4.559m for 2010/11. It has been anticipated that allocations will reduce in future years due to projected reductions in public sector expenditure and an estimate of £3m has been assumed for 2011/12 and 2012/13.

7.4 As part of the 2008/2009 settlement, Ministers agreed to provide Fire and Rescue Authorities (FRAs) with capital grant totalling £34m and £44m in years 2009/10 and 2010/11. This was to assist FRAs with their capital asset needs. On 15th December 2009 CLG announced details of individual Authority allocations of FRS Capital Grant. The allocation for this Authority is £1.599m in 2010/2011.

7.5 A forecast of resources covering the period 2010/2011 to 2012/2013 is shown below:

	2010/2011 £m	2011/2012 £m	2012/2013 £m
Supported Cap Expend	4.559	3.000	3.000
Capital Receipts	2.382	0.309	
Capital Grants	1.599	-	-
Revenue Funding	3.560	-	-
	12.100	3.309	3.000

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:

	2010/2011 £m	2011/2012 £m	2012/2013 £m
Projected Resources	12.100	3.309	3.000
Less: Commitments	6.718	3.309	2.790
Funding Surplus	5.382	0	0.210

The current surplus is required to enable consideration of issues arising from the 2009/2010 Service Plan. Because of the overall resource position of the capital programme and the potential scale of expenditure arising out of the new fire stations approved as part of the 2009/2010 Service Plan, no new capital schemes are proposed for 2010/2011.

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 cannot be delivered cost effectively in house.

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 2010/2011 – 2012/2013 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. <u>PLANNING FOR THE 2011/2012 AND 2012/2013 BUDGET</u>

9.1 In preparing the draft revenue budget for 2010/2011, an expenditure forecast for 2011/2012 and 2012/2013 has also been undertaken by 'rolling forward' the 2010/2011 draft budget; updating for anticipated inflation and pay awards, adding in commitments, etc.

9.2 The forecast does not include any new efficiencies which may be achieved through the Modernisation Agenda nor allow for any essential developments and any other new requirements the Authority may need to respond to. In addition, during 2010/2011 and throughout the remainder of the Medium Term Financial Plan, key national issues such as Regional Control Centres and Firelink will continue to accelerate in pace. Provisional transitional costs associated with Regional Control Centres have been identified and are expected to be met by 'New Burden' Government funding. However, the implications for the Authority arising from these projects, together with other national issues such as the ongoing arrangements for new Dimensions assets and staff costs, will need to be continually assessed to ensure appropriate funding is identified to meet any emerging costs.

A forecast of the likely level of resources assuming a cash standstill grant based on 2010/2011 indicated levels would result in the following position for 2011/2012 and 2012/2013:

	2011/2012	**2012/2013**
	£m	£m
Budget requirement	120.250	121.550
Resources		
- Grant	80.813	80.813
- Precept	39.437	40.737
Supportable expenditure	120.250	121.550
Precept Increase	3.2%	3.3%
Band D Increase (per annum)	£1.54	£1.63

9.3 However, due to restrictions in public sector expenditure it is anticipated that there is likely to be reductions in Government grants and so a number of scenario's 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. FORWARD LOOKING 2010/2011 EFFICIENCY STATEMENT

10.1 An efficiency target of £110m (equivalent to 1.6% per annum) over the three years of the 2007 Comprehensive Spending Review has been set for the Fire and Rescue Service. The 2010/2011 data has been produced on the current reporting basis and is shown on Appendix I.

10.2 As part of the budget setting process, work has been undertaken by Corporate Board and senior managers, supported by the Strategic Planning Improvement and Risk Team (SPIRiT), to identify full year back-office efficiency savings of £1m during 2010/2011. This level of indicated efficiencies was presented to Members at the Policy Planning Seminar on 9th November 2009. Further year on year target efficiency savings of £1m were reflected in the budget presentations to Members at the Policy Planning Seminars on 14th December 2009 and 25th January 2010.

10.3 In order to deliver the efficiency savings identified in 10.2, a new Organisational Efficiency Programme has been developed in order to ensure delivery of more efficient back-office services to ensure the targeted savings are achieved in 2010/2011. The Organisational Efficiency Programme will also consider and formulate those activities and service areas where further savings can be made in future years.

10.4 As part of the Authority's corporate strategy work and the budget setting process it has been recognised that by 2011/12, there are likely to be (potentially significant) reductions in Government grant funding. The budget work undertaken to date indicates that despite a year on year efficiency savings target of £1m (and efficiency savings of £7.7m achieved as part of the National Fire Service efficiency target of £105m by 2007/2008), **there is an anticipated funding shortfall in 2011/12**. The scale of the funding reduction is not likely to be known until after the General Election but will be an issue requiring consideration as part of future corporate strategy proposals in terms of the services and activities undertaken. In addition, the Organisational Efficiency Programme will also need to formulate the specific options which will need to be considered by the Fire Authority during 2010/2011 in order to ensure the Service's expenditure is in line with available funding from 2011/2012 onwards.

11. ROBUSTNESS OF THE BUDGET PREPARATION AND ADEQUACY OF RESERVES

11.1 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.

11.2 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.

11.3 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.

11.4 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 2009/2010 is forecast to be £4.45m and this is approximately 3.7% of the net budget requirement.

11.5 It was deemed that a prudent level of earmarked reserves were established during the Authority's 2008/2009 closedown exercise. A review of these reserves will be undertaken as part of the Authority's 2009/2010 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 2009 is included in Appendix J.

11.6 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.

11.7 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.

11.8 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.

12. <u>EQUALITY AND DIVERSITY IMPLICATIONS</u>

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.

13. <u>LEGAL IMPLICATIONS</u>

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 14th December 2009
District Leaders' Meeting 18th December 2009
Policy Planning Forum 25th January 2010

VIJ RANDENIYA	S. KELLAS
CHIEF FIRE OFFICER	TREASURER

Ref: AU/80801106

APPENDIX A

REVISED EXPENDITURE PROJECTION 2010/2011

	£m
Authority Meeting (9th February 2009)	119.300
Budget Increases	
Interest	0.400
Income	0.300
Other	0.080
Budget Reductions	
Salary Costs	-0.200
Efficiencies	
Support Services	-0.500
Shift adjustments	-0.300
TOTAL	119.080

Ref: AU/80801106

APPENDIX B

SUMMARY OF 2009/2010 REVISED BUDGET AND 2010/2011 BUDGET

	Original Budget 2009/10	Revised Budget 2009/10	Original Budget 2010/11
Subjective Heading	£000s	£000s	£000s
Employees	99,104	97,767	99,563
Premises	5,497	6,135	6,250
Transport	2,065	2,102	2,156
Supplies & Services	8,437	9,241	8,432
Capital Financing	5,105	9,409	5,212
GROSS EXPENDITURE	120,208	124,654	121,613
Income	(3,054)	(2,352)	(2,414)
NET EXPENDITURE	117,154	122,302	119,199
Appropriations to/(from) Reserves	(169)	(5,317)	(119)
TOTAL BUDGET REQUIREMENT	**116,985**	**116,985**	**119,080**

APPENDIX C

SUMMARY OF 2010/2011 BUDGET IN BEST VALUE FORMAT

	Original Budget 2010/11
	£000s
Firefighting & Rescue Operations	105,070
Community Fire Safety	19,030
Corporate and Democratic Core	1,783
Emergency Planning & Civil Defence	422
NET COST OF SERVICES	126,305
Interest payable and similar charges	3,214
Pensions Interest Cost	71,500
Gain in relation to Government Grant payable to Pension Fund	(21,140)
Interest & Investment Income	(240)
NET OPERATING EXPENDITURE	179,639
Contribution from Reserves	(60,559)
TOTAL BUDGET REQUIREMENT	**119,080**

APPENDIX D

CAPITAL PROGRAMME 2010/11 TO 2012/13

Scheme	Project Year In 2010/11	2010/11	2011/12	2012/13
		£000's	£000's	£000's
COMMITTED SCHEMES				
Solihull Refurbishment	2 of 3	1,647	100	-
Walsall Refurbishment	2 of 3	1,679	100	-
Drill Towers/Training Facilities Upgrades	2 of 2	220	-	-
Boiler Replacement Programme	2 of 4	140	300	300
Vehicle Replacement Programme 2010/2011 and 2011/2012	Ongoing	3,032	2,809	
Total Commitments		**6,718**	**3,309**	**300**
NEW STARTS				
Vehicle Replacement Programme 2012/2013	Ongoing	-	-	2,490
Total New Starts		**-**	**-**	**2,490**
GRAND TOTAL		**6,718**	**3,309**	**2,790**
RESOURCES AVAILABLE				
Supported Capital Expenditure		4,559	3,000	3,000
Capital Receipts		2,382	309	-
Capital Grants		1,599	-	-
Earmarked Reserves/DRF		3,560	-	-
		12,100	**3,309**	**3,000**
SURPLUS		**5,382**	**0**	**210**

APPENDIX E

TREASURY MANAGEMENT STRATEGY 2010/11 – 2012/13

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 2010/11 – 2012/13

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 three 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 2010/11 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 Rates*		
		3 month	1 year	5 year	20 year	50 year
2008/09	3.9	5.0	5.3	4.2	4.8	4.5
2009/10	0.5	0.8	1.4	3.2	4.4	4.6
2010/11	1.0	1.5	2.3	4.0	5.0	5.2
2011/12	2.0	2.5	3.3	4.3	5.3	5.3
2012/13	4.5	4.8	5.3	5.3	5.5	5.3

* Borrowing Rates

13. Short term rates are expected to remain on hold for a considerable time. The recovery in the economy has commenced but it is fragile and so there are still some uncertainties concerning interest rates during 2010/2011.

14. Credit extension to the corporate and personal sectors has improved modestly but banks remain nervous about the viability of counterparties. This is likely to remain a drag upon activity prospects, as will the lacklustre growth of broad money supply.

15. The main drag upon the economy is expected to be weak consumers' expenditure growth. The combination of the desire to reduce the level of personal debt and job uncertainty is likely to weigh heavily upon spending. This will be amplified by the prospective increases in taxation already scheduled for 2010 – VAT. Without a rebound in this key element of UK GDP growth, any recovery in the economy is set to be weak and protracted.

16. The MPC will continue to promote easy credit conditions via quantitative monetary measures. Quantative Easing has been extended to a total of £200bn and there is still an outside chance that it could be expanded further in February. Whether this has much impact in the near term remains a moot point given the personal sector's reluctance to take on more debt and add to its already unhealthy balance sheet.

17. With inflation set to remain subdued in the next few years (though a sharp blip is forecast for the next few months), the pressure upon the MPC to hike rates will remain moderate. But some increase will be seen as necessary in 2010 to counter the effects of external cost pressures.

18. The outlook for long term fixed interest rates is a lot less favourable. While the UK's fiscal burden should ease in the future, this will be a lengthy process and deficits over the next two to three financial years will require a very heavy programme of gilt issuance. The market will no longer be able to rely upon Quantitative Easing to alleviate this enormous burden.

19. The programme might well end in February, especially if the economy has returned to a recovery path as seems very likely. With growth back on the agenda and inflation challenging the upper limit of the Government's target range, the majority of MPC members may feel enough assistance has been given to ensure lack of credit is no longer a fundamental threat to the welfare of the economy.

20. The absence of the Bank of England as the largest 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.

21. This incentive will take the form of higher interest rates. The longer fixed interest rates 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. The shorter fixed interest rates will be pressured higher by the impact of rising money market rates.

Borrowing Strategy 2010/11 – 2012/13

22. 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.

23. 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.

24. 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.

25. 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 2010/11 – 2012/13

26. **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.

27. **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.

28. 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.

29. 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.

30. 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.

31. Yield – Local measures of yield benchmarks are:

- Investments – Internal returns above the 7 day LIBID rate

32. 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.

33. **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.

34. 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.

35. 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.

36. 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.

37. 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

38. 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.

39. 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

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

41. 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.

42. 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.

43. **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-2010. 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.

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:

£m	**2010/11**	**2011/12**	**2012/13**
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 2010/11			
	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 Butlers 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 Sandwell MBC. 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. It is proposed for a Treasury Management Workshop to take place in the financial year for the Audit Committee.

Annex E1

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

The Office of the Deputy Prime Minister (now CLG) issued Investment Guidance on 12th March 2004, 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. The Council receives credit rating information from Butlers 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.

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 Council's 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%	0.00%	0.00%	0.00%	0.00%
AA	0.00%	0.00%	0.00%	0.03%	0.06%
A	0.03%	0.15%	0.30%	0.44%	0.65%
BBB	0.24%	0.78%	1.48%	2.24%	3.11%

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 0.03% of the total investment (e.g. for a £1m investment the average loss would be £300). 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 Investment Annual 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 2008/09 and the estimates of capital expenditure to be incurred for the current and future years that are recommended for approval are:

Capital Expenditure				
2008/09 £000 Actual	**2009/10 £000 Estimate**	**2010/11 £000 Estimate**	**2011/12 £000 Estimate**	**2012/13 £000 Estimate**
9.799	7.660	6.718	3.309	2.790

2. Estimates of the ratio of financing costs to net revenue stream for the current and future years, and the actual figures for 2008/09 are:

Ratio of financing costs to net revenue stream				
2008/09 % Actual	**2009/10 % Estimate**	**2010/11 % Estimate**	**2011/12 % Estimate**	**2012/13 % Estimate**
2.62	3.39	4.21	4.36	4.45

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 2009 are:

Capital financing requirement				
31/03/09 £000 Actual	**31/03/10 £000 Estimate**	**31/03/11 £000 Estimate**	**31/03/12 £000 Estimate**	**31/03/13 £000 Estimate**
50,113	53,000	55,000	56,000	57,000

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 2008/09, 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			
	2009/10 £000	**2010/11 £000**	**2011/12 £000**	**2012/13 £000**
	64,000	66,000	68,000	69,000

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			
	2009/10 £000	**2010/11 £000**	**2011/12 £000**	**2012/13 £000**
	59,000	61,000	62,000	63,000

10. The Authority's actual long term borrowing at 31st March 2009 was £49m. 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 2009/10 (see paragraph 7 above) will be the statutory limit determined under section 3(1) of the Local Government Act 2003.

APPENDIX G

SCENARIO ANALYSIS

Financial year 2010/2011 is the final year of the Government's three year finance settlement. Three year finance settlements were introduced to coincide with Comprehensive Service Reviews and to give some predictability to Local Authorities to plan with more certainty over the short/medium term. The next Comprehensive Spending Review, covering the period 2011/2012 to 2013/2014 was due to take place during 2009. The work for this exercise has not been completed and so no indication has been given at this stage of central Government Grant funding levels beyond 2010/2011.

The last year has seen the country enter a significant economic recession. The consequence locally is an increasing demand for public services and the likelihood of reduced levels of central Government Grant funding.

Given the above two issues, there is uncertainty about the likely funding position for the West Midlands Fire and Rescue Authority over the next 3 year period, although it is anticipated that there are likely to be central Government Grant funding reductions. Given the level of uncertainty, various scenarios have been reflected in Policy Planning presentations on 14th December 2009 and 25th January 2010. This Appendix considers further scenarios, primarily focusing on the sensitivity items reflected in Appendix H3.

The sensitivity analysis on Appendix H3 highlights that the two items with the biggest impact on the Fire Authority's budget are; central Government grant funding and pay awards. Part of the budget presentation at the Policy Planning seminar on the 14th December 2009 focused on the potential impact of grant funding, given the anticipated reductions in public sector expenditure. Options were considered from a cash stand still grant to a grant reduction of 5%. The various scenarios are shown below:

3 Year Budget Forecast 2010/11 – 2012/13 1.99% Precept Increase 2010/2011, 2.5% Increase 2011/2012 & 2012/2013. Grant Standstill/Reductions from 2011/2012			
	2010/2011 £000	**2011/2012 £000**	**2012/2013 £000**
Efficiency Savings Target	-800	-1,000	-1,000
Forecast revenue budget	119,080	120,250	121,550
Revenue support grant	-80,800	-80,800	-80,800
Precept income	-38,280	-39,150	-40,100
Shortfall	0	**300**	**650**
1% annual grant reduction		800	1,600
Budget Shortfall		**1,100**	**2,250**
3% annual grant reduction		2,400	4,800
Budget Shortfall		**2,700**	**5,450**
5% annual grant reduction		4,000	8,000
Budget Shortfall		**4,300**	**8,650**

As indicated earlier in this Appendix, in terms of sensitivity analysis, pay award assumptions are the most significant expenditure item within the Authority's budget. The assumption over the Medium Term Financial Plan is for a 1% pay award in each of the 3 years (other than for Principal Officer's which assume 0% in 2010/2011). A 1% pay award assumption is in line with the pre budget report (9th December 2009) which indicated a Public Sector pay cap of 1% from 2011.

Given that pay ceilings of 1% will apply from 2011, the volatility in terms of scenarios relating to pay awards is limited to pay freezes (although pay reductions should not be totally ruled out). As a consequence, taking the grant scenarios reflected earlier in this Appendix, the budget shortfalls indicated by that exercise would be less if there was a public sector pay freeze, as apposed to a pay cap, from 2011. The impact of a public sector pay freeze on the Authority's forecast revenue budget and subsequent budget shortfall across the range of percentage Government Grant reductions is shown below:

3 Year Budget Forecast 2010/11 – 2012/13 1.99% Precept Increase 2010/2011, 2.5% Increase 2011/2012 & 2012/2013. Grant Standstill/Reductions from 2011/2012			
	2010/2011 £000	**2011/2012 £000**	**2012/2013 £000**
Efficiency Savings Target	-800	-1,000	-1,000
Forecast revenue budget	119,080	119,520	119,890
Revenue support grant	-80,800	-80,800	-80,800
Precept income	-38,280	-39,150	-40,100
Shortfall/-Surplus	0	-430	-1,010
1% annual grant reduction		800	1,600
Budget Shortfall		**370**	**590**
3% annual grant reduction		2,400	4,800
Budget Shortfall		**1,970**	**3,790**
5% annual grant reduction		4,000	8,000
Budget Shortfall		**3,570**	**6,990**

The other annual expenditure assumption that needs to be considered as part of the budget setting process relates to general inflation. The Authority's Medium Term Financial Plan has assumed 2% inflation in each of the next 3 years. Given that the largest element of expenditure for the Authority is employees, the impact of general inflation assumptions is less significant than pay award assumptions but none the less, if general inflation was assumed to be zero % or if the impact on the Authority from general inflation could be absorbed within existing resources, the budget shortfalls would reduce compared to the figures in the previous 2 tables of this Appendix. The impact of zero percent general inflation from 2011 on the Authority's forecast revenue budget (assuming pay freezes from 2011) and subsequent budget shortfall across the range of percentage Government Grant reductions is shown below:

3 Year Budget Forecast 2010/11 – 2012/13 1.99% Precept Increase 2010/2011, 2.5% Increase 2011/2012 & 2012/2013. Grant Standstill/Reductions from 2011/2012			
	2010/2011 £000	**2011/2012 £000**	**2012/2013 £000**
Efficiency Savings Target	-800	-1,000	-1,000
Forecast revenue budget	119,080	119,270	119,390
Revenue support grant	-80,800	-80,800	-80,800
Precept income	-38,280	-39,150	-40,100
Shortfall/-Surplus	0	-680	-1,510
1% annual grant reduction		800	1,600
Budget Shortfall		**120**	**90**
3% annual grant reduction		2,400	4,800
Budget Shortfall		**1,720**	**3,290**
5% annual grant reduction		4,000	8,000
Budget Shortfall		**3,320**	**6,490**

All of the items shown on Appendix H3 will have an impact on the Authority's budget dependant upon the percentage variation on each specific item compared to the original budget assumptions. However, because the scenarios within this Appendix have focused on those items with the highest budgetary impact, the above tables give the best indication across reasonable assumptions as to the range of potential budget situations the Fire Authority might be facing over the next 3 financial years.

The future level of central Government grant funding is likely to be the most singularly important element of the Authority's budget over the next three year period. Whilst there are no specific indications of what the level of central Government grant will be, there is a general view that many public sector services are likely to be facing reductions of circa 15% over the three year period commencing 2011/2012. Therefore, the scenarios in this Appendix, particularly at the 5% grant reduction level, are felt to provide reasonable parameters in terms of future budgetary positions.

A presentation by the Chief Fire Officer at the Policy Planning Seminar on 14th November 2009 focussed on the sensitivity of various elements of the Authority's budget and also provided an indication of the scale of employment costs in certain areas of the service as shown below.

24 hour pump	£900k
12 hour pump	£495k
Target Response Vehicle (TRV)	£320k
40 support staff (based on average Grade 8)	£950k

Therefore, given the potential scale of the 2011/2012 budget shortfall in the first table of this appendix at the scenario where there is a 5% reduction in central Government grant funding (resulting in a budget shortfall of £4.3m), there is a wide variety of options that could be considered using the above examples for illustrative purposes only, i.e.

Option 1

5 x 24 hour pumps = £4.500m

Option 2

9 x 12 hour pumps = £4.455m

Option 3

2 x 24 hour pumps plus 5 x 12 hour pumps = £4.275m

Option 4

40 support staff plus 1 x 24 hour pump plus 5 x 12 hour pumps = £4.325m

Option 5

20 support staff plus 1 x TRV plus 7 x 12 hour pumps = £4.260m

These and any other combination of the illustrative examples together with any other service options will be considered as part of the Organisational Efficiency Programme referred to in Section 10 of this report.

APPENDIX H1

WEST MIDLANDS FIRE AND RESCUE AUTHORITY

BUDGET FORECAST 2011/2012 TO 2012/2013

	Budget 2011/12	**Budget 2012/13**
Subjective Heading	**£000s**	**£000s**
Employees	99,850	100,500
Premises	6,700	7,100
Transport	2,200	2,250
Supplies & Services	8,600	8,700
Capital Financing	5,400	5,600
GROSS EXPENDITURE	122,750	124,150
Income	(2,400)	(2,500)
NET EXPENDITURE	120,350	121,650
Appropriations to/(from) Reserves	(100)	(100)
TOTAL BUDGET REQUIREMENT	**120,250**	**121,550**

APPENDIX H2

INFLATION ASSUMPTIONS

Pay Awards:		%
- Uniformed Staff		
	July 10	1.0
	July 11	1.0
	July 12	1.0
	July 13	1.0
- Non-Uniformed Staff		
	April 10	1.0
	April 11	1.0
	April 12	1.0
	April 13	1.0
General Prices:		
	April 10	2.0
	April 11	2.0
	April 12	2.0
	April 13	2.0
Pensions Increase Order:		
	April 10	0.0
	April 11	2.0
	April 12	2.0
	April 13	2.0
Residential Rents:		
	April 10	2.0
	April 11	2.0
	April 12	2.0
	April 13	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	£590k	
General inflation	£125k	
Energy costs	£ 12k	
Fuel	£ 9k	

Income

Government Grant	£800k
Council Tax	£380k
Interest receivable	£200k

APPENDIX I

WEST MIDLANDS FIRE & RESCUE AUTHORITY
EFFICIENCY SAVINGS PLANNED IN 2010/2011

				All figures £'000				
Category	**Quality cross-check** (QCC) met	**One off or recurring?**	**Capital**	**Revenue**	**Annual Cashable Efficiency Gain**	**Cumulative Cashable Efficiency Gain**	**Annual Non-Cashable Efficiency Gain**	**Cumulative Non-Cashable Efficiency Gain**
Revised Shift Systems/Crewing					300	1,200		
Other IRMP Savings					7	658		
Reduced Ill Health Retirements					75	201		
Other HR Savings					142	826		
Better Procurement					24	74		
Corporate Services					584	953		
			TOTAL		**1,132**	**3,912**		

APPENDIX J

EARMARKED RESERVES AS AT 31ST MARCH 2009

	£000s
Insurance	8,116
Capital Works	3,588
Budget Carry Forwards	709
BA Sets and Accessories	699
Project Management	570
Station Works	554
Boiler Replacement Programme	490
Training	265
LAA Match Funding	194
Legal Costs	190
System Enhancements/Upgrades	117
Fire Prevention & Education	112
Fire Control Support	87
Firefighting and Rescue Equipment	77
Total	**15,768**

General Reserves (3.7% of overall budget)	**4,451**