

Hampshire Fire and Rescue Service

Finance and General Purposes Committee

Item: 6

29 October 2013

Medium Term Financial Strategy Update

Report by the Head of Finance

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1. Summary

- 1.1. This report provides an update to the Committee on the budget development process for 2014/15 and 2015/16 and the medium term prospects for the Fire Authority's finances to 2017/18
- 1.2. The Authority's early action in implementing its efficiency savings programme, the Safer, Stronger Pathway to 2020, in preparation for the significant grant reductions arising from the 2010 Comprehensive Spending Review (CSR), has placed it in a strong position to produce a 'steady state' budget for 2014/15.
- 1.3. However, the continued poor economic prospects means that the period of austerity is likely to last until at least 2017/18 and possibly on to 2020, placing a further significant strain on public sector funding which will inevitably lead to more grant cuts from 2015/16 onwards. The Authority's early action has given itself the time and capacity it needs to develop further efficiency options and to begin to implement this next phase of savings from 2015/16 onwards.
- 1.4. The Authority's current efficiency programme, as detailed at Appendix 1, has successfully achieved its targets to date and in some cases even ahead of schedule. These savings are currently profiled to be achieved up until 2015/16. This report will examine how this savings programme can contribute to balancing the budget over the next two financial years and will highlight any shortfall that may still need to be met from further development of the efficiencies programme and how this might be achieved.
- 1.5. The strong position the Authority finds itself in provides testament to its ability to plan ahead to ensure it is in a good position to be able to deal with any future challenges. However, this report will outline that with further significant grant reductions expected and inflationary pressures, along with the national pressure to avoid council tax increases, that the financial outlook for 2016/17 and 2017/18 remains just as challenging, but that a continued focus of planning ahead and early delivery will give the Authority the time and capacity to deliver what is required.

2. Recommendations

- 2.1. That the Committee note the changes to the financial forecasts.
- 2.2. That the Committee confirm that no increase in council tax should be used as a planning assumption for the 2014/15 budget process.
- 2.3. That the Committee agree to use the Investment and Sustainability reserve to fund the Risk Cover Review area manager

3. Introduction and background

- 3.1. An annual update on the medium term financial strategy (MTFS) is normally presented to the Committee in autumn to help inform and direct the work on detailed budget setting that will take place over the coming months.
- 3.2. The revised Government grant figures for 2014/15 and the indicative 2015/16 figures were announced on the 26th June 2013. Therefore it has been possible to produce slightly more detailed financial planning forecasts for the next two years which shows that the current efficiency programme will leave a budget deficit of £2.6m still to be met in 2015/16 assuming no council tax increases and delivery of the current savings programme that has been in place for some years now..
- 3.3. This report is divided into three main sections:
 - The budget position for 2014/15.
 - A forecast for 2015/16, together with details of how the current efficiencies programme will help reduce the anticipated gap.
 - Consideration of the medium term position to 2017/18.
- 3.4. By way of background the next two sections of this report will look at the broader economic outlook and outline some of the key issues for the Authority arising from the Comprehensive Spending Review for 2015/16 which was announced on the 26th June 2013.
- 3.5. The penultimate section of this report deals with the Authority's useable reserves in the context of the financial challenge that the Authority will continue to face in the future. Appendix 3 examining a reserves strategy in more detail is also attached.

4. Economic Outlook

- 4.1. At the start of the CSR period, it was clear any new Government would have to tackle the underlying structural deficit and bring down the national debt to GDP ratio.

- 4.2. Headline figures in the CSR 2010 assumed a 25% cut in spending on the Fire Service, back loaded over the last two financial years of the review period. For HFRA, the actual reduction in grant was only 18% over this period, which has contributed to the positive position in 2014/15.
- 4.3. Despite the cuts in this area and across the wider public sector, it became apparent last year that economic growth was slower than expected and that the Government deficit reduction programme has not been as successful as first anticipated. The debt to GDP ratio had actually become worse during this period and is now not expected to start improving until at least 2016.
- 4.4. Early warnings have been given that economic growth is likely to remain sluggish for some time and the period of austerity would last to at least the 2017/18 financial year. The position was further reflected within the CSR 2015/16 which was released on the 26th June 2013.

5. Comprehensive Spending Review 2015/16

- 5.1. On 26th June details of the Comprehensive Spending Review for 2015/16 were published. The headlines in respect of the Fire Service, which will directly impact on the resource levels, were:
 - A cut in grant to the Department of Communities and Local Government (DCLG) as a whole, equating to around 7.5%-10%.
 - A £45 million Fire Efficiency Incentive Fund to invest capital in ensuring that fire service assets such as fire stations are appropriately located to ensure efficient and effective service delivery.
 - A £30 million resource fund through the local government settlement to encourage joint working between fire and rescue authorities, collaboration with other blue lights services, and to meet the upfront costs of service transformation.
 - Resources have been made available to extend both the 2011/12 and 2013/14 council tax freeze grants until the 2015/16 financial year. This would equate to an additional £1.367 million to the Authority in 2015/16.
 - Provision of a further two years (2014/15 and 2015/16) of council tax freeze grant at an equivalent 1% increase level.
 - Local authorities will have to hold a referendum if they increase council tax by more than 2% in these years
- 5.2. It has now been clarified that the 10% grant reduction will apply to all funding which was originally included in the Start Up Funding Assessment (SUFA) produced for the 2013/14 settlement, which means that reductions will apply to virtually all previous funding streams as follows:-
 - Revenue Support Grant

- Council Tax Freeze grant
 - Business Rates Top up Grant
- 5.3. As a large part of funding comes from the Business Rates model, which the government is unable to alter without implementing a reset in the system, this means if the government reduces grants by 10% across all the previous funding sources it can only implement this by directly reducing the Revenue Support Grant. In Hampshire Fire and Rescue Service's case this equates to an 18% reduction in 2015/16.
- 5.4. The MTFs forecast figures provided later in this report assume a 9% cash cut in all grant funding sources and a 2% increase in local business rates. The 2014/15 and 2015/16 figures have been informed by the indicative settlement figures published by the DCLG.
- 5.5. The forecast in this report also assumes that the extension of the council tax freeze grant for previous year's decisions will be payable to the Authority irrespective of any council tax decisions they make in 2014/15 and 2015/16. There is however, a risk that more specific criteria could be applied to the receipt of the additional grant.
- 5.6. Whilst the indicative figures do provide some indication of the likely grant reductions across the sector, they do not provide any confirmed figures. Therefore we have still been required to make some assumptions around the level of grant reductions, particularly in later years.

6. Budget 2014/15

- 6.1. The budget reported to the Committee in January 2013 assumed there would be an additional £1.8 million unallocated surplus, which could be used to bolster the useable reserves.
- 6.2. The position was based on a number of key assumptions;-
- No council tax increase for 2014/15
 - No council tax freeze grant for 2014/15
 - Pay award of 2%
 - General inflation on other expenditure of 2.5%, with the exception of fuel and waste collection costs
 - Efficiency savings of £3.022M
- 6.3. The projected surplus is now slightly lower at £1.6m. This decrease is mostly due to a reduction in efficiency savings, mainly as a result of the decision to defer the removal of the third pump at Southsea fire station.
- 6.4. This reduction in savings has been partially offset by the change in government grants which this year is not expected to fall by as much as originally anticipated and an assumed 2% increase in business rates.

- 6.5. As in previous years, the surplus will be placed into reserves to assist either with capital investment or improvement and sustainability measures.
- 6.6. Given the favourable position for 2014/15 members are asked to confirm that no increase in council tax should be used as a planning assumption for the 2014/15 budget process.

7. Budget 2015/16

- 7.1. The budget report presented to Committee in January 2013 assumed there would be a deficit of £2.617 million.
- 7.2. The position was based on a number of key assumptions;-
 - Drop out of the 2011/12 and 2013/14 council tax freeze grant
 - No council tax increase for 2015/16
 - No council tax freeze grant for 2015/16
 - Pay award of 2%
 - General inflation on other expenditure of 2.5%, with the exception of fuel and waste collection costs
 - Efficiency savings of £250,000
- 7.3. The projected deficit now remains slightly lower at around £2.5 million. Extra income has been incorporated into the projection due to the introduction of a 2014/15 and 2015/16 freeze grant in these years equivalent to 1%, as the baseline forecast assumes no council tax increase is applied and also a 2% increase in business rates has been assumed.
- 7.4. However, this has been partially offset by the reduced efficiency savings from 2014/15.
- 7.5. Also extra revenue costs have arisen from the consultation to allow retained firefighters to join the 'modified pension scheme' of the 2006 New Fire fighters Pension Scheme. This will give fire fighters the same benefits as the now closed 1992 Fire Fighters Pension Scheme for the period between 2000 to 2006. In total this has been estimated to add up to £1million to the revenue budget p.a.
- 7.6. The cost may be broken down into 2 parts. The first relates to the employers contributions for those eligible fire fighters who join the modified pension scheme. Employers are currently paying 11% contributions for members of the 2006 scheme and it is expected that employers contributions will increase to the same level as the 1992 FPS scheme i.e. 21.3% when members join the modified scheme (possibly April 2015). Assuming all eligible fire fighters join the modified scheme the increased cost is estimated at £800,000 per year.

- 7.7. Secondly, this will create a deficit on the 2006 scheme because employers only start paying the higher amount from April 2015 and the benefits accrue from 2000. The Government Actuaries Department has estimated the cost of spreading the deficit over 15 years equates to approximately 1% of the employers contributions. This is estimated to cost £250,000 per year. There is a possibility however that this aspect of the increase may be delayed until the next pension scheme revaluation in 2017/18.
- 7.8. Whilst the current projected deficit does present a challenge for the Authority, work is being undertaken to develop further efficiency options which will reduce the budget deficit, which are explored in more detail in the next section. In any event, if there is no early achievement of the next phase of savings, the Authority has sufficient reserves to 'balance off' the budget in 2015/16 to allow greater time to develop and implement the efficiency savings. In considering the budget for 2015/16 this may be a deliberate strategy that the Authority would want to consider.

8. Medium Term

- 8.1. In looking at the forecasts over the medium term, there are only three key factors that need to be taken into account;-
- The extent of any further grant reductions
 - Allowances for inflation and known base changes
 - Assumptions on council tax increases
- 8.2. One known base change to occur in 2016/17 is caused by changes to the national pension arrangements. Public sector employees who are currently in the pension scheme and therefore opt out of State Earnings Related Pension scheme (SERPS) will no longer receive a reduced employer's National Insurance rate. This is estimated to add a further £1 million to the Authority's pay bill. The Government has already indicated that it does not intend to fund this additional burden.
- 8.3. The current forecasts indicate, with a similar level of grant reductions to be applied from 2016/17 onwards and with the fall out of all the currently announced council tax freeze grants, that the budget deficit in these years will become significant, rising to around £12M in 2017/18, assuming no council tax increase throughout the period. The position is illustrated in the graph below:

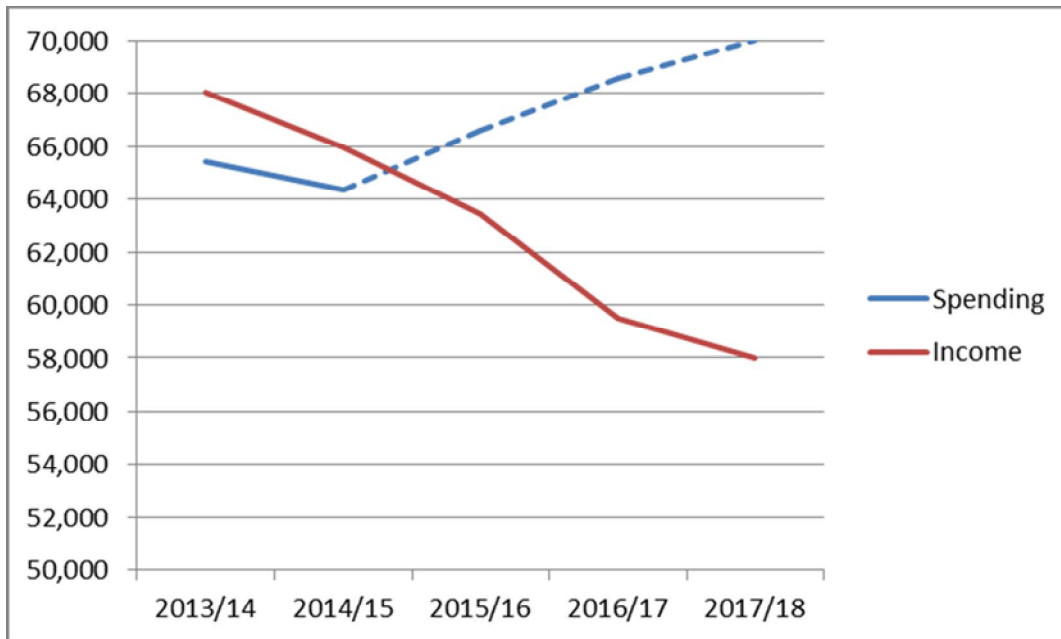


Chart showing developing funding gap before any planned measures are put in place.

- 8.4. Final decisions on council tax can only be made in each relevant year. However, at the moment it important to understand how previous years decisions impact on our ability to raise council tax in the future and to demonstrate how these decisions currently effect the longer term forecasts of the Fire Authority.
- 8.5. Appendix 2 therefore sets out 2 scenarios relating to increasing council tax and shows the impact it would have on the current projected medium term position and on the Band D council tax.
- 8.6. In any event, the Authority needs to start planning to close a maximum forecast budget gap of £12M by 2017/18 and to facilitate this a Budget Alignment Group, chaired by the Director of Service Delivery has been put in place to tackle this challenge.
- 8.7. A key strand of work that will shape the Service over the coming years is the Risk Cover Review that will undertake a fundamental examination of cover across the County together with many other related factors such as the use of technology and vehicle strategy.
- 8.8. Directors have identified the need for an area manager to project manage the Risk Cover Review and seek agreement to use the Investment and Sustainability reserve to fund the cost of £90,000 spread over this year an next.

9. Reserves Strategy

- 9.1. The Fire Authority has followed a deliberate strategy over the current CSR period of achieving savings in advance of need and generating surplus funds in the early part of the programme which can then be used to provide funding and capacity to develop the next phase of savings or be used for capital investment or service improvement.
- 9.2. This strategy means that the Authority now finds itself in a good position with their level of reserves. However, due to the number of different reasons reserves are held, simply using these reserves to bridge future funding gaps would see these reserves used up very quickly, at the cost of investing these elsewhere and would simply delay the point at which recurring savings needed to be found, making this option undesirable.
- 9.3. At the end of the 2012/13 financial year the Authority's useable reserves along with their general fund balance stood at £27.5 million. Appendix 3 sets out in more detail what those reserves are for and explains that in reality only 24% (£6.5 million) of these reserves are actually freely available to support the revenue budget at this moment in time. However, it is planned to use these reserves in a constructive way as outlined in the Appendix rather than just to support the revenue budget on a short term basis.
- 9.4. Any underspends in the current year together with any surplus and / or underspends in 2014/15 will be treated in the same way and will be available to fund the transformation programme that will be required to deliver the substantial savings outlined in this report.

10. Capital Investment

- 10.1. Within the medium term projections the Authority's capital programme has only been financed to the end of the 2017/18. Any further year's programmes would need a contribution from the Capital Payments Reserve or Revenue Budget in order to fund it at a similar level to the current annual programme of around £3.5 million. The Government's capital grant currently only accounts for around 30% of the Authority's annual programme.
- 10.2. Over the medium term it has been assumed the Capital Programme will remain around this 'normal' level and any scope to grow the programme above this would also require further financing from the Capital Payments Reserve.
- 10.3. At this stage therefore the reserves strategy that has been put in place is supporting the capital programme into the medium term, but beyond this position as reserves begin to be used up an alternative strategy may be required in order to properly sustain the Authority's capital investment requirements.

11. Supporting our Corporate aims and objectives

- 11.1. The Authority's service plan is a key element in directing the work of the Service. It has led to proposals to improve service delivery – Make life safer.
- 11.2. There are also internal priorities which are designed to increase the capacity of the Service – Making our service stronger. The development of the budget is clearly a key strand in providing sufficient resources to support the corporate aims and objectives of the Authority and decisions on the budget and council tax will have a direct impact on the Authority's ability to provide an adequate level and quality of services. Any financial implications arising from the service plan will need to be included in the budget discussion.

12. Risk Analysis

- 12.1. The financial projections for the Fire Authority over the medium term contain significant risks around assumptions for grant reductions, pay awards, inflation etc. The biggest of these relates to reductions in grant which for 2014/15 will not be notified to the Authority until December this year and only indications for the next two financial years.
- 12.2. However, the Authority has been aware of these risks for some significant time and has taken early action in terms of reducing operational expenditure and building up reserves to fund the cost of change and invest to save schemes which will save revenue costs into the future.
- 12.3. Once there is more certainty around the budget position, the key risk will be around the delivery of the current efficiency savings programme which at the moment is still relatively back loaded into the 2013/14 and 2014/15 financial years. Work is also being undertaken to develop a new efficiency programme to address the projected deficit in future years. A key strand of which is the Risk Cover Review and the appointment of the area manager will provide resource for this important piece of work.

13. People Impact Assessment

- 13.1. The development of the budget itself does not necessarily have a direct impact on people, but clearly some of the decisions made around efficiency savings and the outcome of national pay awards will. In considering efficiency savings that have an impact on staff, a full people impact assessment will be included as part of that proposal and will form part of any formal documentation that is used for consultation purposes.

14. Consultation

- 14.1. This report outlines some of the issues that will be taken into account in the development of the 2014/15 budget and will form the basis for formal consultation with stakeholders in early January 2014. Feedback from stakeholders will help inform the draft budget which will be reported to F&GP in

late January.

15. Background Papers

- 15.1. The following documents disclose the facts or matters on which this report, or an important part of it, is based and has been relied upon to a material extent in the preparation of the report: Budget 2013/14 – 14 February 2013 HFRA
Hampshire Fire and Rescue Authority Plan 2014 to 2018 - 14 June 2013
HFRA

	Agreed Target £'000	Forecast 2011/12 £'000	Actual 2011/12 £'000	Forecast 2012/13 £'000	Actual 2012/13 £'000	Forecast 2013/14 £'000	Actual 2013/14 £'000	Forecast 2014/15 £'000	Forecast 2015/16 £'000
Travel	150	50	50	100	100	150	150	150	150
Overtime	80	26	26	52	52	77	77	77	77
Operational equipment and appliances	100	0	0	0	100	100	100	100	100
Training and development	60	60	60	60	60	60	60	60	60
Emergency catering at incidents	110	44	44	81	81	81	81	81	81
Networked Fire Control Services Project	275	0	0	0	0	0	0	252	275
Selective paging	100	0	0	0	0	0	0	75	100
Partnership working	330	0	0	0	50	135	164	330	330
Efficient and Flexible Crewing	1,400	399	399	400	1,160	1,461	1,461	1,461	1,461
Staff Review	2,420	550	628	610	862	971	988	2,230	2,460
Rationalisation of emergency response	1,000	0	0	0	0	0	0	436	436
A: Total CSR1	6,025	1,129	1,207	1,303	2,465	3,035	3,081	5,252	5,530
Investing in our environment - based on Nov 12 price structure	0			0	30	80	80	185	185
Joint working *					8	16	16	16	16
Other on-going efficiencies agreed 2012		8		8		431	431	431	431
B: Total CSR2	0	8	0	8	38	527	527	632	632
Total cumulative efficiency savings	6,025	1,137	1,207	1,311	2,503	3,562	3,608	5,884	6,162
Year on year increase in efficiency savings						2,251		2,322	278

* Forecast for 2014/15 and 2015/16 not yet available - minimum savings forecast at this stage.

SCENARIOS FOR THE MEDIUM TERM POSITION

	2014/15 £'000	2015/16 £'000	2016/17 £'000	2017/18 £'000	Band D Council Tax
Baseline	(1,610)	2,547	8,981	12,230	£61.38
Option A	(1,610)	1,837	7,547	10,058	£65.14
Option B	(1,610)	1,483	6,819	8,940	£67.07

- Baseline shows accepting the Council Tax Freeze Grants (CTFGs) and applying 0% council tax increases over the four year period.
- Option A looks at accepting the 2014/15 Council Tax Freeze Grant but increasing council tax by the maximum 2% referendum limit in 2015/16, 2016/17 and 2017/18.
- Option B is based on accepting the 2014/15 Council Tax Freeze Grant and increasing council tax by 3% in 2015/16, 2016/17 and 2017/18.

RESERVES STRATEGY

Introduction

The level of reserves held by public sector authorities has attracted a lot of media attention over the years, and is often bought to the headlines by comments from Central Government saying reserves should be used to lessen the impact of the austerity measures.

As the level of reserves have often been built up for specific purposes, and as using these reserves to bridge funding gaps only effectively means delaying the point at which savings need to be found, it is not really a viable option to use these reserves for this purpose. Instead the Authority chooses to use the reserves for investment and improvement in the service and as a sensible means of giving the authority the time and capacity to deliver on the next phase of savings.

At the end of the 2012/13 financial year the Authority's reserves and General Fund balance stood at £27.5M. This appendix sets out in greater detail the reserves and their purpose and outlines the strategy that the Authority has adopted in using, and more importantly, to contributing to reserves.

Reserves Position 31 March 2013

Current useable reserves together with the General Fund balance totalled £27.5M at the end of the 2012/13 financial year.

The table below summarises each of the Authority's reserves into partially and fully committed reserves, and for those partially committed reserves the amount which is either committed or is known will need to be funded from the reserve over the medium term. This demonstrates the fact there is only quite a small percentage of the reserves available for other purposes.

The narrative beneath the table explains in more detail why the reserves are held and why the majority of these reserves cannot be used for any other reasons.

<u>Fully committed to Existing Spend programmes</u>	Balance as at 31.03.13 £'000	Known & Committed to 2017/18 £'000	Available for Use £'000
Revenue Grants Unapplied Reserve	1,780	1,780	0
Earmarked Underspendings Reserve	858	858	0
Capital Grants Unapplied Reserve	681	681	0
Capital Receipts Reserve	1,054	1,054	0
	4,373	4,373	0

<u>Partially committed reserves</u>			
Improvement & Sustainability Reserve	3,853	3,702	151
Capital Payments Reserve	14,659	12,268	2,391
Grant Reduction Reserve	2,148	650	1,498
	25,033	20,993	4,040
General fund balance	2,500	0	2,500
	27,533	20,993	6,540

Fully Committed to existing spend programmes

These reserves, really only represent the extent to which resources, in the form of Government grants or contributions to capital are received or generated in advance of the actual spend on the project.

These reserves have significantly increased in the last few years, with the Capital Grants Unapplied Reserve being used for the first time this year. This is due to the introduction of the International Financial Reporting Standards (IFRS) in 2010/11 which requires unapplied government grants to be shown as earmarked reserves.

Partially committed reserves

These represent reserves which have been built up for specific purposes, but still have a balance which is to be committed to any specific spending. Therefore, potentially these could be used to mitigate the loss of Government grants. However, the Authority has decided these should be used in specific areas which bring about benefits to the service and the residents of Hampshire.

The Improvement and Sustainability Reserve:- This reserve was set up to fund expenditure which was to improve the long term efficiency of the service.

The Capital Payments Reserve:- This reserve was set up to finance the costs of the future capital programme as the government capital grant was cut.

The Grant Reduction Reserve:- This reserve was set up to finance the costs of the voluntary redundancy scheme. Last year the estimate of the likely costs to be paid out of this fund was reduced to just £600k for this year and £50k for next, leaving an uncommitted balance. Also a further contribution was made from last years underspend. Although as yet the remaining balance is to be committed, when the additional contribution was made at the end of last financial year it was on the basis the remainder of this fund would be available to fund other priority investments for the service such as the Integrated Business Centre.

Reserves Strategy

To build reserves up in such a manner has received praise from Government and External audit. It is seen as a sensible, prudent approach as part of the medium term financial strategy.

The Authority's reserves have allowed them to develop sensible options around service reform and efficiencies and given them time to make reasoned decisions around which option to take without having to make rushed, urgent decisions which risk public protection.

It is now clear that the period of austerity will last longer than originally thought and therefore that it may be necessary to extend plans to look beyond the traditional 3-4 year period normally considered in the past.

A core strand of this strategy going forth will be the continued use and replenishment of reserves in line with the strategy and ensuring there is sufficient capacity to cope with the challenges ahead, possibly even up to 2020.

The Authority adopts a well established approach based on a cyclical pattern as follows:

- Planning ahead of time and implementing efficiencies and savings in advance of need.
- Generating surplus funds in the early part of the programme
- Using these resources to fund investment and transformation in order to achieve the next phase of savings.

Looking further ahead a similar strategy can be applied up until 2017/18, allowing planned reductions to be made in order to provide resources to support the next transformation process.

It is important to highlight that the strategy the Authority has adopted means that if the Authority is in a position that reserves begin to decrease over the next few years, it may be a sign that there is something wrong within the savings programme or financial strategy that might therefore need to be addressed. In any event, it needs to be stressed that the strong financial position that the Authority finds itself in is not an accident and is one of which the Authority should be proud.