

**DRAFT**

**MPA BUDGET SUBMISSION**

**TO THE GLA**

**NOVEMBER 2004**

**PART 3**

**2005/06 BUDGET AND  
MEDIUM TERM FINANCIAL PROJECTION**

## **A. Budget guidance**

1. The revenue budget for 2005/06 and the medium term financial forecasts to 2007/08 set out in the attached statements have been developed taking account of the guidance issued by the Mayor on 30 June 2004.
2. The guidance included specific policy objectives for the MPA to address in its submission as follows:
  - Plans to increase the numbers of police officers and police community support officers, while at the same time accelerating progress towards the target of 30% black and minority ethnic officers and 25% women officers, and plans for the deployment of additional officers.
  - Plans for the expansion of the Safer Neighbourhoods programme providing reassurance and working with Londoners to tackle anti-social behaviour and improve quality of life.
  - Plans to free up police officers for front-line duty by, where appropriate, using civilian staff for back room posts covered by police officers.
  - The implementation of plans that increase the safety and security of women, and the manifesto proposals on domestic violence and hate crime.
  - The manifesto proposals on a real time reporting system and the targeting of police resources.
  - Other initiatives designed to deliver improvements in public confidence in policing for all London's communities and improve all Londoners' feelings of safety and security.
3. The first of these objectives is dealt with partly through the options for the continuation of the Step Change programme and partly through the Budget and Equalities Submission. The second objective is also part of the Step Change programme. Civilianisation is considered at paragraphs 17–18 below. Further more detailed comments on civilianisation and the other objectives in the Mayor's guidance are addressed in the Business Plan to be submitted separately with the Budget Submission.
4. The Mayor's guidance recognised that, in the context of the implementation of a new government spending review (SR2004), budget options would have to be developed with continuing uncertainty around government grant. The guidance therefore set no minimum cash saving targets but the budget submission must exemplify proposals which span the range:
  - A budget requirement restricted to the amount that could be funded by a 2.5% increase in the MPA's share of the GLA council tax precept.

- A budget requirement restricted to the amount projected for 2005/06 in the published final 2004/05 GLA budget.
5. The forward plan figures in the published final 2004/05 GLA budget exclude provision for the next stages of the Step Change programme. In view of this and because additional funding was to be sought from the Government, the further expansion of police numbers beyond phase 1 was not covered by the above parameters and was to be treated separately.
  6. The guidance specifically required the development of a menu of options covering intermediate levels between the two ends of the range. The implications of this are referred to in paragraph 16 below.
  7. The guidance prescribes the format in which the revenue budget is to be presented and this is reflected in the detailed statements. The guidance also requires that the submission includes details of reserves and balances and related policies and a report by the Chief Financial Officer on the robustness of the proposed budget estimates and the adequacy of the financial reserves.

## **B. Overall position**

## **C. Budget process**

8. In approaching the review of the budget proposals for the 2005/06 Medium Term Financial Plan, the starting point was the approved MTFP for 2004/05. This document already indicated an increase in expenditure in 2005/06 that would require a substantial precept increase if no changes were made to the assumptions underlying the financial projections and before any new growth items were included. Based on a relatively optimistic assumption that there would be a ceiling of 5% applied to formula grant increases, the precept increase would be 17%. This represented the upper limit of the range within which the Mayor's guidance sought exemplification of budget options.
9. In the light of this the Finance Committee agreed two intermediate budget options for exemplification, namely budget requirements equivalent to 9.9% and 5.0% precept increases. These would be in addition to the lower end of the guidance range, ie a budget requirement producing a 2.5% precept increase.
10. In order to develop a budget within the range indicated by the Mayor and taking account of likely precept capping limits, an overall savings target of £60m was agreed by the Finance Committee. To provide some further flexibility to address new issues including the Bichard and

Morris Inquiries, the MPS Management Board required the savings target to be increased to £70m.

11. The process agreed to put this into effect was to issue each Business Group with a Control Total derived from the expenditure projection contained in the 2004/05 MTFP reduced by a share of the overall savings target. Business Groups were free to amend growth proposals or identify savings proposals that were needed to draw up a budget within the Control Totals. The Control Totals were issued to Business Groups at the beginning of August 2004.
12. Guidance to Business Groups was that scope for growth was likely to be very limited and that priority needed to be given to the major Change Management programmes being implemented in the MPS. Attempts have been made to link the budget proposals in this submission more closely to the planning processes within the MPS. The planning priorities and linkages with the financial growth proposals are outlined in the Business Planning Section of the Budget Submission.
13. During the course of the budget review, Business Groups identified many more operational pressures that give rise to financial requirements. This led to returns in early September exceeding the Control Totals by £135m. These returns were considered at a number of meetings of the Planning Process Board set up to coordinate the financial and planning processes of the MPS. Further guidance was also given at the Change Coordination Committee of MPS Management Board members.
14. Arising from directions given at these meetings, Business Groups have reduced their submissions to the extent that the budget proposals have been reduced to £21.8m above the Control Totals. In reaching this position there have clearly been a number of difficult decisions. The savings proposals are identified in Schedule 3.12 within the Budget Submission.
15. In addition, a number of significant items have been excluded that would have appeared as growth proposals had resources been available. A separate briefing is being prepared on these items that will follow at the Finance Committee. In particular, however, attention is drawn to the fact that no growth is included to respond to the Bichard and Morris Inquiries. There is also no bid for resources to fund the medium term strategy for police staff pay that has been previously reported to HR Committee and was costed at £12.7m in 2004/05. Members are asked to endorse that this programme will no longer be pursued.
16. The budget proposals now put forward would require a precept increase of 11.96% excluding any contribution that may be made from reserves. Further savings approaching £50m would be required to

achieve the exemplification of a precept increase at 2.5% and £36m for a precept increase of 5%. A proposal recommended by the Treasurer to utilise £11 of earmarked reserves as set out in paragraph 48 below would mitigate this position. Nevertheless, the MPS Management Board consider that the extent of savings already identified in both this submission and in recent years have placed considerable strain on the organisation in meeting the objectives set for the MPS. Further savings of this magnitude would necessarily involve reduction of police officer numbers effectively rolling back some of the progress made in delivering the Step Change and Safer Neighbourhoods programme in 2004/05. Detailed exemplification of these options has not therefore been included in this documentation.

17. The Mayors Guidance also required information on plans to free up police officers for front-line duty by, where appropriate, using civilian staff for back room posts covered by police officers. Civilianisation had previously been incorporated into the Step Change Programme with the growth in police officer numbers being partly provided by civilianising existing police officer posts on a 'head for head' basis. Practical considerations have resulted in a refocusing of efforts to achieve civilianisation by releasing police officers from various duties taken over by police staff. These considerations have also led to the separation of the proposals from the Step Change Programme.
18. The Director of HR leads on MPS Civilianisation generally and proposals are included in the Business Group submissions where civilianisation can contribute to achieving the overall budget constraints. In particular, the TP submission proposes strengthening of the police staff on Boroughs that would facilitate the release of police officers for front-line duties. These are commented on more fully in paragraph 21 below.

#### **D Expenditure pressures and savings**

19. The expenditure pressures impacting on 2005/06 include the following corporate items:

a. *Inflation/Pay Awards*            £78.47m

Pay awards for all police officers and staff have been included at rates reflecting current expectations of the outcome of negotiations and the ongoing effect of the Hay pay review. Non-pay inflation is included at 2.5%.

b. *Police pay reform*    £5.1m

This provision relates to the ongoing effects of reform of the police pay structure including Special Priority Payments.

c. *Employer's pension contributions for police staff*  
£24.551m

The rate of employer's contribution has increased by approximately 5% of pay increasing the amount to be paid over to the Cabinet Office for the police staff pension scheme.

d. *Payments to ATOC re police officer free travel* £9.3m

The cost of the free travel agreement has increased substantially as a result of survey data that indicates a higher take up of the free travel facility than had previously been forecast. Costs were capped in 2004/05 but this protection is no longer available for 2005/06.

d. *Police pensions* £14.1m

The underlying level of increased pension costs in 2005/06 based on current projections amounts to £24.1m in higher lump sum and annual pension payments above the pension liabilities in 2004/05. This can be offset, however, by a reduction in the current level of expenditure that is resulting in a forecast underspending on this budget in 2004/05. This has arisen from a reduced number of medical retirements and fewer officers exercising their right to retire when they attain retirement age. Savings of £10m have therefore been applied to reduce this budget requirement.

Recent trends in expenditure do also indicate that it may be possible to make a further reduction in the pension budget. However, it must be stressed that the numbers of retirements are difficult to predict and that the liability for lump sums may increase rapidly if the number of retirements exceeds expectations.

e. *Step Change Phase 1* £15.626m

The full year costs of the 2004/05 Step Change provision amounts to £15.626m across all Business Groups. Phase 2 proposals for 2005/06 have been excluded from this part of the Budget Submission and are reported on separately.

20. The overall impact of these pressures alone is some £70m in excess of inflation. The review of budget requirements by Business Groups also identified significant operational pressures in addition to those already reflected in the 2004/05 MTFP. After consideration by the MPS Management Board these have been substantially scaled back and savings of £65.78m identified to offset funding requirements. Details of the growth proposals are included in Schedule 3.2 and the savings proposals in Schedule 3.12. The major items impacting on the proposals reflected in this Budget Submission include the following.

21. Within Territorial Policing (TP), proposals have been included for funding the new Traffic Criminal Justice Unit and the Victim and Witness focus desks. Transitional funding was included in the 2004/05 budget to help begin the establishment of these functions. Permanent funding is now required to ensure continued development of these roles. Benefits are anticipated in improved performance in Criminal Justice disposals and in releasing police officer resources in Boroughs for front-line duties. This will facilitate the release of 160 police officers to reduce the cost of establishing additional Safer Neighbourhood teams in 160 wards in 2005/06 as part of the Step Change Programme. The police staff employed as part of the Traffic CJU will also allow the civilianisation of 56 police officer posts undertaking enquiries related to traffic offences. The funding of the Traffic CJU is linked with the income anticipated from the decriminalisation of Red Routes that contributes to the savings identified in TP.
22. The Specialist Crime Directorate (SCD) has lead responsibility for the implementation of the National Intelligence Model required by the Home Office. Additional funds are required to discharge this responsibility. The operation of the Control Totals in preparing the budget has meant that SCD has contained this pressure by identifying savings to offset the cost. Within these savings there is a sum of £8.9m to be achieved by a fundamental review of the SCD structure of service delivery. Details of this will need to be worked out in time for implementation in 2005/06. Proposals under consideration include an element of civilianisation and a reduction in police overtime.
23. For Specialist Operations there is a requirement to provide heightened security arising from the G8 meeting scheduled for July 2005, Britain's presidency of the EU and the General Election likely to be called in 2005. These events are over and above the normal level of annual activity and are anticipated to need an extra £3m primarily in police officer overtime. In addition proposals for armed hospital guards and a team to undertake planning for the 2012 bid for the Olympic games are included in the Budget Submission.
24. The implementation of C3i and Airwave also represent further pressures in 2005/06. The dual running of Airwave is currently forecast to require an additional £6.386m in 2005/06 prior to offsetting savings in 2006/07 and 2007/08 as Metradio is phased out. A specific provision set up with grant funding in 2003/04 has also been fully utilised in 2004/05 resulting in an increased funding requirement of £4.1m in 2005/06.
25. Expenditure associated with C3i will increase by £5.549m in 2005/06 and a further £3.874m in 2006/07 before budget reductions offsetting these increases come on stream in 2007/08 and 2008/09. Some delays in the roll out of this programme have adversely affected the profile of business benefits being achieved and increased the costs attributable to this project.

26. The amount of growth within the DoI Business Group has also forced this area to identify substantial budget savings towards meeting its Control Total. Savings totalling £8.2m are proposed from within its Departmental budget that are detailed in Schedule 3.12. These will clearly impact on a number of IT programmes and delay operational benefits from their implementation.
27. The Resources Directorate savings proposals include a reduction of £4.2m in Property Services Directorate that will come partly from vacancy management but primarily reduced expenditure on buildings facilities management. Given the level of backlog maintenance previously reported this cut would clearly exacerbate the situation regarding the condition of the MPS estate.
28. As part of the savings proposals, items have been included for capitalisation of expenditure within the existing revenue budget for both Property Services and DoI. £5m in each area is proposed to be transferred to the Capital Programme and this is reflected in the Capital Strategy included with the Budget Submission. This proposal will reduce the immediate charge to the Revenue Account but will require additional borrowing and an increase in Capital Financing Charges.
29. Forecasts of interest on revenue balances continue to indicate that actual receipts will exceed the current budget provision in 2004/05. At present a sum of £1m has been included in the Budget Submission but this will be kept under review to assess whether further savings can be anticipated.

## **E Government Grants**

30. A summary of projected levels of grant funding over the medium term is set out in schedule 3.3. The medium term period coincides with the three years covered by the Government's latest spending review SR2004 the conclusion of which was announced in July 2004. However there remain significant uncertainties about the review's precise implications for police authorities generally and the MPA in particular, which are unlikely to be resolved until the provisional grant settlement for 2005/06 is published in mid November. Grant prospects in the medium term remain further clouded by the likely incorporation of full 2001 census data into the grant formula from 2006 together with the outcome of an associated review of the formula itself. At this stage grant changes arising from new arrangements for financing police pensions due to be implemented from April 2006 are also unclear.
31. At this stage there is still no published disaggregation of the total Home Office provision reflected in SR2004 across its service responsibilities. Total Home Office resources show an increase in 2005/06 of 6% with



an average annual increase of 5.4% over the three year review period. The Chancellor of the Exchequer stated that 'with the Immigration and Nationality Department budget now flat, the rest of the Home Office budget will see an annual real terms increase of 4 per cent.'

32. Until we see further detail we do not know the increase in the police provision nationally, nor how much of that provision will be applied to central services or ring fenced for specific purposes. In particular it is not possible to say how much grant will be available for distribution by way of the allocation formula. Experience in previous years suggests that the increase in formula grant will be lower than that for police resources as a whole.
33. In 2004/05 all police authorities received a similar flat rate increase of about 3.3% in general grants. As a result the MPA's actual allocation was £56 million less than we were entitled to under the formula which had become more favourable to the Metropolitan Police following the review carried out in 2002. There will only be the normal data changes in 2005/06 and relative formula entitlements should therefore remain similar to the current year.
34. The Chair of the Authority and the Mayor have been lobbying ministers to ensure that they are fully aware of the potential implications for London of final decisions in relation to next year's grant settlement.
35. Given the overall increase in Home Office resources and the stated wish of the Home Secretary not to repeat the 2004/05 approach it seems probable that there will be a more realistic ceiling applied to grant gains next year. In that case an assumption of a 5% ceiling does not appear unreasonable and this has been built into our grant forecasts. If in the event this assumption proves to be over-optimistic every 0.5% reduction in the ceiling would mean lower grant of £9.1 million, equivalent to 1.7% on the precept.
36. Earmarked grants have been estimated on the best information available. However a number of issues remain unresolved as set out in the following paragraphs.
37. As part of SR2004 the Home Secretary announced that there would be additional resources to secure an increase in community support officers (CSOs) nationally from 4,000 currently to 20,000 by March 2008. To achieve this a new Neighbourhood Policing Fund (NPF) is to be established. An initial tranche of funding (£50 million) has been made available for recruitment of CSOs during 2004/05. A bid has been submitted for the full complement of PCSOs required for the next planned phase of safer neighbourhoods under the Step Change programme. It is unlikely that the bid will be agreed in full or that the funding will match the MPS costs related to the number of CSOs approved. It is understood that there will be no further funds available from the NPF until 2006/07. At this stage no NPF funding has been

included in schedule 3.3. The amount eventually approved will effectively offset growth in Step Change costs.

38. A new provision of £50 million for counter terrorism has been included in the Home Office's total resources under SR2004. No decisions have yet been announced as to the allocation of this funding. The Home Office's attention has been drawn to the evidence, including the report by Avail Consulting, that funding for national, international and capital city functions of the MPS seems to be falling short of costs largely because of the pressures around counter terrorism. It has been suggested that counter terrorism grant should be made available to support expenditure which is already being incurred. As with the NPF, no assumption has been made about additional counter terrorism funding in the draft budget.
39. In the original proposals for the 2004/05 settlement the Home Office had transferred the Airwave specific grant into the main formula grant. Following strong representations from police authorities the specific grant was partly reinstated for the final settlement. It is unclear whether there will be any specific Airwave funding for 2005/06 and nothing has been included in our grant estimates.
40. Decisions on the specific funding for street crime reduction have been made by the Home Office on an annual basis. The 2004/05 MPA budget includes grant income of £12.5m that was matched by specific expenditure and the Budget Submission is based on maintaining this level of grant and expenditure. However, it is anticipated that the grant in 2005/06 will be substantially lower and the commitment given so far by the Home Office amounts to only £2.5m. When details of the actual grant are known it will be necessary to reduce both the grant and expenditure budget figures accordingly. If the reduction is as much as £10m this will clearly impact on service currently being provided and require TP to implement savings involving a reduction of police officer numbers.

## **F Reserves**

41. The MPA maintains a general reserve to meet unforeseen or emergency expenditure which cannot be contained within the approved budget and has agreed that this reserve be established at a minimum of 1% of net budgeted expenditure, provided that there are adequate accounting provisions and earmarked reserves, reasonable insurance arrangements, a well funded budget and effective budgetary control. At 31 March 2004 the general reserve stands at £25.6 million, in line with the minimum policy level. The conditions attached to the policy are broadly satisfied and the minimum is therefore acceptable. The general reserve must not be allowed to fall below the 1% level.

42. The Authority's balance sheet also contains earmarked reserves established to meet specific expected revenue costs. The largest earmarked reserve relates to police pensions and currently amounts to £45.5 million. This is discussed further at paragraphs 44-48 below.
43. The remaining earmarked reserves at 31 March 2004 total £65.9 million but use of £23.7 million has already been assumed in finalising the budget for 2004/05. Of the remaining £42.2 million, it is currently estimated that approximately £30 million will be utilised in the current financial year and the balance in future years. At this stage no sums have been identified as not being required for the original purpose and thus available to support the funding of the 2005/06 budget.
44. The police pensions reserve requires particular consideration. The bulk of the reserve was originally built up as a provision to cover the current liability to meet the commuted lump sum pension costs of serving officers who had reached full pension entitlement and could retire at one month's notice. The provision was eventually sufficient to meet 75% of the estimated liability, a level which was acceptable to the external auditor. The implementation of FRS17 and the full disclosure of the total accrued liability in respect of police pensions on the face of the balance sheet rendered this provision redundant in accounting terms. The potential commitment to meet the commuted payments remained but the provision had to be reclassified as a reserve.
45. At the same time as the provision was being established the Finance Committee considered a report on future pension costs by actuaries Hymans Robertson. In the light of their projections the Authority agreed to build a reserve to assist in meeting the additional lump sum costs arising from an increase in officers attaining full service for retirement purposes. Sums have been set aside for this purpose in each of the last two years.
46. New financing arrangements for police pensions are likely to be introduced from April 2006 and these will have significant implications for the need to hold pensions reserves. Under the new arrangements police authorities will no longer be responsible for meeting pensions costs directly. The charge to police authorities' budgets will be by way of employers contributions to a separate pensions account whose balance will be met by Home Office grant. Police budgets will not be impacted by the volatility of commuted lump sum payments, nor by growth in the number of pensioners since the employers contributions will be calculated to reflect the accrued liability of current officers.
47. The principal reasons for maintaining pensions reserves will therefore be eliminated. There are two risks for which reserves may be required:
  - Until the Home Office produces exemplifications of the new arrangements it is impossible to assess the net impact on the MPA at the point of transition. If there was to be a net deterioration in the

Authority's financial position it might be appropriate to use reserves to help adjust to the new arrangements.

- The Authority will probably retain a degree of responsibility for the costs of ill health retirements. If it was considered that the number of ill health retirements might fluctuate in the future it may be desirable to have reserves available to smooth the costs year-on-year.
48. Without further clarification neither of these risks can be adequately assessed, although it would seem, prima facie, that they would not justify as large a reserve as currently held. In the circumstances it is proposed that the pension reserve should be applied in 2005/06 towards its stated purpose and should fund the commuted lump sum costs associated with the increased number of retirees compared with 2004/05. This would utilise approximately £11 million of the reserve and reduce the precept requirement accordingly. Further consideration of the pensions reserve should be deferred until there is greater clarification around the impact of the new financing arrangements.

## **G Precept Implications**

49. The precept implications of the expenditure and savings reflected in his budget submission together with the current estimates of government grant and the proposed use of reserves are summarised in the following table.

	2004/05 (£m)	2005/06 (£m)	% Variance
Net expenditure	2,555.1	2,703.1	5.8
Specific grants	188.1	206.4	9.7
Transfer from reserves	23.7	11.0	
Budget requirement	2,343.3	2,485.7	6.1
General formula grants	1,822.0	1,913.1	5.0
Precept requirement	521.3	572.6	9.8

50. This approximates closely to the 9.9% precept increase option agreed for exemplification by the Finance Committee. The precept requirement would need to be reduced by a further £25 million to secure a precept increase of 5% and by £38 million if the precept increase was to be restricted to 2.5%.
51. The cost of options for continuation of the Step Change programme would add to this precept increase. The latest figures would require precept funding, after allowing for specific grant, of £46.6 million, equivalent to a precept increase of 8.9% for this purpose alone.

## **H. Robustness of the estimates**

### **I. Medium term financial projections**

### **J. Consultation**

## Summary of Technical Assumptions

### Part 1: Corporately reviewed factors

- The impact of the Police Reform agenda on police pay and allowances
- The on-going impact of the Hay review on police staff pay costs.
- The on- going implications of growth in police pensions.
- The progressive reduction in the cost of rent/housing allowance and compensatory grant.
- The progressive reduction in officers in receipt of the £1,000 allowance to compensate for housing allowance anomalies.
- The progressive effects of the increasing overall cost of the London Pay Lead for police officers.
- The full year effect in 2005/06 of the additional police officers and PCSOs in 2004/05. (Phase 1 of Step Change)
- The adjustment of forecast pay awards and latest estimates of movements in RPI.
- The on-going impact of the contract to provide free rail travel to police officers.
- An increase in employer's pension contribution costs for police staff

### Part 2: Technical assumptions pertaining to finance projections

- The starting point is the approved MPA 2004/05 budget.
- Pay awards for police officers and police staff are included at rates reflecting current expectations of negotiations
- Price inflation of 2.5% throughout the period
- General grant increases of 5% per annum throughout the period and changes in specific grants as currently known (see schedule 3.3)
- The revenue implications of the capital submission are reflected in the figures (excluding Phase 2 of Step Change)
- Levels of capital funding are broadly comparable with the current year, except for an increase in unsupported borrowing to fund capitalisation

### Part 3: Factors excluded from the finance projections

The projections specifically **exclude** the following:

- Costs associated with Phase 2 of the Step Change Programme.
- Any additional Police Community Support Officers funded by local authorities.
- Partnership income arrangements and associated expenditure.