

**CABINET MEETING: 27 July 2017**

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**BUDGET STRATEGY 2018/19 AND THE MEDIUM TERM**

**REPORT OF THE CORPORATE DIRECTOR RESOURCES**

**AGENDA ITEM: 4**

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**PORTFOLIO: FINANCE, MODERNISATION & PERFORMANCE (COUNCILLOR  
CHRISTOPHER WEAVER)**

**Reason for this Report**

1. To consolidate and update the financial strategy of the Council in readiness for the preparation of the 2018/19 revenue and capital budgets.
2. To outline the timetable that the budget process will follow in order to present the 2018/19 Budget to Council in February 2018.
3. To provide an update in relation to the Council's financial resilience.
4. To update the Council's Medium Term Financial Plan (MTFP).

**Structure of the Report**

5. The following table provides a guide to the key sections of the Report. Appendix 1 provides a short overview of the Budget Strategy in a question and answer format.

<b>Section of Report</b>	<b>From Para</b>	<b>Detail included in section</b>
General Background	5	<ul style="list-style-type: none"><li>• National Planning context</li><li>• Welsh Government planning context</li></ul>
Cardiff Context	14	<ul style="list-style-type: none"><li>• Council's Priorities</li><li>• Key Risks</li><li>• Financial Resilience</li></ul>
Budget Reduction Requirement	25	<ul style="list-style-type: none"><li>• MTFP and budget reduction requirement</li><li>• Updates since February 2017 Budget Report</li><li>• Overview of key assumptions</li></ul>
Budget Strategy	29	<ul style="list-style-type: none"><li>• Approach to Budget Strategy</li><li>• Summary of Budget Strategy</li><li>• Future Work Programme</li></ul>

Section of Report	From Para	Detail included in section
Consultation and Engagement	44	<ul style="list-style-type: none"> <li>• Consultation with the public, employees and other key stakeholders</li> </ul>
Capital Programme	46	<ul style="list-style-type: none"> <li>• Capital Programme</li> <li>• Borrowing &amp; Financial Resilience</li> <li>• Known Pressures</li> <li>• Developing the Investment Plan 2018/19 to 2022/23</li> </ul>

## General Background

### National Planning Context

6. The national context for this report is uncertain due to a combination of factors. These include the potential impact of the UK's exit from the European Union, the timing of the next UK Budget and the recent pressure on the UK Government to reconsider its existing policy in relation to public sector pay and ongoing financial restraint.
7. On 19 June 2017, the UK commenced negotiations regarding the terms of its exit from the European Union (EU). At this stage, it is too early to gauge the outcome of these negotiations, including in particular, the terms of any trade deal and the impact this may have on the economy. Having triggered the exit process, UK is due to leave the European Union by 29 March 2019 unless the 27 member states agree to extend this period. The terms of exit secured and their economic impact will need to inform future iterations of the council's MTFP and budget strategy.
8. In the weeks since the June 2017 General Election, there has been mounting pressure on the Government to ease ongoing financial restraint and to review the 1% cap on public sector pay. There were initial indications that the Chancellor may review this in the Autumn 2017 budget. However, subsequent clarifications have confirmed the Government's stance is that the 1% pay cap will remain in place until 2020, although it will consider the reports and recommendations of independent pay review bodies. The likely level of future pay awards and the extent to which these are funded, will need to be kept under close review as a small fluctuation in pay awards can have a significant impact on the MTFP.
9. The timing of the UK budget adds an additional level of complexity and uncertainty to the planning process for 2018/19. In the 2016 Autumn Statement, the Chancellor announced that following the Budget in Spring 2017, Budgets would be delivered in the Autumn. Whilst the date of this autumn's Budget has not yet been confirmed, it is reasonable to assume that it will take place in November or December comparable to the date of Autumn Statements in previous years. This means that the Provisional Financial Settlement for Welsh Local Government, usually published in October, will not reflect the Autumn Budget. If the latter holds any change for the Welsh Block Grant, Welsh

Government may need to revisit their own budget. It is therefore conceivable that the Final Settlement may be later than usual and with a greater element of change compared to the provisional settlement. The Council's outline budget timetable is included at Appendix 2 and will be kept under review in this regard.

10. The Chancellor's budget announcement in March 2017 set out the economic context based on figures produced by the Office for Budget Responsibility (OBR). The economic figures showed an improvement on November 2016 figures. Some of the main indicators from this statement were:-
  - Forecast growth of 2% this year and 1.6% in 2018; a revision upwards from the growth prediction of 1.4% in the November 2016 Spending Review
  - Inflation forecast to increase to 2.4% in 2017 (above the target rate of 2%), before falling back to 2% in 2018
  - National debt forecast to fall from 81.1% in 2017/18 to 77% of GDP in 2021/2022.
11. The OBR Report noted that risks to the global economic outlook remain significant, with the global oil market, outlook for US fiscal policy, the nature of trading arrangements agreed following the UK's departure from the EU, and the effects of sterling depreciation among the key sources of uncertainty. The OBR is required to base forecasts on stated government policy. This is far from straightforward with regards to ongoing negotiations around the UK's exit from the EU, as there is no meaningful basis for predicting the precise end-point of the negotiations for use in the forecast and there is considerable uncertainty about the economic and fiscal implications of different outcomes.

### **Welsh Government Planning Context**

12. The planning context at a Welsh level also presents elements of uncertainty and change over the medium term. Two notable areas are the devolution of tax powers to the WG over the next two years and the continued progression of Local Government Reform. With regards the latter, the consultation on WG's White Paper, Reforming Local Government: Resilient and Renewed, closed on 11 April 2017. There is a clear expectation that over the medium term, local authorities will consider where regional working may be appropriate along with the funding arrangements, such as pooled budgets, which regional working would entail. The Council's financial planning will need to factor in developments as further clarity emerges.
13. There are no indicative funding figures for Welsh Local Government for 2018/19 or beyond. The financial settlement for the current financial year reflected an average increase in Aggregate External Finance (AEF) of 0.2% across Wales, with individual Authority settlements ranging between -0.5% and +1.1%. Cardiff received an increase in AEF of 0.5%, which in cash terms equated to £2.3 million. However, the inclusion of new responsibilities within the overall funding envelope meant that the actual increase in spending power was £294,000. The settlement was for one year only with no indicative figures for 2018/19 and beyond.

14. In the absence of indicative AEF, the Council has assumed an annual funding reduction of 1% within the MTFP. However, the Council has a Financial Resilience Mechanism (FRM) designed to withstand an AEF reduction up to 1% worse than planned. The FRM is a £4 million base budget that was set up during the 2016/17 budget round in order to improve the Council's financial resilience over the medium term. The base budget is used annually for one-off investment so that it is available for immediate release in the event that AEF is worse than planned for in the MTFP. Once released, the FRM will provide no further mitigation in respect of subsequent settlements.

## Council Background

15. The Council approved its Corporate Plan for the period 2017-2019 in February 2017. With reducing funding and increasing demand for services, councils must be clear about their priorities. For Cardiff, the Corporate Plan 2017-19 identified these as:
- Better education and skills for all
  - Supporting vulnerable people
  - An economy that benefits all our citizens
  - Working together to transform services
16. The Corporate Plan aligns with the Liveable City Outcomes, which in turn align with the national ambitions for Wales' wellbeing as defined in the Wellbeing of Future Generations (Wales) Act 2015. These core documents along with the recently published five-year policy programme, Capital Ambition, will form the strategic backdrop for the continued development of the 2018/19 budget and MTFP. Capital Ambition sets out the vision for Cardiff to become a leading city on the world stage, focussing on:-
- **Working for Cardiff** - making sure everyone who lives and works here can contribute to, and benefit from, the city's success
  - **Working for Wales** - a successful Wales needs a successful capital city
  - **Working for the future** - managing the city's growth in a sustainable way
  - **Working for public services** - making sure that public services are delivered efficiently, effectively and sustainably in the face of rising demands and reduced budgets.

## Risk and Financial Resilience

### Risk

17. The risk assessment carried out as part of 2017/18 budget preparation identified a number of financial and operational challenges over the medium term. Whilst these risks all remain relevant, this report does not repeat the comprehensive list in full as many of the issues are covered in other sections. The following table and the next section on financial resilience summarise the key risks from a financial planning perspective.

Area	Key Challenges
<b>Demand Pressures</b>	<ul style="list-style-type: none"> <li>• Increased volume and complexity of demand in social services</li> <li>• Continuing pupil number growth</li> <li>• The potential impact of welfare reforms</li> </ul>
<b>Funding Uncertainty</b>	<ul style="list-style-type: none"> <li>• The absence of indicative AEF figures</li> <li>• The potential for negative redistributive impacts within the formula e.g. when specific grants transfer into AEF</li> <li>• General uncertainty in relation to specific grants.</li> </ul>
<b>Capital</b>	<ul style="list-style-type: none"> <li>• The increasing demands on the revenue budget of additional borrowing undertaken in previous years</li> <li>• Pressure placed on scarce resources by the condition of property and infrastructure assets,</li> <li>• The increasing financial exposure of the Council in relation to the development of the 21<sup>st</sup> Century Schools Band B Programme and Cardiff Capital Region City Deal</li> <li>• The potential for capital schemes predicated upon income generation failing to do so.</li> </ul>
<b>Other</b>	<ul style="list-style-type: none"> <li>• The expectation that inflation will remain at or above 2% over the MTFP period</li> <li>• Exceptional price inflation already being experienced in some areas as a result of National Living Wage and other pressures</li> <li>• The impact of BREXIT as terms of departure unfold</li> <li>• The implications of Welsh Local Government Reform and expectations for regional working</li> <li>• The pressure of delivering organisational change in conjunction with increasing demands on business as usual.</li> </ul>

18. These challenges undergo review as part of the financial monitoring process and through the Corporate Risk Register, and both Cabinet and Senior Management Team receive regular updates in this regard. The Council's Audit Committee also regularly review the Corporate Risk Register. Given the identified risks, care is taken to ensure that changes to service delivery and business processes do not have a negative impact on the financial control environment.

### **Financial Resilience**

19. The Council has approved a budget reduction requirement of £25 million for 2017/18, building on £105 million in the previous three years with a further £73.5 million requirement anticipated over the next three. In light of the scale of this financial challenge and in the context of the risks identified in the previous section, it is vitally important to undertake regular review of the Council's financial standing, risks and resilience. The development of a deliverable budget strategy is a key document in this regard.

20. Key challenges in respect of financial resilience include:-
- The need to deliver significant levels of savings during a period of prolonged financial austerity
  - The impact that delays to the delivery of savings proposals has on the budget monitoring position
  - The cumulative impact of achieving 2017/18 savings in addition to the unachieved 2016/17 savings which remain to be realised
  - The complexity associated with delivering the change required to continually reshape the organisation
  - The increasing ratio of capital financing charges to controllable revenue budgets as controllable budgets reduce, which impacts on the relative affordability of the capital programme.
  - Increasing level of demand for services.
21. The financial resilience snapshot included at Appendix 3 provides an overview of the financial health of the Council at the time of setting the Budget Strategy for 2018/19. Financial snapshots are produced at intervals during the year and are designed to provide a rounded overview of the Council's financial resilience through consideration of past, present and future information. The current snapshot reflects the draft Statement of Accounts 2016/17, the 2016/17 Outturn Report, the risk profile of 2017/18 savings and the budget strategy reflected within this report.
22. The first column of the snapshot is backward looking and contains information in relation to the Council's Reserves. Reserves are an important part of financial resilience as in times of uncertainty they provide a financial cushion. They can also help ensure a healthy cash position. The unaudited statement of accounts show that the level of the Council's General Reserve is £14.3 million. Whilst this is a decrease of £1 million since last year's position, this was a planned reduction approved as part of the 2016/17 Budget. The Council's General Reserve stands at 2.4% of its net revenue expenditure. Whilst 2016/17 comparator information is not yet available, this remains below the Welsh average as at 31 March 2016.
23. The snapshot shows an increase in earmarked reserves in 2016/17, which now stand at 10% of the revenue budget. Part of the increase relates to a new £2.5 million strategic budget reserve created in order to assist the Council with the challenging budgetary situation over the medium term. This reserve will be drawn down to assist with budget strategy over the next three years as described later in this report. An increase in the Employee Changes Reserve was another contributory factor to the overall increase in earmarked reserves. The transfer to Employee Changes Reserve was in line with the financial model for redundancy that seeks to move to a position whereby 50% of annual redundancy costs are funded from the base budget with 50% from reserves. The move towards this model enabled a significant reduction in the redundancy budget for 2017/18 with a further reduction planned in 2018/19.

24. The second column of the snapshot outlines the 2016/17 outturn position and the level of savings achieved in 2016/17. Whilst the Council's outturn for 2016/17 came in as balanced overall, the position at directorate level was an overspend of £7.6 million which was offset by the Council's general savings contingency which stood at £4 million in 2016/17, along with other underspends in corporate areas such as redundancy and insurance. Within the 2016/17 outturn position, £6.5 million of 2016/17 savings were unachieved. The delivery of delayed savings in addition to those included in the 2017/18 Budget is a key area of risk that will be monitored closely as the current financial year progresses. The 2017/18 Budget sought to improve the risk associated with the 2016/17 position through the write out of £1.073 million of prior year savings deemed to be unachievable, and through realigning particular pressures in relation to Social Services, which were the most significant factors in the £7.6 million directorate overspend. Monitoring of savings has already commenced in the current year with regular consideration at Senior Management Team and timetabled for discussion with Cabinet Members.
25. The final column summarises the contents of this report and the future financial challenge. The two preceding columns add additional context to the scale of the challenge ahead. The local affordability indicator at the bottom right of the snapshot indicates that the proportion of the Council's net budget spent on servicing debt is set to increase over the medium term. It is of note that the indicator is based on the existing capital programme, with no new schemes. This issue is revisited in the capital section of the report.

### **The MTFP Budget Reduction Requirement**

26. The 2017/18 Budget Report identified a budget reduction requirement of £27 million for 2018/19 and £81 million over the three-year MTFP period. The £81 million is a base case scenario predicated upon the Council receiving Welsh Government funding decreases of 1% each year.
27. As part of robust financial planning, the MTFP undergoes regular refresh to reflect the most recent information. For the most part, the refresh undertaken during the first quarter of 2017/18 has either confirmed the assumptions that are already included within the MTFP, or gives no reasonable basis to depart from them at this stage. In these and other areas, further review will be required as the year progresses. The elements of the MTFP that have been updated as part of review during the first quarter are:-
- Particular areas of exceptional price inflation
  - Assumptions regarding potential specific grant reductions
  - Incremental salary drift for non-teaching staff
  - The level of emerging financial pressures for 2018/19
28. These updates have had the effect of reducing the 2018/19 gap to £23.5 million and the three-year position to £73.5 million as set out below.

	Medium Term Budget Gap			
	2018/19 £000	2019/20 £000	2020/21 £000	TOTAL £000
Schools Growth	6,727	8,993	6,556	22,276
Pay and Price Inflation	5,418	4,885	4,471	14,774
Capital Financing, Commitments & Realignment	576	1,276	2,658	4,510
Non Schools Demographic Growth	3,538	3,350	3,350	10,238
Emerging Financial Pressures	1,500	3,000	3,000	7,500
Fall out of 2017/18 Reserve Funding	1,500	0	0	1,500
Estimated 1% funding reduction	4,282	4,237	4,195	12,714
<b>TOTAL</b>	<b>23,541</b>	<b>25,741</b>	<b>24,230</b>	<b>73,512</b>

29. The following table includes additional detail on the pressures included within the above table and summarises the key assumptions that underpin them.

Plan Area	Pressures covered and key assumptions
Schools Growth	<ul style="list-style-type: none"> <li>• <b>Pay award</b> - assumed at 1% for teaching and non-teaching staff in line with cap</li> <li>• <b>Incremental Drift</b> - the estimated cost of annual pay scale progression for teachers</li> <li>• <b>Teacher's Superannuation</b> – includes the anticipated effect of employer's contribution rates as a result of changes to the discount rate used to set employer's rates for unfunded public sector schemes</li> <li>• <b>Pupil Number Growth</b> - the estimated annual growth resulting from rising pupil numbers</li> <li>• <b>Other Growth</b> - growth that relates to needs pressures including complex needs enhancements.</li> <li>• <b>Non Domestic Rates</b> - to reflect anticipated increases in rateable valuations associated with the development of the schools estate</li> </ul>

Plan Area	Pressures covered and key assumptions
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Pay and Price Inflation	<ul style="list-style-type: none"> <li>• <b>Pay award for non-schools staff</b> - assumed at 1% in line with public sector cap</li> <li>• <b>Voluntary Living Wage</b> - assumed uplift pending announcement of rate in November 2017</li> <li>• <b>Employer's Superannuation</b> - the next planned step in employers' superannuation contribution rates (from 23.3% to 23.5%) as set out in the 2017/18 Budget Report. The plan also includes the full year effect of potential auto-enrolment take-up</li> <li>• <b>Exceptional price inflation</b> - generally, directorates are required to absorb price inflation within existing resources. However, the plan allows for specific fee uplifts in unavoidable areas.</li> </ul>
Capital Financing, Commitments & Realignments	<ul style="list-style-type: none"> <li>• <b>Capital Financing</b> - figures reflect the incremental cost of servicing debt based on the existing capital programme with no assumption of new schemes from 2017/18 onwards.</li> <li>• <b>Commitments and Realignments</b> – includes commitments in relation to finance for the Central Enterprise Zone, the full and later year effects of pressures identified as part of the 2017/18 budget process and anticipated specific grant fall out. Credit amounts included within this section reflect the fall out of budgets allocated in previous budgets rounds for a time-limited period and the realignment of the redundancy budget in line with the planned model.</li> </ul>
Non-Schools Demographic Growth	<ul style="list-style-type: none"> <li>• Most of the growth within this section of the plan is in the area of social services. As well as growth in numbers, this reflects increasing complexity of demand.</li> </ul>
Emerging Financial Pressures	<ul style="list-style-type: none"> <li>• In the interests of financial resilience, the plan includes £1.5m in 2017/18 and £3m per annum thereafter in recognition that it is impossible to foresee all issues and that in reality additional burden may arise as the MTFP progresses. The figures will undergo review as the MTFP rolls on.</li> </ul>
Fall out of 2017/18 Reserve Funding	<ul style="list-style-type: none"> <li>• The 2017/18 budget included £1.5 million use of reserves. The plan reflects the fall out of this sum in 2018/19. Appropriate use of reserves for 2018/19 and beyond is covered in a later section of this report.</li> </ul>
Estimated 1% funding reduction	<ul style="list-style-type: none"> <li>• Estimated annual reduction in AEF in the absence of indicative figures</li> <li>• As part of strengthening financial resilience in the 2016/17 budget, a financial resilience mechanism was established to assist with funding settlements being worse than anticipated, which would cover a further 1% (in one year but not annually)</li> </ul>

### Approach to Budget Strategy

30. Two years ago, in preparation for the 2016/17 Budget, the Council undertook a detailed three-year analysis of budgets. This work provided an outline savings framework for Budget Strategy over the period to 2018/19 and proved a solid foundation from which to take forward the 2016/17 and 2017/18 budgets. This work has undergone incremental refresh and roll forward at regular intervals during the interceding period, but two years on it is timely for the Council to pause and reset this work, taking stock of the challenges on the medium term horizon with a new administration.
31. A significant amount of work has taken place since the February 2017 Budget Report in respect of budget strategy and financial planning. To date this has focussed predominantly on the 2018/19 position. All aspects of the budget have

undergone review with particular focus on Schools, Social Services, and capital financing. Collectively these areas, which are all under significant aspects of price and demand pressure, account for 70% of the Council's net budget. A robust 2018/19 position is key to providing a solid foundation from which to take forward work to shape the later years of MTFP strategy scheduled for the autumn and this has been the focus during the early part of this financial year.

### **Budget Strategy to address Medium Term Reduction Requirement – Updated**

32. The Budget Strategy is framed around four overarching assumptions:-
- Council Tax Increases
  - Use of Reserves
  - Cap on Schools' Growth
  - Savings Requirements
33. These assumptions have been reviewed as part of the approach referred to in the previous section. At this stage, two assumptions remain unchanged. The first relates to council tax increases which are retained at 3.7% per annum within the MTFP, and the second relates to the cap on (non-pupil number) schools growth, which is retained at 30% per annum. These assumptions will be kept under review as the budget process progresses and further clarity emerges around key unknowns.
34. The 30% cap on schools will not result in a reduction in the current level of schools budgets. Within the plan, schools would receive £17.7 million additional budget over the next three years. The cap reflects schools contributing to the Budget Strategy by managing 30% of their emerging pressures within their existing budgets. This is with the exception of increasing pupil numbers, which would continue to be fully-funded.
35. The updated strategy contained within this Report increases the annual draw-down from earmarked reserves to support the budget from £1.5 million to £2.35 million. The additional £850,000 per annum will be met from the strategic budget reserve that was created as part of 2016/17 outturn to assist with the challenging medium term financial position.
36. Collectively, the budget strategy assumptions already outlined in respect of council tax, cap on schools growth and use of earmarked reserves contribute £21.5 million towards a £73.5 million budget gap. This leaves £52 million to address through savings over the next three years, of which £15 million fall in 2018/19. The challenge of achieving ongoing savings of this level, based on the history of savings outlined in earlier sections of the report should be noted.
37. As already noted, work over recent months has focussed predominantly on the 2018/19 position. The output of work to identify savings is summarised in the next table in a thematic format. Over the summer, directorates will work to refine 2018/19 proposals, undertaking additional due diligence in readiness for public consultation later this year.

38. Whilst the table also includes savings in a thematic format for 2019/20 and 2020/21, at this stage these are much more loosely defined than for 2018/19, and a detailed piece of work will take place over the autumn to develop these. It is important to note therefore, that for later years, the strategy depicts a direction of travel that will require further challenging work over coming months to result in a fully defined set of savings proposals. As part of this detailed work, the other budget strategy key assumptions will also need to be kept under review in order to ensure that, based on the developing detail, the strategy reflects an appropriate balance of risk, resilience and impact across its constituent parts.

### Summary Overview

39. The table on the next page draws together the detailed consideration of all aspects of Budget Strategy set out in earlier sections into a summarised overview.

<b>Estimated Budget Reduction Requirement</b>	<b>2018/19 £000</b>	<b>2019/20 £000</b>	<b>2020/21 £000</b>	<b>TOTAL £000</b>
Schools Growth	6,727	8,993	6,556	<b>22,276</b>
Pay and Price Inflation	5,418	4,885	4,471	<b>14,774</b>
Capital Financing, Commitments & Realignment	576	1,276	2,658	<b>4,510</b>
Non Schools Demographic Growth	3,538	3,350	3,350	<b>10,238</b>
Emerging Financial Pressures	1,500	3,000	3,000	<b>7,500</b>
Fall out of 2017/18 Reserve Funding	1,500	0	0	<b>1,500</b>
Estimated 1% funding reduction	4,282	4,237	4,195	<b>12,714</b>
<b>Budget Reduction Requirement</b>	<b>23,541</b>	<b>25,741</b>	<b>24,230</b>	<b>73,512</b>

<b>Strategy to Address Budget Reduction Requirement</b>				

<b>Budget Strategy Assumptions</b>				
Cap on Schools Non-Demographic Growth @ 30%	1,416	1,902	1,245	<b>4,563</b>
Council Tax at 3.7%	4,686	4,860	5,040	<b>14,586</b>
Use of Earmarked Reserves*	2,350			<b>2,350</b>
<b>Total Assumptions</b>	<b>8,452</b>	<b>6,762</b>	<b>6,285</b>	<b>21,499</b>
<b>Directorate Savings</b>				
Business Processes including Digitalisation	4,446	2,844	3,728	<b>11,018</b>
Income / Commercialisation	2,122	3,100	2,692	<b>7,914</b>
Collaboration	759	3,847	1,507	<b>6,113</b>
Prevention and Early Intervention	1,400	1,986	2,012	<b>5,398</b>
Review of Third Party Spend	4,152	4,248	4,371	<b>12,771</b>
Service Reduction / Removal	2,210	2,954	3,635	<b>8,799</b>
<b>Total Directorate Savings</b>	<b>15,089</b>	<b>18,979</b>	<b>17,945</b>	<b>52,013</b>
<b>Total Strategy to Address Gap</b>	<b>23,541</b>	<b>25,741</b>	<b>24,230</b>	<b>73,512</b>

\* This reflects £2.35m use of reserves per annum, with a total of £7.05m drawn down over the MTFP period

### Medium Term Financial Plan Scenario Analysis

40. The base case scenario is underpinned by an assumption of annual AEF reductions of 1%. A sensitivity analysis undertaken around some of the key variables of the plan to consider a worse-case scenario considered:-

- The possibility of an annual AEF reduction of 2% compared to the 1% included in the base case
- A more pessimistic outcome of the impact of the change in discount rate on Teacher's Employers Contribution rates
- Annual pay awards of 2% for all staff compared to the 1% within the base case

<b>Worse Case Scenario</b>	<b>2018/19 £000</b>	<b>2019/20 £000</b>	<b>2020/21 £000</b>	<b>TOTAL £000</b>
<b>Base Case MTFP Position</b>	<b>23,541</b>	<b>25,741</b>	<b>24,230</b>	<b>73,512</b>

<b>Changes:</b>				
AEF	4,282	4,237	4,195	<b>12,714</b>
Pay Award	2,760	3,435	3,470	<b>9,665</b>
Pensions Issues - actuarial	0	1,900	0	<b>1,900</b>
<b>Revised MTFP Shortfall</b>	<b>30,583</b>	<b>35,313</b>	<b>31,895</b>	<b>97,791</b>

41. One key risk across the life of the MTFP is the level of pay awards. The MTFP extrapolates the general theme of restraint in respect of public sector pay over the medium term. However, with economists and other financial analysts predicting that inflation will hit 2% - 3% in the next two years, higher than it has been for many years, it is reasonable to assume there may be upward pressure on pay increases. As noted earlier in the report, removal of the public sector pay cap is an area that has received much press coverage in recent weeks. The table above shows that annual pay awards of 2% for all staff would add £9.7 million to the MTFP. In recent days, the Department for Education recommended that the teachers' pay award remain at 1% for the year from September 2017, so the risk of a 2% award has been pro-rated for 2018/19.
42. A 1% annual fluctuation in AEF has the biggest impact on the base case MTFP, adding £12.7 million to the estimated budget reduction requirement. Release of the Council's FRM would immediately mitigate this sum by £4 million. This would remove the opportunity for further one-off investment through the FRM and there would be no additional benefit for future years beyond 2018/19.
43. The worse case scenario models the potential for employers' contributions rates in respect of teachers' pensions to increase to 20% over the medium term, higher than the increase from 16.48% to 18% that is included within the base case MTFP. Commentators advising academy schools in England in relation to potential risk factors over the medium term have suggested that the rate could increase to 20% over this period. This issue will require careful monitoring as it largely depends upon a discount rate, which is a factor of the inflation rate, and which will therefore be changeable over this period.

### Other Known Unknowns

44. A number of "known unknowns" are being monitored in relation to the MTFP period. These are currently too uncertain to quantify but will require close scrutiny over the next few months and years as many have the potential to be significant in terms of amount. These include:-
- NJC proposal to review pay-scales in conjunction with employers as a result of NLW changes
  - The terms agreed as part of the UK's exit from the European Union and their impact on the economy
  - Specific projects to be agreed as part of CCRC arrangements
  - The 21<sup>st</sup> Century Schools Band B programme – overall quantum and funding arrangements

- Any new capital schemes or increases in expenditure on asset maintenance and their impact on revenue
- The impact of WG's devolved income tax powers from 2019
- The impact of WG devolved powers for land transactions tax (replacing stamp duty) and landfill tax from 2018
- Local Government Reform in Wales and associated requirements for pooled budgets.
- The WG pilot on 30 hours childcare (from 12.5 hours) for children aged three and four
- The potential for the Office of Tax Simplification (OTS) to recommend modifications to the National Insurance system

### **Consultation and Engagement**

45. The Council places a high regard on being open and honest about difficult choices. In order to provide an opportunity for people to have their say on what is important to them and their communities, a detailed consultation on 2018/19 budget proposals will take place later in the Autumn once Provisional Settlement affords additional clarity to the funding position. Over the summer, the Ask Cardiff survey will pave the way for the detailed consultation through consulting on a number of budget themes. The proposed Budget Timetable Framework for 2018/19 is included at Appendix 2. Throughout this period, involvement and consultation will take place with Cardiff Citizens, the third sector, School Budget Forum, Scrutiny Committee, Audit Committee and Trade Unions.

### **Employee Engagement**

46. Employee engagement at all levels within the organisation continues to be given high priority through a number of mechanisms including frequent directorate-led roadshows, dissemination of the core brief, the ambassador network and the launch of the staff app. The Council has in place various fora to engage directly and work with employees at all levels of the organisation. Employees will continue to receive briefings through these channels at all key stages of the budget process.

### **Current Capital Programme**

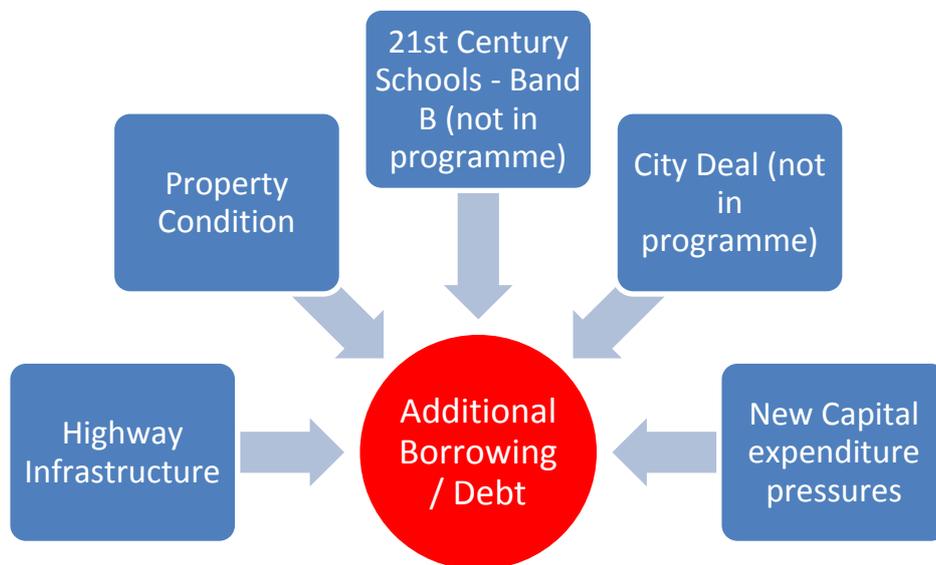
47. The Council sets a five-year rolling capital investment programme, updated annually. The level of General Capital support provided by WG as part of the annual settlement has decreased by 35% since 2010/11. Cardiff's allocation is the lowest per capita in Wales and is now insufficient to meet current annual sum commitments and indicative increases to such allocations. This means that the Council has an embedded borrowing requirement each year, even before new schemes or additional amounts are approved.



48. Additional borrowing to balance the capital programme has been limited to £10 million during each five-year period over the last two years. This represented a balanced position recognising the requirement for investment and the additional borrowing costs resulting from this in order to ensure that any borrowing is affordable, prudent and sustainable.

**Known Pressures**

49. Pressures on the need to borrow are arising from a number of sources



**21<sup>st</sup> Century Schools – Band B**

50. Band B of the WG’s 21<sup>st</sup> Century Schools Programme is due to commence from April 2019 and will run for 5 years until the conclusion of the 2024/25 financial year. WG have requested that local authorities provide an outline of their potential Band B requirements and work is currently being undertaken to identify and finalise the Council’s priorities. The focus of the programme is intended to be on the condition of assets and sufficiency of places and officers are working within these parameters.

51. The level of investment required from the Council is likely to be substantial and will have significant capital financing implications. As such, careful

consideration will be required as to the overall affordability of the capital cost envelope of the programme.

### **Building Property Condition**

52. The Council's annual sum allocation for properties is £4 million, split between schools (£2.7 million) and other properties (£1.3 million). The financial year 2016/17 saw some temporary school closures and disruption in respect of remedial electrical works. Whilst the Corporate Property Asset Management Plan recognises that various initiatives need to be undertaken to ensure a sustainable asset base and address a backlog of maintenance, there is a need to refresh property surveys to be able to understand the state of the estate and to develop a risk and evidence based approach to additional investment in determining priorities for existing budgets. The costs of these surveys were approved as part of the budget proposals in 2017/18.

### **Highway Network Assets**

53. Highway network assets include carriageways, footpaths, street lighting, bridges and traffic infrastructure. Current annual sum expenditure on these items is £3.2 million. Whilst it is recognised that delaying investment increases future costs of treatment, any additional investment towards a steady state, where the condition of the assets is no better or worse than current, also needs to be on the basis of an approved highway asset management plan. This will also require an understanding of the state of the network and to develop a risk and evidence based approach to additional investment and in determining priorities for existing budgets.

### **City Deal**

54. The Council's contribution to the Investment fund of £120 million is £28 million and secures HM Treasury Grant of £375 million over 25 years for the Region. Given that detailed proposals are yet to be determined, the Council's commitment is not currently included in the Capital programme, but is modelled to be paid for by additional borrowing.

### **Other**

55. Whilst the focus of investment will be on existing assets, it is also important to recognise that there may be other unavoidable commitments that the Council needs to support, after consideration of all other funding options. These items and the timing of any such implementation would need to be carefully considered when prioritising the investment programme.

### **Borrowing and Financial Resilience**

56. The Council's Capital Financing revenue budget includes the costs of interest and a provision for debt reduction. The latter is based on WG guidance and the Policy approved by Council as part of the budget. Based on assumptions included in the 2017/18 budget, this is forecast to increase from £34 million in

2017/18 to £37 million by 2020/21 and is now larger than some directorate net expenditure budgets.

57. The proportion of the Council's net controllable budget that is spent on servicing debt has increased over recent years.

<b>Capital Financing Costs expressed as percentage of Controllable Budget</b>			
	<b>2011/12 Actual %</b>	<b>2021/22 Estimate %</b>	<b>Difference 11/12 – 21/22 (%)</b>
Net capital financing Budget	13.47	18.32	36.01
Gross capital financing budget	15.17	23.19	52.87

58. Capital receipts are important and serve to increase the affordability of the Capital Programme. In 2018/19, the first call on capital receipts up to £1 million will be to pay for Capital programme commitments. However most capital receipts are currently earmarked for specific schemes.
59. Significant areas of capital expenditure on 21<sup>st</sup> Century Schools Programme (Band A) and the Cardiff Enterprise Zone, including the Transport Interchange, are assumed to be paid for from the disposal of assets. Incurring expenditure prior to receiving the proceeds of any such receipts represents a significant risk to borrowing and will need to be a consideration in view of affordability and timing of expenditure on these schemes.
60. Borrowing has long-term financial consequences and costs span generations. Affordability of capital investment must have regard to the Council's responsibilities for the Wellbeing of Future Generations (Wales) Act 2015. Accordingly, previous advice for development of the budget strategy in terms of the capital programme remains even more relevant for members to consider when developing the investment plan.

*“Particular Attention needs to be given to the medium and long term impact of additional borrowing on the Council’s revenue budget, as it is clear that continuing to increase levels of additional borrowing within the General Fund is not consistent with the significant level of savings to be found”.*

*“Within this financial climate of reducing revenue resources all action necessary must be taken to reduce both initial capital expenditure and the subsequent need to borrow.” – S151 Officer*

### **Developing the Investment Plan 2018/19 to 2022/23**

61. In formulating the five-year Capital Programme for 2018/19 to 2022/23, it is clear that there are pressures for investment, but affordability is a significant risk, both now and in the future. Additional borrowing has been limited to £10 million over each five year period during the last two years and even sustaining this requires a fundamental review of how new and existing pressures can be afforded as part of a long term investment strategy.

62. The approach to developing the investment priorities in the capital programme between 2018/19 to 2022/2023 will be as follows:-
- Directorates to consider whether existing commitments can be reduced / deferred
  - Any new funding bids for this iteration of the 5 year capital programme will focus on Asset Renewal only and :-
    - be evidence based
    - be risk prioritised
    - have considered all alternative solutions for funding and achieving the same outcome before request for council funding
    - demonstrate value for money in expenditure and approach to delivering outcomes
  - Any new capital expenditure pressures that do not relate to existing assets that are to be retained in the long term, need to be considered in the context of external funding or robust invest to save business cases.

### **Reasons for Recommendations**

63. To seek Cabinet approval for the budget strategy in respect of 2018/19 and the MTFP.
64. To note the Budget Timetable Framework and forward this to Council for approval.

### **Legal Implications**

65. It is the responsibility of the Cabinet to receive financial forecasts and develop a medium term financial strategy with a view to proposing a Budget for the Council to approve. The report highlights the seriousness of the financial challenges ahead. As stated in the body of the report, it is important that members take note of the statements made by the Section 151 Officer in this regard.
66. There are no general legal issues arising from the report. Specific legal issues will be addressed as part of the proposed budget preparation.
67. The report provides that the proposed Budget Timetable framework for 2018/19 will make provision for consultation. It is important to note that consultation raises the legitimate expectation that any feedback received from the consultation will be taken into account in developing the proposals consulted upon.
68. In considering this matter and developing the budget proposal regard must be had to the Council's duties under the Equality Act 2010 and appropriate steps taken to ensure that i) the Council meets the requirements of the Public Sector Equality Duties; and ii) due regard as been / is taken of the likely impact of decisions in terms of equality and discrimination.

## **Financial Implications**

69. The report sets out the Budget Strategy for 2018/19 and the medium term. It is written during a period of prolonged financial constraint and with significant planning uncertainty, both at a national and Welsh level. The absence of indicative funding settlements for future financial years continues to prove problematic from a financial planning perspective. Ongoing budget reductions of the scale required to achieve a balanced position require appropriate lead in times and implementation in a planned and rational way. The change in timing of the UK's budget from Spring to Autumn has the potential to cause additional uncertainty around the 2018/19 financial settlement.
70. The Council has identified £105 million in savings over the past three years and £17 million in the current year. Building on this, the current strategy indicates that savings will contribute £52 million towards the £73.5 million budget reduction requirement over the next three years. Achieving ongoing savings of this scale is extremely challenging. It requires further organisational change, exploration of preventative measures and the adoption of more commercial approaches in untested markets. In challenging change environments such as these, careful monitoring of financial controls and financial resilience is key.
71. The financial resilience snapshot at the time of this report shows that reserves have increased during 2016/17. This improves the Council's financial resilience generally, as reserves provide a financial cushion, but also more specifically in that one of the reserves created as part of 2016/17 outturn was to assist with the challenging medium term position and is used as part of this budget strategy. Whilst the 2016/17 outturn position was balanced overall, there was an overspend of £7.6 million at directorate level which was offset by the £4 million general contingency and underspends in corporate areas such as insurance and redundancy. Delivery of delayed 2016/17 savings in addition to planned 2017/18 savings will require close monitoring and this has already begun.
72. The report sets out the strategy for addressing the budget reduction requirement. Collectively, a 30% cap on schools (non-pupil number) growth, a 3.7% council tax increase and £2.35 million annual use of reserves will contribute £21 million to the £73.5 million budget reduction requirement, leaving a savings requirement of £52 million. Further refinement of 2018/19 savings will take place over the summer to allow work over the Autumn to focus on later years of the MTFP, which are currently more loosely defined. This work will need to consider the balance of risk, resilience and impact across the constituent parts of the strategy.
73. The report models a worse-case scenario of £30.6 million for 2018/19 and £97.7 million over the medium term. The main variables that contribute to this potential worsening are the potential for pay award of higher than 1% and the risk that funding settlement may be worse than a reduction of 1% per annum. In recent years, the likelihood of pay awards exceeding 1% was considered low. However, with inflation anticipated to rise and recent pressures on the UK Government to reconsider the public sector pay cap, this may be more of a

financial risk to the MTFP than in previous years. The Council has a financial resilience mechanism that would enable it to withstand one funding reduction of 1% worse than covered by the MTFP. Thereafter, funding reductions that deviate from 1% would require a review of the strategy.

74. The report sets out that the position in respect of capital is also challenging. Welsh Government support has fallen by 35% since 2010/11 and there are significant pressures on the capital programme, including maintaining the Council's property and highway infrastructure and addressing corporate priorities. Additional investment can only be funded through additional borrowing or through the disposal of assets. It is important to note that additional borrowing has affordability implications for the revenue budget. As revenue budgets reduce and capital financing costs increase, interest costs and debt repayments account for an increasing proportion of the revenue budget as evidenced by the affordability indicators included in this report.
75. The requirement to meet increasing costs associated with debt can only be met from future savings or from council tax increases. This clearly limits the scope for further additional borrowing in future years and reduces the Council's overall flexibility when making decisions on the allocation of its revenue resources. Additional borrowing is not sustainable in the long term and consideration must be given to prudential indicators, control mechanisms for different types of unsupported borrowing and core areas of investment.

### **HR Implications**

76. The report outlines the UK and Welsh contexts under which the budget is being set together with the continued financial challenges faced by the Council in balancing reducing finances with increasing demands. The Council will continue to review the shape and scope of the organisation and the way in which services are delivered and efficiencies achieved. New service delivery models will need to meet demand pressures and reflect budgetary realities alongside securing further efficiency savings through better collaboration and partnerships, integration of service delivery and reducing duplication of effort and resources.
77. Given the level of savings required in 2018/19 and beyond, it will be key that the savings proposals identified are robust and deliverable. The extent of financial challenge in a continued period of restraint will result in savings targets for controllable budgets which will be considerably challenging and will result in significant changes to how local government services are delivered. The availability of resources to support the delivery of these radical and sustained changes will be key.
78. Whilst it is not possible to provide specific HR implications on any changes at this time, it is clear that the ongoing budget difficulties will continue to have significant people implications associated with actions necessary to manage the financial pressures facing the Council. As service delivery proposals are developed, there will need to be consultation with employees (those directly and indirectly impacted) and the Trade Unions so that they are fully aware of

the proposals, have the opportunity to respond to them and understand the impact that the new model of service will have on them. Further and specific HR implications will be provided when relevant models are proposed. Any proposed reductions in resource levels will be managed in accordance with the Council's recognised policies for restructuring which include, where appropriate, redeployment and voluntary redundancy.

79. The Council's Voluntary Redundancy Scheme has been widely publicised to employees. Whilst those interested in leaving on this basis (with a post subsequently deleted) should express an interest to do so, a business case to support the exit will still need to be made and signed off. Flexible retirement continues to be another option available and a Sabbatical policy is in place as well as ability to request voluntary reductions in working hours. Redeployment, access to Cardiff Academy courses and access to the Trade Union Learning Representatives to support members and non-members with training and development to support new skill requirements will remain available. Additionally the purchase of Additional Annual Leave Policy remains in place and has provided the opportunity for employees (excluding those based in Schools) to buy up to an additional 10 days annual leave.
80. A Trade Union Partnership Meeting has been established and will meet on a monthly basis to facilitate early discussion with Trade Unions on key organisational proposals, with more detailed discussion continuing with employees and trade unions at local directorate level. It is essential that there continues to be appropriate consultation on proposals which are taken forward by the Cabinet. Many of these will have people implications which will need to be considered at an early stage in consultation with the Trade Unions and employees impacted.

## **RECOMMENDATIONS**

The Cabinet is recommended to:

- (1) Agree the budget principles on which this Budget Strategy Report is based including the use of a targeted approach to meeting the Budget Reduction Requirement both in 2018/19 and across the period of the Medium Term Financial Plan.
- (2) Agree that directorates work with the relevant Portfolio Cabinet Member, in consultation with the Corporate Director Resources and Cabinet Member for Finance, Modernisation and Performance Management to identify potential savings to assist in addressing the indicative budget gap of £23.5 million for 2018/19 and £73.5 million across the period of the Medium Term Financial Plan.
- (3) Agree that relevant bodies who raise precepts and levies on the Council be formally contacted to request that funding reductions are also fed into these settlements which should be in line with those it is expected that Welsh Government will impose in respect of local authority funding.

- (4) Delegate to the Corporate Director Resources in consultation with the Cabinet Member for Finance, Modernisation and Performance, the authority to identify an alternative budget reduction requirement upon receipt of further clarification in respect of Welsh Government funding.
- (5) Agree that any new capital investment approvals, to be funded by borrowing between 2018/19 and 2022/23, will be only for asset renewal in relation to existing assets.
- (6) Delegate to the Corporate Director Resources in consultation with the Cabinet Member for Finance, Modernisation and Performance, the authority to amend the Budget Strategy, if this amendment does not significantly depart from the underlying principles. Any requirement to significantly depart from these principles would require a further Budget Strategy Report to Cabinet.
- (7) Agree that the Council seeks expressions of interest from officers in respect of the voluntary redundancy scheme
- (8) Propose that Council agree that the Budget Timetable Framework set out in Appendix 2 be adopted and that in the intervening period that the work outlined is progressed with a view to informing budget preparation.
- (9) Agree that there will be a two stage process in relation to consultation on 2018/19 proposals. This will commence with the Ask Cardiff Survey including a section on general budget themes, followed by more detailed consultation on 2018/19 proposals later in the Autumn, once there is further clarity on the 2018/19 funding position.

**CHRISTINE SALTER**  
**Corporate Director Resources**  
21 July 2017

*The following appendices are attached;*

Appendix 1 – Budget Strategy Frequently Asked Questions  
Appendix 2 - Proposed Budget Timetable Framework 2018/19  
Appendix 3 – Finance Snapshot – Financial Resilience

*The following Background information has been taken into account*

2017/18 Budget Report – February 2017