APPENDIX 2

Acting Chief Executive Response to Section 114 Notice

22 December 2022

Executive Summary

This report provides further comment by the Acting Chief Executive on the Section 114 Report issued by the Acting Director of Finance and Section 151 Officer. Specifically, it summarises work undertaken by officers and members in conjunction with Commissioners and Department of Levelling Up, Housing and Communities (DLUHC) over the past four months and provides comment on the implications of the Section 114 report and further action that will be required to support financial recovery moving forward. It highlights work already undertaken on producing a first draft of the council's Improvement and Recovery Plan (IRP) that will address financial, governance and organisational cultural failures that underpin the extremely serious situation that the council currently finds itself in. This IRP has been submitted to Commissioners and will need to be further iterated after the publication of the Best Value Inspection (BVI) report. The IRP will need to be jointly owned by officers and members and be the primary focus of the council moving forward in order to drive the transformational change required to support recovery.

The report highlights the need for members to agree and officers to deliver some difficult choices in the near future that will allow the council to operate under a substantially reduced revenue budget. The report outlines and discusses the levers available to the council to support recovery including council tax increases; asset disposals; debt reduction through divestment of the investment portfolio; savings through service rationalisation, reduction and transformation, including a review of the capital programme; growth; and support through exceptional financial support from government. The report also highlights that even after full use of these levers, it is likely that the council will require additional support from central government yet to be negotiated.

1. Recommendations

Council is recommended to:

1.1 Recognise the progress made by officers and members in conjunction with commissioners over the last four months as part of government intervention

1.2 Await the BVI report, which will now be provided to the Secretary of State by 17 February 2023

1.3 Acknowledge the progress made on the Improvement and Recovery Plan, its critical importance as the council's Corporate Plan for recovery, and await a final version, which will be submitted to both Cabinet and Full Council for approval once the BVI report has been published

1.4 Acknowledge and accept the scale of the challenge that the council faces and support the steps that it will need to take relating to council tax increases, asset disposals, savings, and growth to support recovery, appreciating these will be a prerequisite for negotiating government financial support.

1.5 Accept that current modelling suggests the council will require capitalisation direction from central government for at least the next five years along with further government financial support, yet to be negotiated, in order to achieve long-term financial sustainability

1.6 Approve the Expenditure Control Arrangements set out in section 5.8 and Appendix 4.

2. Introduction

2.1 The report of the Acting Director of Finance and S151 Officer that issues a Section 114 notice sets out the extremely serious financial situation that Thurrock Council finds itself in and confirms that the council does not have sufficient resources available to meet its expenditure commitments. The Acting Director of Finance and S151 Officer has concluded that the council has no prospect of setting a balanced budget in 2022/23 or 2023/24 without significant Extraordinary Financial Support from central government.

2.2 The issuing of a Section 114 report is an incredibly serious matter and urgent ongoing action is required to return the council to a path of financial sustainability. The failure of the council's investment strategy and wider financial and organisational governance has culminated in a requirement to write down £275m relating to council investments, an overall 2022/23 projected in year deficit of £452m and a predicted deficit in 2023/24 of £184m as set out in the Acting Director of Finance's S114 report.

2.3 The scale of the deficit faced by the council is unprecedented and will require both immediate and ongoing concerted action by officers and members over many years in order to return the council to a path of financial and operational sustainability and recovery. The scale of that challenge is enormous. Recovery will require a collective ownership of the problem, a laser like focus of the entire organisation on recovery, and some extremely difficult choices.

2.4 This report describes some high-level background and context to the Acting Director of Finance and Section S151 Officer’s decision to issue a Section 114 notice and sets out action that the council has already taken over the last four months to attempt to understand the scale of problem, address some of the immediate challenges and mitigate risk. The report goes on to describe additional longer-term action required to support recovery and return the council to financial and operational sustainability.

3. Background

3.1. On Friday 2 September 2022, the Secretary of State for Levelling Up, Communities and Housing made Directions to Thurrock Council under section 15(5) and (6) of the Local Government Act 1999 because of:

- the scale of the financial and commercial risks potentially facing the council, compounded by the council’s approach to financial management and the seriousness of allegations made by third parties about the processes that had been applied to the operation of the council’s commercial strategy, and;

- the failure of the council to provide assurance to Ministers and the Department of Levelling Up, Housing and Communities (DLUHC) on the adequacy of the actions being taken to address the issues, taking account of the scale and pace of the response required.

3.2. The Secretary of State appointed Essex County Council as Commissioners and Best Value Inspectors to Thurrock Council.

3.3. The Secretary of State’s Directions to Thurrock set out under the Act are provided in Appendix 3.

3.4. As Best Value Inspectors, Essex County Council commissioned a team to carry out the inspection of Thurrock Council. The team was directed by the Secretary of State to consider whether Thurrock Council, in carrying out specific functions, had effective arrangements in place for getting best value in its governance, audit (internal and external), risk management, and overview and scrutiny functions, and how they affect the provision of services.

4. Action Already Taken in Response to Government Intervention and the Council’s Financial Situation

4.1. In response, officers and members have worked collaboratively and at pace with Commissioners, the Best Value Inspection Team, and DLUHC over the past four months. The primary focus of work has been to diagnose the extent of financial and wider governance and organisational cultural problems facing the council and to put in place robust action to mitigate the immediate financial and governance risks. The Acting Director of Finance and s151 Officer has set out the scope of the findings of this work to date in section 4.2 and 4.3 of his report.

4.2. A new governance structure has been set up to oversee the intervention and government directions. An Improvement and Recovery Board of Commissioners, senior/chief council officers and DLUHC with overall responsibility for oversight of all elements of the intervention and directions has been meeting monthly. A Finance Recovery Board of the same, with responsibility for oversight of the financial directions has been meeting fortnightly. A Strategic Investments Advisory Group with responsibility for oversight of the programme of work relating to the council's investments including procurement of specialist advice, mitigating financial loss and maximising financial recovery, and legal recourse has been meeting at least fortnightly.

4.3. An interim Directors' Board structure providing additional leadership capacity was agreed by General Services Committee in September 2022. New Interim Directors of Place, Legal and Governance, and Street Scene and Leisure are now in post. Work is still ongoing to recruit a new Chief Financial Officer after the preferred candidate withdrew shortly before his start date in December 2022.

4.4. A review of wider short-term staffing capacity and capability requirements to deliver recovery at all levels of the council has been completed and resource agreed. Recruitment to these posts is currently underway.

Financial Recovery

4.5. The council's Corporate Finance Team, the Portfolio Holder for Finance and Cabinet have worked closely with Commissioners to address the directions relating to finance. Existing short-term debt held by the council and borrowed from other public bodies has been refinanced through the Public Works Loan Board (PWLB) allowing the council to repay its existing creditors.

4.6 Informed by specialist advice procured from Camdor Global Advisors, Cabinet has agreed specific action to divest of the council's investments in order to reduce overall borrowing. Actions to mitigate further capital impairment on the three most significant problematic investments: Pure World Energy, Just Loans Group, and Toucan/Rockfire and ensure maximum financial recovery have been agreed and implemented. A review of all other investments held by the council as part of its investment strategy is currently underway. Actions taken to date in conjunction with a wider divestment strategy will contribute to the significant write down of the debt associated with the funding of the investment strategy. Further action has been taken to update the Minimum Revenue Provision (MRP) policy to ensure debt associated with capital investments is written down appropriately.

4.7 In parallel, the Capital, Treasury and Investment strategies of the council are in the process of being updated to support the actions taken to date and ensure they are aligned with the objectives of the intervention. This will include meeting the objectives of reducing debt and updating the MRP policy.

4.8 A draft MRP policy supporting the prudent write down of capital investments has been agreed with Commissioners. This has been shared with external audit and initial discussions support the implementation of the revised policy. A more detailed response will be provided in early 2022/23. The policy has been set based on a prudent write down of capital investments from the point of inception for each individual investment.

4.9 The new Interim Director of Place has commenced a review of all council assets in order to ascertain the scope of the opportunity to generate further capital receipts to offset capital impairment of some of the council's investments. Validation of the values of the first 13 high value sites is due to be reported by 31 January 2023, with reporting of a wider operational property review by end of March 2023.

4.10 A Delivery Risk Assessment on all 2022/23 savings proposals has been undertaken to provide assurance on delivery.

4.11 A 20-year MTFS (Medium Term Financial Strategy) model has been developed as a starting point for further discussions with DLUHC on Exceptional Financial Support and development of a medium-term action plan to return the council to financial sustainability.

Best Value Inspection

4.12 On 14 December 2022, it was agreed that the Best Value Inspection Team will be provided with more time to complete their report. Essex County Council will now provide their report to the Secretary of State by 17 February 2023. In light of the extended timescale, the BVI team will issue interim headline findings and recommendations to DLUHC.

4.13 Throughout the course of the inspection, council officers and members have worked collaboratively, openly and transparently with the inspectors in order to support their work and to provide a report which is truthful, accurate and can be used to support the recovery of the council. This inspection is ongoing, and the council will consider and respond fully to its findings and recommendations when published.

4.14 It is expected that the Best Value Inspection report will be critical of both the financial and governance arrangements that have led to the current dire state of the council's finances, but also find broader failings in some wider aspects of its historic corporate organisational culture.

Improvement and Recovery Plan (IRP)

4.15 In line with the Secretary of State's Directions, the council has developed at pace an Improvement and Recovery Plan. As a starting point, the IRP has focussed on the existing directions, recommendations made by other independent reviews such as the Corporate Peer Challenge, and the views of both officers and members as to areas where the council needs to transform.

4.16 The plan has been developed jointly through extensive consultation with officers at all levels of the council and through consultation between officers and members. The plan focuses on 13 workstreams centred around five key themes shown below:

Financial Sustainability	Governance & Scrutiny	Strategic Direction	Place Leadership & Growth	Leadership & Culture
• Capital & Treasury Group • MTFS, Saving Programme & Budget Setting • Strategic Investment Advisory Group	• Strengthening governance & financial delegations • Collective Decision Making	• Strategic Direction • New Operating Model	• Place Leadership • Growth	• Culture Change • Building a fit for purpose organisation • Building organisational capability • Communication and Engagement

4.17 It is tempting, in the context of the Section 114 notice and the scale of the financial deficit reported by the Acting Director of Finance and s151 Officer, to focus only on the failure of the council's Investment Strategy and the poor financial decisions taken by a few individuals as explanation of the cause of council's current problems. However, if the decisions of the few leads to the financial collapse of an entire organisation, this speaks to a wider organisational and systemic failure of governance and scrutiny, which in itself suggests fundamental historical problems of organisational culture. The BVI report will undoubtedly provide detailed comment on these issues shortly, but the process of developing the IRP has already given the organisation the opportunity to reflect and have an open and honest conversation about where it needs to change fundamentally in order to improve and to recover. It has allowed both officers and members to articulate and begin to drive forward the change needed through the development and delivery of the plan.

4.18 The Leader and I have both signalled our joint intention to create a new open, transparent and collaborative organisational culture and begun to make changes. Cabinet and Directors' Board now meet regularly and are working in a positive and constructive way, and Directors and I have undertaken additional engagement sessions at individual political group meetings. We have sought to improve relationships with the media including the reinstatement of media briefings attended by the Leader, relevant Directors and me to answer media questions on Cabinet papers prior to each Cabinet meeting. I have taken steps to significantly improve staff engagement at all levels of the organisation including fortnightly Leadership Groups (also attended by the Leader), fortnightly 'all staff' MS Teams conversations with Directors' Board, and regular Managers' Conferences. A new staff Communication and Engagement strategy has been developed and is embedded within the Improvement and Recovery Plan.

4.19 However, as a council, we should recognise that we are still in a 'diagnosis' phase, which means while issues are being identified, rapidly assessed and tackled, there are more challenges to be discovered and understood. We are still in the process of fully quantifying the financial and organisational issues we will need to address in the coming years, but it is imperative that we work to do so at pace.

4.20 The first version of the IRP has been submitted to Commissioners. Once the BVI report is published, the council will need to iterate the plan to encompass any new findings.

4.21 Delivery of the plan will need to be the primary focus of the entire organisation moving forward to ensure that we drive the fundamental organisational, financial, governance and cultural change required to deliver recovery. A governance structure around each theme is being set up and resources aligned to the programmes that sit within the themes with named DB and Cabinet sponsors and Senior Responsible Officers for each programme. A strengthened Corporate Transformation Team will take responsibility for delivery assurance and monitoring of progress.

4.22 A final version of the Improvement and Recovery Plan will be brought to both Cabinet and Full Council for approval in the last quarter of 2022/23 after the BVI report is published. The final version of the IRP will act as the council's Corporate Strategy moving forward.

5. **Action the Council Must Take to Continue to Support Financial Recovery**

5.1. There are essentially only five mechanisms available to the council to support financial recovery:

- Council tax
- Asset disposals
- Revenue savings through service rationalisation and transformation
- Growth
- Exceptional financial support from government

<u>Council Tax</u>

5.2. Thurrock's council tax benchmarks 53rd lowest out of 56 Unitary Authorities (7th centile) and is also the lowest within its CIPFA (Chartered Institute of Public Finance and Accountancy) group of comparable local authorities. Successive past administrations have chosen not to increase council tax at the same rate as comparable local authorities. This has led to a lower council tax revenue base and consequent lower overall increase in council tax revenue even where council tax has been increased at the maximum allowable rate in recent years. Historically, this deficit has been ameliorated by income generated from investments, but this is clearly no-longer a feasible strategy. To support financial recovery, members will need to support increases in council tax including a request to DLUHC for dispensation to raise council tax at a rate that exceeds the national referendum limit. It is likely that future government financial support will be contingent on an agreement to increase council tax.

Asset Disposal

5.3. As set out in 4.9, the new Interim Director of Place is leading a workstream on Asset Disposals, overseen by the Financial Recovery Board. The council owns a large number of property assets that sit in either the General Fund, Housing Revenue Account, or are owned by Thurrock Regeneration Limited. The Council already has an assets approach called 'Retain, Reuse, Release' that promotes the rationalisation of operational property and the reuse or release (disposal) of surplus assets. However, this approach lacked clear policies and criteria to ensure best value was achieved and operational needs continued to be met.

5.4. In addition to raising capital to offset the impairment from financial investments, an expanded and accelerated disposals programme offers an opportunity to accelerate the rationalisation of the council's operational estate and relinquish properties from the wider portfolio that either carry revenue liabilities or generate a low net return.

5.5. Cabinet has already approved disposal of assets valued at circa £92m. Initial findings from the Assets Disposal workstream has identified further short-term (2022/23-2024/2) opportunity and longer-term (2024/25+) of circa £65m. A detailed analysis of the remaining portfolio is underway to ascertain value, potential for capital receipts and impacts of disposal. A review of the property assets held in the Housing Revenue Account suggests limited scope for capital receipts through an HRA stock transfer.

5.6. Proposals on further asset disposals will be brought forward for agreement by Cabinet via Overview and Scrutiny in 2023. A Commercial Strategy will also be developed to ensure that where assets are retained, that they provide market level rental yields unless there is a strong business case not to do so.

Revenue savings through cost control, service rationalisation and transformation

5.7. In order to access Exceptional Financial Support and other future financial flexibilities or dispensation from DLUHC, the council must first demonstrate that it has done everything possible to reduce revenue spend.

5.8. In line with the requirements of the S114 notice, from 19 December 2022, the Acting Director of Finance and S151 Officer has put in place mechanisms to control all non-essential spend. These controls will ensure maximum value for money from every pound spent. Full details of the arrangements are provided in Appendix 4 of this report. In summary, all new spend over £500 will be subject to additional approval checks to ensure that it is classed as 'essential' including a mini business case. All spend over £25,000 will require a full business case. Three levels of spending control are in place for reviewing and approving new spend:

- **Directorate Spending Control** will require approval of all new spend over £500 from the relevant Director, a service representative and finance representative
- **An Expenditure Control Panel (ECP)** will meet three times a week and will chaired by a senior officer from the Corporate Finance Team plus an officer from the Commercial Services Team and Internal Audit will review and approve/reject all business cases
- **A Strategic Approval Panel (SAP)** comprising of the Acting Chief Executive, Acting Director of Finance and S151 Officer, and Interim Director of Legal and Governance together with the Finance Officer from the ECP will meet twice weekly to review any business case escalations from the ECP and any areas of concern raised by the ECP relating to wider corporate spending patterns.

5.9. As part of budget setting for the 2022/23 financial year, the MTFS for 2022/23 and 2023/24 already contained £14.2m and £3.69m proposals for savings through service rationalisation, efficiencies, and wider transformation, respectively. Throughout 2022/23, the operating deficit of the council has worsened as a result of inflationary and demand led pressures relating mostly to adult and children's social care placements. This has been managed through the use of one-off reserves which has balanced the operating budget in 2022/23. These reserves do not provide ongoing support for the budget and hence the pressures need to be managed in 2023/24. A programme of further savings is being finalised and will be confirmed in January 2023. The current operational gap is £16.4m which includes £10.9m of savings.

5.10. A programme to identify further substantial savings proposals has been developed through Directors' Board in consultation with Directorate Management Teams and Leadership Group. This will be brought to Informal Cabinet for further member engagement and through Overview and Scrutiny to Cabinet in February 2023 for approval as part of the council's budget setting process for 2023/24.

5.11. However, members should not underestimate the scale of the savings that the council will be required to make by government over the medium term as part of any agreement to access continued financial support. The scenarios presented in the 20-year MTFS model being discussed with DLUHC assume a year-on-year savings target of at least 5% until 2028/29. To put this in context, these levels of savings will increase the proportion of the General Fund spent on Adult and Children's Social Care externally commissioned placements from 28.6% in 2023/24 to 52.4% by 2028/29.

5.12. In order to deliver the scale of savings required, the council will need to undertake a programme of radical service reform and transformation. It will simply not be possible to deliver the scale of savings required through 'salami slicing' existing budgets. Whilst there have been some services within the council that have embraced a learning and transformative approach to improving services and driving efficiencies, there are parts of the organisation and cross-cutting activities that require urgent reform. We have already started this work by undertaking a comprehensive analysis to benchmark the cost of spending on all services against other unitary authorities and CIPFA comparator local authorities. Though many services have low comparative spend, some services, particularly in Environment and Waste benchmark comparatively highly.

5.13. Members will need to agree, and officers will need to deliver a savings and transformation programme that:

- Recognises that we will no-longer be able to afford to deliver the current range of services or maintain some services at existing levels and that significantly rationalises the current service offer to live within a substantially reduced financial envelope.
- Reduces the staffing establishment of the council in the context of the above.
- Prioritises services that deliver our statutory obligations to protect the most vulnerable residents.
- Transforms remaining services to ensure that they are as efficient and cost effective as possible, continuously benchmarking cost against our peers.
- Provides new integrated and preventative operating models that address silo working, rationalising the number of different service 'front doors' with fewer roles upskilled to undertake more functions to reduce failure demand and associated cost.
- Prioritises actions that reduce spend on social care placements including further market development, timely placement review and prevention/early intervention in conjunction with NHS and third sector partners.
- Maximises and leverages the resources within the community and of our partners including the private and third sector. In short, we need to 'deliver less and facilitate more'.

5.14. Historically, responsibility for both delivery of service transformation and for monitoring of wider savings has sat within different directorates. Alongside this, a small Corporate Transformation team has focussed on delivering specific individual projects. The approach has resulted in siloed working with an inconsistent approach to savings and transformation delivery and monitoring. To address this and ensure stronger delivery grip, an enhanced Corporate Transformation and PMO (Programme Management Office) is being created with responsibility for providing effective project management support, delivery risk assurance, and monitoring/reporting of a single corporate transformation and savings approach.

Growth

5.15. Thurrock remains a borough of huge economic growth opportunities. The Thames Freeport represents an opportunity for the creation of over 25,000 new jobs with an additional 30,000 jobs indirectly through supply chains, significant investment in training and skills, targeted interventions to tackle deprivation and disadvantage in communities funded through retained business rates, and over £4.5 billion in new public and private investment. Overall, it is anticipated that the Thames Freeport will contribute £5.1 billion of Gross Value Added to regional economy.

5.16. Over the medium term, economic growth within the borough represents an enormous opportunity for increased prosperity and wellbeing for residents. The council must work with partners and the private sector to secure this ‘growth dividend’; both increases to council revenues through business rate growth, and a reduction in demand-led services associated with the reduction in inequality and deprivation that increased economic prosperity will bring.

Exceptional financial support from government

5.17. The Section 114 notice confirms that exceptional financial support is required from government. Initial discussions have not confirmed the form of that support, but this is likely to be in the form of a capitalisation direction initially.

5.18. A capitalisation direction from government gives local authorities special dispensation to use capital funding to resource revenue spending commitments. Capital funding can be in the form of both capital receipts from, for example, the sale of assets, or through borrowing. Given the scale of deficit that the council is facing, the 20-year MTFS model confirms that a capitalisation direction will be required in the form of additional borrowing to close revenue deficits every year over the medium term.

5.19. Longer term reliance on capitalisation directions funded solely through borrowing clearly will not return the council to financial sustainability. Unless borrowing to fund short-term revenue deficits can be repaid, overall debt rises over time placing increased pressure on revenue budgets from additional interest and MRP charges, and the requirement for further short-term borrowing the following year; in short, a negatively reinforcing cycle of borrowing and debt.

5.20. The 20-year MTFS model shows a falling budget deficit from £187M in 2024/25 to £89.7M in 2028/29 assuming council tax rises, delivery of year-on-year savings targets, and repayment of debt through investment divesting and further asset sales. However, this ongoing budget deficit will also require capitalisation directions each year to close that year's budget deficit and set a balanced budget. From 2029/30, the model suggests that the budget deficit will rise steadily each year as the council enters a downward debt spiral, having exhausted all other mechanisms to address its deficit.

5.21. As such, the current model clearly shows that the council will not be able to reach financial and operational sustainability without further government assistance over a longer time period. Negotiations with DLUHC as to the nature and scope of this assistance are at an early stage and remain on-going.

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