

# London Borough of Newham

## Finance Review

### Final Report to the Mayor

November 2018



# Terms of Reference - 1

- We adopted a two phase approach to the project:
  - Phase one - Identification of a long list of Key Issues in each of the Areas reviewed to be completed by 16 July 2018
  - Phase two is the detailed review of a short list of key areas as agreed from phase one to develop options for the way forward with a costed road map with practical timelines for the achievement of the desired outputs to be completed by approximately 20 August 2018
- The approach included a CIPFA Finance Health check covering:
  - An assessment of the financial health of the Council's budget in the year 2018/19 and onwards
  - An assessment of the financial assumptions and associated key decisions made that have had a material impact on the Council's budget and medium term financial strategy
  - A review and identification of any significant financial risks that need to be addressed
  - A high-level analysis of the council's spending
  - Generation of a comparative report looking at spending on different aspects of services for children and young people

## Terms of Reference - 2

- To carry out a benchmarking exercise of areas of opportunity to make financial savings/produce additional income including:
  - Reviewing the cost of services provided by OneSource against services provided in similar councils and, potentially the wider public sector (Using the Cipfa VFM toolkit)
  - Discretionary expenditure and services
  - Comparison of fees and charges with other similar authorities including changes over time
  - Alternative Delivery models
- To undertake a health check on the Councils processes currently being developed for financial control and governance:
  - To consider greater involvement by the residents of the Borough in the financial processes by undertaking research and producing a report on different approaches to participative appraisal and benchmarking including UK and internationally (including for example Scandinavian countries)
  - To review the Council's approach to managing, planning and prioritisation of expenditure relating to land and building assets including the potential for income generation and capital receipts

## Terms of Reference - 3

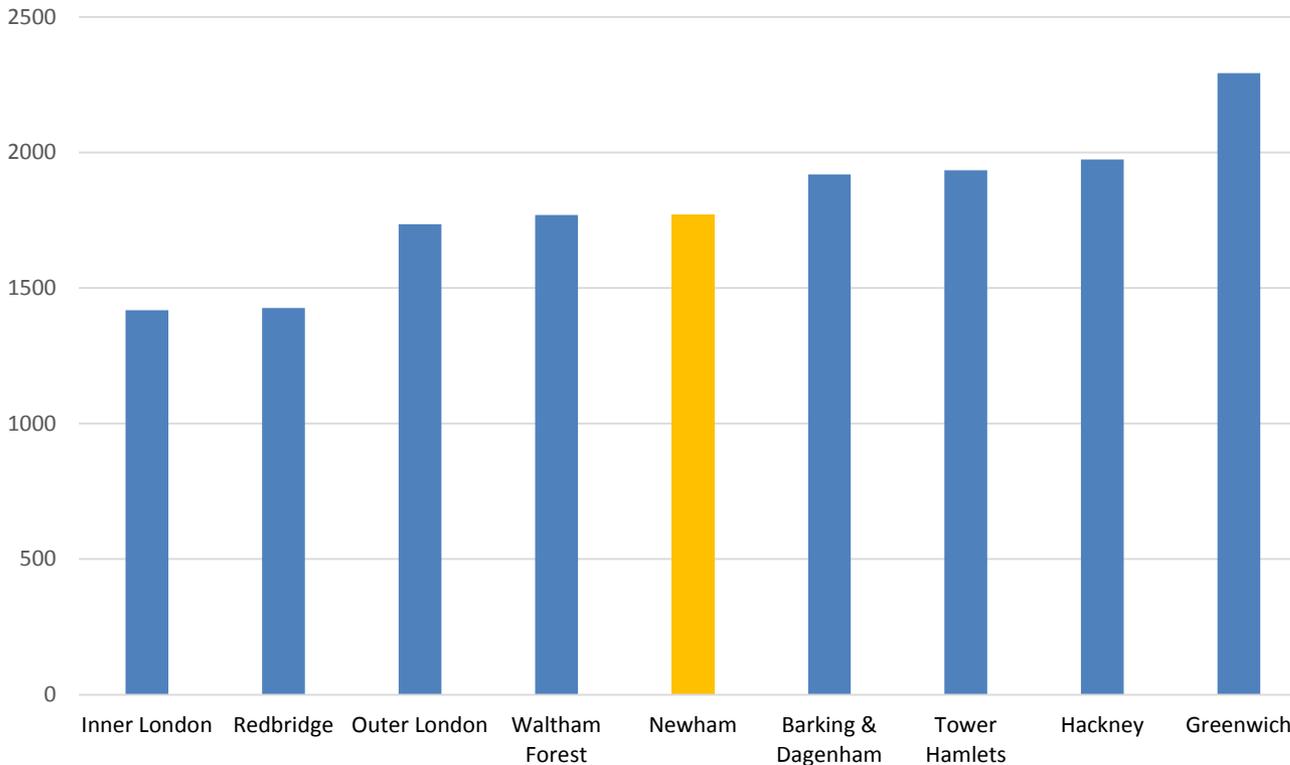
- We also reviewed and reported to the Mayor and Chief Executive on a number of specific issues including:
  - Small Business Programme
  - The Olympic Stadium
  - Lender Option Borrower Option (LOBO) Loans
  - Car Parking Charges
  - Every Child a Musician
  - Red Door Ventures
  - Repairs and Maintenance Services

## Background

- We were asked to review the Council's financial position at the end of the 2017/8 financial year and in the first quarter of 2018/9 and respond to a series of specific questions.
- Our review covered the decisions of the previous administration up to that point.
- This presentation contains only the high level results of our work, based on a series of interviews and reviews of documentation in July last.
- More detailed presentations have been made to the Mayor, the Chief Executive and the Corporate Management team.
- This is seen as Phase 1 of support to the Council.
- We were grateful to the frank and open discussions we had with officers from across the Council and OneSource.

# Newham is by comparison a higher than average spender but neighbours are even higher...

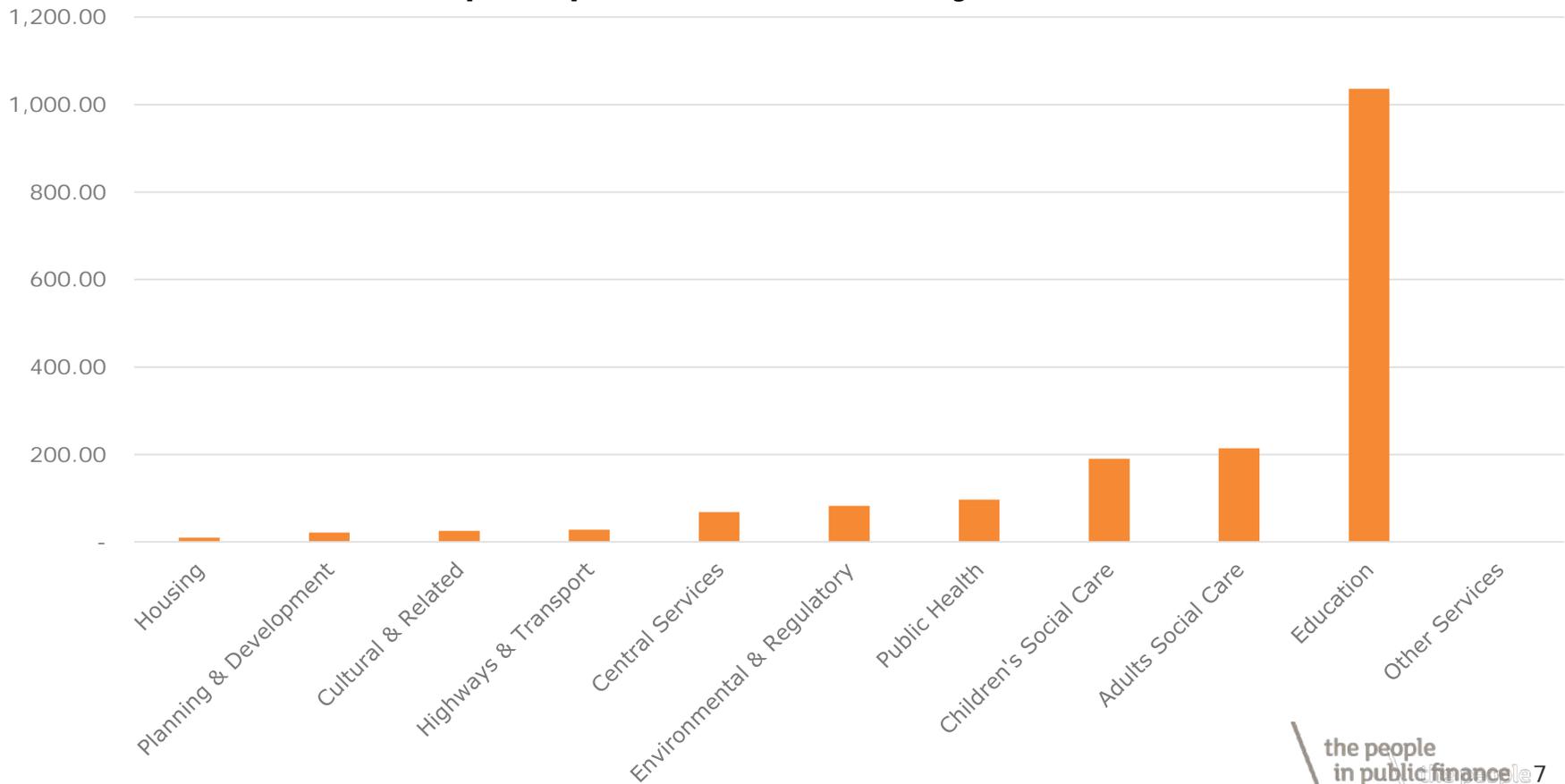
Overall Spend per Head 2016/17



Based on 2016/17 nett spend per head of population we compared Newham against; Inner London and Outer London averages and, for context, the 6 neighbouring Boroughs.

# Newham (2016/7) spend is dominated by 3 service areas....

**Spend per Head 2016/17 by Service**



The Council has not, in the past, made full use of its revenue raising opportunities.

The 2018/19 Budget of £261.2m was reflective of:

- No increase in the Adults Social Care Precept and not taking 6% over 3 years (reducing income by £2.855m in 2018/19)
- The 10<sup>th</sup> year of zero increase in CT (Each 1% of CT would generate £0.714m in 2018/19; 3% increase (the maximum without a referendum) would generate £2.142m.

# The 2018/19 Budget was balanced but contains some areas of concern....

- It was assumed that 2017/18 would break even (in the event £7m of reserves have been used to balance 2017/18)
- Savings not realised in 2017/18 need to be addressed in addition to the new budget savings of £1.17m
- Some but not all known budget pressures were provided for and Mayoral Priorities of £14.2m were built in
- At period 2 of 2018/19, the Children's Social Care budget appears to be heading for another overspend approaching (as in 2017/8) c£12m and there are also potential further budget pressures including the Syrian Refugee project, asylum seekers grant, Troubled Families grant and, across CYPS, there is a £3m pressure on salaries.
- Although the Adults Care Service appears to have adequate arrangements in place to control its budget, additional financial pressures include recruitment and retention of social workers, demand for dementia placements, increasing costs of care packages and contributions to the corporate transformation programme
- As at period 2 of 2018/19 Parking are forecasting an overspend of £1.85m due to an increase in the income budget of £5.7m over 2017/18

## The Council has significant balances and reserves.....

- Reserves total £1.741 billion, as at 31 March 2017, of which £1.307 billion are unusable.
- The other usable\* reserves of £433.68m are split as follows:
  - General fund balances - £17.29m (An acceptable 6.6% of the budget requirement)
  - HRA balances - £55.78m
  - Earmarked reserves - £110.58m
  - Capital reserves - £213.08m
  - Schools - £36.95m

\* The potential to redirect/use these reserves has limits. Only general fund balances and some earmarked reserves are available to help balance a general fund gap.

## The Councils financial position will remain challenging, so need strong MTFS

- The MTFS (February 2018) shows a starting position shortfall of £10.5m for 2019/20, although spending pressures in the current year mean this will rise.
- However:
  - There are opportunities on the balance sheet. The Council will hold long term assets of treble the value of loan liabilities
  - Projected usable reserves are projected to be £488m by the end of 2020/21 compared with £433m at 31 March 2017 - an increase of 12% As at 31 March 2017 General Fund and Earmarked Reserves represented 29.5% of total usable reserves which provides an opportunity to redirect these now or in the future

# Despite the reasonable financial position, we thought budget planning could be improved.....

- There is no corporate plan or service plans, so there is a lack of clear vision and outcome measures
- The former Mayor's plans for service delivery was unclear and the construction of budgets lacked corporate leadership; decision making was restricted
- There was a lack of transparency on financial matters between members and officers
- Savings targets were insufficiently planned and quantified. Budget cuts were imposed.
- There is a lack of understanding of the Council's position, the level of savings required and the level and use of reserves
- The failure to provide for demographic change has put increased pressure on budgets
- Base budgets were set approximately 4 years ago and subsequent increases have been incremental

# We thought there were some weaknesses displayed in Financial Control.....

- There is a lack of Member involvement in financial reporting and budget control; Audit Board is non-decision making. Overview/Scrutiny has had almost no impact
- There was a perceived lack of pressure from former CEO and FD to achieve budget targets, overspends were “absorbed” and there were limited consequences for failing to meet budgets
- Major issues of financial control have arisen in the repairs and maintenance division, RMS; Overspend in Children’s Services.
- Compliance with financial regulations is variable/training is lacking; Internal Audit opinion for 2017/18 is currently under consideration but unlikely to be positive
- Services have invested in personnel and systems (Aszeus; Verto) to give them control of commitments
- Cash Payments were still being made
- OneOracle implementation poor and a lack of training
- Business partners are stretched too thinly leading to a lack of support to budget managers on financial issues
- There are significant issues with capital spend....

# We are especially concerned at the apparent lack of control of Capital Expenditure

- There is a view that the capital programme does not have as high a profile with members as revenue
- There is a lack of accurate profiling of capital expenditure
- Projections are over-ambitious in terms of speed of delivery
- Generally a lack of delivery on capital schemes: End of period 3 (18/9):
  - Total capital expenditure in 2017/18 was £187.1m
  - The overall approved budget for 2018/19 was £535.9m
  - The 2018/19 Revised Budget is £973.6m; this includes capital slippage on schemes brought forward from 2017/18, additional approved budgets and the re-profiling of budgets by Project Managers to reflect their latest expectations
  - At the end of period three, actual spend to date totalled £20.9m
  - The full year capital expenditure is forecast to be £486.7m (49.9% of the Revised Budget), creating slippage of £486.9m

## Our view on OneSource is that it has strengths

- Approximately £15m in savings has been delivered across all services of which £8m is attributable to Newham
- Overall Customer Satisfaction results is good - 81% Business partners are considered to be very good.
- Finance services may perform comparatively better than average. (Quicker reporting at cycle end; lesser reporting variance; lower debtor days)

## And it has weaknesses...

- HR/OD satisfaction in Newham (Spring 2018) fell by 35%;
- Finance service may be more expensive; support to decision-making is under-resourced;
- Staffing issues: too many interims employed, lack of clarity in roles and responsibilities and too much "Churn". Staff doing the 'same' job on different terms and conditions. Business partners are stretched too thinly;
- SLAs in place but may have been too loose
- OneOracle implementation has been poor and there has been a lack of training

# We think that Asset Management is not sufficiently focused....

- There is no documented strategic vision or Asset Management Plan for the estate / lack of Corporate Plan to provide direction
- There is no corporate property group to enable senior level consideration of issues and opportunities and the role of the Strategic Investment Board is not clear/lacks a political steer
- There is no clear strategic function and dedicated resource in the property team – tendency for strategic function to be lost in day to day estate management
- There is a legacy of fragmentation of property data across different systems. This has led to a lack of confidence in the quality of data
- Limited access to data – held and controlled by OneSource leading to inability to access and use robust data for strategic planning and decision making; inability to report on property performance and no clear performance targets

# Facilities Management has weaknesses...

- FM function has been reviewed to take better control of budget overspend and expenditure
- The function only has corporate landlord responsibility for part of the portfolio (approx. 98 assets)
- There is a lack of condition and compliance data across the portfolio to inform a maintenance strategy and budget prioritisation and the balance of planned to reactive maintenance is too low (estimated at 20:80, aim for 75:25 –industry perceived best practice average is 70:30)
- The lack of evidence to understand maintenance need makes it difficult to determine resource requirements, but current funding for building maintenance and FM is not reflecting expectations
- The costs of managing vacant properties are often not understood or covered in budget provision.
- The procurement of FM and compliance services has not previously been coordinated

## Estate Management has weaknesses....

- The team operates with a large proportion of agency staff and the Head of Property is the only Registered Valuer able to sign off estates issues and valuations.
- A decision was taken to appoint external agents to manage the commercial portfolio, but the appointment was not formally signed off due to changes in directors and the management by OneSource
- The commercial portfolio managed by the team (commonly referred to as a Tenanted Non-Residential Portfolio (TNRP)) includes numerous assets providing community facilities generating an income of £10.583m pa. Historically budget expectations have exceeded the rent roll
- Historically there has been a reluctance to dispose of any assets or to proactively review and challenge the performance of the estate. (the Accommodation review and the vacant site review are now underway being led by the Director of Asset Management Services)
- There has been a lack of coordination between OneSource and the Business & Growth team to share skills and knowledge about the portfolio.
- There has not been a coordinated or robust challenge process to assess the existing and potential use of assets.

## We were asked to look at some specific issues

We reviewed and reported to the Mayor and Chief Executive on:

- Small Business Programme
- The Olympic Stadium
- Lender Option Borrower Option (LOBO) Loans
- Car Parking Charges
- Every Child a Musician
- Red Door Ventures
- Repairs and Maintenance Services

We noted that in most of these areas action was being taken

- Involving Citizens – We provided exemplars of alternative approaches taken by Councils.

## Small Business Programme

- Set up as an alternative to privatisation with aims of:
  - Providing additional funds for Newham
  - Empowering staff
  - Cutting down bureaucracy
  - Being responsive to residents needs
- First one created in 2016 and there are now 12 each based on a business case. They are Teckal compliant
- Managed by a single Corporate shareholder with Members and officers on the Shareholder Board
- Total turnover of around £50m with profits of £12.5m over the life of the current MTFS. £3.0m forecast for 2022/23
- Very little external business varying between 1% and 5% of turnover except for the Language Service which is 99%
- There have been questions over the legality of some services such as Juniper which is making a profit on selling meals to schools
- Options for rationalisation under consideration as there is duplication. For example, Streets & estates has three separate companies. Efficiencies have been achieved and the learning could now be applied to in-house services
- Programme currently on hold

## The Olympic Stadium

- A number of decisions were taken between November 2011 and March 2013. The key financial considerations were that it would require an investment of £40m and would provide an annual return of £3m of which £2m would accrue to Newham. External advisers concluded that the £3m was unachievable
- However, the decision was taken to proceed using the council's urgency procedures and the final decision making was delegated to the CEO leading to a lack of scrutiny by a wider group of members and a lack of transparency
- Counsel's report into the matter was published on 17 July 2018 and it concluded that ***"There was nothing unreasonable or unlawful in principle in the Council seeking to invest in the stadium by way of a loan"***. The report also concluded that ***"it is lawful for a local authority...to decide to make an investment where the projected benefit of the investment outweighs the risk that it will not be repaid"***. However, the condition (1a) that a surplus of £3m p.a. would be generated ***"was adopted and was not varied, and I think that the Council erred in deciding that it was met"***
- The QC's report raises a number of questions about the council's decision making processes which we recommend should be addressed at the earliest opportunity

# Lender Option Borrower Option (LOBO) Loans

- The council took out a variety of LOBO loans with Barclays and RBS several years ago. The original portfolio value was £536m. Some have been restructured and the balance sheet value as at 31 March 2018 is £315m
- The issue is that these loans are at high interest rates compared with current market rates, although this would also have been the case with traditional PWLB borrowing. The costs of breakage are very high and the current fair value is set at £686m
- The risk of any of the loans being called in by the lenders is considered, by officers that we have interviewed, to be low
- We understand that the decision to enter into the loans has been investigated by the Council's auditors, Ernst and Young, following an objection to the accounts. The firm concluded that the officers did not act irrationally and that the loans were lawful
- Subsequently financial advisers have been appointed to advise on restructuring and the possibility of pursuing a claim against the banks. Now on hold pending a claim by the Council against Barclays

## Car Parking Charges

- In 2016/7 yield per head was £27.04 per head of population. The Outer London average is £22.41
- The Parking Operations was underspent by £5.63m at the end of 2017/18 partly due to auto-ticketing and higher income from permits
- As at period 2 of 2018/19 Parking are forecasting an overspend of £1.85m due to an increase in the income budget of £5.7m over 2017/18
- This is based on previous years performance and the commissioning of a new vehicle pound giving rise to a significant increase in income
- However, this is not going ahead
- Also yellow box junctions are now established and compliance has increased which has had an adverse impact on actual income generated from fines

## Every Child a Musician

- £400k was first added to the Budget in 2016/17. The Budget report gave no indication of how this was constructed
- According to the Council's Budget Framework 2018/19 the Every Child a Musician provision of £300k will continue the development of the programme which enables children in Years 5 to 7 at Newham schools to receive a free musical instrument and tuition for 3 years. This will help maximise the cognitive development of a child and provide an educational benefit which accrues from early instrumental learning
- £150k is in the 2019/20 budget
- At the end of 2017/18 there was a £374k overspend which is due to removal of one off growth for expenditure that was ongoing
- This suggests the current level of activity is unsustainable and the programme needs to be re-evaluated

## Red Door Ventures

- RDV was set up to build around 3,000 properties over the next 20 years
- Originally planned to build £500m of houses within the borough but plans became stuck
- Looked at two other schemes in West London for £200m but the schemes fell through
- The 2018/19 revised capital programme at period 3 includes £430m for RDV
- At period 3 the forecast spend is only £55m giving a variance of £375m
- A change to the MRP enabled the creation of a £50m reserve to finance the start of projects, being repayable after 15 years
- RDV schemes are currently on hold and the reserve is not being used
- There are regular monitoring meetings with RDV, the CEO and finance

## Repairs and Maintenance Services (RMS)

- Major issue over financial control in the repairs and maintenance division, RMS, highlighted by a whistle blower
- Led to an overspend of around £9m in 2017/18 due to poor pricing of highways work
- RMS cut prices arbitrarily by around 20% and then used sub-contractors at higher rates. A number of undocumented deals have been uncovered
- Also problem of not raising invoices until month 12 so commissioners were unsighted
- There was a manipulation of WIP at the year end
- Work was billed at higher than quoted rates to hide the effect of the price cuts
- There have been allegations of fraud and staff have been suspended or dismissed
- Full investigation is being carried out
- There has been a lack of compliance with Standing Orders
- Highways work has been stopped pro-tem

## Involving Citizens

- The addendum to the original Mayors presentation indicated exemplars from across the world.
- Participatory Budgeting (PB) allows local citizens to play an active role in making decisions on public finances and budgets.
- Tower Hamlets used PB between 2009 and 2010. Over £5 million was funded towards a project called 'You Decide!'. Guided by council and Local Area Partnership (LAP) priorities, council staff shortlisted a series of potential projects and members of the community voted on the shortlisted projects that they wanted. Each LAP area had £280,000 to spend on projects such as youth inclusion programs and street lighting.
- The community overall felt they could better influence their local environment and services. 77.2% wanted the council to repeat the event in the future.
- Harrow, Salford, Newcastle and Norfolk (and South Gloucestershire (and Birmingham)) are other alternative approaches.

# Action Plan – Our Proposals 1

## Stage 1 – September 2018 – March 2019

- As a matter of urgency, at the mid year budget review, assess the extent to which the reserves may be required to support the 2018/19 revenue budget
- Commence a culture change programme within the council's existing transformation plans to look at leadership/ delegation/ transparency in particular
- Address weaknesses in governance at both officer and member levels
- Produce a corporate vision and corporate plan
- Address the lack of Corporate Memory through a knowledge strategy

## Action Plan – Our Proposals 2

### Stage 2 – October 2018-February 2019

- Carry out phase 1 of a fundamental budget review with external challenge/monitoring and new corporate standards. Adopt outcome based budgeting
- Carry out a review of the capital programme project by project
- Consider strengthening the financial Business Partner support capacity for the current budget cycle as part of a financial control improvement programme
- Produce new service plans that fit with the corporate plan
- Re-examine the use of reserves
- Give consideration to an increase in Council Tax and maximising use of social care precept
- Undertake comparative budget reviews in those areas of service spend that appear high to understand the reasons for the disparity
- Commission report on the anticipated budget pressures for the next three years in Adult Social Care
- Commission detailed review of the Children's Social Care budget forecast for next three years

## Action Plan – Our Proposals 3

### Stage 3 – April 2019 – September 2019

- Continue the financial control improvement programme by:
  - Improving systems for revenue and capital budget monitoring and reporting to members
  - Reviewing the efficacy of financial systems and financial reporting
  - Updating the Council's Constitution and financial control procedures
  - Reviewing the operations and budgets of OneSource

## Action Plan – Our Proposals 4

### **Stage 4 – April 2019 – September 2019**

- Commission an external review of the Council's asset portfolio and its management in order to provide an integrated plan for future direction
- Carry out management review of asset management, property and facilities management to provide a focused and directed organisation
- Carry out a detailed review of each small business
- Review the Council's loans portfolio especially re LOBOs
- Trial a process of involving the community in budgeting priorities

### **Stage 5 – October 2019 – February 2020**

- Complete phase 2 of the fundamental budget review in the 2020/21 budget cycle.