

# Improvement and Assurance Panel

London Borough of Croydon

Rt. Hon. Michael Gove MP  
Secretary of State  
Department of Levelling Up, Housing and Communities (DLUHC)  
2 Marsham Street  
London SW1P 4DF

Ref: Report 6

Date: 22 November 2022

Dear Secretary of State,

We write to give you an update on the position in Croydon since our last report in March 2022. In agreement with your officials, we anticipate writing future such updates at six-monthly intervals.

Since our last report Croydon has changed its fundamental model of governance, with the election of a Mayor on 5 May 2022 and of a new Council on the same date. The Mayor, Jason Perry, is a Conservative. He has determined to operate on the basis of personally retaining all delegated executive functions and has appointed an advisory Cabinet. The Council is comprised of 34 Conservative, 34 Labour, 2 Green and 1 Liberal Democrat councillors.

The new governance arrangements are now six months old and are thus far supportive of transparent and informed decision-making.

The Mayor has set some clear intentions and ambitions for the Council, including a commitment to meeting the requirements that were set for the extraordinary Government support that the Council has received. Setting these out in his Business Plan, which has just been published, he has made clear that returning the Borough to financial stability will be his number one priority and that nothing will be off the table in undertaking the measures necessary to bring this about. The Mayor has been clear with us in that he is prepared to take firm decisions around the emergent difficult issues that we refer to in this report and we believe that doing so will be essential in the light of the situation that the Council is in. We have found our interactions with Mayor Perry to be purposeful and constructive and look forward to them continuing in that vein.

In our last letter we recorded the progress that the Council had made in addressing transformation of its service operations, recruitment of permanent senior appointments and the enhanced exercise of firm financial management. We reflected that as the Council sought to move to a position of balancing its finances without the need for extraordinary

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financial support while at the same time having to reduce and manage risk in some precarious areas such as the operation of its housing service, maintaining this progress would be a severe test.

So it has proved to be. In respect of its core responsibilities for the delivery of day-to-day services to residents in a manner which is both operationally competent and sustainably within budget, the Council has for the most part continued to respond well to this test. Adults and Children's Services, between them accounting for some 70% of the Council's net revenue expenditure are making steady progress in improving the efficiency of their operations, and in reducing their costs.

Place-based services have struggled, most notably around highways and car parking, where projections for income for this year were unduly optimistic, and as anticipated in our last letter, these services will be significantly overspent this year as a consequence. This is disappointing, but the Service's management is comprehensively getting to grips with the problem and plans are in preparation for re-basing the budget for next year around a more realistic and robust service configuration.

We have regularly referred to the pace of all of this change, which we would wish to have been faster, and have encouraged the Council accordingly. The Council has consistently made clear to us its intent to undertake its transformational activity whilst at the same time minimising risk through extensive research and analysis and being firmly resistant to the risk of procedural challenge. Whilst this certainly reinforces sound, evidence-based decision-making it also can absorb considerable time and effort – possibly more than a 'good enough' approach would need.

It is important that we point out that 'pace' in this sense is not a reference to the Council – and in particular its staff – not working hard enough. We have much evidence of managers and staff grasping the scale of the problem and doing their best to fix it. Rather it is to observe that, as is common with many authorities that have deteriorated over a period of time, the business systems of the Council, its data and information bases, the understanding of what good looks like and the performance management systems needed to improve outcomes are all in very poor repair. It takes time to fix all of these things, and until that happens (and it is happening, over time), the application of hard work in itself is not sufficient to effect change. The syndrome of 'two steps forward and one step back' is prevalent in many authorities that are or have been in some form of intervention, and Croydon is no different in this regard. We have accepted that while the approach the Council is taking is perhaps an understandable one given its past experiences, it can only be tenably so if the resulting pace of change remains affordable within the Council's existing means and without any need for further extraordinary financial support. It is on this basis, and under its own steam (albeit underpinned by the three-year package of support offered by the Government in November 2020, and due to conclude next year) that the Council has been effecting its recovery. The original 'Renewal Plan' of November 2020 has been subject to intensive review and we are pleased to see the recent publication of its successor, which in its first iteration expands upon the rationale for decisions on priorities and permits such

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priorities to be progressed speedily, minimising delays over concerns of risk and encouraging and enabling the Council to implement change more quickly.

Three areas of critical activity have necessarily been the focus of our attention since our last report. These are Housing, Property and Finance.

## Housing

It is over 18 months since ITV News coverage and an investigation by ARK consultancy revealed shocking deficiencies in the council's housing service. The Council's overall response to address these deficiencies has been too slow, with interim postholders occupying key positions for much of this time and not initiating many of the necessary changes. An independent Housing Improvement Board was established, and this is proving valuable in maintaining focus on priority actions. These include steps recommended as urgent in the ARK report which are now beginning to be acted on, including determining what should happen to the Regina Road estate which was the focus on the ITN investigation.

The operation of the Service is now led by a new Housing Director who is substantively in post. She is undertaking a forensic review of the Service's processes and procedures which has uncovered the extent of dysfunction within the service, which is considerable. This dysfunction may be characterised by, amongst other things, the absence of accurate data on the fundamentals of the service, the poor level of maintenance of the stock, little knowledge of stock values, ineffective management of voids, the lack of specialist knowledge within operational teams and a culture which neither supports responding to tenants nor accepts the need to undertake change.

In response to this the Housing Director is beginning to put in place the foundations of a more responsive and effective service, commissioning a full appraisal of housing assets, enhancing performance in the repairs service, and improving the management of void properties and arrears. She is also tackling high-profile issues such as project planning for the replacement of poor-quality housing blocks, such as in Regina Road.

This new sense of purpose and direction has, however, yet to yield much in the way of tangible improvement. The improvement programme, which has identified its proposed outcomes, is work in progress, with a need to fully quantify and develop interim milestones for each of its objectives. The cost and income challenges facing all social landlords are a particularly high risk for one which is facing them from such a parlous starting point. The forthcoming replacement of the repairs contractor poses sizeable operational and financial risks. In our view, there is a need for substantial corporate support for the Director: as one of the council's principal areas of weakness, there will need to be much continuous and facilitative engagement from the corporate centre, finance, HR and legal.

The Council's response to the accidental fire that occurred in early October at Sycamore House, an Emergency Accommodation complex in Thornton Heath, which affected more

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than 50 households, was both rapid and comprehensive, effectively locating alternative accommodation for many residents. Both the Panel and the chair of the Council's Housing Improvement Board have recognised the step change in leadership demonstrated in the response to this incident by both the Mayor and Deputy Mayor (who is the responsible Cabinet Member) and by the Director and other officers from across the Council who were involved.

The recovery of this service is, however, a long-term project and the risk of instances of failure and of sub-optimal responses will exist throughout this time.

Priority actions for the Council will be to:

- Provide strong corporate support for the development and governance of the improvement programme, both in terms of expertise in designing it and of critique and challenge.
- Ensure that the re-procurement of the repairs service and handover to the new supplier is managed successfully.
- Rapidly complete the commissioning of its asset survey and develop a credible asset plan based on it.
- Taking account of the asset position, and current cost and income pressures, urgently reach a view on whether its HRA business plan is viable and, if not, what mitigating actions it can take.
- Bring newly arising void times and arrears to the sector median within two years and make inroads on the historic backlog on both.
- Complete its overhaul of systems for handling customer and councillor complaints to ensure it responds on time and efficiently and makes use of them within performance data.

## Property

The disposal of property following the Council's ill-judged entry into this market and which in large part precipitated the crisis which came to a head in late 2020 continues to progress well.

### ***Brick by Brick Croydon Ltd (BBB)***

Construction activities are now complete on 21 of the 23 sites developed by BBB with 451 units sold or under offer, leaving 15 units remaining. The two outstanding sites containing 285 units are approaching completion and should be available by the end of 2022. To accelerate the winding down of BBB a decision was taken to pursue a bulk sale of the two remaining developments and negotiations are ongoing with two of the parties who

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submitted offers. Once complete, the Council will need to plan for a managed wind down (solvent run-off) as opposed to placing BBB into the hands of an insolvency practitioner which would be more costly and carries significant reputational risk. They will also need to ensure that all relevant documentation is compiled and stored appropriately as protection from corporate memory disappearing as staff leave. This will require a nominated point of contact within the Council management team to act as 'Transition Manager' over the next 12 months. The Council have engaged external support to review the winding down options available and ensure that the BBB Directors' responsibilities are factored in, given the circumstances.

The likely financial outcome for the Council as sole shareholder of BBB has worsened since we reported in December 2021 with a potential loan write-off of circa £60m. There are a number of factors that have contributed to this deterioration including recent weakening of the property market, the proportion disposed of by bulk sale at a discount and dispute settlements with contractors. It is disappointing that exposure to the market downturn was exacerbated by the delays on some developments in satisfying planning conditions, leading to a large number of properties standing empty for many months before sales could be completed. Progress on resolving many of these conditions only gathered pace once the new management was appointed early this year.

The actual amount of loan write off won't be finalised until negotiations are complete on the two remaining developments and other outstanding assets and liabilities quantified. Assuming the sales progress to completion this would generate loan repayments in the range of £90-£95m in the current financial year, against the outstanding debt and forecast accrued interest of £151m at year end. As the loans to BBB for working capital were issued by the Council at approximately double its weighted average cost of borrowing, it will have received between £17-£18m of 'income' from this surcharge over the life of BBB, thus inflating the level of loans to be written off. Whilst the forecast deficit has increased, it still compares favourably to the disposal option to a third party of BBB that was considered by the Council last year, especially the cash generation which would have been £60m less in the current year due to the deferred payment terms of the offer.

## ***Fairfield Halls***

Utilisation of the facilities within Fairfield Halls continues to slowly improve following the disruption caused by Covid and some significant events are scheduled over the next year as well as the venue forming an integral part of the Borough of Culture plans. Despite that, there is a concern that the full potential of Fairfield Halls is not yet being realised and further effort is required in marketing the venue to a wider potential audience and these initiatives are currently being implemented.

We have commented in earlier reports that despite the extensive and costly refurbishment works that have been carried out, there remain some issues with the fabric and operability of the building that continue to pose a risk to the operator and Council. Although these works have a cost, it is relatively minor and priority should be given to ensuring the works are progressed as a matter of urgency

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## ***Other Commercial Investments***

Due to the financial pressures faced by the Council and the need to reduce its debt burden a review of all assets has been ongoing with a number of assets identified for disposal. Approximately £25m has been received or is due before the end of 2022 as a result of a number of minor property disposals and the conclusion of the Taberner House commercial arrangements. Of the other significant commercial investments, only Vulcan Way and Imperial Way are generating a surplus at a market level with the Colonnades and Davies House close to or in deficit once the relevant interest charge and MRP are correctly apportioned. All are being considered for disposal.

We have reported previously on an investment the Council holds in a Resonance property fund with two tranches of £30m and £15m made in 2014 and 2017 respectively. The initial tranche was due to be redeemed in 2022 but the Council agreed to extend this by 12 months as exit conditions were deemed to be unsuitable at that time. Having recently reviewed the performance of this investment the Council has now concluded that it no longer offers an acceptable rate of return and is in discussion about exiting the fund. Due to the relatively high illiquidity of these funds, the timing and level of recovery of the investment is uncertain.

## **Finance**

In our last letter, we noted that the 2019/20 accounts had still not been closed due to two outstanding issues, namely the bank and cash reconciliation and the accounting treatment of Croydon Affordable Homes / Croydon Affordable Tenures (CAH/CAT). We are pleased to say that the former issue has now been settled but unfortunately, the CAH/CAT issue remains outstanding, although some progress has been made and it is anticipated that the issue will be closed before the end of the current financial year. The worst-case scenario for resolving CAH/CAT would be that an additional revenue charge in the order of £70m would be made in the current financial year. However, discussions are underway between the Council and its external auditors and it is hoped that a lower adjustment can be agreed (£9m) based on further information being identified.

Our last report referred to our concerns relating to a projected 2021/22 overspend position which had been growing for several months at that point. In the event, the year is projected to finish with a balanced position (subject to audit) due to one-off savings which only became visible towards the end of the year. However, the underlying pressures amount to £19m. These are impacting the current year and are made up as follows: -

- Parking income – the reduction in demand for parking in the borough following the pandemic
- Overly optimistic new traffic income projections were built in which didn't reflect the operational challenges of implementing new traffic schemes
- A deficit in the Housing Benefit budget which was only identified at the very end of the year and therefore was not built into the 2022/23 budget.

Since then, further issues have become apparent:

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- the Opening the Books project has revealed a range of significant legacy problems, most notably relating to MRP, HRA/General Fund recharges, and Housing Benefit. These problems originated some years ago, are continuing and amount to considerable sums.
- Inflation and demand pressures have increased – largely as a result of the current wider economic situation, although the Council did include an inflation contingency within their 2022/23 budget which means the in-year pressures have been absorbed to some extent.

In total, these legacy pressures (including prior years liabilities) amount to some £74.6m. It should be noted that the situation remains under review – the Opening the Books project is not due to conclude until January 2023, the economic climate is volatile, and it is likely that further issues will be found.

A breakdown of the £74.6m is set out below:

	<b>£m</b>
Correction to Croydon Affordable Homes/Croydon Affordable Tenures	9.0
Corrections for Capital Charges - Minimum Revenue Provision: -	
• 2021/22	4.4
• 2022/23	1.2
Realignment of the HRA, General Fund and Capital Programme: -	
• 2019/20	10.0
• 2020/21	10.0
• 2021/22	10.0
• 2022/23	10.0
Other adjustments: -	
• 2021/22 – Provision for Bad Debt Shortfall	20.0
<b>Total impact of legacy issues on the general fund reserve as at 31 March 2023</b>	<b>74.6</b>

Many of the legacy issues identified also need to be reflected in the Medium-Term Financial Strategy on an ongoing basis. The Council has undertaken some financial modelling to assess its position building on some basic assumptions regarding Council Tax increases (as per the Autumn Statement), a reasonable savings target (£20m per year), and a capitalisation direction with the following profile:

	<b>£m</b>
Legacy issues to 2022/23	74.6
2023/24	80.0
2024/25	60.0
2025/26	40.0
2026/27	15.0
<b>Total</b>	<b>269.6</b>

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Whilst this delivers a budget for the next 2 years which is more or less balanced, the medium to longer term view indicates a deficit in the order of £50m per year, even with the above support. This is a situation which, unless alternative solutions are found, will leave the Council in a position of delivering minimal service provision at best. At worst it will leave it in a position of unviability.

The 'usual' tool that is used to assist councils when they are facing a financial challenge of the amount indicated above is to apply a capitalisation direction which allows an authority to capitalise expenditure and if need be, to finance that capitalisation through borrowing. In considering this, it is important to consider the debt profile already being held and assess the affordability of this route.

The Council currently owes £1.3bn, excluding £300m HRA debt. The servicing costs of this debt amount to £47m a year which equates to 16% of its current revenue budget. This figure is likely to increase to closer to £57m as the present loans mature in the coming months and have to be replaced by more expensive PWLB arrangements. If the £269.6m figure referred to above has to be funded by borrowing following a capitalisation direction, debt servicing would end up in the order of £73m or 24% of the revenue budget, rising further still if the on-going deficit also has to be financed in this way too.

Other councils in this situation have embarked on asset disposal programmes to reduce the burden on their revenue accounts, freeing up funds either to meet budget pressures, contribute to savings targets, or to pay for a capitalisation direction – thereby negating the need for further borrowing. Initial indications suggest that Croydon is not able to do this to any appreciable extent - it has significant levels of negative equity on its saleable assets (circa £300m) which effectively hinders its ability to reduce debt levels by way of an asset disposal programme.

Given this, the Council believes that the 'usual' approach of seeking a capitalisation direction to cover the budget gap would not be appropriate to resolving the problems it faces and has put forward some options to be considered by DLUHC – we are aware that discussions are underway on these suggestions which are:

1. The write-off of Croydon's negative equity debt, or its deferment over a long period (40-80 years).
2. Spreading any MRP for the capitalisation directions over a longer period than the 20 years currently specified.
3. Reducing the interest rate charged by the Public Works Loan Board on the capitalisation directions by at least the 1% surcharge but preferably further.
4. Dispersal of asylum seekers and ex-offenders currently housed in Croydon by government departments and other agencies.
5. Granting permission to increase Council Tax further beyond the newly announced national cap.



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6. Granting permission to use the Growth Zone business rates more flexibly within the designated area e.g., to cover clearing graffiti, all street cleaning and bin collection and all community safety in the designated area.
7. Reforming local government funding to fully reflect demographic demand in Croydon.
8. Issuing Capitalisation Directions to deal with legacy issues
9. Issuing Capitalisation Directions to smooth the transition to financial and operational sustainability.

Clearly there are many and various potential combinations of the above, and further work is needed to refine the model – specifically looking holistically at the debt position and reviewing the asset base to determine ways of reducing debt servicing costs. Additionally, time will have to be taken to consider the implications of the recent Autumn Statement and to understand the local government settlement once released in late December. A final confirmation of the CAH/CAT position will also have to be factored in as will any additional issues arising from the further work being undertaken on the Opening the Books project.

Notwithstanding the good progress being made on cost-effective improvement to day-to-day operational delivery, such is the scale of the challenge relating to legacy issues, including the consequent debt servicing costs, that this burden threatens to swamp the authority. The potential need to issue a s114 notice that we flagged in our last letter has now been realised, with the Council's CFO (s151 officer) reaching this conclusion today.

## Conclusion

The Council's progress towards normality has been steady and sustainable if a little slow. It has not been, and is not, without setbacks, but in general these have been or are being addressed and incorporated into service plans and working practices.

The overall economic position and the cost pressures being experienced as a result would on their own have required the adoption of a less risk-averse and speedier approach to the change being brought about and the plans being put in place to effect this are needed in any event, as are those to deal with the housing issues referred to above. The additional financial pressure on the Council's revenue budgets brought about by the increased costs of its structural debt, however, add a degree of challenge to future sustainability which place it beyond the Council's ability to meet.

Yours sincerely,

Tony McArdle  
Margaret Lee  
Phil Brookes  
Jon Wilson