

REPORT TO:	CABINET 25th November 2020 COUNCIL 30th November 2020
SUBJECT:	Strategic Review of Companies and other investment arrangements Brick by Brick Croydon Ltd (“BBB”) Shareholder decision – Directors and articles of association
LEAD OFFICER:	Katherine Kerswell – Interim Chief Executive
CABINET MEMBER:	Leader of the Council Councillor Hamida Ali
CORPORATE PRIORITY/POLICY CONTEXT/ AMBITIOUS FOR CROYDON	
The strategic review arises from the report in September on the wider review of the Council’s general fund budget and the development of the Croydon renewal plan.	

FINANCIAL IMPACT
In order to ascertain the financial impact of the Council’s previous investment and lending decisions in particular those relating to BBB, further detailed work will be required. The impact of the non payment to date of any interest and dividends is reflected in revised spending plans.
In relation to Director changes and changes to BBB’s articles of association, this does not have a direct financial impact on the Council.
FORWARD PLAN KEY DECISION REFERENCE NO.: 3320CAB
The decision is due to be taken under Special Urgency (notice published on 20 November 2020).
This decision cannot reasonably be deferred because the results of the Strategic review need to be reported as a matter of urgency to limit the Council’s cost exposure. When commissioned at the September Cabinet, it was always the intention to report to the November Cabinet, but no separate listing was made in the forward plan. If the report is not considered at this meeting, the Council will not be able to take appropriate action in regard to its associated companies and other entities where necessary.
The agreement of the Chair of the Scrutiny & Overview Committee has been obtained.

1. CABINET RECOMMENDATIONS
The Leader of the Council has delegated to the Cabinet the power to make the decisions set out in the recommendations below
The Cabinet is recommended to:
1.1 Note the recommendations set out in the report by PwC, and refer the report to the December meeting of the Scrutiny and Overview Committee for their

challenge and assessment. A report from that meeting to be presented at the January Cabinet meeting alongside an action plan.

- 1.2 Authorise the initial further work required on the options identified by PWC regarding the Council's interest in BBB in order to best inform further consideration of those options at the January Cabinet meeting.
- 1.3 Agree that funding of BBB shall continue in line with current loan arrangements and conditions, provided that all funding for construction, and completed unit purchases shall be reviewed on a site by site basis.
- 1.4 Agree that all site transfers to BBB, be halted until the Council has completed the options appraisal.

The Cabinet, on behalf of the Council, exercising its functions as sole shareholder of BBB is recommended to:

- 1.5 Approve the special resolutions contained in Appendix [2] to amend the articles of association of BBB to
 - i. allow quorate meetings to take place with any two Directors present, removing the requirement for an Executive Director to be present and
 - ii. provide for the provision of all unanimous or majority decisions taken by the Directors and minutes of all Directors meetings to the Council as sole shareholder.
- 1.6 Approve the ordinary resolutions contained in Appendix [2] to appoint two Non-Executive Directors to the Board of BBB (both with a finance background), also noting and agreeing that BBB shall indemnify those new Directors in accordance with the company's articles of association and by utilising the company's own insurance policy.
- 1.7 Approve the ordinary resolutions contained in Appendix [2] to remove the two current Directors of BBB, in their capacity as Directors (also noting Executive Directors are employees of the company).
- 1.8 Approve the ordinary resolution contained in Appendix [2] to provide for the right of the Council as sole shareholder to inspect any of the Company's accounting or other records or documents at any time.

2. COUNCIL RECOMMENDATIONS

- 2.1 The Council is asked to note the recommendations set out above, which are to be considered by Cabinet on 25th November 2020 and that Council shall receive a verbal update in respect of the outcome, in accordance with recommendation xii of the "Croydon Renewal Plan and amendments to the 2020/21 General Fund Budget" report to Council of 21st September 2020.

2. EXECUTIVE SUMMARY

- 2.1 This purpose of this report is to receive and note the reported outcomes of the strategic reviews requested by Cabinet and Council in September 2020. The review has highlighted that the governance arrangements with the Council's subsidiaries are not adequate and that existing protocols need to be enforced and enhanced. In addition governance of the Council's loan portfolio has also been inadequate.
- 2.2 The initial financial conclusions of these past decisions have been included in forecasts for the current year. However, further detailed work will be required with regard to BBB to enable the Council to determine the optimum future relationship with BBB.
- 2.3 Additionally, the purpose of this report is to seek approval from Cabinet, exercising their functions as the sole shareholder of BBB on behalf of the Council, to resolve by ordinary and special resolutions of the company the changes to the Board of Directors and amendments to the articles of association of the company as detailed in the recommendations set out in Appendix[2].

3. THE REVIEW

Background

- 3.1 The Cabinet at its meeting on 21st September 2020, instructed that a strategic review be undertaken of the Council's group of companies and other entities and to report back to the November Cabinet. To ensure that the review was independent the Council asked Mr Chris Buss former Director of Finance and Deputy Chief executive of Wandsworth council to act as client for the review and reporting direct to the Interim Chief Executive.
- 3.2 Following a procurement exercise PwC were appointed to undertake the review which covered the following five areas:
- BBB – Council's wholly owned company
 - Croydon Affordable Housing - LLP group structure
 - Growth Zone
 - Revolving investment fund (RIF)
 - Asset investment fund (AIF)

The review concentrated on BBB due to the high value of loans with the company and the higher public profile of that investment.

- 3.3 PwC undertook the review over four weeks interviewing a range of council staff, staff from BBB and a number of other parties. Daily report backs were made to the Council and the project was completed in time for this report to be made to the November committee as requested. The report from PwC is attached and the key findings are summarised in paragraphs 3.4 - 3.9.

Key Findings

- 3.4 The review commenced by examining BBB and reached the following findings. The financial governance arrangements within BBB are lacking, there is an absence of company wide cash flow and forecasting arrangements and inadequate reporting at board level of financial issues. BBB's performance has consistently been below that forecasted in its business plan. As a matter of urgency a Finance Director should be appointed. The Council's oversight of BBB has been lax, allowing inadvertently for loans to expire without formal agreement to extend them. BBB's ambitious strategy of development, endorsed by the Council when it agreed the business plans, has placed the Council at risk in relation to these loans.
- 3.5 The absence of adequate financial systems and processes in BBB means that the Council cannot have assurance as to the accuracy or veracity of the financial information produced by BBB. The outcome is that additional work will be required to enable the Council to determine what is the best strategy for the Council in its future relationship with BBB including which of the options detailed in the report is recommended for future action. It is for the Council as the sole shareholder to determine the future arrangements for BBB including future funding of the company. The work to enable this decision to be made has commenced and will report back as soon as it is completed.
- 3.6 The review has indicated that budgeted income figures within the Council in respect of interest receivable in the current year and potential dividends are at risk. The likelihood of receiving them cannot be confirmed due to forecasts and financial systems within BBB not being suitably robust to enable the Council to place reliance on them.
- 3.7 With respect to the Croydon Affordable Housing, the review identified a range of governance and possible accounting issues as well as issues over tenants having the ability to pay. However, the report does not recommend discontinuing the current arrangements with external investors and suggests exercising caution about further delivery of affordable housing through this route until a further review is undertaken .
- 3.8 The review of the Growth Zone arrangements has noted that the Council's financial circumstances mean that investment though the Growth zone will be limited but that at present the Growth Zone should remain in existence.
- 3.9 The RIF, which was set up as a Council investment portfolio with Cabinet approval in September 2014, and AIF, set up as part of the Council's investment strategy in 2018, both need improved governance around them and clearer reporting to the Council both in terms of costs and reporting. The asset investment fund is under performing compared to the original business plan and there is currently a loss of asset value, this will need to be considered in any decision to dispose of any of the assets.

Next steps

- 3.10 The review makes a number of recommendations for acceptance and implementation by the Council. These are detailed in Appendix 1 and relate

both to the Council's own arrangements but also those of its subsidiaries (BBB and the Croydon Affordable Housing LLP group companies). Many of the findings of the review echo the findings of the report in the public interest issued by Grant Thornton. As with that report, it is recommended that the Council accepts all the recommendations and instructs officers to draw up an action plan to ensure that these recommendations are implemented.

- 3.11 The issues arising with BBB have been raised with the management of BBB at a meeting attended by the Chief Executive and the Leader of the Council. They were also discussed at a Shareholder Investment Board meeting held on the 17th November.
- 3.12 Once the second phase of the review has been completed, the Council should be in a position to determine the future of BBB. This will take some time. There are over 20 schemes currently on site which have existing funding agreements in place, although some of these are past the repayment period. To stop BBB drawing down on those agreements could present cash flow issues with consequences that would further increase the risk to the Council. It will therefore be necessary to make payments to BBB in line with current loan arrangements ensuring that conditions for funding are met. The purchase of completed units previously agreed in July will also need to be reassessed on a site by site basis and reviewed in the light of the resources available to the Council.
- 3.13 The Council is also due to transfer a number of sites to BBB, including some with planning approval, in the light of the current review, it is proposed to suspend the transfer of all sites to BBB until the Council has completed the options appraisal.

Functions as sole shareholder

- 3.14 The Council, as BBB's sole shareholder, is able to amend the company's articles of association and also has the ability to appoint and remove Directors.
- 3.15 There have been recent changes to the Board of Directors at BBB, meaning there are currently only two appointed Directors of BBB (which is the minimum number of Directors to enable quorate meetings to take place). Given the proposed removals, it is necessary to appoint two new Directors of BBB.
- 3.16 Given PwC's report and recommendations, it is proposed that the new Directors have a strong background in finance. The following individuals are recommended to be appointed as Directors because of the skills and experience they have, as detailed below:
 - a. Duncan Whitfield is the Strategic Director of Finance and Governance at the London Borough of Southwark with over 20 years experience in the local government finance sector.
 - b. Ian O'Donnell is a finance consultant working on the financial review at the Council. A CIPFA accountant, he has been a consultant since June 2019 and has previously worked as the Executive Director of Resources and s151 officer at Ealing Council as well as the Director of Finance at Waltham Forest Council with a career spanning over 30 years in local government.

- 3.17 In relation to the associated indemnity, it is recommended that the Directors be indemnified under BBB's own insurance policy. This would not cover criminal acts, any other intentional wrongdoing, fraud, recklessness, any acts outside of their powers or the bringing of any action in defamation.
- 3.18 To strengthen oversight of the Company by the Council, as sole shareholder, two further resolutions are recommended. The first enables the Council to have sight of all minutes of Directors meetings and records of all decisions made by the Directors in future. The second ensures the ability of the Council to inspect all Company accounting or other records or documents at any time.

4. CONSULTATION

- 4.1 No formal consultation has been made on this report, other than factual accuracy checks with external third parties including BBB .

5. PRE-DECISION SCRUTINY

- 5.1 The Report in the Public Interest which was discussed at the emergency council meeting on the 19th November 2020 raised a series of concerns in regard to BBB and the Council's relationship with its external companies and entities. Recommendations 17 and 18 in the Action Plan for the Report in the Public Interest describe the strategic review report being presented to Scrutiny and Overview before being presented at Cabinet.
- 5.2 With the kind support of the Chair of Scrutiny and Overview, the report has in fact been presented to Cabinet first. This is due to the timing of the receipt of the report and the need to progress some interim urgent measures based on its findings. The strategic report and proposed action plan is referred to the December meeting of Scrutiny and Overview committee for a full review and challenge prior to it returning in January to Cabinet for final decision.

6. FINANCIAL AND RISK ASSESSMENT CONSIDERATIONS

- 6.1 It is important that the Council has a thorough understanding of all of its investments, particularly where they are deemed high risk or the financial exposure can change. This will enable the Council to mitigate and manage those risks and inform any future decisions.
- 6.2 The Council has budgeted £16.7m of interest and investment income from BBB within the 2020/21 Budget and therefore the financial position of BBB has a considerable impact on the Council's finances.
- 6.3 The estimated cost of this review to date is £125k These costs have been included in the quarter two financial monitoring.
- 6.4 In order to respond to the recommendations in the review , it will be necessary

to review the capacity and skills of officers and Members to ensure they are suitably qualified and trained to undertake their roles.

6.5 Options

The Council has a clear need to carry out this work, in order to inform its Medium Term Financial Strategy and the financial support required from MHCLG.

The Council did not have sufficient capacity or in-house expertise to carry out this review, so external support has been commissioned.

6.6 Risks

By accepting and responding to the recommendations of this review, the Council can address the ongoing risks:

- That the Medium Term Financial Strategy will not properly reflect the financial impact of its investments; and
- The Council may be exposed to financial losses over the medium to long term
- The Council needs to make significant improvements to its governance arrangements over external organisations and its investments.

Approved by: Lisa Taylor, S151 Officer and Director of Finance, Investment and Risk

7. LEGAL CONSIDERATIONS

7.1 The Interim Director for Law and Governance comments that as sole shareholder of BBB, the Council has the ability to act on this Report and its recommendations. The Council has authority under the general power contained in Section 1 of the Localism Act 2011 to continue to take steps in relation to the operation of the company (including its financial relationship with the company), having particular regard to the Council's fiduciary duties.

Approved by: Sean Murphy, Interim Director of Law and Governance and Deputy Monitoring Officer

8. HUMAN RESOURCES IMPACT

8.1 There are no direct implications for LBC employees. However, the implications of the issues raised and how they are addressed may have an effect on the medium term financial plan. Any subsequent savings plans that have a staffing impact will be subject to agreed HR procedures and formal consultation

Approved by: Sue Moorman, Director of Human Resources

9. EQUALITIES IMPACT

- 9.1 There are no equalities impacts arising from this report. However the implications of the issues raised and how they are addressed may have an effect on the medium term financial plan. Any subsequent savings plans that have a staffing impact or impact on vulnerable and/or groups that share a protected characteristic will be subject to agreed HR procedures, formal consultation and equality analysis

Approved by: Yvonne Okiyo, Equalities Manager

10. ENVIRONMENTAL IMPACT

- 10.1 There are no environmental impacts arising from this report

11. CRIME AND DISORDER REDUCTION IMPACT

- 11.1 There are no Crime and disorder reduction impacts arising from this report

12. REASONS FOR RECOMMENDATIONS/PROPOSED DECISION

- 12.1 The report by PwC details a wide range of governance failures on behalf of the Council, in its relationship with BBB in particular but also in respect of Croydon Affordable Housing. The recommendations made by PwC will improve the Council's oversight of all of the areas covered by the review. The additional work required on BBB will enable the Council to fully consider its options with regard to the future of BBB with a view to minimising the future financial risk to the Council and maximising the return on its financial outlay in support of the company.

13. OPTIONS CONSIDERED AND REJECTED

- 13.1 The Council has the option of either accepting all or in part the recommendations included within the strategic review. Having examined the recommendations it is difficult to argue from a Council perspective that none of the recommendations should be implemented as they will improve the Council's governance of its directly owned companies and other investments.
- 13.2 In relation to the exercise of the Council's functions as sole shareholder of BBB, the option to do nothing has been considered but is not recommended. In particular, the appointment of Directors with the right expertise will assist with implementing the recommendations of the PwC report, and the carrying out of any further agreed options for its future.

14. DATA PROTECTION IMPLICATIONS

14.1 WILL THE SUBJECT OF THE REPORT INVOLVE THE PROCESSING OF 'PERSONAL DATA'?

NO

14.2 HAS A DATA PROTECTION IMPACT ASSESSMENT (DPIA) BEEN COMPLETED?

NO

CONTACT OFFICER:

Chris Buss, consultant

APPENDICES TO THIS REPORT:

Appendix 1 - PwC Report
Appendix 2 – Proposed BBB Shareholder resolutions

BACKGROUND PAPERS:

PwC Report