

To: All Elected Members – Croydon Council
From: Jane West, Corporate Director Resources and S151 Officer
Date: 22/11/22
Subject: **Report under Section 114(3) of the Local Government Finance Act 1988**

Recommendations: -

1. That the Elected Members of Croydon Council must consider this report from Jane West, Corporate Director of Resources and Section 151 Officer (Chief Financial Officer - CFO) issued under Section 114 (3) of the Local Government Finance Act 1988.
2. That this report must be considered at a Meeting of the Full Council which must be held no later than the end of the period of 21 days of issue of this report beginning with the date of issue of this report (date above) and
3. That the authority must decide whether it agrees or disagrees with the views contained within the report and what action (if any) it proposes to take in consequence of it.

1 Purpose of the report

1.1 This is a report written by and issued by myself, Jane West, Corporate Director Resources and S151 Officer (Chief Finance Officer or CFO), to meet both my statutory and professional responsibilities. Members of Croydon Council must consider this report and respond as required by the Local Government Finance Act 1988.

1.2 The Local Government Finance Act 1988, places certain responsibilities on the Chief Finance Officer. Section 114(3) states:-

'The chief finance officer of a relevant authority shall make a report under this section if it appears to him that the expenditure of the authority incurred (including expenditure it proposes to incur) in a financial year is likely to exceed resources (including sums borrowed) available to it to meet that expenditure.'

This is a mandatory duty placed upon the Chief Finance Officer in these circumstances.

1.3 The purpose of this Section 114(3) report is to make it clear to all Members of the Council that it faces a financial situation of an extremely serious nature with significant estimated unfunded financial deficits forecast from 2023/24 onwards. My conclusion as the S151 Officer is that Croydon currently has no prospects of returning to financial sustainability without significant and extraordinary

financial support from government above and beyond the usual mechanism of Capitalisation Directions.

- 1.4 This section 114(3) report has serious operational implications and puts in place a prohibition period regarding new expenditure beginning with the day this report is sent to you and ending on the first business day following consideration of this report by Full Council.
- 1.5 I have consulted with the Head of the Paid Service and the Monitoring Officer prior to issuing this report.
- 1.6 A copy of this report has been sent to the Council's auditors who will also be notified of the date, time and place of the Full Council meeting in due course.

2 Details of the Report

- 2.1 Since I joined the Council in March 2022, mindful of my statutory duty under Section 114, I have kept the need to issue a S114(3) notice under constant review. As a new S151 officer, I am required to make my own assessment of the Council's financial position. It should be noted that when the original S114(3) notices were issued in 2020 by the previous S151 officer, she would not have been aware of some of the current issues which are now being raised.
- 2.2 My professional judgement as the S151 Officer for Croydon Council continues to be that in the current financial year (2022/23) it is possible that the Council will be able to balance its budget. This is despite new issues emerging from the Opening the Books project around historic capital charges which are understated in the Council's accounts and of charges made to the capital programme and to the Housing Revenue Account that should have been charged to revenue. In my professional view, even if all these new charges to revenue are required, Croydon Council would technically be able to meet these costs within its current reserves and provisions. Whether it would wish to do so is something that needs to be further explored as this would leave the Council with no contingency for unforeseen challenges.
- 2.3 The Council has produced a monthly Financial Performance Report each month since May 2022. While its in-year financial position for 2022/23 is challenging, it is currently projected that the Council will be within its budget at the end of the financial year.
- 2.4 There is an unresolved issue in relation to the capital receipts from Croydon Affordable Homes/Croydon Affordable Tenures that have been applied to £70m in revenue transformation costs under the government's Flexible Use of Capital Receipts rules in the 2019/20 financial accounts. This issue was reported in the 7 March 2022 Budget report as having the potential to require a new Capitalisation Direction from government. If this matter is resolved in the Council's favour, there will be the need for a £9m charge to reserves which can be accommodated within the Council's current reserves and provisions. However, if the external auditors require the adjustment of £70m, the Council

will be in deficit in 2022/23. This would require a S114(3) Notice specifically for 2022/23.

- 2.5 The more significant problem for the Council is that the work which has been done in preparation for the 2023/24 Council Tax Setting in February or March 2023 has identified that expenditure the authority is projected to incur in each year of the period 2023/24-2026/27 will exceed resources (including sums borrowed) available to the Council to meet that expenditure. The combination of the ongoing budget requirements of these legacy budget adjustments, fundamental structural issues within the Council's finances such as the toxic debt burden of negative equity from historic uncontrolled borrowing and the national and global issues the local government sector is currently facing has undermined the progress being made on the financial recovery. The S151 Officer has concluded that this necessitates a S114(3) Notice to be issued.
- 2.6 It is clear that in order to balance the Council's budget in 2023/24, and later years, further assistance will be required beyond the Capitalisation Directions usually deployed by central government. Extraordinary support beyond Capitalisation Directions could include write off of all or part of the Council's outstanding debt, permission to repay debt over a longer period and/or at a lower rate of interest or permission to increase the Council Tax beyond the referendum cap.
- 2.7 The Council has begun a dialogue with the Department for Levelling Up, Housing and Communities (DLUHC) but it is unlikely that it will receive confirmation of potential solutions to the Council's unbalanced budget before February 2023, despite government officials working very closely with Council officers in a very supportive manner.
- 2.8 This S114(3) notice is being issued in accordance with the statutory guidance to instigate formal immediate action to avoid a negative general fund balance within the next financial years of the budget cycle based on current forecasts. The purpose is to make clear to all Members of Croydon Council as well as staff and residents that the Council faces an extremely serious financial situation which currently has no solution in sight. By 2023/24, expenditure is forecast to be significantly greater than income resulting in a financial deficit being forecast, with insufficient reserves available to fund this.
- 2.9 In reaching the conclusion to issue this S114(3) notice today, I have had to make a number of judgements. At the time of writing this report there is a forecast general fund deficit forecast for 2023/24 financial year in excess of £77m, assuming a council tax increase at the Council Tax Referendum Level of 5% set by government for 2023/24. There are also potential risks in the treatment of 2019/20, 2020/21 and 2021/22 costs arising from the ongoing external audit of the accounts. The Council does not currently have a fully deliverable robust action plan to avoid a negative general fund balance next financial year.

2.10 In reaching my professional judgement I have taken into account the continuing work on the Budget for 2023/24 and the Medium Term Financial Strategy and on the planned application to DLUHC for assistance. However I do not consider these measures are certain in delivering the funds the Council needs at this time to deliver a balanced budget next year. While positive conversations are continuing with DLUHC there continues to be no certainty that any application for assistance will actually be approved. Time to the end of the financial year is rapidly running out and I now consider that if I do not issue this S114(3) notice today I will not be undertaking my statutory duties as the Council's S151 Officer.

2.11 The remainder of this report sets out:-

- The s114 legal background
- The historical background to the Council's financial position
- Medium Term Financial Strategy Outlook
- Conclusions
- Next steps.

3 S114 Legal Background

3.1 Under the Local Government Finance Act 1992 local authorities are required by law to have a balanced budget. However, what is meant by balanced is not defined in law and the CFO is required to use their professional judgement to ensure the local authority's budget is robust and sustainable.

3.2 S114(3) requires the CFO to report to all the authorities' Members if there is, or is likely to be, an unbalanced budget. This is usually undertaken in consultation with the Head of the Paid Service and the Council's Monitoring Officer.

3.3 As the Chartered Institute of Public Finance and Accountancy (CIPFA) state in their publications, such a notice is only given in the gravest of circumstances and the issuing of a S114(3) notice should not be seen as a failure. I can assure all Members that the decision to issue this notice has been carefully considered in consultation with the Mayor, the Cabinet, the Chief Executive, the Council's Monitoring Officer and the Corporate Management Team all of whom support this step. It is being issued today as I am not being presented with the evidence that gives assurance that that a sufficient level of savings options and delivery of savings can be implemented during the remainder of this financial year or in next year to balance the 2023/24 budget.

3.4 A S114(3) notice has serious operational implications. Section 115 (3) of the Local Government Finance Act 1988 states that the:

'Full Council must meet not later than the end of the period of 21 days beginning with the day on which copies of the report are sent to consider and respond to this notice.'

3.5 The service of a copy of this report upon you starts the beginning of a 'prohibition period' regarding new expenditure which ends on the first business

day after the day upon which the Council considers the report. During this prohibition period the authority must not enter into any new agreement which may involve the incurring of expenditure (at any time) by the authority indeed any such contract entered into during this period would be deemed void under section 115(6) of the Act.

- 3.6 In practice this means that all new spending is prohibited (i.e. a spending freeze is imposed) between now and the first business day after the day of the full Council meeting. All new expenditure must stop with immediate effect, this includes, amongst other things, the appointment of new permanent or temporary staff, all avoidable spend for example on ICT, supplies and services, equipment, expenses and overtime payments. The use of Purchase Cards (Pcards) is not allowed, except in emergency circumstances.
- 3.7 Subsection (6B) requires that authority for the purposes of subsection (6) shall:
 - (a) be in writing,
 - (b) identify the ground on which it is given, and
 - (c) explain the chief finance officer's reasons for thinking that the ground applies.
- 3.8 Subsection (8) states that if subsection (6) is not complied with, the Council shall be taken not to have had power to enter into the agreement (notwithstanding any option to do so under contract or otherwise). Therefore, the Council's actions will be deemed unlawful.
- 3.9 During this time the Council will continue to have financial commitments in relation to statutory responsibilities and the Council already has a process in place that allows proposals for urgent spending to be considered and if appropriate approved by me as CFO. This is in the form of a daily Spend Control Panel chaired by myself, or my deputy S151 Officer or another manager within the Council's Finance team. The CFO may only authorise expenditure which improves the Council's situation, prevents it from getting worse or prevents it from recurring.
- 3.10 S116 requires the Council to notify its external auditors of the report and the time, date and place of the full Council meeting. The external auditors also need to be informed of the outcome of the meeting as soon as practicable. The external auditors have been kept informed of the emerging financial position and the planned work. The external auditors will need to consider the implications of this report on their statutory functions and the implications for their opinion on the 2019/20, 2020/21 and 2021/22 accounts which remain unsigned.
- 3.11 CIPFA guidance recommends that informal contact is made with the Department for Levelling Up, Housing and Communities, lead Members and statutory officers in advance of issuing a S114 report, to undertake some scenario testing and to ensure a robust action plan to address the issues raised. The Mayor and the Cabinet have been kept up to date on the emerging

budget situation, as have the Corporate Management Team including the key statutory officers and there has been regular liaison with DLUHC officials.

4 The historical background to the Council's financial position

- 4.1 The “Opening the Books” programme initiated by the Executive Mayor has revealed further historic legacy issues that have undermined the ability of the Council to not only balance its budget but also become financially and operationally sustainable over the current agreed medium term financial strategy. In particular, the level of debt the Council has to service means its general revenue budget is unable to meet the needs of the people of Croydon.
- 4.2 In October 2020, the Council’s external auditor, Grant Thornton, issued the first of two reports in the public interest (RIPI) into Croydon Council which stated that for many years the Council had failed to pay due regard to the seriousness of its financial position and the urgency with which action needed to have been taken.
- 4.3 In November 2020, the then Director of Finance, Risk and Assurance and S151 Officer published the first of two Section 114 notices. These notices made clear to all Members of Croydon Council as well as staff and residents that the Council faced an extremely serious financial situation in that financial year (2020/21). It was also made clear that the Council’s expenditure was predicted to be significantly greater than its income resulting in a financial deficit being forecast, with insufficient reserves to fund this. The financial year ended with an overspend of £67m, thus confirming the conclusions of the external auditor in the RIPI of the seriousness of the Council’s financial position.
- 4.4 In December 2020, the Council submitted a formal request to the Government (then MHCLG) for £150m of extraordinary financial support otherwise known as a Capitalisation Direction. The Government appointed an Improvement and Assurance Panel (IAP) following the outcome of a non-statutory rapid review report and sought assurance from them on the £150m request. The Government agreed to the extraordinary financial support subject to continued positive assurance from the IAP.
- 4.5 The Council agreed the Croydon Renewal Plan to address the issues highlighted in the RIPI and the S114 notices to ensure the Council could move to becoming a sustainable local authority, in financial, governance and operational delivery terms. However, the early implementation of the Renewal Plan began to reveal further worrying aspects of the Council’s operations and a lack of resilience that needed significant improvement.
- 4.6 Since then, the Council has made progress in delivering the Renewal Plan, as recognised by the Improvement and Assurance Panel and the Minister of State for Equalities and Levelling Up, Housing and Communities who noted the Council’s “significant progress” and that the “foundations for a sustainable future were being established”. The Council is in its third year of receiving

extraordinary financial support and has benefitted from the opportunity to capitalise revenue expenditure of £145m so far.

- 4.7 The two RIPI's and the two S114 notices revealed truly significant deficiencies in the Council's capabilities in financial planning, financial management, risk assessment, governance and a serious deterioration in the Council's financial and operational resilience to withstand external challenges.
- 4.8 As such, and despite significant efforts to fully identify the risks and liabilities the Council faced for the December 2020 submission, it was very likely that further issues were likely to arise that it was not possible to account for in the original £150m request. The March 2021 Regina Road revelations and the deficiencies in the Housing repairs service are an example of this.
- 4.9 Then in March 2022 it was reported to Cabinet and Full Council that a significant issue in relation to Croydon Affordable Homes/Croydon Affordable Tenures (CAH/CAT) had been identified that could mean that adjustments would be required to the accounts for both 2019/20 and 2020/21 and that the adjustments could result in an in year (2022/23) charge to the Council's reserves of £73m.
- 4.10 The S25 comments of the Corporate Director of Resources and S151 Officer in that Council Tax setting report noted that such a significant adjustment to the Council's reserves could result in the Council facing another S114 notice needing to be published. Since then, significant work has been undertaken by officers, external partners and with the external auditor to ensure this historic legacy financial issue is correctly accounted for. This further work has identified that the legacy adjustment required in relation to CAH/CAT is likely to be a reduction to reserves of £9m which is still significant. This is not yet fully resolved and a further adjustment, reducing reserves by a further £61m, may still be necessary.
- 4.11 From both the delivery of the Council's Renewal Plan and the more recent Opening the Books project, initiated by the Mayor in July 2022, further historic legacy issues have been identified that the Council needs to resolve in order to close the three years of outstanding accounts. As well as the CAH/CAT adjustment, further legacy adjustments have been identified for the 2019/20, 2020/21, 2021/22 and 2022/23 accounts arising from historic accounting errors. These total a reduction to reserves in those years of an estimated £74.6m.
- 4.12 The RIPI outlined in some detail the significant level of the Council's debt and its borrowing and highlighted that in three years (2017/18 – 2019/20) the Council borrowed some £545m. The impact of the Council's borrowing and the toxic debt burden the Council is having to service after historic uncontrolled borrowing has become critical to the sustainability of the Council's revenue budget. The Council owes £1.6bn (including £300m HRA debt) and this costs the Council at present £47m a year to service before the Council can spend any money on services for the people of Croydon. The Council also has significant levels of negative equity on its assets.

- 4.13 Given the emergence of these further historic legacy issues, the significance of the impact of the toxic debt burden on the Council's budget and the lack of financial and operational resilience the Council has to withstand major shocks in the national and local economy, the original 2020/21 Croydon Renewal Plan and the accompanying transitional Capitalisation Directions are unable to cope with the now more fully understood financial position. This is despite significant savings of some £90m and £50m in asset sales being delivered over the past two years.
- 4.14 Many of the legacy issues identified also need to be adjusted in the Medium Term Financial Strategy on an ongoing basis, creating a gap of £47.9m in every year moving forward before any future challenges are accommodated.
- 4.15 The Financial Performance Reports for 2022/23 have set out some of these challenges from mistakes in the budget set for the year. For example three areas in particular have caused a £19m overspend in the current year:-
- Parking income – the reduction in demand for parking in the borough following the pandemic should have been better assessed in the assumptions for projected activity in 2022/23
 - New traffic income projections were included with insufficient contingency built in to reflect the operational challenges of implementing new traffic schemes
 - A deficit in the Housing Benefit budget for 2021/22 should have been recognised earlier. It was only picked up at the very end of the year and therefore was not built into the 2022/23 budget.

5 Medium Term Financial Strategy Outlook

- 5.1 There are a myriad of economic and financial issues facing the whole country and the Council is not immune from these. As well as the legacy issues set out above, the Council is facing the same challenges as other councils, namely rising inflationary costs, the impact of the cost-of-living increases on its residents and businesses and more recently rapidly increasing interest rates. Croydon has been able to act more prudently than many other councils and set aside a £20m ongoing budget for additional pressures from inflation in 2022/23 but further growth will be required in the later years of the MTFS.
- 5.2 Croydon also faces structural issues that have important implications for its annual budget. Croydon is home to many vulnerable children due to having the highest number of children and young people in any London borough and for many years being the main port of entry for unaccompanied asylum seeking children and young people. Croydon also has the highest number of residential and care homes of any London borough which creates a different intensity of demand for services to older adults. Croydon experiences a disproportionate level of emergency and temporary accommodation costs compared to other London boroughs and we are home to over 1,000 asylum seekers living in local

hotels. The Council also has a disproportionately high level of outstanding borrowing, much of which is not asset backed ie it is toxic debt.

- 5.3 The costs arising from historic financial and operational mismanagement, structural challenges in the borough and the current national economic and financial uncertainties have been worked through. The conclusion is that, in order to balance its budget, Croydon needs to reduce its spending by £130m next financial year alone (before any council tax increase) which is simply untenable out of a net budget of some £300m. The current financial projections for 2023/24 to 2026/27 are set out in Appendix A.
- 5.4 This reduction equates to 43% of the Council's net budget, a reduction the Council is not able to safely meet in 2023/24, 2024/25 or 2025/26 without significant and extraordinary financial support from central government. It is also likely that further cost pressures will arise in the latter two years of the next MTFS period.
- 5.5 The estimated ongoing legacy issues that need to be adjusted for in the base budget are as follows.

	£m
Parking and Traffic income over-estimate	13.8
HRA/General Fund alignment correction	9.5
Housing Benefit budget error	9.0
One off benefit of NHS income built into the ongoing budget	5.0
Minimum Revenue Provision correction	2.6
Correction of private sector landlord licensing income wrongly credited to the general fund (covers the cost of the scheme once this is in place)	1.5
Capitalisation of salaries correction	1.3
Housing structural deficit	5.2
Total additional cost of corrections	47.9

- 5.6 On top of these legacy issues, the other components to the £130m required reduction in the Council's 2022/23 budget are: the inherited budget gap of £27m from the March 2022 budget setting; plus the £19m in savings and 3% council tax increase already planned for 2023/24; the impact of increased interest rates on the £300m in temporary borrowing that needs to be financed; and other new pressures facing all local government from increased inflation and demand pressures.

- 5.7 Given the scale of the continuing financial challenge, the Council will need to continue to reduce spending for years to come. To balance the books, the Council is going to need to reduce its expenditure significantly in each of the next three years. That will mean difficult decisions about the services we are able to provide and ultimately, as set out in the Mayor's Business Plan, the Council will need to do less and spend less in the future.
- 5.8 Although still far from identifying sufficient savings to meet the projected budget gap for 2023/24, a range of savings proposals have been developed through a series of Star Chambers over the summer. A Transformation Programme has also been developed. The proposed savings arising from this work are set out in the Medium Term Financial Strategy 2023/24 to 2025/26 Update report to be discussed at Cabinet on 30 November 2022.

6 Conclusions

- 6.1 The combination of these historic legacy, national and global issues have all undermined the progress being made on the financial recovery and has necessitated that, as the Council's S151 Officer, I must take the decision to issue this S114(3) Notice. I have concluded that the expenditure the authority is projected to incur in each year of the period 2023/24-2026/27 will exceed resources (including sums borrowed) available to the Council to meet that expenditure.
- 6.2 It should not be underestimated quite how damaged some of the Council's financial and governance capabilities have been. Delivering the genuine operational and sustainable transformation needed will not happen overnight. While the 2020 Report in the Public Interest (RIPI) from the Council's external auditors, Grant Thornton, identified the root causes of the problems, the depth of the problems facing Croydon was not able to be fully understood at that time.
- 6.3 Significant new issues have been uncovered since late 2020. It is clear that the original 2020/21 Croydon Renewal Plan and the accompanying transitional capitalisation directions were a response to the known issues at that time. Two years on, the Council has made significant progress but now needs to correct further legacy issues which have been identified as necessary to sustainably resolve Croydon's historic financial challenges.
- 6.4 It is estimated that given the scale of the historic financial, governance and operational mismanagement which needs resolving, it is unlikely the Council will be able to become sustainable without significant and extraordinary financial support from central government.
- 6.5 That is why the Mayor has instructed officers to begin discussions with Government to request a funding package that assists the Council with its legacy financial issues and provides extraordinary financial support to safely balance the Council's ongoing budget whilst providing capacity to deliver the Council's transformation plans safely and sustainably. Discussions have been held with the IAP and they have advised the Council to be prudent in its

assumptions about the level of change and the pace of change that can be sustainably delivered.

- 6.6 The Medium Term Financial Strategy 2023/24 to 2025/26 Update report for Cabinet on 30 November 2022 has been published alongside this S114(3) Notice that sets out in more detail the reasons why I have reached this conclusion. It describes the immediate measures that are required under the S114(3) Notice.

7 Next steps

- 7.1 The requirement of this S114(3) notice is that the Council must meet within 21 days of issue, in order to consider this report and decide whether it agrees or disagrees with the views contained in the report and what action (if any) it proposes to take in consequence of it. At this stage I am unable to offer remedies to ensure the Council is able to set a balanced budget in 2023/24 and future years and elected Members must take responsibility to make choices and decisions to reduce costs immediately to ensure the Council is able to have measures in place to enable it to set a balanced budget in 2023/24 and future years. This will not be possible without significant and extraordinary support from central government.
- 7.2 Elected Members must by law agree to cease all non-essential expenditure and reduce the Council's operational and service delivery costs immediately. In practice, throughout this financial year the Council has been operating with a very stringent spending control process in place that allows proposals for urgent spending to be considered and if appropriate approved. This is in the form of a daily Spend Control Panel chaired by the S151 Officer or another manager within the Council's Finance team.
- 7.3 The timetable for activity over the coming months is as follows.

Activity	Timescale
Issue S114 Notice	22 November 2022
Medium Term Financial Strategy 2023/24 to 2025/26 Update to Cabinet	30 November 2022
Papers issued for Full Council	2 December 2022
Full Council Meeting	12 December 2022
Statutory deadline for Full Council to agree the 2023/24 Budget and Council Tax	11 March 2023

- 7.4 Negotiations will be ongoing with central government over the coming months in the lead up to Council Tax Setting in February or March 2023.

Jane West
Corporate Director of Resources and S151 Officer
22 November 2022