



You are hereby summoned to attend a meeting of **CITY COUNCIL (EXTRAORDINARY)** in the Council Chamber - at the Council House on Tuesday, 4 January 2022 at 5.00 pm to transact the following business

AGENDA

Pages

- 1 **APOLOGIES FOR ABSENCE**
- 2 **DECLARATIONS OF INTERESTS**
- 3 **TO RECEIVE OFFICIAL COMMUNICATIONS AND ANNOUNCEMENTS FROM THE LEADER OF THE COUNCIL AND/OR THE CHIEF EXECUTIVE**
- 4 **CONSIDERATION OF AND RESPONSE TO SECTION 114 REPORT AND SECTION 5 REPORT DATED 15TH DECEMBER 2021** 3 - 60
Report of the Leader of the Council

IF YOU NEED ANY ADVICE ON DECLARING AN INTEREST IN ANY ITEM ON THE AGENDA, PLEASE CONTACT THE GOVERNANCE OFFICER SHOWN ABOVE, IF POSSIBLE BEFORE THE DAY OF THE MEETING

CITIZENS ARE ADVISED THAT THIS MEETING MAY BE RECORDED BY MEMBERS OF THE PUBLIC. ANY RECORDING OR REPORTING ON THIS MEETING SHOULD TAKE PLACE IN ACCORDANCE WITH THE COUNCIL'S POLICY ON RECORDING AND REPORTING ON PUBLIC MEETINGS, WHICH IS AVAILABLE AT WWW.NOTTINGHAMCITY.GOV.UK. INDIVIDUALS INTENDING TO RECORD THE MEETING ARE ASKED TO NOTIFY THE GOVERNANCE OFFICER SHOWN ABOVE IN ADVANCE.

Dated 22 December 2021

Director for Legal and Governance

To: All Councillors of Nottingham City Council

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City Council – 4 January 2021

Report of the Leader of the Council

Lead Officers **Mel Barrett, Chief Executive**
 Clive Heaphy, Corporate Director for Finance and Resources and
 Section 151 Officer
 Malcolm R. Townroe, Director of Legal and Governance and
 Monitoring Officer

Consideration of and Response to Section 114 Report and Section 5 Report dated 15th December 2021

1 Summary

- 1.1 On 15th December 2021, the Council's Section 151 Officer was required by law to issue a report under Section 114(2) of the Local Government and Finance Act 1988. At the same time, the Monitoring Officer elected to issue a further report under Section 5 of the Local Government and Housing Act 1989.
- 1.2 Following the issuing of a Section 114 report to all Councillors the law requires Full Council to meet within 21 days to consider the report, decide whether it agrees or disagrees with it and what action (if any) to take in response.
- 1.3 This report presents to Council:
- a) the Section 114 report (including the Section 5 elements), (appendix A),
 - b) the report of the Chartered Institute for Public Finance Accountants (CIPFA) that informed the Section 114 report (appendix B)
- It also presents a draft written response to the Section 114 report for Council to consider for approval (appendix C, to follow).

2 Recommendations

- 2.1 It is recommended that Council:
- a) Gives due and proper consideration to the Section 114 report and its response to it.
 - b) endorses the views contained in the Section 114 report
 - c) accepts all of the recommendations contained within the Section 114 report, in particular:
 - i. to note and endorse at its meeting the actions proposed by the Section 151 Officer in paragraphs 8.2.1 – 8.2.5 of the s114 report
 - ii. to endorse the recommendations made by CIPFA at 9.3 – 9.9 in the s114 report (which have been accepted by the Section 151 and other Statutory officers)
 - iii. to note the actions taken at recommendation 9.10 in the s114 report
 - d) approves the draft written response to the s114 report.

3 Reasons for recommendations

- 3.1 Nottingham City Council fully recognises the serious nature of s114 and s5 reports being issued. It fully accepts the findings, conclusions and recommendations made by the Section 151 Officer and the Monitoring Officer in the report.
- 3.2 Under section 115 of the Local Government Finance Act 1988 Council is required to consider and respond to a report made by the Section 151 Officer under Section 114 of that act. It is also required to consider any report made by the Monitoring Officer under Section 5 of the Local Government and Housing Act 1989.
- 3.3 On 15th December 2021, the Council's Section 151 Officer was required by law to issue a report under Section 114(2) of the Local Government and Finance Act 1988. At the same time, the Monitoring Officer elected to issue a further report under Section 5 of the Local Government and Housing Act 1989. Both reports are issued in respect of acts of unlawfulness by the Council in respect of 'management fee rebates' made to the Council by its wholly owned and controlled company Nottingham City Homes over the period 2014/15/ to 2020/21 inclusive.
- 3.4 Prior to the issuing of the report concerns had been raised by the Council's Section 151 Officer and were investigated by the Chartered Institute of Public Finance and Accountancy (CIPFA) and found to represent illegitimate spend. External legal opinion was sought and confirmation provided that these acts were unlawful.
- 3.5 Tenant funds of £15.868m have been wrongly used by the Council's General Fund over a period of 7 years. This money rightly belongs to tenants of the Council and should be applied toward the management and maintenance of the Council's Housing stock within the Housing Revenue Account ring fence as defined in law.
- 3.6 The s114 report makes recommendations to correct the unlawful use of those funds (at 2021/22 prices). The report also seeks to understand how and why this occurred, and to confirm that all transactions between NCC and NCH (as well as between entities within the NCH 'group' are reasonable and justified. Finally the recommendations seek to strengthen the Council's HRA client function (the HRA cannot be delegated, only the management and maintenance of the stock) and review the relationship and governance arrangements between the Council and NCH.

4 Other options considered in making recommendations

- 4.1 No other options were considered. The actions were deemed unlawful and must be remedied and steps must be taken to ensure that this cannot re-occur.

5 Background (including outcomes of consultation)

- 5.1 The background and findings to the Section 114 report are set out fully in the report,

6 Finance colleague comments (including implications and value for money)

- 6.1 The Council has budgeted each year since 2014/15 for contributions from NCH into the Council's General Fund. On average these are budgeted at around £2.3m per annum but have been in excess of £4m in some years.

- 6.2 Stopping this unlawful source of income will impact immediately on the Council's General Fund reserves but in the medium term financial plan. This income has already been discounted for future years.
- 6.3 HRA reserves will be the immediate beneficiary of the proposed actions and it will enable the Council to reduce its management fee to Nottingham City Homes in 2021/22 and future years.
- 6.4 Further investigations are taking place through CIPFA and should these yield any further issues, additional provision may need to be made.

7 Legal and Procurement colleague comments (including risk management issues, and legal, Crime and Disorder Act and procurement implications)

- 7.1 The legal issues that arise following the issue of a section 114 report and a s5 report are alluded to above. In simple terms the statutory requirement is for the Council to meet to consider its response to the s114 report within 21 days of its issue. Meeting on the 4th January 2022 will enable the Council to fulfil this obligation.

8 Equality Impact Assessment (EIA)

- 8.1 Has the equality impact of the proposals in this report been assessed?

No



An EIA is not required because this report does not contain proposals for new or changing policies, services or functions.

Yes



Attached as Appendix x, and due regard will be given to any implications identified in it.

9 List of background papers other than published works or those disclosing confidential or exempt information

- 9.1 None

10 Published documents referred to in compiling this report

- 10.1 Local Government Finance Act 1988 and Local Government and Housing Act 1989

Councillor David Mellen
Leader of the Council

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**Report to all Councillors of Nottingham City Council under s.114 of the Local Government
Finance Act 1988**

Report of: Clive Heaphy, Section 151 Officer

Date of Report: 15th December 2021

Purpose of report and executive summary

- 1.1 Matters have come to my attention which require me to make a report under Section 114(2) of the Local Government Act 1988. Members of the Council are asked to consider this report within 21 days of the date of this report. I also draw members' attention to a further report at the end of this document issued by the Monitoring Officer under the Section 5 of the Local Government and Housing Act 1989.
- 1.2 I have briefed extensively the Leader of Nottingham City Council, leaders of political groups, chairs of relevant committees, members of the Council, the Council's auditors, representatives of the Department for Levelling Up, Housing and Communities, the Improvement and Assurance Board and the Board of Nottingham City Homes on these matters. Briefing has been both verbal and written.
- 1.3 The Local Government Finance Act 1988, Section 114(2), requires that the chief finance officer of a relevant authority shall make a report under this section if it appears to him that the authority, a committee of the authority, a person holding any office or employment under the authority or a joint committee on which the authority is represented—
 - (a) has made or is about to make a decision which involves or would involve the authority incurring expenditure which is unlawful,
 - (b) has taken or is about to take a course of action which, if pursued to its conclusion, would be unlawful and likely to cause a loss or deficiency on the part of the authority, or
 - (c) is about to enter an item of account the entry of which is unlawful.
- 1.4 The acts of unlawfulness and the purpose of this report relate to
 - 1.4.1 The treatment by Nottingham City Council of annual 'management fee rebates' from Nottingham City Homes since 2014/15 (funds derived from the Housing Revenue Account (HRA)) as General Fund (GF) income in breach of the HRA Ring Fence under the Housing Act 1989 (S74).
 - 1.4.2 The receipt by Nottingham City Council since 2014/15 of annual 'management fee rebates which are paid by Nottingham City Homes Limited (a wholly owned and controlled company of NCC), in breach of its Articles of Association.

- 1.5 Under this report, I am not requiring the cessation of spending by the Council but rather bringing to members' attention acts of unlawfulness. However, I have imposed a management action prohibiting NCC entering into new agreements and spending commitments with Nottingham City Homes unless expressly approved in writing by myself in consultation with the Head of Paid Service (Chief Executive) and Monitoring Officer as appropriate.
- 1.6 The background, legal framework, findings and recommendations are set out in this report and the report from CIPFA which is attached. In summary,
- 1.7 Having completed their review, CIPFA conclude that *'however the payment made by NCH to NCC since 2014-15 is defined or described, the GF has benefited from these payments totalling £15,858,500 in the period from 2014-15 to 2020-21. As discussed this seems to be a breach of the HRA ring-fence which is, potentially, unlawful.'*
- 1.8 CIPFA also conclude that *'furthermore, if it is determined, on the basis of legal advice, that the payments NCH has made to NCC are prohibited distributions of surpluses these are also, potentially, unlawful.'*
- 1.9 An External Barrister has reviewed the CIPFA report and is of the opinion that in respect of the statements at 1.7 and 1.8, these constitute acts of unlawfulness.
- 1.10 This unlawful position appears to be the result of a systematic and planned approach between NCC and NCH since 2014/15 whereby Nottingham City Council received an annual 'management fee rebate' from NCH in breach of its Articles of Association which NCC subsequently treated unlawfully as General Fund income.
- 1.11 Additional issues have also come to CIPFA's attention which raise further question about more breaches which could further threaten the integrity of the HRA ring-fence and which will be the subject of further investigations.

2. Legal framework for a Section 114 report

- 2.1 Section 114 (2) of the Local Government Finance Act 1988 requires the Chief Finance Officer of a relevant authority to make a report under this section if it appears to him that the authority, a committee of the authority, a person holding any office or employment under the authority or a joint committee on which the authority is represented
 - (a) has made or is about to make a decision which involves or would involve the authority incurring expenditure which is unlawful,
 - (b) has taken or is about to take a course of action which, if pursued to its conclusion, would be unlawful and likely to cause a loss or deficiency on the part of the authority, or
 - (c) is about to enter an item of account the entry of which is unlawful.

- 2.2 The process for issuing a s.114 report and the effect of it are set out in the 1988 Act. Subsection 3(A) requires the Chief Finance Officer to consult, so far as reasonably practicable, the Head of Paid Service (Chief Executive) and the Monitoring Officer. The Council's Chief Executive as Head of Paid Service and the Monitoring Officer have been fully engaged prior to this report being issued.
- 2.3 Section 115 requires Council to consider the report at a meeting where it shall 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. The meeting must be held no later than 21 days beginning with the day the report was sent and this decision is reserved to full Council.
- 2.4 Section 116 requires the Council to notify its external auditors of the report and the time, date and place of the 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 2021/22 or prior year accounts.
- 2.5 CIPFA guidance recommends that contact is made with Department for Levelling Up, Housing and Communities, lead members and statutory officers in advance of issuing a s.114 report, to undertake some scenario testing and to ensure a robust action plan to address the issues raised. Lead members have been kept up to date on the emerging budget situation, as have the Executive Board including the key statutory officers and there has been regular liaison with the Improvement and Assurance Board, DLUHC officials and CIPFA.

3. Background

- 3.1 As Section 151 officer, I have sought assurances in relation to the financial relationship between the Council and its wholly owned and controlled subsidiary, Nottingham City Homes and in particular
 - a. The basis on which NCC has budgeted for and received annual payments into its General Fund from NCH given the statutory ring-fence in operation for HRA funds;
 - b. The basis on which transactions have been made between NCC and NCH for services provided;
 - c. The basis of transactions between NCH companies:
 - i. Nottingham City Homes Limited (NCH);
 - ii. Nottingham City Homes Registered Provider Limited (NCHRP);
 - iii. Nottingham City Homes Enterprises Limited (NCHE).

given that each company operates independently under their own Articles of Association.

- 3.2 Having sought assurances from NCC and NCH colleagues as to the legitimacy of these transactions of concern, I was unable to satisfy myself and I commissioned, with the knowledge and support of the Head of Paid Service and Monitoring Officer, in consultation with the Leader of the Council and the Chartered Institute of Public Finance and Accountancy (CIPFA) to undertake investigatory work to inform my S151 opinion in respect of financial legitimacy. The CIPFA report dated 10 December 2021 is appended and I quote extensively from it throughout my Section 114 report. It is important that the two documents are read together.
- 3.3 In conjunction with the Head of Legal & Governance (Deputy Monitoring Officer), an external barrister's opinion was sought, to review the lawfulness questions raised by myself and the CIPFA report.
- 3.4 The Statutory Officers have reviewed and fully accepted the findings and recommendations of the reports.

4. Operation of the HRA

- 4.1 The Housing Revenue Account (HRA) is intended to record expenditure and income on running a council's own housing stock and closely related services or facilities, which are provided primarily for the benefit of the council's own tenants.
- 4.2 The main features of the HRA are:
- it is a landlord account, recording expenditure and income arising from the provision of housing accommodation by local housing authorities (under the powers and duties conferred on them in Part II of the Housing Act 1985 and certain provisions of earlier legislation).
 - it is not a separate fund but a ring-fenced account of certain defined transactions, relating to local authority housing, within the General Fund.
 - the main items of expenditure included in the account are management and maintenance costs, major repairs, loan charges, and depreciation costs.
 - the main sources of income are from tenants in the form of rents and service charges.
 - the HRA should be based on accruals in accordance with proper accounting practices, rather than cash accounting.
- 4.3 The HRA is governed by legislation and the key legislation relating to the HRA is:
- Housing Act 1985 (Part II);
 - Housing Act 1988;
 - Local Government and Housing Act 1989 (section 74);
 - Local Government Act 2003;
 - Localism Act 2011.

- 4.4 Legislative features are that:
- it is a ring-fenced account within the General Fund.
 - Credits and Debits are prescribed by statute.
 - There is no general discretion to breach the ring-fence.
 - The Local Housing Authority (LHA) (NCC in this instance) cannot budget for a deficit within the HRA.
 - all borrowing within the HRA is in line with the CIPFA Prudential Code.
- 4.4 The latest guidance published by the [then] Ministry of Housing Communities and Local Government (MHCLG) on the operation of the HRA ring-fence on 10 November 2020 replaced Circular 8/95 which had been published by the former Department of the Environment (DoE) on 1 May 1995. The latest guidance restates Ministers' established policy for the HRA and introduces no new issues of principle. In fact, since the introduction of the HRA ring-fence in 1990, there has been no change in relation to policy or issues of principle in respect of the HRA ring-fence.
- 4.5 The latest guidance, as was the case previously, makes it incumbent on NCC to be fair to both tenants and to council tax payers in applying the "who benefits?" test to ensure there is no breach of the HRA-ring-fence in contravention of the legislation and guidance governing the HRA. The "who benefits?" test guards against, on the one hand, tenants subsidising council taxpayers (and the services provided to them through the General Fund) and, on the other hand, council taxpayers subsidising tenants (and the services provided to them through the HRA).

5. ALMOs and Companies Limited by Guarantee

- 5.1 An arms-length management organisation (ALMO) is a not-for-profit company that provides housing services on behalf of a local housing authority (LHA). Establishment of an ALMO separates the day-to-day housing management role of the landlord from the wider strategic housing role of the LHA. The LHA retains the strategic housing function and ownership of the housing and tenants remain secure tenants of the LHA.
- 5.2 ALMOs were first established in 2002. The main driver for the establishment of ALMOs was access to funding through the Decent Homes Programme. Since this came to an end with the introduction of HRA self-financing in 2012, the number of ALMOs has reduced significantly as LHAs have questioned the rationale for continuing with their ALMOs. Some LHAs have taken services back in-house whilst others have transferred their stock to their ALMOs (having made constitutional changes to the ALMO and registered it as a Registered Provider (RP) of social housing.
- 5.3 A company limited by guarantee is a type of corporation used primarily for non-profit organisations that require legal personality. A company limited by guarantee does not have a share capital or shareholders. Instead it has members who act as guarantors of the

company's liabilities: each member undertakes to contribute an amount specified in the Articles of Association in the event of insolvency or of the winding up of the company.

- 5.4 A company limited by guarantee is not prohibited from distributing its profits by the Companies Act or any other law if allowed to do so by its Articles of Association but it is commonplace for such restrictions to be put on profit distribution in the Articles of Association.

6. Legal status of Nottingham City Homes and its subsidiaries

- 6.1 **Nottingham City Homes Limited (NCH) is NCC's ALMO.** NCH was incorporated on 22 November 2004 and is a company limited by guarantee. NCC is the sole member and is thus, a company controlled by NCC.
- 6.2 NCH manages NCC's affairs in relation to its housing stock and tenants through a Partnership Agreement, but NCC remains the owner of the stock and manages the HRA including its policies and strategies. A management fee is paid by NCC to NCH for these services based on delivering to a specification.
- 6.3 An extract from Clause 8 of the Articles of Association adopted by NCH in September 2019 stated in relation to the Application of Income and Property:
- 6.3.1 *"The Income and property of the Organisation shall be applied solely towards the promotion of its objects as set forth in the Articles of Association and no portion thereof shall be paid or transferred, directly or indirectly, save as provided below, by way of dividend, bonus or otherwise howsoever by way of profit, Provided That nothing herein shall prevent any payment in good faith by the Organisation..."*
- 6.4 The remainder of Clause 8 (subsections 1-6) set out the circumstances whereby income and property can be applied and includes at subsection 4
- 6.4.1 *"of reasonable and proper remuneration to the Council Member or employees thereof (not being Board Members) in return for services rendered to the Organisation."*
- 6.5 Thus, there is a clear prohibition as set out in the Articles of Association adopted in September 2019, on the distribution of profits (which can be taken to include surpluses in the case of a not-for-profit organisation) through a dividend to NCC.
- 6.6 **Nottingham City Homes Registered Provider Limited (NCHRP)** is also a company limited by guarantee. NCHRP was incorporated on 5 October 2015. NCHRP is a controlled subsidiary of NCH, NCH being the parent company NCHRP.
- 6.7 NCHRP is, in addition, registered as a not-for-profit Registered Provider of social housing with the Regulator under the Housing and Regeneration Act 2008.
- 6.8 The Articles of Association of NCHRP, adopted in September 2019 state at Clause 7

6.8.1 *The Company shall not trade for profit. The income and property of the Company must be applied solely towards the Objects and (except to the extent authorised by this Article 7):*

6.8.1.1 *no part may be paid or transferred directly or indirectly by dividend, bonus or profit to a Member; and*

6.8.1.2 *a Board Member may not directly or indirectly receive any money or benefit from the Company*

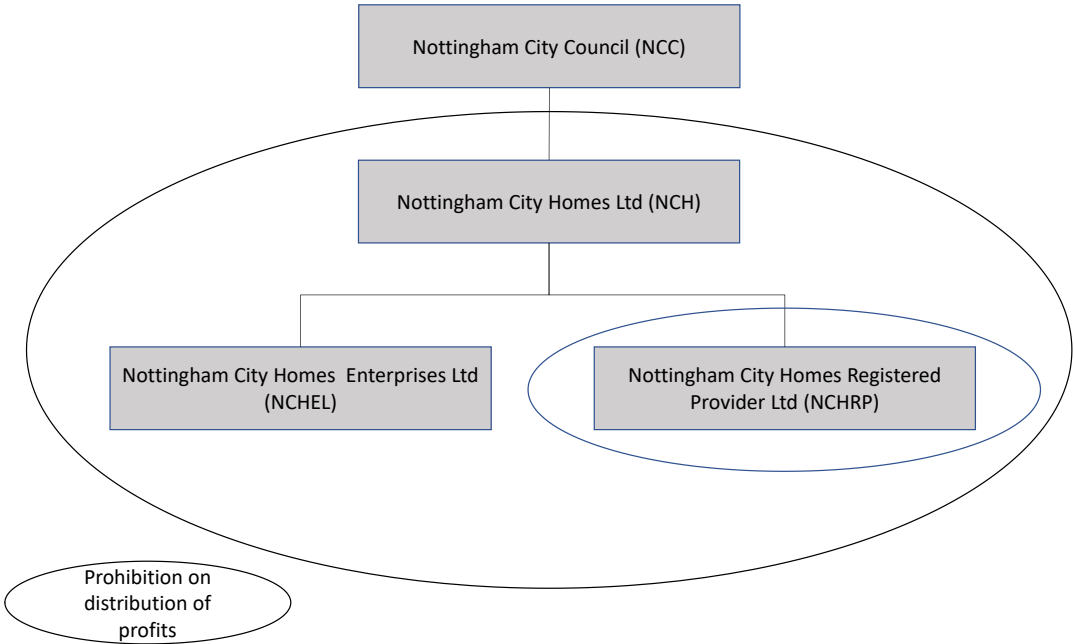
6.9 **Nottingham City Homes Enterprises Limited (NCHE)** is a company limited by shares. NCHE was incorporated on 2 October 2015 and 100% of the shares are owned by NCH. Thus, like NCHRP, NCHE is a controlled subsidiary of NCH, NCH being the parent company.

6.10 Clause 37.1 of NCHE’s Articles of Association adopted in September 2019 states, in relation to dividends:

6.10.1 Subject to the Act, the Company may by ordinary resolution declare dividends in accordance with the respective rights of the shareholders. No dividend may exceed the amount recommended by the Board

6.11 **Nottingham City Homes Group (NCHG)** comprises NCH and its subsidiaries NCHRP and NCHE. Given NCH is controlled by NCC, by extension all entities in the group are ultimately controlled by NCC.

6.12 The Articles of Association of NCH, NCHRP and NCHE, taken together, prohibit the distribution of any profits (through a dividend) to NCC as is illustrated in the diagram below.



7. Summary of Key Findings from CIPFA

- 7.1 CIPFA established that 'management fee rebate' payments made by NCH to NCC since 2014-15 have been described in various ways. The payments made by NCH to NCC have been consistently budgeted for by NCC since 2014-15 and subsequently accounted for in the Council's GF. CIPFA comment that these payments have directly supported NCC's General Fund in coping with the financial challenges faced by the City Council.
- 7.2 None of the payments in question made by NCH to NCC has been returned to the HRA despite the HRA accounting for more than 95% of the funding provided by NCC to NCH.
- 7.3 CIPFA considered the nature and various descriptions applied to these payments taking into account the accounting concept of substance over form. On this basis CIPFA's consideration of the nature of the payments made by NCH to NCC which started in 2014-15 concluded that:
- *If the monies paid by NCH to NCC were a legitimate management fee refund (rebate), then they should have been paid back to the HRA, which pays the management fee (and is the single largest source of funding of NCH); or*
 - *if related to NCH savings and/or efficiencies, then the beneficiary in NCC, if such savings and/or efficiencies were not retained by NCH, should have been the HRA through a reduction in the management fee.*
- 7.4 In both cases, CIPFA are clear that it should have been the HRA that benefited from any rebate and not the General Fund.
- 7.5 Instead, given that payments made by NCH to NCC have been accounted for by NCC to the benefit to the GF rather than to the HRA, CIPFA conclude that the payments could reasonably be argued to be '*a mechanism conceived to divert HRA funds to the GF*' and that if so, in CIPFA's view, this is '*an illegitimate use of HRA funds and a clear breach of the HRA ring-fence which is, potentially, unlawful*'.
- 7.6 Legal opinion in relation to the CIPFA report concludes the HRA ring fence has been breached and that such a breach is unlawful in contravention of Section 74 of the Local Government and Housing Act 1989.
- 7.7 Moreover, CIPFA's view is that 'if, in fact, the payments made by NCH to NCC are distributions of surpluses conceived as a mechanism by NCC to divert HRA funds to the GF, the issue for NCC is exacerbated since NCC has made NCH complicit in this.'
- 7.8 CIPFA say in their report that '*Importantly, NCH cannot pay a dividend (distribute a surplus) to NCC since it is prohibited by NCH's Articles of Association. Subject to further work it is quite possible that NCH may have entered into illegitimate transactions which have not been accounted for properly in NCH Group Financial Statements. Consequently, the actions of NCH's Directors in entering into these transactions and potentially breaching NCH's articles of Association will need further explanation given that this is also, potentially, unlawful*'.

- 7.9 Legal opinion confirms that however labelled, in substance they are a dividend and/or a distribution of a surplus. As a result, the Council has been in receipt of payments which were in contravention of NCH's Articles of Association.
- 7.10 CIPFA have raised concerns about a potential conflict between NCH's Articles of Association and the Partnership Agreements between NCC and NCH. In the event of a conflict, the Articles of Association prevail.
- 7.11 CIPFA also state that *'during the course of our work, a number of other issues, separate from the payment NCH makes to NCC, have been raised which are relevant to the management of the HRA and to safeguarding the integrity of the ring-fence. It has been suggested to us that decisions have been taken by NCC that could be challenged as having undermined the integrity of the HRA ring-fence. These decisions fall into two key categories*
- i) Decisions that have resulted in a loss of income to the HRA to the benefit of the GF*
 - ii) Decisions that have resulted in the HRA bearing disproportionate costs to the benefit of the GF*
- CIPFA have been provided with a schedule of issues which will require further investigation. NCH is not party to these potential breaches of the ring-fence'*
- 7.12 CIPFA further state that *'concern has been raised during the course of our work about the possibility of HRA funds (or resources paid for by the HRA) being utilised by NCH on non-HRA activities.... This could potentially lead to breaches of the integrity of the HRA ring-fence.'*
- 7.13 Finally, CIPFA note that *'Following a restructuring in 2016, the HRA client function [within NCC] was significantly reduced. NCC as the Local Housing Authority (LHA) retains the strategic housing role. Concern has been raised as to whether NCC has retained sufficient capacity to provide the strategic direction necessary to fulfil this strategic role. The question of whether NCC has adequate capability to properly scrutinise the activities of NCH has also been raised.'* *A full review of governance arrangements will be undertaken including the strengthening of the client function and a review of the Partnership Agreement.*
- 7.14 The issues at 7.11-7.13 will require further investigation.

8. Remedies

- 8.1 The payments of the 'management fee rebate' funds into the GF are unlawful. That unlawfulness cannot be undone but NCC can rectify the wrong done to the HRA financially and proposes the following;
- 8.2.1 In respect of financial years 2014/15 -2019/20, set aside in its General Fund reserves the sum of £14.366,500 to repay the HRA (this is net of 8.2.2 below). Interest will be added to bring the payment to 2021/22 prices. Repayment will be made as soon as the sum for each individual year is validated following further detailed work (see below).

- 8.2.2 In respect of the financial year 2020/21, NCC's draft published accounts will be amended by £1,492,000 to remove this 'management fee rebate' from being recognised within the GF and no invoice will be raised by NCC.
- 8.2.3 For 2021/22, no 'management fee rebate' will be due from NCH and NCH's management fee for the year will be adjusted by a corresponding amount.
- 8.2.4 From 2022/23 onwards, the management fee will be set at the correct level to deliver our required specification and any small surplus made by NCH can be retained for investment in HRA services. A genuine rebate is permissible only retrospectively and if NCH do not perform a function for which they have been contracted and paid. Such a rebate is to the benefit of the HRA not the GF. It can never be budgeted for.
- 8.2.5 A review is underway on the process and systems that failed to prevent these unlawful beaches to ensure that they cannot be repeated. This includes a review process in respect of 'novel' proposals by appropriately trained and experienced staff. Further training of members and officers in relation to the Housing Revenue Account and housing management function is planned.
- 8.3 Inevitably, this will weaken the Council's General Fund reserves and its ability to withstand future financial shocks. The provisions of section 25 Local Government Act 2003 require that, when the council is making the calculation of its budget requirement, it must have regard to the report of the Chief Finance (section 151) Officer as to the robustness of the estimates made for the purposes of the calculations and the adequacy of the reserves.

9. Recommendations

- 9.1 Council are asked to note and endorse at its meeting to be held within 21 days of the issue of this Notice, the actions proposed by the Section 151 Officer in paragraphs 8.2.1 – 8.2.5
- 9.2 Council are also asked to endorse recommendations made by CIPFA at 9.3 – 9.9 below (which have been accepted by the Section 151 and other Statutory officers) and recommendation 9.10.
- 9.3 *In addition to commissioning legal advice on the lawfulness of the transactions, NCC will need to consider, in consultation with the Department for Levelling Up, Housing and Communities (DLUHC), formerly MHCLG (and the Improvement and Assurance Board), and NCC's auditor and subject to that legal advice, what further actions are necessary.*
- 9.4 *that NCC examines in detail the chronology of events in relation to the payments NCH has made to NCC including who conceived the payment, the accounting transaction detail, who authorised it, who knew about it, how challenges to the legitimacy of the payment were dealt with and by who and any other facts that can provide insight into how the situation came to be.*

- 9.5 *In the event that the S151 considers that the GF is required to repay the HRA or NCH, consideration should be given to how the HRA or NCH should be additionally recompensed to reflect the opportunity cost of not having access to funds they may have been entitled to.*
- 9.6 *As a consequence of the concerns raised by the S151 and the work undertaken and the conclusions that CIPFA have drawn, the examination and resolution of other potential breaches of the HRA ring-fence referred to in the main report is recommended*
- 9.7 *Further analysis of the finances of NCHG to provide assurance to NCC that HRA funds have been properly applied and have not been used inappropriately to fund non-HRA activities undertaken by NCH, which could potentially breach the integrity of the HRA ring-fence. This would involve a forensic financial examination of:*
- i) Transactions for services flowing between NCC and NCH,*
 - ii) Transactions for services flowing between NCH and its subsidiaries;*
- 9.8 *Review of the adequacy of NCC's HRA client function in order to assess whether it is sufficient to properly scrutinise the activities of NCH and provide the proper strategic direction, controls and assurance on behalf of NCC as the Local Housing Authority (LHA).*
- 9.9 *Consequential to CIPFA's work and in light of the changes that have taken place in how LHAs provide housing management since the end of the Decent Homes programme, they also recommend that NCC commission a review of the NCC/NCH group relationship and future operating model to include the purpose, structure, finances and governance in relation to the housing management function as set out in the Recovery and Improvement Plan.*
- 9.10 Until the review as set out at 9.9 is concluded, management controls are being applied prohibiting NCC entering into new agreements and spending commitments with Nottingham City Homes unless expressly approved in writing by Section 151 Officer in consultation with the Head of Paid Service (Chief Executive) and Monitoring Officer, as appropriate.

10. Next Steps/Timescales

- 10.1 The obtaining of the opinion of legal Counsel has been actioned.
- 10.2 The matter has been discussed with the Improvement and Assurance Board, the Department for Levelling Up, Housing and Communities and NCC's Auditor.
- 10.3 The Chief Executive has commissioned an independent investigation through the Local Government Association in accordance with recommendation 9.4 above.
- 10.4 CIPFA have been commissioned to undertake further forensic analysis detailed at 9.5 and 9.6 above.
- 10.5 Subject to the agreement of the Lord Mayor, Council will consider this item at its meeting of 4 January 2022.

- 10.6 The Director for Growth and City Development will bring forward proposals for strengthening the Housing Client function and governance arrangements to be able to effectively manage the strategic aspects of housing and to provide adequate scrutiny of NCH.
- 10.7 The scope and timetable for a review of the NCC/NCH group relationship and future operating model to include the purpose, structure, finances and governance in relation to the housing management function as set out in the Recovery and Improvement Plan will be drawn up
- 10.8 I will monitor the Council's response to this Notice to ensure that sufficient action is taken at pace to address the issues I have identified.

Clive Heaphy

Corporate Director, Finance and Resources (interim) and Section 151 Officer

15th December 2021

Report to all Councillors of Nottingham City Council under s.5 of the Local Government & Housing Act 1989

Report of: Malcolm Townroe, Monitoring Officer

Date of Report: 15th December 2021

- 1.1 The report of the Chief Finance Officer (S151 Officer) under s114 Local Government Finance Act 1988 dated 15 December 2021 and set out above identifies matters which could equally be the subject of a report by me as Monitoring Officer under s5 Local Government and Housing Act 1989 (LGHA 1989).
- 1.2 I have concluded, having, as required, consulted both with the s151 Officer and the Head of Paid Service, that a separate report under s5 LGHA would only duplicate the information provided by the s151 Officer and upon which he has already consulted me as Monitoring Officer along with the Head of Paid Service. As a consequence, I have decided not to prepare a separate report under s5 LGHA 1989 as I am satisfied that the relevant information will be brought to the attention of all members of the authority, as required by s5 LGHA 1989, by virtue of the s114 report.
- 1.3 I would ask that this endorsement is considered in that light and for all intents and purposes considered to be a fulfilment of my s5 obligation.

Malcolm Townroe

Director for Legal and Governance and Monitoring Officer

15th December 2021

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Nottingham City Council: HRA Review

Final Report

10 December 2021

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1. Executive Summary

Introduction

CIPFA was commissioned by Nottingham City Council (NCC) to examine the nature and legitimacy of payments made by Nottingham City Homes (NCH) to NCC which, in the period 2014-15 to 2020-21, amount to £15,858,500. The scope also included a review of intra-company transactions within the NCH group of companies.

This is because there were concerns raised by the NCC Section 151 Officer that arrangements between NCC and NCH could constitute a breach of the Housing Revenue Account (HRA) ring-fence.

The Council retains statutory responsibility under Section 74 of the Local Government and Housing Act 1989 for operating the Housing Revenue account including the accounting flows, allocations of funds and approval of expenditure.

The HRA ring-fence

The latest guidance published by the Ministry of Housing Communities and Local Government (MHCLG) on the operation of the HRA ring-fence on 10 November 2020 replaced Circular 8/95 which had been published by the former Department of the Environment (DoE) on 1 May 1995. The latest guidance restates Ministers' established policy for the HRA and introduces no new issues of principle. In fact, since the introduction of the HRA ring-fence in 1990, there has been no change in relation to policy or issues of principle in respect of the HRA ring-fence.

The latest guidance, as was the case previously, makes it incumbent on NCC to be fair to both tenants and to council tax payers in applying the "Who benefits?" test to ensure there is no breach of the HRA-ring-fence in contravention of the legislation and guidance governing the HRA.

The "Who benefits?" test guards against, on the one hand, tenants subsidising council taxpayers (and the services provided to them through the General Fund (GF)) and, on the other hand, council taxpayers subsidising tenants (and the services provided to them through the HRA).

The Nature of Payments Made by NCH to NCC

The payments made by NCH to NCC since 2014-15 have been described in various ways, initially as an "NCH management fee refund", but also as 'savings/efficiencies. The

payments made by NCH to NCC have been consistently budgeted for by NCC and NCH since 2014-15 and subsequently accounted for in the Council's GF. These payments have, thus, directly supported NCC's GF in coping with the financial challenges faced by the City Council.

None of the payments made by NCH to NCC has been returned to the HRA despite the HRA accounting for 95% plus of the funding provided by NCC to NCH.

NCH has had no control over how NCC has chosen to account for the payments NCH has made to NCC, specifically in the decision that these payments have been accounted for in the Council's GF.

We have considered the nature and various descriptions applied to these payments taking into account the accounting concept of substance over form. On this basis of our consideration of the nature of the payments made by NCH to NCC which started in 2014-15:

- If the monies paid by NCH to NCC were a legitimate Management Fee refund (rebate), then it should have been paid back to the HRA, which pays the Management Fee (and is the single largest source of funding of NCH);
- If related to NCH savings and/or efficiencies, then the beneficiary in NCC, if such savings and/or efficiencies were not retained by NCH, should have been the HRA through a reduction in the Management Fee.

In both cases it is clear that it should have been the HRA that benefited from any rebate and not the General Fund.

Instead, given that payments made by NCH to NCC have been accounted for to the benefit to the GF (to council taxpayers) rather than to the HRA (to council tenants), the payments could reasonably be argued to be a mechanism conceived to divert HRA funds to the GF. If so, in our view, this is an illegitimate use of HRA funds and a clear breach of the HRA ring-fence which is, potentially, unlawful..

Moreover, if, in fact, the payments made by NCH to NCC are distributions of surpluses conceived as a mechanism by NCC to divert HRA funds to the GF, the issue for NCC is exacerbated since NCC has made NCH complicit in this.

Importantly, NCH cannot legitimately pay a dividend (distribute a surplus) to NCC since it is prohibited by NCH's Articles of Association. Subject to further work, it is quite possible that NCH may have entered into illegitimate transactions which have not been accounted for properly in NCH Group Financial Statements. Consequently, the actions of NCH's Directors

in entering into these transactions and potentially breaching NCH's Articles of Association will need further explanation given this is also, potentially, unlawful.

Overall Conclusion

However the payment made by NCH to NCC since 2014-15 is defined or described, the GF has benefited from these payments totalling £15,858,500 in the period from 2014-15 to 2020-21. This is at cash rather than current prices.. As discussed in our Conclusion to Section 7, this seems to be a breach of the HRA ring-fence which is, potentially, unlawful.

Furthermore, if it is determined, on the basis of legal advice, that the payments NCH has made to NCC are prohibited distributions of surpluses these are also, potentially, unlawful.

Recommendations

Given the potentially serious implications for both NCC and NCH, it is essential that NCC commissions legal advice on the issues of lawfulness set out in this report. In addition, NCC will need to consider, in consultation with the Department for Levelling Up, Housing and Communities (DLUHC), formerly MHCLG, and NCC's auditor and subject to that legal advice, what further actions are necessary.

We also recommend that NCC examines in detail the chronology of events in relation to the budgeting for and payments NCH has made to NCC including who conceived the payment, who authorised it, the accounting transaction detail, who knew about it, how challenges to the legitimacy of the payment were dealt with and by who and any other facts that can provide insight into how the situation came to be. The technical competency of the staff who were involved should also be reviewed so that this situation can be avoided in the future.

In the event the GF is required to repay the HRA or NCH, consideration should be given to how the HRA or NCH should be additionally recompensed to reflect the opportunity cost of not having access to funds they may have been entitled to. One option would be to treat the monies received by the GF as a loan and apply an appropriate rate of interest to the sum to be repaid.

As a consequence of the work we have undertaken and the conclusions we have drawn, we also recommend more work is required in relation to the other issues we raise in Section 8. More specifically, we recommend:

- Examination and resolution of other potential breaches of the HRA ring-fence referred to in Section 8;

- Further analysis of the finances of NCH Group to provide assurance to NCC that HRA funds have been properly applied and have not been used inappropriately to fund non-HRA activities undertaken by NCH, which could potentially breach the integrity of the HRA ring-fence. This would involve a forensic financial examination of:
 - Transactions for services flowing between NCC and NCH,
 - Transactions for services flowing between NCH and its subsidiaries;
- Review of the adequacy of NCC's HRA client function in order to assess whether it is sufficient to properly scrutinise the activities of NCH and provide the proper strategic direction, controls and assurance on behalf of NCC as the Local Housing Authority (LHA).

Consequential to our work and in light of the changes that have taken place in how LHAs provide housing management since the end of the Decent Homes programme, we also recommend that:

- NCC commission a review of the NCC/NCH group relationship and future operating model to include the purpose, structure, finances and governance in relation to the housing management function as set out in the Recovery and Improvement Plan.

2. Introduction

Background

CIPFA was commissioned by Nottingham City Council (NCC) to examine the nature and legitimacy of payments made by Nottingham City Homes (NCH) to NCC which, in the period 2014-15 to 2020-21, amount to £15,858,500. The scope also included a review of intra-company transactions with the NCH group of companies.

This is because there were concerns raised by the NCC Section 151 Officer that arrangements between NCC and NCH could constitute a breach of the Housing Revenue Account (HRA) ring-fence.

The Council retains statutory responsibility under Section 74 of the Local Government and Housing Act 1989 for operating the Housing Revenue account including the accounting flows, allocations of funds and approval of expenditure.

Work undertaken

In the production of this report we have examined information provided to us by both NCC and NCH. We have, through necessity, relied on the information provided to us by NCC and NCH but have sought to ensure that the information we have received from different sources is consistent, verified and accurate.

We have consulted with officers of both NCC and NCH in order to understand the information presented to us as a basis for our analysis, conclusions and recommendations.

The following people have been consulted in the course of our work:

NCC

- Clive Heaphy - Corporate Director, Finance & Resources
- Name redacted
- Name redacted
- Name redacted
- Name redacted
- Name redacted
- Name redacted
- Name redacted

NCH

- Name redacted
- Name redacted

Legal issues

This report raises issues of a legal nature. CIPFA is not able to give a legal opinion or to provide legal advice. Where such legal issues are raised, we recommend that NCC seeks legal advice in order to resolve the legal issues that have been raised.

3. The Housing Revenue Account

Overview

The function and main features of the Housing Revenue Account (HRA) are set out below:

The Housing Revenue Account (HRA) is intended to record expenditure and income on running a council's own housing stock and closely related services or facilities, which are provided primarily for the benefit of the council's own tenants.

The main features of the HRA are:

- it is a landlord account, recording expenditure and income arising from the provision of housing accommodation by local housing authorities (under the powers and duties conferred on them in Part II of the Housing Act 1985 and certain provisions of earlier legislation)
- it is not a separate fund but a ring-fenced account of certain defined transactions, relating to local authority housing, within the General Fund
- the main items of expenditure included in the account are management and maintenance costs, major repairs, loan charges, and depreciation costs
- the main sources of income are from tenants in the form of rents and service charges
- the HRA should be based on accruals in accordance with proper accounting practices, rather than cash accounting

Legislative features are:

- ring-fenced account within the General Fund
- Credits and Debits are prescribed by statute
- no general discretion to breach the ring-fence
- cannot budget for a deficit
- all borrowing within the HRA is in line with the CIPFA Prudential Code

Source: www.gov.uk

Legislative Framework for the HRA

The HRA is governed by legislation. The key legislation relating to the HRA is:

- Housing Act 1985 (Part II);
- Housing Act 1988;

- Local Government and Housing Act 1989 (section 74);
- Local Government Act 2003;
- Localism Act 2011.

In addition to legislation, Government issues guidance in relation to the operation of the HRA and in respect of the HRA ring-fence.

Operation of the Housing Revenue Account ring-fence

On 10 November 2020 the Ministry of Housing Communities and Local Government (MHCLG) published guidance on the operation of the Housing Revenue Account ring-fence (this is reproduced in full in Appendix 1). This guidance updated and replaced Circular 8/95 which had been published by the former Department of the Environment (DoE) on 1 May 1995.

Circular 8/95 states “The Circular restates Ministers’ established policy for the housing revenue account and introduces no new issues of principle. It is intended to be a helpful reference document for authorities, tenants and auditors. It is not intended as an authoritative statement of the law on the keeping of the housing revenue account, and authorities should take their own legal and accounting advice, as necessary, and will need to satisfy their auditors about their decisions.”

The guidance published in 2020 states “This guidance restates ministers’ established policy for the HRA and introduces no new issues of principle. However, it does highlight the need to be fair to both tenants and council taxpayers and that there should be a fair and transparent apportionment of costs between the HRA and General Fund.”

In this context reference to the General Fund (GF) means any revenue account within the General Fund other than the HRA.

The 2020 guidance, like Circular 8/95, restates the intention of the guidance is to be a helpful reference document for authorities, tenants and auditors and that it is not intended as an authoritative statement of the law on the keeping of the HRA, encouraging each local housing authority (LHA) to take their own legal and accounting advice, as necessary, and to satisfy their auditors about decisions taken in respect of the HRA ring-fence.

Thus, there has been no change in relation to policy or issues of principle in respect of the HRA ring-fence since its establishment in 1990. Both Circular 8/95 and the guidance published in 2020 place **responsibility on the LHA to ensure compliance with the requirement to maintain the HRA ring-fence** in compliance with guidance and relevant legislation.

The 2020 guidance also states “At its most basic, when taking any decision on whether expenditure or income should be accounted for in the HRA, the test that should be applied is “Who benefits?” That is to say: who is the major contributor of the item of income, or the major beneficiary of the expenditure under consideration? Hence, should the HRA bear the full cost or only part, or should it benefit from the entirety of the income, or is some of it applicable to the General Fund?”

The guidance published in 2020 provides advice on the allocation and apportionment of costs between the HRA and the GF necessary to maintain the HRA ring-fence in relation to:

- Amenities;
- Management and maintenance services,
 - Core services,
 - Core plus services,
 - Non-core services;
- Homelessness administration (relating to properties held under Part II of the Housing Act 1985 and used to support homelessness);
- Housing advisory services.

What does this mean for Nottingham City Council?

It is incumbent on NCC, as the LHA, to be fair to both tenants and to council tax payers in applying the “Who benefits?” test to ensure there is no breach of the HRA-ring-fence in contravention of the legislation and guidance governing the HRA.

The “Who benefits?” test guards against, on the one hand, tenants subsidising council tax payers (and the services provided to them through the GF) and, on the other hand, council tax payers subsidising tenants (and the services provided to them through the HRA).

Consequently, NCC needs to be diligent in the application of HRA funds and ensure they are only used for HRA purposes in line with relevant guidance and legislation.

This means, by way of illustration, in observing the principle of “Who benefits?” NCC must ensure:

- NCC council tax payers do not benefit from any income that should be properly allocated to the HRA, the deprivation of such income being a detriment to council tenants;

- NCC GF costs should not be apportioned to the HRA on an unfair basis (or on a basis that cannot be supported and evidenced) to the benefit of council tax payers and to the detriment of council tenants;
- Costs properly borne by council tenants should be charged to the HRA and not to the NCC GF, subsidising council tenants at the expense of council tax payers.

In being diligent, defending against any breach of the HRA ring-fence, NCC should:

- Take every precaution to ensure every decision affecting the fair allocation and apportionment of costs and income between the HRA and the GF is mindful of the need to maintain the HRA ring-fence and guards against any breach of the HRA ring-fence;
- Ensure those empowered to make decisions affecting the fair allocation and apportionment of costs and income between the HRA and the GF understand the consequences of their decisions in regard to the HRA ring-fence;
- Have robust processes for ensuring the fair allocation and apportionment of costs and income between the HRA and the GF, supported by evidence that demonstrates a fair allocation and apportionment of costs and income in line with the “Who benefits?” test.

4. ALMOs and Companies Limited by Guarantee

Arms-length management organisation (ALMO)

An arms-length management organisation (ALMO) is a wholly Council owned not-for-profit company that provides housing services on behalf of a local housing authority (LHA). Establishment of an ALMO separates the day-to-day housing management role of the landlord from the wider strategic housing role of the LHA. The LHA retains the strategic housing function and ownership of the housing and tenants remain secure tenants of the LHA with the ALMO acting in the capacity of a managing agent.

ALMOs were first established in 2002. The main driver for the establishment of ALMOs was access to funding through the Decent Homes Programme. Since this came to an end with the introduction of HRA self-financing in 2012, the number of ALMOs has reduced significantly as LHAs have questioned the rationale for continuing with their ALMOs. Some LHAs have taken services back in-house whilst others have transferred their stock to their ALMOs (having made constitutional changes to the ALMO and registered it as a Registered Provider (RP) of social housing.

As of July 2008, seventy ALMOs were managing over half of all council housing, consisting of more than a million properties. There are now just twenty-five ALMOs, all represented by, the National Federation of ALMOs Ltd, (NFA), which manage 326,000 properties.

Companies limited by guarantee

A company limited by guarantee is a type of corporation used primarily for non-profit organisations that require legal personality. A company limited by guarantee does not have a share capital or shareholders. Instead it has members who act as guarantors of the company's liabilities: each member undertakes to contribute an amount specified in the Articles of Association in the event of insolvency or of the winding up of the company.

A company limited by guarantee is not prohibited from distributing its profits by the Companies Act or any other law if allowed to do so by its Articles of Association but it is commonplace for such restrictions to be put on profit distribution in the Articles of Association.

Such restrictions will usually apply both to profits while the company is running and to the distribution of assets (after paying creditors) when the company is wound up. Any distribution of profits would make a company limited by guarantee ineligible for charitable status.

5. The Nottingham City Homes Group

Nottingham City Homes Limited

Nottingham City Homes Limited (NCH) is NCC's ALMO. NCH was incorporated on 22 November 2004 and is a company limited by guarantee. NCC is the sole member and NCH, is thus, a company controlled by NCC. NCH is also a 'Teckal' company meaning that at least 80% of its revenues must be derived from NCC and that NCC must exert strong control over the activities of NCH.

Clause 7 of NCH's Memorandum of Association of May 2008 states, in relation to the Application of Income and Property:

The income and property of the Organisation shall be applied solely towards the promotion of its objects as set forth in the Memorandum of Association and no portion thereof shall be paid or transferred, directly or indirectly, save as provided below, by way of dividend, bonus or otherwise howsoever by way of profit, to the Council Member and no Board Member shall be appointed to any office of the Organisation paid by salary or fees or receive any remuneration or other benefit or money or money's worth from the Organisation **Provided That nothing herein shall prevent any payment in good faith by the Organisation:**

At Clause 11, in relation to Winding Up, the Memorandum of Association of May 2008 states:

If, upon the winding up or dissolution of the Organisation, there remains, after the satisfaction of all its debts and liabilities any property whatsoever, the same shall be paid or transferred to the Housing Revenue Account (as defined in the 1989 Act) of the Council Member

Clause 8 of the Articles of Association adopted by NCH in September 2019 stated in relation to the Application of Income and Property:

The income and property of the Organisation shall be applied solely towards the promotion of its objects as set forth in the Articles of Association and no portion thereof shall be paid or transferred, directly or indirectly, save as provided below, by way of dividend, bonus or otherwise howsoever by way of profit, **Provided That nothing herein shall prevent any payment in good faith by the Organisation:**

In relation to Winding Up, the Articles of Association adopted by NCH in September 2019 state at Clause 12:

If, upon the winding up or dissolution of the Organisation, there remains, after the satisfaction of all its debts and liabilities any property whatsoever, the same shall be paid or transferred to the Housing Revenue Account (as defined in the 1989 Act) of the Council Member.

Thus, there is a clear prohibition as set out in the Memorandum of Association of May 2008 and restated in the Articles of Association adopted in September 2019, on the distribution of profits (surpluses) through a dividend to NCC.

In addition, in 2008 and as restated in 2019, should the company be wound up it is the HRA that would benefit from any property remaining after all debts and liabilities of the company had been satisfied.

Nottingham City Homes Registered Provider Limited (NCHRP)

Nottingham City Homes Registered Provider Limited (NCHRP) is also a company limited by guarantee NCHRP was incorporated on 5 October 2015. NCHRP is a controlled subsidiary of NCH, NCH being the parent company and sole member of NCHRP.

NCHRP is, in addition, registered as a not-for-profit Registered Provider of social housing with the Regulator under the Housing and Regeneration Act 2008.

The Articles of Association of NCHRP, adopted in September 2019 states at Clause 7 in relation to Application of Income and Profit:

- 7.1 The Company shall not trade for profit. The income and property of the Company must be applied solely towards the Objects and (except to the extent authorised by this Article 7):**
- 7.1.1 no part may be paid or transferred directly or indirectly by dividend, bonus or profit to a Member; and**
 - 7.1.2 a Board Member may not directly or indirectly receive any payment of money or benefit from the Company.**

This restates Clause 7 of the NCHRP Articles of Association adopted in October 2017.

Nottingham City Homes Enterprises Limited (NCHEL)

Nottingham City Homes Enterprises Limited (NCHEL) is a company limited by shares. NCHEL which was incorporated on 2 October 2015. All of the shares are owned by NCH. Thus, like NCHRP, NCHEL is a controlled subsidiary of NCH, NCH being the parent company and sole shareholder.

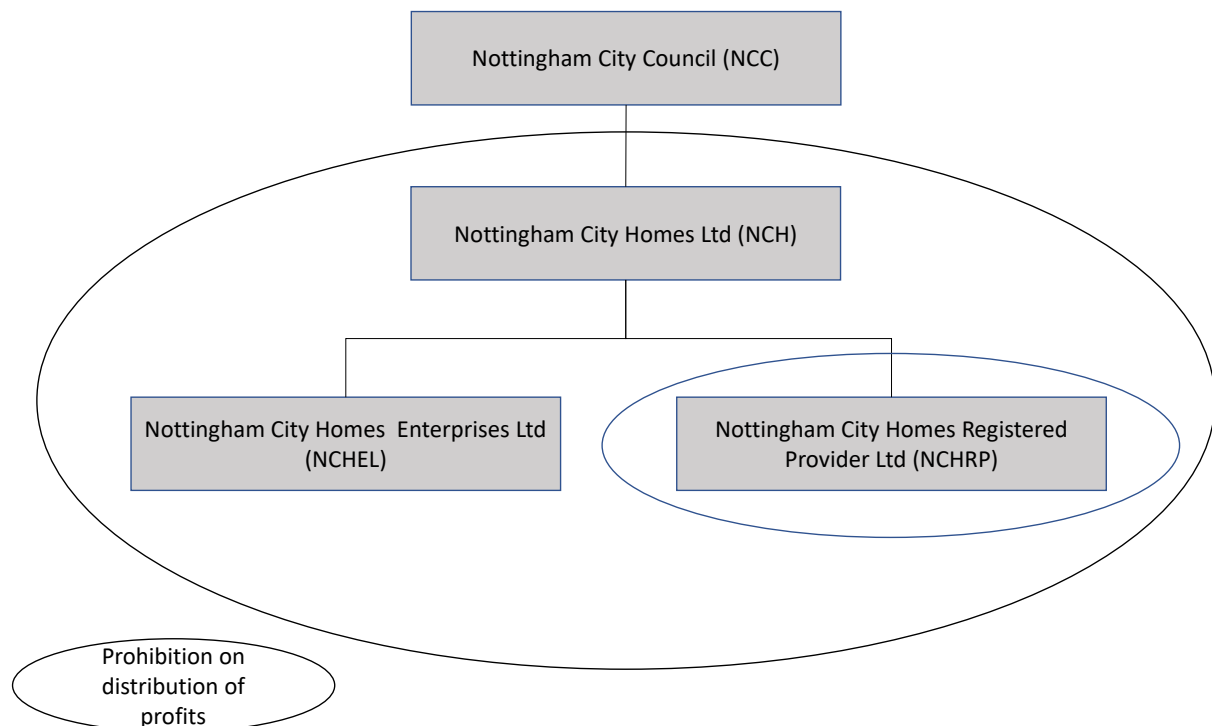
Clause 37.1 of NCHEL's Articles of Association adopted in September 2019 states, in relation to Dividends:

Subject to the Act, the Company may by ordinary resolution declare dividends in accordance with the respective rights of the Shareholders. No dividend may exceed the amount recommended by the Board.

Nottingham City Homes Group (NCHG)

Nottingham City Homes Group (NCHG) comprises NCH and its subsidiaries NCHRP and NCHEL. Given NCH is controlled by NCC, by extension all entities in the group are ultimately controlled by NCC.

However, the Articles of Association of NCH, NCHRP and NCHEL, taken together, prohibit the distribution of any profits (through a dividend) to NCC as is illustrated in the diagram below.



Conflict between the Articles of Association and the Partnership Agreements

The Partnering Agreement signed between NCH and NCC in 2011, which we are informed was drafted by external legal advisors, refers to the Use of Surplus (Paragraph 50) and states “Any surplus generated by the organisation (NCH) will (unless otherwise agreed by the parties) be used to fund further activities and/or initiatives undertaken by it”. The phrase “unless otherwise agreed by the parties” might suggest a distribution of profits through a dividend to NCC is possible but it is not explicit. Such an interpretation would conflict with the Memorandum and Articles of Association current in 2011.

In addition, Schedule 3 of 2011 Partnering Agreement states, in Clause 7 in relation to Surpluses:

- 7.1. If at the end of the Financial Year the Organisation has either not spent all the Management Fee, or through other means, has generated a surplus it shall be entitled to apply the same at its discretion. The Council may call for any part of the surplus that is not so applied to be repaid to it.

This is a more explicit reference to the potential for a dividend.

In September 2020 a new Partnership Agreement was signed between NCH and NCC which is explicitly in conflict with NCH’s Articles of Association. Paragraph 50.2 states, in relation to Use of Surplus “Any surplus generated by the Organisation will in the first instance be used to fund activities and/or initiatives undertaken by it in line with the Corporate Plan as agreed with the Council, or support any other Council objective consistent with NCH’s remit”.

However, Paragraph 50.4 states “Any surplus identified in addition to the above may be returned to the Council”. This would, by definition, be a dividend and is in direct conflict with NCH’s Articles of Association.

Both Agreements demonstrate an unfamiliarity and/or misunderstanding with the prohibition in NCH’s Articles of Association relating to the distribution of surpluses (profits) through its explicit reference to the return of surpluses to the Council. We understand that the new Partnership Agreement was agreed without the benefit of external legal advice.

We are not in a position to offer a legal opinion but on the assumption that the Articles of Association would take legal precedence over the 2011 Partnering Agreement and the 2020 Partnership Agreement, this would mean that any provisions providing for a distribution of surpluses (profits) through a dividend being paid to NCC (whether implicitly or explicitly) would be null and void.

We are further informed that the September 2020 Partnership Agreement was not properly executed as it was not signed by authorised signatories within either NCC or NCH. We have not verified this information.

NCHG Financial Position

NCHG Consolidated Income Statement shows NCHG made a loss in the year ending 31 March 2021, on ordinary activities after taxation, of £4.077m (£6.070m in the year ending 31 March 2020).

Nottingham City Homes Limited (Company limited by guarantee) CONSOLIDATED INCOME STATEMENT For the year ended 31st March 2021			
	<i>Notes</i>	Year to 31 March 2021	Year to 31 March 2020
		£'000	£'000
TURNOVER	2	68,287	67,029
Operating expenses	3	(71,173)	(71,657)
Other operating income		2,129	1,788
OPERATING LOSS		(757)	(2,840)
Interest payable	5	(3,306)	(3,213)
Interest receivable	5	0	0
LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION		(4,063)	(6,053)
Taxation	7	(14)	(17)
LOSS ON ORDINARY ACTIVITIES AFTER TAXATION AND LOSS FOR THE FINANCIAL YEAR		(4,077)	(6,070)

NCHG's accumulated loss to 31 March 2021 is £121.802m. Thus, even if NCH was not prohibited by the Articles of Association from paying a dividend, they would be unable to pay a dividend since they are a loss making entity year-on-year and on an accumulated basis.

Going Concern

NCHG's auditors (Bishop Fleming LLP) gave the following opinion in relation to the Financial Statements for the period ending 31 March 2021:

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the group or parent company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

The Strategic Report (included in the Financial Statements) records the approval of the Board on 24 June 2021 to adopting the going concern basis in preparing financial statements. The following statement supported the adoption of the going concern basis.:

This is based on the new 30 year Partnership Agreement which is in place with Nottingham City Council to pay management and repairs fees in return for delivery of housing management and maintenance services as set out in the current Partnership Agreement.

In addition, the Council recognises that, following the processing of accounting transactions for defined benefit pension schemes under FRS102, the Company does not have sufficient reserves to offset the resultant deficit. It therefore undertakes to provide continuing support to enable the financial statements of NCH to be prepared on a going concern basis. Nottingham City Council confirms annually that it will continue to assist NCH in meeting their pension fund liabilities as and when they fall due, to the extent that money is not otherwise available to NCH to meet such liabilities.

NCC Funding of NCH

Table 1 below shows income received by the NCH Group from NCC in the five years to end of 31st March 2021 together with the forecast for 2021-22 (data supplied by NCH).

NCH INCOME - FROM NCC	2021/22	2020/21	2019/20	2018/19	2017/18	2016/17
	£'000	£'000	£'000	£'000	£'000	£'000
HRA Management Fee,	22,852	22,649	22,374	22,996	22,842	22,516
HRA Fee Adjustment	(1,210)	(1,492)	See note below			
HRA Repairs Fee,	26,739	26,884	26,899	27,167	27,329	27,260
HRA Capital Fee	1,800	1,156	1,638	1,830	2,302	2,858
HRA Capital Works	12,591	10,450	8,329	7,323	7,213	6,174
HRA - Other	725	857	955	322	305	239
HRA Sub-total	63,497	60,504	60,195	59,638	59,991	59,047
Non-HRA						
- GF Repairs & Mt'nce	1,076	445	1,540	1,707	1,376	732
- Nottingham On-Call	736	818	832	832	1,247	716
- Other	677	709	662	592	332	1,119
Non-HRA Sub-total	2,489	1,973	3,034	3,131	2,954	2,567
Total	65,986	62,476	63,229	62,769	62,945	61,614
HRA %	96%	97%	95%	95%	95%	96%

Note: Prior to 2020/21 the HRA Fee Adjustment was accounted for as a cost by NCH rather than as a reduction in income.

Table 1: NCH Income from NCC

In every year, including the current financial year, the HRA has accounted for 95% or more of the income received by the NCH from NCC.

In the year ending 31 March 2021 reported turnover of NCHG was £68.287m. Thus, NCC was the source of 92% of NCHG turnover (89% from the HRA and 3% from non-HRA). The HRA is, therefore, the single largest source of funds for NCHG.

NCH Borrowing from NCC

In addition to the annual funding identified in Table 1 above, NCHG has borrowed money from NCC. These loans have been to support NCHG capital expenditure on housing provision with the exception of one loan in respect of vehicles. A schedule of loans provided by NCC is set out below:

Issued to	Loan	Year Loan Issued	Original Loan amount	Loan outstanding at 30 September 2021	Duration (years)
NOTTINGHAM CITY HOMES	Lenton 1	2015/16	1,500,000	1,423,381	50
NOTTINGHAM CITY HOMES	Radford 1	2016/17	6,000,000	5,741,128	50
NOTTINGHAM CITY HOMES	Lenton 2	2017/18	5,300,000	5,139,443	50
NOTTINGHAM CITY HOMES	Radford 2	2017/18	526,000	510,065	50
NOTTINGHAM CITY HOMES	Vehicles	2017/18	1,981,000	-	3
NOTTINGHAM CITY HOMES	Homelessness 1	2017/18	4,745,000	4,390,395	30
NOTTINGHAM CITY HOMES	Homelessness 2	2019/20	5,277,000	5,047,939	30
NOTTINGHAM CITY HOMES	Homelessness 3	2020/21	4,810,000	4,741,859	40
NOTTINGHAM CITY HOMES REGISTERED PROVIDER LIMITED	Church Square	2018/19	2,230,000	2,183,002	50
NOTTINGHAM CITY HOMES REGISTERED PROVIDER LIMITED	Martins Reach (Rad Allotmts)	2019/20	1,115,000	1,101,667	50
NOTTINGHAM CITY HOMES ENTERPRISES LIMITED	NCH EL loan - Arkwright Walk/Ma	2020/21	1,992,000	1,967,897	40
NOTTINGHAM CITY HOMES ENTERPRISES LIMITED	NCH EL loan - Market Rent Propel	2020/21	9,142,000	9,031,385	40
NOTTINGHAM CITY HOMES ENTERPRISES LIMITED	NCH EL loan - Clifton Triangle/Fal	2020/21	3,228,000	3,188,942	40
NOTTINGHAM CITY HOMES ENTERPRISES LIMITED	Ryehill	2020/21	2,403,000	2,392,370	40
NOTTINGHAM CITY HOMES ENTERPRISES LIMITED	Market Rent 2	2020/21	2,338,400	2,328,056	40
	TOTAL NCH , NCHRP & NCHL		52,587,400	49,187,530	

Table 2: Schedule of loans from NCC to NCH

These loans are funded from the GF, are all asset backed and have six-monthly repayments of interest and principal to the GF.

6. NCH Payment to NCC

NCH payment to NCC 2014-15 to 2020-21

Since 2014-15 NCH has been making an annual payment to NCC. A variety of inconsistent descriptions have been applied to this payment. In Table 3 below we set out the originally budgeted sum for this payment, in- year adjustments and the amount due together with the narrative attached to the invoice raised by NCC to NCH.

Financial Year	Budgeted £	In-Year Adjustments £	Payment Due £	Invoice Narrative
2014-15	750,000	-	750,000	NCH management fee refund
2015-16	2,000,000	-	1,500,000	Refund of NCH fees for 2015 / 2016
			500,000	NCC/NCH Borrowing Facility One Off Fee
2016-17	2,500,000	-	2,500,000	DR Refund of NCH Man Fee 16/17
2017-18	3,625,000	-	3,625,000	Management Charge 2017/18
2018-19	4,150,000	-	4,150,000	Management Charge 2018/19
2019-20	4,150,000	- 2,808,500	1,341,500	Annual services po NCH 671503
2020-21	2,950,000	- 1,458,000	1,492,000	No narrative as invoice not yet raised
	20,125,000	- 4,266,500	15,858,500	

Table 3: NCH Payments to NCC

Note, we understand the invoice to NCH relating to 2020-21 has not yet been raised and, we understand, the payment by NCH to NCC has yet to be made. There is an opportunity to stop this payment but this would require adjustment to the published draft accounts for 2021/22. and is a decision for the Section 151 Officer.

Total budgeted payments from NCH to NCC in the period 2014-15 to 2020-21 amount to £20,125,000. In-year adjustments in 2019-20 and 2020-21 reduced the amount invoiced by £4,266,500 in this period to £15,858,500. This averages £2,265,500 per annum over this seven year period.

The annual amount of the payment by NCH to NCC increased year on year after 2014-15 to a peak of £4,150,000 in 2018-19, before falling in 2019-20 and 2020-21 due to a number of adjustments from the base budget. These adjustments included one permanent adjustment in 2019-20 and a number of one-off adjustments in 2019-20 and 2020-21 as set out in Table 4 below.

Financial Year	Adjustment £	Permanent or One-off	Explanation Provided by NCC
2019-20	- 1,200,000	Permanent	Fee reduction agreed (NCH Management Fee reduced by same amount)
2019-20	- 1,608,500	One-off	Reduction due to Investment in Arboretum project
2020-21	- 125,000	One-off	Reduction due to Investment in Arboretum project
2020-21	- 1,225,000	One-off	Laura Chambers Lodge
2020-21	- 108,000	One-off	interest above PWLB + 4%
	- 4,266,500		

Table 4: Adjustments to NCH Payments to NCC

Subject to any in-year adjustments, the payments made by NCH to NCC have, as is evidenced above, been budgeted for and invoiced, by NCC and paid into the GF.

These payments have, thus, directly supported NCC's GF in coping with the financial challenges faced by the City Council.

None of the payments made by NCH to NCC has been returned to the HRA despite the HRA accounting for 95% plus of the funding provided by NCC to NCH.

NCH has had no control over how NCC has chosen to account for the payments NCH has made to NCC, specifically in the decision that these payments have been accounted for in the Council's GF.

The adjustment of £1,608,500 in 2019-20 relates to the cost of HRA properties purchased by NCH as part of the Arboretum project. Our understanding is that the HRA was required to make up this shortfall in the payment by NCH to NCC, initially through the transfer of HRA capital receipts to a GF reserve.

The £1,608,500 was then transferred from HRA reserves to the GF revenue account. The narrative attached to the transfer was "Offset reduction in rebate from Arboretum HRA Stock Purchase".

NCC's position, in relation to these transactions, is that they are permissible under legislation relating to the use of non-RTB (Right to Buy) receipts on wider regeneration activities. As a consequence, the HRA did not benefit from the sale of HRA assets and the GF received the £2,950,000 that had been budgeted for (after taking account of the permanent adjustment in 2019-20).

NCH to NCC payment 2021-22 to 2025-26

In 2021-22 NCC had budgeted for a rebate of £2,164,000 (after adjustments from an initial base of £2,950,000). We understand that NCC has now written out from its forecasts any further assumptions in relation to a payment from NCH in 2021-22 and reduced the Management Fee payable to NCH by a corresponding amount..

NCC has included an annual payment from NCH of £1,210,000 in its Medium Term Financial Plan (MTFP) from 2022-23 to 2025-26. However, we understand that in the current version of the draft MTFP, no further income is assumed for MTFP purposes from 2022/23 onwards and were anything legitimate to be received, it would not be budgeted for and would be taken straight to reserves.

Description of the NCH payment to NCC

As is shown in Table 2 above, the payment made by NCH to NCC was described as “NCH management fee refund” in 2014-15. Various other descriptions have been used since by NCC in describing the payment.

We have been informed that it has been referred to in the past as a dividend but legal representatives at meetings where this term was used warned that this term should not be used. We do not have documented evidence of this.

In NCC Executive Board reports going back to 2014-15, when the payment from NCH to NCC was first made, reference had been made to the payment from NCH to NCC in various ways:

- In 2014-15 the £750,000 paid by NCH to NCC was identified as a “Big Ticket” saving, relating to NCC & NCH Common Services, as part of NCC’s transformation programme;
- In 2015-16 and 2016-17 the payment from NCH to NCC was included in a list of Revenue Budget Corporate Items;
- In other Executive Board reports reference is made to NCH efficiencies.

As noted in Table 1 above, NCH’s accounting treatment of the monies returned to NCC changed in 2020-21, on the advice of the NCHG auditor. Prior to 2020-21 this was treated as an expense in the NCHG Financial Statements. In 2020-21 it was described as “Fee Adjustment for return to Parent undertaking” and treated as a reduction in income/turnover.

There has, thus, been no clear and consistently applied description to the payment made by NCH to NCC since 2014-15.

7. The nature of the NCH payment to NCC

The concept of substance over form

In this Section we consider the true nature of the payment made by NCH to NCC since 2014-15 taking into account the accounting concept of substance over form. Substance over form means that the economic substance of transactions and events must be recorded in the financial statements rather than just their legal form in order to present a true and fair view of the affairs of the entity.

We understand, from discussion during the course of our work, that the legitimacy of crediting the GF with the payments NCH has made to NCC has been challenged in the past within NCC but that such challenges have been rebuffed. The basis of such challenge is that the payment being credited to the GF breaches the HRA ring-fence.

The application of substance over form

As is mentioned above, the payment made by NCH to NCC has been referred to in different ways over time within NCC, initially as an “NCH management fee refund”. NCH now report it as a “Fee Adjustment for return to Parent undertaking.”

Many of these descriptions revolve around the idea that the payment NCH has been making to NCC since 2014-15 is, in some way, a refund (or rebate) of the Management Fee paid by the HRA to NCH.

By definition a rebate is a refund of excess monies paid back to the account from which it came. Therefore, to legitimately be a refund or rebate of the Management Fee, the payment would need to be a refund of monies intended for use in relation to the purposes for which the Management Fee is paid which are unspent. If this were the case, the payment could be regarded as a legitimate rebate.

However, there is a prima facie case that any such **legitimate** rebate should be returned to whence it came. That is, the HRA given the HRA pays the Management Fee in whole (and provides 95% plus of the income NCH receives from NCC). On this interpretation, on the basis that payment is a legitimate rebate, the £15,585,000 that has been paid into the GF Fund should have been paid into the HRA as, otherwise, NCC is in breach of the HRA ring-fence.

In order to be a legitimate rebate, one would expect some sort of schedule of what costs/activities the Management Fee was intended to fund and what monies were unspent in

relation to these costs/activities in order to arrive at the refund (rebate). No such schedule exists to our knowledge.

Other features of the payment made by NCH to NCC undermine the interpretation of the payment as a refund (rebate) of some of the Management Fee provided by the HRA to NCC:

- The payment from NCH to NCC is an annually budgeted item in NCC's GF (and has historically been included in NCC's GF MTFP). In addition, the budgeted payment from NCH to NCC has been subject to in-year adjustments which suggest some thought is applied to how much NCC expects to receive. A refund (or rebate) by its very nature would be subject to uncertainty and, whilst it would be possible to forecast in-year how much it might be, the final value of such a refund (rebate) would not be certain until the end of the financial year;
- NCC invoice NCH for payment of the budgeted sum (subject to any agreed in-year adjustments). If it were legitimately a refund (rebate), the expectation would be that NCH raise a credit note (rather than receive an invoice) if any refund (rebate) was due;
- Given the scale of the refund (rebate), it would have been logical, if it were truly a refund (rebate), to reduce the Management Fee rather than budget for an increasing payment from NCH to NCC (reaching a peak in 2018-19 before reducing). This would have reduced the funding provided by the HRA to NCH, thereby benefiting the HRA and tenants; in contrast to the historical position since 2014-15 where the GF and, hence, council tax payers benefit from the refund (rebate). This would have ensured the integrity of the HRA ring-fence and passed the "Who benefits?" test.

In our opinion, the description of the payment made to NCH to NCC as relating to savings or efficiencies is also at best weak and at worst misleading. As with a refund (rebate) there would likely be a degree of uncertainty on the value of such savings/efficiencies that might be achieved in any one year.

There might also be an expectation that NCH would retain some if not all of any savings/efficiencies it achieves to better serve the objects of the company. Alternatively, all or part of such savings/efficiencies might be expected to result in a reduction of the Management Fee. This course of action would have benefited the HRA whereas the refund (rebate) paid to NCC by NCH benefits the GF; that is, a reduction in the Management Fee would have benefited council tenants rather than council tax payers. Again, the "Who benefits?" test is pertinent in considering whether the integrity of the HRA ring-fence has been safeguarded.

So, if the payment made by NCH to NCC is not a refund (rebate) of some of the Management Fee provided by the HRA to NCH and it is not related to NCH savings/efficiencies, what is it?

As we have mentioned above, it has been described in the past by some within NCC as a dividend although this description was frowned upon, for good reason given NCH is not allowed by its Articles of Association to pay a dividend.

However, discussions held during the course of our work suggests the payment NCH makes to NCC is generated from surpluses and, therefore, appears to be a dividend. That is, whatever the description used by NCC or NCH, on the basis of the concept of substance over form, the monies returned to NCC by NCH appear to be a distribution of surpluses despite the payment not being accounted for as a dividend by NCH or by NCC.

We did ask NCH to provide information on how any surpluses had been generated from HRA and non-HRA activities undertaken by the NCH group. This was a one-off exercise undertaken by NCH as it is not something routinely done. An analysis in relation to 2020-21 was provided to us. Without this work being undertaken annually, it is not possible for either NCC as client or NCH to confirm that HRA funds have been adequately ring-fenced and used for permitted purposes.

The analysis provided, in relation to 2020-21, reconciles an NCHG surplus of £4.409m, prior to the payment due to NCC of £1.492m in 2020-21, to the loss on ordinary activities after tax of £4,077m reported in NCHG's Financial Statements for the year ending 31 March 2021. The analysis provided showed that 89% (£3.926m) of the £4.409m was generated from HRA activities with non HRA activities contributing 11% (£0.482m) of the £4.409m.

Were it the case, which it is clearly is not, that NCH could distribute surpluses, this analysis would suggest that, since 89% of the surplus identified in 2020-21 was from HRA activities that any such surplus (or at least 89% of that surplus) should be paid to the HRA; meaning tenants rather than council tax payers would benefit from any surplus generated by NCH from HRA funds.

Conclusion

On the basis of our consideration of the nature of the payment made by NCH to NCC which started in 2014-15:

- If the monies paid by NCH to NCC were a Management Fee refund (rebate) then it should have been paid to the HRA, which pays the Management Fee (and is the single largest source of funding of NCH);

- If related to NCH savings/efficiencies, then the beneficiary in NCC, if such savings/efficiencies were not retained by NCH, should have been the HRA through a reduction in the Management Fee.

In both cases it should have been the HRA that benefited not the General Fund.

Instead, given the payment made by NCH to NCC has been of benefit to the GF (to council taxpayers) rather than to the HRA (to council tenants), the payment could be argued to be a mechanism conceived to divert HRA funds to the GF. If so, in our view, this is an illegitimate use of HRA funds and a clear breach of the HRA ring-fence which is, potentially, unlawful..

Moreover, if, in fact, the payments made by NCH to NCC are distributions of surpluses conceived as a mechanism by NCC to divert HRA funds to the GF, the issue for NCC is exacerbated since NCC has made NCH complicit in this.

Importantly, since NCH cannot legitimately pay a dividend (distribute a surplus) to NCC, NCH may have entered into illegitimate transactions which have not been accounted for properly in NCHG Financial Statements. Consequently, the actions of NCH's Directors in entering into these transactions and potentially breaching NCH's Articles of Association will need further explanation given this is also, potentially, unlawful.

8. Other Issues Arising

During the course of our work a number of other issues, separate from the payment NCH makes to NCC, have been raised which are relevant to the management of the HRA and to safeguarding the integrity of the HRA ring-fence.

Potential Breaches of the HRA ring-fence

It has been suggested to us decisions have been taken by NCC that could be challenged as having undermined the integrity of the HRA ring-fence. These decisions fall into two key categories:

- Decisions that have resulted in a loss of income to the HRA to the benefit of the GF;
- Decisions that have resulted in the HRA bearing disproportionate costs to the benefit of the GF.

An example of the former is a car park on HRA land for which it receives no income, the income going to the GF. We understand this has been the case for at least a decade.

An example of the latter is cessation of a rebate on the cost of public realm (including grounds maintenance, street lighting, and street cleaning) charged to the HRA by the GF to reflect Right to Buy (RTB) properties on council estates.

We have been provided with a schedule of more than a dozen such issues which will require further investigation. NCH is not party to these potential breaches of the HRA ring-fence.

Use of HRA funds to fund non-HRA activities

Concern has been raised during the course of our work about the possibility of HRA funds (or resources paid for by the HRA) being utilised by NCH on non-HRA activities.

Given NCH needed to undertake a one-off exercise to support our current work in order to identify surpluses derived from HRA and non-HRA activities, it might suggest that there may be insufficient segregation and analysis of source of funds, application of funds and any resulting surplus or loss resulting from on HRA and non-HRA activities undertaken by NCH.

The position is made more complex by inter-group transaction relating to services provided by NCH to its subsidiaries.

There is, thus the possibility, that HRA funds provided to NCH are applied to non-HRA activities. This could potentially lead to breaches to the integrity of the HRA ring-fence.

HRA Client Function

We understand that following a restructuring in 2016 the HRA client function was significantly reduced. NCC, as the LHA, retains the strategic housing role. Concern has been raised as to whether NCC has retained sufficient capacity to provide the strategic direction necessary to fulfil this strategic role; The question of whether NCC has adequate capability to properly scrutinise the activities of NCH has also been raised.

9. Overall Conclusion and Recommendations

Overall Conclusion

However the payment made by NCH to NCC since 2014-15 is defined or described, the GF has benefited from these payments totalling £15,858,500 in the period from 2014-15 to 2020-21. As discussed in our Conclusion to Section 7, this seems to be a breach of the HRA ring-fence which is, potentially, unlawful.

Furthermore, if it is determined, on the basis of legal advice, that the payments NCH has made to NCC are prohibited distributions of surpluses these are also, potentially, unlawful.

Recommendations

Given the potentially serious implications for both NCC and NCH, it is essential that NCC commissions legal advice on the issues of lawfulness set out in this report. In addition, NCC will need to consider, in consultation with the Department for Levelling Up, Housing and Communities (DLUHC), formerly MHCLG, and NCC's auditor and subject to that legal advice, what further actions are necessary.

We also recommend that NCC examines in detail the chronology of events in relation to the budgeting for and payments NCH has made to NCC including who conceived the payment, who authorised it, the accounting transaction detail, who knew about it, how challenges to the legitimacy of the payment were dealt with and by who and any other facts that can provide insight into how the situation came to be. The technical competency of the staff who were involved should also be reviewed so that this situation can be avoided in the future

In the event the GF is required to repay the HRA or NCH, consideration should be given to how the HRA or NCH should be additionally recompensed to reflect the opportunity cost of not having access to funds they may have been entitled to. One option would be to treat the monies received by the GF as a loan and apply an appropriate rate of interest to the sum to be repaid.

As a consequence of the work we have undertaken and the conclusions we have drawn, we also recommend more work is required in relation to the other issues we raise in Section 8. More specifically, we recommend:

- Examination and resolution of other potential breaches of the HRA ring-fence referred to in Section 8;

- Further analysis of the finances of NCH Group to provide assurance to NCC that HRA funds have been properly applied and have not been used inappropriately to fund non-HRA activities undertaken by NCH, which could potentially breach the integrity of the HRA ring-fence. This would involve a forensic financial examination of:
 - Transactions for services flowing between NCC and NCH,
 - Transactions for services flowing between NCH and its subsidiaries;
- Review of the adequacy of NCC's HRA client function in order to assess whether it is sufficient to properly scrutinise the activities of NCH and provide the proper strategic direction, controls and assurance on behalf of NCC as the Local Housing Authority (LHA).

Consequential to our work and in light of the changes that have taken place in how LHAs provide housing management since the end of the Decent Homes programme, we also recommend that:

- NCC commission a review of the NCC/NCH group relationship and future operating model to include the purpose, structure, finances and governance in relation to the housing management function as set out in the Recovery and Improvement Plan.

Appendix 1: Guidance – Operation of the Housing Revenue Account ring-fence

Published: 10 November 2020). Source: www.gov.uk

1. Introduction

This guidance updates and replaces Circular 8/95 published by the former Department of the Environment (DoE), to which the Ministry of Housing, Communities and Local Government (MHCLG) is a successor. It gives advice to local housing authorities in England on certain aspects of the Housing Revenue Account (“the HRA”).

DoE Circular 8/95 provided valuable advice and gave clarification of whether various items of expenditure and income should be accounted for inside or outside the HRA. However, circumstances have changed: estates are not necessarily purely council-owned and an increasing proportion of those living on these estates are no longer tenants of the council.

This guidance restates ministers’ established policy for the HRA and introduces no new issues of principle. However, it does highlight the need to be fair to both tenants and council taxpayers and that there should be a fair and transparent apportionment of costs between the HRA and General Fund.

This guidance is intended to be a helpful reference document for authorities, tenants and auditors. This guidance is not intended as an authoritative statement of the law on the keeping of the HRA, and authorities should take their own legal and accounting advice, as necessary, and will need to satisfy their auditors about their decisions.

2. Statutory background

Expenditure and income relating to property listed in section 74 of the Local Government and Housing Act 1989 (“the 1989 Act”) must be accounted for in the HRA. This comprises mostly housing and other property provided by authorities under Part II of the Housing Act 1985 (“the 1985 Act”).

Schedule 4 to the 1989 Act (as amended by section 127 of the Leasehold Reform, Housing and Urban Development Act 1993) specifies the debit and credit items to be recorded in the HRA. The Housing (Welfare Services) Order 1994 specifies the welfare services which must be accounted for outside the HRA.

3. General principles

The statutory provisions referred to above reflect the government's policy that the HRA remains a ring-fenced account within the General Fund; it should still be primarily a landlord account containing the income and expenditure arising from a housing authority's landlord functions.

Property in the HRA

At its most basic, when taking any decision on whether expenditure or income should be accounted for in the HRA, the test that should be applied is "Who benefits?" That is to say: who is the major contributor of the item of income, or the major beneficiary of the expenditure under consideration? Hence, should the HRA bear the full cost or only part, or should it benefit from the entirety of the income, or is some of it applicable to the General Fund?

In some cases, such as rental income or expenditure on housing repairs, it is clear that the HRA is the correct accounting vehicle. Conversely, legislation places transactions concerning rent rebates and housing benefits in the general fund. Nevertheless, there is a substantial 'grey area' of items of income and expenditure where differing and perhaps unique local circumstances will suggest different solutions. These are the decisions where local flexibility is best employed using the "who benefits?" approach.

The main consideration when deciding whether the costs and income associated with a particular property should be accounted for in the HRA is the powers under which the authority is currently providing that property. Section 74 of the 1989 Act sets out the property that must be accounted for in the HRA, by reference to the powers under which that property is held.

A property has to be accounted for within the HRA if it is currently provided under Part II of the 1985 Act or any of the other powers specified in section 74 of the 1989 Act (referred to here as "Part II housing"). The account also extends to any outstanding debts or receipts which arose when a property was so provided and which are still outstanding following its disposal.

If a property is not provided under the powers listed in section 74(1), or covered by a direction under section 74(1)(f), the authority must not account for it in the HRA - subject to certain exceptions set out in section 74(3). The HRA (Exclusion of Leases) Direction 1997, made under section 74(3)(d) of the 1989 Act, excludes from the HRA leases of up to 10 years for dwellings taken out by authorities for the purpose of housing homeless households.

If an authority wishes to include in the HRA property which is ancillary to Part II housing but not up to now provided under Part II, it will be necessary to obtain consent from the Secretary of State under section 12 of the 1985 Act (see also section 15 of the 1985 Act for London authorities). Such applications will be considered on their individual merits.

Equally, properties which may originally have been provided under one of the powers in section 74 of the 1989 Act (or their predecessor powers) may no longer fulfil their original purpose. In these circumstances, the authority should consider their removal from the HRA by appropriating the property to a different purpose. Examples of properties which might fall into this category are estate shops and other commercial premises, such as banks, post offices, workshops, public houses, industrial estates and surgeries, where there is no longer any connection with the local authority's housing.

The decision is for the authority to take, though it should be able to explain the basis of its decision to its external auditor and tenants, if called upon to do so.

Authorities should have regard to the powers available to them to hold property when they are considering whether to appropriate it out of the HRA. Section 19(2) of the 1985 Act requires authorities to obtain the Secretary of State's consent before a house, or part of a house can be appropriated for any other purpose.

If a property is transferred between the HRA and any other revenue account within the General Fund, this will involve adjustments to the HRA and other revenue accounts in accordance with any direction under paragraph 5(1) of part 3 of Schedule 4 to the 1989 Act and HRA capital financing requirements, and in accordance with the relevant determinations under Chapter 3 of Part 7 of the Localism Act 2011.

Amenities

These include play and other recreational areas, grassed areas and gardens and community centres. In each case it is for the authority to form its own judgement on whether provision is proper under Part II of the 1985 Act and the extent to which the costs should be charged to the HRA. There can only be a charge to the HRA where the amenities are provided and maintained in connection with Part II housing accommodation.

Where an amenity is shared by the community as a whole, the authority must have regard to paragraph 3 of Part III of Schedule 4 to the 1989 Act. This requires a contribution to be made from the General Fund to the HRA reflecting the general community's share of the amenity.

Management and maintenance services

The landlord is often best placed to provide wider services for neighbourhoods and communities that go beyond their traditional remit. When taking decisions locally, authorities need to demonstrate transparency to both tenants and Council Taxpayers that there is a fair apportionment of costs between the HRA and the General Fund.

To assist in determining what should and what should not be charged to the HRA, management and maintenance services can be expressed as core, core plus or non-core services.

Core services may be regarded as the 'bricks and mortar' functions of housing management, maintenance, major repairs and any associated debts and so forth. They are generally provided for the principal benefit of the landlord's tenants and leaseholders, not the wider community. Core plus services are those provided as additional services ancillary to the primary purpose of housing provision, which may have wider benefits to the overall community. A service that cannot be defined as core or core-plus should be accounted for in the council's General Fund.

Core services

- Repair and maintenance
 - Responsive
 - Planned and cyclical
 - Rechargeable repairs
- General tenancy management
 - Rent collection and arrears recovery
 - Service charge collection and recovery
 - Void and re-let management
 - Lettings and allocations of HRA properties only, any work carried out in respect of non HRA properties should be charged to the General Fund
 - Management of repairs
 - Antisocial behaviour: low level
 - General advice on tenancy matters
- General estate management
 - Communal cleaning
 - Communal heating and lighting
 - Grounds maintenance
 - Community centres
 - Play areas

- Estate officers and caretakers
- Neighbourhood wardens
- Concierge
- CCTV
- Policy and management
 - HRA share of strategic management costs
 - Setting of rent levels, service charges, and supporting people charges
 - Administration of the Right to Buy

Core plus services

- Contribution to corporate antisocial behaviour services. Where the service is entirely charged to the General Fund it may be appropriate for the HRA to contribute to these costs
- Tenancy support
- Maintenance of tenant gardens - unless a separate charge is made for the service
- Supporting people services - HRA housing related support services only, for example:
 - Sheltered accommodation wardens
 - Alarm services

Non-core services

It is the view of MHCLG that it is inappropriate to assume that these services will be wholly charged to the HRA. Their costs should be met from the General Fund.

- Administration of a common housing register – costs should be split appropriately between the HRA and General Fund
- Street lighting
- Dog wardens
- Personal care services
- Homeless administration
- Housing advisory service

The landlord should decide, within the requirements of existing legislation, whether it is appropriate to account for a proportion of these in the HRA or in the General Fund, using the 'Who benefits' principle. If the benefits of the service accrue primarily to the wider community, it is probable that the cost is a better fit in the General Fund, though it would be permissible to recoup a portion of any such cost from the HRA where it can be demonstrated that there is a benefit to HRA tenants or properties.

This does not imply any general discretion to transfer resources across the ring-fence; rather it is for the authority to apportion any costs or income for a service appropriately between accounts to reflect the benefit enjoyed by HRA tenants and leaseholders on one hand and the wider council taxpayer on the other.

Where a local authority is taking decisions concerning the correct place to account for new services or is reviewing existing practice in the light of evolving circumstances, the government would expect that tenants should be consulted, or involved in the decision-making process.

Homelessness administration

Authorities should consult the decision of the Court of Appeal in *R. v London Borough of Ealing, ex parte Lewis*, (1992) 24 HLR 484, when deciding how to account for homelessness administration costs. The case decided that not all the costs associated with homelessness administration by Ealing Borough Council should be charged to the HRA; only costs that fall within the description of 'management of houses and other property' can be included in the HRA.

Housing advisory services

The Court of Appeal's decision referenced above also covered Ealing Borough Council's costs on housing advisory services. Authorities should have regard to this aspect of the decision when considering the apportionment of costs relating to the provision of housing advice.

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Document to Follow

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