

Subject:	External Review of Housing Financial Management and Council Response
Corporate Director(s)/Director(s):	Sajeeda Rose, Corporate Director, Growth and City Development
Portfolio Holder(s):	Cllr. Linda Woodings
Report author and contact details:	Kevin Lowry Interim Director of Housing
Other colleagues who have provided input:	Clive Heaphy, Corporate Director, Finance and Resources Beth Brown, Head of Legal and Governance
Subject to call-in:	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
Key Decision:	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
Criteria for Key Decision:	
(a)	<input checked="" type="checkbox"/> Expenditure <input type="checkbox"/> Income <input type="checkbox"/> Savings of £750,000 or more taking account of the overall impact of the decision
and/or	
(b)	Significant impact on communities living or working in two or more wards in the City <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
Type of expenditure:	<input checked="" type="checkbox"/> Revenue <input type="checkbox"/> Capital If Capital, provide the date considered by Capital Board Date:
Total value of the decision:	£750k
Wards affected:	All
Date of consultation with Portfolio Holder(s):	23 April 2022
Relevant Council Plan Key Outcome:	
Clean and Connected Communities	<input type="checkbox"/>
Keeping Nottingham Working	<input type="checkbox"/>
Carbon Neutral by 2028	<input type="checkbox"/>
Safer Nottingham	<input type="checkbox"/>
Child-Friendly Nottingham	<input type="checkbox"/>
Healthy and Inclusive	<input type="checkbox"/>
Keeping Nottingham Moving	<input type="checkbox"/>
Improve the City Centre	<input type="checkbox"/>
Better Housing	<input checked="" type="checkbox"/>
Financial Stability	<input type="checkbox"/>
Serving People Well	<input checked="" type="checkbox"/>
Summary of issues (including benefits to citizens/service users):	
<p>Nottingham City Council (NCC) is responsible for council housing and the operation of the Housing Revenue Account (HRA). These responsibilities are outlined in legislation (principally the Local Government and Housing Act 1989 and subsequent amendments) and any guidelines on operation of the HRA from Government. This responsibility cannot be delegated.</p> <p>Housing Management and Maintenance functions can be delegated and since 2005 NCC has arranged that Nottingham City Homes (NCH) manage HRA funds on behalf of, and under the control of NCC. NCH is a wholly owned Company and a Partnership Agreement is in place covering working arrangements between the NCC and NCH. NCH acts as an Arms' Length Management Organisation (ALMO) and was originally set up to access Decent Homes Funding. It is recognised that beyond investment to achieve decent homes standards, NCH has had success in improving core housing services. NCH have achieved improvements to housing stock, including the response to fire safety following Grenfell and home insulation works. The Council will want to build on the improvements made to date in terms of housing quality and safety standards.</p>	

HRA funds are for the benefit of the council's tenants and leaseholders and are funded primarily by rents and service charges. The HRA is a strictly ring-fenced account of the General Fund (GF) for specific purposes set out in the legislation and guidelines.

A review commissioned by the Council has identified that NCC, including through its arrangements with NCH, has acted unlawfully in relation to breaches of the HRA Ring Fence.

The issue was previously reported to and considered at an Extraordinary meeting of Full Council on 4 January 2022. Amongst other actions agreed, two further reports were commissioned. This paper addresses key points arising from the findings of these two reports by an independent investigator, Richard Penn and CIPFA (Chartered Institute of Public Finance and Accountancy).

The further work commissioned from Richard Penn and CIPFA, following the identification of initial breaches, has identified the causes of the unlawfulness and how it came about and that the scale of unlawful use of funds diverted away from the HRA is greater than first identified.

CIPFA's initial report identified the unlawful treatment by NCC of the NCH 'management fee rebate' which was valued at £14.367m. CIPFA's additional work has uncovered a further sum of up to £25.759m of detected and assessed issues taking the overall scale of the issue of up to £40.126m. This comprises:

- i) Issues raised in the original report concerning the unlawful treatment by NCC of NCH 'management fee rebates of £14.367m (35.8% of the total).
- ii) Issues forming workstream A of CIPFA's review which concerned historical decisions taken by NCC without full consideration of the HRA ring-fence totalling £8.503m (21.2% of the total).
- iii) Issues forming workstream B of CIPFA's review which concerned the extent to which HRA monies have been spent by NCH on non-HRA activities between 2014-15 and 2020-21 totalling £17.158m (43.0% of the total).

The investigations the council has commissioned have identified issues with historical financial mismanagement, a lack of adequate record keeping and governance failures that have occurred. Consequently, it is important that the council acts swiftly and decisively to deal with the matters raised to provide assurance to itself, tenants, taxpayers, the Improvement and Assurance Board and Government. Members will need to have confidence that officer and external auditor advice is robust and consequently that the council's accounting and use of HRA is legal and passes the 'who benefits' test to ensure that the impact of HRA monies are spent in accordance with the ring fence for the benefit of Council tenants.

As well as rectifying past omissions and learning lessons, a key focus looking forward is on ensuring that decisions are taken which makes sure that these unlawful events cannot happen again. This includes clarity of roles for those responsible for safeguarding the HRA ring-fence, clear performance and financial controls within the council and in relation to the management of NCH, close monitoring of spending in the HRA, improved governance including enhancing the role of scrutiny and clear records to support future decisions around spending within the HRA..

Does this report contain any information that is exempt from publication?

no

Recommendations

1. To receive and note the Key Findings Report from Richard Penn following his independent investigation (Attached as Appendix 1).
2. To receive and note the further work undertaken by CIPFA (including appendices relating to workstreams A and B). (Attached as Appendix 2)
3. To note that the current organisational arrangements between the NCC and NCH do not provide officers sufficient assurance that the HRA ring fence can be adequately protected under existing arrangements, and in turn councillors have been unable to gain the required level of assurance in relation to the HRA ring fence.
4. To authorise the Corporate Director of Finance and Resources and Section 151 Officer, following the receipt of further work from CIPFA outlined in this report, to seek a Ministerial Direction from government to repay in aggregate up to £40 million from the General Fund to the HRA (subject to any mitigations to reduce this sum).
5. To note the options and key lines of enquiry for funding the rectification of the breach to the HRA ring fence and to note that there will be an impact on the 2022/23 – 2025/26 MTFP which will be reported to Executive Board and/or Full Council in due course.
6. To approve, the serving of a 12 months' Notice to Terminate on NCH in respect of its housing functions and to take over direct management of council housing from the expiry of that notice period or sooner by agreement.
7. To note that should the recommendations of this report be accepted, there will be engagement with tenants and leaseholders to ensure a smooth transition and continuity of service about ongoing service provision. This will include how the voice of tenants will be heard by NCC as the landlord after the service is brought under direct control.
8. To authorise the Corporate Director of Growth and City Development to take such steps as may be necessary to deliver an effective transfer of housing management functions back to the Council, in consultation with the Portfolio Holder for Housing, Corporate Director of Finance and Resources and Section 151 Officer and Director of Legal and Governance and Monitoring Officer. This to include, amongst other things, arrangements for the protection of employment rights for NCH staff through TUPE transfer, arrangements for effective tenant and leaseholder engagement and empowerment in the decision making about services, and the transfer of relevant third party contracts and any other relevant arrangements as may be necessary to support an effective transition.
9. To authorise the Corporate Director of Growth and City Development to take such steps as may be necessary to affect such short term and practical arrangements in relation to the governance arrangements of NCH to facilitate an effective transition, in consultation with the Portfolio Holder for Housing, Corporate Director for Finance and Resources and Section 151

Officer, the Corporate Director of Resident Services (in their capacity as the shareholder representative for NCH) and Director for Legal and Governance and Monitoring Officer, including positive liaison with the NCH Board and effecting any changes that may be necessary to the Articles of Association of NCH and Board appointments.

10. To delegate to the Corporate Director of Growth and City Development a provisional budget of £750,000 to deliver on the above recommendations from HRA funds, as a proper use of those funds, in consultation with the Portfolio Holder for Housing, Corporate Director for Finance and Resources and Section 151 Officer and Director for Legal and Governance and Monitoring Officer.

11. To note that a report is brought back to Executive Board and subsequently to Full Council to identify arrangements for a greater level of councillor engagement in overview and scrutiny arrangements for policy development, priority setting and holding to account for performance in relation to housing management matters, following the return of management of the council's housing stock to the council.

12. To note that the Overview and Scrutiny Committee will receive update reports to enable the implementation plan and consultation arrangements to be reviewed during the transition through the Council's scrutiny arrangements.

1.0 Background

1.1 In the late summer 2021, the Section 151 officer became concerned with both the use of funds within the NCH Group (NCH Enterprises Ltd and NCH Register Provider Limited) and how a substantial value of HRA funds repaid by the Council found their way into the Council's General Fund. In respect of this and with the support of the Leader and Deputy Leader of the Council, an investigation was commissioned and conducted by CIPFA.

1.2 On 15th December 2021, the Council's Section 151 Officer issued a report under section 114(2) of the Local Government Finance Act 1988. At the same time, the Monitoring Officer issued a further report under section 5 of the Local Government and Housing Act 1989. Both reports were issued in respect of acts of unlawfulness by the Council in respect of "management fee rebates" made to the Council by NCH over the period 2014/15 to 2020/21 inclusive.

1.3 This issue has arisen following a difficult period for the Council during which the Council has had to take extensive action to address the various issues raised. These actions have included working with the Department for Levelling Up, Housing and Communities (DHLUC) who, in conjunction with NCC, and have established an Improvement and Assurance Board which reports to the Secretary of State.

The Improvement and Assurance Board are monitoring the response to the HRA issues, just as they have the wider Together for Nottingham Plan (formerly the Recovery and Improvement plan) and are seeking timely and effective action to address the matters at hand.

1.4 Full Council considered the Section 114 and the Section 5 Notice at an Extraordinary Council meeting on 4 January 2022. The Council accepted the

Section 114 Notice and its recommendations in full. This included commissioning further reviews to understand how this practice had occurred and next steps including what would be required to ensure that there is no repeat in future. Specifically, Council agreed to:

- i. Carry out a review of the processes and systems that failed to prevent the unlawful breaches to ensure that they cannot be repeated. This will include a review process in respect of 'novel' proposals by appropriately trained and experienced staff.
- ii. Commission legal advice on the lawfulness of the transactions and in consultation with the Department for Levelling Up, Housing and Communities, the Improvement and Assurance Board and the Council's external auditors, consider what further actions are necessary.
- iii. Examine in detail the chronology of events in relation to the payments Nottingham City Homes has made to the Council 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 whom and any other facts that can provide insight into how the situation came to be.
- iv. In the event that the Section 151 Officer considers that the General Fund is required to repay the Housing Revenue Account and Nottingham City Homes, consider how the Housing Revenue Account or Nottingham City Homes should be additionally recompensed to reflect the opportunity cost of not having access to funds they may have been entitled to.
- v. As a consequence of the concerns raised by the Section 151 Officer and the work undertaken and conclusions drawn by CIPFA, examine and resolve other potential breaches of the Housing Revenue Account ring-fence.
- vi. Further analyse the finances of the Nottingham City Homes Group to provide assurance that Housing Revenue Account funds have been properly applied and not used inappropriately to fund non-Housing Revenue Account activities undertaken by Nottingham City Homes, which could potentially breach the integrity of the Housing Revenue Account ring-fence. This will involve a forensic financial examination of:
 - a. transactions for services flowing between the Council and Nottingham City Homes; and
 - b. Transactions for services flowing between Nottingham City Homes and its subsidiaries.
- vii. Review the adequacy of the Housing Revenue Account client function in order to assess whether it is sufficient to properly scrutinise the activities of Nottingham City Homes and provide the proper strategic direction, controls and assurance on behalf of the Council as the Local Housing Authority.
- viii. Consequential to CIPFA's work and in light of the changes that have taken place in how Local Housing Authorities provide housing management since the end of the Decent Homes Programme,

commission a review of the Council and Nottingham City Homes 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.

1.5 The two further reports by Richard Penn, a highly respected and experienced Local Government Investigator, and CIPFA have now concluded and the terms of reference, key findings and recommendations are detailed below.

2.0 Further reports received

2.1 The Penn Report

In conducting the review Richard Penn analysed the initial CIPFA report and other relevant documentation. He conducted numerous interviews with current and former members and senior officers of the Council and NCH. His Key Findings Report (the Penn Report) is attached at Appendix 1.

The Penn Report was commissioned to answer four fundamental questions.

- *Who conceived the payments, who authorised them and accounting transaction details?*
- *Who knew about the payments?*
- *How challenges to the legitimacy of the payments were dealt with and by whom?*
- *Any other facts that may provide insight into how the situation came to be.*

Findings and recommendations from the Penn Report are set out below in section 3.

2.2 CIPFA Report

- CIPFA's Phase 1 report identified the potential for further breaches of the HRA ring-fence in two specific areas which have been the focus of the Phase 2 work.
- In examining the issues raised, CIPFA have taken into account the [then] MHCLG's 2020 guidance on operation of the HRA ring-fence together, where appropriate with any earlier guidance in relation to the HRA (namely Circular 8/95).
- CIPFA have now undertaken the work set out in 1.3iv) above and a draft report is attached with separate appendices for the two workstreams namely.
 - transactions for services flowing between the Council and NCH (Workstream A); and
 - transactions for services flowing between NCH and its subsidiaries (Workstream B)

Findings and recommendations from CIPFA are set out below in section 3.13

3. Conclusions and recommendations

3.1 Penn Report

The Penn Report identified, amongst other things, a lack of alignment in the interests of NCH and the Council in relation to the management of the HRA. NCH consider that they have no responsibility in the management of the Council's HRA funds to account properly for HRA and non HRA funds and as such the current organisational arrangements between NCH and the Council are not fit for purpose, not sustainable and expose the Council to risk. This is all in the context of the current intervention arrangements with an Improvement and Assurance Board being in place to oversee the Council's improvement journey in relation to strategic financial management, governance and culture.

3.2 The Penn Report concludes that the payments in question were conceived initially by the then Corporate Director of Development as part of a wider and ongoing budget and savings exercise. The concept of the payments would have been evaluated by a working group of officers and councillors, and subsequently agreed at budget meetings by the Executive.

3.3 Having been adopted in 2014-15 these savings/payments became a standard expectation of the budgeting process. The Penn Report concludes that it was not case that the payments were a "*mechanism conceived to divert HRA funds to the General Fund (GF)*". However, it is clear that the annual rebate received by NCC was used to benefit the pressures on the GF, and that as the annual expectation of savings/payments grew "*it is likely that this became an accepted mechanism to divert funds from the HRA to the GF*".

3.4 Awareness of the payments was wide and covered many officers of NCC and NCH as well as Councillors. The budgetary process was in the public domain and the information was widely available. Specific reference is made to the fact that at the inception of the first tranche of "savings" in 2014-15 the s151 Officer, the Director of Finance and the HRA Finance expert were all sighted on the proposal and none of them raised concerns about its legitimacy. After the in-principle agreement to this proposal no further concerns were raised by officers later in the process, including the Monitoring Officer or any of the Legal team.

3.5 There appears to have been little or no challenge as to the legitimacy of the proposed savings regime either within NCC or NCH. Where officers, Councillors or NCH Board members, in their interviews, indicated that they did raise concerns they were apparently either reassured about legitimacy, ignored, or dissuaded from voicing their concerns wider.

3.6 NCH Board raised concerns about the growing scale of required savings but appear not to have overtly challenged the HRA ring fence nor the lawfulness of directing HRA funds to the General Fund.

3.7 NCH have sought their own independent legal advice and still dispute, based on that advice, the conclusions of the S.114 report, the section 5 report and CIPFA as

to the unlawful breach of the ring fence. The Penn Report makes no attempt to adjudicate on this.

3.8 The Penn Report does not conclude that the savings were a mechanism conceived to divert HRA funds to the General Fund but does conclude that there were widespread failures of governance. Particular mention is made of NCH's failure to challenge. "*NCH had a sufficient knowledge of the HRA ring fence to know that returning surpluses back to the Council to help with General Fund budget pressures could not be justified but they went along with the proposal.*" The Chair of NCH did report that there had been a formal enquiry challenging the use of HRA, but this did not result in any form of review or revision of the approach.

3.9 The Penn Report observes that "*This episode has been a disappointing setback for the Council on an improvement journey which has centred on improving strategic financial management and governance – poor examples of both have been identified through this investigation. Notwithstanding that, that the issue has been identified and dealt with quickly by the Council itself demonstrates that the improvement journey is very much on track*".

The Penn Report makes the following recommendations.

3.10.1 Relationship with NCH

- *Having regard to the CIPFA Review and this investigation, urgent consideration is given by the Council to bringing back 'in house' the management of the Council's housing stock and related functions.*
- *Between now and when a 'Notice to Terminate' is served, the Council to expedite the significant strengthening of the governance arrangements applied to NCH, to ensure that the Council can demonstrate and exert the required control over NCH as a wholly owned Teckal company, to provide the necessary assurance over the management of the Housing Revenue Account.*
- *This should include amending the Articles of Association, the rules governing how the company operates lodged at Companies House, to give the Council the right to appoint and dismiss the Chair of the Board and the Chief Executive.*
- *Penn also recommended the ongoing strengthening of the Council's local housing authority role, to include effective client arrangements of NCH, together with the undertaking of project planning for the return of council housing management to the Council, with the necessary resources being allocated.*

3.10.2 Improved governance within NCC

- *Arrangements should be made for additional advice, guidance and support for the Council's Finance Team including external support and expertise.*
- *that the Monitoring Officer and the s151 Officer should be formally and more actively involved than has been historically the case in fulfilling their statutory responsibilities for the provision of advice to elected members on any proposed action by the Council that could potentially be unlawful along with the Chief Executive, as the Council's third statutory officer.*
- *That any such advice from the Council's three statutory officers must be fully respected by both members and officers and given due weight in the Council's*

decision-making processes.

- *That the Council's External Auditors should be required to have a greater focus on how the Council is taking decisions and responding to the advice from the Council's statutory officers rather than relying on 'materiality' to trigger potential intervention.*
- *Whilst the operating environment may have been considered challenging or difficult, the investigation has found that a number of former NCC officers fell below the standard that could reasonably be expected in showing the necessary intellectual curiosity, and providing clear advice about the inappropriateness of action by the Council in this regard.*
- *The Council should seriously consider passing details of the CIPFA Report and this (Penn) Report to relevant professional bodies where relevant professional qualifications were and are held, for those professional bodies to determine whether they wish to consider any support, guidance or action in this matter. This would be a serious step and proper consideration needs to be given to the relevant evidence before any such action is taken to avoid potential litigation.*
- *That the Council's Constitution - including the various Codes of Conduct - should be critically reviewed to ensure that the lessons learned from this experience have been fully encapsulated in the requirements set out in the Council's Constitution.*

3.11 CIPFA Report

The further report from CIPFA is attached at Appendix 2 and has drawn the following summary of conclusions.

CIPFA's findings in their original report focussed on the unlawful treatment by NCC of the NCH 'management fee rebate' and was valued at **£14.367m**, which was the subject of the initial report to Council on the 4th of January 2022.

CIPFA's additional work has uncovered a further sum of up to **£25.759m** of detected issues taking the overall scale of the issue as up to **£40.126m**. This is based on a detailed review although given the lack of data and supporting evidence in some areas, CIPFA have had to rely in some areas on estimates and extrapolations to arrive at the financial impact over the last seven years.

The issue can be broken down into three main parts.

- i. Issues raised in the original report concerning the unlawful treatment by NCC of NCH 'management fee rebates of **£14.367m** (35.8% of the total).
- ii. Issues forming workstream A connected to historical decisions taken by NCC without full consideration of the HRA ring-fence, presented as a non-negotiable requirement to those responsible for administering the HRA totalling **£8.503m** (21.2% of the total). Further issues have been identified which may vary this total further.
- iii. Issues forming workstream B connected to the extent to which HRA monies have been spent by NCH on non-HRA activities between 2014-15 and 2020-21 totalling **£17.158m** (43.0% of the total).

In relation to **workstream B** which focussed on the treatment of funds within NCH and the NCH group, CIPFA conclude that.

3.12 *“In our opinion, the duty on NCC to ensure that HRA monies are only spent to the benefit of HRA tenants does not cease when it delegates the service provision to an arms-length management organisation. On the basis of our analysis, the failure to require its arms-length management organisation (NCH) to maintain this ring-fence for its operations means that, in addition to the £14,366,500 payments to the NCC General Fund that need to be remedied, a further £17,256,213 of HRA funds between 2014-15 and 2020-21 were not utilised by NCH on HRA activities by 31 March 2021. This estimate is based on the assumption that NCC funding reconciles with the records held by NCH.”*

3.13 CIPFA specifically comment in relation to workstream B that.

1. *Funding from the ring-fenced HRA account received by NCH between 2014-15 and 2020-21 exceeded its spending on HRA activities, that the scale of the gap does not take into account the annual payments made by NCH that NCC credited to the GF and that the capacity for NCH to remedy this gap without support from the Council is very limited.*
2. *CIPFA have not seen any evidence that NCH has the appetite to ring-fence HRA funding and expenditure from its non-HRA activities.*
3. *CIPFA find that the ledgers kept by NCH do not differentiate between HRA and non-HRA activities and as a result, separating HRA funding and expenditure within NCH has proved very difficult. As NCH does not consider that it has any obligation to ring-fence HRA funds, there is no statement or prime records available to show how such monies received have been applied each year.*
4. *Difficulties in identifying how HRA funds have been utilised are compounded by out-dated recharges between account codes that CIPFA could not validate and they were unable to adequately confirm the number of properties managed on behalf of the Council as specified in NCH’s financial statements for 2020-21.*

3.14 Recommendations from CIPFA in relation to NCH through workstream B are.

1. *NCC should, as a matter of priority, revise existing funding agreements with NCH to specify an obligation to ring-fence HRA activities, including the production of an annual statement that shows the funding received and how it has been utilised.*
2. *Having established the extent of HRA funding that has not been utilised for HRA activities, determine whether NCH has the capacity to remedy this matter without financial support and if it cannot (as seems likely) consider how the Council would fund a further £17,158,617 to replenish the HRA.*
3. *Alongside the actions to introduce an HRA ring-fence, the basis of costings and recharges for work done by NCH and its subsidiaries needs to be updated, with the onus on actuals rather than estimates. A similar approach should be used for all other services provided to subsidiaries and other organisations.*

3.15 In relation to **workstream A** which focussed on the treatment of funds charged by NCC to the HRA, CIPFA conclude sums of £8.3m should be repaid from the General Fund to the HRA.

1. *On the basis of the evidence that was provided to CIPFA and conversations with NCC staff in relation to this evidence, we conclude that a number of decisions have been taken that cannot be justified and appear to undermine the HRA ring-fence.*
2. *The details of this undermining are set out in the CIPFA report but relate to charges for items which should not, under DLUHC guidance be charged to the HRA and/or where charges are being made, the evidence and basis is not obviously evidenced and thus without basis.*
3. *In addition to the above there are other issues that we [CIPFA] have examined where a firm conclusion cannot be made on the fairness of the charges made to the HRA since there is no clear basis or SLA on which these charges are based. In particular, we would draw attention to the £500,000 charge that was introduced in 2019-20 for Corporate and Democratic Core. No evidence has been provided to support this new charge.*

3.16 CIPFA have recommended that

1. *NCC considers our conclusions in relation to each of the items that combined have a value of £8,503,030 and determines:*
2. *The amount the HRA should be reimbursed (taking into account any interest that might have accrued on the sums to be paid to the HRA)*
3. *Any adjustments that might be necessary to reflect these amounts are based on historical values which may well have changed since the relevant decisions were taken.*
4. *The actions needed to rectify these items from 2022-23 onwards*
5. *Undertake work in relation to all charges to the HRA from the GF to provide a sound basis for the calculation of such charges combined with SLAs that have sufficient granularity to support these charges and any changes over time.*

4 Council Response

4.1 The Council accepted in full the recommendations made at the Extraordinary Council Meeting on 4 January 2022. The Council commissioned further reports which are integral to the recovery process that the Council has embarked upon.

4.2 It is of deep concern that notwithstanding the seriousness of the issue, as evidenced by the service of a Section 114 Notice, a Section 5 Notice and exchanges of correspondence between the Chair of the Improvement and Assurance Board and the Minister in relation to the HRA issue, that CIPFA, as part of their most recent work, have reported that they have seen no evidence of measures to properly separate HRA and non HRA funding and expenditure. As a result, the Council cannot be sufficiently assured that the HRA ring fence is appropriately protected.

4.3 The advice in the reports and in this report are evidence based or founded on the most reasonable assumptions that could be made at the time. For this reason, officers strongly advise that the findings of the Penn Report and CIPFA should be accepted in full and the recommendations in this report accepted and implemented. The recommendations include rectifying the deficiencies identified and ensuring that future governance and financial controls are adequate and strengthened to protect the ring fence.

4.4 To achieve this, it will be necessary to strengthen the Council's technical and professional capacity and capability on HRA and Housing to implement this effectively. The current year accounts (2021/22) and the MTFP will be impacted and this could result in a potential gap each year. This will be considered in due course via the appropriate governance routes and mitigated to ensure the financial stability of the council. There will be further work in regard to the values reported to ensure that the precise sum for repayment is identified.

4.5 Further the oversight of any future charges to the HRA will be undertaken by the Interim Director of Housing and the Senior HRA accountant who will both act as "HRA Champions" for the Council and provide that required assurance to the Council regarding the future management of the HRA. As part of broader tenants and member involvement in relation to the council housing function of NCC, the Council will establish governance and oversight arrangements in relation to the HRA for members and tenants that are based on best practice in the sector. In addition, the Council will strengthen the role of the Council's Scrutiny arrangements to strengthen the overall governance arrangements covering the management of housing and the HRA.

4.6 Recommendation 6 is to bring the Housing Management function back "in-house" by service of 12 months termination in accordance with Clause 59.3 of the 2020 Partnership Agreement. This will mean the return to the Council of the direct management of council housing from the expiry of that notice. This can be effected earlier by agreement between the parties.

4.7 This process will include undertaking the necessary due diligence and project planning to bring housing management staff into the council, address and where appropriate transfer contracts, resolve issue relating to assets and balance sheets and ensure that existing housing management and services remain the same for tenants. NCC will remain as the landlord.

4.8 This will also include making any changes that may be necessary to the Articles of Association of NCH and Board appointments in the interim period.

4.9 This project will incorporate the necessary engagement and communications work to reassure staff and tenants. The Penn Report firmly recommends that in order for the Council to be able to demonstrate the necessary level of assurance over the use of HRA funds and during the transitional phase there will be a requirement for strengthened financial management, together with appropriate transition management arrangements to provide in improved level of assurance in the management of the HRA.

4.10 It should be noted that the process of reverting services back to the host Local Authority is now a common practice. From the initial creation of Housing ALMO's to gain Decent Homes grant funding from Government in the early 2000's, there were nearly 70 ALMO's. As Decent Homes Grant Funding is no longer available, many local authorities have taken the services back and there are now only just over 20 ALMOs still operating.

4.11 It should be noted that the Together for Nottingham Plan already includes an action to review Council companies and subsidiaries. Progress on this issue will be monitored by the Companies Governance Executive Committee.

5 Technical Steps to deliver recommendations

5.1 It should be noted that there is no recommendation from the Penn Report or CIPFA to enter into a full options appraisal. Where there is unlawful activity in regard to HRA and in the context of the existing Together for Nottingham Plan to address other financial issues, the Council needs to act decisively and quickly for the benefit of tenants.

5.2 To terminate the agreement with NCH notice should be served under 59.3 of the 2020 Partnership agreement which states:

"The Council will be entitled to terminate the Agreement at any time on giving not less than 12 months written notice to the Organisation."

5.3 At the expiry of the notice period (or sooner by agreement) the service would be transferred to the council by a "lift and shift". This means that the staff involved in day-to-day delivery will continue to provide customer service and tenants and leaseholders will experience a seamless transition. This reversion of the service is to allow greater accountability for the use of rent payer's money and to retain services under the control of the Council.

5.4 A detailed project plan will be developed that includes, but not limited to:

1. **Clarity of decision.** Why the agreement is being terminated and what NCC hope to achieve by in sourcing.
2. **Governance.** Project Boards at various levels to oversee the project and to ensure engagement with key parties of tenants, leaseholders, staff, unions, stakeholders and contractors.
3. **Resources.** There will need to dedicated capacity in particular in the areas of legal, finance (HRA), HR and communications. A budget of £750k to support NCC and NCH will be required. This will cover the costs of legal and professional services and will be drawn from retained HRA.
4. **Communications plan.** A detailed and timed communications plan aimed at all levels of engagement and progress including reactive capacity for press enquiries etc.,
5. **Risk Register.** A detailed and RAG rated living risk register covering impacts on the Council as well as NCH. The risk to service disruption has to be mitigated.
6. **Tenant engagement.** Notwithstanding the references at 2 and 4 above an engagement programme to develop how tenants will communicate with their landlord (rather than the landlords agent as at present) will be critical and

consistent with the emerging White Paper requirements, consumer standards and Tenant satisfaction measures (TSM's).

7. **Subsidiaries.** NCH have two subsidiaries. Careful consideration will be required in terms of the legitimate use in the future and protecting the benefits they provide for NCC e.g., provision of temporary accommodation.
8. **TUPE.** The proposal is for a “lift and shift” which means that the service would transfer back to NCC intact. The workforce of NCH would transfer to NCC and the legal and practical engagement processes including consultation and engagement with unions and staff will be observed and commence early in the process.
9. **Post transfer structure.** Building the council department that will bring together delivery services from NCH and strategic housing functions currently delivered in various departments within NCC structures
10. **HRA.** Dedicated resources are needed to implement the Penn and CIPFA recommendations.

6. Consultation Process

6.1 There will not be a formal tenant referendum exercise prior to serving Notice of Termination to NCH. This is because council tenants will remain tenants of the Council and housing management services will remain the same and will continue to be delivered in the same way. There are no proposed changes to service or policy warranting a referendum but we are seeking to deliver on the themes emerging from the Social Housing White paper, the new Tenant Satisfaction measures, Consumer Regulations and the fire and building safety agenda. Tenants will be engaged with and supported to work with the Council to review services and develop any service designs for the future as required by section 105 of the Housing Act 1985. The Council proposes to create a forum for tenants to not only oversee the smooth transition of services, but to develop the way in which tenants can interact directly with their landlord rather than the agent of the landlord. They will be supported in this process by an Independent Tenants Friend (ITF) who will be able to support and advise. This will be an independent individual or agency that can provide technical information and advise about the meaning and impacts of the proposals. Tenants will be involved in their appointment. We will want to ensure that the model of tenant and leaseholders' engagement is meaningful and influential and meets best practice standards.

6.2 There will be an extensive communications and engagement strategy for tenants and staff embedded in the processes.

6.3 Colleagues in NCH and NCC will be engaged and included in the transition process. NCH staff and unions will be formally consulted as part of the TUPE process.

7 Other options considered in making recommendations

7.1 This report proposes robust, swift and decisive action to address acts of unlawfulness in relation to breaches of the HRA ring fence by the Council including through its arrangements with NCH.

7.2 An alternative approach would be to retain NCH as an ALMO and to explore with its management the necessary improvements that the Council requires to be made. This

approach has been rejected as the governance and financial controls are not fit for purpose. CIPFA have advised that they have seen no evidence from NCH of an appetite to ring-fence HRA funding and expenditure from its non-HRA activities, and moreover NCH considers that it has no obligation to ring fence HRA funds. Given the seriousness of the issue and gravity of the situation that the Council faces, in the light of evidence received this alternative approach is considered untenable and has been rejected.

8 Finance colleague comments (including implications and value for money/VAT)

1. CIPFA's initial work which focussed on the unlawful treatment by NCC of the NCH 'management fee rebate' and was valued at **£14.367m**.
2. CIPFA's additional work in response to the Section 114 report has uncovered a further sum of up to **£25.759m** of detected and assessed issues taking to overall scale of the issue of up to **£40.126m**. This comprises:
 - i. Issues raised in the original report concerning the unlawful treatment by NCC of NCH 'management fee rebates' of **£14.367m** (35.8% of the total).
 - ii. Issues forming workstream B of CIPFA's review related to the extent to which HRA monies have been spent by NCH on non-HRA activities between 2014-15 and 2020-21 totalling a further **£17.158m** (43.0% of the total).
 - iii. Issues forming workstream A of CIPFA's report related to historical decisions taken by NCC without full consideration of the HRA ring-fence, presented as non-negotiable to those responsible for administering the HRA totalling **£8.503m** (21.2% of the total).
3. CIPFA have spent in excess of 7 months undertaking this work. During that time, they have strenuously and robustly sought evidence from both NCC and NCH to evidence charge made by NCC to the HRA and charges within the NCH group. It is clear the level of justification, to support charges and the basis and allocation of costs has not been present and as a result CIPFA have had to draw conclusions from incomplete workings.
4. CIPFA's additional work in response to the Section 114 report has uncovered a further sum of up to **£25.759m** of monies potentially owed by to the HRA. This may be in cash or could potentially be in the form of assets transferred to HRA ownership.
5. The maintenance of an absolute ring-fence is one of the most fundamental principles of local government finance well understood by members and officers and its breach on this scale represents a major breakdown in controls, governance and financial management and requires the council to ensure that officer advice is clear, based on the latest legislation and well informed
6. CIPFA have, wherever possible over a number of months, sought to get firm evidence to support their conclusions and arrived at a firm conclusion on the value of the breach to be remedied. However, in spite of their efforts, it is clear that the Council's poor performance (and to some extent that of NCH) to maintain adequate

SLA's, records pertaining to the basis for charging, working paper, written rationale for not adopting Government guidance, has led to CIPFA being required to make approximations and estimates in some areas in arriving at their conclusion. Such an approach is entirely reasonable and normal in the accounting world – the lack of evidence on the part of NCC and NCH is of concern.

7. Whilst the Council can do further work to try to make these figures more precise, the main possibilities lie in the area of assets not SLA charges where further work is just as likely to result in an increased deficit as a reduced one. It is strongly recommended that the figures identified by CIPFA are accepted and that NCC seeks a direction from DLUHC to pay up to £40.1m from General Fund source to rectify past wrongs
8. This does not mean that further work should not be done to seek to mitigate this figure and the most likely area is in relation to assets held by NCH Enterprise and the NCH Registered Provider companies but arguably paid for by surpluses generated by HRA activities. There are no guarantees of a successful strategy, but it is clear that work is needed. Other areas are unlikely to yield any meaningful mitigation.
9. Further review work will need to undertake to assess and evidence an appropriate value of transactions between HRA/GF for the future and to potentially mitigate the total figure to be repaid.
10. The funding of this identified sum of up to £40.1m (before mitigations) will be a challenge for a Council whose finances are already stretched. The first c£15m has already been earmarked from General Fund Reserves to remedy the phase 1 issue of the misappropriation of "management fee refunds". In the absence of mitigations, a further £25.1m would need to be found. Taking these from reserves could well leave the Council vulnerable to managing service demand and other inflationary pressures.
11. An alternative approach could be to consider a request to DLUHC for a further capitalisation direction up to the full value or a mix reserves and capitalisation. Further work will be needed to draw a final conclusion on the optimised funding route.
12. The issues identified by CIPFA, whilst historic, will impact on the current MTFP and lead to a budget deficit rather than balanced budget. This will require further financial modelling and re-consideration of the S151 officer assessment of the robustness of the budget.
13. In addition, further urgent work will need to be undertaken to provide clarity on the financial framework which NCC expect NCH to operate within and the controls and monitoring regime and to provide the statutory officers with the necessary assurance that the integrity of the ring fence will be maintained.
14. In relation to the work to bring NCH in-house, this will require a dedicated project team to be established to drive the work around HR (TUPE transfer), procurement (contract transfer or termination) and assets management alongside the other workstreams
15. The cost of this is estimated at £750k subject to detailed cost estimates. This is a legitimate charge to the HRA and will be met from HRA reserves.

16. Further work may be needed, especially around the rationalisation of the NCH Group Company structure and the Companies Governance sub-committee will have oversight.

Clive Heaphy, Corporate Director, Finance and Resources 25th April 2022

9 Legal colleague comments

- Nottingham City Homes is a wholly owned Council Company established in 2005.
- Since its establishment Nottingham City Homes have established two subsidiary companies, Nottingham City Homes Enterprise Limited and Nottingham City Homes Registered Provider Limited.
- The relationship between NCH and NCC is governed in accordance with a partnership agreement, most recently updated in September 2020.
- Clause 59.3 of the Partnership Agreement states that the Council are entitled to terminate the partnership Agreement on giving not less than 12 months' written notice to Nottingham City Homes.
- The notice period can be shortened with the agreement of both parties in writing in accordance with clause 64.1.
- Once notice to terminate has been given to Nottingham City Homes the Council must ensure that matters of housing management as set out in section 105 of the Housing Act 1985 remain unchanged. Any change which substantially affects secure tenants would require a formal consultation process to be undertaken.
- In accordance with the Local Government and Housing Act 1989 the Council has a duty to keep, in accordance with proper practices, an account, called the Housing Revenue Account ("the HRA").
- The HRA must 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.
 - Credits and Debits are prescribed by statute.

- the main items of expenditure included in the account are management and maintenance (M&M) 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
 - No general discretion to breach the ring-fence.
 - A Local Authority cannot budget for a deficit.
 - All borrowing within the HRA must be in line with the CIPFA Prudential Code.
- The Council must ensure the proper and lawful processes are followed to support the transitional arrangements, including but not limited to employment, contracts, company and commercial matters and tenancy transfer.

Beth Brown, Head of Legal and Governance, 25th April 2022

10 Equality Impact Assessment (EIA)

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

- No
- An EIA is not required because:
There is no change to delivery of services.
(Please explain why an EIA is not necessary)
- Yes

11 Data Protection Impact Assessment (DPIA)

11.1 Has the data protection impact of the proposals in this report been assessed?

- No
- A DPIA is not required because:
No data is being processed at this point.

12 Carbon Impact Assessment (CIA)

12.1 Has the carbon impact of the proposals in this report been assessed?

- No
- A CIA is not required because:
No new policies are being proposed at this stage.

13 List of background papers relied upon in writing this report (not including published documents or confidential or exempt information)

1. Key Findings Report, Richard Penn (March 2022)
2. CIPFA HRA Review Phase 2 Consolidated Report

14 **Published documents referred to in this report**

- 14.1 Report to Extraordinary Council 4 January 2022 on unlawful use of HRA
- 14.2 Letter(s) from Minister Badenoch to Sir Tony Redmond on HRA Issue
- 14.3 Response from Sir Tony Redmond to Minister Badenoch on HRA issue