

For General Release

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| REPORT TO: | CABINET 17 May 2021 |
| SUBJECT: | Ongoing Review of Brick by Brick Croydon Ltd and associated matters relating to the company |
| LEAD OFFICER: | Katherine Kerswell – Interim Chief Executive Chris Buss – Interim Director of Finance, Investment and Risk |
| CABINET MEMBER: | Leader of the Council – Councillor Hamida Ali |
| CORPORATE PRIORITY/POLICY CONTEXT Delivery of the Croydon Recovery plan, and to resolve the future of Brick by Brick. | |

FINANCIAL IMPACT

This report considers a number of issues arising from the February report on Brick by Brick. Although no final decision is recommended on the future of the company, there are two issues which have a financial impact on the Council. The first relates to the recommended purchase of 104 social housing units which will be met from existing provision within the HRA capital programme. The revenue cost to the HRA will be positive and there are deferred general fund costs of £450,000, relating to less temporary accommodation being required. The second relates to Fairfield Halls where the decision taken in February 2021 not to build out the College Green site adjacent to the Halls which was originally designed to cover the cost of the refurbishment scheme means that the works undertaken together with related interest costs will now be a charge to the capital programme.

The impact of the above is to reduce the net liability of Brick by Brick to the Council as at 31st March 2021 to £163,042,060 terms of loans and interest outstanding.

FORWARD PLAN KEY DECISION REFERENCE NO.: 1421CAB

The notice of the decision will specify that the decision may not be implemented until after 13.00 hours on the 6th working day following the day on which the decision was taken unless referred to the Scrutiny and Overview Committee.

The Leader of the Council has delegated to the Cabinet the power to make the decisions set out in the recommendations below

1. RECOMMENDATIONS

Cabinet is recommended to:

- 1.1 Agree that the Council recognises the costs of the Fairfield Halls refurbishment, being a total of £69.261 million (as identified in Appendix 1), as capital expenditure rather than as a Capital Loan and to:
 - i. Agree, in principle, that the existing Fairfield Halls refurbishment contracts with Brick by Brick be novated to the Council (subject to review of the

- individual contracts, to be finalised and authorised by the Interim Executive Director of Place under their delegated authority); and
- ii. Agree, in principle, that specialist consultants or contractors, required to identify any additional remedial works to the building, be appointed (in accordance with the Council's Tenders and Contracts Regulations).
- 1.2 Approve that the Council's Housing Revenue Account (HRA) can acquire 104 residential units from Brick by Brick as set out in Appendix 2 and as further detailed in the Part B restricted report.
- 1.3 Agree that the consolidated loan agreement shall, if required, be varied to include a further loan draw down amount of up to £10 million to cover additional working capital, in the event that this is required by Brick by Brick due to possible delays with forecast sales receipts (this is in addition to the £9.99m agreed by Cabinet in February 2021) and agree that authority be given to the Interim Chief Executive in consultation with the interim Director of Finance, Insurance and Risk and Section 151 officer and in consultation with the Leader and the Cabinet Member for Croydon Renewal and Cabinet Member for Resources and Financial Governance; to agree such draw down sums (not exceeding the overall additional £10m) as appropriate to address immediate operational needs.
- 1.4 To delegate authority to Interim Executive Director of Place after consultation with the interim Director of Finance, Insurance and Risk and Section 151 officer & the Interim Chief Executive for the Council to acquire further units or other assets from Brick by Brick as detailed within 3.14 of this report, any such acquisition of units to be within existing capital budget provision.
- 1.5 Otherwise note the progress made with regard to the previous February 2021 Cabinet recommendations on Brick by Brick.

2. EXECUTIVE SUMMARY

- 2.1 This purpose of this report is to receive and note the updated outcomes from the second stage of the strategic review with particular regard to the future activities of Brick by Brick reported to Cabinet in February. The report identifies that work is still being undertaken on the option of a sale whilst further soft market testing is still being undertaken on the two alternative build out schedules identified in the February report. It is intended to bring a firm recommendation to a June Cabinet meeting.
- 2.2 The options contained in this report specifically confirm the proposed arrangements for the purchase of 104 social housing units from Brick by Brick and also looks at the arrangements for accounting for the work on Fairfield Halls following the decision in February not to transfer the College Green site to Brick by Brick.
- 2.3 The Cabinet are also requested to authorise if required further working capital loans of up to £9.99million in the event that forecasted sales are delayed.

3. UPDATE ON THE REVIEW

Background

- 3.1 The Cabinet at its meeting on the 18th February received a report on the way forward on Brick by Brick and agreed a number of specific recommendations were made concerning Brick by Brick.

These were in summary to:

- a. Agree to proceed with the option set out as scenario 2 of that report, which is a build out of sites by Brick by Brick combined with a sale of sites under construction whilst still considering the option of a sale of the business, with a further report to Cabinet in April / May 2021.
- b. Agree that revised funding arrangements be entered into with Brick by Brick to reflect the current loan positions and proposals for the future, including, where relevant, moving to a 100% debt funding position (as opposed to 25% equity and 75% debt); extending relevant loans and repayment periods; allowing delays with repayments of existing loans; agreeing to further funding of no more than £9.99 million in relation to sites proposed for Brick by Brick to continue developing (and only where absolutely necessary within an appropriate repayment period)
- c. Agree for the necessary steps to be taken, in accordance with the Council's Tenders and Contracts Regulations, to appoint marketing agents to consider the disposal options for the College Green site (note, this is the site adjacent to Fairfield Halls which was due to transfer to Brick by Brick, but is currently held by the Council);
- d. Agree for the Council to review those sites Brick by Brick propose not to develop and to receive a future report to Cabinet on the potential use and future of each site;
- e. Approve that the Council's Housing Revenue Account (HRA) can acquire residential units from Brick by Brick as part of this review.

Update on Options

- 3.2 Following the Cabinet decision in February the Council has had a period of negotiating with a single bidder for the company, a best and final offer was received from the bidder on April 19th. The offer is subject to due diligence both on the business and the offer, this will involve advice from PwC and a further external report from specialist commercial consultants. In addition further work is being undertaken on the soft market testing with regards to the two build out scenarios agreed in February. It is intended that work on these options will be reported to Cabinet next month with a recommendation going forward on the future of the company.

Loan agreement

- 3.3 The February report detailed the fact that the existing Loan agreements with Brick by Brick needed to be revised to deal with the issue that the Council had never provided any equity. The loan agreements have been consolidated to cover all sites excluding any expenditure or loans relating to the Fairfield Halls refurbishment.
- 3.4 In line with the delegation agreed at the February Cabinet this loan agreement is expected to be agreed by the Interim Chief Executive after consultation with the interim Director Finance Risk and Insurance and Section 151 Officer and interim Executive Director and deputy Monitoring Officer and in consultation with the Leader, Deputy Leader and Cabinet Member for Resources and Financial Governance prior to this cabinet meeting.
- 3.5 The February report placed a limit on the amount of additional working capital that the Council could loan to Brick by Brick of £9.99 million. This limit was based on the assumption that Brick by Brick would be able to recycle sales income from both affordable and market priced house sales. This limit has been reached as anticipated in the February report. However anticipated sales of both private and affordable units have not been made in line with forecasted revenues, due in part to the deferral of the final decision on the purchase of affordable rent units discussed in this paper and as such it is possible that the company will need further funds for working capital. At present there is no mechanism for increasing this limit. Without working capital the company will not be able to function and the Company could be forced into insolvency destroying any value that may be in the Company.
In the light of this it is recommended that further working capital funds be provided. Although this is considered an unlikely scenario; in the event it does prove necessary; it is recommended that Cabinet agree that authority be given to the Interim Chief Executive in consultation with the interim Director of Finance, Insurance and Risk and Section 151 officer and in consultation with the Leader and the Cabinet Member for Croydon Renewal and Cabinet Member for Resources and Financial Governance; to agree such draw down sums (not exceeding the overall additional £10m) as appropriate to address immediate operational needs.

Brick by Brick 19/20 Accounts and Business plan 21/22

- 3.6 The 2019/20 accounts for Brick by Brick were published in late March and were reported to the April Shareholder and Investment Board. The accounts were qualified and showed a loss of £803,451 for 2019/20. The auditor's comments concerning lack of information is not surprising in the light of the work of PwC reported to Cabinet in February.
- 3.7 The business plan for 2021/22 is being prepared by the management and board of the Company and will be presented to the June Cabinet. This is a month later than anticipated in the February report and is due to the need to address in detail the alternate scenarios in more detail. The plan will include the costs of both scenario 1 and scenario 2 as set out in the February report.

Former Brick by Brick sites inc, College Green.

- 3.8 The Cabinet agreed in February not to transfer a number of sites to Brick by Brick. The largest of those sites was the College Green site which it was agreed would be marketed with a view to disposal. Marketing agents are being procured to advise on the disposal of this site with a possible recommendation to sell for September. Work on identifying the future of the smaller sites is being undertaken over the next few months with an intention to report on the future use or disposal of those sites.
- 3.9 The fact that Brick by Brick will not be able now to build out sites for which planning consents have been granted does have a knock on effect with regard to those 29 sites left with the company. Many of the planning consents were linked with regard to the overall level of affordable housing to be delivered across those sites with planning consent. Given some of those sites will not now be delivered by Brick by Brick, this means that some of the sites under construction may require further affordable housing to be delivered to fulfil the requirements of the section 106 agreements. There is a shortfall in delivery of 61 habitable rooms of affordable housing across all sites which will require either a commuted lump sum payment or conversion of sale units to affordable housing. Discussions are ongoing between the Council as the planning authority and Brick by Brick to determine the impact this will have on individual sites.

Fairfield Halls refurbishment

- 3.10 The refurbishment of Fairfield Halls was undertaken by Brick by Brick at what was intended to be at nil cost to the Council as the arrangement was structured in such a way that the costs would be covered by the development profit from the adjacent College Green site. As explained in paragraph 3.8 this arrangement is no longer taking place, which means that Brick by Brick no longer has the capacity to fund the expenditure on Fairfield Halls. Following discussions with the External Auditor and taking advice from CIPFA, it is proposed to treat all the costs incurred by Brick by Brick on the refurbishment as Council capital expenditure rather than as a loan. The existing total expenditure is £69.261million, details of this are set out in Appendix 1. The impact of this is to reduce the level of indebtedness of Brick by Brick to the Council to £163,042,060.
- 3.11 The existing contracts between Brick by Brick and contractors and consultants involved in the original refurbishment will be novated to the Council to ensure that the Council is able to enforce any warranties or guarantees under the contracts. There are however outstanding works to complete the refurbishment. In order to ascertain what is required quickly and the likely cost the Council has directly appointed Faithorn Farrell Timms (a specialist in concert venues) to undertake a survey of the property and to review the original contract documentation. It is possible that additional specialist advice or exploratory works may be required, if this is needed any proposed appointments, including any direct appointments, will be made in accordance with the Council's Tenders and Contracts Regulations. This work will then inform the basis of a contract to complete the refurbishment of the halls.

Purchase of affordable rent units

- 3.12 The expansion of the Council's stock of social housing for rent is a key objective. In the February 2021 report the Cabinet agreed that the Housing Revenue Account (HRA) could acquire residential units from Brick By Brick, subject to a review of affordability and HRA revenue implications (please refer to the analysis in Appendix 2). The Council, therefore, bid to purchase, for the housing revenue account, up to 190 units of housing from Brick by Brick. The units in some instances were also available for shared ownership. Brick by Brick has sought bids from the Council and another registered provider and the outcome is that, subject to confirmation of grant from the GLA, the Council is the preferred bidder for 104 units of accommodation. It was the intention to complete these sales by mid-April 2021. This has not been possible, pending this report and there has been a subsequent impact on Brick by Brick's working capital, hence the recommended arrangements in paragraph 3.5.
- 3.13 As part of the Report in the Public Interest, the External Auditor has expressed the view that the Council needs to consider how these units are acquired, if at all. Following the February report the External Auditor is of the view that the Cabinet, prior to making a final decision on the matter, should fully appraise themselves of the options to determine whether this purchase is the best available option to the Council. In order for the Council to determine whether to confirm the purchase of the units, an appraisal paper has been written which is contained as Appendix 2. In the light of that paper the Cabinet are recommended to agree that the Council continue to purchase the 104 units on a cash sale basis.
- 3.14 It is possible that some of the 190 units not purchased by the Council, or other units, such as in paragraph 3.9, become available to purchase as affordable rent units. If they do become available it is proposed that, subject to there being sufficient budgeted resources within the HRA capital programme and that the units pass the affordability test agreed in February, that delegated authority be given to the Interim Executive Director of Place in consultation with the Interim Director of Finance, Risk and Insurance and Section 151 Officer & the Interim Chief Executive to make offers for those units.

4. CONSULTATION

- 4.1 No formal consultation has been made on this report, other than factual accuracy checks with external third parties. Consultation on the future use of sites will need to take place in line with the Council's normal arrangements.

5. PRE-DECISION SCRUTINY

- 5.1 The Report in the Public Interest which was discussed at the Council meeting on the 19th November 2020 raised a series of concerns in regard to BBB and the Council's relationship with its external companies and entities. The Report in the Public Interest describe the report arising from that strategic review being presented to Scrutiny and Overview before being presented at Cabinet. This

report is a consequential report from the original strategic review, however the matters within it are likely to be a matter for further scrutiny.

- 5.2 With the kind support of the Chair of Scrutiny and Overview, the report has in fact been presented to Cabinet first prior to Scrutiny. The report will be referred to a future meeting of Scrutiny and Overview committee for a full review and challenge.

6 FINANCIAL AND RISK ASSESSMENT CONSIDERATIONS

- 6.1 The report already reflects a number of financial implications which are detailed within the report however this section will provide key financial risk areas and further areas of consideration as part of the ongoing development of Brick by Brick matters.
- 6.2 As paragraph 3.3 notes that the Council (as a lender) has now entered into a revised consolidated loan agreement. This loan agreement now provides the Council with further security, as previously not all loans were covered within a formal legal agreement. Furthermore, the revised loan agreement has been put together with agreed values from both the Council and Brick by Brick.
- 6.3 The key financial exposure for the Council in relation to Brick by Brick is the over £210m of loans that it has provided to the Company along with the accrued interest income. As of 2021/22 the Council has now started to provide for Minimum Revenue Provision (MRP) within its General Fund revenue account for the amount that the Council assess to be at risk of payback.
- 6.4 The February 2021 Brick by Brick Cabinet report highlighted 3 potential options to help the Council recoup its loans and ensure best possible outcome for Brick by Brick. There are 3 alternate options summarised below:
1. Option to continue development of all 29 schemes within Brick by Brick
 2. Option for build out & then disposal of incomplete developments with completion date beyond October 2021.
 3. Sale of the Company (Share Sale).
- 6.5 Work on the three options are continuing as expected and it was noted in the February 2021 report that whilst the sale option can be worked in parallel for some time, there will come a point when the Council will need to decide if it wants to continue with disposing of sites or sell the Business. This situation still exists as the Council is still evaluating the received offer and further work continues as detailed within paragraph 3.2.
- 6.6 Should the decision be made to sell Brick by Brick, the structure of the sale and the due diligence exercise will determine the financial impact on the Council. The Council will need to assess the impact it has on the loans that have been provided to Brick By Brick and how those will be paid back along with the outstanding interest.
- 6.7 However, with the added complexity from the way the planning applications that were submitted by Brick by Brick, Options 1 and 2 could become difficult for

Brick by Brick to deliver unless the situation is rectified as set out in para 3.9.

- 6.8 Furthermore, since the February 2021 Cabinet report the key issue in relation to Fairfield Halls, as explained within 3.10 and 3.11 and further detailed within Appendix 1 will have a material impact on the Council's accounts. Advice is being sought from CIPFA to ensure the accounting treatment from Fairfield Halls is done accurately. As Appendix 1 advises this will be brought back to a future Cabinet report.
- 6.9 Appendix 1 also provides a financial breakdown of the monies spent by Brick by Brick on the refurbishment of Fairfield Halls and will provide an indication of the charges that the Council will need to meet to pay Brick by Brick for the works.
- 6.10 In addition to the 3 options the disposal of College Green site by the Council and the review of remaining sites will continue as indicated within the February 2021 report, any capital receipts arising will reduce the overall loss from Brick by Brick to the Council.
- 6.11 Recommendation 1.3 is required to ensure the Council continues to provide necessary funding to support the solvency position of Brick by Brick Ltd. Further funding will be provided as a last resort solution and only to ensure the Council's position is protected. The Council will fund this working capital injections through borrowing from the Public Works Loan Board (PWLB). Whilst these will come with a cost, the Council's MTFS will be updated to reflect the impact.

Approved by: Chris Buss, Interim Director of Finance Investment and Risk.

7. LEGAL CONSIDERATIONS

- 7.1 The Interim Director of Law & Governance comments as follows.
- 7.2 Under the Council's general power pursuant to Section 1 of the Localism Act 2011, the Council may exercise its rights as sole shareholder of Brick by Brick Croydon Ltd to take the steps identified in this report. Under the Articles of the company, the matters addressed are within the scope of "reserved matters", i.e. matters for which the company needs shareholder approval and where the Council (as shareholder) may direct the company (and its directors).
- 7.3 In addition, these matters fall to the Council to decide as lender to the company, under the executed and secured loan agreements and in respect of other monies provided to the company (whether as loans or otherwise). As lender, the Council is entitled to (and should) act to protect its overall financial position and take steps to maximise the recovery of these sums. This will include the consolidation of the overall loan position (as previously authorised), by injection of further funding in support the company's ability to realise revenues to repay the loan, and by recognition of the spending on Fairfield Hall as capital expenditure (in accordance with proper accounting practice).

- 7.4 The recommendation to acquire affordable rent units into the HRA gives rise to no legal concerns on the basis that the acquisition has been fully appraised and validated in the manner described in paragraphs 3.12 to 3.14 (and in Appendix 2).
- 7.5 In relation to Fairfield Hall, the recommended course of action is a lawful means for placing the Council in the best overall position to enforce warranties and guarantees and to carry out any additional works required (in compliance with procurement law as may apply depending on the nature and value of works to be carried out).
- 7.6 As advised in February when previous decisions were made, Members will need to be mindful of the Council's financial position (including under the Section 114 notice), its fiduciary duties and the requirement to have regard to all relevant factors and to disregard irrelevant ones. The Council must act in accordance with the principles of Wednesbury reasonableness, meaning decisions that a rational person might make, having regard to all relevant considerations.
- 7.7 In taking decisions under this report, Members will need to be careful to separate what is in the interests of Brick by Brick from what is in the interests of the Council (including in its capacity under the HRA). Fundamentally, these decisions need to be made solely having regard to what is in the interests of the Council (allowing for the fact that the interests of the company are intertwined with those of the Council, as Appendix 2 highlights).
- 7.8 Equally, when making decision on the recommendations, Members should apply their minds to the overall financial considerations involved, including the degree to which the financial arrangements being recommended are somewhat circular in nature.
- 7.9 In relation to "State aid", the recommendations in this report (building as they do on the decisions previously made), external legal advice from Browne Jacobson LLP has confirmed that these further steps give rise to no breach of the new "subsidy control" regime (formerly State aid). This is on the basis that the Council is acting as a rational private-sector party would act (being sole shareholder and lender), and having taken financial advice identifying options that such a private sector party would rely on (i.e. focussed on how the Council may best recover the investment made to date alongside other relevant considerations such as the risks and timings involved).

Approved by Doutimi Aseh, the Interim Director of Law & Governance.

8. HUMAN RESOURCES IMPACT

- 8.1 There are no immediate HR impact issues in this report. If any should arise these will be managed under the Council's policies and procedures.

Approved by Jennifer Sankar, Head of HR Place, for and on behalf of Sue Moorman

9. EQUALITIES IMPACT

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

Approved by: Yvonne Okiyo, Equalities Manager

10. ENVIRONMENTAL IMPACT

- 10.1 There are no environmental impacts arising from this report

11. CRIME AND DISORDER REDUCTION IMPACT

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

12. REASONS FOR RECOMMENDATIONS/PROPOSED DECISION

- 12.1 There are three separate decisions required of the Cabinet resulting from this report with respect to two of those on Fairfield Halls and the purchase of social housing units the reasoning is set out in Appendices 1 and 2 respectively. The third decision relates to the arrangements if required for extending a working capital facility to Brick by Brick. Failure to do that could result in the Company becoming insolvent and thus placing all of the Council's loans at risk.

13. OPTIONS CONSIDERED AND REJECTED

- 13.1 The options with regard to the purchase of affordable housing are set out in Appendix 2. With regard to Fairfield Halls refurbishment, there is no real alternative to the proposed general accounting treatment and the alternative to not extending a working capital facility are as set out in the report.

14. DATA PROTECTION IMPLICATIONS

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

NO

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

NO

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| CONTACT OFFICER: | Chris Buss, Interim Director of Finance, Investment & Risk |
| APPENDICES TO THIS REPORT: | Appendix 1 – Note on Fairfield Halls accounting Appendix 2 – Note on Purchase of Social Housing |
| BACKGROUND DOCUMENTS: | None |