

Mr Jason Perry
Mayor
Croydon Council
Town Hall
Katharine St
Croydon CR0 1NX

20 February 2023

Dear Mayor Perry

HRA BUSINESS PLAN & BUDGET UPDATE REPORT JANUARY 2023

This letter contains the Improvement Board's observations on the officer report which you are considering at the 22 February Cabinet meeting.

We are grateful to officers for taking us through their proposals and responding to our questions at the 24 January board meeting and a subsequent informal discussion. Subject to the points we make below, from what we have seen, the budget preparation and business planning process has been carried out robustly and professionally. This is a vitally important aspect of the council's recovery from past mismanagement and poor practices.

In summary, the Board **supports** the recommendations in the officer report, but we make four additional recommendations, which we hope you and your Cabinet will support:

1. Future budget approval reports should contain variant projections showing the financial impact of changes to key assumptions, both to the year 1 budget and to the long-term plan.
2. The council should continue to pay careful attention to ensuring that recharges to the HRA of costs which are not directly part of the landlord service are fair and appropriate.
3. Ahead of the next annual business planning rounds, the council should adopt a framework for HRA business planning incorporating key financial ratios, so that planning is clear and consistent and risk contained.
4. Future HRA annual budgets and business plans should be discussed in draft each year with the Tenant and Leaseholder Panel.

Uncertainty and Risk

Budget approval, of course, needs to be of a single set of numbers based on best current judgement about a range of assumptions. However, even in social landlord organisations with a long track record of sound financial management, assumptions, particularly on matters outside the organisation's control, like inflation, are, of their nature, subject to considerable uncertainty. In Croydon's case, the council's failure, over many years, to maintain an accurate understanding of the condition of its stock, and therefore of investment needs, and the legacy of other kinds of mismanagement, mean that there is currently much greater uncertainty, particularly about the medium to long term.

It is important that, when approving annual budgets and long-term financial plans, decision-takers have as full an understanding as possible of the impact of variant assumptions from the central case, and therefore of the key risks to financial viability which need to be managed. **We would therefore recommend that future budget approval reports should contain variant projections showing the financial impact of changes to key assumptions, both to the year 1 budget and to the long term plan. Reports should also highlight key risks identified by the variant projections and show how they could be mitigated, if they occurred.**

While the greater focus should be on downside risk, it may also be helpful for plans to show upside variants, for example the financial impact of voids or arrears management performance improving faster than the central case.

Our observations about uncertainty and risk in the plans recommended for approval in the paper are as follows:

- In 2023-24 and the two years following, **there may be even greater increases than projected in pressures on repairs and maintenance**, driven by materials and labour costs, and by the potential unwinding of suppressed demand for repairs. Costs in the construction and buildings sector have been rising faster than general inflation. Officers have reflected this in their proposals by increasing significantly in real terms projected spending in 2023-24 compared with the current year. But subsequent years are based on a 3% assumption. In our view, there is potential for actual costs to increase rather more. In addition, if customer handling and repairs work performance improves, as we all hope it will, tenants who have been discouraged from reporting repairs may be more likely to report them if the reporting process is more straightforward and repairs work done promptly and efficiently. That would be proper and positive, but would lead to increased costs. (In the short term certainly, though there should be benefits from reduced disrepair.) However, officers' current projected levels of surplus offer, in our view, a strong cushion against these risks.
- In our view, **the longer term plans are subject to considerably more uncertainty and risk**. Paragraph 4.6 of the officer report says: "The business plan demonstrates that the HRA is financially viable." This is only true on the basis of current knowledge and assumptions, and it should be a central priority over the next twelve months to get to a much more solidly-based long term business plan. By law, the HRA cannot go into deficit. In a social housing business, it is vital to plan spending, especially on stock investment, very carefully, over 25 to 30 years. Failure to do this creates strong risks that the plan will crash because of spending demands which have not been properly projected and cannot be mitigated by any available short-term responses. At first sight, the officer report and accompanying Savills report project a reasonably comfortable medium to longer term position. However, this is subject to **two huge areas of uncertainty, current asset position and the cost of meeting net zero requirements**. As the officer paper notes, work is under way to understand properly both the current state of the stock, and therefore future necessary capital investment, and the cost of meeting government requirements on net zero. In our view, it is not unlikely that this work, when complete, will require some careful medium to long term planning to ensure the plan remains viable. On the upside, it could also be that this work opens up interesting possibilities for positive investment and regeneration which would strengthen the business plan.

Recharges to the HRA

It is entirely fair and appropriate in principle that costs outside the council's landlord service should be recharged to the HRA where they represent a fair valuation of costs properly attributable to it, both costs, such as grounds maintenance, provided by other parts of the council, and back office costs such as finance, HR and ICT. However, it is vital that the costs are estimated fairly, and that recharged activity is actually delivered to a high standard. We understand that, in preparation for the 2023-24 budget, there has been a focus on ensuring recharges are estimated fairly. **We recommend that future planning rounds should continue to pay close attention to this.**

Framework for HRA business planning

In the housing association sector, a key part of business planning is to apply benchmark ratios, for example on interest cover, lending to stock value, and interest cover. Adopted plans need to avoid breaching these

benchmarks, if possible allowing strong margins so they are resilient to downside risks. In the housing association sector, benchmarks reflect loan covenants set by bank lenders, as well as board's judgements about prudent financial constraints. The council's business planning is not subject to external lender requirements. Nevertheless, as the Savills report indicates, it would be good practice for the council to adopt a set of benchmarks as a framework for HRA business planning and debt management. **We recommend that, ahead of the next annual business planning rounds, officers develop proposals on such a framework, for approval by you.** The Board stands ready to provide independent assurance of their proposals.

Tenant and resident involvement in budget setting and business planning

The council's landlord service, far more than any other council service, is provided for paying customers. Those customers need to be involved in planning how the money they pay the council is used. **The council should consult the Tenant and Leaseholder Panel during the development of future HRA annual budgets and business plans.**

I am copying this letter to the Deputy Mayor, to colleagues on the improvement board, and to Katherine Kerswell, Jane West, Susmita Sen, Velvet Dibley and Democratic Services. It will be posted on the Board's web page.

Yours sincerely



Martin Wheatley
Chair, Independent Housing Improvement Board