

**UPDATED MANAGEMENT RESPONSE
TO THE INTERNAL AUDIT REVIEW OF
COMMERCIAL ASSETS**

JANUARY 2018

Action Plan

The purpose of this action plan is to provide a summary of the matters arising during the audit of Commercial Assets, together with the recommendations to mitigate risks, the response to the recommendations, along with the officer responsible and timescale for implementation. In order for you to identify the most significant matters arising, which affect the reliance that can be placed on the controls reviewed, the recommendations have been prioritised.

Ref.	Finding	Recommendation	Responsible Officer and Timescale	Management Response
1	<i>Risk: Strategy and Policy</i>			
1.1	<p>A Property Strategy was approved by Cabinet on 15.12.15 and this was updated in a Resources Overview and Scrutiny Committee Report in 19.3.15.</p> <p>This sets out the purpose of the portfolio of non-operational property and the objectives and general direction of the property base.</p> <p>The Council does not have an Asset Management Strategy or Asset Management Plan, therefore it is not possible to determine how the Property Strategy supports the delivery of the Council's overall objectives.</p>	<p>An Asset Management Strategy and Asset Management Plan should be devised detailing the long term approach to management of the assets, derived from, and consistent with, the Council's overall corporate objectives.</p> <p>Priority: Medium</p>	<p>Head of Property Assets</p> <p>February 2018</p> <p>(revised timescale June 2018)</p>	<p>Agreed</p> <p>Updated below.</p>

Updated management response from Head of Property Assets: The existing Property Strategy is still relevant but there is recognition that it should be updated at least every three years.

There is significant on-going activity in this area:

- Following on from December 2016 Cabinet which approved a commercial investment strategy, Hartnell Taylor Cook have been commissioned to review the non-operational (commercial) estate. Their review will also include the production of an assessment criteria for future investment but it was felt that the current estate needed to be put in order before investing further. Their report is due in a couple of weeks.
- A review of operational assets will then be carried out.
- A corporate landlord review is also being carried out on Health and safety in buildings following an internal audit review. The outcome of this will also be relevant to the Asset Management Plan. The outcome of this is planned for the end of February.

The above will help inform the asset management strategy and plan which is expected to be ready by the end of June 2018

Ref.	Finding	Recommendation	Responsible Officer and Timescale	Management Response
1	<i>Risk: Strategy and Policy</i>			
1.2	<p>A Commercial Investment Strategy has been devised which was approved at the December 2016 Cabinet Meeting.</p> <p>The Cabinet report notes that the Strategy will support the three themes set out in the 2016/17 Budget Management, 2017/18 Draft Budget and Medium Term Resourcing Plan to respond to the financial challenges reported to Cabinet in October 2016.</p> <p>It does not, however, refer to links between any other relevant strategies or policies, such as the Economic Strategy, Local Plan or Commercialisation Strategy.</p>	<p>Links between the Commercial Investment Strategy and other relevant Council strategies and plans should be identified and reviewed to ensure they do not conflict.</p> <p>Priority: High</p>	<p>Corporate Director: Resources and Growth</p> <p>February 2018 (revised timescale June 2018)</p>	<p>Agreed</p> <p>Updated below.</p>
<p>Updated management response from Head of Property Assets: Part of the work Hartnell Taylor Cook have been commissioned to do is to draft an investment strategy. This will be from the view of a commercial agent and will need to be ‘feathered in’ with existing and future Council priorities, strategies etc. Their report is due by the end of February 2018 with, as per 1.1, the asset management strategy and plan expected by the end of June 2018.</p> <p>Updated management response from Head of Finance – Deputy S151: Changes to the Prudential Code will mean that the Council's Capital Strategy going forward will not only include cash and bank investments but also commercial investment. We will be developing the reporting of this over the next 6-12 months. The Capital Strategy will link capital and commercial investment and funding to Council strategies and policies.</p>				

Ref.	Finding	Recommendation	Responsible Officer and Timescale	Management Response
1	<i>Risk: Strategy and Policy</i>			
1.3	<p>The Commercial Investment Strategy report identified specific mitigation measures with regard to the risks associated with commercial property investments. However a risk register is not in place for property assets in general.</p> <p>General risks can include a fall in capital and rental values, tenants defaulting and an increase in financing costs. All these factors could have an impact on the net return to the Council.</p> <p>The 2016/17 Business Plan for Property notes that <i>'Commercial rental income has been maintained in line with budget targets but there is an ongoing challenge to maintain rent levels due to the higher rental assets becoming obsolete and the risk of tenant failure'</i>.</p>	<p>A risk management process should be introduced to the property assets function to ensure there is informed decision making.</p> <p>This should include production and regular review of a property assets risk register, identification of mitigating actions and a review to ensure they effectively address the risks identified. Relevant risks should be escalated to the economy risk register to be reviewed at SMT meetings.</p> <p>Priority: High</p>	<p>Head of Property Assets</p> <p>February 2018</p> <p>(revised timescale June 2018)</p>	<p>Agreed – This will be linked with 1.1 above.</p> <p>Updated below.</p>
<p>Updated management response from Head of Property Assets: Again, this will drop out of the review of the non-operational estate. The Property Asset business plan for 2018/19 will include a review of risks etc.and other measures for reviewing the performance of the non operational estate</p>				

Ref.	Finding	Recommendation	Responsible Officer and Timescale	Management Response
1	Risk: Strategy and Policy			
1.4	<p>Throughout the audit, officers stated that the purpose of the Commercial Investment Strategy was purely to generate income to help deliver long-term financial resilience.</p> <p>It is understood that additional income targets have been set for commercial property assets of £0.5m per annum from 2017/18 for the next three years. Aside from this annual additional income target, the longer term ambitions for commercial assets have not been defined.</p> <p>Since the income target was set, one acquisition has been made, Delta 900, at a cost of £3.55m and which would result in an annual net increase in income of £71,536, once the borrowing costs are deducted. In the short term, while the acquisition is funded from existing balances, the annual surplus will increase to £180,141.</p> <p>The recent disposal of the Bus Depot will reduce the annual rental income by £293,000.</p> <p>There is a risk that the 2017/18 income target may not be achieved.</p> <p>It is not clear how the £0.5m income target was set, however the Head of Property Assets estimates that investment of approximately £100m would be needed in order to generate this amount of additional income, net of costs.</p>	<p>The longer term ambitions for commercial assets should be determined and documented.</p> <p>In their report published in September 2016, the NLGN¹ recommended that <i>'investment strategies must balance ambition with prudence - councils should publish a 25 year forward view of their investment strategies showing how they have managed risk and demonstrating that they have not committed local taxpayers to unacceptably high levels of risky debt. This should include modelling for a post Brexit downturn'</i>.</p> <p>The income target for property assets should be clearly calculated to ensure that it is understood and based on realistic expectations.</p> <p>Commercial asset actual income generation vs estimates should be reported monthly, taking into account the long term effect of acquisitions and disposals.</p> <p>Priority: High</p>	<p>Head of Property Assets February 2018</p> <p>(revised timescale June 2018)</p>	<p>Agreed – this will link to the MTRP which now has a 4 year income strategy.</p> <p>Updated below.</p>
<p>Updated management response from Head of Finance – Deputy S151: Budgets are monitored closely with each property asset being reviewed in detail through monthly meetings between the finance team and property teams. Any new investment purchases will be brought in to this existing monitoring process. The current Income target of £500k per annum increasing year on year has been re-profiled over the 2 years 2018/19 and 2019/20, partly to allow the Hartnell Taylor Cook report to be produced and inform realistic targets.</p>				

¹NLGN – New Local Government Network – Securing a Resilient Future: Capital Spending for Social Value (September 2016)

Ref.	Finding	Recommendation	Responsible Officer and Timescale	Management Response
2	<i>Risk: Processes</i>			
2.1	<p>It is too early to assess whether the planned approach to identifying and responding to investment opportunities is comprehensive whilst allowing officers to respond quickly. However, the details contained within the Cabinet report seem reasonable and reflect the approaches found at other local authorities.</p> <p>A number of further actions were identified in the report that need to be actioned in order to ensure appropriate governance arrangements are in place for future investment opportunities and the risks associated with commercial investments are mitigated, where possible.</p> <p>These actions are in development and need to be completed as soon as possible.</p>	<p>As is planned, the following should be devised:</p> <ul style="list-style-type: none"> • Commercial Investment Strategy Board and Terms of Reference • Property Investment Strategy • Investment and Appraisal Criteria (See Appendix C for examples found during the audit). This should include a risk assessment for each potential investment. • Target rate of return which is consistent with the assumptions made in the MTRP • A definition of what 'good' is in relation to the type of asset, location and tenant. • The level at which a cap on the percentage of income that is derived from a single organisation or tenant is set and a cap on the single asset value as a percentage of gross asset value. • The appointment of investment advisors. <p>Priority: High</p>	<p>Head of Property Assets</p> <p>December 2017 (revised timescale June 2018)</p>	<p>Agreed – the actions listed in the recommendations have commenced.</p> <p>Updated below</p>
<p>Updated management response from Head of Property Assets: This is also being covered by the work Hartnell Taylor Cook are undertaking and their updated report reflecting officer input is expected within the next two weeks with the target to agree the final report by the end of February.</p>				

Ref.	Finding	Recommendation	Responsible Officer and Timescale	Management Response
3	<i>Risk: Portfolio Management</i>			
3.1	<p>As part of the drafting of the Commercial Investment Strategy Cabinet Report in December 2016, a summary of the current asset value of each asset category was prepared along with their respective current rental income and gross yield.</p> <p>This information was not included in the final report but does provide some general performance information. Based on this information, it was concluded by the Regeneration and Projects Officer that the overall rate of return from the existing estate of investment properties was 8.8% and considered to be healthy.</p> <p>It was noted that the portfolio is quite heavily reliant on the ground rent portfolio to reduce risk exposure and that the industrial sector is under represented.</p> <p>Aside from this analysis, there is no other information collated regularly on the makeup of the portfolio.</p> <p>Consequently it is not possible to confirm that the commercial asset portfolio is being proactively managed.</p>	<p>A review of the existing commercial portfolio should be formally conducted to consider:</p> <ul style="list-style-type: none"> • The composition of the Council's portfolio • A review of types of assets and their potential • The Council's key corporate plan objectives and how they link to the property portfolio • Areas for potential change and development of the property portfolio • The risk of existing tenancies. <p>Following this review, a gap analysis of the commercial assets portfolio should be conducted in order to inform the Council's Property Investment Strategy (see AP 2.1 above).</p> <p>Consideration should be given as to whether the following Guiding Principles² are appropriate:</p> <ul style="list-style-type: none"> • To create a portfolio that minimises management costs and resources • To increase returns and create higher gross income • To ensure that the Council is not exposed to unduly high risk • To create a portfolio that is focussed on long-term sustainable performance and will have fewer assets but with good prospects for long-term growth • To dispose of assets which are underperforming, have limited potential for rental or value growth, or are likely to have disproportionately high resource implications. <p>Priority: High</p>	<p>Head of Property Assets</p> <p>February 2018 (revised timescale June 2018)</p>	<p>Agreed – this information will be used to inform the development of the Asset Management Strategy and Plan referred to in 1.1 above.</p> <p>Updated below.</p>
<p>Updated management response from Head of Property Assets: see AP 1.1 above - the Hartnell Taylor Cook should be completed by the end of February 2018. Regular portfolio reviews will be undertaken with Hartnell Taylor Cook to monitor performance and assess any adjustments required</p>				

² These Guiding Principles were taken from a 2014 report produced by Montague Evans where they were commissioned by Rushmoor Borough Council to assess the health of its property portfolio and to provide advice on the Council's approach to investment properties.

Ref.	Finding	Recommendation	Responsible Officer and Timescale	Management Response
3	<i>Risk: Portfolio Management</i>			
3.2	<p>The operating costs of the Council's commercial assets have not been calculated.</p> <p>It has also not been possible to obtain clear details of the following:</p> <ul style="list-style-type: none"> • Rent Arrears and bad debts • Voids • NNDR liability • Staffing costs • Overheads • Repairs and Maintenance • Backlog maintenance • Opportunity Costs • Legal costs <p>As a result, the financial performance of the commercial property portfolio and the returns made from investment may be being overstated.</p> <p>For example, a report was produced on 14/2/17 of all outstanding debts which have been raised under the transaction for Commercial Rent and are more than 30 days overdue. The total outstanding debt was £715,407.36 with £101,572.52 of this identified for write off (19.4% and 2.8% of annual gross rental income respectively).</p> <p>In addition, without details of these costs it is not possible to properly assess market risk and opportunities to make informed decisions about the future of the portfolio. It is also difficult to compare the performance of the portfolio against other forms of investment.</p>	<p>When calculating the financial performance of the commercial property portfolio all operating costs should be identified and accounted for.</p> <p>Once these costs have been calculated they should be compared to other local authorities to determine whether they are reasonable.</p> <p>Priority: High</p>	<p>Head of Property Assets</p> <p>December 2017</p> <p>(revised timescale July 2018)</p>	<p>Agreed – operating costs need to be understood in order to report accurately on the performance of the portfolio.</p> <p>Updated below</p>

Updated management response from Head of Property Assets: The position on arrears is monitored. In addition to rent for the commercial estate, which is around £4m, Credit Control collect a total of £6.2m a year of income related to commercial property, in addition to rents, the recovery of service charges, building insurance premiums and one-off windfall payments. Since 1/4/13, the total sum invoiced by credit control for commercial rent is £31.5m. The amount outstanding for more than 30 days is £0.5m, reflecting arrears of 1.65% of the amount invoiced. £185,000 has been written off over the period.

Other costs are identified but work is ongoing to ensure a breakdown of all costs covered in a single budget, for example lift maintenance, can be applied to each property where appropriate. Also further work with finance on coding costs to improve cost allocation to individual assets is being undertaken over the next 5 months.

Ref.	Finding	Recommendation	Responsible Officer and Timescale	Management Response
3	<i>Risk: Portfolio Management</i>			
3.3	<p>Performance of the Council's commercial assets are not benchmarked.</p> <p>Officers explained that this may not be beneficial due to differing market factors in other local authorities which would make it difficult to properly compare.</p>	<p>Benchmarking should be conducted to identify and apply best practices from industry and government to improve the performance of the property assets and services.</p> <p>The 2015-16 CIPFA Benchmarking Property Services Value for Money Exercise used the following to compare the management of investment property:</p> <ul style="list-style-type: none"> • Total Income from Investment Property • Total Cost of the Management of Tenanted Non-Residential Property – Investment Property • Total Cost to Income Ratio • Average Cost of Management Per Asset • Average Income per Asset • Average Income per m2 • Number of staff FTE engaged on the Management of Tenanted Non-Residential Property - Investment Property • Average Salary per FTE engaged on the Management of Tenanted Non-Residential Property - Investment Property <p>Priority: Medium</p>	<p>Head of Property Assets</p> <p>February 2018</p> <p>(revised timescale September 2018)</p>	<p>Agreed</p> <p>Updated below.</p>

Updated management response from Head of Property Assets: We have previously participated in the CIPFA benchmarking (2015/16) and are now planning to take part for 2018/19. Previous benchmarking has shown that the Council has a small team compared to the size of the estate which advises on all aspects of asset ownership, for example there is not a separate team for education assets. Benchmarking can only provide certain information and doesn't necessarily reflect the priorities of individual councils for example how much spend is felt appropriate to allocate for the maintenance and improvement of assets. The results of the next benchmarking exercise will be reported more widely than in the past. The benchmarking commences in May 2018 and full results will be known in February 2019

Ref.	Finding	Recommendation	Responsible Officer and Timescale	Management Response
3	<i>Risk: Portfolio Management</i>			
3.4	<p>Aside from the additional income target set for commercial assets, referred to in AP 1.4 above, there are no set performance indicators for the service.</p> <p>The 2016/17 Business Plan for Property includes the following actions to improve performance in the next two years:</p> <ul style="list-style-type: none"> • A restructure has been completed to maximise the commercial return from non-operational assets and improving the use of data to help inform decision making. • Support has been obtained to sell low yielding assets and acquire higher yielding assets to help maintain/increase income whilst accepting a higher level of risk to achieve this. <p>However, no performance indicators have been included in the Business Plan.</p> <p>Consequently, it is not possible to assess whether the actions have achieved the expected outcomes, including maximising commercial returns.</p>	<p>Performance indicators should be established for non-operational/commercial assets.</p> <p>Examples of relevant performance indications used by City of York Council include:</p> <ul style="list-style-type: none"> • Increase the rent roll by 2½% per annum net of sales. • Reduce the cost of management (now 20% in total). 15% is the first target figure. • To increase the percentage of rent collected within the quarter due (currently 98%). • To complete 20% of condition surveys for each of the next 5 year to assess repair backlogs. • To monitor capital receipts through the Asset Management Group. • To revalue 5 yearly. • To maintain full occupation – keeping the void rate less than 3% of properties. <p><i>Note – these performance indicators are used by the City of York Council and the percentages included are their targets, it is acknowledged that they may not be appropriate or applicable to Swindon but are included as an example.</i></p> <p>Regular monthly reports on the performance of the estate should be produced. These reports should provide a general update on the management of the estate and issues arising, and cover in detail all aspects of income, debt management, lettings activity and also disposals across the corporate portfolio as a whole.</p> <p>Priority: High</p>	<p>Head of Property Assets</p> <p>February 2018 (revised timescale June 2018)</p>	<p>Agreed.</p> <p>Updated below.</p>
<p>Updated management response from Head of Property Assets: As per AP 1.3 above, the Business Plan will be prepared shortly and will include agreed performance indicators focussed on what is helpful for the Swindon and not necessarily what others are doing. For example a blanket indicator to increase rent by a set % could make premises unaffordable and increase the level of voids.</p>				

Ref.	Finding	Recommendation	Responsible Officer and Timescale	Management Response
3	<i>Risk: Portfolio Management</i>			
3.5	<p>The current process for recording and reporting on property assets is reliant on disjointed software, excel spreadsheets and paper processes. Whilst these processes are known to the Property Team, they are not streamlined or efficient.</p> <p>Information requested by the Auditor, such as a list of outstanding/overdue rent reviews could not be provided.</p> <p>The service is in the process of upgrading the GIS software currently used to record property assets and lease information. It is anticipated that the upgrade will allow the service to improve data management.</p> <p>Alongside this, discussions are underway with an existing provider, CoStar³, as to how the service can use them to make more effective use of their data by providing them with online access to commercial property current availability, comparable evidence for valuations, tenants, and lease data including lease breaks and reviews.</p> <p>Timely access to property and facilities management data to support strategic asset planning, as well as performance monitoring is essential.</p>	<p>The property asset management data required to enable the service area to manage and report on the performance of the commercial asset portfolio should be identified.</p> <p>The existing data management arrangements should then be reviewed to determine whether it is capable of providing the required information in a timely and accurate manner.</p> <p>Priority: Medium</p>	<p>Head of Property Assets with advice and support from IT</p> <p>March 2018</p> <p>(revised timescale June 2018)</p>	<p>Agreed – this links to the Council's digitalisation programme.</p> <p>Updated below.</p>
<p>Updated management response from Head of Property Assets: 20,000 documents relating to the ownership of the Council's asset base have been scanned and all property data has been held electronically for over five years. Certain key information is held on a back-up paper system as the GIS was not corporately supported. However, working with IT over recent years the GIS has recently been migrated on to a new corporately supported system, QGIS, which means back up paper records are not required. We are continuing to work with IT so that property data can be available on the Internet which has been a key driver for migrating to the new QGIS system.</p>				

³ Costar are a commercial property information and analytics provider. The company's suite of online service offerings includes information about space available for lease, comparable sales information, tenant information and information about properties for sale. Its service span all commercial property types, including office, industrial, retail, land, mixed-use, hospitality and multifamily.

Ref.	Finding	Recommendation	Responsible Officer and Timescale	Management Response
3	<i>Risk: Portfolio Management</i>			
3.6	<p>A Property Information spreadsheet was supplied to the Auditor listing all property assets, their current rent, asset value along with the lease termination date and next rent review date. This showed a number of properties where the rent review date had passed and/or the termination date had passed. There was no other additional information recorded to note the reason for the elapsed dates.</p> <p>In addition, a number of properties have a 'Tenancy at Will'. This agreement can be terminated at any time by either the tenant or the Council and it exists without a contract or lease and is unspecific in duration or the exchange of payment.</p> <p>It was not possible to establish the reasons for these due to staff unavailability and lack of audit time.</p> <p>Whilst it is acknowledged that it is likely that Officers are aware of these properties and the reasons for the apparent overdue reviews, there is a risk that rental income may not be maximised.</p>	<p>Outstanding lease events should be resolved and a review of all properties subject to a 'tenancy at will' should be conducted to ensure rental income is maximised.</p> <p>Priority: Medium</p>	<p>Head of Property Assets January 2018</p> <p>(revised timescale June 2018)</p>	Agreed and completed.
<p>Updated management response from Head of Property Assets: Completed. We have drilled down a lot more rigorously on the budget that picks these areas up. Monthly meetings are held with Finance and all Property related actions are triggered to maximise income. 'Tenancy at will' allows tenants to get in properties early and start paying rent. A full tenancy can then be granted when resources allow. Leases will be allowed to deliberately continue where a termination could lead to a rent reduction. Rent reviews where there is no evidence to support a rent increase are kept open in case evidence arises that could support pursuing an uplift.</p>				