LAI0012

Written evidence submitted by Cllr Lawrence Nichols, Liberal Democrat member of Spelthorne Borough Council

Introduction

I am a Spelthorne Borough Councillor and I have tried to develop a good understanding of the commercial property assets and associated borrowing of Spelthorne Borough Council. I was elected to the Council in May 2019, and therefore was not a councillor during the period between 2016 and 2019 when Spelthorne borrowed £1bn for investment in commercial properties. Since May 2019 the Council has undertaken a number of smaller investments which they are intending to eventually redevelop as housing. I believe that the Council's processes for approving and thereafter monitoring high value transactions involving public money are inadequate.

Before retiring in 2017 I was Head of IT for UK Export Finance (UKEF) and prior to that IT Director for the invoice finance business of the Royal Bank of Scotland. In both of these roles I was involved with the risk management systems supporting complex financial products. While working for UKEF I took part in government project Gateway reviews and I was certified in Managing Successful Programmes.

Purpose of Spelthorne's investments

The reason for Spelthorne's investments in commercial property has been to generate revenue to cover for the cuts and reductions in grants from central government. At the February 2019 annual budget meeting the Council Leader said:

> "Our commercial assets continue to perform robustly, with the asset values increasing, the tenants paying their rent on time, and those assets which were fully let on acquisition remaining fully let. These assets are generating net income of £10m per annum for the Council to support the delivery of services for our residents. This is after meeting all costs including interest, (fixed for the duration of all loans), and crucially capital repayments, as well as building a significant sinking fund."

More recent acquisitions have been to support the Council's ambitions to build houses in the borough and to facilitate the regeneration of Staines town centre.

All of the Council's investments have been predicated on easy availability of low cost PWLB loans.

So long as the economic environment is stable, the Council's decision to avail itself of the low cost PWLB loans, and to invest in securely performing assets, appears to be a good one. The

Council has been making appropriate provisions into a sinking fund to cover voids, re-lets, rent-free periods etc. which should be adequate to cover most economic circumstances. The level of net income being received by the Council (£10m pa) is greater than the Council Tax yield(£8.2m).

The current coronavirus pandemic goes beyond the risk parameters considered by the Council at the point of investment and will have a major impact on the finances going forward. I do not believe that the pandemic is a direct short-term threat to the financial viability of Spelthorne.

I am very critical on the Council's processes for acquisitions and the lack of scrutiny of the commercial portfolio, but by using low-cost PWLB loans Spelthorne has been able to bolster its finances and preserve its service provision when it would otherwise not have been possible. The level of funding cuts imposed by central government has forced Councils to take radical steps to avoid financial collapse.

Spelthorne's decision making process

Formal Council agreement for commercial investments is given by approval of a Cabinet paper, which is accompanied by supporting documentation – in a classic project environment this would be considered to be a business case.

Given the level of public money involved, the information presented and the process of approval are inadequate.

I would make the following observations which relate to some or all of the investments:

1. **There is no evidence that any of the Cabinet members have any experience in property investment of this magnitude.** When the initial investment decisions were made the Council officers also were not experienced.
2. **The "business case" has been set out in very simplistic terms with minimal consideration of the risks.** The Cabinet is presented with a proposal and the expected price. Details of the property are provided, sometimes in the form of a marketing brochure, and an "independent" report supporting the proposal is generally attached. Whilst there is usually quite a detailed analysis of the local commercial property market , there is rarely any proper financial[1] or risk analysis. There is an optimism bias with information focused on supporting the deal.
3. **The approved documents do not contain any success criteria for the financial performance of the assets.** For example, at least one of the buildings was not fully let when purchased and no provision for monitoring this were described, nor was there any financial impact

[1] Reports did include a description and credit rating for existing tenants

assessment of possible scenarios. On most occasions the length of the unexpired leases has been stressed, but no indication is given of the strategy to maintain the rental income long term. The lack of criteria and targets makes any ongoing scrutiny difficult.

4. **The Cabinet papers have been kept confidential** and not released into the public domain after the deal has been completed. I have had concerns about some recent housing development purchases and asked for the papers to be released. This was refused until I submitted a Freedom of Information request and this was not successful until the Information Commissioner wrote to the Council. The Council has disclosed to the public almost no information related to the commercial investments.
5. **The process has relied heavily on external advisors.** For most of the investments the advisors have been the same and the Cabinet paper has included an agreement to set aside the Council's Contract Standing Orders in the appointment of advisors and for them to be paid success fees. Based on the procurement information released by the Council the two principle consultants have received fees of over £4m.
6. From discussions with other councillors, it is clear that **most members have very little understanding of the Council's investments** and the financial implications for the Council beyond the income being generated.
7. **There has been no attempt to reach out to members from other political groups.** In practice decisions are made by a small inner clique within the controlling group. Members are generally completely unaware of an acquisition until it reaches the point of a Cabinet decision.

From my personal experience I do not think that a bank Credit Committee would have agreed to lend the amount of money borrowed from the PWLB for any of the Council's investments, without significantly better quality information and consideration of all the relevant risks.

Spelthorne's monitoring of commercial investments

I sit on the Council's Overview and Scrutiny Committee and the Audit Committee. In the past year there has been no serious consideration by either committee of the performance of the commercial property portfolio. It should be noted that the quality of scrutiny in Spelthorne is generally very poor – this is in part a consequence of over 40 years of single party control.

I would like to make the following points:

1. **There is no standardised reporting of the commercial portfolio**. I would have expected to see on a regular basis information relating to income, costs, occupancy, voids, tenant status etc.
2. **The commercial portfolio is not separated from other Council financial reporting**. The Council has employed a number of staff to support the commercial estate, but these and other associated costs are not identifiable within the accounts. This problem is

being compounded by current expansion in the housing development activity. It is impossible to undertake any consideration of value for money within the existing arrangements.

3. **There is no risk evaluation or monitoring by members of the commercial portfolio**. The Council's corporate risk register contains a single entry to cover all aspects of the £1bn portfolio, with limited operational actions noted. Members have been reassured that officers do undertake active risk management, but there is no available evidence to demonstrate how this is being done.
4. **The external auditors (KPMG) have yet to finalise the VFM statement for 2017/18.** They had raised concerns over some aspects of property acquisition in the previous financial year. The accounts for 2018/19 have not yet been finalised.
5. **The members of Spelthorne's Audit committee have very limited experience** relevant to the management of high-value financial risks. Apart from the external auditors (now BDO), there is no independent external expertise on the Audit committee. The Audit committee has not met since early in November 2019.

I have asked questions about commercial investments and other topics in public and in private meetings with officers, something that has upset the Council Leader. I raised my concerns about the investment approval process in writing with the Cabinet and the relevant officers, including the Chief Executive, but I received no reply at all. After raising a range of issues, the controlling group appear to have adopted a policy of not responding to my emails. In Spelthorne Council there is little interest in listening to alternative points of view or for scrutiny of Council policies and decisions. In this context it is unsurprising that the Council's approach to commercial investment is both flawed and non-transparent.

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