Response from the S151 Officer

Thank you Chair

The Public Interest Report sets out KPMG's conclusions to their Value for Money opinion for 2017-18 and makes 5 recommendations which it is proposed that the Council accept, as we either have always been applying the best practice suggested, or due to the time which elapsed before KPMG published their report we are have had in place for somewhile. It is very frustrating that KPMG have taken so long to reach their conclusions.

Firstly, it is important to note that the Auditors are not saying that we have a financial black hole as is the case with a few other councils who have been in the news. The auditors acknowledge that the rent income does currently comfortably more than covering the financing costs relating to the borrowing financing the acquisition of the assets. We have never approached the Government for any emergency funding. In our response we do highlight that despite the extreme stress test of the economic impacts of COVID-19 we achieved 100% collection of investment assets rental invoiced in 2020-21 and 99.98% in 2021-22. Within the portfolio we do have some challenges with some churn of some tenants but that is why we have been building up our sinking funds reserves balances by setting aside each part of the income, to ensure we have a safety net to cover dips in income. This enables us to manage those challenges without impacting on the Revenue Budget.

By the end of 2022-23 we anticipate that we will have £36m in the sinking funds reserves. It is due to our sinking funds reserves that we have the highest ratio of revenue reserves to net revenues budget of any district or borough council in the country. The Auditors' report does not make a single reference acknowledging our sinking funds approach as a key part of our risk mitigation strategy – an approach not all councils with investment assets have in place. The Auditors equally fail to acknowledge our prudent approach to Minimum Revenue Provision under which we are paying down our debt on an annual basis, like a mortgage, again in contrast to some councils.

We do not have any issue agreeing to any of the 5 recommendations as we are already doing what the recommendations are asking.

It is very important that the Council agrees to accept this evening the recommendations, as this will in turn enable KPMG to conclude their work on the 2017-18 Statement of Accounts, they have indicated that they are aiming to issue an unqualified opinion on the Accounts by the end of December. This will then in turn enable BDO in the New Year to start the work of clearing the backlog of audits. It is important that this catchup process starts as soon as possible

Dealing with the three recommendations with financial aspect:

Recommendation 3 - The Council should ensure that it has regard to all relevant statutory guidance, including specific aspects of that guidance that apply to particular decisions or transactions, and specifically record its reasons for departing from such guidance if it decides to do so

We agree the recommendation The Council has always had regard to all relevant statutory guidance seeking relevant expert advice and will continue to do so. It will in future more clearly record reasons for departure, not that we are anticipating any departures from statutory guidance. Note moving forward the Council's Capital Programme and Capital Strategy is focused on ensuring that all capital spend is consistent with the revised terms of the Public Works Loans Board and the CIPFA Prudential and Treasury Management Codes. We run our Treasury Management and Investment strategy reports past our professional advisers to ensure that appropriately reference and comply with statutory guidance. We will seek early discussions with our auditors if we have concerns about issues of interpretation with respect to interpretation of guidance, a recent example being discussing risks around abortive capitalised costs.

Recommendation 4: The Council should develop its investment property portfolio modelling to bring these in line with the expected practice of an institutional investor. This should include robust stress testing and sensitivity analysis which incorporates scenarios that cover the highest level of risk for expenditure, revenue, tenant behaviour and external socio-economic factors. Consideration should also be given to the diversification of the portfolio and whether this should be addressed over medium to longer term.

We agree the recommendation. The Council since the commencement of the Pandemic in March 2020, has been refreshing and reviewing on a weekly basis scenario modelling on a worst case and expected case basis to assess the adequacy of its sinking funds reserves. It is notable the PIR report omits to make any reference to the Council's use of Sinking Funds reserves as its key mitigation measure against the risk of not being able to cover financing payments at any point in the future.

The Council sought to invest within the borough and close to the Borough within the Heathrow Economic Functional area which it understands well and which drives the prosperity of the Borough. This is the rationale for the geographic concentration of the portfolio. Whilst the Council is managing a small number of investment assets it has a considerable number of tenants who are operating across a wide range of economic sectors this is monitoring in the investment reports. There is therefore considerable diversification by tenant sector.

The Council is already committed to undertaking a review of its Sinking Fund Strategy covering the next 50 years bringing independent consultants to review assumptions about future income levels, rental activity and to make recommendations around levels of sinking funds contribution to reserves to ensure that we continue to have a sufficient level of reserves to cover any dips in income and to cover all financing and management costs. For the sinking fund review we are considering the option having outside experts review the methodology and make recommendations to feed into the refresh of the modelling. The modelling refresh will include stress testing.

Recommendation: The Council should develop an action plan as part of the management of its investment portfolio which addresses each of the weaknesses identified in paragraph 6.9. This should be linked to a portfolio risk register, which monitors each of the KPIs, tenant performance and risk to the debt repayment strategy for each investment property asset

Whilst we believe we undertake actions which address the risks set out in in 6.9 of the report, we will, linked to the sinking funds reserves review, undertake an action plan to identify the scope for any improvements. Relevant points to notes with respect to the issues in 6.9 are as follows:

- The investment assets portfolio is constrained geographically by a desire to be focused within our local Heathrow functional economic area (an are which the Council has a good understanding of and which drives the economic prosperity of the Borough), however the tenants by sector are relatively diversified.
- The sinking fund strategy review looking at a) short term 5 year perspectives, b) medium term 5 to 30 years and c) 30 years plus. Since 2019 the Council has diversified its overall portfolio by its regeneration acquisitions. , with regular reporting against KPIs of the overall portfolio and of individual tenants, along with maintaining five yearly business plans plus five year refreshing of the sinking fund reserves modelling. As stated above we will undertake an action plan to review the portfolio linked to the sinking fund review and look to draw out from the risk analysis in the individual business plans an overall portfolio risk register
- We already undertake regular worst case and expected case sensitivity analysis on a rolling 10 years basis
- The Assets team has increased significantly in size since 2017/18 with the addition of a number of skilled assets professionals with private sector experience of managing portfolios of office and retail assets. A testament to the skills of the team and their proactive approach to managing the portfolio and engaging with tenants are the investment asset rental collection percentages of 100% and 99.98% for the years 2020-21 and 2021-22
- The building up of sinking funds reserves balances (anticipated to be £236m at end of 22-23) is design to mitigate against repayment risk.

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