Spelthorne Borough Council FAQs

Key questions and answers on the Public Interest Report (PIR)

Q1. Who is the External Auditor and what is their role?

A1. The Local Audit and Accountability Act 2014 defines the framework within which Auditors assess whether local authorities are spending taxpayers' money and delivering their services in the most efficient and effective ways and therefore fulfilling the duty of best value which all councils must meet. The duty of best value was established under the Local Government Act 1999 and requires all councils in England to:

"secure continuous improvement in the way its functions are exercised having regard to a combination of economy, efficiency and effectiveness."

In practice this means councils must deliver a balanced budget, deliver the statutory services prescribed and secure value for money in spending decisions.

External Auditors are under a duty to issue a report in the public interest when a significant matter comes to their attention which they believe the Council should consider or the public should know about i.e., it is in the public's interest to know about this.

The Council's External Auditors for accounts up to end of 2017/18 are KPMG. For accounting periods subsequent to this the Auditors are BDO. External Auditors are appointed independently of the Council by Public Sector Auditor Appointments.

Q2. What is the Report about?

A2. The Report relates to three commercial property acquisitions by Spelthorne Borough Council in the financial year ended 31 March 2018. The three acquisitions were

1. 3 Roundwood Avenue, Stockley Park in July 2017 for £21.4 million
2. World Business Centre 4, Heathrow in September 2017 for £47.2 million
3. Hammersmith Grove in January 2018 for £160 million

All three properties were funded through loans from the Public Works Loan Board with the drawdown of the funding being in each case 2 days before completion with interest rates fixed on a long-term basis and financing paid down on an annual basis over 40/50 years. The financing costs of these acquisitions are more than covered by rental income associated with the assets.

The PIR addresses certain legal, financial and governance issues in relation to the three acquisitions, from which it then seeks to draw inferences as to the implications of the acquisitions for the Council's "overall finances" (not defined) (paragraph 1.1. of the PIR). The report makes 5 recommendations which the Council must consider and respond to within one month.

Q3. What does the Report say?

A3. The report and the Council's response have been made available for the public to see on the Council agenda papers, part of the Council website and it is proper that at this stage the

report should speak for itself. Spelthorne Borough Council will be responding in full and in public to the report at an Extraordinary Council meeting on Thursday 8 December, including the actions we will take with regard to each of the 5 recommendations made.

Q4. Do you accept the Report's findings?

A4. The report on the three properties, which has taken over four years to produce, makes 5 recommendations, which we accept and which were implemented by Spelthorne Borough Council several years ago.

Q5. What are you doing to address the criticisms?

A5. Between, 1 April 2018 and 31 March 2021, Spelthorne Borough Council took various decisions to implement new controls to reduce risk. By doing so they have complied with all the recommendations made by KPMG in their report dated October 2022.

Q6. What are the current investment assets positions?

A6. The current investment and regeneration portfolio is performing well, with 99.98% of rents collected for 2021/22. Having come through a global pandemic, which saw the worst economic downturn for over 300 years, by prudent management, the Council has continued to provide in excess of £10m per annum of funding towards the Council's frontline services, affordable housing and regeneration programmes. Through careful planning, the Council has also set aside of £34m of cash backed Sinking Fund Reserves, which has ensured that there are sufficient funds to meet unexpected conditions, such as the impact of the war in Ukraine, resulting in dips in rental income when there are lease breaks or non-renewal of individual leases.

Q7. What does this mean for Council Tax payers?

A7. The Council is not risking council taxpayers' cash to buy commercial properties; the low-cost government funding for this strategy comes from the financial markets. As A6 highlights above, sinking fund balances have been built up to cover any dips in income.

The vast majority of Council Tax goes to Surrey County Council, Spelthorne residents pay less than 10% of their bill towards Spelthorne Council services. Business Rates are set nationally by Government and we have no discretion on what we charge.

The residents of the Borough have benefitted from the £10m per annum plus funding received from the Investment portfolio, as the Council has been able to fully support and deliver frontline services and affordable housing for our key workers and residents in the Borough. There has been no adverse impact on Council Tax rates or our residents in any of the financial years since 31 March 2018.

The Council has also been very focused on identifying and managing risk. It has only acquired high quality assets after extensive due diligence both on the assets and the tenants. The Council's assets team proactively engaged with tenants during the COVID-19 pandemic to ensure tenants continued to pay rent. The Council has modelled the future risk of there being dips in rental income when existing leases have break clauses exercised or end when space becomes vacant and then rent-free incentives need to be offered. The Council is

setting aside sufficient funds in its sinking funds reserves to ensure that it can cover such dips in income without any impact on the Council's budget or council services.

Q8. What does this mean for the rest of the Council's investments?

A8. There is no impact on the remainder of the Council's investments, as the recommendations made by the KPMG report have already been reviewed and implemented, a few years before they published their report.

Q9. What happens next?

A9. The Council will meet on 8 December to discuss the report and will formally respond to the Public Inspection Report from KPMG.

Q10. Why does the Council have commercial investments?

A10 The Council took a long-term strategic view to acquire key investment and regeneration properties in order to offset the ending of general government grant support and to generate long term sustainable income to support and fund Council services, affordable housing, and regenerations programmes.

Q11. How can the Council invest in properties? I thought councils were short of cash.

A11. The Council did make a number of investment asset acquisitions up to autumn 2018 as part of a Capital Strategy to generate sufficient long-term income to offset the impact of the removal of Government grants. Since then, the Council have focused on in-Borough housing and regeneration and the Council is not now making acquisitions for income generating purposes.

Councils are short of cash as government funding has been removed in recent years. The Council started its investment policy to make up this shortfall and avoid cutting services and to help it build affordable housing across the Borough which meets the needs of residents.

We took advantage of low-cost government finance in order to buy high quality investment assets which generate an income stream. The income generated is more than the financing costs and we are using this surplus to maintain Council services and build affordable and keyworker housing which meets the needs of residents.

Q12. Why did the Council invest in areas outside Spelthorne? Shouldn't we be putting money into our own area?

A12. The Council is no longer acquiring investment assets - whether inside or outside the Borough. Historically, there were very limited opportunities to purchase assets in Spelthorne which meet our "best-in-class" criteria. Where we have invested in the past beyond our boundaries, we have only done so in the Heathrow Economic Area to purchase those best-in-class assets which would provide a profit. The furthest distance any investment has been from the Borough is 33 miles.

The Council is putting money into its own area. We have a range of projects that have delivered housing across the Borough (in 2021 - one 25 affordable rent scheme, one 55 unit mixed affordable, keyworker and private rental scheme, a single person homeless hostel and

a 20-unit family emergency accommodation scheme) and regenerating Staines-upon-Thames town centre and Ashford.

Q13. Doesn't the government have guidelines in place to stop councils doing this?

A13. The government has guidance that councils are not allowed to borrow to directly fund services. Indirectly, we can borrow money which when invested yields a surplus which goes into protecting services and building houses. The Council always abided by this and sought appropriate high quality legal advice to ensure that we stayed within the law.

At the time of the initial investment Councils were able to invest in projects to generate yield to support services. In 2019, Spelthorne Borough Council made a policy decision not to take out any further investments that were purely for yield. Shortly thereafter, the government prevented Councils from undertaking borrowing to fund services. At all times, Spelthorne Borough Council complied with prevailing legislation and guidelines at the time of each investment. This has been confirmed by the expert legal advice obtained by the Council and in the Public Interest Report.

Q14. Why does the Council have £1bn of debt if its annual budget is around £22m?

A14. The Council has this amount of debt because it has purchased assets of equivalent value. We will be steadily paying off that debt over the loan periods. The assets generate an income stream which goes into the annual budget. The net income stream (after allowing for things like interest payments, setting aside contributions to build up the sinking funds reserves and management costs) is approximately £10m per annum. If we did not have this income, we would be forced to cut a large proportion of the Council's discretionary services and increase charges to make up the difference.

Q15. Can the Council afford the repayments?

A15. Yes. Each acquisition is affordable. We make allowance for things like interest repayments, loan repayments, management costs and sinking funds for longer-term refurbishments before we take any surplus into the Council spending plans. We are very prudent in our approach.

Q16. What will happen if the property market crashes?

A16. If the values of the properties decrease (property market crash), then the Council will still have a number of tenants in situ who will be paying rent (for example BP paying rent until 2036). We aim to have tenants signed up on leases for around 10 years. We are investing on a long-term basis, and we fully expect to hold these assets through a number of economic cycles. We have made allowances for costs such as refurbishment and void periods when there are no tenants, and we are building up sinking funds to ensure the money is there to cover any unforeseen issues, such as the cost-of-living crisis when we need it. We currently have £34m set aside and by April 2023 this will rise to £36m.

Q17. The assets value on the Council's balance sheet has reduced by £50m in 2020-21, is this a threat to the council taxpayer?

A17. No. The Council is looking to hold the assets for the long term and short-term fluctuations in asset value do not impact on the Revenue Budget bottom line. As a result of the worst economic recession for more than 300 years assets, values across the county were

reduced and the Council's independent valuers reduced the value of the investment assets by 5.4%. However, what is important is the assets have continued to provide the same level of income as before (and in case of BP site the annual rental is rising from September 2021.) We anticipate the values will recover over time.

Q18. What's a 'sinking fund' and how big is it?

A18. A sinking fund is a sum of money set aside to cover for foreseeable future costs and unforeseen events. For example:

- when tenants move out and we have a void period before the next tenant moves in
- when we need to refurbish a building

Q19. Councils shouldn't be playing the property market. Do you know what you are doing?

A19. Local authorities have a long track record of investing in property to regenerate their areas and provide housing and income. Other local authorities have assets far in excess of Spelthorne.

Although this is a relatively new strategy for Spelthorne, we have recruited expert staff into the Council from the private sector and we also use top City firms of surveyors and solicitors to advise us.

Q20. How much money is the Council making? Where is it going?

A20. The Council is receiving around £57m gross a year in rental income. After deductions, we can spend around £10m of this on services for residents and new homes for residents.

The remainder of the money goes into paying interest, paying off loans, making provision for the management costs of the buildings and contributing to our sinking fund for the future.

Q21. How much have we spent, and how much are those assets now worth?

A21. Since 2016, we have invested £914m in commercial assets. We will have the assets valued on an annual basis. We have no current plans to sell any of the assets, but this revaluation is for good estate management purposes.

All these figures are publicly available in our accounts. In addition, we have also published details of our assets in our residents' magazine, the Bulletin, and in an annual commercial assets report. We will continue to inform residents of these details because we want to encourage questions and transparency.

Q22. Are Councillors qualified to manage commercial property investments? Shouldn't this be left to the professionals?

A22. Councillors represent the voice of the resident and are there to challenge the advice and recommendations of officers and experts. They bring a common-sense approach to the scrutiny of our investment strategy.

Councillors need the advice of experts and professionals to help them decide what to do for the best. This takes place at regular fortnightly meetings between officers and key

councillors. If they are not happy with the advice, they can challenge and stop the investments proceeding.

Any decisions on whether to proceed with an acquisition need to go to the Development Sub Committee and then the Corporate Policy and Resources Committee. The broad base of councillors on these committees' means there is a range of expertise which can be brought to bear from their professional financial, business and property perspectives.

Q23. Does SBC have an acquisition strategy?

A23. Yes. When the Council made acquisitions in the past, it had a set of investment parameters. These investment parameters were agreed by councillors in consultation with residents. These investment parameters were agreed in December 2017 (Cabinet agenda, item 7). (**Cabinet agenda, item 7**). Since 2018-19 the Council has ceased to acquire any further assets for income generation with its activity now focused on housing and regeneration.

The Council's Capital Strategy which is refreshed annually and published each February provides more detail about our approach.

Q24. Are you planning more acquisitions?

A24. We have not made investment asset acquisitions since autumn 2018.

The current strategy is to focus towards maximising the rent from our current investment portfolio to support our revenue budget and regeneration and housing programme, as well as increase our capital reserves.

Should a suitable property become available that supports our regeneration and housing programme, we will carefully consider all our options before acquiring it. This decision would have to be made by Council.

Q25. What impact do rising interest rates have?

A25. All the loans we take out are on a fixed rate basis (an average of 2.31% across the portfolio) i.e. the rates we pay will not change over the duration of the loan. This allows us to model cash flow with some certainty and consider different scenarios over the life of the assets. This means that the investment asset acquisitions we made in the period up to 2018 are on fixed low rates of interest which are not impacted by the recent rises in current interest.

If interest rates rise in the future, it may have an impact on whether we can afford to borrow on the same basis to progress our affordable housing delivery and regeneration programme across the Borough. In response to rising interest rates and increased construction inflation, the Council is exploring alternative ways of funding its Capital Programme from sources other than borrowing.

Q26. How many properties has the Council purchased?

A26. View our **full list of investment acquisitions**