

<b>Item No.</b> 9.	<b>Classification:</b> Open	<b>Date:</b> 20 September 2016	<b>Meeting Name:</b> Cabinet
<b>Report title:</b>		Scrutiny Review of Southwark's Non-residential Property	
<b>Ward(s) or groups affected:</b>		All	
<b>Cabinet Member:</b>		Councillor Fiona Colley, Finance, Modernisation and Performance	

## **FOREWORD – COUNCILLOR FIONA COLLEY, CABINET MEMBER FOR FINANCE, MODERNISATION AND PERFORMANCE**

I'd like to thank overview and scrutiny committee for the work they undertook reviewing the management of the council's non-residential property portfolio. It was an unusual review in that as the review progressed it became clear that in order to deliver a robust review of the management processes and the assurance members were seeking that the committee would need additional resource and expertise.

I was glad to be able to agree with the chair of OSC that auditors RSM would be appointed to conduct an independent review to investigate the questions OSC had raised. The overall results of the review were very positive and provided a high level of assurance of the management processes and adherence to council policy. That said there were of course areas where processes could be improved and this report sets out the work that is underway to address these, including a further in depth audit and the forthcoming Asset Management Plan which will come to cabinet in November.

The committee also received recommendations from Community Southwark regarding VCS property and these are being taken forward as part of the development of the new voluntary sector strategy.

## **RECOMMENDATIONS**

1. That cabinet note the actions that are being taken to address the key recommendations made by overview and scrutiny committee in their report to cabinet on 7 June 2016, regarding the review of the council's non-residential property.
2. That cabinet note the actions recommended below follow positive steps by overview and scrutiny committee, cabinet members, officers and internal audit towards a refreshed approach to the management of the commercial property estate. Full proposals will be reported in detail to cabinet in November, where approval will be sought to a new asset management plan dealing specifically with non-residential property.

## **BACKGROUND INFORMATION**

3. At its meeting of 7 June 2016 cabinet was asked by overview and scrutiny committee (OSC) to note and report back on recommendations arising from

OSC's review of the management of the council's non-residential property portfolio.

4. The portfolio consists of properties let out on commercial terms by the council to generate rental income, including shops, business units, and miscellaneous other assets. It includes premises occupied by the voluntary and community sector.
5. In formulating its recommendations to cabinet, overview and scrutiny committee drew upon a review of the estate by internal auditors RSM reported in January 2016 and a separate report from Community Action Southwark (now Community Southwark) in relation to the voluntary and community sector.
6. Overview and scrutiny committee recommended:
  - a) That a new policy should be introduced which makes available to the public information about the non-residential properties Southwark is renting and leasing out. The register should include the name of the tenant, the annual rent, the amount of any up front premium paid, the date the agreement was signed and the date the agreement is due for renewal. This should be phased in over two years;
  - b) That officers should be instructed to introduce a robust documentation management system for all documents relating to the non-residential portfolio
  - c) That officers should be instructed to introduce a robust system for monitoring lease renewal dates and the repair and maintenance of properties
  - d) That the director of regeneration be asked to carry out a review which should include checking that appropriate process controls are in place throughout the property portfolio
  - e) To ensure that the Asset Management Plan includes a framework which allows flexibility for officers to negotiate rents. This should include clarity about deviation from market rents and ensure that checks are put in place where such decisions are made.
7. The OSC report drew attention to three recommendations made by Community Southwark (CS), that:
  - a) It would be useful if CS could be provided with a comprehensive picture of the VCS estate in Southwark. This should include what organisations are utilising which buildings and for what purpose;
  - b) CS would like to see full VCS involvement in the development of any new council VCS premises strategy;
  - c) The council should produce a clear, easy to read, downloadable document for their website that outlines policies on rate relief. Lease terms, availability of rent subsidy, rent free periods and asset transfer and processes required to nominate community assets under the Localism Act.

## KEY ISSUES FOR CONSIDERATION

### Releasing lease data and information about rents

8. The commercial estate consists of a wide range of property types, locations, states of repair and tenants/uses. As a result the terms on which different assets are let also tend to be quite diverse and leases and rents charged are often not readily comparable.
9. Terms are individually negotiated for each by professional surveyors having regard to a range of considerations (see below) and transactional evidence from the property market. In the vast majority of cases, negotiations are concluded locally between the parties. This may involve the tenants employing professional representation. Where the parties cannot agree, leases contain third party dispute resolution clauses (expert witness or arbitrator).
10. Almost inevitably tenants in the same parade, for example, may find themselves occupying similar premises on different terms. In each case the detail of the contracts reflect a specific deal negotiated between the parties at the point it was struck, having regard to market and a variety of other factors at that time. Nevertheless, the process today is a transparent one. Properties are let on market terms including rents, without hidden concessions to distort that market basis, determined by reference to transactional evidence. Lease terms are agreed according to best practice and the Landlord & Tenant law prevailing at the time the lease is entered into.
11. The main, but by no means exclusive, variables considered in determining the rent (or licence fee) are:

Factor	Variables
Economic	<ul style="list-style-type: none"><li>• Transaction date</li><li>• Prevailing market conditions</li><li>• Other occupation costs</li></ul>
Property	<ul style="list-style-type: none"><li>• Location</li><li>• Size</li><li>• Quality / condition of accommodation and facilities</li><li>• Asset strategy considerations</li></ul>
Legal	<ul style="list-style-type: none"><li>• Type of tenure (lease, licence, etc.)</li><li>• Security of tenure</li><li>• Length of lease (or licence)</li><li>• User clause</li><li>• Other lease terms and restrictions</li><li>• Headlease obligations (where the property is leased by the council)</li><li>• Repair, maintenance and compliance obligations.</li></ul>

12. For example, in some cases the relatively basic nature of the properties being let means that, without any subsidy or concession the rent settled on the asset will

be low because this is all the property will support in the market. Elsewhere, particularly around regeneration schemes, temporary “caretaking” occupations by the VCS may help to keep premises secured or otherwise reduce holding costs, and these tangible benefits are reflected in rents charged.

13. As a result, making realistic comparisons between one tenancy and another requires careful analysis of all the facts and circumstances of the letting.
14. The data is potentially commercially sensitive with potential to create downwards pressures on rents and additional costs in regeneration schemes. In addition some of the data refers to private individuals who are commercial tenants rather than firms, and its release may conflict with the requirements of the data Protection Act.
15. Therefore data about rent and lease terms is not released on a general basis other than where the council is required to do so by law, or where it may wish to do so on a confidential basis to partner organisations. Where appropriate we share data with partner agencies on a confidential basis where this will help to provide strategic perspective on the estate or aspects of it, such as in the review of the voluntary and community sector currently taking place.
16. The council complies with central governments “Open Data” policy requirements by already publishing data about premises including commercial properties, excluding lease terms.

#### **Document management and estate management systems**

17. In their January 2016 report internal auditors RSM recommended that a document management system should be used more robustly to ensure all key documents and key decisions are saved in one place. Also that key documents and correspondence needs to be retained and kept in the document filing system. In addition the Manhattan estate management system should be updated as soon as a lease or a transaction in respect of it is completed, and accurately reflect the lease document and any subsequent variations.
18. All recent key documents for the commercial estate are held centrally, with detailed information recorded in the council’s non residential estate management system “Manhattan”. All new agreements are recorded and stored accordingly.
19. In each case where issues were identified by the auditors these related to historic agreements, some of which were 20 years older or more, and in some cases not originally granted by the council, where documentation was incomplete. Any anomalies identified are investigated and regularised as they arise.
20. Officers will continue to refine robust systems in operation for document management and to maintain key tenancy data, including trigger dates for lease renewal, rent review, other rent transactions and buildings maintenance. Process checks to ensure the reliability of the data are outlined below.

#### **Ensuring appropriate process controls**

21. In their January 2016 report internal auditors RSM recommended that:

- a) a documented, clear and transparent audit trail should be maintained if a decision has been taken to deviate from the council's policy to charge market rent;
  - b) circumstances and criteria under which a tenancy can be granted on a Tenancy at Will Basis is documented. All tenancies at will need to be proactively monitored to ensure that they meet the criteria and are replaced with full lease agreements where circumstances have changed.
22. The auditors returned this summer to undertake a further review of the management of the portfolio this summer. Concluding an amber / green level of assurance, they found that whilst controls employed in the management of the portfolio are suitably designed and consistently applied across many areas, action is nevertheless needed to strengthen the control framework to manage identified risks (income maximisation, fraud avoidance).
23. In response property will:

- a) Ensure that the rationale for all new lettings and terms agreed is clear and fully documented. Over the past year Property has updated its systems for approving valuations for new lettings and other tenancy transactions, moving from a paper driven process to an end to end online one. The valuation, which fully explains the rationale for the rent set is approved by the case officer, his or her line manager and the head of property.

In practice the auditors concerns were in relation to older agreements and more complex arrangements where rents appeared to be lower than expected, but on analysis of the full circumstances of the transaction could be demonstrated to represent the best rent obtainable at the time the transaction took place. This included long leases at a nominal rent where the council had received a premium at the commencement of the lease in consideration of the rent to be foregone.

- b) Introduce process checks to confirm that new rent and lease terms have been entered onto the property management system database accurately. As mentioned above, all approvals and records are maintained electronically. Since the auditors visit a routine has been built to compare the respective data and generate an exception report for review by the head of property where a variance is found.

We use the same approach to ensure that there is sufficient safeguarding in data entry and processing to ensure that unauthorised changes cannot be made. Here also and discrepancy between approved data and that held in the Manhattan system will generate an exception. The systems themselves contain a full audit trail to a key stroke level for investigation purposes.

- c) Produce a written procedure in respect of setting, approving and monitoring rent, to be incorporated in the forthcoming commercial property Asset Management Plan.
- d) Formally document the circumstances and criteria by which a tenancy at will is granted, also to be incorporated in the AMP.

Tenancies at will confer minimal rights on tenants whilst allowing the landlord considerable flexibility. Typically they are used to bring premises into use quickly, pending the grant of a full lease, or to maximise options to recover possession of the premises should circumstances warrant it. They can be terminated with immediate notice.

All such tenancies are recorded in the Manhattan estate management system and monitored to ensure they continue to meet the criteria underlying their grant. Currently the portfolio contains 34 tenancies at will. 17 of these are continuing, where the rationale for their grant continues to apply. 12 are being replaced by full lease, subject to negotiation and completion of legal formalities. The remaining 5 remain under review.

- e) Ensure that disaster recovery and backup arrangements are put in place and documented and are sufficiently robust across Property's business critical systems.

### **Responding on Community Southwark's recommendations**

- 24. The OSC report drew attention to a report on premises from Community Southwark. A wider review of Voluntary and Community Sector Strategy is underway and we will fully respond to Community Southwark's recommendations as part of this process.
- 25. A full review of the council's engagement with the Voluntary and Community Sector is underway and will be reported to Cabinet shortly. The report will discuss means of facilitating supply of appropriate premises to the VCS, looking at how the sector can use premises more effectively and improving information about the availability of premises.
- 26. Officers will share with Community Southwark information about council premise occupied by the VCS, and the basis on which they occupy, to help establish a clearer picture of how organisations can best be supported to manage financially and to utilise and share premises, and to explore how current provision compares to new and emerging demand.

### **Policy implications**

- 27. The Council's overarching plan for the prudent stewardship of its property assets, geared to the achievement key corporate outcomes is the Corporate Asset Management Plan. Last approved in 2010, an update is planned for 2016/17 to ensure the core objectives of the Council Plan are fully reflected. The AMP aligns with the Medium Term Resource Strategy. Rents etc – consistent with the AMP and income maximization
- 28. It provides that the council will manage its tenanted premises to maximize revenue income with regard to new lettings, rent review, lease renewal and minimizing arrears of rent. The recommendations made in this report are consistent with these objectives
- 29. A full Asset Management Plan for the commercial estate shall be reported to Cabinet in November 2016, with full coverage of the estate and its management, to include rent policy and steps to be undertaken in relation to the VCS estate

## **Community impact statement**

30. This report provides a response to overview and scrutiny committee's review of Southwark's non-residential property. In formulating the recommendations of this report the potential impact on the community has been taken into account, including people identified as having protected characteristics. No specific equality implications have been identified in relation to this report.

## **Financial implications**

31. All of the recommendations arising from this report will be contained within existing departmental revenue budgets.
32. The combined projected income from the estate for the current financial year is £11.65 million. This is used to support the delivery of the council's priorities, primarily to the benefit of the HRA.
33. Disclosure of rents charged may create downwards pressures on this income and give rise to additional management costs. In turn this may detract resource from other aspects of managing the portfolio including tackling debt.

## **Consultation**

34. Consultation has not been undertaken in connection with this report and is not proposed.

## **SUPPLEMENTARY ADVICE FROM OTHER OFFICERS**

### **Director of Law and Democracy**

35. The report refers to the council's non-residential property portfolio and considers the possibility of publishing more detailed information about leases and rents as suggested by the Overview and Scrutiny Committee.
36. It should be appreciated that some detail concerning leases is already required to be published. The Land Registration Act 2002 together with the Land Registration Rules 2003 provides that leases for more than seven years for a valuable consideration are registrable and accordingly in such circumstances the lease document is available to the public. This obligation is upon the Lessee so that they can ensure their lease is properly protected.
37. However, beyond this, there is no legal requirement on a Landlord to disclose the terms of what is essentially a private contract between two parties. The recent Local Government Transparency Code 2015 requires Local Authorities to publish certain information which includes overall detail of land assets but the Code does not extend to recommending publishing individual lease terms.
38. The report states that to disclose further detail which is normally considered to be commercially sensitive could create downwards pressure on rents and there is also a concern in relation to data protection. However, in making their decision, it is confirmed that Members are not constrained by any further requirement for transparency.

## Strategic Director of Finance and Governance (FC16/012)

39. The report is requesting cabinet to approve the recommendations following the work undertaken in response to the Overview and Scrutiny Committee's meeting of 7 June 2016 on the management of the council's non residential property portfolio as reflected in paragraph 1 (a-e). Full details and background are provided in the main body of the report.
40. The report indicates that disclosure of the rents details is potentially commercially sensitive which could create a downward pressure on rent. The strategic director of finance and governance notes that this could have a detrimental effect on the council's income and incur additional budget pressure on staff resources and therefore not recommended.
41. The strategic director of finance and governance notes that all other recommendations as reflected in the report will be contained within existing departmental revenue budgets.
42. Staffing and any other costs connected with this report to be contained within existing departmental revenue budgets.

## BACKGROUND DOCUMENTS

Background Papers	Held At	Contact
Scrutiny report, Cabinet 7 June 2016 (item 8)	160 Tooley Street, London SE1 2QH	Matthew Jackson 020 7525 1332
<b>Link:</b> <a href="http://moderngov.southwark.gov.uk/ieListDocuments.aspx?CId=302&amp;MId=5147&amp;Ver=4">http://moderngov.southwark.gov.uk/ieListDocuments.aspx?CId=302&amp;MId=5147&amp;Ver=4</a>		

## APPENDICES

No.	Title
None	

## AUDIT TRAIL

<b>Cabinet Member</b>	Councillor Fiona Colley, Finance, Modernisation and Performance	
<b>Lead Officer</b>	Eleanor Kelly, Chief Executive	
<b>Report Author</b>	Matthew Jackson, Head of Property	
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<b>CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER</b>		
<b>Officer Title</b>	<b>Comments Sought</b>	<b>Comments Included</b>
Director of Law and Democracy	Yes	Yes
Strategic Director of Finance and Governance	Yes	Yes
<b>Cabinet Member</b>	Yes	Yes
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