The Chartered Institute of
Public Finance & Accountancy

Runnymede Borough Council

Review of debt/investment risk profile

July 2023

A Report by:

The Chartered Institute of Public Finance and Accountancy

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. CIPFA shows the way in public finance globally, standing up for sound public financial management and good governance around the world as the leading commentator on managing and accounting for public money.

Further information about CIPFA can be obtained at www.cipfa.org

Any questions arising from this submission should be directed to:

John O'Halloran

CIPFA
77 Mansell Street
London
E1 8AN

Tel: +44 (0)20 7543 5600
Email: john.o'halloran@cipfa.org

Fieldwork for this review was undertaken in March 2023, and all of the information gathered, and the data analysed by CIPFA was correct at the time of writing this report. The data provided in this report has been reproduced with the permission of the council and is derived from various council reports.

Contents

1 Executive summary

This report for the Department for Levelling Up, Housing and Communities (DLUHC), examines Runnymede Borough Council's (RBC) indebtedness. We have looked at the overall position, the associated challenges, and the council's capacity to manage them. The background, DLUHC's requirement and our approach are set out in section 1. Our work has identified that RBC has a strong grasp of the challenges it faces, has already taken action to mitigate risk and has further proposals to strengthen its approach. However, there are several areas where arrangements could be improved.

In section 2, we consider the level of borrowing and investment risk in detail. RBC is highly indebted relative to other councils, but it secures reasonable returns on its investments. It has a realistic capital programme. It has determined not to take on major new borrowings in the immediate term and has decided not to make further investments for yield. This is a sensible and prudent approach and shows that the council is responding to the changes in guidance, current market risks and the cost of borrowing.

Having already disposed of assets previously held for regeneration which no longer reflect RBC strategic priorities, it is considering further disposals. Minimum Revenue Provision (MRP) is being reviewed to provide further prudent cover for outstanding debt. Investment losses and other financial challenges are mitigated through a sinking fund, and RBC is embarking on a savings plan to reduce its reliance on investment income and reserves to balance the budget. It will be important for these plans to be finalised soon. They must prove sufficiently comprehensive and deliverable across the short to medium term. The council would also benefit from an improved focus on risk. Overall, however, RBC's approach is sensible and mature.

The council has enjoyed continuity at Chief Executive level and in key member roles. This has helped it develop a consistent strategy underpinning its commercial and regeneration ambitions. In section 3, we consider capacity and capability, focusing on the assets and finance teams particularly, whilst noting the capabilities and needs in programme management. RBC's committee system seems to work. The council requires increased capacity in areas such as asset management, where it has new and ambitious plans. It may also benefit from structural changes to accord commercial and regeneration activity a greater focus. Such steps could support decision-making and aid the delivery of the 5-year strategy and savings plans.

In section 4 we recommend 5 risk mitigations for the council to consider. They address issues of risk appetite, Medium Term Financial Plan (MTFP) detail, sinking fund policy, capacity and capability, and the decision-making profile of commercial and regeneration activities. Typically, they reinforce or extend efforts currently being made, in effect working 'with the grain' of what RBC is already doing.

2 Introduction

2.1 Background

Since May 2022, DLUHC has been working with and monitoring several local councils with high levels of indebtedness relative to their revenue budgets, reserves or Council Tax base. Runnymede Borough Council (RBC) is one such.

Working with partners, CIPFA is leading a programme of DLUHC-commissioned reviews to examine the financial management and sustainability of selected authorities. As part of this programme, in early 2023 the Department asked CIPFA to review the debt conditions and management arrangements in RBC.

2.2 Requirement

Following an initial 2-day ‘triage’ assessment of each of the affected authorities, conducted in January/February, CIPFA and the Department concluded that each council required a substantial review. A further 29-day investigation was allocated to each council, with work to be undertaken in February and March 2023, and initial draft investigations and findings to be presented to the Department, subject to any unavoidable constraints, by the end of the week beginning 20 March 2023.

Advising the authorities of work commencement, DLUHC summarised the work as follows:

Objectives

First, to assess the level of risk that the council is exposed to due to its current debt and investment profile and future capital plans. In assessing this, the review should consider both the inherent risk and the council’s arrangements to manage risk. The review must consider the forward position of the council and the level of risk to financial stability due to sensitivity to changes in future assumptions.

Secondly, to include as part of the considerations of the review whether it is appropriate and necessary for the councils to take actions to reduce its risk (for example, by reducing debt), and the options by which the council may do this and the viability of such options. The report should provide recommendations that can reasonably inform the government’s and council’s consideration of further actions.

The focus of the review is intended to be on the financial risks arising due to the council’s investment and debt profile; we expect the review to consider other elements of the council’s finances so far as they are relevant.

Review areas

The review will cover, but is not limited to, the following main areas in pursuit of the above objectives:

1. An assessment of the council’s financial risk due to its profile of investments and debt (current and planned). Investments includes both financial and non-financial investments (property) that generate commercial income. This is not limited to investments purely or primarily for profit. The review is expected to take a risk-based approach and identify and

focus on those investments which present the highest potential financial risk (by value, complexity or sensitivity).

2. An assessment of the council's capacity, capability and arrangements for managing its investment and debt risks, and whether these are sufficient and appropriate for the council's activity. Review Area 1 sets out a review of the council's inherent risk exposure, the intent of Review Area 2 is to assess the council's arrangements to manage and mitigate its risk position.
3. An assessment of actions the council can reasonably take to reduce its debt and commercial exposure, or other actions it can take, with respect to reducing its overall level of risk over the short, medium and long-term. The government has set out that any actions to reduce capital risk should seek to avoid unintended consequences or risks to value for money. The review should consider options and consider their viability.

During the course of their work, the reviewers may request information, data and interviews they deem appropriate to meet the objectives and cover the review areas. The Department for Levelling Up, Housing and Communities appreciates the co-operation of the council with this review.

2.3 Methodology

To address DLUHC's 3 questions, the broad approach was as follows:

Desktop analysis

DLUHC provided an extensive library of documentation. This in turn had largely been supplied to them by the affected councils. We reviewed the material and made supplementary document requests to the council and also examined other relevant materials for purposes of comparison. We would like to record our gratitude to RBC officers for their ready compliance with our requests for reports and data.

Specialised inputs

Some comparative data analyses were conducted on issues such as commercial property, revenue spend, and indebtedness. They feature throughout this report.

Interviews

The bulk of the fieldwork comprised interviews. These provided the invaluable 'triangulation' of our analysis. Council officers, members, auditors and other experts were invited to give views and respond to queries provoked by documentary evidence. We would like to thank everyone involved for their courtesy and constructiveness.

Report drafting, feedback and fact-checking

The above inputs were then analysed and subjected to our professional and expert judgement. The result is this report.

The reports belong to DLUHC and are thus submitted 'sight unseen' from the viewpoint of the affected Councils. Nevertheless, we have kept them abreast of our work. Specifically, we have made them aware of what to expect from our conclusions, in particular those set out in Section 4 of this report, to minimise 'surprises'.

We have also endeavoured to fact-check figures and their implications with the affected authorities or where possible use agreed and public domain materials. However, the data and associated analysis are inevitably somewhat volatile. Nevertheless, the review team is confident that only the most fundamental shifts to the figures cited here would have any material bearing on our recommendations.

3 Current and future financial risk profile

3.1 Background summary

Runnymede Borough Council has £653 million borrowing (as at 31 March 2022). At 71 times core spending power, this is the third highest borrowing relative to size of all UK authorities after Woking and Spelthorne. It has predominantly used this borrowing to invest in property, in and out of the borough. The council has ceased acquiring yield investments following changes to the Public Works Loan Board (PWLB) terms. RBC characterises much of its investment as regeneration, though clearly there is a commercial element and income is required to cover debt servicing costs at least.

The Council applied for £4 million in Exceptional Financial Support for 2020/21 due to a fall in commercial income. Following analysis and consideration of the council's financial position, the application was declined due to the Council's adequate reserves position and uncertainty about the financial pressures. Since then, income has recovered, and RBC's internal auditor considers the investment portfolio profitable.

Evidence provided for the review indicates that RBC's investment strategy is indeed currently revenue positive. The latest reported position shows that investment properties yielded £23.9 million in 2021/22. However, it is important to consider more detailed financial information to get an accurate picture of the current and future position.

3.2 Analysis of risk profile

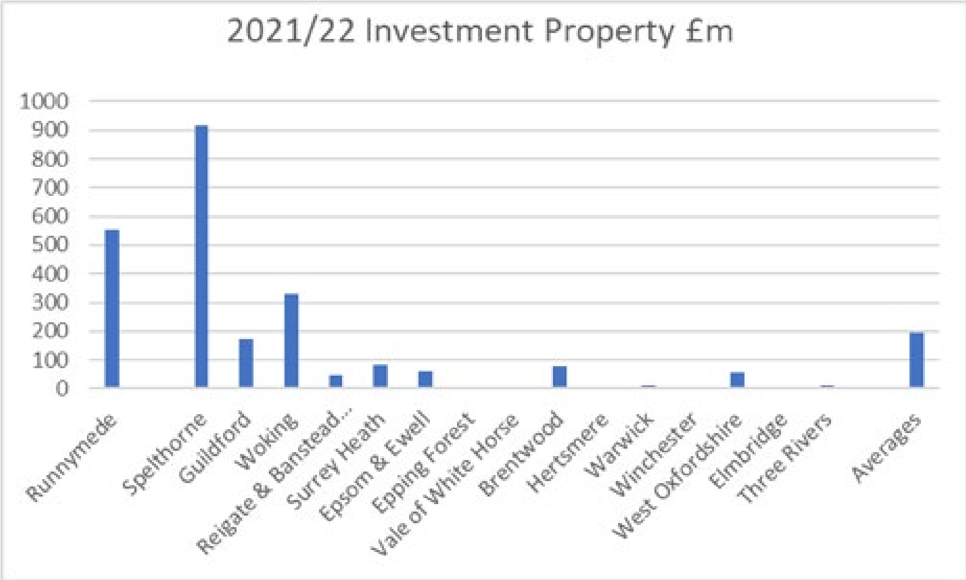
RBC investments and its level of indebtedness

Investments and returns

The council has been reporting on investment properties since the introduction of the International Financial Reporting Standard (IFRS) in 2009. The commercial strategy to purchase specifically for investment started in 2014/15. In that time, it has developed a portfolio of retail, residential, industrial and office premises with a combined historic cost of £524 million. The latest fair value assessment of the portfolio, at 31 March 2022, gives a value of £546 million. RBC's investment property holdings are high compared to its Nearest Neighbours[1] group (figure 2.1).

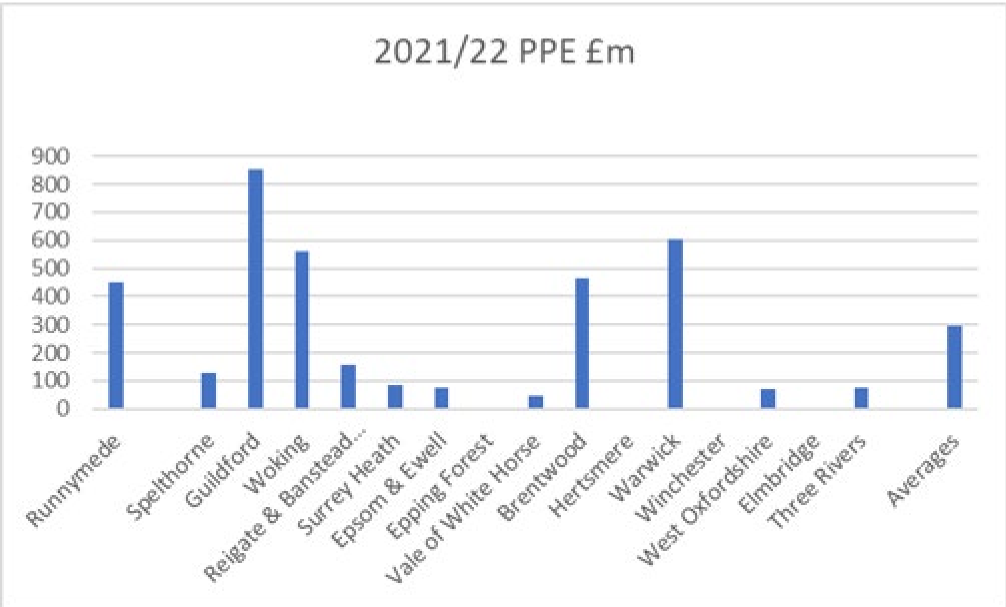
[1] CIPFA uses a "Nearest Neighbour" statistical analysis to provide councils with comparators against other councils with similar traits. The tool uses 40 metrics based on a wide range of socio-economic indicators to illustrate the differences between Nearest Neighbour councils. The variables employed are descriptive of characteristics of the area each council administers and not the way in which resource of services are taken into account.

Figure 2.1: Nearest Neighbour comparison – Investment Property 2021/22



However, its Property, Plant and Equipment (PPE) holdings are in line with its Nearest Neighbours (see figure 2.2 below).

Figure 2.2: Nearest Neighbour comparison – Property, Plant and Equipment 2021/22



RBC makes net returns on their investment properties at around 5% (£23.9 million in 2021/22) with similar returns expected in 2022/23. However, refinancing of loans and a challenging market could affect these returns. The return is still below average when compared to other Nearest Neighbour group councils, accepting of course that most other councils' investment activity is not on the same scale (figure 2.3 below).

Figure 2.3: Nearest Neighbour comparison – Investment Property returns (%) 2021/22

Commercial income represents a substantial revenue source for RBC. At £23.9 million in 2021/22, it provides 42% of the council's overall funding and is used to support both core and discretionary services, the latter including CCTV provision, careline schemes and community meals. This exposes RBC to significant financial risks should anticipated income fail. A 2.5% income reduction would be equivalent to the cost of providing centres for older people, a 0.7% reduction would equal expenditure on community meals.

Table 2.1 shows income projections for the investment properties over the next three years.

Table 2.1: Income projections for investment properties over the next three years

	Gross and net income by financial year:					
All figures in £000	2023/24 (forecast) £		2024/25 (forecast) £		2025/26 (forecast) £	
Name	**Gross**	**Net**	**Gross**	**Net**	**Gross**	**Net**
Lyne Farm (Land & Buildings)	£21,500	£21,500	£21,500	£21,500	£21,500	£21,500
131-137 Station Rd, Addlestone	£64,850	£64,850	£80,250	£80,250	£80,250	£80,250
55 Guildford Street, Chertsey	£0	£0	£14,000	£14,000	£14,000	£14,000
153-155 Station Rd, Addlestone (& 1-5 Manton Terrace)	£55,900	£55,900	£61,900	£61,900	£61,900	£61,900
7 High Street, Egham (Charta Place) 9-12 High Street, Egham (Charta Place)	£177,323	£177,323	£214,427	£214,427	£214,427	£214,427
Sainsbury Centre, Chertsey	£330,000	£330,000	£330,000	£330,000	£330,000	£330,000
13-15 Ashwood Road	£14,000	£14,000	£14,000	£14,000	£14,000	£14,000
Surrey Towers Telecom Licences	£45,052	£45,052	£45,052	£45,052	£45,052	£45,052
Housing Garages (Various)	£702,400	£702,400	£702,400	£702,400	£702,400	£702,400
92 Station Road, Addlestone	£42,000	£42,000	£42,000	£42,000	£42,000	£42,000
Osprey House, Addlestone	£11,900	£11,900	£11,900	£11,900	£11,900	£11,900
1-39 Egham Precinct (Arndale Shopping Centre)	£606,658	£606,658	£265,105	£265,105	£16,000	£16,000
Tudor Court, High Street, Egham	£178,000	£178,000	£178,000	£178,000	£178,000	£178,000
Compass House, Chertsey	£1,481,917	£1,481,917	£1,481,917	£1,481,917	£1,481,917	£1,481,917
Egham Precinct Car Park/Travelodge/Waitrose	£1,233,953	£1,233,953	£1,235,750	£1,235,750	£1,235,750	£1,235,750
Hitachi House, Staines	£552,352	£552,352	£552,352	£552,352	£552,352	£552,352
610 Chiswick High Road	£3,659,237	£3,659,237	£3,659,237	£3,659,237	£3,659,237	£3,659,237
Unither House, Chertsey	£692,498	£692,498	£692,498	£692,498	£692,498	£692,498
Addlestone One Development	£1,500,000	£750,000	£1,694,000	£1,694,000	£1,694,000	£1,694,000
Egham Business Park	£1,568,268	£1,568,268	£1,568,268	£1,568,268	£1,568,268	£1,568,268
World of Duty Free Warehouse, Windsor Road, Egham	£950,000	£950,000	£950,000	£950,000	£950,000	£950,000
VW Financial Services HQ, Milton Keynes	£2,706,912	£2,706,912	£2,706,912	£2,706,912	£2,706,912	£2,706,912
Pine Trees Business Park Egham	£3,867,423	£3,867,423	£4,168,323	£4,168,323	£4,542,750	£4,542,750
Axis One, Langley	£1,166,000	£1,166,000	£1,166,000	£1,166,000	£1,166,000	£1,166,000
Scandinavia House (Volvo HQ), Maidenhead	£685,000	£685,000	£685,000	£685,000	£685,000	£685,000
New Globe House, Maidenhead	£981,037	£981,037	£980,541	£980,541	£980,541	£980,541
Royal Mail Distribution Centre, Thorpe Industrial Estate	£300,000	£300,000	£300,000	£300,000	£300,000	£300,000
Chertsey Business Park	£957,747	£957,747	£957,747	£957,747	£957,747	£957,747
Honeywell House	£1,870,401	£1,870,401	£1,870,401	£1,870,401	£1,870,401	£1,870,401
Parish Hall Student Accommodation/Corn Merchant House	£980,000	£980,000	£1,147,500	£1,147,500	£1,147,500	£1,147,500
Magna Square Development	£493,000	£419,050	£512,000	£435,200	£515,000	£437,750
General Expenditure - not allocated out to specific properties	£0	-£100,000	£0	-£100,000	£0	-£100,000
	£27,895,328	£26,971,378	£28,308,980	£28,132,180	£28,437,302	£28,260,052

It is inherently difficult to forecast too far ahead given the number of variables affecting rent and income collection. However, the data suggests that RBC will face challenges in sustaining the revenue (and hence service) contribution it derives from property. The council does not allocate commercial income to specific services, treating it rather as a ‘below the line’ adjustment, which effectively reduces net service costs. Inability to sustain income from property will have an impact on the council, which is why they have established a sinking fund. We do not know the potential impact of this, and we have recommended that a more detailed analysis is undertaken to understand the risk This is only one part of the modelling, which would also include savings plans, use of reserves, borrowing strategy, all of which we have recommended should be considered by RBC in an updated MTFS. The council does undertake monitoring of income collection, which is a useful starting point and will support the analysis.

While forecasts are initially positive with an anticipated 4% increase in net return between 2023/24 and 2024/25, there is only a 0.4% uplift predicted for 2024/25 to 2025/26 based on the updated DLUHC return. The latest medium-term financial forecast (MTFF) records this projected growth over the next 5 years, including this year, 2022/23. It assumes additional income of £642,000 in 2022/23, £848,000 in 2023/24, £1.1 million in 2024/25 and £1.375 million in 2025/26. These projections already factor in some adverse factors, assuming void levels and bad debts of 5%, consistent with current trends, and a reduction in rent collection levels of between 0.5% and 1% compared to previous years. Arrears as at September 2022 were running at 4.49%. Vacancy rates were below 4%.

Reports on these matters to councillors and officers vary in detail. Papers to the Company Board (see section 3) only provide summary positions. Further detail is reported through to the Corporate Leadership Team and Corporate Management Committee as appropriate. These structures are effective. Overall, however, investment portfolio reporting could be improved and given more up-to-date detail. The proposed indicators in the Asset Management Plan and the recent investment in asset-management software should help.

Better reporting would also improve risk management, given the historic interdependency of property income and the deliverability of services, discretionary ones in particular.

Table 2.2 shows the top 10 sources of investment income and their overall share. They include ‘blue chip’[2] companies. Several however are out of area, where there is competition to accommodate them from other councils and providers. Some have rent reviews in the coming years. Success in negotiating and maintaining rent levels will be vital to protecting services.

[2] ‘Blue chip’ companies are those that are considered to be a good investment due to previous good performance.

Table 2.2: Top 10 sources of investment income/ as a percentage of gross income

Location	Top 10 income	Sum of Estimate 2022/23 £
In area	BUPA Insurance Services Ltd	2,250,365
In area	Compass House Group Plc	1,481,917
In area	Hitachi Capital (UK) Plc	1,080,440
Out of area	Honeywell Control Systems Ltd	1,870,401
Out of area	Nordic Entertainment Group UK Ltd (2228654)	3,659,237
Out of area	SDL Limited	980,541
Out of area	Travelport International Ltd	1,165,952
Out of area	VW Headquarters	2,706,912
In area	Waitrose Limited	860,875
In area	World Duty Free Centre	950,000
	Grand Total	**17,006,640**
	Gross Income	28,451,882
	Income (after bad debts and voids)	25,902,462
	Top 10 tenants % of Gross income	60%
	Top 10 tenants % of Income (after bad debts and voids)	66%

Of the 181 leases associated with the properties, 47% end within 10 years and 53% within 15 years. Negotiations will need to start early to ensure that lease commitments are managed and secured to give greater certainty on income. We have received reassurances from the Head of Property that discussions are progressing well.

Valuations

While the Fair Value basis of valuation is reasonable for investment assets, over time the council should consider different bases for valuation as it further develops its asset management plans. This could become more appropriate in the long term as RBC may face challenges in:

- re-letting its largest buildings if the current lease terms are not extended
- maintaining buildings at the highest standard to uphold current rental levels
- competition as alternative non-council office sites emerge

RBC might also want to consider getting alternative valuations and we note that the Council is currently retendering its valuation services.

Repairs risk

In the medium to long term there are also risks related to upkeep of the stock.

Under the terms of their lease, tenants pay a service charge, covering the cost of general repairs and maintenance. They are also required to make good any alterations to their building at the end of their tenancy. Nevertheless, further risks remain, including those relating to:

- **Reconfiguration of buildings**. When a tenancy ends it may be necessary to reconfigure a building to make it attractive to a new tenant or even to sub-divide it to attract multiple tenants. RBC would need to meet these costs.

- **Top quality office accommodation**. The council's investment portfolio includes quality office space, which in turn justifies high rents. Considerable investment in the buildings will be needed over time to ensure they continue to meet the grade, especially as definitions of high-spec office accommodation change.

- **Mechanical and electrical installations**. During long periods of commercial ownership, mechanical and electrical works may need to be replaced. It is unlikely that all of this will be covered by a service charge for tenants, typically occupying the building for as little as 5 to 10 years.

The above risks, likely to materialise in the medium to longer term, are of course hard to quantify. However, a full stock condition, suitability and sufficiency survey, supported by periodic reviews, can assist in making judgements about necessary provisions. The MTFS will determine whether the sinking fund will be sufficient to meet costs relating to building reconfiguration, required investment in office accommodation, and mechanical and electrical installations outlined above. Benchmarking and further contributions to the fund (as set out in this report) show close monitoring by the council.

Borrowing, the debt maturity profile and Minimum Revenue Provision (MRP)

The council's borrowing has grown in recent years (Figure 2.4). Debt as a proportion of total service expenditure rose over the last three years from 44.56% in 2019/20 to 56.57% in 2021/22 (Figure 2.5). However, RBC has now decided not to make any further commercial investments, to limit further borrowing and to make some asset disposals. This is a sensible approach to financial planning given RBC's indebtedness, as well as increasing interest rates and market volatility.

Figure 2.4: Nearest Neighbour comparison – PPE v Investment Property v LT Borrowing

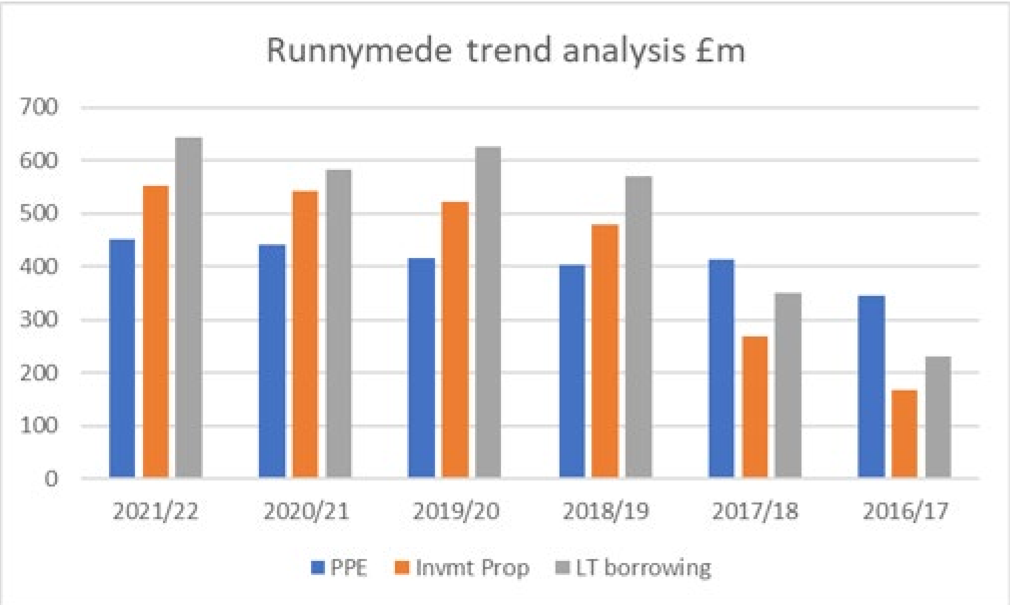
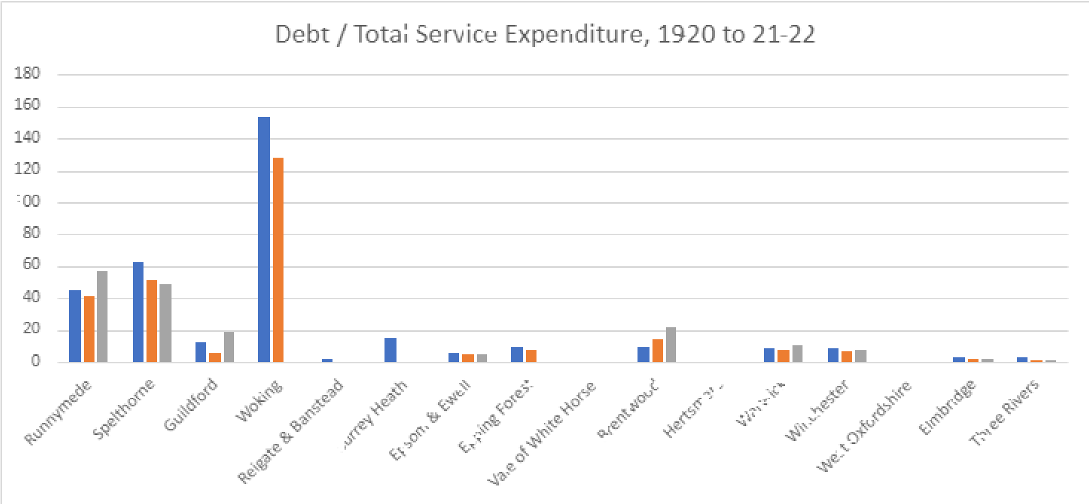


Figure 2.5: Debt as a proportion of total service expenditure compared to family group (2019/20 to 2021/22)



The council's borrowing nevertheless remains significant. Short and long-term loans total £654 million as at 31 March 2022, with £100 million earmarked for allocation to the Housing Revenue Account (HRA), £460 million for investment projects, £93.8 million to regeneration, with the balance in Trust Funds. RBC repaid £10.5 million in 2022/23. It was due to take out a further £12 million loan, but has not done so, consistent with its decision to restrict future borrowing and investment.

The debt presents immediate challenges. Loans are maturing. MRP (the money the council must set aside to meet the costs of debt-financed capital) remains high. Figure 2.6 shows when debt matures and is due for repayment. There is evidence of particular pressure over the next few years. All but £40 million of loans are fixed-term PWLB arrangements repayable on maturity. Figure 2.7 shows the continuing increase in MRP payments the council must make. This will have a direct effect on the revenue budget. The increased MRP payments, which reflect the change in the size of the programme since the MRP policy was agreed, will need to be reflected in the MTFS. We cannot comment further on this until the impact of the MRP, savings plans etc. on the MTFS is known.

Figure 2.6: Runnymede Borrowing Maturity Profile (2021/22-2070/71)

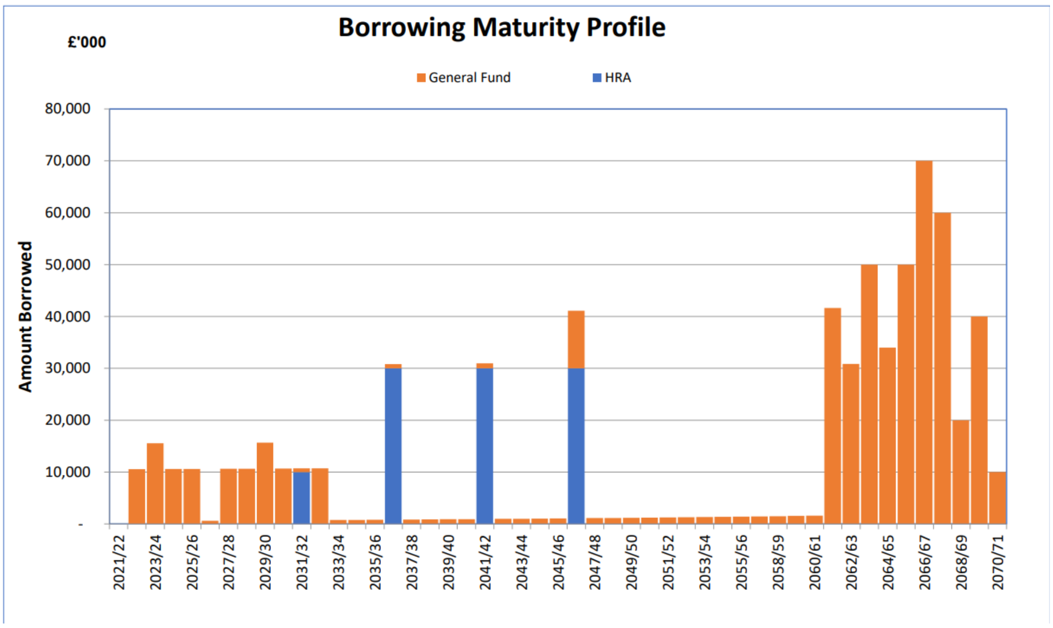
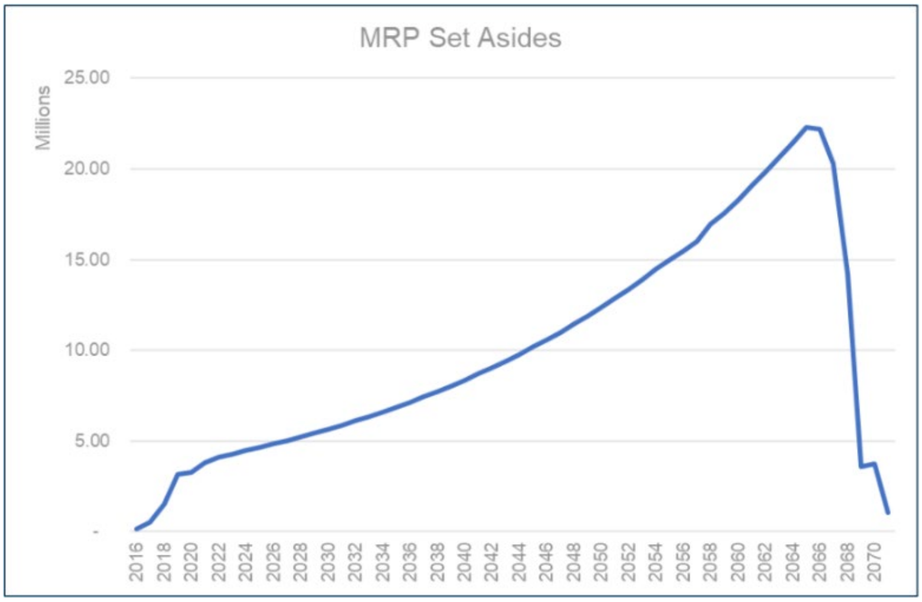


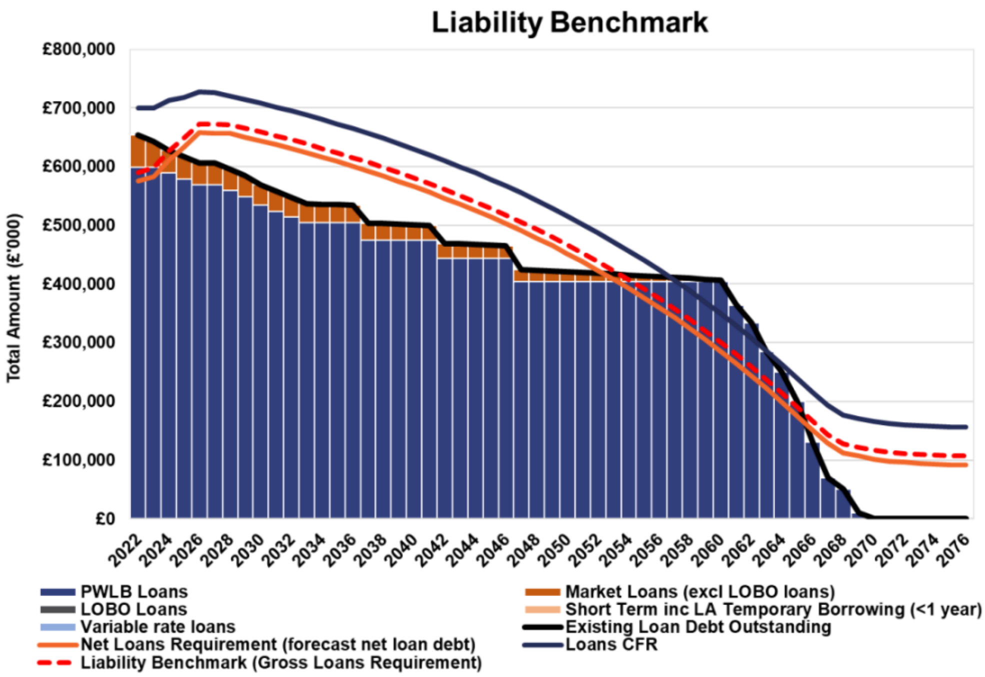
Figure 2.7: Increasing MRP set asides



The council is considering various measures to manage its position including debt rescheduling, potential early loan repayments to take advantage of current PWLB discounts, or switching loans to the HRA. It will need to develop these plans further to ensure they are effective mechanisms for decreasing the financial burden. RBC would be well advised to consider other additional alternatives and contingencies, including potential divestment of assets, especially where the net implications are positive for revenue.

RBC's position against the liability benchmark introduced as part of the 2021 Treasury Management Code reveals the extent of its future borrowing requirement. In Figure 2.8, the black line denotes the existing loans outstanding with the red dotted line indicating gross liability. The red line still significantly exceeds the black line, showing the extent of the future borrowing requirement, even after that requirement was limited in the latest capital programme.

Figure 2.8: Liability benchmark 2022-2076



The current MRP policy dates back to December 2014. It says that:

“The council will use the asset life method as its main method for calculating MRP. In normal circumstances, MRP will be set aside from the date of acquisition. However, in relation to capital expenditure on property purchases and/or development, we will start setting aside an MRP provision from the date that the asset becomes operational and/or revenue income is generated.”

The council applies the annuity method, which increases the provision by 4% each year. This is based on the assumption that increases in income from rent reviews will make up the difference. This practice needs updating. It is important for the council to plan for its assumed 40-year asset lifecycles and 50-year borrowing projections. Moreover, the existing MRP policy was introduced when RBC only intended to borrow £200 million to £300 million. The Council accepts the need for a review. It may then have to meet the challenge of making extra MRP provision.

Companies and loans

The property portfolio houses a variety of tenants, from residential to commercial occupiers, along with voluntary, sporting, leisure, charity, and faith groups, as well as key service providers. The management of the Private Rental Sector element is through the SPV (special purpose vehicle) company known as RBC Investments Ltd. It has £26.3 million of loans from RBC and £2.8 million of working capital. In addition, there are two other companies, RBC Services (Addlestone) Ltd, and RBC Heat Company Ltd. RBC Services manages the multi-let mixed use properties and/or office or industrial units. It makes no profit, being purely a holding company for service charge accounts. RBC Heat manages energy plants at Magna Square and ADD1. All three companies have separate governance arrangements from RBC’s (see section 3). Further investment in RBC Investments is currently on hold and the council has no plans for any future borrowing through the company. The other two companies’ futures are under review. A new business plan for the companies is being formulated for the period 2023 to 2028.

Risk mitigations

Reserves

The council has built up its unallocated reserves in recent years to mitigate revenue risks: 1.99% of total service spend in 2019/20 rising to 2.28% in 2021/22 (Figure 2.7). It also confirmed its commitment to increase its minimum reserve level to £5 million from £3 million in the 2023/24 budget report. This also includes additional provision in 2023/24 for lost income of £857,000, 3% of the budgeted investment income. This is sensible since the reserve figure is still low compared to the Nearest Neighbours group (see comparators in figure 2.10). It is important that RBC aligns its reserves policy to its risk register and any identified future cost pressures.

Figure 2.9: Total unallocated reserves as a percentage of total service expenditure (2019/20 – 2021/22)

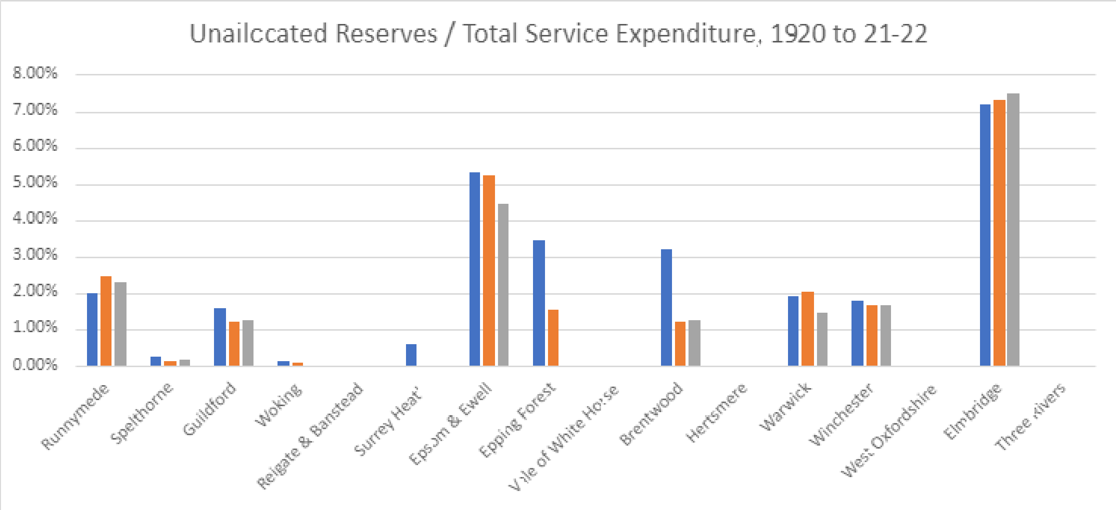
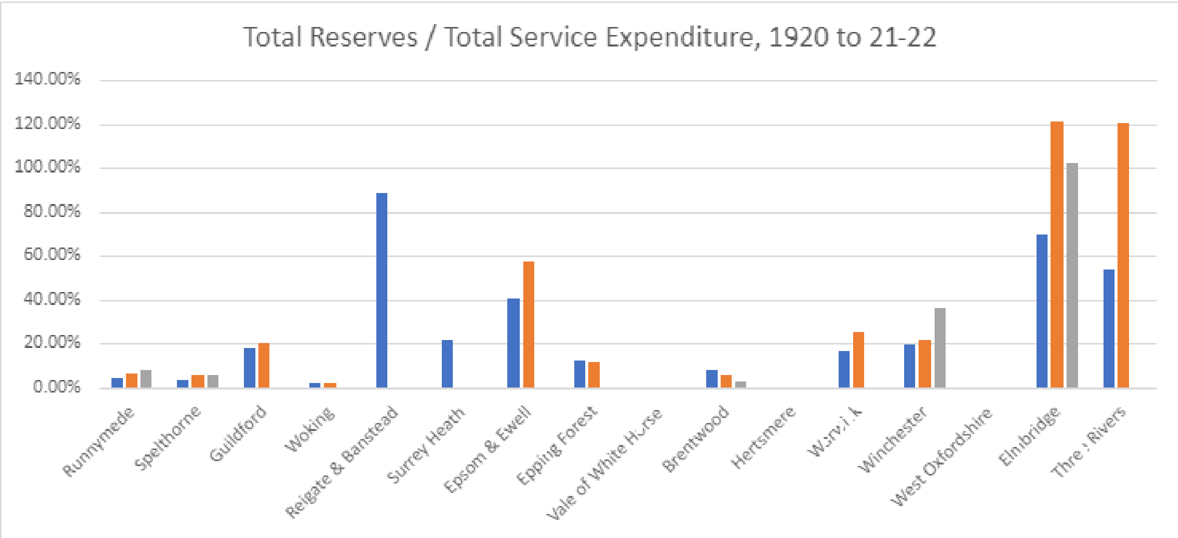


Figure 2.10: Total reserves as a percentage of total service expenditure (2019/20 – 2021/22)



Sinking fund

Additionally, however, the council has two sinking funds or earmarked reserves in respect of its property portfolio. These total £10.695m as at 31 March 2023. This provides further shock-absorption against revenue pressures. It is earmarked to cover property repairs, renewals and lost rental income. The council adds to this fund when it can. Amounting to £3 million in 2018/19 by the end of 2021/22 the fund had reached £5.7 million, some 30% of total investment property income. The Council is currently allocating £750,000 per annum to each fund (£1.5m in total). RBC nevertheless recognises the need to do more to develop the sinking fund approach and policy.

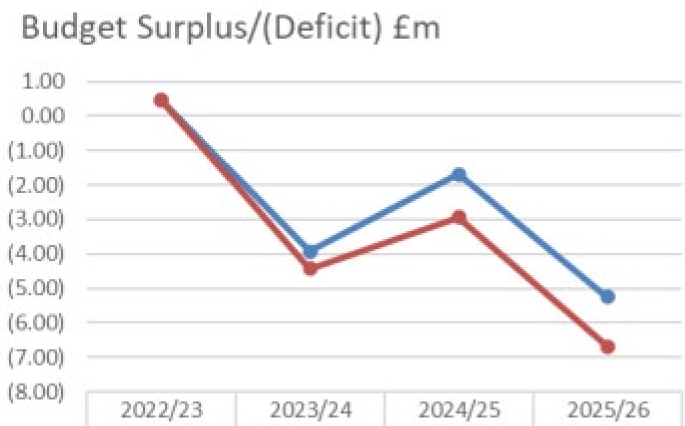
The council is currently awaiting the outcome of work on the stock condition, suitability and sufficiency of its assets. This review will be critical to determining what appropriate sinking fund provision should be. In calculating what proportion of rental revenue is retained in the fund, RBC must take full account of the repair risks identified earlier and their impacts over the long-term. As we have seen, costs may go well beyond mere day-to-day upkeep and entail mechanical/electrical works, buildings/estate reconfiguration, or updating the estate to meet rising quality thresholds. The budget for repairs and maintenance in the revenue budget for

2023/24 has already been increased. The stock condition review work should give a clearer picture of the needs here. It may lead to a requirement to increase immediate repair budgets and sinking fund contributions.

Savings plans and Medium Term Financial Forecast (MTFF)

The council is facing significant budget challenges. In 2022/23 it is having to draw down £2.225 million from the Business Rates Equalisation Reserve. The Council previously reported the need to use £1.888 million of working balances but is now expecting a £479,000 contribution to balances for the current year. However, underlying pressures remain. The MTFF projects a deficit of £3.9 million in 2023/24 due to higher than expected pay awards, falls in commercial income and service budget growth. The position recovers somewhat in 2024/25 with the forecast deficit down to £1.7 million as growth items are partially offset by recovery in commercial and business rate income. However, the gap widens again in 2025/26 to between £3.5 million and £5.2 million as the New Homes Bonus reduces and additional borrowing costs are included. These figures are net of any future spending growth, which is shown in Figure 2.9.

Figure 2.11 Projected budget surplus/(Deficit) 2022/23 to 2025/26



	2022/23	2023/24	2024/25	2025/26
Current Forecast	0.48	(3.93)	(1.70)	(5.24)
Forescast plus future growth	0.48	(4.43)	(2.95)	(6.69)

However, we have observed in the course of our investigations that the council has a substantial body of discretionary services. It has also started to develop savings plans. These factors may give some latitude in meeting the revenue budget challenges.

3.3 Conclusions

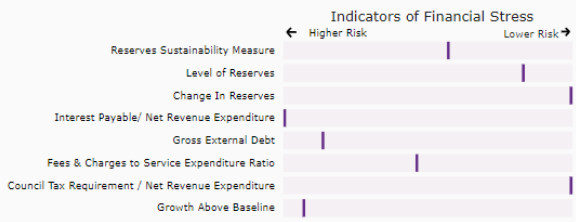
The council is highly indebted relative to other local authorities. However, it does secure a reasonable return on its investments, has a realistic capital programme given its circumstances, and is reducing its borrowing needs. It is managing investment losses and other financial challenges through an increasing sinking fund. It is developing a savings plan to reduce overreliance on investment income and reserves to balance the budget going forward. Plainly the plan will need to be comprehensive and robust.
This will depend in part on the competence of officers and the effectiveness of RBC decision-making, which we will assess in the next section.

3.4 Additional analysis and modelling

We have assessed RBC on the CIPFA Financial Resilience Index.

Figure 12: CIPFA Financial Resilience Index

Results Breakdown



Indicator	Min	Indicator Value	Max
Reserves Sustainability Measure	25.31	100.00	100.00
Level of Reserves	40.36%	300.00%	300.00%
Change In Reserves	-10.60%	280.09%	280.09%
Interest Payable/ Net Revenue Expenditure	0.00%	1,844.41%	1,844.41%
Gross External Debt	£0k	£654,084k	£1,900,817k
Fees & Charges to Service Expenditure Ratio	10.86%	22.30%	38.49%
Council Tax Requirement / Net Revenue Expenditure	42.34%	100.00%	100.00%
Growth Above Baseline	-6.11%	203.14%	204.14%

Results Breakdown

Indicator	Min	Indicator Value	Max
Unallocated Reserves	12.78%	300.00%	300.00%
Earmarked Reserves	26.00%	300.00%	300.00%
Change in Unallocated Reserves	-36.90%	284.81%	1,048.72%
Change in Earmarked Reserves	-11.39%	278.18%	278.18%
Change in HRA Reserves	-75.25%	43.94%	43.94%

The Resilience Index is a comparative analytical tool showing a council’s position on a range of measures associated with financial risk. This assessment highlights high risk factors for RBC in relation to interest levels and gross external debt.

4 Capability, capacity, management, governance

4. 1 Overview

This section considers the capability and capacity of the key council functions, in particular the teams for Assets, Finance, Internal Audit, Legal, Procurement, and Programme Management. Here, we also examine decision-making and oversight, including the effectiveness of governance arrangements in place, particularly those focused on property, investments and RBC's companies.

We note in overview that the council has already recognised some capacity challenges it faces at senior level. Notable is the recruitment to a new post of Assistant Chief Executive, which will help expand senior management and decision-making capacity.

4.2 Financial and corporate capacity and expertise

Asset Management capability, capacity and plans

The Assets and Regeneration Team is led by a Corporate Head who is a member of the Royal Institution of Chartered Surveyors (RICS's professional membership status is subject to ongoing Continuing Professional Development). The Corporate Head is supported by 3 team functions: Property Portfolio Management, Building Surveying and Facilities Management.

The Property Portfolio Management team oversee both the operational and investment assets. The team comprises four chartered surveyors: a Property Portfolio Manager and three Portfolio Surveyors. There is also a Graduate Surveyor and two property administrators who provide support across the team functions.

New Asset Strategies

In February 2023, RBC approved a series of Asset Strategies and an Asset Management Plan. The combined programme is ambitious. It signals a shift from the prior emphasis on acquisition and development to a corporate landlord approach. The aim is to ensure the existing property portfolio is managed and monitored so as to optimise performance and returns.

The strategies include much of what would be expected in the responsibilities of an assets and property team. They comprise:

- a Service Delivery Plan setting out RBC's aims for property
- a Corporate Landlord policy clearly describing how the team will fulfil its role in managing Council assets and asset-related budgets
- a commercial lettings policy, inscribing the need to let properties on proper market terms, while also clarifying the support available to the voluntary sector, a continuing challenge for RBC
- an accommodation policy which recognises that space allocation for services is a corporate decision, while empowering the Asset team to review needs regularly and ensure there is a process in place to manage changes
- an acquisition and disposals policy. Consistent with current restrictions, it acknowledges that acquisitions will be limited in nature and clearly linked to corporate objectives. The policy also includes transparent processes for approving disposals. They are comprehensive and provide reassurance on the council's ability to sell assets when appropriate, applying due legality and achieving best value

- a repairs and maintenance policy, confirming the need for proper stock condition surveys alongside practical protocols for managing contractors and achieving regulatory and contractual compliance
- an investment property update, defining reporting responsibilities and Key Performance Indicators (KPIs) for the bi-monthly Assets and Regeneration group and arrangements for regular reporting to the Corporate Leadership team and the Corporate Management Committee (members)

This strategic and operational material is supported by a scheme of delegation, clearly defining key decision-making responsibilities.

In its Investment Property update, the council categorises the nature of its investments, distinguishing sharply between ‘core’ and ‘opportunistic’ activity. This is captured in Figure 3.1 and explained more fully in Table 3.1:

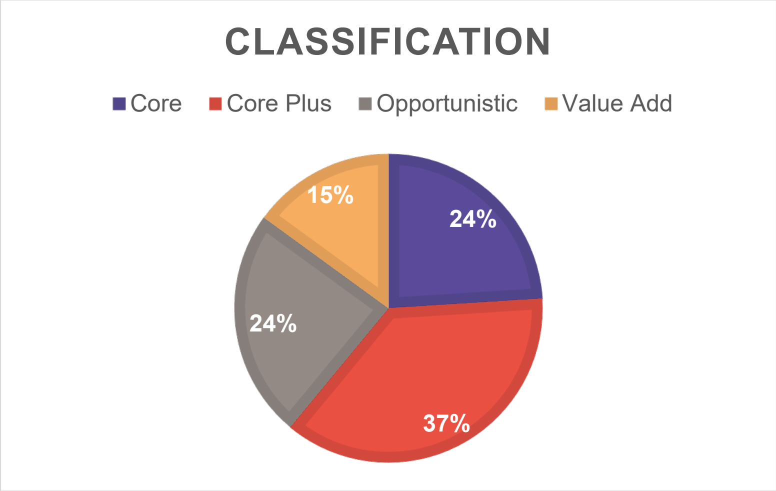
Figure 3.1: Investment risk/reward

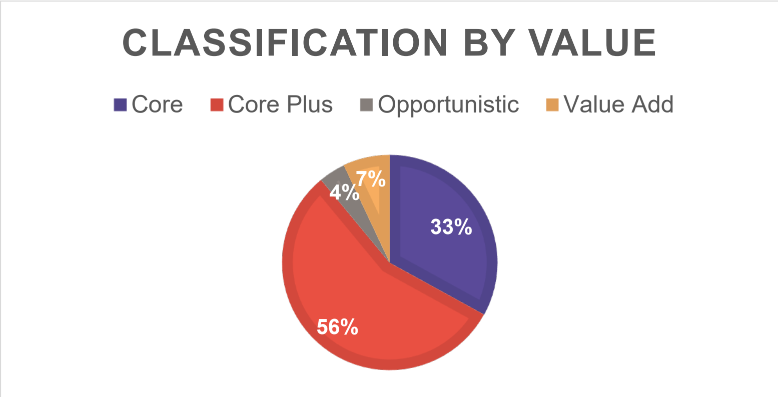
Table 3.1: Risk/reward explanatory

Core	Prime locations, let on long terms, to secure covenants. Buildings tend to be impressive historic fit for purpose or modern purpose-built buildings. This asset class is the most liquid.
Core Plus	Similar in nature to Core but weaker in some of the key areas of the characteristics. It therefore may be in a good rather than prime location, or there could be a mix of covenant strengths, or a mix of lease lengths. There may be significant potential to improve value through good asset management. This asset class will be liquid in stable market conditions.
Value Add	These opportunities offer the chance to increase the capital value of the property by adding to or enhancing the property. These properties may show a higher level of vacancy rates, be more advanced in terms of building life cycle, requiring a degree of refurbishment or other attributes which can be improved or enhanced. These assets can become illiquid in poor market conditions.
Opportunistic	Assets that can be re-positioned through thorough refurbishment, change of use or partial redevelopment or extension. These assets are generally illiquid until the potential is released.

The update further develops this categorisation (Figures 3.2 and 3.3), thereby providing a good baseline for RBC’s divestment approach. (It should also help the council develop a better definition of risk appetite, which we recommend as part of efforts to improve risk management.)

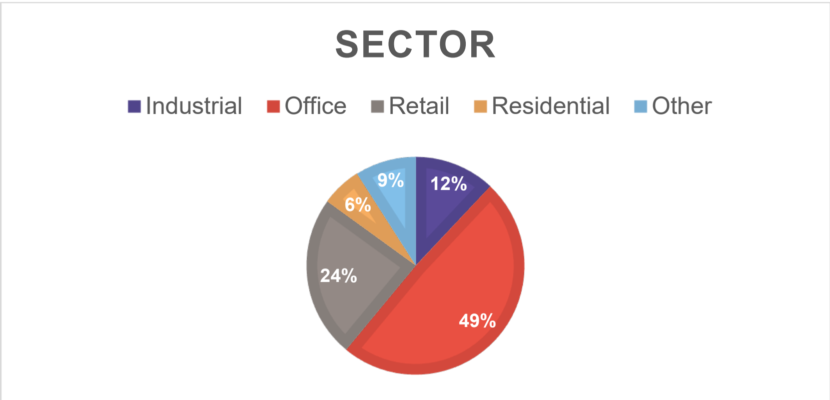
Figures 3.2 and 3.3: Investment classifications

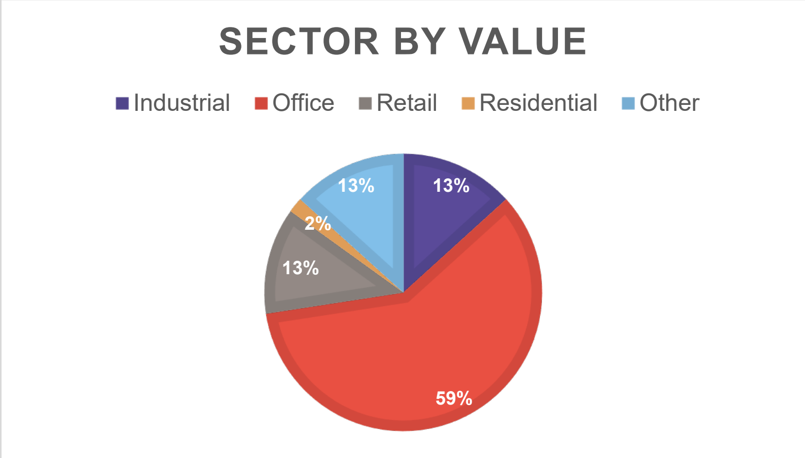




The document also sets out actions to agree reversionary leases or renew leases with under 5 years remaining. The aim is to ensure that the performance of the core and core plus portions of the portfolio is optimised. Associated targets appear reasonable and sensible. There are also summaries of asset holdings by sector and sector by value (summarised in Figures 3.4 and 3.5). Again, key actions to minimise void periods, update financial forecasts and push lettings are included and linked to the objective of maximising net returns.

Figures 3.4 and 3.5: Investments by sector





These actions are then bought together in a set of key performance indicators (Table 3.2).

Table 3.2: KPIs

Reference	Description	Metric
KPI 001	Investment Property Income	Variance from s26 target income
KPI 002	Investment Property Rent Arrears	As a percentage of the total portfolio income – to be taken in the 2-4 weeks prior to Quarterly Payment Dates
KPI 003	Vacancy Rates	As a percentage of the total portfolio area in SQ FT
KPI 004	Tenant Retention	Number of renewals completed and tenant breaks not exercised
KPI 005	Income Return (Proportionality)	Investment income as a percentage of all general fund income
KPI 006	Capital Return	Difference in Capital Values, determined annually.

The new approach to assets is comprehensive with a good balance of strategy, policy and procedures. As we have mentioned in section 2, the approach is fortified by the acquisition of new software, which should help enhance reporting still further. There are tangible measures and action plans against which to measure progress. These innovations however are challenging. The shift to a 'corporate landlord' model will require different skills. The Head of Property has recognised the scale of the task in managing the council's portfolio and is about to tender for an overall facilities management contract for September 2023. Ad hoc support and advice will also be replaced by convening a panel of external service providers. Bitesize briefings to members and officers are happening to inform them of progress on these matters.

Despite the emphasis here on the use of existing or external capacity, delivering this approach will undeniably demand supplementary in-house capacity. Since the relevant skills are scarce and in high demand, the council may have to innovate further to secure them, possibly through collaboration with neighbouring authorities.

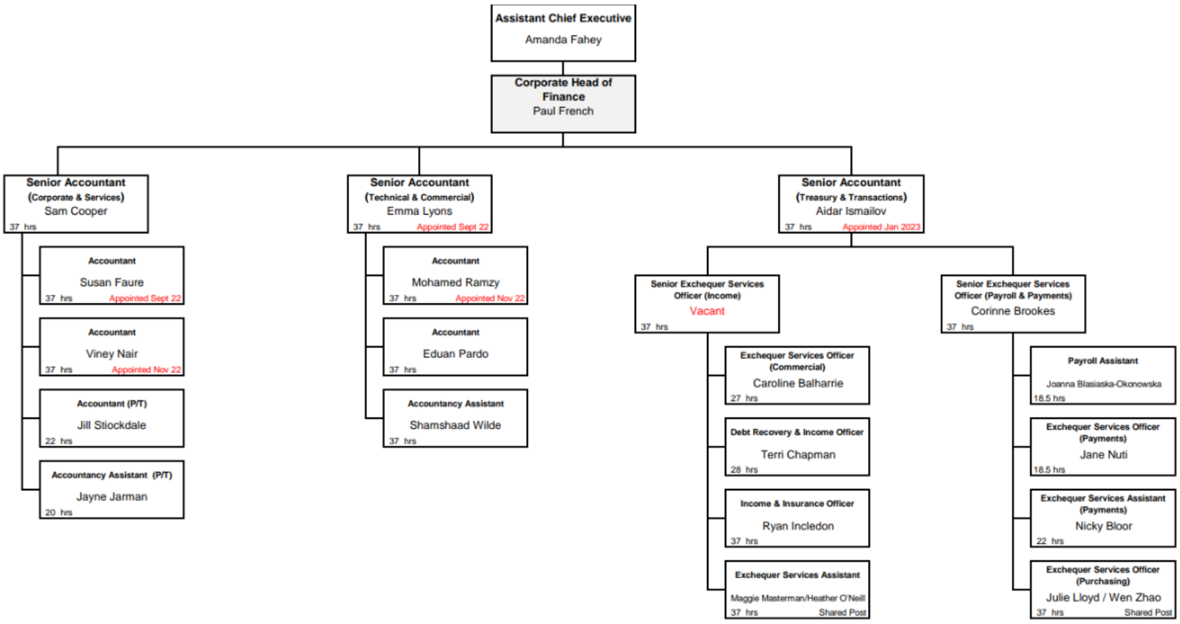
Finance capability and capacity

The council has assessed itself against the CIPFA Financial Management Code. This identified the need to conduct further stress testing on its MTFP, develop its risk management arrangements and improve its reporting on achieving savings and associated targets. Our review findings confirm the soundness of these intentions, while our suggested mitigations provide some reinforcement to them. Overall, however, the evidence of our analysis and interviews suggests that RBC exhibits a broadly sound approach to financial management.

The council also has a longstanding Head of Finance who has considerable experience and knowledge of the challenges associated with RBC's commercial approach and borrowing.

Until recently the team was carrying 2 to 3 vacancies. It has now met these internally, filling gaps and providing continuity. While this places significant responsibility on more senior team members to get the new recruits up to speed, RBC has a strong record on training. Chart 3.1 shows the current structure and recent recruitment. It constitutes reasonable capacity for the workloads and complexities RBC faces.

Chart 3.1: Finance structure



The finance team is currently overseeing work on the robustness of the MTFP and specifically its savings plans. In this, they will undoubtedly need assistance from the council's programme management capacity (see below).

Internal audit capability and capacity

The Internal Audit Plan is monitored at Audit Committee and agreed with them and the S151 Officer. At 175 days, the plan seems modest. But it covers the principal areas of council business, including systems development, investments, commercial property, and rent arrangements. There were no significant concerns identified in its latest audit report. Internal Audit is provided by an external provider. The contract is due to go out to tender shortly.

Table 3.3 below shows the focus of audit work in respect of Commercial Property and Rents, with 6 days allocated to each in 2022/23. As RBC develops its risk management arrangements, it might provide further assurances if audit planning were more closely aligned to the risk register. The relative weighting of work may also merit consideration. 6 days working on the areas shown below might not reflect their importance for the council.

Table 3.3 Audit work in the areas of commercial property and rents

Review	Type	Days	High-level Scope
Commercial Property	Assurance	6	Failure to maintain tenancies and to generate the projected return on investment will have significant financial consequences for the Council. The review will focus on the governance and reporting arrangements, project management and budgetary control for a number of key redevelopment projects.
Commercial Rents	Assurance	6	Commercial Rents are becoming a major income stream for the Council and an annual audit is required to provide assurance that all rents are collected in accordance with the rental/lease agreement. The review will focus on the processes for ensuring that all commercial rents are appropriately recorded, the database of commercial properties is accurate and up to date, and testing a number of commercial properties to confirm that rents are paid in accordance with their agreement.

Other capability/capacity including legal procurement and programme management

RBC is fortunate to have an experienced Head of Programme Management with a wide range of skills and deep understanding of the council. Their experience of service redesign and review work will be key to ensuring that savings plans are robust. They will however need additional analyst support. There is evidence of the Corporate Leadership Team (CLT) and Members rejecting growth requests. The council has a reasonable history of efficiency programmes, but delivering savings plans, especially those with a target date of July 2023, will stretch the existing capacity. Some of these issues are reflected in the corporate risk register.

Recently, it was decided to move Procurement to report to the S151 Officer. This provides an improved profile for its activities, important with new property and internal audit contracts to manage, amongst others, and given the potential role of competitive sourcing in achieving savings. However, the team requires new recruits, again challenging in current labour market conditions. The council may again need to consider other approaches, including working with neighbouring authorities and pooling procurement resources.

The legal team is led by an experienced and qualified lawyer with over 30 years' experience of public and private sectors, including local government. Appropriate articles and memoranda of association are in place for the wholly owned companies, while a sample review of contract and legal documentation associated with investments shows appropriate legal involvement. It is important, however, in developing the panel of experts supporting the new asset strategy, that the property team can draw on specialist commercial legal advice in a timely manner, given the importance of legal assurance in manging complex deals.

4.3 Decision-making, oversight and governance

RBC, which has a majority Conservative administration, operates a committee system, which appears to work well. Of particular interest to this review are the Corporate Management Committee and its subgroups, as well as the Company Board, which oversees the wholly owned companies. Evidence from interviews suggests that these elements interact effectively. The responsibilities of committees, how reports are generated, ideas escalated and considered, and the role of the scrutiny committee are well understood, with considerable confidence at member and officer level. No concerns have been expressed in respect of member relations within the council. Continuity in officers and members has provided stability and there is a mature scrutiny approach.

Development and property business cases are considered by the Corporate Management Committee and are subject to appropriate input from all relevant departments and officers. There is member training. Briefings are held to inform members of developments. Interview feedback suggested that information members need is readily supplied by officers.

As the new asset arrangements emerge, along with the developing approaches in areas such as risk management, it will be important that decision-making responsibilities continue to be effectively mapped and accountabilities monitored. Indeed, this may be the right moment to consider whether more could perhaps be done to strengthen political and administrative governance still further. In particular, there may be opportunities to locate property and investment issues more conspicuously within the committee system, with clearer oversight and accountability.

There is also probably some work to do around defining the precise governance of the council companies, notwithstanding their reasonably effective interactions with the committee system. There is currently limited activity being conducted through the companies but they continue to meet their statutory duties in reporting under the Companies Act. They hold a combined Company Board meeting with separate formal sessions for each of the three. A councillor chairs the meeting and also acts as non-executive director. The meeting is also attended by the Managing Director (who is also the RBC Head of Property) and the Company Accountant. Verbal and summary updates are provided to the Board three times a year. But detail is limited. Provisions are in place to deal with potential conflicts of interest, such as the Deputy Head of Property providing the company updates to the council. But the arrangements are not ideal. Broader representation, perhaps with a wider group of non-executives, might be appropriate.

4.4 Conclusions

RBC has significant strengths in finance and programme management, with strong plans for asset management. Realising these plans will have resource implications. The investment in new software, mentioned in section 2, will be beneficial. But while the combined focus of the new approach will provide better information for members, whose decision-making arrangements are generally sound, they may also provide a pretext for making further improvements to council and company decision-making.

5 Our recommendations

As should be clear from this report, the review team is assured of the council's seriousness in engaging with the challenges it faces. Plans and assumptions seem sensible. There are challenges however, working to support the approaches RBC is already adopting, we make 6 key recommendations: .

Recommendation number	Recommendation description
1	**As part of the exercise to enhance its overall risk management arrangements, the council should develop a risk appetite statement, including specific elements for its commercial and regeneration portfolio and divestment opportunities, and formalise a moratorium on commercial investment** The council has recognised that more work is needed to provide robust and comprehensive risk management. Finance is leading this work. Clear risk appetite statements, aligned with corporate assumptions and consistent with the 5-year strategic plan, could underpin effective monitoring of risk. They would provide a reference point for decisions, ensuring actions affecting the property portfolio are consistent, setting out criteria for future activities affecting borrowing, investment, revenue generation, and budget protection. The risk appetite statement should formalise RBC's broad commitment to restraining borrowing, limiting further investments and considering options for asset sale. While RBC's informal restrictions are a positive step, we would recommend that RBC puts in place a formal moratorium on new debt-funded asset investment. The terms of the restriction would allow for 'force majeure' or certain categories of desirable economic intervention. We would recommend that this is actioned as a priority.
2	**The council should update the MTFP to reflect different scenarios in savings delivery, in the relationship of stock condition findings to MRP, and in commercial income performance** The council's S151 Officer's Section 25 statement clearly articulates the risks facing the Council in the short to medium term, particularly projected deficits and future borrowing costs. Reporting could be further enhanced by modelling a number of scenarios for additional cost pressures and income volatility. This would also help prepare the Council to respond promptly to emerging challenges.
3	**The Finance and the Asset teams should work together to determine the appropriate scale of the sinking fund to the extent that the sinking fund can cover income and repairs risks** This work will need to be informed by longitudinal work on income as well as the forthcoming stock condition, suitability and sufficiency assessment. It should of course make provision for unforeseen and one-off liabilities, like the recent changes to regulations around cladding.

4	**RBC should develop and monitor capacity and capability to support priority areas** The council has experienced and capable officers. However, it is very reliant on key individuals to oversee and drive initiatives. The council has recognised this and is creating additional capacity and resilience through the establishment of a new Assistant Chief Executive post, by putting more analysts in its programme management team, and aligning procurement with finance. However, there remain critical resourcing challenges, particularly in key areas such as property, procurement and legal. Capacity is also needed to support the finance and programme management functions in developing savings plans. But like any other district council, RBC has to compete for people. So the council must be imaginative. It may need to reach out to near-neighbours and collaborate with them, pooling scarce resources.
5	**The council should work to elevate the profile of and focus on Commercial and Regeneration priorities in formal decision-making and oversight** The council's decision to increase the scope of its asset management activities may justify the creation of a dedicated forum, perhaps a new committee, to support the existing work of the Corporate Management Committee. The new structure could receive portfolio risk reports in line with the emerging asset strategy. It could examine benchmark information, income data, void levels and disposals plans. It might also be a useful discipline to provide this new structure with a fully mapped and integrated property timeline. This would set out key decision points, such as lease terminations and rent reviews. The parallel reporting in the Company Board could also be strengthened through a review of its composition, with the potential to alter and widen its membership and recruit expert non-executives.
6	**Improve reporting on investment performance and expected returns** While steps have been taken to support better reporting (e.g., the proposed indicators in the Asset Management Plan and the new asset management software), more detailed reporting is required on these matters to keep senior leadership and members informed in sufficient detail. Risk management would also be improved as there would be greater oversight of property income to support service deliverability.

In this report, CIPFA means CIPFA Business Limited, a company registered in the United Kingdom with registered number 02376684.

The contents of this report are intended for the recipient only and may not be relied upon by any third party. Once issued in final form, the recipient may use this report as it wishes, save that any commercially sensitive and/or proprietary information pertaining or belonging to CIPFA should not be published or shared outside the recipient organisation without CIPFA's prior consent. For the avoidance of doubt, all intellectual property rights in the tools, models, methodologies, and any proprietary products used by CIPFA in creating this report belong to CIPFA.

Nothing in this report constitutes legal advice. The recipient should seek its own legal advice in relation to any contractual or other legal issues discussed in this report.

77 Mansell Street, London E1 8AN
+44 (0)20 7543 5600

CIPFA.org