The Chartered Institute of
Public Finance & Accountancy

Eastleigh Borough Council

Review of debt/investment risk profile

July 2023

A Report by:

The Chartered Institute of Public Finance and Accountancy

July 2023

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.

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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 Eastleigh Borough Council's (EBC) borrowing and investments. We have looked at the overall position, the associated risks and the council's capacity to manage them. The background, DLUHC's requirements and our approach are set out in section 1. Despite the council's apparently high indebtedness, we have identified few matters of major concern. We have nevertheless made some recommendations for EBC to consider.

Section 2 examines the council's overall borrowing, its investment portfolio and the associated risks. The council appears to understand the challenges its indebtedness position creates and has clear strategies and mitigations for managing them. EBC's investment portfolio has a clear strategic purpose. However, there may be potential divestment opportunities. On borrowing, EBC has a balance between short-term and long-term debt. The Finance Team has a good understanding of treasury management and has put in place numerous measures to manage interest rate fluctuations.

The council is conducting a phased re-opening of its Housing Revenue Account (HRA) as it delivers a substantial housing development programme. There is commercial sector experience in-house to meet these ambitions and recruitment plans to secure supplementary capacity. Care will need to be taken given the scarcity of this expertise, as well as the potentially far-reaching effects of a new HRA on all other aspects of council business.

The council faces a specific challenge around nitrate credit accounting, potentially impacting the Medium Term Financial Plan (MTFP). The council is awaiting a ruling but has plans at the ready to compensate for any potential revenue impact.

Section 3 investigates EBC's capacity and capability in treasury management, finance, commercial property and housing. Though there is a high level of capability and experience, there are some concerns around resilience and capacity, especially in Finance and Asset Management. Nevertheless, the council has demonstrated an awareness of how it needs to change and increase resources to deliver on its strategic ambitions and work is already underway. Internal Audit function is very traditional, however, and lacks the experience or expertise in the more complex areas of EBC business. There is a need to broaden its capacity and scope. Governance seems sound, with mostly effective member scrutiny, notwithstanding EBC's near-uniform political make-up.

In section 4, we have set out a number of recommendations for further strengthening EBC's resilience and performance. They address issues of commercial activities, debt-funded asset investment, strengthening internal audit, ensuring that capacity and capability are available within the finance team and the wider council, and managing the impact of reopening the Housing Revenue Account (HRA).

2 Introduction

2.1 Background

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

Working with partners, CIPFA is leading a programme of DLUHC-commissioned reviews to examine the financial management and sustainability of selected councils. As part of this programme, in early 2023, DLUHC asked CIPFA, supported by Grant Thornton, to review the debt conditions and management arrangements in EBC.

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 authority required a substantial review. A further 29-day investigation was allocated to each authority. Work was to be undertaken in February and March 2023, and initial draft investigations and findings presented to the Department, subject to any unavoidable constraints, by the end of the week beginning 20 March 2023.

Emailing the authorities to advise them of project commencement, DLUHC summarised the review 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 governments 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 cooperation 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 document library which had largely been supplied to them by the affected authorities. We reviewed the EBC 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 EBC officers for their ready compliance with our request for reports and data.

Specialised inputs

Some comparative data analyses were conducted on issues such as commercial property, revenue spend, and indebtedness. Where relevant they are found in the body of the 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 thus are submitted 'sight unseen' from the viewpoint of the affected councils. Nevertheless, we have kept EBC 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 EBC. However, it should be noted that the data and associated analysis are inevitability volatile and subject to wider economic circumstances.

We recommend that, prior to final publication of the review, DLUHC should oversee a final fact check, in case material changes in investment positions have ensued. For example, current market volatility related to SVB and Credit Suisse may have short-term impacts. Prudent authorities will factor them into their calculations in the period between report draft and publication. Where possible, these should feature in published versions.

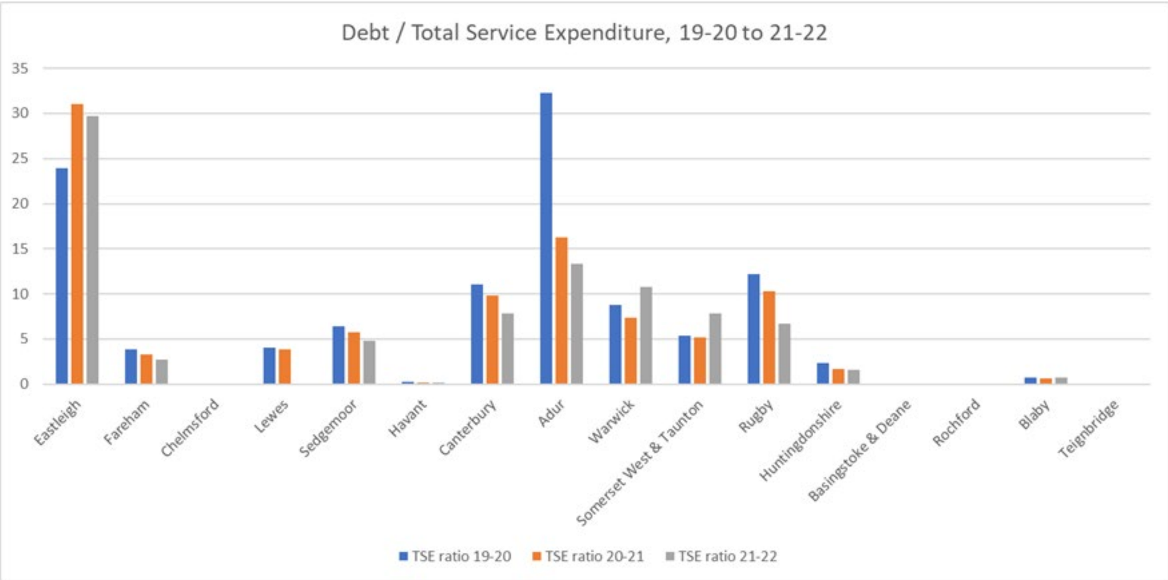
Nevertheless, the review team is confident that only the most fundamental shifts to the figures cited here would have any material bearing on our recommendations.

3 Current debt and investment position

3.1 Background summary

EBC had £525 million borrowing (as at 31 March 2022). At 30 times total service expenditure, this is the fourth highest borrowing relative to size of all UK authorities after Woking, Spelthorne and Runnymede. It can be seen that ECB is significantly above its nearest statistical neighbours from the graph below.

Graph 1: Debt compared to total service expenditure 2019-20 to 2021-22



This borrowing has been used in the main to invest in properties. By value, 91% of its investments are in the borough. EBC characterises much of its investment as housing development (£261 million); economic development and regeneration are £175 million combined.

Although the scale of debt is significant, there is a range of mitigations such as the spread of short-term and long-term loans, and substantial dedicated reserves.

A long-term approach has been possible at EBC as the property portfolio was purchased against clear strategic criteria, based on supporting economic development and regeneration in Eastleigh. Its Corporate Continuous Improvement Programme evidences an appetite to meet budget targets through savings and service transformation. More recently, the council's investment focus has moved towards affordable housing. This will lead to a reduction in the level of borrowing on the General Fund and EBC's borrowing relative to size.

A key challenge for ECB is managing a property portfolio on this scale.

3.2 Details of the council's debt and investments

Debt

As at 27 February 2023, EBC held external borrowing of £504.715 million at an average interest rate of 2.52%. This borrowing is split between loans from the Public Works Loan Board (PWLB) of £350 million at an average interest rate of 1.83% and £154.715 million from other bodies at an average interest rate of 2.71%. The latter borrowing is predominantly from other local authorities. The breakdown by category of organisation is in Figure 1:

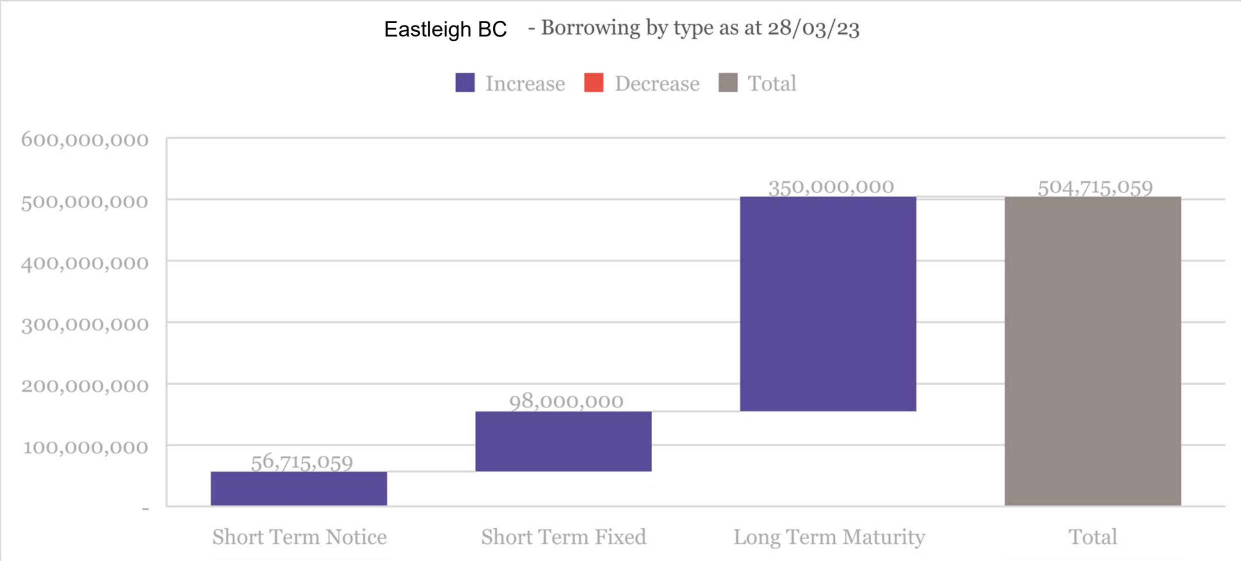
Figure 1: Borrowing by category

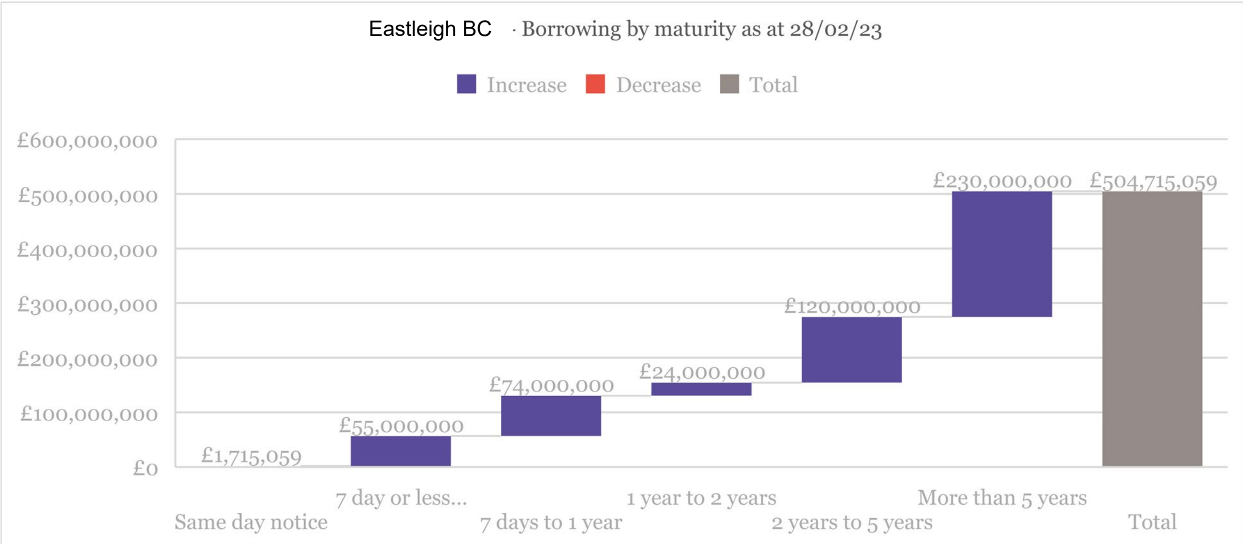
Type of organisation	Borrowing at 27 February 2023	Average interest rate
Other local authority	£73,000,000	3.03%
Combined authority	£45,000,000	2.03%
Other public sector	£20,000,000	0.45%
Police body	£10,000,000	0.76%
Local authority pension fund	£5,000,000	4.00%
Parish council	£1,414,624	3.25%
Charity	£153,712	3.25%
Other body	£146,723	3.25%

EBC currently has no Lender Option, Borrower Option (LOBO) loans from financial institutions. Its 2023/24 Treasury Management Strategy states that its main objective when borrowing is to balance securing low interest with achieving certainty over the period when funds are required. As a result, the Council currently holds loans with various maturity dates balanced between long and short-term.

The council's debt portfolio as at 28 February 2023 is set out by type and borrowing in Figures 2 and 3:

Figures 2 and 3: Debt by type of borrowing





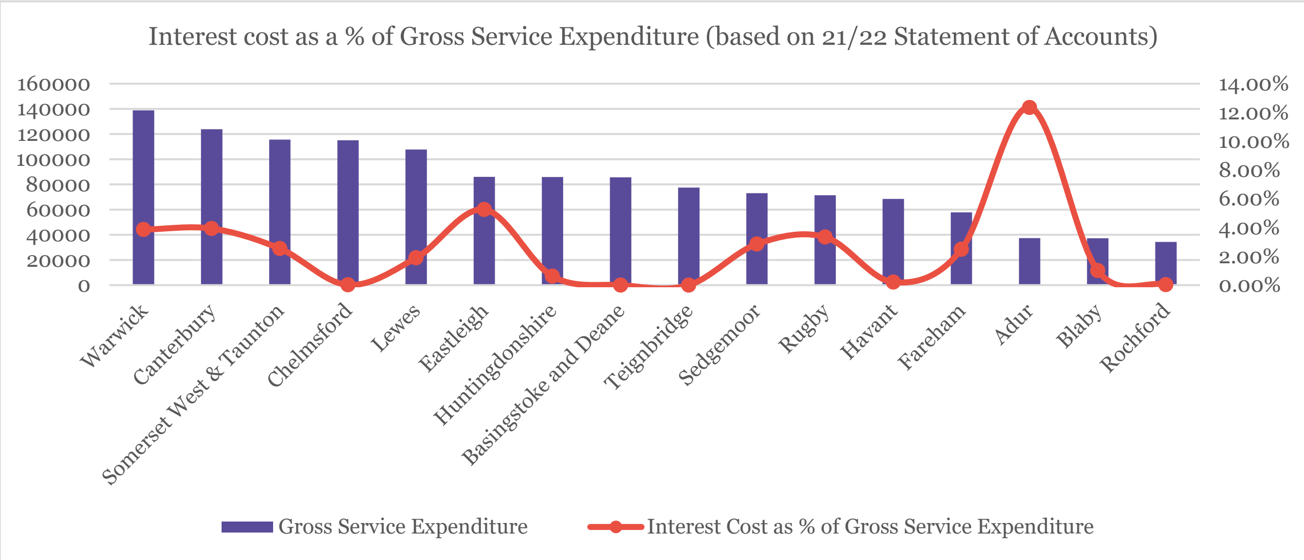
As at 28 February 2023, 11.24% of borrowing was Short Term Notice loans with a notice period of either same day or 7 days or less. 19.42% was Short Term Fixed borrowing with a maturity date of less than 2 years. The remaining 69.35% was Long Term Maturity borrowing held with PWLB with maturity dates ranging from 2 to 46 years. This blend of long-term and short-term loans follows advice from Arlingclose, EBC's treasury management advisors. It allows certainty on ongoing liquidity and borrowing costs through long term funding along with flexibility and lower costs in the immediate term.

In the Treasury Management Strategy presented to Cabinet on 23 February 2023, EBC forecasts that external borrowing will increase to £539 million by 31 March 2023. By the end of 2023/24 it will increase to £607 million, then to £692 million in 2024/25, with a further rise to £708 million in 2025/26. This is a 40% appreciation overall from the current external borrowing level.

The average interest rate of EBC borrowing for 2022/23 is forecast to be 2.69%. [*SENTENCE REDACTED*]. In response to this and recognising that predicting interest rates remains difficult in current economic climate, EBC have included interest rate projections in their MTFP.-The MTFP is based on the average interest rate of external borrowing peaking in 2023/24 at 5% before reducing to 4.88% in 2024/25 and 3.42% in 2025/26, reaching 3% in 2026/27 and 2027/28.

In 2022/23 EBC expects to spend £7.5 million on servicing its external debt. Based on interest rate projections in the MTFP and the anticipated increased borrowing, this is expected to rise by 99.81% in 2023/24 to £14.986 million. A further increase of 9.59% in interest payable to £16.423 million is expected in 2024/25. As forecast interest rates begin to drop from 2025/26 the annual cost of servicing the council's debt is also expected to drop to £13.304 million.

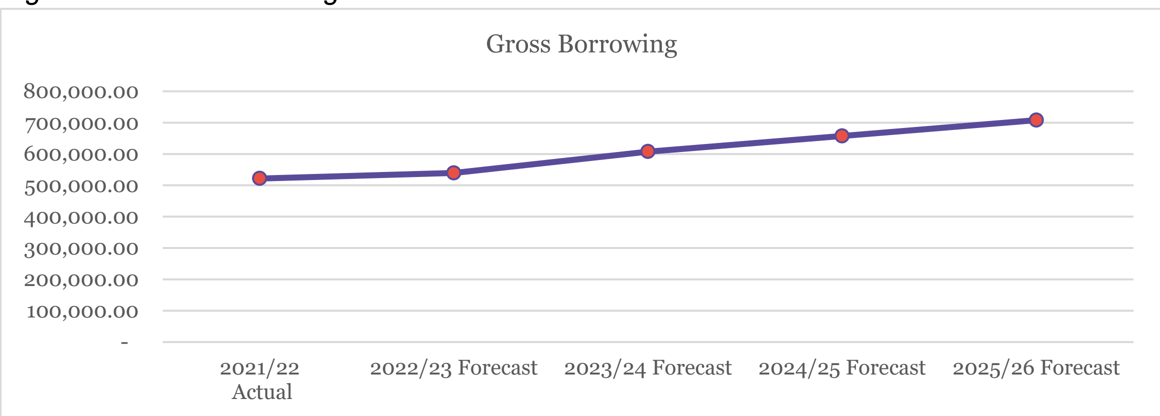
Figure 4: Interest as percentage of service spend in comparable authorities



We have analysed interest cost as a percentage of gross service expenditure across comparable authorities. At 5.25% of gross service expenditure against a comparator of 2.38% EBC is an outlier (see Figure 4)

The 2023/24 Treasury Management Strategy forecasts external borrowing requirements over the period to 2025/26 based on the General Fund Capital Financing Requirement (CFR) as described in Fig 5. It forecasts that external borrowing will reach £707.972 million by 2025/26, an increase of 31.29% from the 2022/23 forecast borrowing. The council's core funding for capital expenditure comes from borrowing in response to cuts to government funding.

Figure 5: Gross borrowing



Investments

According to the 2023/24 Investment Strategy, EBC invests money for 3 broad purposes. These are:

1. Treasury Management Investments – the investing of cash surpluses from day-to-day Council activities (for example, when income is received in advance of expenditure and is invested before it is required)
2. Service Investments – investments to support local public services by lending to or buying shares in other organisations
3. Commercial Investments – to achieve corporate objectives for the council, to deliver the council's Continuous Improvement Strategy or to earn investment income through the purchase and building of property.

Treasury Management Investments

As of 27 February 2023, the council held £22.299 million of Treasury Management Investments with 4 different counterparties. £10 million of these are a constant Strategic Fund investment held in the CCLA LAMIT Property Fund. Taken in November 2017, it delivers a 3.60% rate of return. The remaining £12.299 million are Money Market Fund investments held with approved counterparties bearing credit ratings of A or A+. They deliver an average return of 3.91%.

Based on its CFR, external borrowing and Balance Sheet resources, EBC forecasts that Treasury Management Investments will fluctuate between £20 million and £27 million over the period to 2025/26.

Service loans

EBC's 2023/24 Investment Strategy states that it will lend money to residents, employees, businesses and charities to where appropriate and where certain conditions are met (see section 2.2), to support local services, consistent with its Corporate Objectives of stimulating economic growth and regeneration, and increasing provision in affordable housing.

As at 27 February 2023, the Council had 3 service loans of this sort, totalling £6.409 million. The breakdown and purpose of these investments is in Figure 6.

Figure 6: Service loans

Name of investment	Investment principal at 27 February 2023	Rate of Return	Effective Maturity Date	Purpose of investment
Doswell Projects Limited	£1,823,568	[REDACTED]	31 Dec 2025	In March 2022 the Council sought approval from Cabinet to provide Doswell Projects Limited with housing funding of up to £3 million to be drawn down over a period of 18 months starting in June 2022. The purpose of the investment was to support Doswell Projects Limited with the acquisition of land within the Borough for the construction of 7 dwellings. The reason that this investment was deemed to be attractive to the Council was that it would secure housing development in the Borough in line with the Housing Corporate Strategy

				(2008) and the Eastleigh Homes Delivery Strategy whilst also supporting a small new developer. The Investment was approved by Cabinet on 24 March 2022.
Aspect Eastleigh Ltd	£1,250,000	[REDACTED]	31 March 2023	Aspect Eastleigh Ltd is a development vehicle between the Council and VIVID housing association to deliver a house building programme of c.300 homes. This investment is the Council's contribution to the equity requirements for the project. VIVID oversee the development contracts and will take on the management and maintenance responsibilities once developments are complete. For each individual development that is progressed a separate LLP is established where the equity is invested for the project. The Council has Member representation on the Aspect Board and all funding from the Council for the establishment of an LLP must be approved by Cabinet. This vehicle has been beneficial in developing the Council's housebuilding ambitions in Eastleigh but the intention is that these will be wound down as the HRA is re-opened and the number of properties grows.
RB Sport and Leisure Holdings Ltd ('RBSLH')	£3,335,697	[REDACTED]	8 Nov 2056	In December 2020 the Council provided RBSLH with a Covid-19 business support loan facility of up to £11.732m to help secure the future of the business, continue to pay the rent due to the Council and provide the benefits the business brings to the wider community. The need for this support from the Council was driven by the Covid-19 pandemic and the impact it had on the cashflow position of RBSLH.

				The investment is in the form of a loan to RBSLH with £5.2 million approved in December 2020 and an additional £6.532 million requiring further approval if required. The initial tranche of the loan was; £1.5 million for Debenture Redemption, £2.2 million for repayment of Barclays Loan and £1.5 million Cash Flow Package.

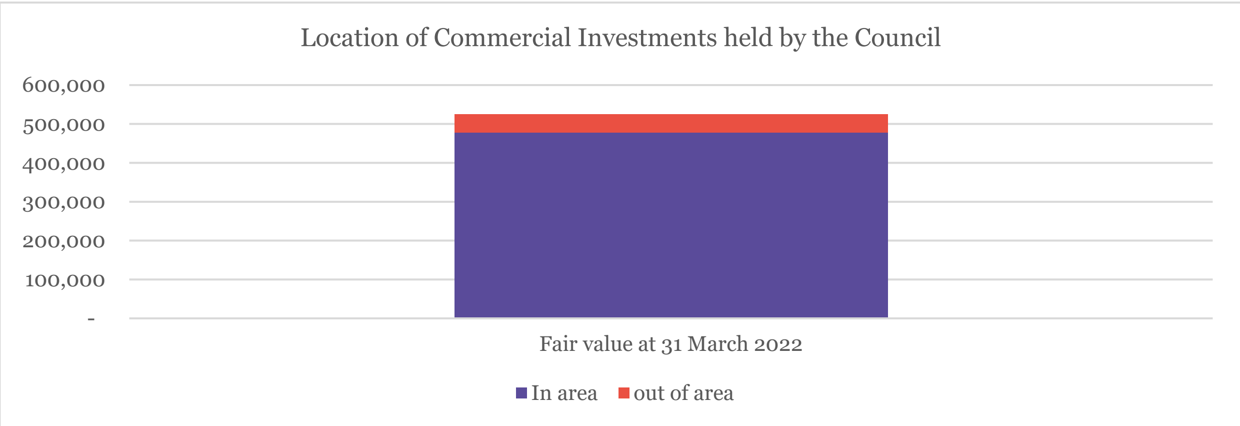
Commercial, housing and regeneration investments

The 2023/24 Investment Strategy states that EBC invests in commercial and domestic property primarily for regeneration, economic and housing development. This is achieved through direct investments within the Borough or indirect impacts derived from income generated through investments in the wider region which is then spent on local regeneration and housing.

As at 28 February 2023 the Council held 51 property investments with a total fair value, calculated at 31 March 2022, of £524.805 million. Outstanding borrowing against these investments totals £514.563 million.

Property investments by location

Figure 7: Investments by location



90.97% (£477.424 million) of the Council's property investments, by value, are within the borough of Eastleigh. The remaining 9.03% (£47.381 million) is out of area and represents 2 investments, one located in Bournemouth near to the airport and the other located in Hove. Both out of area investments are held for income generation purposes and both were made during the 2017/18 financial year.

Property investments by type of investment

The council has 6 different types of investments and the details for each of these investment types is as follows:

1. Commercial Purchase (45.86% of investments by value totalling £222.373 million) – purchase of a commercial building, with a lease in place, or to be re-leased
2. Housing Construction (25.64% by value totalling £131.933 million) – the construction of housing in the borough where construction is undertaken by the council

3. Housing Investment (19.99% by value totalling £116.49 million) – an investment in a housing development to be delivered by a third party
4. Service Construction (4.22% by value totalling £35.889 million) – construction of an asset for direct service delivery, construction carried out by the council
5. Commercial Construction (3.86% by value totalling £16.243 million) – construction of an asset that will provide income to the council
6. Housing Purchase (0.42% by value totalling £1.877 million) – purchase of existing housing sites to use for housing purposes

Figure 8: Property holdings by type (in £ millions)

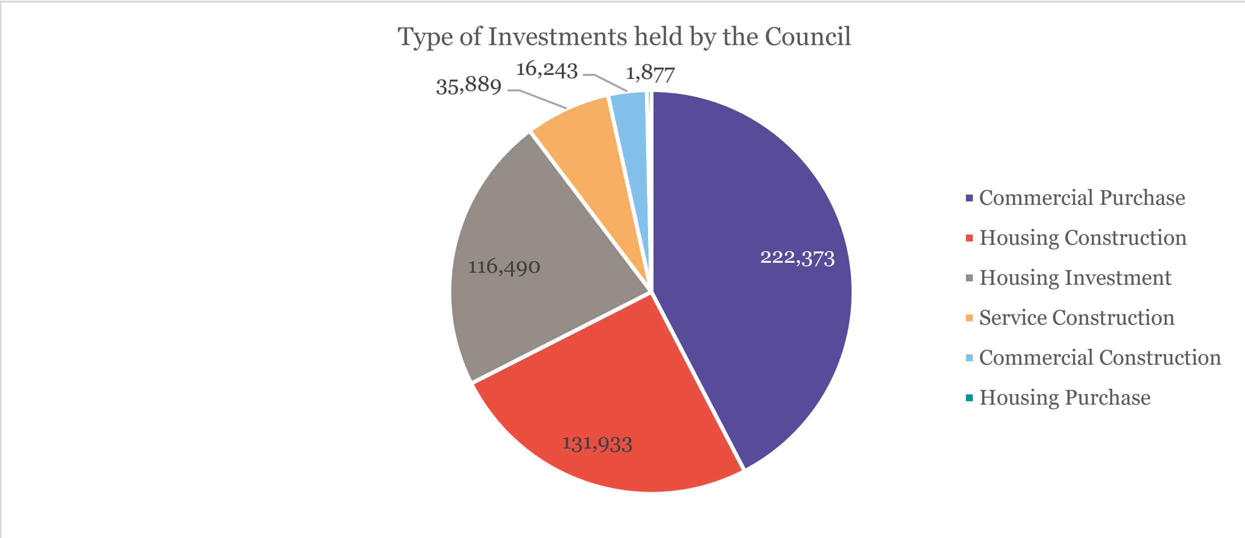
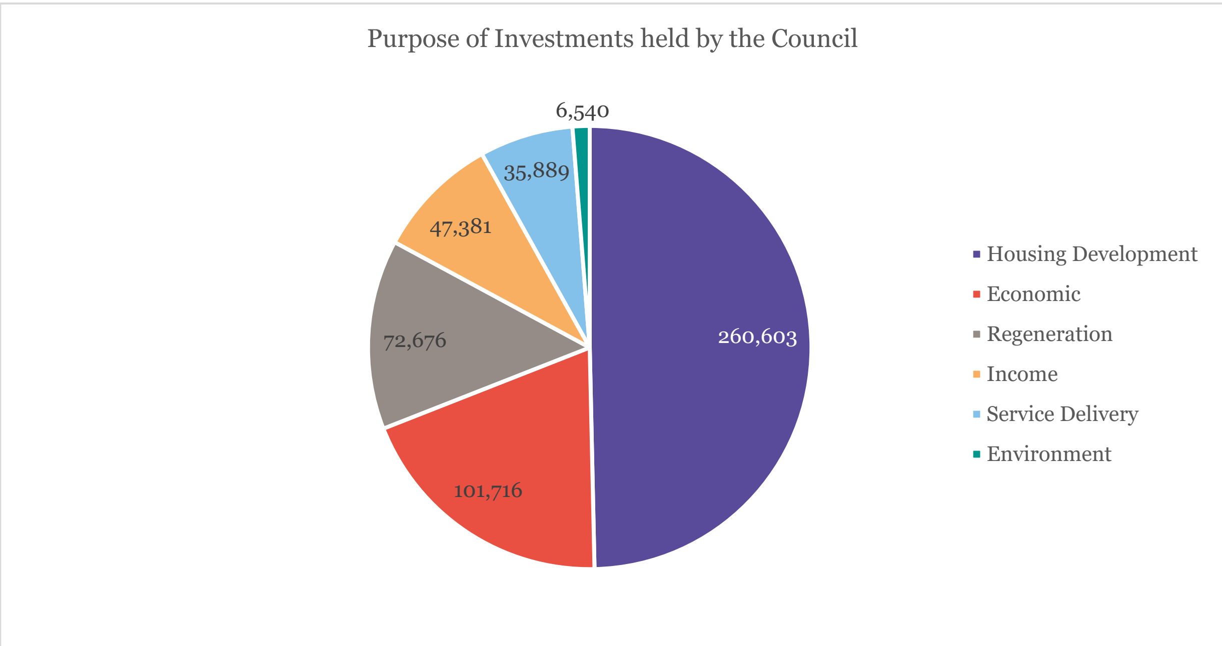


Figure 9: Investments by purpose (in £ millions)



Property Investments by purpose

EBC identifies 6 different purposes behind its property investments. Nearly half by value have the purpose of 'Housing Development':

1. Housing Development (49.66% of investments by value totalling £260.603 million) – assets purchased or constructed for housing needs in the borough
2. Economic (19.38% by value totalling £101.716 million) – assets purchased to enhance or ensure economic activity in the borough

3. Regeneration (13.85% by value totalling £72.676 million) – assets within the borough that have been either purchased for regeneration, can be regenerated in the future, or were assets already owned by the council that have now or will be regenerated
4. Income (9.03% by value totalling £47.381 million) – assets purchased outside of the borough for the purposes of income generation
5. Service Delivery (6.84% by value totalling £35.889 million) – assets delivering service objectives
6. Environment (1.25% value totalling £6.54 million) – assets delivering environmental objectives such as green energy

Income from property investments

In 2021/22 the council's property investment portfolio generated total income of £18.978 million. The interest cost on the borrowing against these investments totalled £4.413 million and the MRP cost was £3.435 million. The net income in 2021/22 generated by the portfolio was £11.129 million.

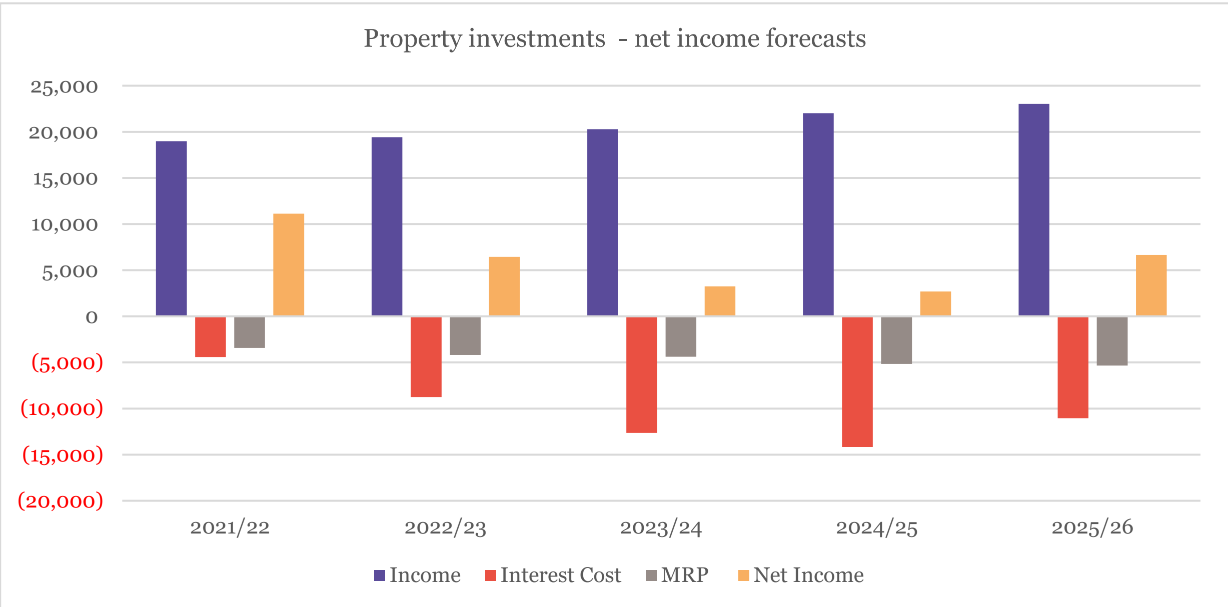
Income from these investments is forecast to increase to £19.415 million in 2022/23. Rising interest rates during the year mean EBC calculates that interest costs will also rise by £4.35 million to £8.763 million. There is also a forecast increase in MRP to £4.203 million. The overall impact is that net income in 2022/23 will fall by £4.68 million to £6.449 million.

EBC predicts continued pressure on interest costs in 2023/24. Costs are forecast to increase to £12.648 million. Income generated is anticipated to decrease to £20.282 million, whilst the MRP is also expected to fall to £4.39 million. Net income in 2023/24 is thus estimated as declining to £3.243 million.

By 2024/25 the Council forecasts that income will rise to £22.028 million. It also predicts that interest rates will reach 4.88% meaning associated costs of £14.172 million. The forecast MRP cost in 2024/25 is £5.164 million. Accordingly, EBC anticipates net income of £2.692 million.

The Council predicts a further increase in the income in 2025/26. It is expected to reach £23.034 million. A forecast reduction in interest rates means the Council ~~is~~ expects associated interest costs of £11.044 million with the projected MRP calculation at £5.336 million. In 2025/26 EBC estimates net income of £6.654 million.

Figure 10: Net property income (in £ millions)



Investments detail

Of the 51 property investments held by the council at 28 February 2023, over 50% of the total outstanding borrowing relates to 7 sites. Detail is found in figures 11 and 12.

Figure 11: Investments by outstanding borrowing

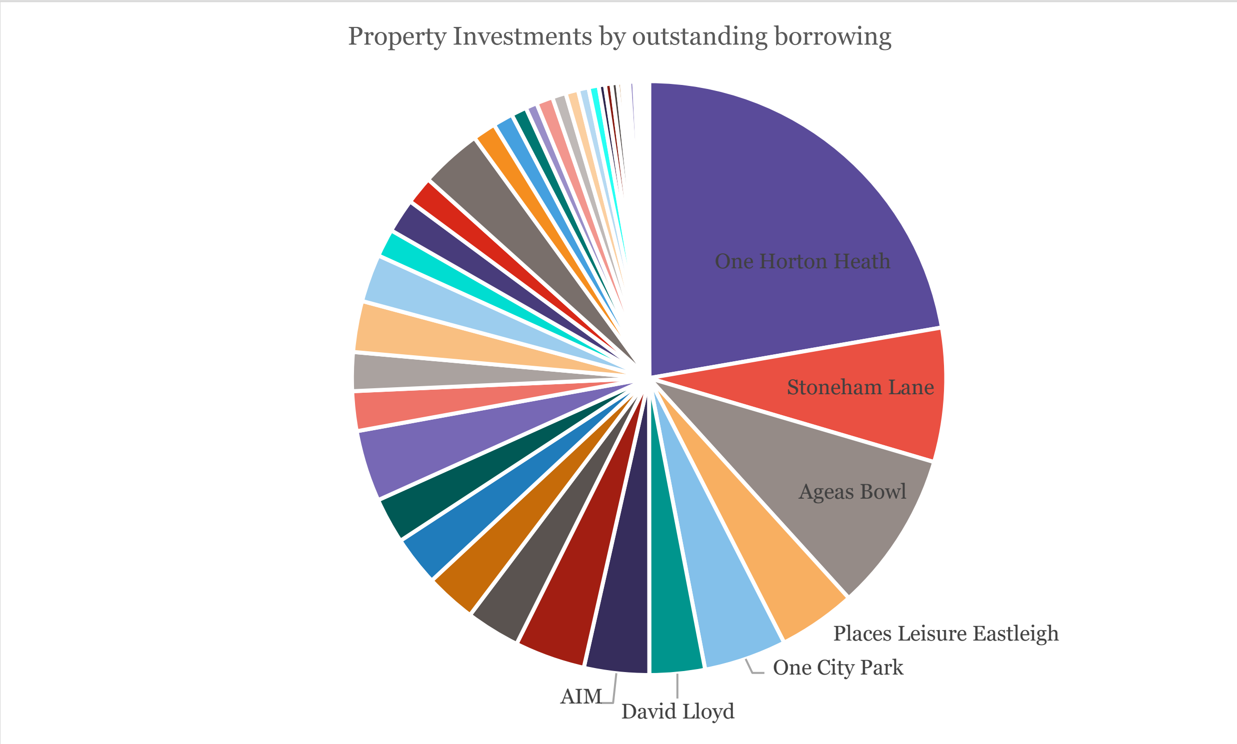


Figure 12: Detail behind the major sites:

Site Name	Fair value at 31 March 2022 (£m)	Outstanding Borrowing (£m)	Type of Investment	2023/24 Forecast Net Income (£m)	2023/24 Forecast Yield	Reason for Investment
One Horton Heath	114.606	114.606	Housing Development	N/A	N/A	One Horton Heath is a 310-acre development site within the borough that the council acquired in March 2018 and is a major residential-led development site in the council's Local Plan 2016-2036. The council's purchase of this land and involvement in developing One Horton Heath was a direct result of market failure. Without the council's intervention the planned development was not going to be delivered by the private sector within a timescale or manner that was acceptable to the Council. At One Horton Heath the council's aim is to create a development that better meets the council's housing aspirations and the needs of the local community better than a traditional developer-led project would. The council's aim is to deliver a development that delivers critical infrastructure projects in the area and delivers a housing mix and tenure mix that supports local needs. Currently the council has a resolution to grant outline planning permission for the development of 2,500 homes along with related infrastructure and green space. The development at One Horton Heath is split into 4 separate development phases which enables the Council to take a staged approach to the development and make decisions at various gateways on how best to proceed and manage risk at an appropriate level. The council currently have approval to

						proceed with the development of Phase One and are expected to complete construction in 2026 with homes available to residents from 2024. The council's plan for the completed residential dwellings at One Horton Heath has 3 distinct elements: 1. Affordable housing – this will be managed by the Council through the HRA 2. Private rentals – these houses will be retained by the Council in the General Fund and let as rental accommodation on the private market. 3. Market sales – these dwellings will be sold by the Council on the open housing market to generate capital receipts.
Stoneham Lane	49.075	37.509	Housing Development	N/A	N/A	In October 2016 Cabinet approved the recommendation that the Council entered into a pre-emption agreement to purchase 146 dwellings at the Stoneham Lane Development with North Stoneham Developments Limited ('NSDL') for as estimated cost of £38.2 million. The reason for the council investment at Stoneham Lane was the withdrawal of the private sector partner that had in place to take the development forward. This withdrawal, along with the Section 106 obligations attached to the site, put delivery of the whole site which included housing and wider community benefits at risk. The Council investment into the site and loan to NSDL secured the future development of the site.
Ageas Bowl	42.850	44.825	Economic	[REDACTED]	[REDACTED]	In May 2009 the council was approached by the Ageas Bowl as Allied Irish bank had withdrawn their funding for the Ageas Bowl Business Plan which threatened the major improvements to the stadium along with the financial viability of Hampshire County Cricket Club.

						This approach came at a point when the council had an Asset Management Plan that encouraged active investment in the property market to secure key strategic sites across the borough. The council made the decision to invest in the Ageas Bowl on the basis that it would; create jobs during the construction period and in the completed Hotel and Conference facility, have an economic impact on the region and sub-region, would contribute to the visitor economy, bring major international cricket matches to the borough, raise the media profile of the borough, deliver a financial return on investment to the Council and improve the financial stability of Hampshire County Cricket Club. The total cost to the council of providing this financial support was £39.684 million which covered the following; hotel purchase and retention, purchase of hotel land, purchase of the stadium, external fees and internal fees. Annual gross income of £2.297 million is received by the council in relation to the Ageas Bowl.
Places Leisure Eastleigh	35.889	21.704	Service Delivery	[REDACTED]	[REDACTED]	Fleming Park Leisure Centre was the largest leisure centre in Eastleigh and in July 2012, Cabinet agreed to improve or redevelop the site to better meet the needs of service users. Based on an options appraisal and feasibility study Cabinet agreed in November 2013 to develop a new leisure centre at Fleming Park adjacent to the existing facility. The new facility, called Places Leisure Eastleigh, opened in Spring 2018 at a total cost of c.£30 million, £10 million more than the initial estimates. The facility is owned by the council but is operated by Places for People, the council's leisure centre management company.

						Annual gross income of £0.964 million is received by the council in relation to Places Leisure Eastleigh.
One City Park	27.050	23.070	Income	[REDACTED]	[REDACTED]	In 2017 the council identified an opportunity to expand its property portfolio through the purchase of Building One City Park in Brighton and Hove for £23.045 million. The investment was approved by Cabinet on 7 December 2017.
David Lloyd	21.520	15.504	Economic	[REDACTED]	[REDACTED]	In 2017 the council were offered an off-market opportunity to acquire the Long Leasehold interest in the David Lloyd Racquet Club site located next to the entrance of the Ageas Bowl for £15.940 million. The Council owned the freehold of the land that the gym is located on. The council proceeded with this investment as it aligned with the Corporate Plan to operate in a commercially focussed way and using investment property to generate a sustainable income for the council. The investment was approved by Cabinet on 7 December 2017.
AIM	20.331	£18.209m	Income	[REDACTED]	[REDACTED]	In 2017 the council was offered an off-market opportunity to acquire the 250-year long leasehold of the AIM facility on Aviation Business Park in Bournemouth, just over 30 miles away from Eastleigh. The council undertook a financial business case review of the opportunity and determined that the long-term investment of the council in this asset and the resultant rental returns would support the on-going delivery of council services in the borough. On 15 June 2017 Cabinet approved the recommendation to invest in the facility. At the point of purchase the building was jointly sublet to AIM Aviation (Jecco) Ltd and AIM Aviation Ltd on a 25-year full

						repairing and insuring lease that had started in April 2016. In June 2022 the Aim Altitude (UK) Ltd entered administration and were immediately purchased by AVIC Cabin Systems (UK) Ltd who are an arm of the overall parent company. Aim Altitude (UK) Ltd owed the council £0.288 million at the point of entering administration. Currently the council are in discussions with the new company to extend the lease until the end of 2024 and have also engaged CBRE to negotiate this lease and seek a new tenant for the site. The council are confident that this can be resolved without any significant financial impact. Where required the council have utilised the Property Reserve to mitigate any lost income.

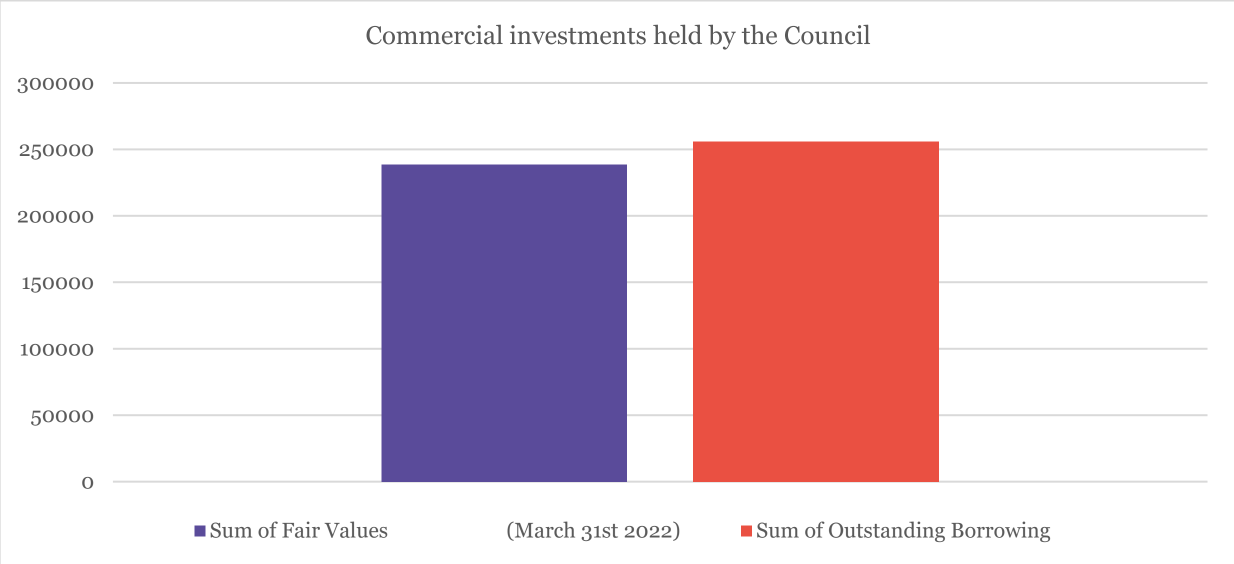
EBC's 51 property investments can be split into 3 distinct categories:

1. Commercial – investments in commercial sites such as office and retail spaces
2. Housing – investments in land and sites for the purpose of housing development
3. Service – investments in assets to support the delivery of core council services

Commercial

The council holds 30 individual investments categorised as commercial. The fair value of these sites at 31 March 2022 was £238.616 million with total outstanding borrowing against them of £255.879 million.

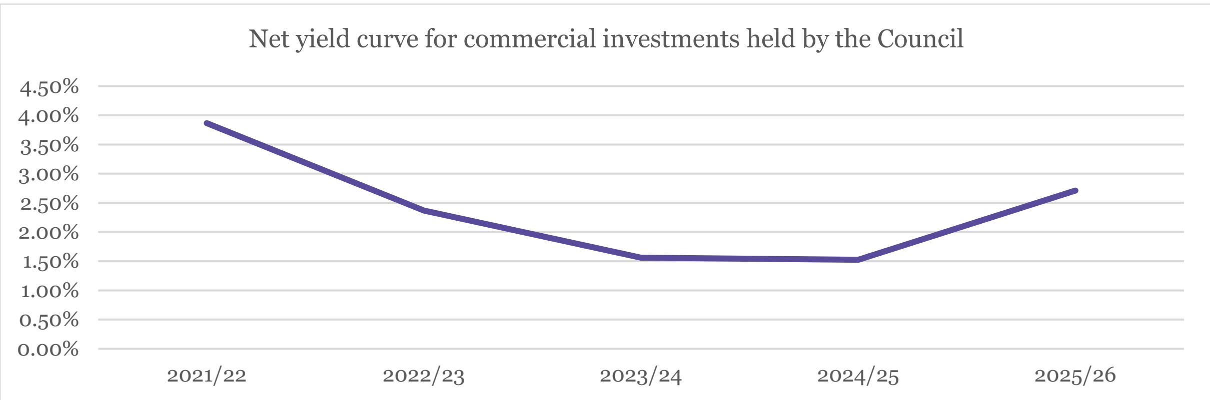
Figure 13: Commercial investments (in £ millions)



Outstanding borrowing exceeds the fair value of these assets as at 31 March 2022, meaning the council is in negative equity on this part of its portfolio. This needs to be considered in the context of other mitigations, including the sinking fund, MRP provision and savings place. Any impairment should be recognised in the accounts.

In 2021/22 the net yield delivered by these assets was 3.87%. Due to increasing interest rates this is forecast to reduce to 1.52% by 2024/25 but increase again to 2.71% in 2025/26.

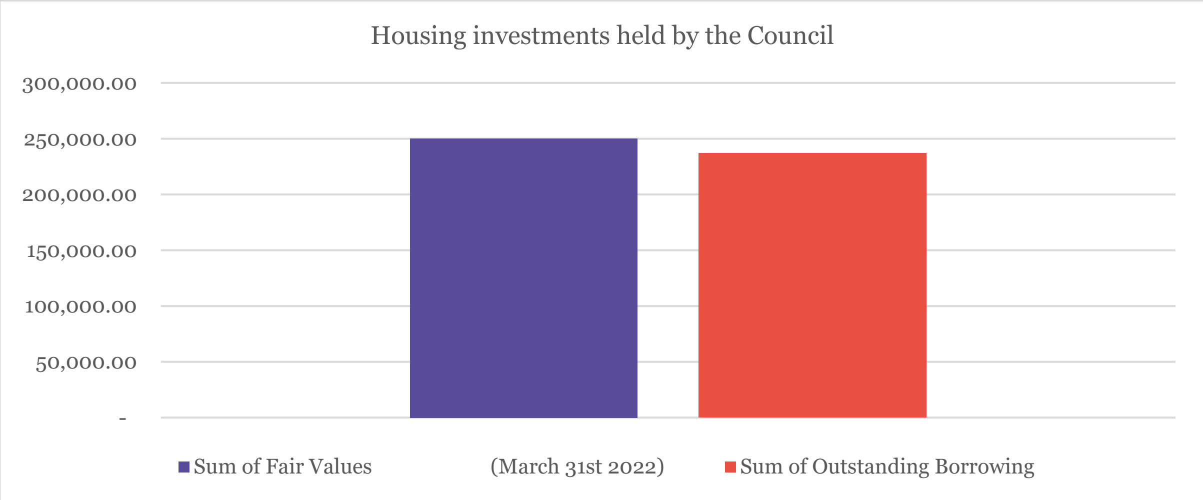
Figure 14: Net yield



Housing

EBC currently holds 20 sites purchased to support housing provision in the borough. The total fair value of these sites at 31 March 2022 was £250.3 million with a total outstanding borrowing of £236.98 million for them.

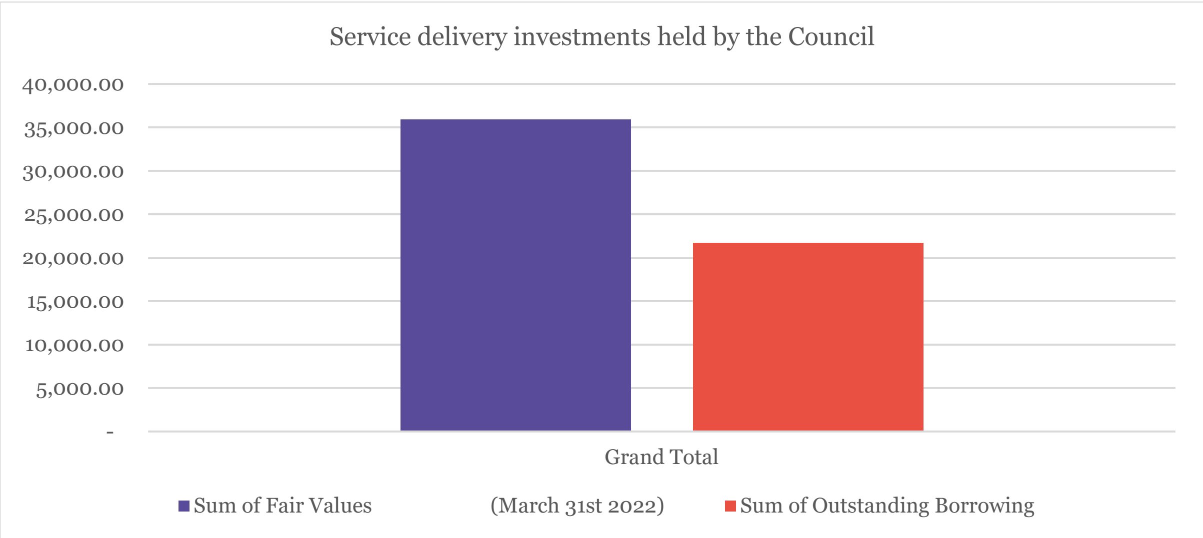
Figure 15: Housing investments (in £ millions)



Service delivery investments

One asset is currently invested in for direct service delivery, Places Leisure Eastleigh (mentioned earlier in connection with one of three service loans). Its fair value as at 31 March 2022 was £35.899 million with remaining borrowing of £21.704 million against it.

Figure 16: Service investments (in £ millions)



Nitrate credits

Eastleigh falls within the Solent water catchment. There is evidence of high nitrogen and phosphorus levels in the area. Any developments located here must demonstrate that they do not cause net increases in nitrates. To that end, developers can purchase ‘nitrate credits’ to offset impacts.

Nitrate credits can be created by removing land from agricultural use and laying it fallow. To generate its own nitrate credits EBC has purchased 194 acres of agricultural land that have produced total of 3,338 credits.

The council has used these credits for 3 purposes:

1. To offset permanently the nitrate impact of third-party developments in the borough that were previously temporarily offset by land at One Horton Heath
2. To secure the council's requirements for nitrate credits for its housing development pipeline (excluding One Horton Heath)
3. To sell to third party organisations to offset nitrate impacts of developments that have received planning permission. The price at which the Council is selling these credits is £3,000 plus VAT

The land for credit-generation was purchased for £6 million. It is valued at £1.4 million under its restricted use for the next 100 years. The council currently has 3,239 nitrate credits for sale. At a price of £3,000 per unit (excluding VAT) the projected associated income is £9.717 million.

Since the scheme is new, there is no accepted accounting approach for the valuation and disclosure of nitrate credits, nor for recognising income as credits are sold.

The council's proposed approach is to match income generated from sales with extra MRP charges until the debt associated with the land purchase is repaid. Revenue through this phase would be nil. Further credits sold would be classified as 'profit' credits and income recognised as revenue. EBC have received technical accounting advice to that effect from a CIPFA-qualified accountant with a background in public sector external audit.

EBC's external auditors EY, however, have taken a different view on the treatment of income generated by 'profit' credits. EY argue they should be considered capital receipts since the income has been generated from borrowing taken out to make the initial land purchase.

Ongoing discussions between the Council and auditors are seeking to reach an agreeable resolution on the accounting treatment. CIPFA have also flagged the issue to DLUHC as a matter with wider policy implications on which the Department may need to adjudicate. We will be happy to assist in the resolution of this matter.

Minimum Revenue Provision Policy

EBC's MRP policy (set out in the Statement of Policy on making Minimum Revenue Provision 2023/24, approved by Cabinet on 23 February 2023) relates to the amount charged to the revenue budget for repayment of debt used to fund capital expenditure. Discussions with external auditors indicate no concerns over EBC's approach.

Medium Term Financial Plan

The Council presented its budget for 2023/24 and MTFP to Cabinet for approval on 23 February 2023.

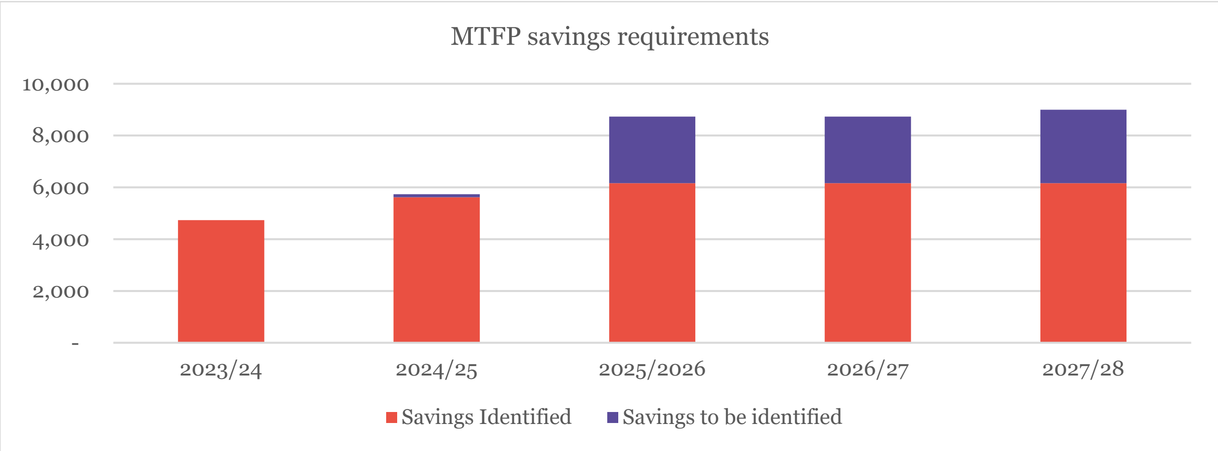
In 2023/24 EBC forecasts that net expenditure will increase to £12.052 million and the Council will contribute £104,000 to General Fund reserves, giving a total budget requirement of £12.156 million. General Fund Closing Balance at 31 March 2024 is expected to be £1.216m after the contribution of £104k as set out in 2023/24 budget. This budget is substantially funded by income received by the council from Government Grant, Non-Domestic Rates and Council Tax.

The 2023/24 budget requires delivery of £4.267 million of Corporate Continuous Improvement savings identified in response to emerging pressures from the Pay Award and increases in interest on borrowing. Based on council information, 38.94% of the required savings have been achieved with the remaining 61.06% identified and agreed but not yet delivered. No concerns were identified during our review that these savings were not going to be deliverable. The delivery of these savings is underpinned by a project team led by senior council officers to control the budget strategy and monitor and forecast against savings delivery.

Over the MTFP period EBC forecasts that it will deliver a balanced budget fully funded through available finance. Delivering this will require a comprehensive suite of further Corporate Continuous Improvement savings. The council estimates that there will be a drawdown from the General Fund Balance of £164,000 in 2024/25 and £52,000 in 2025/26. In 2026/27 the council is forecasting a contribution of £9,000 to General Fund Balances and a contribution of £20,000 in 2027/28. This is from General Fund unearmarked reserves.

The savings requirements, and savings identified to date, are in Figure 17. These requirements look sensible within the context that the income generated from commercial activity has enabled the council to retain discretionary services that many other councils have long-since stopped. This has given the council confidence that its savings programme is achievable. We did not identify any conflicting evidence during our review.

Figure 17: MTFP savings (in £ millions)



Housing Revenue Account (HRA)

In 1996 the Council disposed of its housing stock through a transfer to Eastleigh Housing Association (now VIVID). This disposal led to the closure of the council's HRA.

EBC's Housing Programme, particularly the development at One Horton Heath, will mean the council owning more than 200 affordable homes. Given this proposed scale, EBC's preference is to retain ownership. Accordingly, the council will need to account for them and thus re-establish an HRA.

A Cabinet paper (22 February 2021) set out the options for affordable housing delivery. Cabinet approved the recommendation to reopen the HRA.

The HRA will only include the newly developed stock. EBC has no intention of transferring previously owned stock back from VIVID. The HRA will grow incrementally as new affordable housing units are completed.

The council is now a registered provider and is currently working to complete the required HRA paperwork. It is also training officers on HRA requirements, recruiting an HRA specialist in finance and working with housing partners on management and maintenance arrangements for HRA stock.

3.3 EBC investment and commercial strategy

It is important to understand how the council has arrived at its current borrowing position and the reasoning behind its portfolio of commercial, housing and service delivery assets. Factors in play include:

1. **Political stability.** EBC has been under Liberal Democrat control since 1995 with the same Council Leader for the whole period. Currently 34 of the 39 seats in the borough are Liberal Democrats with one Conservative and 4 Independents. This stability has given the Council confidence to take long-term decisions around investments.
2. **Regeneration and economic development**. The aftermath of the 2008-2009 Financial Crisis significantly impacted Eastleigh. Commercial properties became vacant, inward investment fell. The council identified several key strategic sites in the borough. Their availability and the attractiveness of associated business cases led to the council investing in them for the purpose of regeneration and economic development.
3. **Growing reputation of the council.** As the council invested in commercial and retail assets its reputation in this sector grew and agents approached it with further opportunities. This led to an accelerated programme, with EBC investing where business cases were credible.
4. **Favourable interest rates.** Council investment in these sites coincided with historic lows in interest rates.
5. **Service support.** The investment also coincided with reduced service funding from central government. While the priority for investing in these assets was regeneration and economic development, resulting income was used to subsidise council services. This has enabled the council to continue to deliver a higher level of service than otherwise would have been possible.
6. **Necessary intervention**. The Ageas Bowl and Places Leisure Eastleigh would not have been delivered without EBC intervention. With the Ageas Bowl there was a risk to future viability of both the cricket club and the site. The council provided investment to redevelop the site and protect its economic benefits for the borough. The support for Places Leisure Eastleigh helped replace an outdated existing facility with one that is fit-for-purpose for users.
7. **Enabling housing development**. Recently, EBC’s focus has shifted towards investment in housing. Priorities in the Corporate Plan 2015 to 2025 include to ‘increase provision’ and create a ‘more diverse mix of housing’. To deliver this the council identified sites for housing in the Local Plan and has worked to enable their development. The council has stepped in at the One Horton Heath site, where the private sector appeared unable to deliver the required housing. The updated Corporate Plan for 2023 to 2026 makes ‘creating homes and communities’ a core council priority.

The shift noted in point 7 is palpable. From our interviews it is clear that EBC are not looking to increase the commercial investment portfolio and are managing it as ‘business as usual’. The council have advised that they would only invest again where intervention was deemed critical to the local economy and the business case was credible, as with the Ageas Bowl.

3.4 Modelling/profiling of risks over time

Investment risk

Service loan risks

The council has identified the main risk associated with its Service loans as the borrower being unable to repay the principal lent by the council and/or the interest due to the council.

The total value of these Service Investments at 27 February 2023 was £6.409 million and they were held with three different entities. Further details on the nature of these investments can be found in Figure 6 of this report. These loans are not asset backed but the council has confidence in its risk management and risk mitigations strategy in relation to these loans.

As detailed in the 2023/24 Investment Strategy the council has adopted the following approach to mitigating identified risks:

- upper limits on the outstanding loans to each category of borrower to limit the risk and ensure total exposure remains proportionate to the size and aspirations of the council. The approved limit for service loans for 2022/23 are in Figure 18 below
- assessing the markets in which the council is looking to invest, to ascertain why the market is currently not delivering the outcomes the council requires through its Corporate Objectives. If this is due to financial reasons the council will then assess whether a service loan would provide the means to achieve the desired outcome
- seeking external advice where necessary
- undertaking a credit check and analysis of the beneficiary's financial statement to assess financial strength. Loans will only be provided if the beneficiary is of sufficient strength or additional security on the loan is sought
- including within the terms of the loan any obligations on the borrower to meet certain criteria that align with delivery of council objectives
- where possible, placing a council representative on the board of the project to ensure effective on-going monitoring of the project is maintained
- monitoring of credit ratings and financial statements of beneficiaries to ensure loss adjustments are accurate and timely should there be a decrease in these indicators

Figure 18: Approved service loan limits

Category of borrower	Approved limit 2022/23
Subsidiaries	£13.900m
Businesses	£3.386m
Local residents – mortgages	£0.006m
Employees – loans	30% of employee salary

Commercial and housing Investment risks

The 2023/24 Investment Strategy details EBC's approach to assessing the potential for losses before entering into contractual arrangements for commercial or housing investment. This process is as follows:

- **Assessing covenant strength.** This includes, but is not limited to, credit checks on potential tenants or strategic partners, meetings with the senior management of potential tenants of large value transactions, detailed review of accounting statements, and charges on land where necessary in order to have security over any investment
- **Assessing a thorough financial business case.** Amounts to be invested are costed alongside associated long term costs such as future maintenance and voids. The following specific provisions are set aside:
    - interest rates – to insulate against future borrowing costs financial business cases record a higher long-term interest rates than the cheaper variable rates the council predominantly uses for borrowing. The difference is taken to a ringfenced Interest Rate Reserve to mitigate against further rate rises.
    - void adjustment – a percentage of income is reserved so that EBC can cover income for up to 12 months should a property become void and the council needs to find a new tenant. This is taken to the earmarked Property Reserve.

- maintenance adjustment – depending on asset age, 5% to 10% of income is put in the Maintenance Reserve to cover future upkeep

- **Additional scrutiny by officers.** Decisions on property purchases are subject to additional levels of scrutiny through staff meetings. Discussions will take place between Corporate Leadership Team, Asset Management, Strategic Housing, Development Management, Legal Services and Financial Services to scrutinise due diligence work and the soundness of the financial business case.
- **Post-purchase scrutiny.** Continued monitoring of tenants' credit ratings and financial statements ensures loss adjustments if needed are timely and accurate.

Income risk

The council forecasts gross income of £19.415 million in 2022/23 from its commercial, housing and service delivery investments. This income is the rental charge levied on tenants based on the terms of the rental agreement.

Commercial property market realities and wider economic factors mean EBC is exposed to the possibility that it may not collect all expected income from its commercial portfolio if tenants do not renew leases or, as in the case of the AIM site, enter administration/liquidation. The council manages this risk through its Property Reserve where it holds a percentage of income from its commercial portfolio to mitigate income loss.

Figure 19: Investment properties reserve

The forecast closing balance of this reserve in 2022/23 is £3.614 million, £723,000 lower than the closing balance in 2021/22. This relates to reserve's use to mitigate income loss at the Link One building and Hampshire House.

Treasury management risks

The council's treasury management activity exposes it to various risks both in terms of investment security and compliance with legal obligations. The Local Government Act 2003 requires EBC to have regard to CIPFA's Treasury Management in the Public Services: Code of Practice 2021 Edition. To mitigate these risks the Council has a Treasury Management Practices Principles and Schedules document (TMP) and also reports on a range of prudential indicators.

The TMP document sets out the responsibilities and duties of councillors and officers, providing a framework for reporting and decision making. The prudential indicators reported by the council are in Figure 20.

Figure 20: Treasury management indicators

Prudential Indicator	Detail
Total annual capital expenditure	A forecast of when approved capital expenditure will be incurred
Capital Financing Requirement ('CFR')	Total value of capital spend financed from borrowing
Annual change in CFR	Net impact that capital spend less MRP has on the CFR. When MRP exceeds the spend this will be negative
Net borrowing requirement	Annual actual borrowing estimates
Gross borrowing	Estimated total funds borrowed
Authorised limit for external debt	The affordable borrowing limit determined in compliance with the Local Government Act 2003. This sum cannot exceed the CFR
Operational boundary for external debt	Based on the Council's estimate of most likely requirement for external debt
Proportion of net income from commercial property, housing and service investments compared to budgeted net revenue stream	Percentage that income from borrowing is of the net annual budget
Proportion of financing costs to net revenue stream	Percentage that interest and MRP is of the net annual budget
Liability benchmark	An alternative strategy, showing the lowest risk level of borrowing
Credit risk indicator	A target for exposure to credit risk of investment portfolio
Liquidity risk indicator	A target for exposure to liquidity risk through borrowing without prior notice
Interest risk indicator - Upper Limit for variable interest exposure	The limits attributed to long-term borrowing with a variable interest rate
Interest rate indicator – Upper Limit on fixed interest rate exposure	The limits attributed to long-term borrowing with a fixed interest rate
Refinancing risk indicator	This indicator is set to control the council's exposure to refinancing risk.
Price risk indicator	This indicator shows the maximum long term investment limit
Security of commercial and housing investments	This indicator shows the security of the council's assets by comparing the accounting valuation to the debt outstanding
Commercial, housing and service investment income as a proportion of Usable Reserves	This indicator monitors the availability of reserves to cover the income from commercial property.
Yield of commercial property investment income	This indicator shows the average yield of commercial property
Commercial investments void and maintenance reserve levels	This indicator shows the forecast reserve levels to cover loss of commercial income from voids, or maintenance works required
Commercial investment vacancy levels	Monitors vacancy levels of the property portfolio

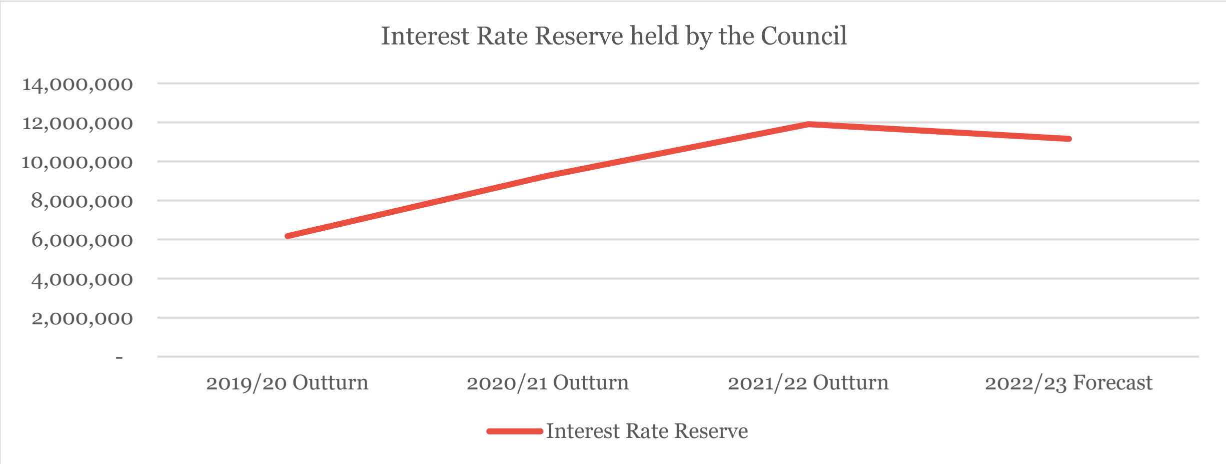
CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the council's total borrowing should be lower than its highest forecast CFR over the next 3 years. Based on the 2023/24 Treasury Management Strategy EBC expects to comply with this recommendation.

Interest rate risk

The scale of the council's borrowing exposes it to the risk of increasing interest rates on the refinancing of short-term borrowing. The wider economic climate and the rapid increase in interest rates has already significantly increased EBC's debt servicing costs.

To mitigate this, the council has established an Interest Rate Equalisation Reserve where it holds the difference between the short-term borrowing rates and the longer-term rates reflected in investment business cases. This prudence has built the reserve to £11.907 million at the end of 2021/22. As interest rates have increased the council has used £748,000 of this to offset increased interest payments during 2022/23.

Figure 21: Interest rate reserve



Medium Term Financial Plan risk

Successful delivery of the council's MTFP is key to its financial sustainability. To meet its targets, EBC must address several issues.

The current MTFP depends on comprehensive savings delivery through the Corporate Continuous Improvement programme. From our interviews with officers and members it has become clear that the commercial activity of the council and the income generated from its investment portfolio has enabled the council to retain discretionary services that many other local authorities have long-since discontinued. We have been assured that given this service 'bandwidth', there is considerable confidence (and commitment) that an extensive savings programme can be developed during 2022/23 and then as required throughout the rest of the MTFP cycle.

Market risks of course mean that the council could face higher actual interest payments than those forecast in the MTFP. EBC's Interest Rate Reserve is intended to manage this. So too is prudent financial planning. The interest rate forecasts included in the MTFP are already *higher* than those in Arlingclose advice.

We have noted the difference of opinion between EBC and its external auditors over the accounting treatment of nitrate credits. This poses an MTFP risk should the income not prove treatable as revenue. If it needs to offset this problem, the council will reclassify its New Homes Bonus income. This renders the potential bottom-line impact of the nitrate credits issue negligible in the council's view.

Housing Revenue Account and housing delivery risk

EBC's decision to reopen the HRA exposes it to numerous issues. Failure to manage the HRA effectively in terms of finance and operations could have reputational and regulatory impacts. The council is addressing this by adopting a phased approach, enlarging the HRA as eligible new housing developments are completed.

However, nearly 30 years have passed since EBC last had an HRA so there is a lack of corporate memory as well as a skills deficit. Therefore, the council is taking steps to ensure that it has the appropriate resources in place. Already in post is an Affordable Housing Policy and Compliance Senior Specialist who is responsible for ensuring that the council has appropriate policies in place. EBC is now looking to recruit an HRA finance specialist. From a management and maintenance perspective the council will be working with several housing partners including VIVID and Fareham Borough Council to service the HRA properties until EBC's property holdings reach an appropriate critical mass to justify in-house provision.

Nevertheless, reopening the HRA may require additional specialist housing skills. It will also change the decision-making character and leadership culture of the wider council, with impacts felt in other service areas. The council must be prepared for this.

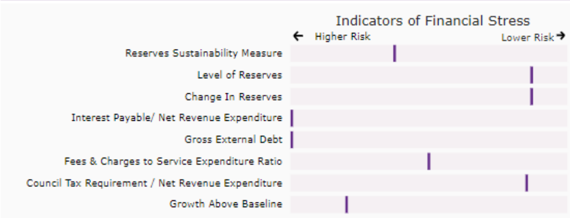
EBC will also be a commercial landlord for private rented properties at developments such as One Horton Heath. This will require a different property-management skillset. Again, the council is increasing its capacity and capability to manage this. At One Horton Heath the council will be selling some of the properties on the open housing market. To manage any associated commercial challenges, the council has recruited an experienced commercial team with deep understanding of the local property market.

3.4 Additional analysis and modelling

We have assessed EBC on the CIPFA Financial Resilience Index.

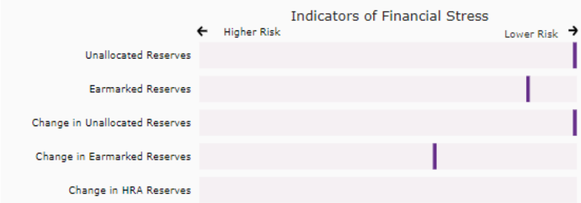
Figure 22: CIPFA Financial Resilience Index

Results Breakdown



Indicator	Min	Indicator Value	Max
Reserves Sustainability Measure	100.00	100.00	100.00
Level of Reserves	121.46%	300.00%	300.00%
Change In Reserves	12.02%	290.32%	319.16%
Interest Payable/ Net Revenue Expenditure	0.00%	54.07%	54.07%
Gross External Debt	£0k	£524,973k	£524,973k
Fees & Charges to Service Expenditure Ratio	7.33%	21.69%	36.46%
Council Tax Requirement / Net Revenue Expenditure	39.62%	77.71%	97.92%
Growth Above Baseline	-12.40%	87.53%	255.33%

Results Breakdown



Indicator	Min	Indicator Value	Max
Unallocated Reserves	8.54%	92.38%	92.38%
Earmarked Reserves	55.94%	300.00%	300.00%
Change in Unallocated Reserves	-80.14%	463.90%	463.90%
Change in Earmarked Reserves	12.47%	265.93%	385.35%
Change in HRA Reserves	-68.95%	na	68.82%

The Resilience Index is a comparative analytical tool showing a council's position on a range of measures associated with financial risk. EBC is at higher risk than comparator authorities[1] in relation to interest payable and gross external debt. This, consistent with the property portfolio, is somewhat offset by the council's more favourable reserves position.

[1] The comparator group used in this report consists of Eastleigh's 15 most statistically similar authorities, as defined by the results of CIPFA's Nearest Neighbours Model.

3.5 Conclusions

EBC has significant borrowing relative to its size, which has been used to acquire a commercial, regeneration and housing investment portfolio. While this quantum of borrowing exposes the council to challenges, there are a range of mitigations in place. Examples include the spread of short-term and long-term loans and substantial dedicated reserves. More generally, the council is politically stable, allowing it to take long-term decisions. Its Corporate Continuous Improvement programme evidences an appetite to meet budget targets through savings and service transformation.

The property portfolio was purchased against clear strategic criteria, based on supporting economic development and regeneration in Eastleigh, with the associated benefits of income returns for the council to support services. Projects such as the Ageas Bowl required council intervention to protect an important economic asset and have also generated revenues. Excluding solar parks (which were part of the One Horton Heath acquisition), EBC has not enlarged its commercial property base since 2018/19, which we consider to be prudent. The portfolio is being managed by the Asset Management Team as business as usual.

The council's investment focus has moved to housing, in line with the Corporate Plan, the Eastleigh Local Plan and the Housing Corporate Strategy. The council is re-opening its HRA to manage the affordable housing. This will reduce the level of borrowing on the General Fund and thus, from that perspective at least, EBC's borrowing relative to size. Based on outstanding borrowing on Housing Investments at the time of our review totalling £236.980 million (against total outstanding borrowing of £514.563 million), approximately 46% of outstanding borrowing will transfer to the HRA.

Despite these mitigations the council does face challenges. At the lower end of the scale, there is the specific issue around nitrate credits, where DLUHC guidance may be required. More generally, the scale of the property portfolio imposes on the council the requirements of ongoing management and periodic review, including the investigation of options to dispose. Ultimately, the frequency of these reviews is a decision for the council. The overall investment portfolio in terms of commercial investment is stable with the council has not made new commercial investments recently. Therefore, annual review of the portfolio appears reasonable to assess the alignment of investments with the overall aims of the council and the wider economic picture. To support this, EBC needs significant financial, treasury management, commercial and decision-making capacity. In the next section, we will examine this in more detail.

4 Investment/debt management resources

4.1 Internal teams

Finance

Team structure

The council's Finance and Housing Programme function is led by an Executive Head, who is a CIPFA qualified accountant. He reports to the Section 151 Officer, a Corporate Director. 6 areas of the Finance and Housing Programme report directly to the Service Director:

- Chief Accountant (CIPFA qualified) with a team of 7 FTE with 2 FTE posts currently vacant. Two team members are CIPFA qualified, one has a CIMA qualification, one is ACCA qualified, 2 have AAT qualifications and there is an ACCA trainee.

- Residential Lettings Manager
- Programme Manager – Housing Delivery
- Strategic Development Manager (Housing Programme) to whom an Affordable Housing Policy & Compliance Senior Specialist reports
- Benefits Specialist Manager
- Senior Revenue Specialists

Capability

Throughout our interviews with officers, members and external organisations the strong capability of the finance team was a common theme. It has significant expertise in both local government accounting and treasury management, the latter especially important in EBC. Officers across the council are impressed with quality of advice they receive from the finance team while members speak of a “tremendous” officer cohort and good working relationships between councillors and finance staff. Members seem to feel they are provided with good financial information, especially given the complexities of some EBC operations. Arlingclose, EBC’s treasury management advisors, spoke of the council’s independently minded finance team, with individuals who possess a good grasp of the markets and their own views on the forecasts they are given.

Currently, the council does not have any HRA expertise within its finance function and is currently undertaking an active recruitment exercise to address this. We believe that this capacity may need further supplementing. More generally, senior EBC leaders will need to prepare for HRA impacts to other service areas and the council’s decision-making culture.

Capacity

There were some concerns raised around the capacity of the finance team to manage all the areas that the council is involved with. The external auditors spoke of a constructive relationship with finance officers. EBC is willing to take on audit recommendations. They do however argue that EBC has occasionally taken decisions without fully thinking through the accounting implications. While they cited specifically the nitrate credits scheme (a novel and as yet ill-defined area) they also noted that the problem was reflected in the number of adjustments required to the financial statements. They indicated that the council relied on a small number of staff, a potential risk given the complexity of EBC business.

The finance team is certainly small considering that complexity and scale. While we are assured that the officers fully understand the issues they face, including treasury management (despite the lack of a separate dedicated team), limited capacity and vacant posts create pressures. At the very least, there may be a case for investigating appropriate ‘flex’ in capacity to address auditor concerns about accounting practices.

Internal Audit

Team structure

Internal Audit is led by the Chief Internal Auditor who is IIA qualified. They are supported by one full time Auditor with extensive experience, one part qualified trainee auditor who is currently working towards becoming a Chartered Internal Auditor (CIIA) and one part-time experienced Casual Auditor who has a Diploma in Internal Audit. The full time Auditor is scheduled to retire within the next 12 months.

Capability

There is significant experience in the Internal Audit function centred on traditional audit work, largely concerning provision of assurance to risk owners on controls and risk, governance and decision-making. There is less understanding of the more complex activity that the council is engaged in. This deficiency is reflected in the emphasis of the work programme. Where more specialised reviews are needed, external resource has to be sourced and the reviews themselves often sit outside the Internal Audit Strategic Plan. Where appropriate, Internal Audit will ‘assure’ the reviews from external experts by monitoring the implementation of recommendations.

Capacity

The Internal Audit function is small and limited. The 2023/24 plan has a total of 491 days of internal audit work, a decrease of 5% on the 2022/23 figure. Treasury Management was subject to review by Internal Audit in 2022/23 and the final report is currently in draft. A review of the governance surrounding the One Horton Heath development was completed in 2021/22 and Internal Audit are currently undertaking a review to ensure that recommendations have been implemented.

Asset Management

Team structure

The Asset Management Team is led by the Lead Asset Manager, an MRICS qualified and a Registered Valuer, who, from autumn 2023, will report to the Corporate Director for Property and Commercial (see below). The wider team includes the following roles:

- Senior Asset (Interim) Manager – 0.64 FTE – MRICS Registered Valuer
- Senior Asset Manager – 1 FTE – RICS Registered Valuer
- Senior Asset Manager – 3 FTE – roles currently vacant
- Asset Manager – 1 FTE – MRICS
- Apprenticeship Asset Manager – 2 FTE (1 is currently on sabbatical)
- Asset Management Administrator – 2 FTE (1 role is currently vacant)

Capability

The team has extensive experience of managing a portfolio of commercial assets. It also utilises an extensive network of external consultant support to provide advice and expertise as required and, responding to the council’s housing ambitions and the need to increase its range of capabilities, the council has recently appointed a new Corporate Director for Property and Commercial (which will also include Housing Management) and approved interim recruitment pending his arrival in the autumn”. Nevertheless, the council’s housing ambitions will mean that going forward the team will need to increase its range of capabilities.

Capacity

Keeping the team up to capacity is challenging. Recruitment is complicated by skills scarcity and competition from other local authorities and the private sector. This has led to some reliance on interim resource to cover gaps.

As a consequence, a number of corporate landlord activities have slipped. For example, the team have begun to look at asset rationalisation and potential exit strategies around certain commercial assets. However, the capacity is not there to conduct a robust exercise, which has slowed matters down, with the team’s predominant focus being on management of the current estate and protecting the council’s interests.

Major Project Delivery Team (One Horton Heath)

Team structure

The Major Project Delivery Team is responsible for delivering the One Horton Heath development. It is headed up by the Project Director who began working for the Council from the local developer that was marketing the site. Reporting to the Project Director are the Strategic Development Manager, Head of Design, Head of Delivery and Head of Commercial. The team also has the following roles:

- Project Co-ordinator
- PR Comms & Marketing Officer
- Land Manager
- 2 Planning Managers
- 2 Technical Managers
- 2 Design Coordinators
- Construction Manager
- Employment and Skill Manager
- Managing Quantity Surveyor (Residential)
- Managing Quantity Surveyor (Non-Residential)
- 2 Contract Quantity Surveyor
- Infrastructure Quantity Surveyor
- Development Manager (Commercial)
- Residential & Disposal Marketing Lead
- Case Management Officer

Capability

The council has created an impressive in-house development team for One Horton Heath with extensive relevant private sector experience and expertise.

Capacity

The team is comparable with counterparts elsewhere dealing with similarly sized initiatives and appears more than adequate to deliver One Horton Heath.

Legal Services

Team structure

The Head of Legal Services ~~Manager~~ and Data Protection Officer is a qualified solicitor with over 10 years' experience. They report to the Service Director for Governance and Support. Within the Legal Services team there are the following roles:

- Senior Legal Specialist (qualified solicitor, 10+ years post-qualification experience)
- Paralegal (CILEx Member)
- Graduate (CILEx Member)
- Senior Chartered Legal Executive (CILEx Member)
- Solicitor
- Barrister
- Trainee Solicitor and Deputy Data Protection Officer
- Legal Assistant
- Performance and Governance Officer

Capability

Our interviews have not identified any issues concerning the capability of the Legal Services team, which accesses external expertise as required.

Capacity

No capacity issues were identified.

4.2 Access to non-council expertise

EBC employs Arlingclose Limited for Treasury Management advice. Arlingclose are experienced advisers with extensive understanding of local authority issues. The council takes professional steers from them on interest rates, treasury management and its investment and borrowing portfolio.

For finance, the council has also utilised external expertise from Ichabod's Industries for technical accounting, TC Group for accounting and tax issues on solar park and housing developments, and TIAA to support company administration for Aspect Eastleigh Ltd. EBC have also engaged a range of property consultancies to provide expertise on commercial investments and housing. These expert organisations include CBRE and Savills.

The council's investments, borrowing and housing plans mean they often need external expertise. For some areas, temporary capacity has been brought in with the longer-term aim of retaining expertise in-house. The HRA is an example of this approach.

4.3 Decision-making, oversight and governance

Treasury Management

Treasury Management Review Group (TMRG)

The TMRG's exists to provide oversight on treasury management activities. It consists of:

- Leader of the Council
- Members of the Cabinet
- Councillors from the party in power
- Councillors from the opposition
- Senior representation from the Finance Team

The TMRG meets quarterly to receive an update on EBC's current borrowing and investment position, as well as on upcoming governance, legislation, accounting or legal changes potentially affecting the council. TMRG members get to ask questions and further their understanding, to enable them to make informed investment decisions.

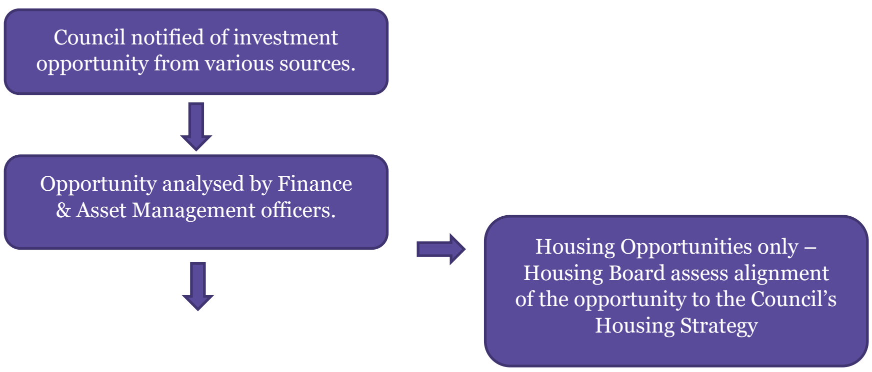
Treasury Management Strategy

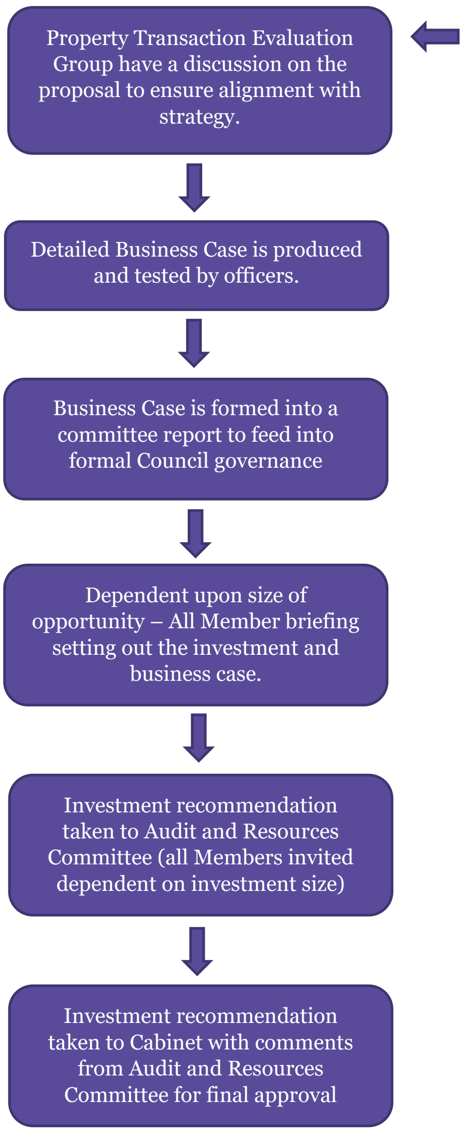
The framework in CIPFA's Treasury Management in the Public Services: Code of Practice (2021 Edition) requires the Council to approve a Treasury Management Strategy before the start of each financial year. The 2023/24 Treasury Management Strategy produced by the Council was approved by Cabinet on 23 February 2023 and fulfils the council's legal obligations. It sets out the council's approach to the management of the cashflows, borrowing and investments, and the associated risks.

Investments

Governance of investment decisions

Figure 23: Investment decisions flow





All EBC investment decisions follow a standardised governance structure, set out in Figure 23 above, enabling officers and members to scrutinise and challenge business cases before the decision to invest is made.

Property Transaction Evaluation Group (PTEG)

The council established PTEG to assess potential property investments. This reflected the number of opportunities being brought to the Council and the need to consider which were sufficiently strong to take forward. PTEG membership is officer only and consists of Asset Management, Finance and Legal representatives, along with a member of the Corporate Leadership Team. Examination of the investment opportunity at this stage includes a high-level assessment of the financial opportunity, land searches and credit checks on existing tenants. The PTEG then decides on the appropriateness of investment and whether to progress to the business case stage.

Business Case

Each commercial investment opportunity the council has progressed has been preceded by a completed business case, setting out the strategic and financial case for investing. These business cases are underpinned by detailed financial modelling over the investment period to understand the long-term implications.

Once tested and checked the business case informs a summary Committee report shared with members for scrutiny, review and approval. These reports set out the proposal in detail, including the financial implications and the risk assessment.

Investment Strategy Report

The council have produced an Investment Strategy Report for 2023/24 which sets out its approach to service and commercial investments. The strategy meets the requirements of Government's 2018 statutory guidance.

Scrutiny

Member scrutiny of investments and indeed other matters is critical to local democracy. As 34 of the 39 EBC seats are held by Liberal Democrats, we raised questions around this scrutiny's robustness. The responses we received during interviews were mixed. Some suggested majority control actually allowed greater scrutiny and vigorous debate. A common theme was that members are well-informed by officers and given significant amounts of information relating to investment matters, including all-member briefings on major issues. Members are also given training from external experts to help them understand treasury management and inform their deliberations. On the whole, arrangements seem robust.

Some interviewees, however, flagged weaknesses, specifically in opposition knowledge on areas such as property, housing and treasury management. Some suggested that recent changes to the membership of the Audit and Resources Committee had weakened it and created training, upskilling and confidence-building needs.

4.4 Conclusions

The main risk facing the council is around its capacity to manage the scale and ambition of its commercial and housing developments. There are shortages within the council's Asset Management Team, Finance, and Internal Audit. On completion, One Horton Heath will create a significant portfolio of commercial rentals alongside a growing HRA. This will necessitate the recruitment of new skills and experience. The council is confident that its phased approach will facilitate this. But it remains a risk to be managed.

Governance for investment decisions and treasury management appears robust, with clear processes. Despite some concerns, which should be addressed, members are equipped with good information, training and have many opportunities for challenge and review.

5 Recommendations

Our overall picture of EBC is positive. We are assured that the council is aware of risks with processes in place to mitigate them. Nevertheless, our review has identified issues and we are accordingly recommending steps for EBC to consider. These are:

Recommendation number	Recommendation description
1	**To review the portfolio and consider opportunities for divestment.** We recommend that the council reviews its overall commercial portfolio and considers whether there remains an economic development and/or regeneration purpose for retaining assets. If the financial case for divestment is attractive and derives net revenue, it should be considered seriously, especially where the council only holds an asset for income generation. Out of area assets should also be reviewed to establish whether they remain compatible with EBC's overall strategic direction. The review may be dependent on available specialist skills, specifically in asset management (see recommendation 4 below). We would recommend that this is actioned as a priority.

2	**To put in place a moratorium on new debt-funded asset investment.** The council has not purchased a commercial asset since 2018/19 with strategy now focused on housing developments, in effect an informal moratorium. We recommend that this is formalised with a view to ensuring that the overall debt burden does not rise. Plainly the terms of the restriction would allow for 'force majeure' or certain categories of desirable economic intervention, such as applied in the case of Ageas Bowl. We would recommend that this is actioned as a priority.
3	**To strengthen Internal Audit.** Internal Audit lacks the capacity or experience to review some of EBC's more complicated treasury management and investment activity. Therefore, we recommend that the council should either enlarge the function with suitable specialists or commission, as a formal part of the Annual Internal Audit Plan, specialised reviews, which are then undertaken by externally sourced experts.
4	**To ensure appropriate capacity/capability are in place in finance and elsewhere**. As it currently stands there are gaps in expertise and capacity to manage the housing commitments. EBC's phased approach to building up this capacity is sensible and should continue. It should include enhancing relevant capacity and capability in key functional areas such as finance and asset management. We also believe that there may be a need for additional resources in finance more generally. There are vacancies that need filling. There are auditor concerns to be addressed about ensuring that accounting treatments of complex initiatives are correct. This might be achieved through suitable team flexing at critical points, such as scheme inceptions, gateway review stages or when audits impend. Furthermore, in other areas of scarcity, such as asset management, if recruitment remains challenging, EBC should consider collaborations and pooling of expertise with neighbouring councils. Recently identified member training issues for scrutiny should also be addressed.
5	**To manage the impact of reopening the HRA.** EBC's plans for a phased reopening are sensible, with appropriate ambitions set out for recruitment. These should nevertheless be considered with extreme care and highlighted as significant risks given the novelty of the initiative and the comparative scarcity of capable professionals. The impact of the HRA on other EBC functions and how its creation will change the council's culture, strategic character and decision-making should also be considered in detail.

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