



monmouthshire  
sir fynwy

**PRIVATE & CONFIDENTIAL**

INTERNAL AUDIT REPORT

INVESTMENT PROPERTY ACQUISITIONS  
2019/20

Date of Fieldwork	<i>February – July 2019</i>
Date of Report Issue	<i>March 2020</i>
Report Status	<i>Final</i>
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Issued on Behalf of	<i>Andrew Wathan, Chief Internal Auditor</i>
Issued to	<i>Debra Hill Howells, Head Of Commercial, Property, Facilities &amp; Fleet Peter Davies, Chief Officer Resources</i>

## **INTRODUCTION**

This audit has been carried out in accordance with the 2019/20 Audit Plan, which was approved by Audit Committee on 13th June 2019 after consultation with the Authority's Senior Leadership Team and Directorate Management Teams.

During 2018/19, Council approved the borrowing of £50 million to make acquisitions to bring additional funding in to the Council and to allow a more commercially minded approach with the view to identifying additional revenue streams.

At the time of the review, MCC had finalised one acquisition, which was the purchase of Castlegate Business Park, Caldicot. This purchase and the management of the site, was the primary focus of the review. A second major purchase, of Newport Leisure Park was ongoing whilst the audit was in progress, but the audit testing was focused on the earlier Castlegate acquisition.

## **SCOPE & OBJECTIVE OF THE AUDIT**

The objective of the audit was to carry out a review of the Council's arrangements for the acquisition of investment property.

The following control objectives were examined during the audit:

- The Authority has an appropriate strategic and policy framework to govern and control their investment property acquisitions.
- A governance structure has been established to have oversight of the Authority's investment property acquisitions, to facilitate decision making and provide a robust monitoring function.
- Investment decisions have been made based upon detailed business cases, in consultation with expert external and internal advisors.
- Detailed borrowing options assessments are undertaken and presented to the Investment Committee to inform decision making. Relevant payments are made in line with the Authority's Financial and Contract Procedure Rules. Potential income is assessed and specific budget codes are established to manage and monitor the financial arrangements for investment properties.
- Robust risk management processes are in place to protect the Authority and to safeguard its assets. All assets are appropriately insured to mitigate against any loss.

It should be noted that due to the timing of the audit, only the purchase and management of Castle Gate Business Park was reviewed. Assurance on this acquisition only, can be taken from this review.

## **CONCLUSIONS & AUDIT OPINION**

Overall, a number of strengths were highlighted in this review. Some weaknesses were also revealed by the audit, which is understandable given that investment property acquisitions is a new and emerging area for the Authority to be involved in.


Two significant weaknesses were identified, the first surrounding the tender and award of contracts to Alder King as advisors and managing agents. The second related to the Investment

Committee meeting held on 6<sup>th</sup> March 2019, when only 2 of the 5 nominated Committee members were present and hence the meeting was inquorate. Despite this, the meeting proceeded and decisions were taken, in breach of the Committee's own terms of reference.

A further nine moderate risk issues were identified as well as four minor risks. Audit recommendations have been included to help address the significant and moderate risk issues identified and to strengthen the control environment to manage any risks arising.

**Appendix 1** provides a summary of the findings of the audit in table form. Each of these findings has been taken into account in determining our audit opinion on investment property acquisitions. Details of the significant and moderate risk findings and our associated recommendations are given in **Appendix 2**, which also serves as the Action Plan for this audit. Audit findings of a minor risk are listed in **Appendix 3** for management attention. Finally, a summary of control strengths identified during the audit is given in **Appendix 4**.

Overall, the process for investment property acquisitions has been assessed as providing a '**Reasonable Assurance**', which reflects that the financial and administrative systems reviewed were found to be adequately controlled, although risks identified which could compromise the overall control environment. Improvements required.



<b>SUBSTANTIAL</b>	<p>Substantial level of assurance.</p> <p>Very well controlled, with numerous strengths identified and any risks being less significant in nature.</p>
<b>CONSIDERABLE</b>	<p>Considerable level of assurance.</p> <p>Generally well controlled, although some risks identified which should be addressed.</p>
<b>REASONABLE</b>	<p>Reasonable level of assurance.</p> <p>Adequately controlled, although risks identified which could compromise the overall control environment. Improvements required.</p>
<b>LIMITED</b>	<p>Limited level of assurance.</p> <p>Poorly controlled, with unacceptable levels of risk. Fundamental improvements required urgently.</p>

## APPENDIX 1 – SUMMARY OF STRENGTHS AND WEAKNESSES

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The table below summarises the ratings used during the review and the number of occurrences of each rating identified.

RATING	RISK DESCRIPTION	IMPACT	TOTAL IDENTIFIED DURING REVIEW
1	Significant	(Significant) – Major / unacceptable risk identified. Risks exist which could impact on the key business objectives. Immediate action required to address risks.	2
2	Moderate	(Important) – Risk identified that requires attention. Risks identified which are not business critical but which require management attention as soon as possible.	7
3	Minor	(Minimal) – Low risk partially mitigated but should still be addressed. Audit comments highlight a suggestion or idea that management may want to consider.	4
4	Strength	(No risk) – Good operational practices confirmed. Well controlled processes delivering a sound internal control framework.	18

**APPENDIX 2 – SIGNIFICANT/MODERATE RISK ISSUES IDENTIFIED AND ACTION**

No.	Audit Ref.	Issue & Risk	Audit Comment	Recommendation	Who is Responsible	When will the action be Implemented
1	2.3	<p>The Investment Committee meeting of 6/3/2019 was attended by only 2 of the nominated Committee members, therefore the meeting was not quorate in line with terms of reference for this Committee.</p> <p><b>Risk - Decisions taken could be subject to challenge</b></p>	<p>The Investment Committee terms of reference require 3 members to attend for the meeting to be quorate. However, at the meeting on the 6<sup>th</sup> March 2019, only 2 of the designated Committee members attended (the Leader &amp; Cabinet Member for Resources). The three other nominated Committee members all gave apologies for absence. Cllr Davies was also present, but is not identified in the terms of reference or on the Council website as being a nominated member of the Investment Committee.</p>	<p>If meetings are not quorate, reports should be deferred to a later date when the meeting can be reconvened to take decisions in line with the terms of reference.</p> <p><b>Management Response:</b> <b>Agreed. This approach has already been adopted.</b></p>	<p>Democratic Services</p>	<p>Now implemented</p>

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No.	Audit Ref.	Issue & Risk	Audit Comment	Recommendation	Who is Responsible	When will the action be Implemented
2	3.2	<p>Tender evaluations for the role of external consultants were not available.</p> <p>No tender exercises had been undertaken to appoint Alder King to undertake due diligence on the acquisition or as managing agents.</p> <p><b>Risk – Value for money may not be obtained.</b></p> <p><b>OJEU Regulations breached. Potential legal challenge from alternative service providers.</b></p>	<p>Alder King were appointed as advisors. We were informed that a mini competition had been undertaken and that 3 providers had been invited from a framework.</p> <p>Whilst tender documentation was available, there was no evidence available to demonstrate scoring or evaluations of the submissions received. It was reported that a previous member of staff had undertaken the evaluation and the documentation could not be located. From the documentation available, this exercise was to appoint an advisor up to the value of £25,000 spend.</p> <p>It was noted that there had been no tendering process to appoint Alder King to undertake due diligence on the acquisition or, subsequently, to act as managing agents. In 2018/19, MCC spent £188,826 with Alder King. This level exceeded in a single year the OJEU threshold governing procurement activity for supplies and services for local authorities (the threshold was £181,302 in 2018/19).</p>	<p>In future, tender evaluations should be retained and stored in a central location, allowing them to be accessed even if the person undertaking the evaluation leaves the Authority's employment.</p> <p>A tendering exercise should be undertaken at the earliest opportunity to appoint managing agents for the acquired properties. Alder King should be notified of this intention.</p> <p>The tendering exercise should be undertaken in line with the Authority's Contract Procedure Rules and EU procurement legislation.</p> <p>When the next property is acquired, the award of due diligence work should be done via a tender exercise.</p> <p><b>Management Response:</b></p> <p><b>The appointment of managing of Alder King as our investment advisors was subject to a mini tender via the Crown Commercial Services framework as Audit were advised. The appointment of Alder King as managing</b></p>	<p>Head Of Commercial, Property, Facilities &amp; Fleet</p>	<p>June 2020</p>

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				<p><i>agents for the 2 investment properties was commissioned via the CCS framework. The largest issue however remains the payment of agent's commission for acquisition which is the largest contribution to the aggregated fees. This is payable to the agent that introduces the property and would not always be Alder King.</i></p> <p><i>We will procure a new investment advisors appointment, but if the introducing agent is not our investment advisor, commission fees will still be liable.</i></p>		

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No.	Audit Ref.	Issue & Risk	Audit Comment	Recommendation	Who is Responsible	When will the action be Implemented
3	1.3	<p>Critical success factors were not clearly identifiable within the Commercial Strategy.</p> <p>Risks were not explored appropriately.</p> <p><b>Risk – Failure to monitor the success or failure effectively could result in poor decision making.</b></p>	<p>Although some KPI targets were set, none of these were specifically identified as being critical success factors.</p> <p>Risks have been summarised within the strategy but could have been expanded upon to provide greater detail of the threats faced. The current strategy only included 3 risks arising from property investments.</p>	<p>Critical success factors should be clearly laid out within the Commercial Strategy.</p> <p>All risks should be fully explored and documented within the Strategy.</p> <p><b>Management Response:</b></p> <p><b>Agreed in part. Risks resulting from the Commercial Strategy will result from commercial activity that is undertaken by the Authority and will be unique to any commercialisation of services or commercial acquisition or investment. Each of these will require a business case and as necessary associated due diligence which will both identify risks and mitigations. There are overarching risks relating to the delivery of the Strategy which are already captured. However, this will be reviewed further when the Strategy is subsequently reviewed and updated.</b></p> <p><b>In terms of critical success factors, this is evidenced in the Strategy by the delivery of the action plan and stemming</b></p>	<p>Chief Officer, Resources</p>	<p>March 2020</p>



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No.	Audit Ref.	Issue & Risk	Audit Comment	Recommendation	Who is Responsible	When will the action be Implemented
				<i>from delivery of the key aims of the Strategy outlined in section 4.7.</i>		
4	2.4a	<p>The Investment Committee is not included in the current MCC Constitution.</p> <p><b>Risk - Breach of good governance. Potential for decisions to be taken outside of the approved Council processes.</b></p>	<p>At the time of the review, the most recent constitution was reviewed and published in April 2018. The Investment Committee had not been established at that point and so was not included in the Constitution.</p>	<p>The Constitution should be updated to include appropriate details in relation to the Authority's Investment Committee.</p> <p><b>Management Response:</b></p> <p><b>The Constitution is being amended by the Head of Legal Services &amp; Monitoring Officer.</b></p>	<p>Head of Legal Services &amp; Monitoring Officer</p>	<p>May 2020</p>
5	2.5	<p>Officers attending the Investment Committee were not required to complete Declarations of Interests.</p> <p>The Investment Advisor also did not complete a declaration of interests.</p> <p><b>Risk - Conflict of interests may go undisclosed, potential that information provided to Committee may not be fully independent and objective.</b></p>	<p>It was noted that there was no requirement for declarations of interest to be completed for officers attending the Committee, only elected members. Whilst officers were not decision makers themselves, for the sake of transparency and good governance, any personal interests should be declared in advance of the Committee's discussions.</p> <p>Similarly, there were no requirement for the independent advisors to complete declarations at the start of each potential deal.</p>	<p>The terms of reference should be updated to include the requirement for Officers attending the Investment Committee to complete a Declaration of Interests at each meeting.</p> <p>The Investment Advisor should also be required to complete a Declaration of Interests.</p> <p><b>Management Response:</b></p> <p><b>Agreed.</b></p>	<p>Head Of Commercial, Property, Facilities &amp; Fleet</p>	<p>May 2020</p>

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No.	Audit Ref.	Issue & Risk	Audit Comment	Recommendation	Who is Responsible	When will the action be Implemented
6	2.6	<p>The planned criteria for the annual review of investment performance were limited and could be expanded to allow a more rounded assessment.</p> <p><b><i>Risk - Performance may be assessed on limited criteria, full impact of investments in place may not be assessed.</i></b></p>	<p>Due to the timing of the review, the first acquisition had not reached the due date for annual reporting. The Asset Investment Policy stated that:</p> <p>“An annual performance review of the Investment Committee and any acquisitions will be undertaken and reported to Audit Committee to ascertain performance against the following criteria:</p> <ul style="list-style-type: none"> <li>• Governance arrangements and adherence to policy;</li> <li>• Relevant Market indexes;</li> <li>• Property performance locally</li> <li>• Capital, Income and Total returns.”</li> </ul> <p>Consideration could be given to including the following:</p> <ul style="list-style-type: none"> <li>• Internal rate of return achieved;</li> <li>• Percentage of voids (empty property available for letting)</li> <li>• Any socio-economic targets set (e.g. to stimulate economic activity with the County);</li> <li>• Identification of any under-performing investments; and</li> </ul>	<p>A comprehensive template for the annual performance review should be developed and agreed. This should be used for each review.</p> <p><b><i>Management Response:</i></b></p> <p><b><i>Where appropriate the performance review will be broadened to include measures where information is readily available and is relevant to the performance of the portfolio.</i></b></p>	<p>Chief Officer, Resources</p>	<p>March 2020</p>

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No.	Audit Ref.	Issue & Risk	Audit Comment	Recommendation	Who is Responsible	When will the action be Implemented
			<ul style="list-style-type: none"> <li>Disposals/proposed disposals of any under-performing or surplus to requirements investment properties.</li> </ul>			
7	3.3	<p>No truly independent advice was sought over the purchase of Castlegate Business Park.</p> <p><b><i>Risk - Information provided to inform the purchase decision may not be fully independent or objective.</i></b></p>	<p>It was noted, that MCC were informed of the availability of Castlegate Business Park by Alder King. Alder King therefore benefitted from the sale in fees.</p> <p>Alder King also provided financial figures and oversaw the due diligence processes.</p> <p>No further independent advice was requested by MCC prior to agreeing the site purchase.</p>	<p>Consideration should be given to obtaining an independent opinion on future investment purchases.</p> <p><b><i>Management Response:</i></b></p> <p><b><i>Not agreed – any agent would be bound by the standards of the RICS to provide unbiased professional opinion. This approach would result is us getting an independent valuation of an independent valuation. In the event of any deficiency in the advice provided, we would have recourse through their professional indemnity, the RICS and potentially the courts.</i></b></p>	n/a	n/a

**APPENDIX 2 – SIGNIFICANT/MODERATE RISK ISSUES IDENTIFIED AND ACTION**

No.	Audit Ref.	Issue & Risk	Audit Comment	Recommendation	Who is Responsible	When will the action be Implemented
8	5.1	<p>The risk assessment relating to the Castlegate acquisition was limited and lacked information on the evaluation and management of risks identified.</p> <p><b><i>Risk - Risks may not be adequately assessed, meaning management of these risks may be insufficient.</i></b></p>	<p>Risks of the acquisition were included in the Business Case, which was presented to the Investment Committee.</p> <p>The risks were listed and some context given, but there was no measurement of the level of risk involved or evidence of how these risks would be managed.</p>	<p>Formal risk assessments should be completed for each acquisitions. Evidence of monitoring of risks should be retained.</p> <p><b><i>Management Response:</i></b></p> <p><b><i>Not agreed. A risk assessment was prepared based on the findings of the due diligence and input from internal and external advisors. The risks were challenged by the Chief Officer and Assistant Head of Finance and mitigating actions were required and included in the business case.</i></b></p> <p><b><i>Risks are managed at monthly meetings and will continue to be so.</i></b></p>	n/a	n/a

**APPENDIX 2 – SIGNIFICANT/MODERATE RISK ISSUES IDENTIFIED AND ACTION**

No.	Audit Ref.	Issue & Risk	Audit Comment	Recommendation	Who is Responsible	When will the action be Implemented
9	5.2	<p>Copies of the maintenance programme for Castlegate Business Park could not be provided to Audit at the time of the review.</p> <p><b><i>Risk - Maintenance may not be undertaken in a timely manner. Anticipated future maintenance costs may be understated in acquisition decision making.</i></b></p>	<p>Maintenance arrangements for Castlegate Business Park were managed by Alder King. These were included in the service charges paid by tenants.</p> <p>Copies of this maintenance programme had been requested by Internal Audit, but were not provided to us during our review.</p> <p>As Alder King oversee this process, copies of the programme should be retained by the Council to enable MCC to monitor the work undertaken/ ensure compliance to the planned maintenance schedule and also to ensure that the Authority's asset is being maintained effectively.</p>	<p>A copy of the maintenance programme should be obtained, retained by MCC and monitored to ensure compliance.</p> <p><b><i>Management Response:</i></b></p> <p><b><i>A maintenance programme is available and is monitored on a monthly basis.</i></b></p>	<p><i>Head Of Commercial, Property, Facilities &amp; Fleet</i></p>	<p><i>A maintenance programme is prepared on an annual basis to inform the service charge and monitored monthly.</i></p>

**APPENDIX 3 – MINOR RISKS IDENTIFIED**

No.	Audit Ref	Issue	Audit Comment	Noted
10	1.4	<p>The Asset Investment Policy did not include any overview of the Council's ethical standpoint, which may impact on the nature of properties that the Authority would be willing to invest in (e.g. would any potential investments that could be seen as harmful to the environment be considered, etc.).</p> <p><b><i>Risk - Potential reputational damage if investments made are viewed as unethical. Possibility of costs incurred in researching potential investments, which are then declined by the Investment Committee on ethical grounds.</i></b></p>	<p>The current Strategy did not include any reference to what the Council was, or was not, prepared to invest in.</p>	<p>Agreed, this needs a further report to Full Council to agree this position.</p>
11	2.1	<p>Evaluation of the Investment Committee's effectiveness was not included in their terms of reference.</p> <p><b><i>Risk - Committee may potentially fail to keep up to date with best practice or new initiatives.</i></b></p>	<p>The terms of reference should include the requirement for a regular self-review of the effectiveness of the Committee, to allow for new ideas and initiatives to be implemented over time.</p>	<p>Noted.</p>
12	3.1	<p>Unsuccessful investment opportunities were not formally documented or reported to Committee.</p> <p><b><i>Risk - Potential investment opportunities may not be brought to the attention of the Investment Committee and the reasons for their rejection not disclosed.</i></b></p>	<p>As an initial assessment of potential investment opportunities, the Head Of Commercial, Property, Facilities &amp; Fleet Services and Alder King carried out a rough calculation of the expected return for each scheme. Where the 2% target return after borrowing costs was not met, the investment opportunity was rejected, although any with potential scope for economic development opportunities were referred onwards.</p> <p>These discounted investment opportunities were, however, not recorded or reported to the Investment Committee.</p>	<p>Noted – not clear what value this will add, however if required by IC then a schedule can be prepared and presented to IC.</p>

**APPENDIX 3 – MINOR RISKS IDENTIFIED**

No.	Audit Ref	Issue	Audit Comment	Noted
13	3.7	<p>Disposal process outlines in the Asset Investment Policy did not fully accord with those stated in the Authority's Contract Procedure Rules</p> <p><b><i>Risk - Investment property disposals may be undertaken in breach of the Authority's established Contract Procedure Rules.</i></b></p>	<p>The Asset Investment Policy briefly outlines how investments could be identified as non-performing and steps which could be taken for disposal. There was, however, no reference to disposal at <b>peak value</b> as outlined in the Authority Contract Procedure Rules.</p> <p>The Contract Procedure Rules also mention the need for agreement from the Head of Finance for disposals for over £5k. Section 8.4.1 states: "<i>Assets for disposal must be sent to public auction except where better Value for Money is likely to be obtained by inviting Quotations and Tenders. (These may be invited by advertising on the Council's intranet site).</i>"</p>	<p>The disposal of surplus operational assets is different from the sale of commercial investments, Given that if a commercial investment is generating peak income it would be generating an income surplus which is one of the core principals of the investment and therefore it is unlikely we would seek an exit strategy at that point. This needs to be considered as part of the constitution amendments.</p>

## APPENDIX 4 – CONTROL STRENGTHS IDENTIFIED

No.	Audit Ref.	Strength Identified
14	1.1a	The Authority has a Commercial Strategy, which sets out strategic direction/objectives. This is linked, to the Authority's latest Corporate Plan and consistent with the documented strategic objectives.
15	1.2	The Commercial Strategy is integrated with the other key strategic and policy documents of the Council
16	1.4a	An Asset Investment Policy had been developed covering the processes to be followed for the identification, purchase, management and monitoring of investment properties.
17	1.5	The Asset Investment Policy has been prepared in consultation with appropriate internal experts, including Finance, Legal and Estates, and has been based upon good practice guidance for the local government sector.
18	1.5a	Specific actions and performance targets were included in Service Business Plan.
19	2.1a	An Investment Committee has been established to govern the Authority's property investments. Terms of reference were in place for the Investment Committee.
20	2.5a	Declarations of interests were sought for elected members attending the Investment Committee (although see finding 5 above).
21	3.3	Based on the figures provided, the Castlegate Business Park was purchased in line with the Asset Investment Policy and Capital Programme.
22	3.3a	The Castlegate acquisition was the subject of a Business Case, which was created in conjunction with the Council's Finance team.
23	3.4	<p>The Castlegate acquisition was subject to</p> <ul style="list-style-type: none"> <li>• A valuation report supporting the purchase price (although see finding 7 above).</li> <li>• Satisfactory building survey and assessment of economic life; and</li> <li>• Satisfactory report on title.</li> <li>• Due consideration of any existing tenancies, facilities management services, etc.</li> </ul>
24	3.5	Approval for the Castlegate acquisition was obtained from the Investment Committee.



## APPENDIX 4 – CONTROL STRENGTHS IDENTIFIED

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No.	Audit Ref.	Strength Identified
25	3.6	The Castlegate acquisition was conducted in accordance with the Authority's Contract Procedure Rules and Financial Procedure Rules.
26	4.1	A borrowing options assessment was undertaken by Finance.
27	4.2	Cost of borrowing had been compared to the potential income to ensure that the threshold of return anticipated was to be met.
28	4.3	Individual/specific cost centres had been developed to account for all related costs and income to allow effective management of each acquisition.
29	5.3	Castlegate Business Park was found to be appropriately insured.
30	5.4	The Authority had registered the ownership of its investment property assets and retained title deeds to evidence this.
31	5.5	The Authority's investment properties had been included in appropriate asset recording systems.