

FINAL INTERNAL AUDIT REPORT

PLACE DIRECTORATE

Review of Commercial and Non-office Owned Property Audit

Issued to: AD Strategic Property
Head of Estates and Asset Management
Director of Housing Planning and Regeneration
Head of Finance ECS and Corporate
AD Exchequer Services

Prepared by: Internal Auditor

Reviewed by: Senior Auditor
Partner

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Report No.: PLA/09/2021

INTRODUCTION

1. This report sets out the results of our internal audit of the management of commercial property owned by the London Borough of Bromley.
2. The audit reviewed whether effective management of the Council's commercial property portfolio is in place to ensure that:
 - The maximum return is received from the Council's commercial property portfolio;
 - Properties are managed in compliance with relevant legislation and insurance requirements; and
 - Sufficient management oversight is in place, with issues escalated and resolved promptly.
3. In scoping the audit, it was recognised that the service is developing new systems and processes due to the Transformation of Property Programme. Consequently, as part of the evaluation process, the audit considered whether Managers identified key risks and issues and whether the proposed actions will reduce risks to an acceptable level.
4. This fieldwork for this review was completed remotely in response to Covid-19. However, we could not obtain all information required to complete the review.
5. We would like to thank all staff contacted during this review for their assistance and co-operation.

AUDIT SCOPE

6. The original scope of the audit was outlined in the terms of reference issued in March 2022.
7. The audit included a review of relevant documentation, interviews with key officers and testing of related procedures and processes. The controls in place to mitigate the impact of the key risk areas were examined. Controls relating to departmental risks were also examined where applicable.
8. The following were considered to be the key risks to the process:
 - Tenancy agreements are not in place, providing scope for potential disputes between tenants and the Council;
 - Actions are not taken to mitigate risks identified by the Insurance provider within the proposed timeframe;
 - Properties are not maintained following health and safety and insurance requirements;
 - Rent opportunities afforded via lease arrangements are not managed on time so as to result in missed opportunities or delayed revenue streams;
 - Insufficient record-keeping and monitoring of rental income, resulting in financial loss to the Council and debts become irrecoverable (this function is outsourced to the Council's Exchequer Services contractor); and

- There is inadequate governance and reporting on the management of properties. This includes the availability and sharing of relevant information to ensure decision-making robustness.

AUDIT OPINION

9. Our overall audit opinion, number and rating of recommendations are as follows.

AUDIT OPINION	
Reasonable Assurance	(Definitions of the audit assurance level and recommendation ratings can be found in Appendix B)

Number of recommendations by risk rating		
Priority 1	Priority 2	Priority 3
0	3	2

SUMMARY OF FINDINGS

10. Below are examples of controls noted to be in place and working effectively, based on the audit testing conducted. In addition, where we have identified issues, we have also highlighted these below:
- Following the Council's property portfolio management handover from a contractor in May 2021, a gap analysis was conducted by the Asset Management & Estates Team to identify areas where service delivery was not as desired. This gap analysis identified that the existing Property Management System was not meeting the Council's basic requirements for several reasons. These were detailed in a specification for procuring a new Property Management System. The gap analysis also found insufficient capacity to effectively deliver the service functions of the Estates and Asset Management

team, with the team comprising three fewer members than it did before outsourcing. We confirmed that actions were taken to address these issues by filing business cases for additional resourcing and procuring a new Property Management Software System. Our review of these business cases found that the request to award the contract was approved by the Director of Housing, Planning and Regeneration. The Head of Estates and Asset Management indicated that the business case for additional funding for recruiting four surveyors was signed off recently. However, we did not obtain evidence of formal approval for this business case.

The Head of Estates and Asset Management indicated that a risk register relating to Operational Estates is maintained by the Facilities Management team. However, we noted that an operational risk register detailing all of the key risks associated with the management of the Commercial Property Portfolio was not in place (*see Issue 1 in the detailed findings section*).

The Estates and Asset Management team maintains a workstream tracker, which is updated and reviewed weekly. Lease events are identified in a caution list, allowing for projects to be allocated to surveyors in a time-efficient manner to ensure effective property portfolio management. The lease events identified within the caution list are added as tasks to the workstream tracker, which are allocated to surveyors accordingly. Our review of the workstream tracker confirmed that each task is RAG rated in terms of value and the risk profile of the task at hand. Through a review of calendar invites, we also confirmed that weekly meetings to review the workstream tracker were scheduled by the Head of Estates and Asset Management, effective from March 2021.

- The Estates and Asset Management team has documented procedures for the functions associated with managing the Council's property portfolio. Our review identified that these procedures constitute an overarching procedures manual, which was last reviewed in November 2015, before the Council outsourced the property and facilities management of its Estate in November 2016. The Estates and Asset Management team are in the process of reviewing these documented procedures to create a suite of documents that will aid in training recruits to junior surveyor positions. This project is also simultaneous with the creation of technical workflow plans for the new Property Management Software System. We obtained a manual workflow plan and confirmed that procedural documents for each function undertaken by the team were proposed as items to be developed and incorporated into the Property Management Software System. We have not raised a recommendation as a result. The manual workflow plans are a live project that has not yet been completed.

We obtained the work-in-progress guidance notes and flowcharts. Our review of the rent review guidance notes confirmed that the importance and benefits of undertaking rent reviews for the Council are defined. Further, we found that proformas used at different stages of the rent review process are referenced where relevant. The flowchart depicting the rent review procedure is consistent with the information in the rent review guidance notes.

- Proformas had been developed as part of the work-in-progress suite of documents detailed in the manual workflow plan. The Head of Estates and Asset Management indicated that standard documents for external communications are also a

work in progress. A review of the documents produced at the time of writing confirmed that these had been standardised to ensure that a consistent approach in completing process-driven tasks is followed. Our review found that all documents produced for internal use were consistent in design, enhancing the efficiency of the Estates and Asset Management team in completing tasks that are process driven.

- Our testing of a sample of five commercial properties owned by the Council confirmed that:
 - In all five cases, a tenancy agreement was retained on file, with the rights and responsibilities of the tenant and the Council detailed.
- Lease expiry dates and therefore renewals vary from year to year and across different properties. The Head of Estates and Asset Management confirmed that only two lease renewals had occurred during 2021/22 at the time of our fieldwork. Examining these two lease renewal events confirmed that Lease Renewal Agreements were retained on file in both cases, with the rights and responsibilities of both the tenant and landlord defined.
- Our testing of a sample of five rent reviews occurring between May and December 2021 found that:
 - In all five cases, rent reviews were linked to the Retail Price Index (RPI), for which rent review memorandums are not required.
 - In two of the five cases reviewed, the Head of Estates and Asset Management indicated that the Council leases the property from the freeholder. We noted that in these cases, there is no need for the Council to document rent reviews and issue instructions to the Exchequer contractor to ensure that the revised rent is collected following review, as this is the landlord's responsibility. However, the Estates and Asset Management team performs calculations and adjusts rental payments to the landlord accordingly. This is to mitigate the risk of delays in the landlord implementing changes resulting from each RPI-linked rent review.
 - Examination of the data extract from the pre-existing Property Management System found that there were 60 rent reviews due in 2021/22 (15 of which were RPIs). The Property Management System extract indicates that rent reviews were not undertaken for 43 out of the 60 properties for which rent reviews were due in 2021/22 (*see Issue 2 in the detailed findings section*)
- We reviewed the Council's Insurance Policy relating to Council-owned property. We observed that conditions outlining the Council obligations in taking precautions, such as fire precautions, were detailed. However, the Assistant Director of Property indicated that the Facilities Management team maintains a risk register relating to operational estates owned by the Council. We confirmed that, although a risk register specific to commercial property was not in place, risk assessments for undertaking site visits and lone working were available and signed off by the Head of Estates and Asset Management in February 2022. Further, we noted that the Estates Team do not obtain assurance confirming properties are insured by Tenants (when they are required to do so) (*see Issue 3 in the detailed findings section*).

- The Head of Estates and Asset Management and the Assistant Director of property indicated that the Council are not responsible for conducting Health and Safety checks on commercial properties as this is not a statutory requirement. Maintaining properties following Health and Safety standards is contracted to tenants by default. Our review of the lease agreements received for a sample of five commercial properties owned by the Council confirmed that this is provided in each contract. We were also informed that, although not a statutory requirement, there are certain high-risk retail premises for which Health and Safety checks should be conducted. However, we noted that procedures for how this should be done have not yet been documented (*see Issue 4 in the detailed findings section*). It was confirmed that a third-party Health and Safety Consultant, was commissioned to undertake Retail Compliance Audits for these premises in March 2021. We found that the Estates and Asset Management team produced a Health and Safety Compliance Schedule for these audits based on the tenants' statutory requirements. We identified that the Health and Safety Consultant conducted safety checks for 60 retail premises in total during 2021/22. The Head of Estates and Asset Management confirmed that the Council has consulted with external legal advisors to issue legal notices to any tenants identified as non-compliant with Health and Safety standards, reminding them of their legal obligations to comply with Health and Safety legislation.
- The Council requested the services of external legal advisors, in issuing legal notices that remind non-compliant Shop Parades of their legal obligations to comply with Health and Safety standards. We were informed that where tenants fail to demonstrate compliance with Health and Safety standards within a given timeframe, the Council's legal representatives would commence enforcement action.
- The Council's Exchequer Services contractor is responsible for raising and rendering invoices upon request from the Estates and Asset Management team. Recurring sessions to review the rent schedule had been arranged to occur monthly from November 2021. This allows the Estates and Asset Management team to raise any concerns and determine in real-time that the Exchequer contractor has actioned instructions. Our review of email correspondence between the Estates and Asset Management Team and the Exchequer contractor confirmed that an instruction template was created and jointly signed off by both parties. This was used in all instances between December 2020 and March 2022 where instructions were raised. We also confirmed that an agreed action plan was communicated by the Estates and Asset Management team to the Exchequer contractor following each rent review session. However, our review of email correspondence found cases where there were inefficiencies in the communication between the Estates and Asset Management team and the Exchequer contractor (*see Issue 5 in the detailed findings section*). This included an email chain with a request raised by the Head of Estates and Asset Management to the Exchequer contractor for the inclusion of a column that identifies the property address of each tenant detailed in the monthly debtor reports on 1st December 2020. In this instance, we found that this amendment to the monthly debtor report was not actioned until 22nd September 2021, ten months after the query was raised.
- Through discussion with the Operations Manager of Income and Recovery (Exchequer contractor), we confirmed that the Exchequer contractor is responsible for recovering missed rental payments. We were also informed that the Exchequer

contractor issued an aged debtor report to the Council every month. This has recently been amended to include information on the address of each tenant listed in the report. Our review of the aged debtor reports for the months covering March 2021 to March 2022 confirmed that the Exchequer contractor issues aged debtor reports monthly. Furthermore, debt review sessions to discuss unresolved disputes were scheduled quarterly from November 2021. We confirmed that the Estates and Asset Management team share an Action Plan following each session, which includes debt-specific queries. The Exchequer contractor's monthly aged debt reports indicate the following debt over 30 days from December 2021 to March 2022:

- Dec 21: £5.2m (over 30 days)
 - Jan 22: £5.1m (over 30 days)
 - Feb 22: £3.8m (over 30 days)
 - Mar 22: £4.3m (over 30 days)
- We obtained a copy of the system workflow for the debt recovery process agreed upon by the Council and the Exchequer contractor. Our review of this system workflow confirmed that steps taken at each stage of the debt recovery process, following the issuance of two reminder letters at 21 and 35 days after invoicing, are detailed. The stages of debt recovery followed by the Exchequer contractor include calling the debtor and discussing reasons for missed payments. Where the tenant refuses to pay, and the debt exceeds £5000, the system is instructed to auto-transfer the case to a Court Action Workflow. If the debt is less than £5000, the case is auto-transferred to a Debt Collector Workflow. In instances where the tenant agrees to pay the amount of outstanding debt, a payment plan is agreed upon. No further testing was undertaken on this area as the responsibility for debt recovery is with the Exchequer contractor.
 - The Finance team is responsible for reporting on rental income and collection performance, which assists the Estates and Asset Management team in making informed decisions on rental payment plans. We obtained rent reports covering the months April 2021 to March 2022 from the Head of Finance (Environment and Corporate Services). These reports are issued to the Estates and Asset Management team monthly. It was also noted that these reports are a useful indicator of the performance of the Estates and Asset Management in managing the property portfolio.
 - We were informed that annual Investment Portfolio reviews are issued by the Head of Estates and Asset Management to the Council's Resources Scrutiny Committee. These reports are available to the public and detail the investment fund's performance, aiming to demonstrate this performance in a wider market context. Our review of the annual report issued in February 2022 confirmed that the performance of the property portfolio and governance around the portfolio management had been reported.

11. The findings of this report and an assessment of the risk associated with any control weaknesses identified are detailed in the Detailed Findings / Management Action Plan. Any management recommendations are prioritised in line with the criteria set within Appendix A.

DETAILED FINDINGS / MANAGEMENT ACTION PLAN

APPENDIX A

No.	Finding	Risk	Recommendation and Priority	Management Response	Agreed Timescale and Responsible Manager
1	<p><u>Internal Control Framework</u></p> <p>The Head of Estates and Asset Management led the gap analysis undertaken with the assistance of the Estates and Asset Management team.</p> <p>This analysis identified two key risks relating to resourcing and the pre-existing Property Management System.</p> <p>The Head of Estates and Asset Management indicated that a risk register relating to Operational Estates is maintained by the Facilities Management team.</p> <p>However, we noted that an operational risk register detailing all of the key risks associated with the management of the Commercial Property Portfolio was not in place.</p>	<p>Where operational risks are not identified and mitigated, risks could materialise, leading to disruption in the management of the Commercial Property Portfolio.</p>	<p>We recommend that a risk register specific to the Estates and Asset Management team is developed to ensure that appropriate measures are being taken to mitigate all risks associated with the management of the Commercial Property Portfolio.</p> <p style="text-align: center;">Priority 2</p>	<p>The Caution list and Tracker is the Estates' Team day to day operational risk register.</p> <p>This highlights lease events that require monitoring and action and there is a RAG status against each task to prioritise both importance and progress.</p> <p>This was shared with audit.</p> <p>A further risk register to highlight strategic or overarching risks that sit out of the day to day management of the Estate has now been created and forms part of the agenda of the bi-weekly head of service meetings within the Strategic Property department.</p>	<p>Head of Estates & Asset Management</p> <p>Action Completed.</p>

<p>2</p>	<p><u>Rent Reviews</u></p> <p>The Rent Review Guidance Notes detail that the Estates and Asset Management team will be notified of rent reviews nine months in advance of the effective review date. This will be followed by the issuance of two reminders six months and three months prior to the review date.</p> <p>Examination of the data extract from the pre-existing Property Management System found that there were 60 rent reviews due in 2021/22 (15 of which were RPIs). The system extract indicates that rent reviews were not undertaken for 43 out of the 60 properties for which rent reviews were due in 2021/22.</p>	<p>Where open market rent reviews are not conducted for Commercial Properties owned by the Council, there is a risk that the rent does not reflect the rent that would be achieved on a letting in the open market, resulting in financial loss to the Council.</p>	<p>We recommend that the Team Tracker is reconciled with the Property Management System to ensure that rent reviews are undertaken when due.</p> <p style="text-align: center;">Priority 2</p>	<p>The backlog of work that was handed back to LBB on termination of the contract in May 2021 was significant.</p> <p>This was outlined in great detail in a business case to Senior Officers and Members dated March 2022 recommending additional resource would be required to clear the backlog and avoid a build-up of overdue cases reoccurring.</p> <p>Members agreed to the recommendations and recruitment for additional resources is now underway.</p> <p>This was shared with audit.</p> <p>During the audit which was commenced in April 2022, the team confirmed that the new property management system that was being set up would flag rent review dates automatically.</p> <p>This has now been completed.</p>	<p>Head of Estates & Asset Management</p> <p>Action completed.</p>
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<p>3</p>	<p><u>Assurance on Properties' Insurance</u></p> <p>The Assistant Director of Property indicated that the Insurance Provider issues advisory alerts, usually following a reform in the insurance industry.</p> <p>However, no evidence was provided to internal audit to support these were received regularly. In addition, the Head of Insurance indicated that they are not aware of any regular advisory notes issued by the Insurer.</p> <p>We noted that the Estates Team does not obtain assurance to confirm properties are insured by tenants (where tenants are responsible to do so).</p>	<p>Tenants are unaware of their obligations to maintain property following insurance requirements.</p>	<p>The Council should obtain assurance, where the tenant is responsible for the insurance, that all commercial properties are insured to the Council's requirements.</p> <p style="text-align: center;">Priority 3</p>	<p>The Estates Team will obtain assurance confirming that tenants responsible for their insurance arrangements have actually insured the properties in line with Council's requirements.</p>	<p>Head of Estates & Asset Management</p> <p>Sept 22 – Actioned / ongoing action</p>
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<p>4</p>	<p><u>Health and Safety Checks</u></p> <p>We noted that a third-party Health and Safety Consultant had been appointed in March 2021 on an ad-hoc basis to conduct Retail Compliance Audits on Shop Parades.</p> <p>We were also informed that there are plans for the Estates and Asset Management team to conduct Health and Safety checks of these properties, whereby tenants must demonstrate compliance with Health and Safety standards and thus, the terms laid out in the lease agreement.</p> <p>However, we found that the procedures for these checks have not yet been formally documented.</p>	<p>Where Health and Safety checks are not periodically conducted for high-risk retail premises, there is an increased risk that commercial properties are not maintained in line with Health and Safety standards.</p>	<p>Management should identify high-risk retail premises and produce an action plan to conduct Health and Safety checks for a sample of these properties per annum.</p> <p>We recommend that the procedures for conducting these checks are formally documented and that Health and Safety checklists are designed in line with statutory Health and Safety requirements.</p> <p>Further to this, the outcomes of Health and Safety checks undertaken for retail premises should be reported in the annual Portfolio Investment reviews.</p> <p style="text-align: center;">Priority 2</p>	<p>We will (and do) request H&S information from tenants who are legally responsible to discharging these obligations and store these responses on our system.</p> <p>Where no response is received, then appropriate action to clarify the area of concern is made which ultimately could lead to enforcement action.</p> <p>However, we cannot undertake site inspections as we are not resourced to do this and it would expose the Council to liability for matters that are wholly the responsibility of the tenant if we were to start inspecting.</p> <p>In terms for recording outcomes of H&S Checks; this will cover all properties that are reported on within the Investment Fund Annual Report.</p>	<p>Head of Estates & Asset Management</p> <p>Sept 22 Action completed / ongoing</p>
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<p>5</p>	<p><u>Communication with the Exchequer contractor</u></p> <p>The functions of rental payment collection and debt recovery are outsourced to the Council's Exchequer Services contractor.</p> <p>Our review of email correspondence between the Estates and Asset Management team and the Exchequer contractor found one instance where a query was raised by the Estates and Asset Management team for the Exchequer contractor to include the address of each tenant listed in the monthly debtor report. We confirmed that this query had been actioned, but ten months after it was raised.</p> <p>We also found cases where there was more than a one-week time lag between instructions raised by the Estates and Asset Management team, and confirmation received that the Exchequer contractor had actioned these</p>	<p>Where issues in rental payments made by tenants are identified, there is a risk that such issues are not resolved in a time-efficient manner, resulting in financial loss to the Council.</p>	<p>We recommend that the communication between the Estates and Asset Management team is tightened through the introduction of monthly meetings between the Estates and Asset Management team, the Contract Monitoring team and the Exchequer contractor. Minutes from these meetings should be recorded and distributed to all attendees. This would ensure that underlying queries are raised and resolved and assist in monitoring the performance of the Exchequer contractor against their Service Level Agreement.</p> <p>Management should consider implementing the use of an online portal through which instructions can be submitted to the Exchequer contractor by the Estates and Asset Management team.</p> <p>We recommend that the online platform allows the Exchequer contractor to confirm the status of instructions as and when these are completed. This would improve the visibility of actions taken by the Exchequer contractor and allow for the Estates and Asset Management team to monitor the status of instructions raised each month.</p> <div data-bbox="1061 1406 1240 1465" style="text-align: center; background-color: #90EE90; border: 1px solid black; padding: 2px;"> <p>Priority 3</p> </div>	<p>The recommendation is welcomed by the Estates Team as it would bolster the monthly meetings already taking place between the Exchequer contractor & Estates.</p> <p>The Director of Finance has already set in motion a series of meetings to address the audit findings and operational concerns that property raised as part of that audit.</p> <p>Monthly meetings are already taking place between the contractor and the Estates Team. These will be attended by a member of the Contract Monitoring Team.</p> <p>The use of an online portal will be explored with the Estates Team.</p>	<p>Assistant Director Exchequer Services / Service Delivery Manager</p> <p>September 2022 Action completed / ongoing.</p>
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OPINION DEFINITIONS

Assurance Level

APPENDIX B

Assurance Level	Definition
Substantial Assurance	There is a sound system of control in place to achieve the service or system objectives. Risks are being managed effectively and any issues identified are minor in nature.
Reasonable Assurance	There is generally a sound system of control in place but there are weaknesses which put some of the service or system objectives at risk. Management attention is required.
Limited Assurance	There are significant control weaknesses which put the service or system objectives at risk. If unresolved these may result in error, abuse, loss or reputational damage and therefore require urgent management attention.
No Assurance	There are major weaknesses in the control environment. The service or system is exposed to the risk of significant error, abuse, loss or reputational damage. Immediate action must be taken by management to resolve the issues identified.

Recommendation ratings

Risk rating	Definition
Priority 1	A high priority finding which indicates a fundamental weakness or failure in control which could lead to service or system objectives not being achieved. The Council is exposed to significant risk and management should address the recommendation urgently.
Priority 2	A medium priority finding which indicates a weakness in control that could lead to service or system objectives not being achieved. Timely management action is required to address the recommendation and mitigate the risk.
Priority 3	A low priority finding which has identified that the efficiency or effectiveness of the control environment could be improved. Management action is suggested to enhance existing controls.