

# Hinckley and Bosworth Borough Council

## Commercial Rents

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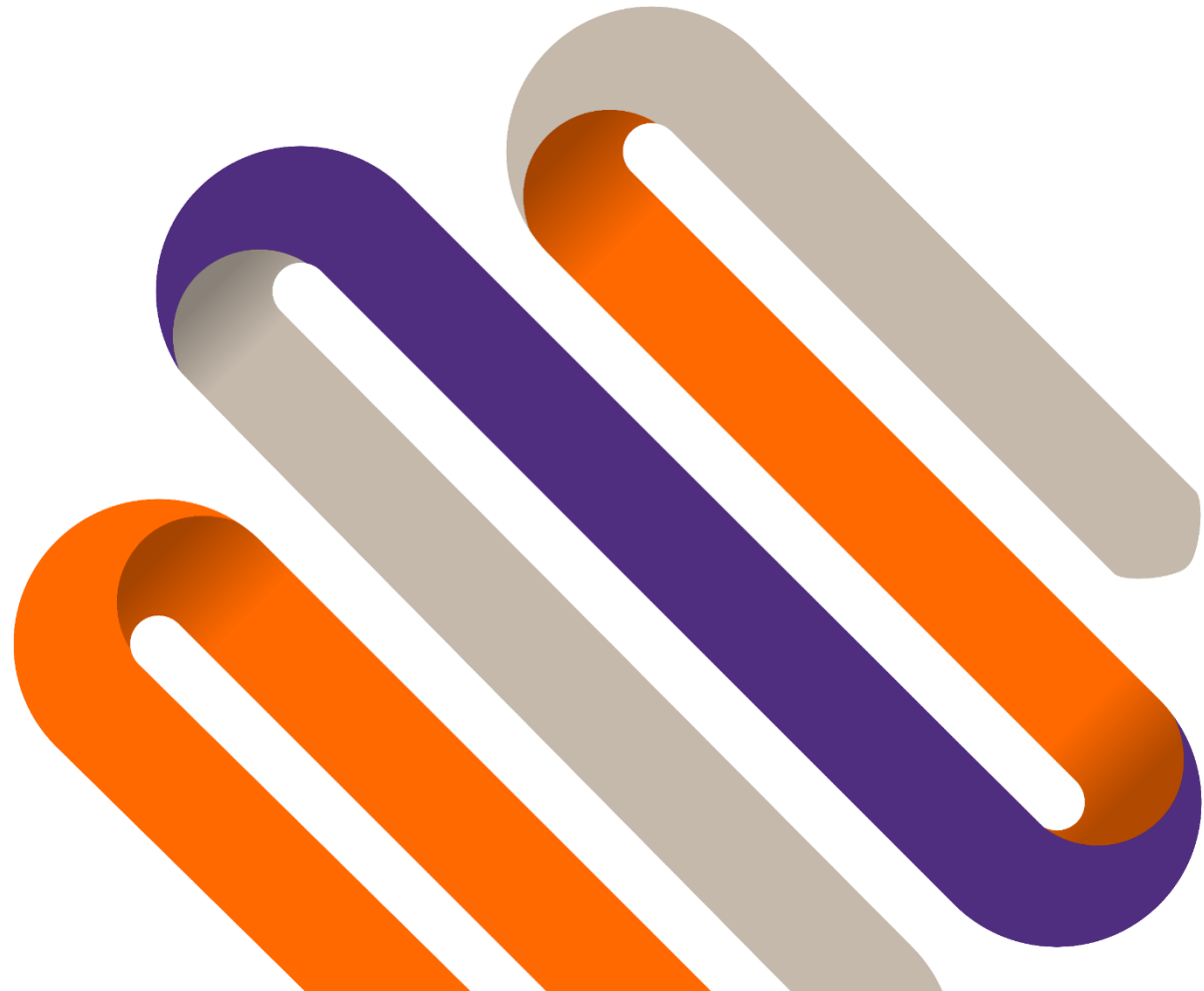
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## Report distribution:

### For action:

- Commercial Estates Surveyor
- Estates & Asset Manager

### Responsible Executives:

- Director (Corporate Services)

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It is the responsibility solely of the entities management and directors to ensure there are adequate arrangements in place in relation to risk management, governance, control and value for money.

# Executive Summary

## Background

Hinckley and Bosworth Council's statutory accounts show that commercial income from leases in 2019/20 was £1.5 million.

The council holds a portfolio of industrial properties made up of 89 industrial units ranging from 500 and 3,000 square feet. In 2019/20 £0.8 million of rent was earned on these properties.

The range of properties available means that it is accessible to a wide range of users. The portfolio supports the Council in delivering its corporate priority 'Prosperity: encouraging growth, attracting businesses, improving skills and supporting regeneration'. Commercial rent provides an important income stream for the Council, which with the current financial pressures within the sector, is increasingly important.

The Council's industrial units are spread over five industrial estates,

- Dodwell's Bridge Industrial Estate (Hinckley Business Park)
- Merrylees Industrial Estate
- Sketchley Lane Industrial Estate (Sketchley Meadows)
- Hinckley Fields Industrial Estate (Sunnyside Park)
- Greenfields Business Park

The Council also earns commercial income from retail and letting out parts of office properties, however we will focus this review on the Council's industrial estate portfolio.

## Objectives

The objective of the review is to provide an independent assessment of the effectiveness of the Council's financial management of its Industrial units. We will focus on the key risks, the design and operational effectiveness of its arrangements around management of tenants' leases and the arrangements for the collection of rents.

Our review focussed on the following potential risks:

- Rental property data and lease information is incomplete or not up to date,
- Lease / rental terms are not appropriately scoped or been reviewed in line with policy,
- All rent due is not collected in line with the lease / rental agreement or in a timely way,
- Rent arrears are not appropriately managed and collected by the Council.

## Timing of our work

The audit work for this engagement was carried out in early 2020, however finalisation of the report was delayed by Covid-19. We met with management in February 2021 to discuss the findings and subsequent progress, to ensure that our report is accurate and our recommendations made remain both relevant and appropriate.

## Limitations in scope

Please note that our conclusion is limited by scope. It is limited to the risks outlined above. Other risks exist in this process which our review and therefore our conclusion has not considered. Where sample testing has been undertaken, our findings and conclusions are limited to the items selected for testing.

This report does not constitute an assurance engagement as set out under ISAE 3000.

# Executive Summary

## Conclusion

### Partial assurance with improvement required

We have reviewed the design and operation of the Council's control arrangements relating to commercial rents and have concluded that the process has provided a **PARTIAL ASSURANCE WITH IMPROVEMENT REQUIRED** level of assurance. The Controls tested are set out in the agreed Audit Planning Brief.

The objectives reviewed are set out below with the assurance rating we have assessed for each one and the number of recommendations raised. We have reported by exception against the areas where we consider that Management and the Audit Committee should focus their attention.

The publication of this report has been delayed due to Covid-19. In the interim, management have conducted their own investigation into this area, the outcomes of which have been reflected in the appropriate 'Action Plan' sections of this report.

Objectives	Assurance rating and number of recommendations
The rent collected is not in line with the underlying lease/rental agreement.	Partial assurance with improvement required (2 high recommendations)
Lease/rental agreement terms are not appropriately scoped and/or have not been reviewed in line with the Council's policies and procedures.	Partial assurance with improvement required (1 high recommendation)
Rent and lease policies are not clear, or based on reliable data so that rent charged or lease terms are not appropriate. This may be because rents are not based on actual costs, market rents or the basis of any subsidy or discount is not clear.	Partial assurance with improvement required (3 medium recommendations)
Rental property data and lease information is incomplete or not up to date,	Significant assurance with some improvement required (1 low recommendation)
Rent arrears are not identified or dealt with appropriately.	Significant assurance (1 improvement recommendation)

## Good practice

We have identified the following areas of good practice:

- A monthly review of the debtors ledger is performed and priority debts are identified and chased.
- A tracking documentation is maintained with details of all current tenancies.

## Areas for development

We have identified several areas which require improvement including:

- The maintenance of up to date lease / rental agreements
- Managements review of the terms of new leases
- Managements review of expected rent reviews
- The basis upon which rental levels are set, including the ability to assess the profit / loss made on individual properties

## Recommendations

Based on our findings, we have raised 3 high, 3 medium and 1 low risk recommendation to address the weaknesses identified.

	High	Med	Low	Imp
Detailed findings	3	3	1	1

## Acknowledgement

We would like to take this opportunity to thank your staff for their co-operation during this internal audit.

# Key findings and recommendations

In this section we set out the detailed findings arising from our work. Details of what each of the assurance level colour ratings represents can be found in Appendix 2b.

Risk Area	Findings and Recommendation	Action Plan
<p>The rent collected is not in line with the underlying lease/rental agreement.</p>	<p><b>Key findings</b></p> <p>No significant controls were identified for ensuring that the rent being collected from tenants was in line with an underlying lease agreement. We noted a lack of segregation of duties in the processes of monitoring, negotiating and processing lease agreements for industrial properties.</p> <p>Furthermore, for 6 out of the 25 units sampled, the lease agreement had either expired or no lease could be provided at all. In all of these cases we could see that rental income was still being received from the tenants.</p> <p>Of the 21 units where a lease / rental agreement was available (whether expired or not), 14 had a variance between the actual annual charge compared to that which was expected based on the underlying lease / rental agreement. However, in all cases the difference noted was below £75 and deemed to be trivial.</p> <p><b>Issue identified:</b></p> <p>There is no process in place to ensure that the rent being collected from tenants is in line with the lease / rental agreement and in some cases there was no lease / rental agreement in place. A potential lack of segregation of duties was also noted.</p> <p><b>Risk:</b></p> <p>There is a risk that the Council could lose out on income if tenants are underpaying. This is likely to be a particular risk where agreements include a provision for a rent increase part way through the tenancy period.</p> <p>The failure to maintain current, formal, lease / rental agreements could expose the Council to the risk of lost income were tenants to contest the amount of rent they believe to be payable.</p> <p>A lack of segregation of duties in the agreement and re-negotiation of lease / rental agreements could impact on the perceived integrity of the Council's decision making in this area.</p> <p><b>Recommendations:</b></p> <ul style="list-style-type: none"> <li>An exercise should be undertaken to ensure that all tenants have current leases / tenancy agreements. Current leases should be periodically reviewed by a member of management to ensure that leases are up to date and new tenancy agreements have been issued where necessary.</li> <li>Additionally, the proposed terms of all new leases should be reviewed and approved by management, before being sent to the legal department. The legal department should not process the preparation of the new lease without evidence of this approval from management.</li> </ul>	<p><b>Management Response:</b></p> <p>An exercise has now been undertaken to ensure all tenants have current leases / tenancy agreements and a backlog programme is in place to update any outstanding agreements. Tenants have regular open discussion with the Commercial Estates Surveyor if their financial circumstances change and they require support outside of their legal agreements. Any support offered to tenants is approved by both the Estates &amp; Asset Manager and Head of Finance.</p> <p>Precedent leases produced by legal services are now in place where appropriate and regular legal update meetings are in place to review the position of the commercial estates these are attended and chaired by the Estates and Asset Manager.</p> <p>Precedent lease agreements are now updated and in place and approved by the Estates and Asset Manager. Rents are advised by an independent surveyor on a 5-year basis and new agreements are negotiated around these terms. Larger value lease agreements i.e. retail lease agreements within the Crescent are agreed in collaboration with the Commercial Estates Surveyor, Estates and Asset Manager and the Head of Finance.</p> <p><b>Responsible Officer:</b></p> <p>Estates and asset Manager</p> <p><b>Executive Lead:</b></p> <p>Director of Corporate Services</p> <p><b>Due date:</b> implemented (not confirmed by internal audit)</p>

# Key findings and recommendations

Risk Area	Findings and Recommendation	Action Plan
<p>Lease / rental agreement terms are not appropriately scoped and / or have not been reviewed in line with the Council's policies and procedures.</p>	<p><b>Key findings</b></p> <p>The majority of the lease / rental agreements sampled included a provision for an annual rent increase. However, no significant controls were identified to ensure that these rent increases are being implemented in line with the agreements.</p> <p>Of the 25 units sampled:</p> <ul style="list-style-type: none"> <li>- 9 had not had a rent increase during the year as the lease / agreement had been newly issued during the year and therefore a rent increase was not yet due, this meant they were not applicable for testing.</li> <li>- 6 had not had a rent increase because the lease agreement had expired and no new agreement had yet been issued (see previous recommendation)</li> <li>- 1 had received a rent increase despite the lease having expired. We were informed that this is because a new lease should have been issued to the tenant with a higher rent,</li> <li>- 4 had received a rent increase in line with the lease agreement, however in all these cases the increase was not implemented in a timely manner,</li> <li>- 4 had received rent increases which were higher than allowed for in the lease agreement. One of these was also implemented later than expected, and</li> <li>- 1 had never had a rent increase (as at March 2020) despite one being due in September 2019.</li> </ul> <p><b>Issue identified:</b></p> <p>There are insufficient checks / controls in place to ensure that rent increases are taking place, in a timely manner, and in line with the underlying lease / rental agreement.</p> <p><b>Risk:</b></p> <p>The Council is at risk of losing income if tenants continue to pay a lower rent than they should.</p> <p><b>Recommendations:</b></p> <p>Controls should be implemented to ensure that annual rent increases are taking place in a timely manner. This could involve management performing a periodic review of tenancies where a rent increase should have taken place.</p>	<p><b>Management Response:</b></p> <p>An exercise has now been undertaken to ensure all tenants have current leases / tenancy agreements and a backlog programme is in place to update any outstanding agreements. All lease agreements are now entered into the ePIMs database when updated alongside diary events for lease renewals.</p> <p>Additional checks are now in place and matters recorded directly into the Lease Terrier. All current lease / rental agreements are now discussed at the fortnightly Legal Update meetings chaired by the Estates &amp; Asset Manager.</p> <p><b>Responsible Officer:</b></p> <p>Estates &amp; Asset Manager.</p> <p><b>Executive Lead:</b></p> <p>Director of Corporate Services</p> <p><b>Due date:</b> implemented (not confirmed by internal audit)</p>

# Key findings and recommendations

Risk Area	Findings and Recommendation	Action Plan
<p>Rent and lease policies for industrial properties are not clear, or based on reliable data so that rent charged or lease terms are not appropriate. This may be because rents are not based on actual costs, market rents or the basis of any subsidy or discount is not clear.</p>	<p><b>Key findings</b></p> <p>It is our understanding that rent charges are generally informed by a valuation report which was performed by Sturgis Snow and Astill (chartered surveyors, valuers and commercial property consultants) in November 2017. We have not identified any controls or checks which ensure that actual rents are in line with the recommendations of this report.</p> <p>Of the 25 units sampled:</p> <ul style="list-style-type: none"> <li>- 6 had rent charges in excess of the rent recommended by the November 2017 valuation report.</li> <li>- 8 were exactly in line with the report, and</li> <li>- the remaining 11 had rent charges below the report's recommendation.</li> </ul> <p>Per discussion with the Commercial Estates Surveyor, maintenance charges were set by reference to figures provided by County Council, at a rate of 28p per square foot. The Council's expenditure accounting is not sufficiently categorised to allow for an analysis of the real cost of providing maintenance services to each of the units and therefore the charge for this service has had to be standardised across all of the units.</p> <p><b>Issue identified:</b></p> <p>Rent charges are being informed by a valuation report which was performed in November 2017, with no reference to the expense incurred in operating the individual properties and therefore with no knowledge of the profit or loss being made.</p> <p>The rent which is actually being charged on a number of properties is not in line with the rent recommended by the report and clear justification of this has not been formally documented.</p> <p><b>Risk:</b></p> <p>There is a risk that the Council is losing income due to the rent charges being too low, either as a result of the valuation report being out of date, the expenses being incurred on the property being higher than expected or because the rent levels recommended by the valuation report have not been implemented.</p> <p><b>Recommendations:</b></p> <p>The Council should consider obtaining more regular valuations to ensure that rent agreements are based on appropriate and timely underlying data.</p> <p>Consideration should be given to investigating the possibility of an accounting system whereby the expenditure incurred on each of the properties can be monitored.</p> <p>Management should review any new leases issued to ensure that the rent level is appropriate and reasonably justified. A clear audit trail which provides evidence of this review should be recorded.</p>	<p><b>Management Response:</b></p> <p>Independent valuations are sought and provided to the Commercial Surveyor approximately at 5yr intervals. These surveys advise the Council on market rents for the premises they provide. An updated valuation exercise was carried out in 2020 and is used as a base point to start negotiations for new lease agreements. It should be noted that these valuations are indicative of the market when they were carried out and are a guide only. Comparable rents in the local area, strength of the incoming tenant's business, investment into the premises etc are all points considered during a negotiation alongside the independent valuation. The valuation exercise by an independent surveyor on a five-year cycle is considered to be appropriate on an a commercial estate of this size where a majority of lease agreements run for a three year period.</p> <p><b>Agreed actions:</b></p> <p>Whilst the current accounting structure does not allow for this level of interrogation an exercise is to be undertaken to allow the Estates and Asset Manager and Head of Finance to better understand the level of profit/support offered to each individual business tenant</p> <p><b>Responsible Officer:</b></p> <p>Estates and Asset Manager</p> <p><b>Executive Lead:</b></p> <p>Director of Corporate Services</p> <p><b>Due date:</b></p> <p>December 2021</p>

# Key findings and recommendations

Risk Area	Findings and Recommendation	Action Plan
<p>Rental property records are incomplete and / or do not include up to date information, such that rent is not being charged where it is due.</p>	<p><b>Key findings</b></p> <p>We were able to successfully reconcile the property records used to track tenancies with the latest property valuation listing provided by the accountant responsible for the fixed asset register.</p> <p>However, no significant controls were identified for ensuring that this is the case.</p> <p><b>Issue identified:</b></p> <p>There is no process in place to ensure that the property record used for tracking tenancies is kept complete and up to date.</p> <p><b>Risk:</b></p> <p>There is a risk that disposals &amp; acquisitions of properties may be missed, due to human error or otherwise and as a result, lease / rental agreements may not be terminated / issued in a timely manner.</p> <p><b>Recommendations:</b></p> <p>Controls should be put in place to ensure that notification of all property additions / disposals provided to the lease / rental team have been recorded accurately and in a timely manner. This could involve management performing a periodic reconciliation of the two property listings detailed above.</p>	<p><b>Management Response:</b></p> <p>An exercise has now been undertaken to ensure all tenants have current leases / tenancy agreements and a backlog programme is in place to update any outstanding agreements. All lease agreements are now entered into the ePIMs database when updated alongside diary events for lease renewals.</p> <p>All acquisitions and disposals are recorded and forwarded to Accounts via Legal Services. Due to the size of our Estate acquisitions and disposals are rare. Any such activity is approved and recorded through the Regeneration and Asset Strategy Group and then to the appropriate Member group.</p> <p><b>Responsible Officer:</b></p> <p>Estates and Asset Manager</p> <p><b>Executive Lead:</b></p> <p>Director of Corporate Services</p> <p><b>Due date:</b> implemented (not confirmed by internal audit)</p>



# Key findings and recommendations

Risk Area	Findings and Recommendation	Action Plan
<p>Rent arrears are not identified or dealt with appropriately.</p>	<p><b>Key findings</b></p> <p>We observed that commercial rent debtors are being reviewed on a monthly basis and key debts are being identified and chased.</p> <p><b>Issue identified:</b></p> <p>n/a</p> <p><b>Risk:</b></p> <p>n/a</p> <p><b>Recommendations:</b></p> <p>A monthly review of the debtors and the preparation of a 'key debtors' list is a good control. We recommend that this is signed and dated in order to evidence that this is indeed happening on a monthly basis and in a timely manner.</p>	<p><b>Management Response:</b></p> <p>An exercise is to be undertaken to agree the maximum number of months of arrears triggers a review by the S151 Officer and Estates and Asset Manager. It is currently considered that a debt of no greater than 3 months should be allowed to be accrued without prior approval from the Council.</p> <p><b>Agreed actions:</b></p> <p>A member of the Accountancy Team is to be invited to attend the regular legal update meetings chaired by the Estates and Asset Manager.</p> <p><b>Responsible Officer:</b></p> <p>Estates and Asset Manager</p> <p><b>Executive Lead:</b></p> <p>Director of Corporate Services</p> <p><b>Due date:</b></p> <p>September 2021</p>

# Appendices

# Appendix 1 – Staff involved and documents reviewed

## Staff involved

- Malcolm Evans - Estates & Asset Manager
- Matt Burns - Commercial Estates Surveyor
- Caroline Stretton - Accountant

## Documents reviewed

- Internal lease tracking spreadsheet
- Sturgis Snow & Astill's valuation report from November 2017
- Insurance premium allocation working paper
- Lease / rental agreements for a sample of properties
- Revenue reports generated by the accounting system for a sample of properties
- Invoices relating to a sample of properties
- A valuation listing of commercial properties held by the Council

# Appendix 2a - Our assurance levels

The table below shows the levels of assurance we provide and guidelines for how these are arrived at. We always exercise professional judgement in determining assignment assurance levels, reflective of the circumstances of each individual assignment.

Rating	Description
<b>Significant assurance</b>	<p>Overall, we have concluded that, in the areas examined, the risk management activities and controls are suitably designed to achieve the risk management objectives required by management.</p> <p>These activities and controls were operating with sufficient effectiveness to provide significant assurance that the related risk management objectives were achieved during the period under review.</p> <p>Might be indicated by no weaknesses in design or operation of controls and only IMPROVEMENT recommendations.</p>
<b>Significant assurance with some improvement required</b>	<p>Overall, we have concluded that in the areas examined, there are only minor weaknesses in the risk management activities and controls designed to achieve the risk management objectives required by management.</p> <p>Those activities and controls that we examined were operating with sufficient effectiveness to provide reasonable assurance that the related risk management objectives were achieved during the period under review.</p> <p>Might be indicated by minor weaknesses in design or operation of controls and only LOW rated recommendations.</p>
<b>Partial assurance with improvement required</b>	<p>Overall, we have concluded that, in the areas examined, there are some moderate weaknesses in the risk management activities and controls designed to achieve the risk management objectives required by management.</p> <p>Those activities and controls that we examined were operating with sufficient effectiveness to provide partial assurance that the related risk management objectives were achieved during the period under review.</p> <p>Might be indicated by moderate weaknesses in design or operation of controls and one or more MEDIUM or HIGH rated recommendations.</p>
<b>No assurance</b>	<p>Overall, we have concluded that, in the areas examined, the risk management activities and controls are not suitably designed to achieve the risk management objectives required by management.</p> <p>Those activities and controls that we examined were not operating with sufficient effectiveness to provide reasonable assurance that the related risk management objectives were achieved during the period under review.</p> <p>Might be indicated by significant weaknesses in design or operation of controls and several HIGH rated recommendations.</p>

# Appendix 2b - Our assurance levels (cont'd)

The table below describes how we grade our audit recommendations.

Rating	Description	Possible features
<b>High</b>	Findings that are fundamental to the management of risk in the business area, representing a weakness in the design or application of activities or control that requires the immediate attention of management	<ul style="list-style-type: none"> <li>▪ Key activity or control not designed or operating effectively</li> <li>▪ Potential for fraud identified</li> <li>▪ Non-compliance with key procedures / standards</li> <li>▪ Non-compliance with regulation</li> </ul>
<b>Medium</b>	Findings that are important to the management of risk in the business area, representing a moderate weakness in the design or application of activities or control that requires the immediate attention of management	<ul style="list-style-type: none"> <li>▪ Important activity or control not designed or operating effectively</li> <li>▪ Impact is contained within the department and compensating controls would detect errors</li> <li>▪ Possibility for fraud exists</li> <li>▪ Control failures identified but not in key controls</li> <li>▪ Non-compliance with procedures / standards (but not resulting in key control failure)</li> </ul>
<b>Low</b>	Findings that identify non-compliance with established procedures, or which identify changes that could improve the efficiency and/or effectiveness of the activity or control but which are not vital to the management of risk in the business area.	<ul style="list-style-type: none"> <li>▪ Minor control design or operational weakness</li> <li>▪ Minor non-compliance with procedures / standards</li> </ul>
<b>Improvement</b>	Items requiring no action but which may be of interest to management or which represent best practice advice	<ul style="list-style-type: none"> <li>▪ Information for management</li> <li>▪ Control operating but not necessarily in accordance with best practice</li> </ul>

