

Our ref:
Your ref:

By email

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Dear

Slough Borough Council – objection to the accounts 2018/19 Decision and Statement of Reasons

I am writing in connection with the above objection in order to set out our final decision on this matter and the reasons for that decision.

Your objection was set out in your email of 19 July 2019 and concerned three aspects of the Council's purchase of its then-new headquarters building at Observatory House, 25 Windsor Road, Slough. You asked us to produce a Report in the Public Interest under section 24 and schedule 7 of the Local Audit and Accountability Act 2014 and also to apply to the court under section 28 of that Act for a declaration that there is an unlawful item of account.

The three specific concerns set out in your objection are:

- That a consultancy firm, Vail Williams, were paid £275,000 unlawfully as the majority of the work they were paid to do was actually carried out by Council officers in house
- That the Council's acquisition of Observatory House was poor value for money overall
- That there are concerns about the backgrounds of some individuals involved in the vendor company, and that 'it is against the law as no Local authority should have transacted with an individual that has a shady background due to it not being in the public interest.'

The detail of your objection, the Council's responses and our findings are set out in turn in the sections which follow.

Background

Prior to the purchase of Observatory House in July 2018, the Council's headquarters building was at St Martin's Place, just outside the centre of Slough.

On 6 March 2018, the Council's 'Lead Members and Directors' group considered a report which assessed various options to meet the Cabinet's stated wish for the Council to relocate its headquarters to within the town centre. Acquisition of Observatory House was one of these options, and the report requested a 'steer' from members on which option(s) should be pursued further.

On 28 May 2018, the Council's cabinet considered a report on the proposed purchase of Observatory House. The meeting approved the acquisition of Observatory House and gave authority to the Interim Chief Executive, in consultation with the s151 officer and the Leader, to 'approve the final terms of the acquisition'.

A significant decision report dated 24 July 2018 (the date of the purchase), signed by the Interim Chief Executive, s151 officer, Leader, Director of Regeneration and project manager, confirmed the final approval of the purchase of Observatory House. The main areas of substance covered in this report were cladding and defects.

The Council employed a range of specialist advisers in relation to the transaction, including:

- Vail Williams, who are the property consultants who approached the Council to draw their attention to the availability of Observatory House and subsequently carried out further work in preparation for the transaction
- Wilks Head and Eve, who undertook a valuation of the property prior to the purchase
- Overall external legal advisers
- Specialist legal advisers in relation to the status of the vendor and its related companies in the legal jurisdiction of Jersey.

The valuation report provided a valuation of £52.07m, compared with the agreed purchase price of £39m plus VAT.

Work done

As part of our consideration, we have:

- Reviewed your objection and the supporting information which you provided
- Made enquiries of Council officers
- Reviewed documentation provided by the Council
- Asked you for further clarification and documentation, and reviewed what you have provided
- Discussed the involvement of Vail Williams with the appropriate partner at the firm
- Consulted with the property team within Grant Thornton
- Shared a statement of our Provisional Views with you and the Council to give both you and the Council the opportunity to make representations before we took our final decision on your objection.

As you are aware, our consideration of your objection has been delayed as a consequence of difficulties with our other audit work at the Council, and the wider events which have affected the Council in the past two years. There have also been difficulties caused by the high turnover of senior officers within the Council, which has in some cases made it more difficult to gain evidence of exactly what happened. We are satisfied that we now have sufficient evidence to determine your objection appropriately.

Payment to Vail Williams

You suggested that the fee which the Council paid to Vail Williams of £275,000 was unlawful because most of the work which Vail Williams were paid to undertake was actually undertaken in-house.

Vail Williams (VW) are a firm of property consultants and valuers operating mainly across the South of England, with a particular specialism in commercial property. They had an ongoing relationship with the Council, in part due to having undertaken valuations of investment properties.

As a result of this ongoing relationship, VW were made aware by Council officers of the Council's desire to relocate its headquarters to the heart of the town. In 2018, when this desire was strengthened, VW were aware of the existence of Observatory House, which was then being marketed for rental. VW approached the vendors to ask if they would consider sale of the freehold: this was initially refused, but after further consideration, the vendors agreed to consider this and determined an 'asking price'. VW then approached Council officers to 'introduce' this proposal to them. Such introductions are normal business in relation to commercial property, and result in the purchaser (the Council) paying a fee to the 'introducer', based on the purchase price of the property. For a fee to be payable, the purchaser would need to have been previously unaware of the availability and suitability of the property, and the 'introducer' is not permitted to be in a contractual relationship with the vendor.

VW confirmed to us that the Council was not aware of the availability of the freehold on Observatory House, so it was appropriate that they should pay the introduction fee.

While VW did undertake some further work to facilitate the transaction, and thus to ensure that it went ahead and they qualified for their fee on completion, we understand that this work did not impact on the fee charged, which was as noted above determined by the purchase price. VW confirmed that they undertook some of the initial legal work, but that this was quickly taken back in house by the Council and allocated to specialist firms where appropriate. They also carried out survey inspections of the property and prepared a 'Purchasers Report' to the Council which commented on issues such as title and price. They did not negotiate the final price with the vendors – this was negotiated by Council officers, based on the original 'asking price' and the defects identified in the property survey.

A payment of £275,000 was made to VW in accordance with the above on completion of the purchase in August 2018. It forms a significant part of the 'purchasers costs' reported to members. We have discussed the arrangement with our own property specialists, who have confirmed that such introduction fees are a normal part of business and that the fee charged in this case was well within expected ranges.

You did not provide any evidence to support the assertion that most of the work which Vail Williams were paid to do was actually done by Council staff at the time of your objection, and you have not been able to provide any when invited more recently. You also did not put forward any other arguments as to why the payment would be unlawful. In view of the fact that the payment was actually an 'introduction' fee determined by the size of the transaction, your grounds for suggesting it was unlawful do not apply, and we have not identified any other aspects which would suggest it was unlawful. We do not therefore consider that the payment of £275,000 to Vail Williams was unlawful or that there is anything about it which merits a Report in the Public Interest.

Overall value for money

The external auditor's responsibility in relation to value for money is in general to assess the arrangements which a council has put in place to achieve value-for-money. It is not appropriate for auditors to 'second guess' decisions taken by councils if they have been taken following appropriate processes. For a project such as this, we would expect the Council to be able to demonstrate that it fits with their strategic objectives, that it is supported by an appropriate business case which makes appropriate assumptions and recognises risks properly, and that the decision was made with due authority under the terms of the Council's constitution. The fact that a project cost 'an extortionate amount' does not mean it is necessarily poor value-for-money, although we would of course expect such a high cost project to be supported by an appropriately strong business case and other processes such as due diligence and valuation.

Other than two specific concerns discussed below, you did not give any reasons for your view that the project was poor value-for-money, beyond stating that it was 'extortionate'. We have nevertheless considered the broad arrangements which were in operation for the project.

In terms of the 'strategic fit' of the project, both the March and May 2018 reports demonstrate that the project is in accordance with the Council's five-year plan and members' stated aim of wishing to move the Council to a location at the heart of the town centre, in order to improve physical access to Council services, increase footfall in the centre and to demonstrate the Council's support for the town centre in order to encourage investors to do the same.

The March report considered a range of seven different options for the headquarters location and set out the pros and cons of these, in the context of other Council initiatives such as the planned 'one public estate' service hubs and the desire to reduce desk ratios down from 0.8 desks per member of staff to 0.5.

As noted above, the Council used a range of professional advisers in relation to the project. As well as the usual property consulting and legal support, it recognised the need for more specialist legal support because of risks arising from its due diligence work on the vendor, which was a special purpose vehicle registered in Jersey. It also obtained an independent valuation of the property to provide assurance that the price negotiated with the purchasers was reasonable.

The decision to go ahead with the purchase was taken by Cabinet on 28 May 2018. They delegated finalisation of the terms of the acquisition to the Chief Executive in consultation with the Leader of the Council and the s151 officer, and this finalisation is recorded appropriately in the Significant Decision Report dated 24 July 2018.

However, we have concerns about the extent of the information available to Cabinet to enable them to take that decision, and in particular the limited extent of information which was made available to councillors, through formal governance processes, to enable them to make an informed decision. Our concerns are:

- The March report was only considered by the 'Lead Members and Directors Group'. This was an informal body with no decision-making powers, the discussions of which were not in public or reported alongside the minutes of other Council committees. While no formal decision was taken, as it could not be, the officer report was brought to it to obtain a 'steer' on which option(s) to pursue in accordance with the town centre regeneration objective. We do not consider that holding such discussions in an informal, non-public forum is appropriate, given the size of the project and the fact that alternative options were not reported formally to members in the subsequent reporting.
- The decision to proceed with the purchase, and the associated delegation to the section 151 officer and the Leader to finalise the terms, was taken by Cabinet in a public meeting on 28 May 2018. The public agenda (Item number 4) included an eight page report, which was supported by a restricted 'part II' report which was cross-referenced from the public report and ran to twelve pages. No separate business case was submitted to members; nor has it been provided to us, although we did obtain a number of other relevant reports such as the Vail Williams 'Purchaser's Report'. It appears that the relevant officers considered the Part II report to constitute a business case and did not prepare any other formal document. While the Part II report included some of the information we would expect to be in a business case, it was in summary form and we would have expected a more comprehensive document to be prepared and provided to members, given the value and strategic importance of the project.

One specific concern which you raised was that, at the time of your objection (in July 2019), the office space on the top two floors of Observatory House was still to let, whereas the business case for the purchase relied on income being generated from renting this space out to external parties. From our review of the Part II report, it was recognised that there was a risk of it not being let initially, with mention of a 'worst case' scenario of no rental being received in the first two years after the purchase. There also appears to have been uncertainty at that stage of how much space the Council would need for its own purpose and therefore the amount that would be left for external occupation. The Council was, however, provided by reassurances from its property consultants that, while there was at the time of the acquisition decision significant availability of office space in the town, demand was expected to increase significantly once Crossrail/Elizabeth Line was operational.

Since you made your objection, we understand that the Council has not been able to secure a tenant for the top two floors. While this is of some significance to the overall finances of the project, as this has extended beyond the original worst-case scenario, this has more to do with events subsequent to the Council's acquisition than demonstrating a flaw in the decision-making. Since the decision was taken in 2018, further delays have occurred in the opening of Crossrail/Elizabeth Line, with partial opening only achieved in May 2022. Probably more significantly, the Covid-19 pandemic has led to significant changes in the market for office space as companies have increasingly moved towards flexible working arrangements as well as cutting costs in response to financial pressures. This could not have been foreseen as anything other than a very remote risk at the time of the acquisition decision.

Another specific concern which you raised in an email dated 15 June 2022 was that the valuation of Observatory House carried out by Wilks Head and Eve had been carried out on the basis of estimated rental yields, which was in your view not appropriate for a building which the Council was going to occupy rather than lease to others.

It must be noted that this valuation did not impact on the price paid by the Council to acquire Observatory House, which was determined through a process of negotiation between the Council and the vendors. Rather, the independent valuation was carried out to provide comfort to the Council on the value of the asset that they were acquiring – in effect to confirm that the negotiated transaction price was appropriate and to ‘triangulate’ the valuation information previously provided by Vail Williams.

It is normal in our experience, and in accordance with the Institute of Chartered Surveyors ‘Red Book’ for the capital value of assets to be derived from estimated theoretical rental yields, suitably discounted to reflect the reduced value of future receipts as opposed to current receipts, even where the property is not in reality going to be leased out. In an open market situation, the capital value of an asset (how much a buyer would be willing to pay for it) is determined by how much money they think they can make from it in the future, which would be determined by the rental yields. We do not therefore accept that valuing it on this basis was inappropriate.

In an email dated 15 June 2022, you drew our attention to press reports that the Council was considering disposing of Observatory House, amongst many other properties, as part of its asset disposal programme, which is driven by its overall poor financial position. You suggested that this demonstrates that the original decision to acquire the building was flawed.

In our view, this would be an invalid inference. Events since the acquisition decision was taken in 2018 have changed the landscape considerably in ways which the Council could not have reasonably foreseen – most notably the pandemic and resulting economic changes and changes to working practices. A significant deterioration in the Council’s overall financial position has also become apparent. However, we should only judge the acquisition decision in the light of what the Council knew (or should reasonably have known) at the time it took the decision, and whether its assessment of risks at that time was appropriate, and in our view, and subject to the separate concerns expressed above, the Council acted appropriately at the time.

Due diligence

The Council purchased Observatory House from a company registered in Jersey, Observatory House (Jersey) Ltd. You expressed concerns about the good standing of this company and therefore whether the Council should have entered into the transaction with it. In particular, you expressed concern that the vendors were connected with an individual who at that time was under investigation by the Serious Fraud Office in connection with their enquiries resulting from the ‘Pandora Papers’ disclosures. You suggested that the Council should not be dealing with such individuals and that this meant the acquisition was unlawful.

The vendor, Observatory House (Jersey) Ltd, was a special purpose vehicle, which was expected to be, and was, liquidated after the transaction had been completed. Information provided to the Council by the Jersey-based administrators of the company stated that it was wholly owned by another company, Falcondale Limited, which had four UK-based directors with equal shares in the company.

Prior to its ownership by Observatory House (Jersey) Ltd, the building appears to have been owned by LRE Capital, for whom a refurbishment scheme was carried out previously by XLB Property. LRE Capital was one of a number of companies run by xxxx. Mr xxxx was arrested by the SFO in May 2017 as part of the ‘Pandora Papers’ investigation, although it must be emphasised that he was never charged with any offence and is today continuing to practice as a company director and is therefore deemed to be a ‘fit and proper person’.

Two of the directors of Falcondale Ltd, owners of Observatory House (Jersey) Ltd, have also been directors of other companies run by Mr xxxx, including LRE Capital Ltd (from November 2017 to December 2018). You therefore maintain that there was a clear link between Mr xxxxx and the vendors of Observatory House at the time of the acquisition, which the Council should have been aware of and which should have deterred it from the acquisition.

We were informed by the Council's former Interim Director of Regeneration in an email on 2 October 2019 that:

'there was absolutely no mention of/connection between LRE Capital Ltd or xxxxx at the point when SBC purchased 25 Windsor Road. To say otherwise is, at best, grossly untrue.'

In our view, it is more than likely that there was some sort of link between the vendors and Mr xxx at the time of the acquisition, although the extent of that link is not clear. We need to determine whether the existence of such a link should in any case have had any impact on the Council's decision-making and whether the Council should have recognised it at the time.

The Council undertook a range of due diligence work in relation to Observatory House (Jersey) Ltd, and also as part of negotiations, sought, although was ultimately unsuccessful in obtaining, a parent company guarantee. It obtained specialist legal advice from a Jersey-based firm in relation to whether or not the company was appropriately set up under Jersey law, and whether the proposed form of sale contract would protect the Council under English law. However, none of the documentation provided to us appears to flag any concerns about involvement by xxxxx.

Overall, in our view the Council took sufficient steps to protect itself financially and we are not convinced that the existence of the link to Mr xxxxx should have had any impact on the acquisition decision from a financial or legal point of view (particularly given that Mr xxxxx was never charged and continues to be a UK company director), and it does not in our view render the acquisition transaction unlawful. The main risk which the Council was taking without apparently realising it was in our view a reputational one, as the Council could have been subject to adverse media and public criticism. Ultimately, however, given the unknown and apparently tenuous nature of the link to Mr xxx, we do not regard this as a significant weakness in arrangements.

Decision – Unlawfulness

If an item of account appears to us to be contrary to law, we have discretion as to whether or not we should seek a declaration to this effect under s28 of the Local Audit and Accountability Act. Relevant factors which we take into account include:

- the significance of the issue concerned;
- the amount of the item of account involved;
- the expense of an application;
- the practical consequences of any declaration;
- whether the Council agrees or not with our view on the lawfulness of items in question;
- the prospects of success.

In this case, you have argued that two transactions were unlawful: the payment to Vail Williams and the overall purchase transaction for Observatory House from Observatory House (Jersey) Ltd.

In relation to Vail Williams, as noted above, we do not have any concerns about the fee paid to Vail Williams and the nature of that fee, which was in essence an 'introduction fee'.

In relation to the overall purchase transaction, the Council has legal powers to acquire property for a range of reasons. As noted above, however, we do have some concerns about the decision-making processes followed in the exercise of those legal powers, and particularly in relation to the extent of the information made available formally to members to inform their decision making, and the use of the Lead Members and Directors group to provide a 'steer' on the favoured option.

It is arguable in our view whether or not these deficiencies undermine the decision-making to the extent that it amounts to an unlawful exercise of the Council's legal powers, as it is hard for the Council to demonstrate that it took account of all relevant information. To reach a definitive view on this point would have required us to carry out further work and seek legal advice, at an additional cost to the public purse, which we do not believe would be proportionate given that, even if we reached the view that the transaction was unlawful, we did not intend to apply to the Court for a declaration that there is an unlawful item of account because:

- The costs of seeking a declaration would be considerable and would fall ultimately on the public purse, and there is no guarantee of an application being successful
- It is difficult to see what purpose such a declaration would serve, given that the transaction took place over four years ago and the Council has been occupying the building since that time
- There has been significant change in senior management at the Council, and the present senior management agree with us that there were deficiencies in the decision making.
- The transaction was, of course, of significant value, but we do not believe that this negates the above factors.
- We also have other remedies available to us in this matter and have determined that the issuing of Statutory Recommendations under section 24 and schedule 7 of the 2014 Act is a proportionate response.

We have carefully considered the specific concerns you raised in relation to the difficulties in letting the top two floors of Observatory House and the valuation method employed and, in our view, these do not impact on the lawfulness of the acquisition.

As noted above, we have also considered whether the concerns you raised in relation to the possible link to Mr xxxxx have any impact on the lawfulness of the acquisition transaction. In our view, given Mr xxxxx's status and the nature of the possible link, we do not believe that it gives rise to any unlawfulness in the acquisition transaction.

Decision – Report in the Public Interest

Whether or not to issue a report in the public interest is a matter for us in the exercise of our discretion. Relevant factors include the quantum of any loss, whether there were significant failings in governance, whether the matters that might be the subject of a report are on-going, whether there has been significant publicity in respect of the issues, whether we have recommendations to make to the Council and whether we believe that our independent view should be expressed in public.

In this case, while this was undoubtedly a significant transaction for the Council, we do not believe that the deficiencies in decision-making merit a Report in the Public Interest. In reaching this view, we have taken into account that:

- The Council is already under considerable public, media and central government scrutiny as a result of other issues in its overall governance and financial management
- There have been significant changes in senior management since the transaction took place, and commissioners are in place
- While there were deficiencies in the way the decision was made, many aspects of the arrangements for the acquisition were sound.

However, our powers under section 24 and schedule 7 of the 2014 Act relating to the issuing of a Report in the Public Interest also give us powers to issue Statutory Recommendations, which the Council is required to consider publicly and provide a public response. We consider that the issuing of one or more such recommendations is an appropriate and proportionate way of drawing our concerns about the decision-making in this case to the attention of the public and other stakeholders.

We are therefore today issuing recommendations under section 24 and schedule 7 of the 2014 Act to remind the Council of the need to ensure that its decision-making is appropriately documented with appropriate background information provided in the formal decision-making domain.

Right of appeal

You have a right to appeal our decision not to apply for a declaration under section 28(3) of the Local Audit and Accountability Act 2014. Please note that there is no right of appeal against a decision not to issue a public interest report.

Should you wish to appeal this decision, you must issue your appeal with the Court within the period of 21 days beginning with the day after you receive this statement of written reasons. We strongly recommend that you seek legal advice before seeking to appeal.

We have copied this letter to the Council.

Yours sincerely

Director