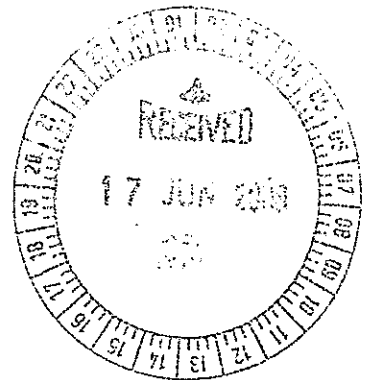


12 June 2008

Mr D Smith  
Acting Chief Executive  
Sunderland City Council  
Civic Centre  
Sunderland  
SR2 7DN



Dear Dave

## **Disposal of Land- Ford and Hylton Club**

I am writing to you to report the outcomes of my review of the proposed sale of the Council's freehold interest in the land which is leased to Ford and Hylton Club ("the Club"). The proposed sale is to Gladedale, a local property developer. In December 2007, the then Chief Executive wrote to me to bring the issue to my attention. Local electors (who are members of the Council) have also contacted me to raise concerns on the sale of land and related transactions.

This letter outlines the scope of my review, my findings and conclusions. I have also made a recommendation to the Council arising from the findings of this review.

### **Background to the issue**

In 1967 the Council granted a 99 year lease of land to Ford and Hylton Lane Social Club and Institute Limited, for the purpose of running a working men's club, the lease was transferred in 1991 to the present leaseholders and one other individual. In 1997 the lease was transferred to the present leaseholders. At the time, one of the leaseholders had just been elected as a member of the Council, both leaseholders are currently members. There was an approved change of use to a private members' club in 1987 and a rent review in 1999.

During 2007, the Council and the leaseholders were both approached by Gladedale Limited to purchase their respective interests and thus acquire the land for housing development.

Prior to this offer, there had previously been an approach from another company, Maxam Holdings, but this did not proceed.

Section 123 of the Local Government Act 1972 requires that Councils should obtain best consideration for the sale of land. This requirement also applies to long leases, such as the lease in question. Local authorities have legal powers to dispose of land at less than market value in order to assist regeneration, but officers have not indicated to us, or stated in Council reports, that the use of such powers is being exercised with respect to this transaction.

### **Scope of review**

I have reviewed the circumstances surrounding these transactions insofar as they are relevant to my responsibilities as external auditor to Sunderland City Council. These responsibilities mainly relate to:

- the legality of the Council's financial transactions;
- financial stewardship and accountability;
- governance, decision making and internal control; and
- securing and improving value for money.

The powers and responsibilities of the auditor are limited in scope and my review has excluded issues that I do not consider to be within the scope of the auditor's role, as follows:

- Issues have been raised as to Cabinet's ability to make an independent decision on the transaction, and the need for members to declare personal or prejudicial interests, given that the leaseholders are both members of the Council. Prior to approving the sale, the matter was referred to the Council's Standards Committee who gave a dispensation in line with the provisions of the Local Government Act 2000 and the Council's own constitution. Any issues or complaints on the approach are a matter for the Standards Board to consider rather than ourselves, and as such, this has not been considered as part of the review.
- Concerns have been expressed on the background to the company which made the earlier approach to purchase the land (Maxam). However, this transaction did not proceed and I have therefore made no further investigation into the issue.
- Concerns were also raised on the potential benefits to the leaseholders from the sale of lease. The leaseholders' disposal of their leasehold interest to Gladedale does not directly involve the Council, and will not appear as an item of account in the Council's financial statements. As such, it is not within the scope of my responsibilities as external auditor.

In carrying out our work we have:

- discussed relevant issues with officers;
- considered issues raised with us by local electors;
- examined relevant records and reports, including independent valuations; and
- sought informal legal advice.

## Summary of Findings

### Proposed sale of freehold from the Council to the developer

Gladedale has made an offer to the Council for the purchase of its freehold interest in the land. Cabinet approved the sale of the freehold in September 2007 to Gladedale for the sum offered and gave authority to sell for best consideration to a replacement purchaser should that sale not proceed. Knight Frank, a firm of independent valuers engaged by the Council, advised that the price offered for the Council's freehold interest, in relation to the market value of the site and the lease agreement terms, was reasonable in the circumstances. The District Valuer has subsequently confirmed the site valuation. Neighbouring land sales appear to fall within similar price ranges, proportionate to the areas of the land sold. At this stage, the Council is satisfied that it has appropriate assurances on the competitiveness of the bid.

It has been suggested that subsequent developments on adjacent sites would increase the value of the land. The Council obtained advice on this from Knight Frank. The firm has advised in writing that in its professional opinion subsequent developments would have no significant impact, in the short term at least, on the valuation already provided.

The Council has approached the developers to seek an increased sale price, but Gladedale have not increased their offer at this stage.

### Proposed sale of leasehold by the leaseholders to the developer

I have no information on the sale of the leasehold interest to Gladedale by the leaseholders. This transaction does not directly involve the Council and will not appear as an item of account in its financial statements. As such, it is beyond the scope of my responsibilities as external auditor.

Issues have been raised as to whether the Council could have improved its position by acquiring the leasehold interest and then negotiating with Gladedale as a single party. The Council has stated that this approach was not pursued as it was considered that this would have meant incurring additional legal costs and assuming a greater element of risk if for some reason the transaction did not proceed.

Whilst in principle I accept this explanation, the report presented to Cabinet in September 2007 did not fully explain the various options available. The Council has accepted this and has stated that it intends to present a more detailed report to the Audit and Governance Committee in due course.

### Lease rental review in 1999

In 1997 the lease of the club was transferred to the current leaseholders. At the time, one of the leaseholders had just been elected as a member of the Council, both leaseholders are currently members. In 1999, in accordance with the terms of the lease, the rent was reviewed and was increased from £375 to £750 per annum.

Knight Frank's report to the Council on the land sale valuation in May 2007 indicated that in its view the current market value of this lease should be a sum significantly higher than that which the Council was currently receiving, and this prompted me to look further at the lease renegotiation process in 1999.

Records on the 1999 renegotiation are poor. The initial proposal from the Council was £3,500 annual rental. The leaseholder submitted accounts for the club and the rental was agreed by the officer in charge at £750 for the next 33 years, on the basis of the reported financial performance and position of the business. Whilst the lease provides for rent to be fixed by an independent surveyor in the event of a dispute, this was not done.

The decision on the increased lease rental value was made by the estates officer responsible for negotiating leases. The decision was not approved by Council members or a chief officer. Rent reviews were not specifically covered by the scheme of delegation at the time. Officers have stated that this approach was custom and practice at the time (the Council's scheme of delegation was subsequently changed to cover this). My view is that there was no delegated authority at that time for the estates officer to agree the revised lease rental on behalf of the Council.

In response to questions raised in my review, the Council has obtained advice from Knight Frank stating that:

- in its opinion, 1999 market rental values for an asset of this type would have been significantly higher than the level agreed; and
- if an annual rent based on market values at the time had been applied instead of the agreed £750, their valuation of the Council's interest in the freehold on the land would increase.

Additionally, it is apparent from comments in the valuation from Knight Frank that the leaseholders had not complied with the terms of the lease in relation to repair and maintenance. The Council has been advised that this failure to meet the conditions of the lease has no impact on the proposed sale price because the building is to be demolished and the site redeveloped. Nevertheless, at the time of our review the Council had not recognised or taken any action on the leaseholders' reported failure to comply with the terms of the lease. The Council has now written to the leaseholders on this issue.

## **Conclusions**

My conclusions are based on the information available to me at this time. If further information comes to my attention or if this matter is raised with me as an objection in the current year of account (2007/08) or future years (depending on the timing of any transaction), then I may need to reconsider the issues.

My overall conclusion, based, on the information available, is that the Council has taken appropriate advice and is obtaining a consideration for the sale of its freehold interest in Ford and Hylton Club land which is consistent with independent valuations. However:

- the Council's position may have been adversely affected by past events; and
- the options for the Council surrounding this decision have not been properly explained to members.

The decision regarding the lease rental review in 1999 was poorly recorded. There is no evidence that, at the time of this lease rental review, the Council obtained any professional valuation of the market rental or value for that site. It is difficult, nine years later to accurately establish the market rental value at that time, specific to the local conditions and position for this site, and the restrictions on the lease. In recent advice to the Council, Knight Frank has indicated the rental agreed may, in their view, have been significantly below market value in 1999. I accept the Council's representations that it may not in reality have been able to achieve the rental figures at the level quoted in the Knight Frank report, given the local conditions, but equally it cannot evidence that appropriate steps were taken in 1999 to meet its responsibilities under Section 123 of the Local Government Act 1972. In conclusion, the Council may have failed to secure value for money in terms of both additional rent income during the period of the lease since 1999 and also increased consideration for the sale of its freehold interest in the land, if rent had been negotiated at a higher level.

The renegotiated lease rental in 1999 was not properly authorised by Council. However, this action cannot be corrected, nine years after the event, and I do not propose any further action on this issue.

The lease terms and conditions were not monitored and enforced, but there is no indication that this would have any impact on the sale itself.

At this point in time there may be little in the way of action that can deal with the effects of these past decisions, or increase the value of the Council's interest. However, past actions on the renegotiation of the lease and management of the lease may have had a detrimental impact on the proposed sale for the Council.

### **Next steps**

Based on our earlier discussions, you have agreed to present this letter, along with a full report on the issue, to a future Audit and Governance Committee for consideration. On this basis, I do not propose to take any further audit action at this stage. You have also indicated your intention to approach Gladedale further on the negotiation of the sale value.

Given the issues identified on the management of the lease, I strongly recommend that the Council should review its arrangements for the agreement, management and rental reviews of leases. We intend to undertake further audit work on property services in order to form a view as to whether the failings identified in the past lease review and current monitoring of compliance with lease conditions are widespread, still exist, or are specific to this transaction.

Yours sincerely



**Lynne Snowball**  
**District Auditor**

cc Mr K Beardmore