Central Bedfordshire Council

Executive **5 February 2019**

Establishing a Council Owned Housing Company

Report of:	Cllr Eugene Ghent, Executive Member Assets and Housing Delivery (eugene.ghent@centralbedfordshire.gov.uk)
Responsible Director(s):	Marcel Coiffait, Director of Community Services (marcel.coiffait@centralbedfordshire.gov.uk)

This report relates to a decision that is Key

Purpose of this report

1. Reliable access to decent housing is fundamental to improving life chances and reducing dependency on wider social support systems. In Central Bedfordshire there is a shortfall between the demand for and supply of new affordable homes:
   - in absolute terms as viability issues have resulted in below policy delivery
   - in specific tenures, particularly in the provision of affordable rental housing, older people's housing and specialist accessible housing.

2. This report sets out the rationale for the creation of a wholly owned Housing Company as part of a proactive approach to increase and influence the supply of new homes in order to help address this shortfall.

RECOMMENDATIONS

The Executive is asked to:

1. **agree to the creation of a housing company, limited by shares and wholly owned by the Council with the overarching aim of increasing housing supply in Central Bedfordshire through:**
   - **The development of sites owned by the Council.**
   - **The creation and where appropriate retention, by the Company, of housing stock with a range of tenures that address gaps in the market not met by either the private sector or through development within the HRA.**

2. **agree to the proposed governance arrangements for the Company as set out at paragraphs 44 to 47;**

3. **delegate authority to the Director of Community Services, in consultation with the Council's Chief Executive, Director of Resources, Monitoring Officer and a reference group consisting of the Leader, Deputy Leader and Portfolio Holder for Corporate Resources, Portfolio Holder for Adults, Social Care and Housing Operations and Portfolio Holder for Assets and Housing Delivery to set up an appropriate company structure, including:**

   a. Commencement of the incorporation of the Company and selection of the name of the company in order to do so.

   b. Approval of the type of company, the articles of the Company and the composition of its Board.

   c. Appointment of Directors and Company Secretary of the Company.

   d. Approval of a Shareholders Agreement to be entered into between the Company and the Council.

   e. Ensuring that the Company will hold appropriate insurances and / or benefit from the insurances that the Council holds.

4. **delegate authority to the Deputy Leader and Executive Member for Corporate Resources to take decisions on the exercise of shareholder powers in the Company;**

5. **delegate authority to the Director of Resources, in consultation with the Deputy Leader and Portfolio Holder for Corporate Resources and in line with the Council's Treasury Management Policy, to agree the terms of a £ 250,000 loan to be made by the Council to the Company to fund set up costs and provide initial working capital; and**

6. **authorise the Director of Resources to determine prices, in agreement with the Company, for any services provided by the Council for the Company.**

Overview and Scrutiny Comments/Recommendations

3. This report was considered at the Corporate Resources Overview and Scrutiny Committee on 31st January 2019 and their comments will be attached at Appendix 4.

Background

4. Central Bedfordshire as an area is seeing, and will continue to experience, significant growth; consequently, the Council is taking a pro-active approach to ensure and influence the supply of new homes in a sustainable way that protects the character of and improves the fabric and public realm of Central Bedfordshire.

5. However there remains a shortfall between the demand and supply of new affordable homes in Central Bedfordshire, both in absolute terms as viability issues result in below policy delivery, and in specific specialist tenures especially in the provision of affordable rental housing, older people's housing, specialist accessible housing and social rented housing for large families.

6. Using its own land assets more effectively to deliver additional housing could assist the Council in satisfying the housing demand caused by the failure of the market to deliver in these areas, whilst at the same time retaining asset value and providing greater control of what is built.

7. Intervening in the housing market through direct delivery also offers opportunities to deliver a wider housing offer in areas and tenures that reduces demand elsewhere on the Council's service provision.

8. The forthcoming Housing Enabling Strategy will provide the evidence of need in terms of numbers, tenure type and location within Central Bedfordshire. In anticipation of this developing the range of tools available to the Council to mobilise land would improve the pace of delivery and diversity of the tenures the Council can offer.

9. Whilst this approach will not provide a 'silver bullet' to address all of the housing demand issues our residents face, it will provide a method to respond proactively to the needs of residents.

Developing within the Housing Revenue Account (HRA)

10. The Council has a HRA programme of building and acquiring new homes and works in partnership with private developers and Registered Providers (RPs); while these initiatives address some of the need there remains a shortfall in provision. The scale of intervention via the HRA was until recently constrained by the limit placed by Government on further borrowing.

11. The removal of the borrowing cap for the HRA has introduced a major new opportunity to create a larger scale HRA housing development programme and the HRA budget for 2019–20 includes a significant financial provision to support this.

    Where appropriate, the Council's land assets will be used to enable expansion of home delivery via the HRA and much work has already been done to understand the range of sites and the opportunities these present. This work was initiated as part of the recent bid to Government to allow an uplift in the borrowing cap. Whilst this bid has been superseded by the removal of the cap, the work carried out remains relevant and puts the Council on the front foot for accelerating the HRA delivery programme.

12. Rightly, the lettings policy of the HRA means any new homes developed will provide housing for those who are most vulnerable, either through homelessness or who require specialist accommodation before any other groups. High levels of demand due to homelessness and demographic change means that homes delivered via the HRA will not meet all of the gaps in the housing market Central Bedfordshire is experiencing, nor meet the aspirations for a wider affordable offer for residents.

13. There are limitations on using the HRA as a route for all housing development. The requirements of the HRA allocations policy limits using the HRA as a development route where there is a desire to deliver a broader affordable offer through a different mix of tenures and target markets.

14. Developing for commercial gain is not permissible within the HRA; it is possible to develop sites using the HRA and then dispose of a proportion of the housing, either through shared ownership or market sales to individuals, in order to subsidise the wider scheme. Consequently the HRA cannot be used to deliver sites where developing for commercial gain is deemed the best use.

15. Many of the Council's strategies are predicated on demand management; this is equally applicable to housing. Being able to offer affordable housing of the right type in the right place can for instance, prevent families from becoming homeless, can provide access for key workers or for young people all of which prevent more expensive impacts on the Council, whether through homelessness, care provision costs or lower educational attainment.

16. The Council can have an even greater impact if it develops a mixture of tools to bring its land assets into play to deliver housing. Being able to deliver housing both within the HRA and outside of its specific constraints, alongside influencing the private sector offers a sophisticated response to a complex but fundamentally important issue.

Options for Delivery outside of the HRA

17. Using General Fund resources to directly develop and/or retain housing is challenging due to legal restrictions on holding housing assets outside of the HRA. Of the very few examples where councils have developed housing within the General Fund these have been where housing provision was an enabler to the required outcome rather than being the primary objective. For example Camden Council's Netley development, where the outcome was to deliver educational and community facilities, but which used housing development and sales to facilitate this.

18. There are however a number of options open to the Council to facilitate housing development outside of both the HRA and the General Fund. All of these have been used by other councils and consequently it is possible to draw on best practice from elsewhere. Potential options and the main advantages and disadvantages of each are covered below.

Disposal of sites (status quo)

19. Currently surplus land assets are sold to developers in return for a capital receipt. In recent years this has proved a successful way of raising capital receipts for the Council and this will remain a necessary route in order to maintain an inflow of capital to the Council. This is a relatively straightforward process however the controls over what is delivered on the site are via the planning system and therefore subject to the viability issues which have led to the current under-delivery of affordable housing. Control over timing of delivery is also difficult. It is not possible for the Council to retain assets via this route, but there is little financial risk to the Council.

Main advantages:

- Provides capital receipts.
- Expertise and labour provided from existing resource in house and can resource multiple sales in this way.
- Low cost and low financial risk.

Main disadvantages:

- Council cannot hold residential assets and unless ground rental deals are entered into no revenue returns are received.
- Only has control over affordable housing delivery through the planning system and this is subject to viability and a commercial return to a developer which in most cases reduces the number of affordable homes below policy level.
- No control over timing and mix of homes or delivery of wider objectives.
- No ability to create a strategic vision around the Council's role in housing delivery.

20. Disposal of land with a Development Agreement (DA) places conditions on what the site can be used for and offers greater control over straight disposals and can, for instance, drive timing and mix of development. It brings in a capital receipt to the Council though this may be reduced compared to disposal without a DA due to the placing of conditions which increase risk or reduce commercial returns to the developer. This can make low value sites undeliverable. Depending on the extent of the conditions in the DA this can require an OJEU compliant procurement process which is time consuming and reduces returns.

Main advantages:

- Once a DA is set up, low cost and low financial risk.
- Some control over development – written in the DA and can drive timing of development and mix.
- Provides capital receipts to the Council.

Main disadvantages:

- Council cannot hold residential assets and unless ground rental deals are entered into no revenue returns are received.
- No ability to create a strategic vision around the Council's role in housing delivery.
- No ability to trade with public sector partners.
- Time consuming if a site by site DA is required and unattractive to the market for low value opportunities.

Joint Ventures (JV)

21. There are a number of potential JV models which the Council could use, all of which involve selecting an external partner usually to provide capital finance and expertise, whilst the Council supplies either land or land and capital finance. The commonest forms suitable for housing development are considered below.

Corporate Joint Venture

22. A Joint Venture set up where the Council puts in land and the Private Sector Partner (PSP) contributes finance. The JV provides the pre-development services then the housing is delivered under scheme specific Special Purpose Vehicles. The need to follow an OJEU process is dependent on whether there is a direct contractual obligation to do works between the Council and the JV vehicle.

23. In this JV format the market value of the CBC land is agreed following completion of pre-planning and with the benefit of vacant possession. The land is transferred with no land receipt, but CBC place a charge over the site. The PSP provides equity and sources debt to deliver the scheme. Finance on land value is rolled up until the scheme is completed in the form of a loan note.

24. Returns are paid back on a priority basis according to the following hierarchy:

    1. Senior Debt Provider.
    2. Council based on pre-agreed land value (including rolled up interest).
    3. Private Sector Partner on pre-planning and construction costs including profit on these costs and overall profit in return for market and construction risk.
    4. Council and JVP on a 50:50 basis on remainder.

Main advantages:

- Ability to bring in development and risk management expertise and resources
- Levering in cash investment.
- Proactive Council role in delivery through role in the JV – objectives can be embedded into the JV Members Agreement.
- Has the ability to trade with public and private sector partners.
- Control over the development mix and timing through active role within the JV.
- Larger pipeline of sites with pre-planning can drive down profit requirement from the private sector to be reinvested in increased affordable housing.

Main disadvantages:

- Council loses a degree of direct control over its assets albeit that control can be exercised through the Council's role within the JV.
- High procurement and set up costs due to complicated structure.
- Loss of some of the profits and surplus to the private sector.
- Council needs to drive site selection and packaging to ensure cherry picking of the best sites does not occur.
- A significant pipeline and opportunity required to justify OJEU procurement for potential partners, risk that level of work does not attract the market.
- Risk that the single partner does not perform.

Programme Level Contractual Joint Venture

25. This is a JV where a private sector partner is identified with whom a contractual JV is formed through a Development Agreement with development services allocated to each party over a programme level, as opposed to a site by site basis. For example, CBC could be responsible up to the point of master planning and in this way can establish design parameters that can be maintained through implementation. The JV partner would then draw up detailed plans for each site.

26. Land transfer is directly from CBC to its partner in return for agreed financial outputs i.e. capital receipts, ground lease income, residential units. In addition to the development management services, the JV partner finances scheme delivery through a combination of debt and equity. The Council would expect to receive reimbursement of pre-development costs from the JV partner. The land is transferred on satisfaction of pre-conditions or on completion of the scheme. The JV cannot offer the land interest as security and this will increase pre-development funding costs.

Main advantages:

- Council has control over the design parameters that can be maintained through implementation through the master planning stage.
- Creates significant development resource and expertise to progress site delivery
- Can make commercial decisions.
- Council can expect to receive reimbursement of pre-development costs from its JV partner.

Main disadvantages:

- Cannot offer the land interest as security and this will increase the pre-development funding costs.
- Not as much control as other JV structures and difficult to balance detailed contractual terms with sufficient flexibility to respond to the requirements and viability of different sites across the pipeline.
- No ability to trade with public sector partners
- Unable to hold assets.
- High set up and procurement costs due to complexity.
- Would need certainty over size of pipeline and opportunity for the market to justify bidding through complex OJEU procurement.

- Risk of ‘cherry picking’ most profitable sites.

Wholly Owned Company (WOC)

27. Councils can use the General Power of Competence contained within the Localism Act, 2011 to provide housing within a 100% council-owned company. Councils have used this structure to develop housing (e.g. Sefton Council), to hold housing assets (e.g. Ealing Council) or both (e.g. Norwich City Council), or to acquire dwellings in the open market (e.g. South Cambridgeshire District Council).

28. In this structure the Council provides equity investment in the company through purchasing share capital and can also use its prudential borrowing powers to lend to the company (or indeed to provide some of the equity) which would provide a return back to the Council in the form of interest repayments.

29. A WOC offers flexibility to develop and dispose of sites including de-risking sites and then selling, direct delivery of the sites, or development in separate JV agreements with private sector partners. The best consideration requirement still exists for transfer of assets from the Council to the WOC subject to affordable housing and State Aid considerations.

30. A WOC is not limited by the constraints of the HRA and can access finance by the Council borrowing through PWLB and / or other sources of lending and then on-lending to the WOC. The WOC can also access s106 Agreement commuted sums for housing, council land and voids, equity investment through the Council purchasing shares, or third-party investment. The WOC can purchase services from third parties and the Council.

    Main advantages:

    - Can hold residential assets outside the HRA.
    - Can engage in development and access development surpluses otherwise flowing to the private sector.
    - Can retain total control over development outputs including timing and mix of housing developed and tenures offered.
    - Risk and reward have the potential to be flexed through delivery route.
    - Financial flexibility to raise debt and equity from a variety of Council and private sources.
    - Retain control and flexibility for future changes to respond to changing housing needs and changing Council policy objectives.
    - Can generate revenue returns to the Council through dividend structure and support the Council’s General Fund revenue budget.
    - No OJEU procurement required to set up the vehicle.
    - Management and support can be provided from within the Council for a fee.

Main disadvantages:

- Requires significant human resource through a combination of employees and external support. This is likely to mean new recruitment, external consultancy support and partnering with the private sector to create additional capacity and capability.
- Financial risk (including falling asset values) sits with the Council.
- Risk of Government policy restrictions on council investment and borrowing for 'non-core' activity.
- The Board of the WOC are required to act in the interests of the WOC and not the Council, which may present a conflict of interest at times.

Income Strip

31. This is a funding mechanism where the Council's land is sold to a third party (funder) and leased back to the Council effectively creating a lease finance structure. The third party finances and controls the construction on the site and leases the building back to the Council. Any profits this would generate arises through the net occupational rent received exceeding the level of rent paid to the investor. The Council lets and manages housing and is exposed to market risk.

    Main advantages:

    - Control over type and quality of housing and speed of delivery.
    - Attractive to the institutional investor sector due to the long term returns from Council backed covenant.
    - Retention of ownership and ability to access long term value from housing price inflation and improvement in areas.
    - Retain control and flexibility for future changes to respond to changing housing needs and changing Council policy objectives.

    Main disadvantages:

    - Resources and staffing required as per WOC.
    - Likely to need to sign up to index linked rental increases which presents a long term revenue risk for the Council if this exceeds rental growth of assets held.
    - Council likely to be required at pre-development stage to de-risk development.
    - Can take a long time to structure financing agreement and overall rate is likely to be higher than PWLB borrowing.

Recommended Option

32. Considering the advantages and disadvantages of each of the options above, it is recommended that a wholly owned company offers the greatest potential benefit to the Council if the risks associated with the model can be effectively mitigated.

33. A WOC offers the Council the greatest control and therefore the greatest flexibility to adapt to changing needs but also to deal with the disadvantages the structure brings, primarily through the mechanisms adopted for delivery.

For example, it would be possible to procure a JV between the company and a private sector partner if it is felt financial risk is better shared. This mechanisms for delivery can also change based on site, groups of sites, or attitude to risk.

34. Establishing a wholly owned company would be a new venture for Central Bedfordshire Council and this report goes on to deal with the mechanisms required for creating and governing such a company. The Company would be a separate legal entity wholly owned by the Council; it would have the power to undertake anything a company can do and in particular develop and hold land and properties. The Company would be run by its Directors but their decision making would be constrained by a Shareholders' Agreement which would define the limits the Council wants to place on the ability of the Directors to make decisions and in particular those that would require shareholder consent. As the Council would be the sole shareholder, decisions on how to exercise shareholder powers would come back to the Council, and based on similar practice in respect of LGSS Law, it is recommended that this responsibility is delegated to the Deputy Leader and Portfolio Holder for Resources.

35. One of the key risks of a WOC is the reliance on additional human resources, both in terms of capacity but also in terms of capability as housing development at scale and pace brings an additional challenge. The Council has a number of skilled staff and has the experience of delivering large sites such as Priory View and bringing Houghton Regis Central forward, however the resources available are not sufficient to deliver the additional sites this approach would bring particularly when set alongside the additional HRA development programme.

36. The solution proposed is to establish a WOC with minimal staffing and to procure a partner to provide the technical expertise to deliver a programme of development. To reduce timescales this procurement could run in parallel with establishing the Company, although appointment of a successful partner would need to be concluded by the Board of the company once formed. The need to manage a HRA development programme exacerbates the demand on resources but also creates an opportunity to share roles between the Council and the Company which would help reduce costs and ensure close collaboration.

37. Potential delivery mechanisms are considered at Appendix 3, although any or all could be used depending on the nature of the pipeline of sites being developed

Creation and governance of a wholly owned company

38. The Council has taken advice from Trowers & Hamlins, Solicitors, via LGSS Law and who have advised that a company limited by shares (CLS) is the most appropriate form of vehicle for a wholly owned company for a number of reasons, including:

- A CLS is the most common corporate vehicle used in England for profit distributing bodies and is a tried and tested model;
- The ability for the Council to invest in the company by way of share equity as well as loan capital;

- The general power of competence, being used for a commercial purpose does not allow for local authorities to participate directly in a limited liability partnership, which would be the other most obvious corporate form for a body established with a view to profit.

39. The company would be set up in accordance with the Companies Act 2006, including the appointments to the Board of the Company. The Memorandum and Articles of Association and any other relevant documents for the setting up of such a company would be in a form approved by the Monitoring Officer.

40. The Council would hold 100% of the shares in the Company and as such would have full ownership. This has the advantage of allowing the Council to retain ultimate control of the Company and therefore the type and mix of properties developed, sales, tenure mix and allocations.

41. The following documentation would be required to complete the establishment of the Company and associated governance arrangements:

- Memorandum of Association and Articles: this is the governing document for the Company
- Shareholder Agreement: a key document as it captures how the Council as Shareholder will exercise its control over the Company.
- Facility Agreement – this sets out the details and terms of any funding arrangements between the Council and the Company.

42. In addition, the Company will be governed via a series of operational documents including:

- A Business Plan – the business plan will need to be developed to cover a rolling 10-year period of investment activity and will outline the company's planned operations. The Business Plan will be reviewed and agreed annually and covers the following: -

    - Company objectives (as established in the Shareholder Agreement)
    - Governance arrangements
    - Operational plans
    - Financial model and assumptions
    - Rents, sales and development assumptions
    - Fees, on costs and tax
    - Funding profile and sensitivity analysis

- Operational Policies – these will need to cover how the Company conducts its business.

Governance

43. Appropriate governance arrangements would need to be put in place so that the Council, as the sole shareholder of the company, can set and oversee the strategic direction of the Company whilst allowing the directors of the Company discretion to carry out the operational management effectively, efficiently and with clear targets and milestones.

44. This will require a clear decision-making framework to ensure the Council as Shareholder makes the appropriate decisions reserved for them and gives sufficient authority to the Company Directors to make decisions in relation to the day to day activities of the Company.

45. Governance arrangements must ensure accountability whilst not hindering operational activity.

46. It is recommended that the following governance structure is implemented:

- A Company Board including an independent Chair who is able to bring external expertise to the Board, four Council representatives (two Councillors and two senior officers) and the Managing Director of the Company. The Board would provide the strategic direction and oversight of the Company and its Council representatives would exercise the Council's rights as shareholder of the Company.

- The Board will be responsible for setting direction and reporting quarterly performance and the Company's annual plan to the Council's Executive.

- Directors of the company would be subject to the provisions of the Companies Act 2006 regarding duties and obligations of Directors. Any actions against the company would stay with the company and there would be no recourse to the council or individual directors, save in certain defined cases for example, fraudulent or wrongful trading. In addition, the Directors would need to be indemnified by the Company for personal liability except in the cases of unlawful actions or fraudulent or wrongful trading.

- The establishment of a Shareholder's Agreement (between the shareholders and the Company) will set out the parameters the Company must operate within and provides the Council, as shareholder, with a mechanism to exercise control over the Company.

- The Directors of a company have a fiduciary responsibility to act in the best interests of the company and promote its long-term success. Under the Companies Act 2006 promoting the success of the company means operating for the benefits of the shareholders. As the Council is the sole shareholder of the Company this reduces the chances of potential conflict of interest between board Directors' roles as an elected Member or officer of the Council and their duty to the Company.

- Notwithstanding the point above it is recommended that the Council’s Chief Finance Officer and its Monitoring Officer should not be appointed to the Company to ensure a clear separation of their roles in their advice to the Council.

- In addition to the Directors of the business, the Company would also need to be appropriately staffed. However it is anticipated that many of the services will be contracted out with the potential for a range of services (subject to agreement between the Council and the Company) to be provided by the Council staff and re-charged to the company. It is important to absolutely demonstrate that all costs of utilising Council staff are recovered and that there is no actual or hidden subsidy so as to avoid any challenge that the Council is providing state aid to the company.

- Given the parallel work to deliver the HRA housing development it may be possible to share staffing or duties between the Council or for either to deliver on behalf of the other. It would be possible that, as in other Councils the role of Managing Director would be filled, at least initially, by adding to the responsibilities of an existing senior manager in the Council. In such an instance the Company would be recharged for the employee’s time, reducing the cost to the Council.

Site Selection

47. Each potential development site would be considered in line with current methodology, as set out in the Council’s constitution and financial regulations as it became surplus to requirements. Disposal options would be compared and decided on via a report to Executive (for disposals over £ 500k) or through delegated powers for sites below this value. Transfer to a Company would need to be at market value and be considered alongside other options such as direct sale or transfer to the HRA.

48. Initially it is expected that a number of sites would be identified together in order to provide the Company with sufficient critical mass to become effective quickly. A list of potential sites is being explored and will be brought to the Executive for consideration should the establishment of a Company be agreed. These sites would form the basis of the detailed business case seeking debt and equity funding which would require approval by Executive.

49. Work has already been carried out to understand the potential of a number of sites that the Council could use to deliver housing; this builds on the work carried out for the bid for an extension of HRA borrowing referred to earlier, which has now be superseded by the lifting of the borrowing cap. From this work it is clear the Council could sustain a significant building programme delivered via both the HRA and a WOC creating a sophisticated response to meeting the potential of each site alongside the needs of residents. The WOC could develop on behalf of itself and the HRA, although it may be appropriate to develop some HRA only sites outside of the WOC where this provides the best outcomes in terms of the type of homes being built.

50. As transfer of sites from the General Fund to either a Company or the HRA needs to meet the best consideration test for the Council there is little impact on the General Fund capital receipts pipeline other than the impact of reduced financial value caused by a greater affordable housing requirement. There would remain some land disposals that are best put to the market and this remains a baseline option for all sites.

Council Priorities

51. Making the best use of the Council's land assets to directly deliver housing supports three of the Council's key priorities:
    a. A more efficient and responsive Council – developing appropriate housing helps to reduce demand on other Council services and reduces asset value leakage to the private sector.
    b. Protecting the Vulnerable; Improving Wellbeing – providing access to the right housing in the right place has a fundamental impact on improving the wellbeing of residents.
    c. Creating Stronger Communities – providing a wide range of affordable housing helps to support sustainable and diverse communities.

Corporate Implications

Legal Implications

52. Legal advice on the establishment a wholly owned company and its implications has been provided by Trowers and Hamlin, Solicitors, via LGSS Law. A copy of this advice is included at exempt Appendix 1.

***Powers to form a Company*:**

53. The Council can rely upon the general power of competence within the Localism Act 2011 to form the Company for operating a business to let homes to rent or to provide homes for sale either on market or sub market terms.

54. Section 1 of the Localism Act 2011 provides local authorities with the power to do anything an individual may do, subject to a number of limitations. This is referred to as the general power of competence. A local authority may exercise the "general power of competence" for its own purpose, for a commercial purpose and/or for the benefit of others. In exercising this power, a local authority is still subject to its general duties (such as the fiduciary duties it owes to its rate and local tax payers) and to the public law requirements to exercise its powers for a proper purpose.

55. In the exercise of its powers under the Localism Act for a commercial purpose, the Council is obliged under the Localism Act to do so via a company.

Powers to fund the Company

56. The Housing Company will need significant funding to acquire land and develop properties. Therefore, as well as the Council having the powers to form the Company it must also be able to provide it with the necessary loan and equity funding.

57. The Council has the power to borrow under the Local Government Act 2003 for the purposes of the prudent management of their financial affairs, or in connection with any of their functions. The borrowing must be affordable, prudent and sustainable and comply with the Prudential Code.

58. As outlined, in the Finance section below the Council would need to borrow monies and in turn support the Company through the provision of loans and subscription to share capital. Section 24 of the Local Government Act 1988 (the 1988 Act) specifically allows the Council to provide financial assistance in connection with the provision of privately let accommodation.

59. If the Council exercises its powers under this section, then under Section 25 of the 1988 Act, it must also obtain the consent of the Secretary of State to do so. If this consent is not obtained, then any financial assistance given will be void. The Secretary of State has set out pre-approved consents in the "General Consents 2010" (July 2011) and the "General Consents 2014" (April 2014). The General Consents 2010 contains Consent C. and the Council can provide financial assistance to the Company under this provision.

60. Any housing made available for sale by the Housing Company would not be covered by the 1988 Act, however the Council can rely upon the general power of competence under the Localism Act 2011 to fund the Company for the purpose of the company operating a business to provide homes for market sale.

Financial and Risk Implications

61. Establishing a Company is predicated on the Company being fully financed by the Council’s General Fund. This is because the Council is able to access funding at very competitive rates from various sources including the Public Works Loan Board (PWLB). The Council can then on-lend funding to the Company.

62. The funding provided from the Council to the Company would be in two parts. Firstly, the Council would provide equity in return for shares in the Company. The Company would pay a dividend to the Council in return for this once it became profitable. The second element of funding would be as a loan from the Council on which the Company will pay interest to the Council and repay the principle sum as agreed in the terms of the loan.

63. If the Council were to invest solely via a loan to the Company, then HMRC may challenge this as a non-commercial arrangement and as way to make excessive interest payments and avoiding an appropriate tax liability.

64. An indicative financial business case for a wholly owned company based on developing a number of Council owned sites is included at Appendix 2. This has been produced for CBC by Strutt & Parker and assessed by the Council's finance team. This work is for illustrative purposes only and is it is not assumed that these sites would be developed via a Company as development via the HRA or through direct sale remain alternatives.
Similarly the scenarios and house / tenure mixes used are to illustrate the potential of direct development and should not be taken as a decision to develop these sites in this way. Any development of these sites would require a separate Executive decision and be subject to planning advice and approval.

65. A number of scenarios are set out, showing cash-flows to the Company and the Council's General Fund and illustrate that using a WOC route has the potential to deliver significant financial benefits over both disposal and Joint Venture methodology.

66. The model demonstrates that the mix of sites and types of tenure can be flexed depending on the benefits being sought i.e. the financial surplus of a base, planning policy compliant model could be used to offset the cost of a greater percentage of affordable homes or used to build out less viable sites, or be paid to the Council as a dividend to support wider General Fund services (or a mix of all three).

67. The WOC delivery option in the financial modelling is based on a policy compliant level of affordable housing being retained by the Company in addition to the delivery of financial returns. This stock could be retained by the Company or could be sold on the HRA or any other Registered Social landlord.

68. The financial scenario for a WOC in the model assumes that the Council will provide both equity investment, in the form of land and capital loans to the Company. One of the final options modelled demonstrates that an equity investment of land worth £ 20 million together with loan finance of £ 20 million could deliver a return of £ 50 million plus retained ownership of the 30% of the homes as affordable stock within a 5 year period.

69. A detailed business case setting out the financial implications and assumptions of the Company undertaking development would be prepared based on actual sites proposed to transfer into the Company for agreement by Executive prior to their transfer.

Taxation

70. The tax and VAT implications in relation to the outline proposals have been assessed by Trowers and Hamlin, however further specialist advice would be sought as part of the work to establish a company.

- **Stamp Duty Land Tax (SDLT)**
  As the Council is a local authority, group relief should be available on the purchase of land. This means that no SDLT should be chargeable whether land was sold or gifted. Some due diligence should be undertaken to ensure that the conditions for SDLT group relief apply.

- **Corporation tax**
  Corporation tax would (at an average of 19%) be payable on revenue surpluses and on the sale of assets by the Company. Assets constructed by the Council and sold are not liable to Corporation Tax. Transfer of Assets creates a potentially complex position depending on the stage of development and any uplift in value from the 'base' value at point of transfer (this is different from the market value).

  The particular tax implications for each land disposal should form part of the considerations when deciding whether to transfer these into the Company.

- **VAT**
  The new Company would not be able to recover all the VAT that it incurs on purchases of goods and services as its sources of income; new property sales and rental are either zero rated or exempt from VAT. The new Company would be able to register for VAT and it is acknowledged that this should be done as soon as possible to reduce any risk of VAT loss on the costs of setting up the new company. The type of construction contracts the Company deploys would also impact VAT exposure.

Financial Impact on the General Fund

71. The General Fund would receive three different types of financial return from the Company:

- ***Interest on loans***
  The Council would finance the Company by taking out loans and on-lending to the Company. Loans made by the Council to the Company would require an interest rate at a margin above the rate the Council has borrowed. An appropriate rate would need to be determined by the Director of Resources taking into account the need to ensure that it is a commercial rate (thus ensuring State Aid provisions are not triggered).

- ***Repayment of loan principal***
  The ability to flex the disposal of some assets through market sales will determine the rate of repayment of the loan principal depending on the shareholder's intentions; however the repayment of the principal loan would be completed within 35 years.

- ***Dividends***
  The Company's profits, net of tax, will be available for distribution to the Shareholders (the Council) and will represent revenue income to the Council.

72. All of the above income streams are subject to risk and would be dependent on the satisfactory financial performance of the Company.

73. The acquisition of equity by a Council and the provision of loans to a third party are both defined as capital expenditures by legislation. To the extent that such expenditure is funded by borrowing there is a requirement to make a prudent provision for the repayment of such debt. In these circumstances the Council is expecting the repayment of the loan debt element in full and therefore there is no requirement to make a provision for repayment of the loan in the Council's MRP assumptions. In relation to any equity element there is a requirement to make prudent provision for the repayment of the debt, limited to a maximum period of 20 years.

74. In addition to the returns to the General Fund as set out above the Council could benefit from the potential to generate income from the provision of services to the Company, e.g. housing management, financial services, property maintenance, subject to capacity existing within these services. This would be subject to the commercial decisions of the Company as well as agreement with the Council.

Risk

75. In relation to establishing a development Company there are a number of key risks which need to be considered. These include:

- Whilst the proposal is for a wholly owned company over which the Council would have ultimate control as sole shareholder, this is a new operating model for Central Bedfordshire Council and brings with it relatively complex new arrangements. Effective governance would be key to ensuring the operating freedom created by the formation of a Company is not at odds with the aspirations and intent of the Council.

- Of particular importance are the control mechanisms for the Company; the Articles of Association and the Shareholders Agreement as these will need to be sufficiently robust to deal with any future circumstance where the interests of the Council need to be protected.

- The potential for changes in legislation impacting the ability to operate a wholly owned company poses a risk to these proposals. The government has expressed concern over the levels of indebtedness of local authorities where borrowing has been used to invest in property to generate financial returns. By acting in a space that can be considered legitimate council activity i.e. the provision of housing that brings benefits to the local place minimises this risk but does not remove it.

- There is a risk that the Company will fail to deliver sufficient returns to cover its liabilities. The level of risk is dependent on many drivers, some of which are outside of the Council or the Company's control such as a downturn in property values or government intervention. In mitigation the proposal is to develop physical assets which in general appreciate in value and which can be sold to improve liquidity in a relatively short time.

It would also be possible to reduce the financial exposure of the Company (and thereby the Council) by bringing in an equity JV partner for some or all of the developments being undertaken.

- It is possible that the Company will fail to attract staff with sufficient commercial skills to manage the Company. This could be mitigated by partnering with a development company to build out the assets. The Council already has the skill-sets required to manage housing stock effectively and if stock is retained it is envisaged that existing council services will be used through service level agreements to undertake a range of functions for the Company.

State Aid Compliance

76. If the Council is acting in a way that a private lender and/or investor would not act in similar circumstances in a market economy, for example by providing a loan on uncommercial terms and at a uncommercial interest rate, and/or was making an equity investment on the terms and for the return which a private investor would not do, then such activity could constitute unlawful State Aid within the meaning of Article 107 of the Treaty on Function of European Union.

77. As such, when the Council establishes the detailed loan arrangements with any company it will need to ensure that an analysis of the relevant risk in relation to the loan is undertaken and also confirm that the interest rate applied is consistent with that which a private lender would require in the same circumstances and that the non-financial element of the loan complies with the terms and conditions which a private lender is likely to require, so as not to constitute unlawful state aid.

78. State Aid will need to be continually kept under review to ensure that the support from the Council is able to continue to be provided throughout the loan period.

79. It is also important that any services provided by the Council to the Company are provided at "arm’s length" commercial terms, as uncommercial terms could also constitute unlawful State Aid.

Procurement Implications

80. In respect of the proposal to establish a wholly owned company, the Company will be a body required to follow the Public Contracts Regulations 2015 (PCR). However, as a wholly owned subsidiary of the Council, the Housing Company would be able to take advantage of the "in house" exemption from the PCR and as such, any contracts let between the Council and the Company (e.g. in relation to housing management services) would not be subject to the EU procurement regime.

81. In respect of delivering the proposed procurement of delivery partners, the Council will act in accordance with the EU Procurement Directives and ensure that all procurement activity is conducted in compliance with the Public Contracts Regulations 2015.

The internal procurement team will be fully engaged with this process, providing support and overseeing the procurement and until any contract award. A full audit trail will be in place covering the entire exercise which will be kept as a full record of the process for the required period.

Equalities Implications

82. Central Bedfordshire Council has a statutory duty to promote equality of opportunity, eliminate unlawful discrimination, harassment and victimisation and foster good relations in respect of nine protected characteristics; age disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex and sexual orientation.
83. These proposals include the potential to increase the supply of specialist accommodation such as accessible homes which in turn would have a positive impact on the equality of opportunity.

Conclusion and next Steps

84. The report sets out the rationale for establishing a wholly owned housing company to develop and retain housing using the Council's land assets where this is the most appropriate option for use of that land.

85. Subject to approval the next steps are:

    a. To set up a Wholly Owned Housing Company including the creation of Articles of Association, and Shareholder agreement and the appointment of initially at least one Director to enable registration of the Company.
    b. To produce a detailed site-based business case to enable the transfer of land to the Company, subject to Executive approval, together with a funding proposal for the Company based on a mix of equity and loans to deliver against the sites identified.

Appendices

Exempt Appendix 1: Legal Advice

Exempt by reason of paragraph 5 of Schedule 12A of the Local Government Act 1972 'Information in respect of which a claim to legal professional privilege could be maintained in legal proceedings.'

Exempt Appendix 2: Indicative financial business case

Exempt by reason of paragraph 3 of Schedule 12A of the Local Government Act 1972 'Information relating to the financial or business affairs of any particular person (including the authority holding that information).

Appendix 3: Delivery option considerations

Appendix 4: Overview and Scrutiny Comments

Background Papers

None

Report author(s): Marcel Coiffait

Director of Community Services

Marcel.coiffait@centralbedfordshire.gov.uk