

CABINET

11 JULY 2017

HOUSING COMPANY

Portfolio Holders: Councillor Alan Jarrett, Leader
 Councillor Howard Doe, Deputy Leader and Housing
 and Community Services
 Councillor Adrian Gulvin, Resources

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Summary

This report sets out proposals for the creation of a Housing Company to maximise the opportunities to invest in or develop property within and outside Medway and in the first instance to enable the development of a number of Council owned sites. The report addresses the key issues for consideration and proposes appropriate next steps.

1. Budget and Policy Framework

- 1.1 The responsibility for managing the Council's land is a matter for Cabinet as is the provision and management of Housing.
- 1.2 The responsibility for agreeing budgetary provision and additions to the Capital Programme is a matter for Council.

2. Background

- 2.1 The Council has a challenging target of enabling delivery of 29,000 houses in Medway by 2035. With an emerging Local Plan a variety of sites are coming forward which will be identified to enable the Council to meet this target. The conversion of these sites into homes is envisaged largely to occur where the private sector engages developers to build them out.
- 2.2 There is currently planning permission for 7,500 units across the Borough on sites owned by third parties that are not being brought forward. Reasons for this non-delivery vary. Where the reason for non-delivery is due to the commercial interests of the land owner/developer, the Council has a very limited ability to encourage activity on the part of third parties.

- 2.3 Cabinet Members have been considering for some time the options the Council has in bringing forward its own sites for development to make a contribution to alleviating the pressure in the system between the demand for housing and the supply, to lead by example and to take a commercial opportunity to provide a revenue income to the Council through the creation of a profitable trading company.
- 2.4 The Council has over time sold off surplus assets delivering a capital receipt which has allowed reinvestment into other capital schemes. This has contributed amongst other things to the popular Community Hub initiative. Whilst one off capital receipts have their place in the prudent management of a local authority' assets and finances, there are other approaches to tackling the revenue pressures the Council continues to face.
- 2.5 The Council has considered the options open to it to generate revenue income and to better optimise its property ownership and land assets. These options include the development of Council sites for housing by the Council and the creation of a separate Council controlled company to build housing units for sale or rental and/or invest in property assets for commercial gain.

3. Research

- 3.1 Cabinet Members and officers have been working to consider the best mechanism to bring forward sites and in particular to look at methods to increase the pace and quality of delivery. That work shows that approximately 70% of Councils now have or are considering a separate housing trading company¹. Over a third of Councils are using entrepreneurial approaches to housing, waste, leisure and tourism. Some are seeing the use of commercial approaches as a direct alternative to reducing services or raising taxes.
- 3.2 Examples of Councils with wholly owned housing companies include:
- Wokingham Borough Council – market housing company.
 - Stoke on Trent City Council – market housing company.
 - Broxbourne Borough Council – “Badger BC Investments” which provides private rented sector housing.
 - London Borough of Newham - “Red Door Ventures” commercial residential development company.
 - Suffolk County Council, Forest Heath District Council and St. Edmundsbury Borough Council – co-own “Barley Homes” a development company of homes for sale.
- 3.3 The Council has a history of innovative approaches to reducing costs by sharing services, such as the building control South Thames Gateway (STG) Kent partnership and an expanding portfolio of shared services with Gravesham Borough Council. The Council has also set up a joint venture through Medway Norse which focussed initially on

¹ Building homes, creating communities: Ensuring councils provide innovative solutions to meeting housing need APSE 2017

facilities management but which has seen considerable growth in its offer. And more recently a trading company in Medway Commercial Group with plans for expansion which have recently been to Cabinet in the area of professional services.

- 3.4 The cost of borrowing remains at historically low levels and offers the Council an effective means to fund sites which are financially viable. The decision making needed to develop out and market a site is not something the Council has vast experience of although it has been a landlord for 3,000 units and has built out some Housing Revenue Account (HRA) sites. That expertise does however exist in the residential market.
- 3.5 Cabinet Members and officers have spoken to a number of local authorities who are seeking to bring forward their own development sites and have taken advice from consultants and from the Managing Director of Property 360 (the subsidiary Housing Company of Hounslow London Borough) about the benefits of setting up a housing company to deliver its aspirations.
- 3.6 Cabinet Members through the Housing Special Projects Board have asked officers to commission feasibility and financial viability work on a scheme for approximately 72 units on the Whiffens Car park site. Officers will in due course be submitting a planning application for that site. This follows closely on the granting of planning permission for 114 units on the Chatham Waterfront site. Both sites are capable of development by one contractor and consideration is being given to that and also the self development by the Council of these key strategic urban centre sites.
- 3.7 Officers have drawn up a draft build programme for a number of sites across the borough, which indicates that a pipeline exists on Council-owned sites which could be built out using traditional constructions methods over a five to ten year period to deliver 1,500+ homes with sites for 500 already identified and further work needed on other sites. Officers are also aware of current opportunities to acquire further strategic sites that could augment those numbers and that build out period.
- 3.8 Officers have also been exploring the options around modular off-site constructed housing with low or no-energy costs and significantly quicker build times.

4. Options

4.1 Option 1: Do Nothing

Clearly the Council as planning authority is already contributing to the local housing market by approving 7,500 units on a variety of sites. As landowner the Council could simply continue to manage its property selling off surplus sites when appropriate, but that would make no physical contribution to alleviating housing demand. It also does not show the kind of community leadership that would be possible through

the creation of a housing company or create a commercial revenue income for the Council over the next five to ten years.

4.2 Option 2: Develop sites without a company structure

The Council has powers to build housing which can be owned in the general fund and then rented or sold. At present, Secretary of State Guidance specifies that Medway could build and own up to 200 properties before it is required to open a Housing Revenue Account. Sites have been identified so far with in excess of 500 units possible and over a five to ten year period that could exceed 1,000 on currently owned Council land. Also Council decision making necessary to carry out the appropriate preparatory steps (such as obtaining planning applications and appointing contractors) is not as dynamic as a company which is house building and or selling/renting, which is structured in a way for example so that it is not a “contracting authority” for the purposes of procurement law. There are other benefits from a company structure such as income from loans which would not be possible if the Council developed housing alone. It would also not be able to offset as much build or sales risk as it could through a housing company. Consideration could be given on a site by site basis to whether the Council develops the opportunity, or the Company.

4.3 Option 3: Create a housing company

There are a number of benefits to delivering housing on its own sites across the borough by setting up a housing company. Firstly it could create income from the loaning of funds to the development arm of the company. Secondly within a company group structure certain tax efficiencies exist such as stamp duty is not payable for “internal” sales. Thirdly the company could recruit personnel with commercial residential housing skills at more attractive rates than would be possible with local authority pay scales. Fourthly a company structure would enable a faster pace of decision making to allow flexible responses to the market and to ensure delivery of much needed housing quicker. Fifthly risk could be ring-fenced as a whole to the company limited by shares or guarantee. Sixthly risk could be ring-fenced to various elements of the company.

5. Advice and analysis

- 5.1 If Cabinet is minded to pursue the creation of a housing company a number of decisions will be needed to assist officers in the preliminary legal steps needed to be taken. Cabinet Members will need to consider whether liability should be limited by shares or guarantee. Appendix 2 includes the respective merits and disadvantages of the two options.
- 5.2 On balance officer advice is that the company limited by shares option is the favoured approach. The company could set up a shareholder board for representatives of the Council to hold a management board to account. The management board could include professionals with housing and other backgrounds to help shape the company’s future and draw on their expertise.

- 5.2 Councils have a clear power to create trading companies set out in the “general power of competence” provisions of section 1 of the Localism Act 2011. Where a Council does things for a commercial purpose it must do so through a company. Section 95 of the Local Government Act 2003 enables authorities to provide, on a commercial basis, anything that is related to a function of the authority or is ancillary, conducive or facilitative to the exercise of that power. The power is widely drawn to include all functions whether express, implied or incidental. The Localism Act 2011 has supplemented these provisions through its general power of competence.
- 5.3 Prior to exercising this power a local authority must prepare a business case in support of the proposed exercise. Appendix 1 includes the features Cabinet can expect to see covered in a business case with some explanatory comments. An Exempt Appendix sets out a potential five year programme for the Business Case to focus on. Cabinet could choose, as other Councils have, to seek an independently commissioned business case and also for that case to be independently stress tested. This would reflect the relatively novel nature of this proposal, the level of risk involved in residential development and the need for an appropriate level of due diligence.
- 5.4 In order to ensure a level playing field with the private sector and to avoid breaching state aid and other legal requirements, a housing company must not be subsidised by the Council. The Council must therefore recover the cost of any land, accommodation, goods, services, employees or any other support it supplies to the company at a commercial rate. It will be necessary to set up suitable systems and financial controls to ensure this is the case and to demonstrate the independence of the company.
- 5.5 The company, if created, would have Articles of Association adopted to provide a similar function to the Council’s Constitution. Consideration could be given to structuring the company in such a way that it was not a “contracting authority” and therefore not subject to procurement legislation.
- 5.6 The governance structure of the company and its relationship to the Council will need to be agreed. Cabinet will need to be clear that the company is a separate legal entity created to develop land to produce housing units, where appropriate to invest in other property opportunities with the express intention of returning a profit to its shareholder the Council.
- 5.7 The Roles and the Responsibilities of the Cabinet, the Board of Directors and the Management Board and employees of the company could be:

Cabinet (representing the Council Shareholder) – Responsible for holding the Board of Directors to account for company performance via an Annual General Meeting (AGM); calling any Extraordinary Meetings if required; agreeing any changes to the Articles of Association or a

change in share capital; responsible for appointing and dismissing company Directors. The Leader could choose to create a Cabinet Committee to allow greater focus on the work of the company with, for example, 2 meetings a year.

A Shareholders Agreement will contain a schedule detailing those matters that are to be decided by the shareholder (the Council). Matters reserved only to the shareholder could include:

- Extending the scope of activities of the company
- Approving remuneration for employees
- Approving the annual Business Plan
- Changing the name of the company
- Forming a subsidiary

Executive Board of Directors – Responsible for the oversight of the company’s trading activities, including signing off the company Business Plan. Responsible for reporting to the Shareholders on a six-monthly basis on company performance; overseeing activities of the Management Board. For example, Cabinet Members could be appointed as Directors if there was a strong commercial reason to do so. For example, up to three Non-Executive Directors (NEDs) could be appointed to offer wider expertise to the company and could chair this board to indicate the separate and commercial nature of the company despite the Council being its sole shareholder.

Management Board – Responsible for developing the strategic plans for the company, considering all potential trading activities, operating, managing and growing the company through the development of existing and new commercial opportunities. Responsible for implementing the company Business Plan, including day to day management of the company’s trading activities. A Managing Director could be appointed to the Management Board or in the initial stages of the development of the company and to keep initial start up costs to a minimum, an Operational Director and a small team could be employed to drive delivery of the first few sites.

Other appointments – the company will need to appoint a Company Secretary, Company accountants, Company Auditors and insurers.

- 5.8 The Council could create a process with criteria to consider whether current and future sites should be transferred into the company for development or retained by the Council. Sites to be transferred to the company could be those that are “oven ready” for development with relevant de-risking already undertaken or not required. Sites retained by the Council could include those which have commercial opportunities for income. There could also be a set of sites retained by the Council which were not ready for development and required some de-risking works first possibly after obtaining external grants. These might support wider regeneration or economic development aspirations.

6. Risk management

Risk	Description	Action to avoid or mitigate risk
Schemes pursued by the Company are built out but not sold or rented	Financial risk to the Council as a potential lender, lack of income and increased borrowing costs	Business Case prepared and audited to deal in more detail with risks and opportunities for the Council of housing company. Strict financial viability carried out on schemes. Marketing expertise sought to promote sites. Consideration of a joint venture in the right circumstances.
The Medway market becomes saturated by available units thereby causing capital values to decrease	Financial risk to the Council as a potential lender, lack of income and increased borrowing costs	Business Case prepared and audited to deal in more detail with risks and opportunities for the Council of housing company. Market research is carried out plus expertise sought to promote sites. Consideration of a joint venture in the right circumstances. The Company produces a medium term financial plan which allows flexibility in delivery and in products.

Risk	Description	Action to avoid or mitigate risk
There is a crash in the housing market such that capital values reduce significantly	Financial risk to the Council as a potential lender, lack of income and increased borrowing costs	Business Case prepared and audited to deal in more detail with risks and opportunities for the Council of housing company. Market research is carried out plus expertise sought to promote sites. Consideration of a joint venture in the right circumstances. The Company produces a medium term financial plan which allows flexibility in delivery and in products.
Tenants exercise their right to buy of General Fund properties or LATCO properties (if extended to Local Authority Housing Companies as predicted)	Financial risk to the Council as a potential lender, lack of income and increased borrowing costs	Business Case prepared and audited to deal in more detail with risks and opportunities for the Council of housing company. The Company produces a medium term financial plan which allows flexibility in delivery and factors in a given percentage of "right to buy" sales.

Risk	Description	Action to avoid or mitigate risk
The housing company's ethos is contrary to Council Policy.	Reputational risk to the Council.	Business Case prepared and audited to deal in more detail with risks and opportunities for the Council of housing company. The Council through the Articles of Association could build in a policy veto provision that ensured the company did not trade in a way that was contrary to Council policy.

6. Consultation

- 6.1 The creation of a housing company has been the subject of internal discussion and the Council has sought professional advice on the prospect. There has been some wider consultation in particular with the Homes and Community Agency who have expressed interest in understanding the opportunities the company might pursue. As sites came forward they would be subject to specific consultation in line with the National Planning Policy Framework. This would involve considerations of sustainable development.

7. Financial Implications

- 7.1 Some of the financial implications have been set out in this report such as the limiting of liability to the Council and how the company could be financed. A detailed financial appraisal of the companies projected performance should be considered as part of the Business Case. Initial revenue start up costs will also need to be considered for the company. The cost of commissioning the Business Case can be set against future capital receipts or income.

8. Legal Implications

- 8.1 Some of the legal implications have been set out in this report such as the structure of the company and the various decision making levels. Further detailed legal advice will be provided in a future Cabinet report when Cabinet considers the Business Case.

9. Recommendations

- 9.1 Cabinet is asked to approve, in principle, the creation of a housing company limited by shares to undertake development activity and property investment principally within but also outside Medway.

- 9.2 Cabinet is asked to note the governance and operational features of a housing company as set out in section 5.7 above and agree the proposed structure and the role of the Council as shareholder as set out section 5.7 above.
- 9.3 Cabinet is asked to agree the principle of the Council financing the housing company through a mix of equity and debt, with state aid compliant loans in a format to be agreed by the Chief Finance Officer.
- 9.4 Cabinet is asked to delegate authority to the Chief Legal Officer, in consultation with the Deputy Leader and Portfolio Holder for Housing and Community Services, to commission a Business Case for future Cabinet approval prior to the setting up of a housing company.
- 9.5 Cabinet is asked to delegate authority to the Chief Legal Officer , in consultation with the Deputy Leader and Portfolio Holder for Housing and Community Services, to commission or produce Articles of Association, a Shareholders Agreement and all other ancillary documentation that may be needed prior to the setting up of a company.
- 9.6 Cabinet is asked to instruct the Chief Legal Officer to submit a further report to Cabinet to seek final approval for the creation of a housing company after consideration of the Business Case and once all of the necessary arrangements and requirements are in place.

10. Suggested reasons for decision

- 10.1 To enable the generation of new and alternative revenue income streams for the Council and to deliver housing units principally in Medway.

Appendices

Appendix 1 – Elements to be covered in the Business Case

Appendix 2 – Characteristics of LATCs limited by shares and guarantee

Exempt Appendix – Potential five year programme

Background Papers:

None

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Appendix 1

Elements to be covered in the Business Case

- **Justification for the formation of the company**

The Council has a number of powers to provide housing but those could also be undertaken by a separate legal entity. A commercial company could for example procure quicker. Details of the benefits of a company would be explored in the Business Case.

- **Assessment of the market opportunity**

The Council through its housing service both Housing Revenue Account landlord and Housing Management has a good detailed understanding of the local housing market. That is both at a political and officer level. Local estate agents confirm that there is an undersupply of available housing for first time buyers through to older residents looking to downsize. The Business Case could draw on this and other market intelligence.

- **The service, 'product' and target market**

The Business Case could look at options for the Company to its marketing. This could include competing with traditional house builders by offering sites in the coming years either for sale or rental in town centre locations. The unique selling point for this approach could be the element of trust people would have in the Council company to deliver on town centre sites and be a trusted landlord.

Alternatively one of the approaches Officers have been exploring is off-site constructed modular modern energy efficient housing possibly as part of a joint venture. The unique selling point could be units delivered at pace enabling customers who rent or buy to live with no or low-cost bills for the life of the property. This could set the council company even more apart in the Medway housing market.

- **Funding arrangements**

Depending on the involvement of third parties on sites, the Council could raise capital funding through prudential borrowing which it would lend to the company at commercial rates. This could be short term low interest rate funding.

- **Operating budgets**

If the Company employs a small initial team to take forward the first sites in Chatham an operating budget will be needed. This team could be funded by commercial loans to the company by the Council against future receipts.

- **Business projections and financial model**

A five to ten year business projection would need to be produced with a financial model to show the level of likely borrowing and debt envisaged as well as the profit and loss projections for the company and the potential return to the Council as shareholder.

- **The funding impact on the Council**

The Council would incur borrowing costs through prudential borrowing. The company would however repay those at a commercial rate. A company limited by shares would minimise the Council's financial liability.

- **Financial performance of the company**

The financial model, based on the business projection would indicate likely performance of the company and the level of likely dividend return to its shareholder.

- **State aid considerations**

Any lending to the company or the provision of services would have to be at a commercial rate.

- **Corporate structure & governance**

The Business Case could set out the suggested governance structure such as an executive shareholders board and a management board. Members could be appointed to the shareholders board to ensure delivery against projects and general profitability.

- **Processes and programme management**

The Business Case could include how a five to ten year programme of sites would be managed through a rigorous viability process. This might involve feasibility to include topographical study, outline drawings, initial discussions with the planning team. These would then be the subject of financial appraisal. At that stage a decision to proceed could be mapped against current work. Levels could be set for risk exposure in terms of borrowing levels for the company, unit sales, market conditions etc. A decision would be possible at this stage whether this was a Council development or a Company development. Decisions could also be made about the tenure mix for the site.

The programme could be monitored in the first instance by an Operations Director who would report to the Management Board and in turn to the Executive Shareholders Board.

- **Risk and sensitivities.**

Clearly the business projection and financial model would need to factor in a number of risks and sensitivities for the company. The

Council would need to keep its own risk log although this would be expected to be at a more strategic level.

Appendix 2 – Characteristics of LATCs limited by shares and guarantee

Companies limited by shares	Companies limited by guarantee
The council is the main shareholder, holding the majority of the share capital. The council's responsibilities for the company's financial liabilities are limited to the value of the shares it owns.	There is no share capital. Companies are guaranteed, usually for a nominal amount. The company must have members (as opposed to shareholders).
A company limited by shares: <ul style="list-style-type: none"> • is registered at Companies House and must comply with the Companies Act 2006 • has Articles of Association 	A company limited by guarantee: <ul style="list-style-type: none"> • is registered at Companies House and must comply with the Companies Act 2006 • has Articles of Association
Risk is "ring-fenced" Directors are not personally responsible for debts the company.	Risk "Ring-fenced" Directors are not personally responsible for debts the of the company.
Unless the company is a public limited company (PLC), it may not offer shares or debentures to the public. There are few examples of LATCs that are PLCs.	

	Pros	Cons
Company Limited by Shares	<p>Suitable for trading goods and services as a means of generating income.</p> <ul style="list-style-type: none"> • Business assets, profits and liabilities belong to the company. • The personal assets and finances of the shareholders are protected by limited liability; • no legal responsibility for debts of the company above what they pay for their shares. • Ability to pay dividends to shareholders, in effect income returned to the Council. 	<p>Limited companies have to maintain a number of important reporting obligations to HMRC and Companies House each year.</p> <ul style="list-style-type: none"> • Record keeping and accounting requirements can be complex. • Not suitable for non-profit or charitable purposes.

	Pros	Cons
Company Limited by Guarantee	<ul style="list-style-type: none"> • Normally used by organisations that operate for non-profit or charitable purposes. • Does not have any shares or shareholders. • The owners are legally bound by financial guarantees rather than shares. • Company is responsible for its own assets, surplus income and debts. • Company members are protected by limited liability, • financial obligation is limited to what they have guaranteed to pay in the event of insolvency. 	<p>Companies limited by guarantee cannot issue shares in return for equity investment in the business</p> <ul style="list-style-type: none"> • Limited companies have to maintain a number of important reporting obligations to HMRC and Companies House each year. • Record keeping and accounting requirements can be complex.
Limited Liability Partnership	<p>Ideal structure for joint business venture in a regulated profession, for example, legal, accountancy.</p> <ul style="list-style-type: none"> • Provides the financial protection of a limited company and the tax-efficiency and flexible nature of a traditional unincorporated partnership. • Financial liability is limited to the amount invested and to any guarantee provided. • LLPs are not taxed as corporations, therefore do not pay Corporation Tax. • Profits are taxed through Self-Assessment. • LLP members pay Income Tax and National Insurance through Self- Assessment on their share of business profits. 	<ul style="list-style-type: none"> • Only appropriate for groups of two or more members. • Income Tax through Self-Assessment can be as high as 45% (contrast with Corporation Tax rate of 20%). • Obtaining equity investment is more difficult. There is no share capital structure in an LLP, so you cannot simply sell part of the business to non-members. • Anyone wishing to invest capital in an LLP must be an appointed a member who participates in the running of the business. • LLPs may only accept loan capital from non-members.