

**Title: The formation of a Local Housing Company**

**Lead Officer: Lisa Barker**

**Portfolio Holder: Councillor Matecki**

**Public report: Appendices C and D to the Executive report and Appendices 1a, 1b, 1c and 2 within the Business Plan (Appendix D) are Confidential**

**Wards of the District directly affected: All**

Contrary to the policy framework: No  
 Contrary to the budgetary framework: No  
 Key Decision: Yes  
 Included within the Forward Plan: Yes  
 Equality Impact Assessment Undertaken: No  
 Consultation & Community Engagement: No  
 Final Decision: Yes  
 Accessibility Checked: Yes

**Officer/Councillor Approval**

| <b>Officer Approval</b>                   | <b>Date</b> | <b>Name</b>        |
|---|-------------|--------------------|
| Chief Executive/Deputy<br>Chief Executive | 3.12.20     | Bill Hunt          |
| Head of Service                           | 19.11.2020  | Lisa Barker        |
| CMT                                       | 4.12.20     | Chris Elliot       |
| Section 151 Officer                       | 4.12.20     | Mike Snow          |
| Monitoring Officer                        | 4.12.20     | Andrew Jones       |
| Finance                                   | 19.11.2020  | Victoria Bamber    |
| Warwickshire Legal Services               | 27.11.20    | Kate Hillier       |
| Portfolio Holder(s)                       | 30.11.20    | Councillor Matecki |

The report has been amended to better reflect that the report is asking Executive to consider two separate but inter-related matters. Firstly, officers are recommending that the Council creates a Local Housing Company (LHC) which then becomes a separate legal entity. The proposed LHC has produced a business plan which has two strands: The purchase of homes that become available on the private market which will require a loan from this Council so that the LHC can purchase those homes. Secondly, the creation of a Joint Venture (JV) enterprise between the LHC and a national house builder which could enable the purchase of significant amounts of land for a large house building programme.

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With regard to this second aspect, this is more problematic for members as not only has the LHC yet to be approved but assuming that members do agree to the LHC's creation, this new company will then seek to become a 50/50 partner in a JV.

Consequently, although the LHC will be a 50% partner in the JV this is not the same as the Council being a 50% partner, albeit it is a 100% shareholder of the LHC. Therefore, before the Council agrees to make any loan to the JV there are documents, information and evidence that officers and members will need to see before signing-off the loan.

Finally, the Council has received detailed legal advice from Trowers & Hamlins LLP, in respect of the creation of a JV. However, this does not cover the scenario of the LHC entering into a JV, albeit many of the issues highlighted will be the pertinent. Should members wish to pursue the proposals outlined in this report, further legal advice will be sought to ensure that the Council's interests are fully protected.

A revised Executive report is attached.

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Contrary to the policy framework: No

Contrary to the budgetary framework: No

Key Decision: Yes

Included within the Forward Plan: Yes

Equality Impact Assessment Undertaken: No

Consultation & Community Engagement: No

Final Decision: Yes

Accessibility Checked: Yes

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**1. Summary**

- 1.1. This report sets out the business case, and seeks approval for the establishment of a Local Housing Company (LHC). The LHC would be a separate legal entity, wholly owned by the Council (100% through its share capital), and be operated to support the Council's housing development plans and objectives and provide the Council with housing related income generating commercial opportunities.

## 2. Recommendations

- 2.1. That Executive notes the Business Case for the establishment of a Local Housing Company (LHC), as set out at Appendix A.
- 2.2. That Executive approves:
  - 2.2.1 The creation of a wholly owned LHC, to be limited by Shares, with the initial purpose of the delivery of intermediate and market housing.
  - 2.2.2 The Articles of Association as set out at Appendix B
  - 2.2.3 The Shareholders Agreement as set out at confidential Appendix C
  - 2.2.4 The appointment of Directors to the LHC, as set out in section 3 of Appendix D
  - 2.2.5 A loan facility of £11.625m is made by the Council to the LHC.
- 2.3. That, subject to approval of recommendation 2.2, Executive recommends approval of the Business Plan as set out at Appendix D to the LHC's Board of Directors, noting the proposed initial projects to be undertaken by the LHC, including the potential Joint Venture proposal set out in detail at confidential Appendix 2 of the Business Plan.
- 2.4. That, subject to approval of recommendation 2.2, Executive delegates authority to the Heads of Housing and Finance, in consultation with the Portfolio Holders for Finance and Housing & Property to:
  - 2.4.1 Take the necessary legal and administrative actions to establish the LHC. (A Memorandum of Association will also need to be signed by one of the Council's authorised signatories on behalf of the Council. This is a legal statement which agrees to form the Company.);
  - 2.4.2 Agree the name of the LHC;
  - 2.4.3 Agree such Operational Policies as would be required by the LHC.
- 2.5. That subject to approval of recommendation 2.3, Executive delegates authority to the Head of Finance and the Deputy Chief Executive (BH), following consultation with the Portfolio Holders for Housing and Property and Finance to consider and put in place:
  - 2.5.1 A Loan Agreement for up to £200k to provide working capital and 100% share issue to the Council to be funded from either share capital issue or loan;
  - 2.5.2 A supply Agreement between the Council and the LHC, consistent with the approved business plans;
  - 2.5.3 Remuneration levels for the Non-Executive Directors.

- 2.6 That subject to the approval of recommendation 2.3, Executive agrees that it:
- 2.6.1 Delegates authority to the Head of Finance and the Deputy Chief Executive (BH), following consultation with the Portfolio Holders for Housing and Property and Finance, to agree the terms and conditions of, and approve loans up to a value of £56.835m.
- 2.6.2 Recommends to Council that the capital programme is adjusted to reflect the loan to the LHC funded by Public Works Loan Board (PWLB) borrowing subject to Council approving changes to the Prudential Indicators as detailed in a further report.
- 2.7 That subject to agreeing recommendations 2.2 and 2.3, Executive notes that the LHC will seek to establish a Joint Venture (JV) company with a national house builder and that the JV will be requesting a loan of £45.210m from this Council and consequently given the need to deal with matters at speed, the following is agreed:
- 2.7.1 That upon the JV's creation it writes to the Council to formally request a loan of £45.210m providing its:
- a. Business plan;
  - b. Details of its corporate governance arrangements;
  - c. Resumes of the appointed directors;
  - d. Constitution;
  - e. Articles of Association;
  - f. Standing orders;
  - g. Schemes of delegation;
  - h. Financial and contract regulations;
  - i. Any other documents as considered necessary by the Head of Finance and/or Deputy Chief Executive & Monitoring Officer.
- 2.8 That subject to agreeing recommendation 2.7, Executive agrees to delegate authority to the Chief Executive, Head of Finance and Deputy Chief Executive & Monitoring Officer, in consultation with the Group Leaders, noting that this includes the Chair of Finance Audit & Audit Committee, to approve a loan request from the JV and determine the terms and conditions of the loan, having taken appropriate legal and commercial advice, and it is then recommended to Council that the capital programme is adjusted to reflect the loan to the JV funded by PWLB borrowing subject to Council approving changes to the Prudential Indicators as detailed in a further report.

### **Addendum from the Council's Monitoring Officer**

Members should note that the report is asking Executive to consider two separate but inter-related matters. Firstly, officers are recommending that the Council creates a Local Housing Company (LHC) which then becomes a separate legal entity. The proposed LHC has produced a business plan which has two strands: The purchase of homes that become available on the private market which will require a loan from this Council so that the LHC can purchase those homes. Secondly, the creation of a Joint Venture (JV) enterprise between the LHC and a national house builder which could enable the purchase of significant amounts of land for a large house building programme.

With regard to this second aspect, this is more problematic for members as not only has the LHC yet to be approved but assuming that members do agree to the LHC's creation, this new company will then seek to become a 50/50 partner in a JV.

Consequently, although the LHC will be a 50% partner in the JV this is not the same as the Council being a 50% partner, albeit it is a 100% shareholder of the LHC. Therefore, before the Council agrees to make any loan to the JV there are documents, information and evidence that officers and members will need to see before signing-off the loan.

Finally, the Council has received detailed legal advice from Trowers & Hamlins LLP, in respect of the creation of a JV. However, this does not cover the scenario of the LHC entering into a JV, albeit many of the issues highlighted will be the pertinent. Should members wish to pursue the proposals outlined in this report, further legal advice will be sought to ensure that the Council's interests are fully protected.

### **3. Reasons for the Recommendations**

#### **Recommendation 2.1**

3.1. The Business Case sets out the rationale and basis for setting up the company and what it is intended to achieve. The Business Case has been prepared using the principles of HM Treasury Green Book Five Cases Model. These are that the business case in support of a new policy, strategy, programme or project must evidence:

- That the intervention is supported by a compelling case for change that provides holistic fit with other parts of the Councils strategy – the "strategic case";
- That the intervention represents best public value – the "economic case";
- That the proposed Company is attractive to the market place, can be procured efficiently and is commercially viable – the "commercial case";
- That the proposed spend is affordable – the "financial case";
- That what is required from all parties is achievable – "the management case".

### **Recommendation 2.2**

#### Recommendation 2.2.1

- 3.2. A report elsewhere on the agenda explains that the current planned activities of the Council's Housing Revenue Account (HRA) are set to utilise all the available resources within the HRA Business Plan. The ability to expand the provision of new homes within the HRA is therefore at its limit and, particularly for tenures other than social and affordable rent, the Council would need to utilise other delivery vehicles to deliver new homes. Legal and commercial advice is that models such as Joint Ventures and/or a wholly owned company which can access alternative funding sources and provide intermediate and market rented properties are viable options available to the Council.
- 3.3. Establishing a LHC would assist Warwick District Council to take a commercial approach to the delivery of new homes and offer a range of products to assist in the delivery of local housing needs. Furthermore, it can offer an alternative to traditional private rented options by offering a good quality product through a trusted organisation.
- 3.4. The LHC model has the aim of making significant contributions to the Council's income in the face of funding shortfalls, and by doing so, put services on a more sustainable footing to support local people as well as raising money to invest in our priority outcomes. At this stage, the initial business activities being worked on are set out in in Appendix D
- 3.5. The advice is that for a company to trade directly with the developer without carrying out a procurement exercise it must be a company to which the Public Contracts Regulations (PCR) 2015 do not apply ie be a 'non-teckal' company. This requires the Company to act commercially and at 'arm's length' from the Council however avoids the potentially expensive PCR 2015 compliant procurement procedures which may be disproportionate to its turnover and allows the company to take advantage of direct approaches from developers.
- 3.6. Being able to operate outside of the PCR 2015 does not mean that a company would not be obliged to secure value for money in accordance with good business practice; it should still seek quotes / conduct a tender process – but it would be free to do so flexibly rather than follow a specified procedure.
- 3.7. It is envisaged that the company would be incorporated in December 2020. It will function as an ethical landlord, providing rented homes of a good quality.
- 3.8. It should be noted that potential housing company developments will be individually assessed on their financial viability and suitability; and that the primary focus will remain on delivering affordable/social rented units through the Housing Revenue Account (HRA), which affords significant efficiencies.

3.9. Advice on the proposed structures has been received from Warwickshire Legal Services (WLS) and Trowers and Hamblins (legal) and the recommendations here have taken that advice into account. It is possible to structure the company in a number of ways each of which has benefits and limitations. The advice is that a single company structure will achieve the Councils objectives within the desired timeline. Advice on Treasury management has been received from Link and KPMG, and on Tax from KPMG and the recommendations within this report have taken that advice on board. Discussions have taken place with a number of Councils who operate a LHC model and the learning from those experiences is also reflected within the proposed approach.

### Recommendation 2.2.2

3.10. The Articles of Association form part of the Companies constitutional documents and are a requirement. They set out the rules about running the company and are needed to set up the company.

3.11. Subject to the Articles, the Directors are responsible for the management of the Company's business and may exercise all the powers of the Company. The Council, as sole shareholder, may by special resolution, direct the directors to take or refrain from taking specified actions.

### Recommendation 2.2.3

3.12. The shareholder's agreement sets out the role of the council as a sole shareholder and provides parameters for what the company can and cannot do. It details how the company will conduct its business and how it will report back to the council. A number of references are made to the business plan, which will require approval from the Executive annually.

### Recommendation 2.2.4

3.13. It is proposed that initially there will be four Directors who will take decisions collectively. The Directors proposed are the Head of Housing and the Strategic Financial Manager as Council directors and two non-executive directors, one with experience in property development and one with experience in property sales and lettings. To support the Company being classed as a non-Teckal company, the two non-executive directors will be appointed by the Board. It is proposed that the Head of Housing will be the chair of the board.

3.14. The quorum for the transaction of the business will be two directors, one of which will be a Council Director. The Council will retain the power to appoint and remove Council directors under the shareholder's agreement and the company shall be permitted to appoint and remove the other two directors.

### Recommendation 2.2.5

3.15. The budget is required to enable the Business Plan to be funded and its activities to be delivered. A budget up to the value of £56.825m has been



identified as being required for the full range of activities set out for the company.

### **Recommendation 2.3**

- 3.16. The Business Plan sets out the aspirations for the company and contains specific proposals for initial lending by the Council. In each subsequent year, the company will be required under the shareholder's agreement to bring their updated business plan to Executive for approval. The company will only be able to carry out business in accordance with its business plan.
- 3.17. The Business Plan proposes two areas of activity. The first activity focuses on the purchase up to 50 Market Rental Homes available on the open market, to be retained by the company for the life of the business plan and seek to continue to acquire further units beyond the life of this business plan as the market and financing allows. These homes will be purchased using a loan from the Council of c £12m to which commercial rates of interest will be charged generating an income for the Council's General Fund. Secondly, the LHC also has the opportunity to create a 6-year Joint Venture with a national property developer which aims to build homes on a large development site in the district. Again, the plan is to finance this using a PWLB loan of up to which the Council lends at a commercial rate. This in turn generates loan profit for the Council. There is also potential for a dividend payable to the Council's general fund upon completion of the development which is funded from the profit share split between the LHC and Developer. The deal includes for the Council to purchase the affordable properties and for the LHC to purchase some additional homes on the site both of which will be the subject of separate reports.
- 3.18. The Council will finance the loan with a prudential rate which is considerably lower than the rate to be charged for the on lending. The LHC/JV will make regular loan re-payments during each financial year during the term of the loan. As a consequence, the Council effectively attracts 'loan profit' over the course of the loan period. The Business Plan sets out that the Council will attract 'loan profit' from year one of operation. 'Profit' is also generated from selling professional services to the company. The Council may also, in future years benefit from receiving dividends from the Company.
- 3.19. The purchase of existing properties to rent out at market level rents is a relatively low risk form of investment. The rented property market is buoyant and a familiar entity to the Council.
- 3.20. The development activity has its risks mitigated by the loan from the Council being secured against the land (which is valued higher than the loan value). Furthermore, the Terms of the loan will require the Council to be a secured creditor and therefore have preference over other creditors.
- 3.21. The market rented activity has its risks mitigated by purchase of an asset which will be valued prior to purchase and insured following purchase.

- 3.22. The Company has no stated intention to dispose of its investments, but will have the option of disposing of assets in the future and realising a capital receipt, which can be returned to the Council if considered desirable or necessary.
- 3.23. As sole shareholder, the Council will exercise some degree of control over the company but the company must be allowed to operate at 'arm's length' to deliver its objectives independently of the Council.
- 3.24. To meet the Council's vision, aims and objectives for the provision of homes there is a real need to open up every opportunity and channel to provide the numbers and type of homes needed. A Local Housing Company can be a very impactful additional channel that can offer the Council a 'triple dividend':
- Much needed extra housing
  - A greater stewardship role in place shaping and meeting climate change objectives.
  - A financial return to the council
- Both activities are geared to produce an income primarily for the General Fund but also for the Housing Revenue Account.
- 3.25. This Business Plan sets out the activities for the first year and presents the latest projections for the Company for 2020/21 -2029/30 in detail. It includes an insight to objectives, priorities and financial projections for the entire 50-year business plan up to 2069/70.
- 3.26. Bids to purchase the land which would be the subject of the JV detail are, at the time of writing, being considered, with the land purchase due to take place in late January. There is a chance that the landowner does not accept our bid in which case, the deal would fall away. Nevertheless, there is a time pressure to establish the company and make the necessary approvals to enable the company and the Council to take advantage of this opportunity. Given that the land purchase could be lost, the report focuses on the other main area of business, namely market rented housing provision. The detail of the development opportunity is set out within the confidential appendices attached to the Business Plan at Appendix D.

### **Recommendation 2.4**

#### Recommendation 2.4.1

- 3.27. Whilst every matter has been considered and is set out in this suite of documents, the unexpected may emerge. This recommendation would enable the timetable to be met.
- 3.28. A Memorandum of Association will also need to be signed by one of the Council's authorised signatories on behalf of the Council. This is a legal statement which agrees to form the company.

#### Recommendation 2.4.2

- 3.29. Whilst striving to adopt a name that is familiar to residents of Warwick District, it should not be exclusive of other communities should the Company develop or acquire properties outside of the district. Additionally, the name adopted cannot already be in use or registered with Companies House and therefore the choice of name will be subject to availability at the time of registration.
- 3.30. Note the intention to name the Company 'Spa Living/Milverton Homes' however, this will be subject to availability at the time of registration.

### Recommendation 2.4.3

- 3.31. In advance of the first property purchase, the company will adopt a range of operational policies covering:
- Rent and lettings policy
  - Sales policy
  - Debt recovery policies
  - Conflict of interest policy
  - Planned / reactive maintenance provision policy.

Where properties are retained by the company they will be let on an Assured Short hold basis. It will be important that the Company adopts a fully commercial approach to both letting and debt recovery.

- 3.32. Given that two directors of the company will also be employees of the council a clear and unambiguous conflict of interest policy will be drawn up which makes clear the respective roles and responsibilities. Such a policy will also need to cover instances where other officers are providing services to the company. The articles of association also address directors' legal responsibilities regarding transactions that it has another interest in.

### **Recommendation 2.5**

#### Recommendation 2.5.1

- 3.33. The LHC will require some start-up funds to enable it to bring to life the business plan. Costs include legal fees, insurances and company registration. The costs are calculated at £200K.

#### Recommendation 2.5.2

- 3.34. The company will, where it is getting market value, agree supply agreements with the Council. Having an agreement will formalise the approach for officer time invested in the company to be recharged appropriately. As a consequence, some of the costs for the company will appear as a receipt for the council.

It should be noted that the company will buy in external support including for company secretarial services and audit services under a separate agreement.

### Recommendation 2.5.3

- 3.35. For the avoidance of doubt, the directors who are also Council employees will not receive remuneration but non-executive directors will receive a remuneration for undertaking the role of non-executive directors. The level of remuneration will be set by the Head of Finance

### **Recommendation 2.6**

#### Recommendation 2.6.1

- 3.36. Full due diligence is still taking place in relation to the two areas of work planned for the Company:
- 1.2.1 The establishment of an arm's length wholly owned housing company which will purchase accommodation in the district to let on a market rate for long term income generation.
  - 2.2.1 A proposed Joint Venture with a Developer to deliver homes
- 3.37. Expert financial and treasury advice is being provided by KPMG's regeneration and housing team, who are experienced in advising on Joint Venture and Local Housing Company implementations. This expert advice will allow the Council to ensure that the arrangements are structured in a way that mitigates risk for the Council, will provide commercial, tax and accounting input, and provides surety on lending as well as maximising the financial return for the Council. As described at para 3.27, there is a time limited opportunity for a JV to develop housing which will enable the Council to acquire much needed affordable housing and generate income for the General Fund thereby maintaining vital Council services. The time pressures prevent a further report being brought setting out the detail of the loan arrangements before the land purchase is due to take place. It is therefore necessary for the delegated authority to be established.
- 3.38. The loan agreement is a written agreement between the Council as lender and the company as borrower, which sets out the terms on which the Council will provide funding to the company in order to enable it to function and achieve its objectives. Any loans to the company will be on market terms in order to comply with state aid obligations.

#### Recommendation 2.6.2

- 3.39. A decision from full Council is needed to provide the authority to add the project to the Council's capital programme and make provision to subscribe for ordinary shares in the LHC and make provision to fund the loan facility that the Council would be required to make available to the LHC/JV. The provisions within this recommendation provide the necessary legal and financial approvals for this to take place.

### **Recommendation 2.7**

#### Recommendation 2.7.1

- 3.40. The company will need to formally request the loan from Warwick District Council and provide key documents as part of this process.

### **Recommendation 2.8**

- 3.41. Expert financial and treasury advice is being provided by KPMG's regeneration and housing team, who are experienced in advising on Joint Venture and Local Housing Company implementations. This expert advice will allow the Council to ensure that the arrangements are structured in a way that mitigates risk for the Council, will provide commercial, tax and accounting input, and provides surety on lending as well as maximising the financial return for the Council.

## **4. Policy Framework**

### **4.1. Fit for the Future (FFF)**

- 4.1.1. "The Council's FFF Strategy is designed to deliver the Vision for the District of making it a Great Place to Live, Work and Visit. To that end amongst other things the FFF Strategy contains several Key projects. This report shows the way forward for implementing a significant part of one of the Council's Key projects."
- 4.1.2. "The FFF Strategy has 3 strands, People, Services and Money, and each has an external and internal element to it, the details of which can be found [on the Council's website](#). The table below illustrates the impact of this proposal if any in relation to the Council's FFF Strategy."

### **4.2. FFF Strands**

#### **4.2.1 External impacts of proposal(s)**

**People - Health, Homes, Communities** - Increasing the supply of good quality housing for rent or sale will extend housing options for a range of income levels and enable more people to establish roots in their desired neighbourhoods. This should therefore make a positive contribution toward community cohesion.

**Services - Green, Clean, Safe** - Empty buildings and derelict building land can be targets for a range of anti-social behaviours and provide opportunities for criminal behaviours. Bringing property back into use and possibly redeveloping land can therefore make a positive contribution to community safety. The company will consider having a minimum standard for property purchase and development including that it achieves at least EPC of C. The company will aim to provide housing that uses sustainable forms of energy. These standards could underpin the CEAP by implementing alternative energy and high specified wall insulation to eliminate the need for use of fossil fuels, minimising the heat demand in housing.

**Money-** Infrastructure, Enterprise, Employment - The financial implications are set out in the body of the report and the attached business plan.

### 4.2.2. **Internal impacts of the proposal(s)**

**People - Effective Staff** – Key staff have been identified who will assist in the delivery of the objectives for the Company.

**Services - Maintain or Improve Services** - The model has the aim of making significant contributions to the Council's income in the face of funding shortfalls, and by doing so, put services on a more sustainable footing to support local people as well as raising money to invest in our priority outcomes.

**Money - Firm Financial Footing over the Longer Term** - The model has the aim of making significant contributions to the Council's income in the face of funding shortfalls, by achieving a good return on investment and making good use of assets. This directly maximises income earning opportunities as the Council will receive a return in three ways: loan interest; margin applied to professional services; dividend. By doing so, the initiative puts services on a more sustainable footing to support local people as well as raising money to invest in our priority outcomes.

### 4.3. **Supporting Strategies**

4.3.1. Each strand of the FFF strategy has a number of supporting Strategies. This report supports the Housing and Homelessness Strategy, specifically objective 2 'Meeting the Need across the District by addressing the need for new home provision'.

### 4.4. **Changes to Existing Policies**

4.4.1. No changes are proposed to any existing Policies however; activities of the company may be referenced within the Housing Revenue Account Business Plan and feature in the Councils balance sheet.

### 4.5. **Impact Assessments**

4.5.1. Increasing the supply of good quality housing for rent or sale will extend housing options for a range of income levels and enable more people to establish roots in their desired neighbourhoods. This should therefore make a positive contribution toward community cohesion.

## 5. **Budgetary Framework**

5.1. A 50-year Local Housing Company business plan has been drafted to ensure the model of the LHC remains financially robust. The detailed assumptions and forecasts contained within the business plan are being finalised at the time of writing this report with key assumptions likely to alter upon the receipt of further detailed expert financial advice from KPMG to quantify and advise on the technical accounting requirements. The business model is for the LHC to purchase accommodation in the district to let on a market rate for long term income generation alongside exploring the viability of a proposed Joint Venture with a national house builder to deliver new homes

- 5.2. The Council is seeking expert Treasury, Joint Venture and Local Housing Company financial advice from KPMG which is ongoing at the time of writing this report. A number of assumptions have been used to calculate the financial position examples noted in the budgetary framework points which are likely to change upon the final advice being received; at which point all financial assumptions and models will be revised.
- 5.3. It is important that a distinction is drawn between the operating profit/loss of the company and the returns available on the council's investment. In essence the company will be making a limited operational profit as, in common with all property investment companies the bulk of its assets are counted in the balance sheets for the company. This is standard practice for companies of this type. Many of the company's costs appear as receipts for the Council, e.g. the recharges for staff time. The company will, where it is getting market value, buy in professional services from the Council.
- 5.4. Although the company is likely to make a limited operating profit, utilising an annuity form of loan, it is over time reducing the debt held against its assets. This situation is reflected with the council's investment as, over time its debt to the PWLB is reduced. The council will need to extend initial working capital of £200,000 revenue funding either upon the receipt of a share issue from the company or in the form of a loan or equity as per the draft loan agreement.
- 5.5. The Council's return on investment is materially affected by the amount of reserves committed to financing the company. As per advice from KPMG the LHC will be almost 100% loan-financed through on-lending by the Council based on market level terms and rates in order for it to remain state aid compliant.
- 5.6. The starting position is that the company will borrow the entire amount from the Council's General Fund who will source financing from the Public Works Loan Board (PWLB). The Council will capitalise this investment to the Local Housing company through a mix of debt and equity with the Council purchasing a nominal amount in Share Capital from the Local Housing Company to become the 100% shareholder. The Start-up cost of the Local Housing company will be not impact general fund reserves negatively.
- 5.7. The debt/equity split will be in line with the nature of the development, and may be up to 80/20% for investments in completed rental assets and around 60/40% for development projects. Indicative rates of interest that the council may estimate charging will depend of the seniority of the loans made to developments. These may range between 3.75-6.00% for senior debt and be significantly higher for subordinated debt. Final gearing and % rates on loans will be advised in further detail as part of the due diligence being completed by KPMG.
- 5.8. The council will need to ensure that it complies with its Treasury Management Policy and make a Minimum Revenue Provision (MRP) for the loan/s that it takes from the PWLB if required. This financial detail will be

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calculated in line with the pending expert advice from KPMG and the Councils Treasury Management contract with LINK.

- 5.9. A headline summary of the council's investment position in relation to the market rental activity is seen in the table below. The Council will facilitate a loan to the Local Housing Company, to enable the purchase of Housing Stock over a 40-year loan term for the purposes of creating market rental activity as per the LHC Business Plan noted in Appendix D. A summary detailing the Council's investment position should the development opportunity progress can be found in confidential Appendix 2 within the Business Plan. All numbers are subject to verification and may change following the confirmation of borrowing rates and corresponding on lending to the LHC at market level interest rates to be agreed.

| <b>GF Revenue Income</b>   | <b>Total 50 Year</b> |
|--|----------------------|
|  | <b>£</b>             |
| <b>Revenue Income</b>  |                      |
| Staff Recharges via SLA  | - 1,175,358          |
| <b>Total Market Rental Recharge Income</b>                       | - 1,175,358          |
| <b>Net Investment Income - Market Rental Loan</b>                |                      |
| PWLB Market Rental Arm Loan - Capital                            | 11,625,000           |
| PWLB Market Rental Arm Loan - Interest                           | 4,870,729            |
| Market Rental Arm Loan repayment from Housing Company - Capital  | - 11,625,000         |
| Market Rental Arm Loan repayment from Housing Company - Interest | - 13,644,563         |
| <b>Net Income from Loan Facilitating the Market Rental Arm</b>   | - 8,773,834          |

| <b>GF Capital Outlay</b>                         | <b>Total 50 Year</b> |
|--|----------------------|
|  | <b>£</b>             |
| Local Housing Company 100% Share Purchase        | 200,000              |
| PWLB Loan Received from PWLB                     | - 11,625,000         |
| On-lending of PWLB Loan to Local Housing Company | 11,625,000           |
| <b>LHC Market Rental Arm</b>                     | <b>200,000</b>       |
|  |                      |
| <b>Net Impact</b>                                | <b>- 8,573,834</b>   |

- 5.10 The full Financial Model for the LHC will be continually assessed for viability and profitability in future weeks upon the receipt of end point expert financial advice with viability assumptions be presented for consideration to the Head of Finance (Section 151 Officer).

## 6. Risks

- 6.1. The purpose in commissioning external legal and financial advice in respect of the options available to the council has been to assist in the early identification of the key risks.
- 6.2. The main risk is that relating to the repayment of loans to the company from the council. As a 100% council owned company, the council will be responsible for any shortfall and repayment of the loan where the income



of the company is less than its outgoings. The council will carry the risk where all or some of the company’s investments generate a loss rather than a surplus. However, each property purchase or project progressed will be subject to a strict financial viability assessment. In the event market conditions change radically the company model allows for the company to dispose of some, or all, of its housing assets to another provider or organisation at in the future, should it wish to exit from the initiative.

- 6.3. The Directors will expect to receive monthly financial reports.
- 6.4. All risks associated with the formation and operation of the company will be entered into the project or corporate risk registers, where appropriate.
- 6.5. It should be noted that the establishment of the company in itself does not create risks or commit the Council/LHC to undertake any development projects.

| <b>Risk</b>                           | <b>Mitigation</b>   | <b>Opportunities</b>   |
|---------------------------------------|---|--|
| <i>Property</i>                       |   |  |
| High and increasing development costs | Detailed financial modelling based on current building costs and stress-testing for price increases   | Property values increase   |
| Property values fall                  | The business plan recognises that short-term fluctuations in the market are inevitable but the outturn is positive over the length of the plan  | Flexibility and control of the portfolio   |
| Insufficient demand                   | Each development will be subject to its own business case which will identify a suitable mix of tenure reflecting current demands in the market | Evidence demonstrates that there is a consistent demand for market and sub-market rented housing |

| <b>Risk</b>  | <b>Mitigation</b>  | <b>Opportunities</b>   |
|--|--|--|
| <i>Community Support</i>   |  | Capacity to meet housing need that cannot be met by the HRA<br><br>Raising standards in the private rented sector          |
| <i>Timescales</i><br><br>Company not established in time to support specific initiatives   | Resources are in place to ensure that the company can be incorporated in December 2020.  |  |
| <i>Project capacity</i><br>There is insufficient capacity to enable the project to be a success  | Key officers have been identified and are deployed on the project.   |  |
| <i>Financial / VfM</i><br><br>The housing company is not profitable and is unable to pay dividends to the Council and/or defaults on loan interest and repayments, resulting in the Council's Investment not achieving the projected return.<br><br>Tax rules/HMRC requirements impacting on viability<br><br>Future Government restrictions on prudential borrowing rules to limit allowable public sector debt forces the housing company to borrow at higher interest rates | The Board will require detailed financial modelling, including sensitivity analysis, to ensure careful selection of investment options that excludes those that fall short of the necessary viability criteria.<br><br>Additional tax advice to be acquired<br><br>The housing company would need to consider commercial debt in order to continue its expansion taking into consideration any effect this may have on the viability of individual schemes | Generation of profit on Disposal<br><br>Maximise available tax relief where possible<br><br>Potential receipt of dividends |

| Risk  | Mitigation   | Opportunities  |
|---|--|--|
| <p>Brexit - worst case scenario: shortage of labour and materials; house price downturn; rising demand for affordable housing as a result of rising unemployment; rising cost of loan finance</p> <p>Financial risk sits with the Council – could create constraints in early years if solely focused on development.</p> <p>State Aid rules breached</p> | <p>Potential development is continually appraised before contracts are agreed and any loan finance is based on fixed rates</p> <p>Advice from KPMG is sought to ameliorate risk and the portfolio of work is balanced through acquisitions for market rent.</p> <p>Advice from Trowers and Hamlins and KPMG sought. The financial arrangement between the Council and the company will be on a commercial basis.</p> | <p>Potential reduction in borrowing costs for the General Fund if gilt yields, and therefore PWLB borrowing costs, fall leading to greater margin for the General Fund</p> |
| <p><i>Legal</i></p> <p>Council acting outside of relevant powers</p> <p>Personal risk arising from the duties and liabilities of company directors</p>  | <p>External specialist legal advice on company governance obtained</p> <p>Appropriate insurance against claims for negligence, breach of trust etc. will be obtained</p>   |  |
| <p><i>Reputation</i></p> <p>Reputational impact of the company on the council</p>   | <p>A marketing and communications plan will be developed to ensure that the branding and image of the company contribute to a positive view of the Council's services</p>  |  |

| Risk  | Mitigation   | Opportunities |
|---|--|---------------|
| Reputational damage in the event of the company's failure | Risks reviewed and evaluated on a regular basis as part of corporate risk management process |               |

**7. Alternative Option(s) considered**

- 7.1. The option of not setting up a LHC has been considered. Because this would not increase the flexibility with which the council can address current and future needs for housing, this option is not recommended.
- 7.2. Options other than a wholly-owned LHC have been considered (e.g., a partnership with a private sector organisation or with another LA), but since it would be unlikely that such partnerships would be able to be aligned wholly with the Council’s objectives, are not recommended.

**8. Background**

- 8.1. LHCs are independent arms-length commercial organisations wholly or partly owned by councils. They can develop, buy and manage properties within and outside of a local authority area. The homes LHCs provide sit outside of the local government housing financing system (Housing Revenue Account) and are not subject to the Housing Act and most of the social/affordable housing regulations.
- 8.2. The Council can use the general power of competence in Section 1 of the Localism Act to incorporate corporate entities. If the Council uses this power for a commercial purpose, Section 4 provides this must be delivered through a company (although there is nothing to stop the Council acting through a company even if it is not acting for a commercial purpose). The Council can also operate affordable housing through a company, without having to use its more "natural" Section 9 Housing Act 1985 power, which would necessitate the properties being accounted for in the Council's Housing Revenue Account (HRA).
- 8.3. The number of companies has increased dramatically among councils across the whole of England. At the last count by CIPFA, around 750 were found. Studies of LHCs shows that the vast majority are engaged in the provision of affordable housing (but not social rented housing), as well as market housing for rent and sale.
- 8.4. Research undertaken by the Smith Institute found that many councils have long harboured the chance to play a more pro-active role in housing and place-shaping. The tight constraints on the HRA system and the Right to Buy (RTB) has made that extremely difficult for stock holding councils. Non-stock

holding councils have meanwhile been largely side-lined by the government's strong support for private sector-led development.

- 8.5. Providing new homes "commercially" using council assets and public borrowing (with no capital grant) effectively frees the council from Whitehall control. It also gives councils a much-welcomed degree of flexibility to offer a mix of housing tenures, rather than just council housing, and exemption from the RTB and rent controls. Councillors often spoke passionately about this, arguing that their LHC gives them some "skin in the game".
- 8.6. In some places, the LHC is also seen as a viable alternative or complement to delivery by the private sector and housing associations. In others, the LHCs purpose is primarily to kick-start development or to change the tenure mix on existing estates. Several LHCs are also providing specialist housing for older people and students, as well as temporary accommodation. Some also offer self-build and eco-homes. Councils claim that LHCs are not just filling gaps in the local housing market and making budget savings, but also driving up standards in the PRS. In some instances, such as Newham in East London, the LHC aims to be the major market provider of PRS homes.
- 8.7. This "quiet revolution" in councils building again is adding to the diversity of supply of affordable homes. There are several main themes that the research revealed:
  - LHCs provide a mix of housing tenures, with the focus on renting (at equivalent affordable rent and market rent levels) and to a lesser extent at social rented levels. Some LHCs provide homes for sale and to meet specialist housing needs (e.g. for temporary accommodation and homes for older people) and several are involved in estate renewal and regeneration schemes.
  - The majority of LHCs are wholly owned by the council, which typically provides loan finance and land.
  - A few LHCs are multi-council and some are subsidiaries of a council-owned regeneration or property company. Some of the larger LHCs have attracted private finance and established 'revolving investment' funds.
  - Councils have been careful in setting up their LHC, taking outside legal and financial advice. With some exceptions, there appears to be little antipathy towards LHCs or evidence of "reckless" lending. There are some concerns over a council's multiple roles – as owner/co-owner, funder and planning authority.
  - The ethos and social purposes of many LHCs are arguably similar to housing associations, operating where they can a cross subsidy model for funding sub-market housing. However, unlike most housing associations, the LHCs, by virtue of being new housing providers, have This "quiet revolution" in councils higher concentrations of market housing for rent and sale. As building again is adding to the mentioned, the proportion of housing at social rents for most diversity of supply of affordable LHCs is much lower.
  - Most LHCs generate income directly from their market housing, as well as through on-lending and from other sources, like the New Homes Bonus. However, there is little evidence to suggest that the LHCs are making

hefty profits or that they are diverting large surpluses into the council's General Fund, rather than re-investing them back into the LHC. However, as our survey showed the financial return is still a key motivation for establishing a LHC. There is a risk that government could intervene to change the way LHCs can generate surpluses. Equally government could seek to fund LHC directly via the HCA, although this may create regulatory problems. Overall on LHC finances, the report found that:

- Most councils expect their LHC to generate a profit, which can be re-invested into the housing company. Besides income from rents and sales, LHCs attract funds from the New Homes Bonus, additional council tax, and planning gain.
- Councils are also generating income from 'on-lending' to the LHC (borrowing long term at below market rates from the Public Works Loan Board and on-lending at a market-rate premium).

8.8. Councils claim that LHCs are there for the long term and are more resilient to market and financial risk than private developers and that the LHC can 'flip tenures' and defer dividend payments if needs be.