

**Report to:** CABINET

**Date of Meeting:** 5<sup>TH</sup> DECEMBER 2016

**Report Title:** FINANCIAL & LEGAL BUSINESS CASE FOR LOCAL HOUSING COMPANY

**Report By:** ANDREW PALMER (ASSISTANT DIRECTOR – HOUSING & BUILT ENVIRONMENT)

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### **Purpose of Report**

This report sets out a proposal to create a Housing Company, which will be wholly owned by the Council.

The Housing Company will be designed to initially acquire and provide housing for both sub-market and market rent in the Borough but with the potential to undertake development activities (and provide housing for sale or rent) either inside or outside the Borough.

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### **Recommendation(s)**

- 1) That the principle of establishing a local housing company is supported on the basis of the governance and constitutional arrangements set out in this report.
- 2) That a detailed company business plan and governance arrangements are developed for a wholly owned Housing Company and implemented subject to final approval by Full Council.
- 3) Funding from the Council to be determined following production of a viable and long term sustainable business plan.

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### **Reasons for Recommendations**

By agreeing to the recommendations, the Council would be improving access to existing housing and delivering additional homes. This is key to the Council's regeneration plans and there are established corporate commitments covering the Council's housing and regeneration ambitions for the town.

There is also a necessity to generate new income streams to safeguard future services provision for residents, which has also been identified as a key corporate aim.

## Introduction

1. The necessity to generate new income streams to safeguard service provision for residents is a key corporate aim and represents one of the single biggest challenges facing the Council.
2. The proposal to set up a Housing Company is therefore set in the context of the Council's policy to generate income through the development of commercial activity across its services and to generate new sources of income where opportunity is identified. In this context the acquisition or development of housing either inside or outside the Borough (either inside or outside of a company structure) will need to develop and be assessed alongside other potential income sources.
3. Improving access to housing and delivering additional homes remains a key regeneration objective and a pre-requisite of addressing the Council's anti-poverty objectives.
4. The Council will need to set the company clear objectives in terms of the balance between generating income that can be invested in supporting the wider activities of the Council and/or the reinvestment of any surplus generated in the provision of "sub-market" housing.
5. The Council recently commissioned Trowers and Hamlin and Savill's to undertake an initial feasibility assessment and advise the Council on appropriate models and structures for a housing company that can help take forward regeneration in the town and generate future income.
6. A briefing took place in July 2016 where members were presented with the consultant's findings and recommendations in terms of how the Council might progress a housing company. The briefing was well attended and generally well received.
7. This report contains a summary of those findings and sets out proposals for the establishment of a Housing Company wholly owned by the council.
8. The proposed Company would be designed to both acquire existing property and to develop new or refurbished homes on land owned or acquired by the Council. However, the initial focus would be on the acquisition of newly built or existing housing in the Borough and include the following specific objectives:
  - to make a financial return to the Council as owner of the Company by delivering housing for market rent (or in the longer term market sale); and
  - Provide additional sub-market accommodation in the Borough where this can be subsidised by the market rent housing (or in the longer term market sale) owned by the Housing Company.

These objectives would support other strategies of the Council.

9. The Housing Company would be required to be financially viable, operate in accordance with an agreed business plan and meet all its statutory obligations.

10. As previously stated it is initially proposed that the Housing Company would be used to purchase individual street properties and/or to acquire homes direct from developers, but will be set up so as to be able to undertake housing development activities in the future should a business case be made. The company might be well positioned to potentially develop or acquire housing on priority sites identified through its own asset management reviews.

11. The Housing Company would be financed by the Council through loans from the Council. The Council, using its own resources, or by borrowing from the Public Works Loan Board. The appropriate sources of finance to be identified by the Chief Finance Officer (s151 Officer).

12. There would be an initial cost in setting up and financing the Housing Company. This would be financed by a loan (revenue monies) to the Company and would be repaid by the Company in line with the business plan assumptions once the Housing Company produced a surplus.

13. The Council would set up the Company to ensure it would be the sole beneficiary of any future dividends, capital growth in the value of the property portfolio and would realise a premium for lending monies to the Housing Company.

14. The Financial modelling undertaken by Saville's indicates that in the short term the Housing Company would be at least cost neutral to the Council, insofar as it receives sufficient rental income to meet all of its costs including financing, housing management, property maintenance and administration. In the longer term, the modelling demonstrates it would produce income and capital growth.

15. The outline business case has been modelled by Savill's and includes a proposal for the Council to initially acquire a mixture of 20 existing properties to subsequently rent. A copy is attached at Appendix A. Variations on this proposal are also included at Appendix C. Please note all modelling is indicative only at this stage. Acquisitions of individual properties or land in future would be subject to detailed viability assessments and in line with the detailed business plan agreed by the Council.

16. It is imperative that a company wholly owned by the Council has an appropriate governance structure for the sound and robust management of the company. The governance arrangements must protect the Council's financial and reputational investment in the Housing Company, whilst not hindering its ability to act swiftly and pro-actively as a separate legal entity. The Council's Chief Legal Officer will work with Trowers and Hamill to achieve this.

17. As sole shareholder, the Council would appoint the directors to the Housing Company and approve the business plan and monitor and hold the Housing Company to account.

18. The directors of the Housing Company would have responsibility for the operation and management of the Housing Company. The directors would be

accountable to the Council for the company's performance through the Council's role as the sole shareholder of the Housing Company.

19. The Council has taken legal advice from Trowers & Hamlin's LLP to ensure that it has the powers and capability to create the company in line with relevant legislation. Trowers & Hamlin's LLP have detailed knowledge and experience of advising a number of Councils about the formation and management of commercial housing companies. A copy of their report is attached at Appendix B.

## Background

20. The Corporate Plan 2016/17–2018/19 contains a specific work programme around income generation and identifies delivery of housing and income from housing, including the establishment of company structures if appropriate, as a key activity of the Council in 2016/17.

21. The Corporate plan also contains commitments to consider appropriate development which can enhance the town as a place to live, work, study and invest in and confirms the council's commitment to remove eyesores and return empty homes to use.

22. There is widespread acknowledgement that there is a national and local housing crisis with demand for homes far outstripping supply. The Council recognises that people need homes with security that allows them to establish roots in their communities. The Council's ambitions are not limited to any one subsection of the local community. The Council believes that neighbourhoods are at their strongest when they are genuinely mixed and diverse.

23. Housing needs to be available to meet a range of incomes. This is important not only to meet the needs of existing residents but also to attract business and skills necessary for the continued regeneration of the town. The Council aims to help create and support a sustainable built environment that will help meet the needs and aspirations of wide sector of both current and future residents. Developing homes for market or sub market rents (and possibly sale in the future) will complement the existing housing market and potentially reduce pressure on affordable rented homes provided by Housing Associations for which there is also an acute shortage.

24. The Councils Housing Strategy 2016-19 has three key strategic priorities aimed at supporting local residents and the economy of the town. Two of the three priorities identified are relevant to the proposal outlined in this report.

- Priority 1 is to address housing needs and aspirations of residents. This includes aims of ensuring an appropriate mix of housing is provided in terms of tenure, price, type, size and location, having regard to the accommodation needs of the town. It also contains a commitment to consider the potential for the Council to invest directly in new housing in pursuit of this objective.
- Priority 3 covering regeneration contains an express commitment to consider the establishment of a Local Housing Company to aid with development and regeneration of the town. Further it identifies the need to ensure that

appropriate housing options are available for keyworkers who can support a vibrant local economy where social housing is not considered a solution to their housing needs.

25. The Local Plan 2011 – 2028 seeks to ensure that 3,400 homes are delivered over the life of the plan. Objective 2 is to ensure that everyone has the opportunity to live in a decent home, which they can afford and in a community in which they want to live. The number of new homes being built currently lags behind the delivery profile.

26. Local Housing Companies are considered a valuable strategic tool for local authorities in helping to pro-actively shape their housing markets. The Elphicke-House Report (2015) commissioned by the Government recognised the role they can play in housing delivery and the former Housing Minister wrote to local authorities in March 2015 stating that the government supported the setting up of local housing companies where they were taking on a role distinct from that of providing affordable housing.

## **A Wholly Owned Housing Company**

### **The Proposal and Company Objectives**

27. The Housing Company would be wholly owned by the Council and established to purchase, develop and deliver housing for both market rent (and potentially development for market sale), and to provide sub market housing.

28. Key objective of the Housing Company would be:

To acquire existing or newly built property with a view to letting these to local people at market or submarket rents.

29. It is assumed at this stage that management of property acquired would be undertaken through the Council's Letstart Agency (Local Lettings Agency) although it is conceivable that it might be undertaken by other service providers.

30. The Council may consider whether it would consider, at a later date, developing land itself (or through a company) owned by itself or acquired on the open market for development or redevelopment. The purpose of such development or redevelopment to provide mix tenure housing for sale, market or submarket rent.

### **Company Structure and Governance Arrangements**

31. Trowers & Hamlin's LLP have advised that a company limited by shares (CLS) is the appropriate form of vehicle for the Housing Company for a number of reasons, including:

- A CLS is the most common corporate vehicle in England for a profit distributing body.

- As the council may look to receive a return from the profits of the Housing Company and the CLS model is a typical form of commercial vehicle established with a view to making a profit.
- The ability for the Council to invest in the company by way of share equity as well as loan debt.

32. The Council would have full ownership of the Housing Company, holding 100% of the shares. This provides the Council with the ultimate 'control' of the company, including the decision making with regard to the allocations, selection of properties and the rents charged by the company, including the "mix" of market and sub-market rents.

33. The Council and Housing Company would need to ensure that appropriate governance arrangements are put in place so that the Council can set and monitor the Housing Company, whilst allowing the directors of the Housing Company to carry out the operational management effectively, efficiently and with clear targets and milestones and being accountable to Members for the success of the Company.

34. The establishment of a Shareholders Agreement (between the Council as sole shareholder and the Housing Company) would set out the parameters under which the Housing Company must operate within providing the Council with complete control over the Housing Company.

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

- The first level of governance would be the exercise of the Council's right as shareholder in the Housing Company, by which the Council would ensure control over the strategic direction and oversight of the Housing Company.
- It is proposed that this is exercised by the Council's Income Generation Board, which in return reports to the Council's Cabinet.
- The second level of governance would cover the day to day operational matters of the company and this would be the responsibility of the Housing Company's Directors. It is suggested that 4 senior officers of the Council are appointed as Company Directors with one being the Managing Director of the Company. This should include a Senior Finance Officer of the Council (who is not the section 151 officer). It is further proposed that an additional director is appointed who can bring external challenge and additional expertise in a housing development, legal or housing finance capacity. Subject to the recommendations set out in this report work will begin in identifying the mix of officers with the right skills to fulfil the duties of a board member.

36. The structure proposed avoids any potential conflict of interest for Members between their role as an elected Member of the Council and the day to day operational management of the Housing Company. However, Members would still exercise control of the Housing Company at a strategic level with Officers tasked with managing the Housing Company within a framework and through delegated authority provided by Members and documented in the Shareholder Agreement.

37. It is recommended that the Council's Chief Finance Officer (s151 Officer) and the Council's Chief Legal and Monitoring Officer are not appointed as Directors to

ensure a clear separation of their role within the Council. Officers need to be mindful to avoid circumstances where a conflict might arise in their role as a Director of the company and that of giving advice to Members in their role as Council decision makers; for example when making decisions to lend to the company, transfer land to the company. Should the Council's Assistant Director for Housing and the Built Environment be appointed as a Director, then the separation of his role needs to be made explicit in the Council's Scheme of Delegations, where it relates to Planning Service responsibilities.

38. Any Council Officer appointed as a Director would not be remunerated. However, it may be appropriate for Non-Executive Directors to receive modest remuneration. Staff and Officer time, including fair charges for assets would be a charge to the Company – required to avoid state aid assets.

### **Documentation Required to Establish the Housing Company**

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

- Articles of Association
- Shareholder Agreement
- Loan Agreement
- Changes to the Council's Constitution and Delegations to officers

40. In addition, the Housing Company would be governed by a series of operational documents, which would be controlled by the Council via the Shareholder Agreement:

- Business Plan –This would be developed to cover a minimum rolling 5-year period of investment activity and would outline the Housing Company's operations. The business plan would need to ensure that it covered a sufficient period to show the company was sustainable and would be reviewed and agreed annually and would cover the:
  - a) Company objectives (as established in the Shareholder Agreement)
  - b) Governance arrangements
  - c) Operational plans
  - d) Financial model and assumptions
  - e) Rents, sales and development assumptions
  - f) Fees, on costs and tax
  - g) Funding profile and sensitivity analysis
- Operational Policies including:
  - a) Rent setting
  - b) Letting policy
  - c) Rent arrears and debt recovery
  - d) Other general policies eg: Health and Safety

## Site Acquisitions/Disposals

41. The Housing Company is a commercial entity with ability to purchase and dispose of sites. It is anticipated that the Council would retain control (as sole shareholder) of the parameters in which the Housing Company would be able to acquire properties (e.g. target yields, maximum purchase prices etc.), but within these parameters, it is envisaged that the board of the Housing Company would have direction as to the identity of individual acquisitions.

42. The Council's Chief Finance Officer would not consider recommending to the Council any loan to the Company where appropriate returns or due diligence had not been undertaken.

## Property Management

43. Taking into account a range of factors including quality of service, costs, ability to deliver and knowledge of tenant requirements it is proposed the Housing Company will seek proposals from the Councils Social Lettings Agency in the first instance to provide these services.

## Financing the Housing Company

### Financial Modelling

#### Assumptions

44. Initial modelling undertaken by Savills is attached at Appendix A. This sets out a business case for both a development business and property investment and rental business. Members attention is drawn to para 3.9 on page 14 and 15 of the report which sets out a business case based upon the acquisition of 20 homes purchased from third parties and let at market rents.

45. Since the July 2016 report was issued, Savills have modelled further variations on a proposed 20 unit property investment and rental scheme and the results are attached at Appendix C.

46. Whilst anticipated returns on an initial 20 unit investment would initially be quite modest, this would represent a relatively low financial risk to the council. However, the Council's initial investment might be supplemented over time by Council development of its own land or by the transfer of completed units into the scheme from land disposed of to private developers (in lieu of capital receipts).

#### Stamp Duty Land Tax (SDLT)

47. SDLT will be payable by the Housing Company and included within the business plan.

## Corporation Tax

48. To the extent that the Housing Company generates a taxable surplus, this surplus would be liable to corporation tax (at a current rate of 20%). A limited company can only declare dividends out of its net-of-tax profits.

## VAT

49. The letting residential accommodation is exempt from VAT meaning that almost all of the VAT incurred in relation to those units (including VAT on management fees and on repairs and maintenance) is irrecoverable. The irrecoverable VAT position is reflected in the business plan.

## Overall Results of Financial Modelling

50. In summary, financial modelling has been carried out to assess the viability of a business plan for the Housing Company, based on the acquisition and rental of a portfolio of properties in the area, with the Company being owned and funded by the Council. Financial modelling shows that a viable proposition can be presented from the perspective of both the Company and the Council, with a positive financial return forecast to be generated by the Council.

## **Legal issues for the Council**

### **Powers to Form the Housing Company**

51. The Council can rely upon the general power of competence within the Localism Act 2011 to form the Housing Company. 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.

52. In the exercise of its powers under the Localism Act for a commercial purpose (as is the case here), the Council is obliged under the Localism Act to do so via a company, as is proposed here.

### **Powers to Fund the Housing Company**

53. The Housing Company would need funding to acquire properties or develop in future.

54. 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. Section 24 of the Local Government Act 1988 (the 1988 Act) specifically allows the Council to provide financial assistance to third parties in connection with the provision of privately let accommodation.

55. 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 Housing Company under this provision.

### **State Aid Compliance**

56. It is also important that any services and funding provided by the Council to the Housing Company are provided on appropriate terms so not to as constitute unlawful State Aid.

### **Policy Implications**

#### **Equalities & Community Cohesion**

57. Increasing the supply of housing, particularly housing offering greater security and designed to extend housing options to a range of income levels will enable more people to establish roots in their desired neighbourhoods and make a positive contribution toward community cohesion.

#### **Crime & Fear of Crime**

58. Empty Buildings and derelict building land are targets for a range of anti-social behaviour and provide an opportunity for criminal behaviour. Bringing property back into use and possibly redeveloping land in due course can make a positive contribution to community safety.

#### **Risk Management**

59. The main risks identified at this stage are legal, financial and reputational. The purpose in commissioning an external appraisal of the options has been to assist in the early identification of the risks and to minimise the impact of these upon any proposals that the Council may wish to consider. A full risk assessment would accompany a future Cabinet covering the company business plan and governance arrangements. The Company would be specifically identified within the councils corporate risk register.

60. The company would be responsible for the repayment of loans to it from the council. As a 100% Council owned company, the Council would be responsible for any shortfall and repayment of the loan where the income of the company is less than its outgoings. The Council would 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 would be subject to a strict financial viability assessments and include an exit strategy in the event housing market conditions changed radically. The Local Housing Company model allows for the Council to

dispose of some, or all, of its housing assets to another provider or organisation at some time in the future, should it wish to exit from the initiative.

61. The Board would expect to receive regular financial reports which in turn would be reported to and scrutinised by the Council.

### **Environmental**

62. The Council is committed to making best use of existing land and building for residential development. Bringing forward development of sites allocated for housing within the Local Plan or reconfiguring existing buildings minimises the risk and need to consider further land releases for housing in the future.

### **Economic & Financial Implications**

63. The financial implications will be developed further as part of the business planning process. Company set up costs are minimal and any investment or lending to the Company would not take place until the Council has signed off the Company business plan. It is anticipated that an initial investment which could be in the region of £4-5m would come from prudential borrowing by the Council.

64. The company would provide an investment vehicle for the local authority that might give a financial return equivalent or better than that achieved through other investment opportunities. In addition to any dividend the Council might receive over time from company profits or capital appreciation of assets, to ensure we are compliant with state aid regulations the Council would lend to the company at market rates thereby deriving a further income from its lending. The Council would be recompensed for any services provided to the Company, and would need to do so to avoid State Aid issues.

65. The Council would not be able to borrow to support the day-to-day activities of the Company or the staff, but would have to lend the money from its own resources.

### **Organisation Consequence**

66. Staffing implications are still to be considered but it has been assumed that existing council staff will be contracted to provide services to the new company, making use of skills already available. There may be a need at some point to buy in additional resources to provide extra company support or specialist expertise as the company progresses. The work to establish the company will be completed by an in-house project team working with the external advisers.

### **Anti-Poverty**

67. Increasing the supply of housing would contribute towards meeting local housing needs, particularly in respect of good quality housing for rent. Demand for all forms of housing outstrips supply. Regenerating neighbourhoods and improving the local housing offer would provide a catalyst for further inward investment and help generate new employment opportunities. More homes and employment in Hastings is the only sustainable way of ensuring that low income households, often least able

to secure or retain suitable housing, will be able to lift themselves clear of poverty.

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### Wards Affected

None

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### Policy Implications

Please identify if this report contains any implications for the following:

Equalities and Community Cohesiveness	Yes
Crime and Fear of Crime (Section 17)	Yes
Risk Management	Yes
Environmental Issues	Yes
Economic/Financial Implications	Yes
Human Rights Act	Yes
Organisational Consequences	Yes
Local People's Views	Yes
Anti-Poverty	Yes

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### Additional Information

- a) Appendix A - Business Case and Financial Modelling -Savills
- b) Appendix B - Report on Legal Issues – Trowers & Hamlin's
- c) Appendix C - Further Scenario Modelling -Savills

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### Officer to Contact

Andrew Palmer

[apalmer@hastings.gov.uk](mailto:apalmer@hastings.gov.uk)

01424 451316