CABINET

Subject Heading:	**Mercury Land Holdings (MLH) Annual Business Plan update**
Cabinet Member:	Councillor Ron Ower – Cabinet Member for Housing Development Company and oneSource
SLT Lead:	Steve Moore – Director Neighbourhoods
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Policy context:	**Havering Housing Strategy** **Havering Economic Development Strategy** **Havering Proposed Submission Local Plan 2017**
Financial summary:	**The Council will increase its funding of Mercury Land holdings to £58.45 million from the Regeneration and Development budget within the approved Capital Programme via equity and loan funding and this will be financed from Council borrowing. The Council will generate income from fees, interest repayments and in time dividends. This will be reflected within the budget strategy over the medium term.**
Is this a Key Decision?	**Yes - Significant effect on two or more Wards**
When should this matter be reviewed?	**Summer 2018**
Reviewing OSC:	**Scrutiny Board**

The subject matter of this report deals with the following Council Objectives

Communities making Havering
Places making Havering
Opportunities making Havering
Connections making Havering

SUMMARY

This report seeks approval of Mercury Land Holdings Limited (MLH) Business Plan for 2017. It builds on Cabinet's decision to create a wholly owned arm's length company of the Council, the purpose of which was to develop a portfolio of homes for market rent (its prime focus) and sale. It was proposed that the Council will dispose of assets (land/buildings) to MLH at market value for this purpose, for which it will receive a market payment. The Council will provide finance to MLH through a combination of equity investment and loans.

This will constitute capital expenditure for the Council within its approved Capital Programme to be financed through Council borrowing. The overall financing arrangements will be subject to an assessment of State Aid compliance, long term affordability, risk and return on investment by the Council.

MLH aims to provide a long term revenue stream as a return on investment to the Council. This will be in the form of loan interest payments, and dividends from MLH to the Council. Repayment of the original loan principal will be set aside to repay the Council's borrowing.

MLH operates in a commercial manner in the same way as any other private sector company, driven by the requirement to generate commercial profits and returns to its shareholders. The Council's rights as a shareholder in MLH are set out in MLH's Articles of Association and the Shareholder's Agreement.

RECOMMENDATIONS

That Cabinet:

1. Agree that the Leader of the Council after consultation with the Cabinet Member for Housing Company Development & oneSource Management, Director of Legal and Governance, the s151 Officer and the Director of Neighbourhoods and following completion of all due diligence will review and approve the detailed business plan and viability assessments relating to individual schemes within the business plan to enable them to proceed.

2. Agree in principle to provide further capital funding to MLH up to a maximum of £58.45m in respect of North Street and Quarles projects through a combination of equity investment and state aid compliant loans. This expenditure to be met from the capital budget for Regeneration and Development within the Approved Capital Programme to be funded from prudential borrowing.

3. Note the estimated gross income, capital financing costs and net income to be generated for the Council in relation to delivery of the MLH business plan as set out in section 7 of this report; and that subject to completion of due diligence, these sums will be used to update the MTFS prior to 2018/19 budget setting in February 2018.

4. Agree that the Leader of the Council after consultation with the Cabinet Member for Housing Company Development & oneSource Management, the Director of Legal and Governance and the s151 Officer will agree the Heads of Terms of all loan agreements.

5. Agree that the negotiation and finalisation of the loan agreements, provided they are broadly consistent with the Heads of Terms, and the decision to release funding subject to satisfactory financial due diligence, be delegated to the Section 151 officer in consultation with the Director of Legal and Governance.

6. Agree in principle to the disposal of assets (land/buildings) to MLH for best consideration except where it is possible for the Council to accept less than best consideration in which case the sum to be paid will be not less than market rate and delegate to the Director of Neighbourhoods, following consultation with the Director of Asset Management, the Director of Legal and Governance, and the Section 151 officer, authority to determine the principles and processes by which the said assets shall be disposed of and the terms of disposal.

7. Delegate to the Leader of the Council after consultation with the Cabinet Member for Housing Development Company & oneSource Management, Director of Neighbourhoods and the s151 Officer, the exercising of the Council's rights as shareholder to give effect to the above recommendations.

8. Agree as a shareholder of MLH to the following changes to MLH's Board so it consists of the following Council officers, as well as an external unconnected individual who has relevant experience in the house building sector, alongside MLH's own staff:

   a. Mercury Land Holdings Development Manager
   b. Mercury Land Holdings Project Manager
   c. Mercury Land Holdings Finance Officer
   d. Chief Executive London Borough of Havering (Managing Director of MLH)
   e. Head of Property Services, oneSource.
   f. Independent expert with experience in the sector

REPORT DETAIL

1. BACKGROUND

Introduction

1.1 The Council's main objectives for entering into the private sector housing market are:

- To generate an acceptable financial revenue return to the Council by operating a business;
- To contribute to dealing with the housing supply issue in the borough which threatens the economic and social well-being of residents and is also a threat to the local economy. It will seek to avoid large tracts of buy-to-let housing characterised by fragmented ownership, poor management of families from outside the borough, who may place unsustainable pressures on local services;
- To ensure a mix of housing, in terms of type, size and tenure, best matched to the needs of Havering; and
- To support the Council's regeneration and growth aims, bringing forward high quality development on regeneration sites in key parts of the borough, notably though not limited to, Rainham along the A1306, and Romford Town Centre.

1.2 The Council's MTFS approved by Cabinet on 13 October 2017 has an annual net income budget of £0.300m in 2017/18 related to the development and operation of the Oldchurch site (Cathedral Court), having removed previous assumed income targets pending the preparation of the attached Business Plan. The estimated revised income budgets are set out in section 7 and will be used to update the MTFS prior to February 2018 subject to the completion of all due diligence and business case approval

Strategic Context

1.3 One of the most significant housing changes in the UK housing market in the past decade or more has been the rise in the private rented sector and the decline in owner occupation.

1.4 According to a Government review, 'this trend seems likely to continue due to a combination of declining affordability, a requirement for more equity from purchasers, changes to how home purchase is financed and a relatively low supply of new housing. Further, the private sector rental market sector continues to meet housing need and this seems likely to continue'. According to the English Housing Review from the DCLG, In 2015-16 the private rented sector accounted for 4.5 million or 20% of households, rising from around 10% in the 90's. Since 2002 the sector has doubled. This is set to rise to 5.79m (or 24%) over the next five years according to market analysis published by Knight Frank.

1.5 London's population is forecast to grow from 8.3 million in 2012 to 9.5 million in 2020. Of this increase, one of the largest groups will be those in the 20 to mid-30s age bracket. This group is the key rental demographic whose aspiration for home ownership may not be satisfied until much later in life. There is now a growing demand from private sector tenants for quality, professionally managed accommodation and this demand is likely to continue to grow.

1.6 It is widely viewed that the relative immaturity of the Private Rented Sector (PRS) offers institutions and larger organisations such as local authorities an opportunity to shape the sector, and the Government is encouraging this activity.

1.7 Numerous local authorities are venturing into this market, include Kings Lynn & West Norfolk; Ealing, Waltham Forest, Barking and Dagenham, Bexley, Enfield and Newham through its Red Door Ventures. Other institutions, such as Registered Providers, are also seizing on opportunities primarily focused on London and the South East.

1.8 Increased competition has seen fierce competitive bidding for portfolios to the point where net yields in London's Zones 1-3 are no longer attractive. As such, investors are now focussing on the outer London boroughs, where investors feel capital growth prospects are more favourable, coupled with acceptable rental yields which cover funding costs. Havering fits these criteria.

1.9 It is becoming increasingly difficult for Havering residents to afford homes. A quality rented sector targeting Havering residents would meet their criteria. Likewise, affordability, coupled with improved connectivity through Crossrail, will undoubtedly make towns such as Romford more attractive for tenants who are being priced out of more central London boroughs and increasingly some mid zone locations.

1.10 There is a real opportunity for Havering to take advantage of this anticipated tenant growth and deliver quality, well located and managed PRS development which will deliver a financial return to the Borough, as well as meet its regeneration objectives.

1.11 LB Havering as a provider of PRS homes would be housing a new generation of tenants who fall outside the traditional categorisation of those in need, who want to live knowing their landlord is holding the property for the long term, giving them peace of mind and security of tenure, but also providing a quality level of service.

1.12 Havering needs to make significant savings and generate additional income in order to meet the challenges presented by reductions in government funding and demographic growth pressures upon expenditure in statutory services in order to balance its General Fund budget over the medium term. The Council is therefore seeking to make a broader use of its asset base to generate long term revenue income streams. Traditionally, the Council has successfully sold land to housing providers and developers in order to obtain capital receipts, to provide market and affordable housing and to meet borough wide housing targets. Whilst this activity will still remain important in part, utilising a Havering Housing Company allows the Council to invest capital resources to generate a substantial income streams on suitable development sites to invest in protecting and supporting other services.

2 OPERATION OF MERCURY LAND HOLDINGS

2.1 The Company will primarily develop a portfolio of homes for market rent and sale. As discussed, these will not be affordable homes and will not be targeted at households towards whom the Council owes a housing duty.

2.2 The Company, on behalf of the Council, will own the market rent units, and will market and manage the rental of those homes.

2.3 Dwellings owned by the Company will be let on Assured Shorthold Tenancies and will not be subject to Right to buy, or to the allocations provisions of Part VI of the Housing Act 1996.

2.4 The Company will prepare a specification for the marketing and management of these units and outsource this activity. Procurement will be undertaken subject to legal opinion and regulations. The outsourcing of its housing management and maintenance services is likely to be the most efficient option at the commencement of its business. LBH Housing Services would be able to respond to the outsource tender.

2.5 It is envisaged that the following human resources will be required in terms of on-going management of the business:

- A commercially focussed development manager, with significant development appraisal experience, to assess potential development opportunities.
- A project manager to act as client in managing the delivery of schemes.
- A Finance resource, which would maintain and update the financial model for the Company.
- Other support services from oneSource as necessary and which is likely to include HR, Legal, Asset Management, IT, Finance and Transactional services.
- The Company will procure the services of relevant professionals, such as chartered surveyors to advise on values and experienced cost consultant/life cycle consultant with capability to ensure value for money in terms of product and supply chain.
- The Company will continue to produce an annual business plan.

3 GOVERNANCE

Council as Shareholder in MLH

3.1 The Council's Cabinet are the prime body acting as the shareholder agreeing MLH's business plan on an annual basis.

3.2 The Leader of the Council, after consultation with Cabinet Member for Housing Development Company & oneSource Management, and after consultation with the Director of Neighbourhoods, Director of Legal Services and the Section 151 officer to exercise the Council's rights as shareholder; whose main role is to protect the council's interests as owner of the company this group will be called the 'Shareholder review group'

3.3 The above group to meet regularly to review MLH's performance with MLH's Managing Director. These meetings are to be attended by MLH's Directors.

3.4 The above group will be provided with financial/technical assistance from the Council to assess MLH's performance against its business plan, as well as its general commercial operations and advice on individual business cases.

MLH Director Roles

3.5 As MLH continues its journey of growing, and until it gets to an appropriate level of critical mass, the Council will continue to support MLH's board through the secondment of the following Council officers, alongside MLH's own staff and an external, unconnected individual who has relevant experience in the house building sector. It is therefore important to ensure they are not acting as officers of the Council for this purpose and are representing the board, so it is important to ensure there are no conflicts of interest within their roles:

- Chief Executive
- Head of Property Services, oneSource

3.6 The Council retains the right (under the Companies Articles and any Shareholder Agreement) to dismiss and appoint all of MLH's Directors.

3.7 The Directors have ultimate responsibility for directing the activities of MLH, ensuring that it is well run and delivering the outcomes for which it has been established. Its role includes:

- Setting and approving the MLH's annual business plan for presentation to the Council's Cabinet.
- Setting budgets, policies and plans and monitoring performance of MLH, and setting a framework for internal controls.
- Ensuring compliance with MLH's objects, purposes and values. Ensuring the financial strength, solvency and good performance of the HC.
- Ensuring MLH complies with all relevant regulation, laws as well as the requirements of the Council
- Dealing with the appointment and appraisal of staff.
- Procuring services necessary for the execution of MLH's objectives.

Council as Funder

3.8 The Council will act as a bank credit committee, whose primary task will be to assess MLH's viability (as an entity) and the viability of each project which loan funding will be used for and, using this analysis, to determine whether to release loan funding to MLH.

3.9 The Council will annually monitor and analyse financial information generated by MLH during the lifetime of each loan to ensure that MLH is not in breach of key financial requirements (which will be stipulated as funding conditions in each loan).

3.10 The key areas which the Funder Role will want satisfied prior to providing funding for a development are:

- That the financial metrics demonstrate that the loan will be repaid;
- There is confidence that the projected rental stream can be maintained;
- That base level sensitivities (which will trigger warning signals) for MLH's general performance and each proposed development are

properly set and that a sufficient margin is added to the base level to provide reassurance to the Funder Role. (This will form part of the HC's obligations under each loan); and

- That evidence is provided that the terms of financing for each project (loan and equity funding), is State Aid compliant. This will be required from an expert third party.

4 First Year of Operation

4.1 Mercury Land Holdings has been successfully up and running for over a year and has undertaken a number of initial activities.

4.2 During its first year work has progressed around the original approved business case in respect of Cathedral Court.

4.3 MLH has completed the development of the site at Cathedral Court with the aim of long term letting of the properties at market rent. In fact of the 65 flats developed all are currently let, well ahead of the assumptions in the business case for this scheme. The financial model developed to enable assessment demonstrates positive revenues after an initial period and a long term positive return.

4.4 MLH has also successfully got planning approval for 44 flats at the North Street site in Hornchurch.

4.5 The Company's business plan for the second year of its operation can be found at appendix A.

4.6 The plan is based on three schemes, a current rental scheme at Cathedral Court consisting of 65 flats, a further development opportunity at North Street Hornchurch which has planning approval consisting of 44 flats for PRS and Quarles Campus, circa 3.75 hectares for the potential delivery of around 99 homes for sale.

4.7 In financial terms, the rental scheme has funding consisting of equity and a short term development loan from the Council that is repayable in March 2018 and replaced by a 50 year repayment loan.

4.8 The development opportunity funding from the Council will again consist of equity and short term development loans that are again replaced by 50 year repayment operating loans once the schemes are completed and the flats rented in the PRS.

Rental

4.9 The plan shows that by year 4 (2019/20) MLH will have a total of 109 flats rented in the PRS market generating a gross annual rental of £1.6m and a net operating income before interest and fees of £1.1m available to service its debts and from year 14 (2029/30) onwards will have reserves available to declare dividends

Development

4.10 MLH is currently forecasting the development of 2 further sites in this business plan funded by equity and development loans from the Council, the development loans are on an interest only basis and repaid as each scheme moves to the operating phase and the flats are either rented or sold with a 50 year fixed term repayment loan. The peak debt is forecast to be £23.6m in year 7 (2022/23).

Council funding and financial return

4.11 The Council will fund the Company through a combination of share capital, short term development loans and fixed term operating loans.

4.12 Share capital – in return for its investment of £20.344 million the Council will be able to receive dividends from the Company and would benefit from the longer term growth of the PRS portfolio. Table 2 below provides details on the level and phasing of debt and equity provided to Mercury.

4.13 Loans – in return for its long term lending the Council will receive arrangement fees and agency fees that is forecast, based on the three schemes, to be worth £5.366 million over the life of the scheme.

4.14 Future developments will be subject to a full and detailed business case and viability assessment report to enable approval and sign off for funding. The company will own market rent units and will market and manage the rental of those homes.

REASONS AND OPTIONS

5 Reasons for the decision:

5.1 The proposition meets the objectives stated in 1.1.2 and the outline business plan contributes to the financial objectives of the Council.

6 Other options considered:

6.1 A review of the alternative options of do nothing, seeking to undertake the proposition in the General Fund or through the HRA, or establishing a formal joint venture either were not feasible or did not fulfil the objectives to the extent of the preferred option as discussed in this report.

IMPLICATIONS AND RISKS

7 Financial implications and risks:

7.1 MLH is 100% Council owned and will receive equity and loan finance from the Council (see 7.9 and 7.10 below). The financing structure will need to be state aid compliant. In particular, this means that the equity and loan mix will need to be at market levels, with market level interest rates. The Council will make a surplus in terms of the margin on the interest rate applicable to this borrowing. This income will contribute to delivering the income target within the Medium Term Financial Strategy. The Council will also receive dividends from profits generated by the company, although the business plan does not specify when these will be paid.

7.2 The investment of equity and/or the granting of loans to MLH will constitute capital expenditure within the Council's approved Capital Programme. The financial strategy intends for this expenditure to be financed from borrowing for which the Council will incur capital financing costs within its annual revenue budget representing the repayment of loan principal and/or interest, dependent upon the financing structure of debt to equity.

7.3 The approval of debt and/or equity finance for each of MLH schemes will be subject to the completion of satisfactory due diligence carried out upon the business case by officers of the Council, supported by external professional experts as required. This work will assess the scheme in terms of its deliverability, risk profile and projected income return on the investment to the Council. Further, the Council will need to be satisfied that its capital investment in agreeing the project finance is affordable in terms of the overall revenue impact and treasury management strategy on an annual basis and over the medium to long term and is state aid compliant.

7.4 The financial modelling undertaken by Council officers is based upon a number of key assumptions that have been signed off by the Director of Neighbourhoods as the lead client for MLH LTD and in liaison with MLH officers. The key assumptions are summarised below:

- Interest rates at 3% assumed PWLB borrowing
- Inflation at 2%
- Build costs assumptions (ranging from £0.191m for a one bed to £0.334m for a 3 bed)
- Potential sale prices £0.223m to £0.265m per unit for affordable sale, £0.226m to £0.483m for private sale
- Rental income achievable for each development assessed at between £986 per month for a one bed and £1,386 per month for a three bed
- Void and re-let rates (2% for each)

These assumptions are based on prudent analysis of the market and expert advice where applicable.

7.5 Each possible scheme should be subject to individual option appraisal.

Risks include the following:-

7.5.1 **Rent Levels** - changes in the market conditions of developing, selling and renting of homes could lead to a continuous reduction in property rental levels and sale prices. The impact would result in not being able to rent or sell homes for prices indicated, and may result in high working capital and insufficient asset cover for loans. This would be mitigated by the ability to reduce rental rates if need be, change tenure mixes and robust assessment of demand and supply before initiating phases of schemes.

7.5.2 **Development and Construction costs** - An Increase in development build costs, resulting in development schemes becoming more expensive and less viable leading to a reduction in viability of the portfolio. The impact on potential new developments would be tested as part of the viability assessment and may not be approved.

7.5.3 **The portfolio size fails to meet economies of scale**, with the result the Company is not able to carry level of overheads and therefore would be less viable. The pipeline of development in early years is being carefully identified and closely monitored by the Council and the future Company Board. Ongoing committed costs should be minimalised.

7.5.4 **The Company being unable to compete equally in the private market for land purchases**, resulting in the Company unable to deliver programme and returns. This is mitigated through the identification of land held by the Council which would be appropriate for the Company to develop.

7.5.5 **An increase in void turn round times/re-let times** greater than model assumptions, resulting in Income from rent is reduced and company's cash flow to service debt is compromised. This would be mitigated through a rigorous maintenance and management agreement, seeking to shift and mitigate this risk to a third party.

7.5.6 **An increase in the market cost of funding,** not offset by increase in rent inflation, the Council though, has tested the proposals with external advisors.

7.5.7 The impact of the above risks can be assessed by robust testing by both MLH and Council officers as part of the viability assessments of potential development schemes. For some schemes, adopting a risk sharing strategy through partnering arrangements with other private sector organisations with significant developer experience may prove beneficial to MLH and the Council, although may reduce the potential return.

7.5.8 **There is potential risk of changes to legislation in future**. The proposed Company is focussing on the private sector market and is not targeting the affordable market tenure. It would not be threatened, at present by recent announcements on affordable housing disposals or limitations on establishing companies by Councils to deliver housing. However future legislative changes will be kept under review.

7.5.9 An increase in interest rates which would increaser the cost of borrowing over the life of the project

7.5.10 Decreased demand for property to rent or a deceased in rent for Private sector leased properties so that there is a shortfall in rent required to repay debt.

7.5.11 The Government previously indicated the intention to extend Right to buy to Council housing companies – there have been no proposals to enact legislation to this effect.

7.5.12 In the event of a down turn, Mercury may be able to sell properties to mitigate potential losses.

7.6 The 2017 Business Plan is based on three schemes, a rental scheme at Cathedral Court consisting of 65 flats (fully let), and a further development opportunity at North Street for PRS consisting of 44 flats and the development and sale of properties on the Quarles site (subject to final approval by the Council).

7.7 The MLH business plan is supported by initial viability assessments that show all three projects appear to be viable for MLH based on existing assumptions as set out in section 7.4 above.

7.8 It will be necessary to determine that the proposed funding from LB Havering to MLH Ltd is compliant with State Aid legislation (that is the Council is not subsidising MLH to the disadvantage of other developers) and Transfer Pricing (charges to a Council subsidiary are not inflated to minimise tax paid requirements. This is achieved by commissioning an independent professional (Grant Thornton) expert to assess the commercial transaction against the existing market conditions, and will be in place before each project is authorised to proceed.

7.9 The MLH business plan indicates that they will require £58.453 million of funding from the Council, consisting both of share capital and loans.

Table 1 Profile of Capital Expenditure

	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	Total
	£ m	£ m	£ m	£ m	£ m	£ m	£ m
Oldchurch	16.31	0.63	-	-	-	-	**16.93**
North Street	-	5.87	6.59	-	-	-	**12.46**
Quarles	-	-	-	14.81	9.00	5.25	**29.06**
Total	**16.31**	**6.50**	**6.59**	**14.81**	**9.00**	**5.25**	**58.45**

7.10 This will be financed by the Council as set out the table below

Table 2 Funding for Mercury Land Holdings

	Oldchurch £ m	North Street £ m	Quarles £ m	Total £ m
Equity	8.615	3.738	7.991	**20.344**
Senior debt	8.319	2.492	17.435	**28.246**
Sub debt	0	6.230	3.632	**9.862**
Total	**16.934**	**12.460**	**29.059**	**58.453**

7.11 In 2016/17 the Council approved a total of £100m in the Capital Programme for Regeneration and Development. £16.934m has been previously allocated to the Oldchurch scheme above and a further £10m to Havering College via Cabinet in June 2017. This leaves a total of £73.066m to fund further regeneration and development schemes subject to Cabinet approval. The sum of £45.519m can therefore be met from within the approved Capital Programme, leaving an uncommitted budget of £27.547m to fund further regeneration and development schemes. The profile of capital investment is within the approved Treasury Management Strategy

7.12 The table below shows the projected annual net income to the Council's General Fund Budget based on the attached business plan, after meeting the Council's capital financing costs of borrowing.

Table 3 MTFS impact of investment in Mercury Land Holdings

		OLDCHURC H	NORTH STREET	QUARLES	
		Net Income	**Net Income**	**Net Income**	**Total Net Income**
		£m	**£ m**	**£ m**	**£ m**
	Year				
31-Mar-17	1	-0.255	0.000	0.000	-0.255
31-Mar-18	2	-0.488	-0.173	0.000	-0.661
31-Mar-19	3	-0.562	-0.377	0.000	-0.939
31-Mar-20	4	-0.560	-0.510	-0.371	-1.441
31-Mar-21	5	-0.143	-0.296	-0.309	-0.749
31-Mar-22	6	-0.144	-0.297	-0.406	-0.848
31-Mar-23	7	-0.146	-0.298	-0.208	-0.652
31-Mar-24	8	-0.147	-0.300	0.000	-0.446
31-Mar-25	9	-0.148	-0.301	0.000	-0.448
31-Mar-26	10	-0.149	-0.302	0.000	-0.450
Total to 25/26		**-2.742**	**-2.854**	**-1.295**	**-6.890**

7.13 Subject to the completion of due diligence on the business case, these forecasts will be used to update the forecast income budgets within the Medium term financial Strategy.

7.14 The Council is required to charge a minimum revenue provision on the equity investment and this has been reflected in the tables above. This is calculated on a 50 year life (2% per annum).

7.15 The Council will benefit from fees charged to MLH Ltd (set out in the table below)

Loan arrangement fee	1.25%
Commitment Fee (Debt standby reserve)	0.47%
Commitment Fee	0.50%
Lenders Agency Fee (per year)	£20,000

7.16 The three projects in the business plan (Cathedral Court, North Street and Quarles) will generate arrangement fees of £1.664m and £3.702m and are reflected in the totals at table 3.

8 Legal implications and risks:

8.1 **General**

Members established a wholly owned local authority company limited by shares. The company's business is the provision of homes for market rent and if required through compliance with planning obligations the construction of affordable homes. Agreement in principle is sought to provide funding to MLH in the form of either equity or loans, and other support and to dispose of council land to it. Delegations are sought to make such decisions and finalise the various documents that will be required to facilitate the above.

8.2 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). A local authority may exercise the General Power for its own purpose, for a commercial purpose and/or for the benefit of others.

8.3 The operation of a business to let homes at market rent with the intention of making profits is a commercial purpose. Section 4 of the Localism Act 2011 requires that where a local authority exercises/uses the general power for a commercial purpose it must do this through a company.

8.4 Further Section 4 of the Localism Act 2011 prohibits the Council doing things for a commercial purpose in relation to a person if legislation requires the Authority to do those things in relation to that same person. This issue is unlikely to arise for MLH as it intends to lease or sell to a Registered Provider any affordable homes it may be required by planning to build.

8.5 Under Part V of the Local Government and Housing Act 1989, the council also has a power to establish companies which can be wholly controlled or influenced by the authority. MLH is wholly owned by the Council and under Part V will be subject to the Local Authorities (Companies) Order 1995.

8.6 Section 2 of the Localism Act 2011 limits the exercise of the new general power where it 'overlaps' with a power which predates it, such as Section 95 of the Local Government Act 2003. Whether the Council relies on the General Power and/or Section 95 it is prudent for it to comply with the requirements and limitations to which section 95 is subject.

8.7 These are set out in Regulation 2 of the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009 (the **Order**) which requires a business case to be prepared and approved by the council before a company starts trading.

8.8 Regulation 2(4) of the Order defines "business case" "as a comprehensive statement of:-

- the objectives of the business;
- the investment and other resources required to achieve those objectives;
- any risks the business might face and how significant these risks are; and
- the expected financial result of the business, together with any other relevant outcomes that the business is expected to achieve

8.9 Before approving the business case Members should satisfy themselves that the document and its appendices) contain the relevant information required by the Order (see paragraph 5.6 above). The Leader of the Council after consultation with the Cabinet Member for Company Development and oneSource Management and other officers to whom finalisation of the business case has been delegated should also ensure that they ensure their due diligence includes compliance with the requirements of the Order

8.1 Section 95 of the Local Government Act 2003 (the 2003 Act) act also permits the council as a best value authority to establish a vehicle to carry out trading in any of its ordinary functions.

9 Finance

9.1 Section 24 LGA 88 provides the Council with the power to provide a wide range of financial assistance to MLH including making a grant or loan to it and as MLH is a body corporate the Council may under Section 24 (2)(d) acquire share or loan capital in it.

9.2 Section 111 of the Local Government Act 1972, provides councils with the power to do anything whether or not involving the expenditure, borrowing or lending of money or the acquisition of property rights which is incidental, conducive or calculated to facilitate the exercise of any of their functions. This would include the exercise of functions under section 1 of the Localism act and s.95 of the 2003 Act referred to above. The council could rely on this power to provide the company with loans and other support such as providing staff and the use of premises. Any support provided must be state aid compliant (see below) and will be the subject of agreements between the council and MLH.

9.3 If the Council intends to borrow to lend to MLH regulation 25 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (SI 2003/3146) treats the giving of a loan by a local authority to a third party (such as MLH) towards expenditure (e.g. works on a new buildings) as capital expenditure providing that if the local authority itself incurred that expenditure (it borrowed to undertake the works itself) it would treat that expenditure (under proper accounting practices) as capital expenditure. It should be noted that the Council borrowing to lend to MLH in connection with revenue funding is not permitted.

10 Land disposal and financial assistance

10.1 Section 32 of the Housing Act 1985 requires the Council to obtain the Secretary of State’s consent for the disposal of land held under the Council’s HRA. The Secretary of State has issued the General Housing Consents 2013 (the General Housing Consents) which set out circumstances in which he pre-approves/pre-consents to a local authority disposing of HRA land and property. Consent A 3.2 of the General Housing Consents permits the Council to dispose of vacant land. Members should note that vacant land means land where there are no dwellings and/or where any dwellings are no longer capable of human habitation and are due to be demolished.

10.2 The Council is entitled to dispose of land held by its General Fund (including buildings) to a third party provided it complies with Section 123 of the Local Government Act 1972. This requires it to obtain a consideration which is not less than the best it could reasonably obtain. If it disposes of a property at an “under-value” it does require the consent of the Secretary of State (except for limited circumstances such as short term leases).

10.3 If the Council was able to sell at an under-value (and remain State Aid compliant) the Council may be able to rely on Circular 06/03 (the Local Government Act 1972 – disposal of land for less than best consideration) which sets out circumstances in which the Secretary of State pre-approves/pre-consent to the disposal of General Fund land at an under-value. If this consent is to apply then the “under-value” (in relation to a disposal) must not exceed £2m and the Council’s purpose in making such a disposal must be to contribute to the economic social or environmental well-being of the authority’s area and/or its residents.

10.4 The finance which Members are requested to approve in principle (whether on commercial terms or otherwise) constitutes 'financial assistance' under the terms of Section 24 of the Local Government Act 1988 (the LGA 88) which permits the Council to provide financial assistance to any other person for the provision of "privately let accommodation". If the Council exercises its powers under this section then under Section 25 of the LGA 88 it must obtain the consent of the Secretary of State to do so. The Secretary of State has set out pre-approved consents in the "General Consents 2010" (July 2011 updated in 2014). If the circumstances of financial assistance meet one of the criteria in the General Consents then the Secretary of State's consent is given.

10.5 Section 24 LGA 88 provides the Council with the power to provide a wide range of financial assistance to MLH including making a grant or loan to it and as MLH is a body corporate the Council may under Section 24 (2)(d) acquire share or loan capital in it.

10.6 The current version of the General Consents 2011 contains Consent C. Under this consent the Council could provide financial assistance to any person.

10.7 When exercising its powers, the Council must, as with any other power, have regard to its own procedural rules, the Wednesbury principles of reasonableness and its fiduciary duties. It must also ensure that its powers are used for the proper purpose.

11 Fiduciary Duties

11.1 The Council's fiduciary duties could be briefly summarised as it acting as a trustee of tax and public sector income on behalf of its rate and tax payers. The Council in effect holds money but does not own it; it spends money on behalf of its business rate and council tax payers.

11.2 Members in making the decisions concerning MLH, whether making investment and or extending loans to that body (and similar activities) should give proper consideration to the risks and rewards of approving the recommendations. In practice Members will want to consider whether the Council will achieve an appropriate return for its risk and that the Council has minimised the risk and potential cost to it if MLH became insolvent and/or defaulted on its loan(s).

11.3 Consideration should also be given to whether the Council's involvement in this arrangement is proportionate and properly balanced against the anticipated benefit as well as the wider interests of its local business rate and tax payers. On a practical basis this means that Members should consider whether the monies they are requested to approve for investment/lending to HC could be better used by the Council for the wider interests of its local tax payers. This should include considering the impact on the Council (and therefore its local tax payers) if MLH became insolvent or otherwise defaulted on loans it had taken from the Council.

12 State Aid

12.1 The council is required to provide funding and ensure it and MLH operates in accordance with the state aid requirements. Article 107 (1) of the Treaty on the Functioning of the European Union (**Treaty**) declares that state aid, in whatever form, which could distort competition and affect trade by favouring certain undertakings or production of certain goods, is incompatible with the common market, unless the Treaty and in practice the European Commission (through regulations and decisions) allows otherwise.

12.2 It is important that any loans/credit or other support provided to MLH are state aid compliant. Loans/credit which the Council generally makes available to MLH must be made on commercial terms and at a commercial interest rate. If the Council subsequently chooses to make an equity investment into MLH its must ensure this is done on commercial terms. It will be necessary for the Council to obtain independent confirmation that such arrangements have been made on commercial terms prior to them being entered into.

12.3 In these circumstances it would be necessary for the Council and MLH to enter into as what is termed an 'Entrustment Agreement' to ensure compliance with State Aid requirements for SGEIs. This should be done when such funding is made available.

13 Human Resources implications and risks:

13.1 Consideration needs to be given as to whether the company's employees should be directly employed by the company, or be agency workers/consultants engaged directly by the company or by the Council on behalf of the company or be employed by the Council and 'seconded' to the company either temporarily or on a permanent basis. Each option will be considered in the light of the needs of the company to be able to attract, recruit and retain their employees by paying an appropriate 'private sector' market rate salary and the possible risk to the Council of creating comparators from an equal pay perspective should the Council act as the employer.

13.2 In as similar manner the Company will need to establish suitable company infrastructure such as accommodation, ICT.

14 Equalities implications and risks:

14.1 An Equality Impact Assessment on the establishment of a private sector focussed Council Owned Housing Company, the results of which led the council to believe it's' operation will have a positive impact on local residents, businesses and staff.

14.2 As the Company was established by the Council, its development had to be compliant with the Public Sector Equality Duty (PSED) in the Equality Act 2010 (EA10).

14.3 Once established the Company will to be operating in compliance with the general duty of the EA10 and will be required to carry out Equality Impact Assessments on relevant projects and initiatives so as to ensure that positive equality outcomes are optimised and any potential/likely negative implications are mitigated.

BACKGROUND PAPERS

None

Appendix: MLH Business Plan Attached