



Cabinet

13 May 2015

Subject Heading:

Establishment of Council Owned Housing Company to deliver Market Rent and Market Sale Homes

Cabinet Member:

Cllr Ron Ower

Cabinet Member for Housing Company Development and OneSource Management

CMT Lead:

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Policy context:

Financial summary:

To follow in Part B report

Is this a Key Decision?

Yes

When should this matter be reviewed?

Spring 2016

Reviewing OSC:

Towns and Communities

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

Havering will be clean and its environment will be cared for
People will be safe, in their homes and in the community
Residents will be proud to live in Havering

SUMMARY

This report seeks the Cabinet's approval to the establishment of a wholly owned arm's length company of the Council, the purpose for which is to develop a portfolio of homes for market rent (its prime focus) and sale. It is proposed that the Council will dispose of assets (land/buildings) to the Company at market value for this purpose, for which it will

receive a market payment. It is proposed that the Company receives state aid compliant loans and funding from the Council. This will provide a long term revenue stream for the Council in the form of interest payments from the Company to the Council. The Company will operate in the same way as any other private sector company, driven by the requirement to produce profits and to operate in a commercial manner. The Council's rights as a shareholder in the Company will be set out in the Company's Articles of Association and the proposed Shareholder's Agreement.

RECOMMENDATIONS

That Cabinet:

1. Agree to the incorporation of a company limited by shares that will be wholly owned by the Council and delegate to the Director of Legal and Governance authority to take all necessary steps to establish the company.
2. Delegate to the Leader of the Council and Cabinet Member for Housing Company Development & One Source Management, approval of the business case for and the Housing Company's (HC) first business plan. In addition, the Group Director for Communities & Resources, following consultation with the Director of Legal and Governance, be authorised to approve the business case as being compliant with legislation, due diligence and being commercially sustainable.
3. Agree in principle to the disposal of assets (land/buildings) to the Company at market rates, and delegate to the Group Director for Communities & Resources, following consultation with the Head of Property and the Director of Legal and Governance, authority to determine the principles and processes by which the said assets shall be disposed of and the terms of disposal.
4. Agree in principle to provide to the company funding through state aid compliant loans, subject to such funding being in line with the Council's financial strategy. Further agree that the Leader of the Council and Cabinet Member for Housing Company & One Source Management following consultation with the Director of Legal and Governance would agree the Heads of Terms of loan agreements. 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, to be delegated to the Group Director for Communities & Resources.
5. Delegate to the Leader of the Council and Cabinet Member for Housing Company Development & One Source Management, supported by a Senior Council Officer other than Group Director of Communities & Resources, to release funds through such loans needed to meet the requirements of the agreed business case.
6. Delegate to the Leader of the Council and Cabinet Member for Housing Company Development & One Source Management, supported by a Senior Council Officer other than Group Director of Communities & Resources, the exercising of the Council's rights as shareholder.
7. Delegate to the Leader of the Council and Cabinet Member for Housing Company Development & One Source Management to agree to the Heads of Terms of the

Shareholder Agreement and authorise the Group Director for Communities & Resources, in conjunction with the Director of Legal and Governance, the authority to negotiate and finalise the Shareholder agreement.

8. Delegate to the Group Director for Communities & Resources authority to approve the Articles of Association following consultation with the Director of Legal and Governance.
9. Agree to the establishment of the Company's board consisting of the following Council officers, as well as an external, unconnected individual (to be recruited) who has relevant experience in the house building sector:
 - a. Group Director for Communities & Resources
 - b. Head of Economic Development
 - c. Head of Property Services, One Source.
 - d. Assistant Director Business Services, oneSource
10. Subject to the final sign off of the Business Case as specified in recommendation 2 and the Council and the company entering into the ancillary agreements referred to above, to agree that the Company may thereafter commence trading.

REPORT DETAIL

1. BACKGROUND

Introduction

- 1.1 Since the summer of 2014 officers, supported by external advisors have been assessing the potential of the Council participating in the development of market rent and sale homes in the borough.
- 1.2 The Council's main objectives for entering into this market are:
 - To generate a financial 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.
- 1.3 The Council's MTFs has a net income target of £600k per annum from such a development proposition by 2017/18.

Strategic Context

- 1.4 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.
- 1.5 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 new housing supply. Further, the private sector rental market sector continues to meet housing need and this seems likely to continue'.
- 1.6 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.
- 1.7 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.
- 1.8 Several local authorities are venturing into this market. These include Kings Lynn & West Norfolk; Ealing, Waltham Forest, 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.
- 1.9 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.
- 1.10 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.
- 1.11 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.
- 1.12 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.
- 1.13 Havering is making significant reductions in its spending due to reductions in its government grant and demographic growth factors. The Council is therefore seeking to make a broader use of its asset base to generate long term revenue streams for the Council. 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, establishing a Havering Housing Company will allow the Council to generate a substantial income streams on suitable development sites to invest in protecting and supporting other services.

2 BUSINESS CASE FOR ESTABLISHMENT OF THE HOUSING COMPANY

Options for Achieving the Council's objectives

2.1 The proposal to establish the Housing Company (HC) is based on a high level options appraisal, conducted to determine the most appropriate means by which the Council's objectives, as set out in paragraphs 1.1.2, could be met.

2.2 The alternatives which were explored included not participating in the market (i.e. do minimum option); to pursue directly through the Council's general fund; pursue through the Council's Housing Revenue Account, and establishing a partnership with a private sector partner. In summary, the limitations of these options and reasons for rejecting them include:

- relying solely on the private sector to deliver quality housing perpetuates the current unsatisfactory position (do minimum);
- other options do not generate revenue income for the general fund (do minimum/HRA);
- the Council does not have powers to directly undertake commercial activity in the General Fund (GF) but only through a company;
- a HRA led initiative would be limited by the HRA borrowing cap (HRA) and the housing tenure targeted is not affordable housing through this initiative; and
- establishing a private sector partnership would place limits Council's shareholder control, takes significant time to establish and would lead to the sharing of revenue (profit).

2.3 The following summarises the rationale for establishing the wholly owned Council Company:

- the Council has the power to on-lend funds to a company at commercial rates. This is an attractive option, as the Council would make a margin on its own borrowing from the Public Works Loan Board (PWL), where interest rates are lower, pension investment funds or Council cash reserves. The cost and returns for a proposed scheme are presented in Part B of this report, which will follow when finalised. This does not preclude the Council refinancing completed projects through commercial loans or having a mixed loan portfolio as the project matures;
- in addition to generating a revenue stream for the General fund through interest from loans, revenue income will also be forthcoming from ground rent and dividend payments from the Company. The Council would also benefit from any increase in value of the company's assets;
- dwellings owned by the company are not HRA properties and thus will not impact on the HRA borrowing cap;
- dwellings owned by the company will be let on Assured Tenancies and as market rented homes will not be subject to the allocations provisions of Part VI of the Housing Act 1996 (which may have particular significance in relation, for example, to any prospective development for market rent);
- establishing a Company isolates elements of financial risk as the HC would be a limited entity;

- establishing a Company provides a flexible operating model to participate in the commercial market place; and
- a Company vehicle can potentially extend its operations to wider trading functions related to housing development (and subject to Shareholder approval).

Delivery Options for the Housing Company

- 2.4 A more detailed options analysis was conducted with the help of external property consultants, Savills, to look at the delivery options for the HC. These are set out in the Part B of this report, which will follow when finalised.

Site Assessments

- 2.5 Savills were asked to assess the development potential of a range of development propositions across the borough for private rented sector housing. This included the preparation of site assessments, providing recommendations on potential development options and undertaking initial financial appraisal work to examine development viability. This helped provide an understanding of the potential financial implications that will form the underlying assumptions for the HC's business plan.
- 2.6 Key issues identified through the review focussed around understanding potential barriers to delivery. For sites in third party ownership, consideration of the potential time and cost implications of bringing these within the fold of a HC had to be made. Likewise the assessment allowed Savills to identify those sites that had potential to proceed in the shorter term and produce income in earlier years in line with the expectations of the HC to begin to generate income within the next 3 to 4 years.

Property Market Assessment

- 2.7 Alongside the information review, Savills was asked to review the local sales and rental markets in both Romford and Rainham. This involved compiling market evidence (including on market pricing and agreed prices) from nearby new build developments and second hand stock, informed through discussions with local agents to understand the key factors to delivery, including demand, attrition and take up rates, target market, and their opinion on the local market as a whole. This is particularly important when considering the rate of delivery of new stock into local property markets, bearing in mind the risks associated with an oversupply of new units depressing value.
- 2.8 Savills undertook detailed market assessments reflecting each of the sites identified. Their recommendations focussed on the strong performance of the property market for both sale and rental properties, particularly in Romford, driven largely by demand from London commuters who recognise the relative affordability of the area and supported by the imminent introduction of Crossrail in 2018.
- 2.9 The sales market is considered to be very competitive and popular at present across both Romford and Rainham. There is high demand for good quality 1 and 2-bed new build flats within Romford Town Centre. Demand is highest amongst the first time buyer market, with buyers originating from both the local area and London (young professionals and buy-to-let investors, all of whom are conscious of affordability and good returns on investment).

- 2.10 Rainham experiences a wide range of achievable values, depending on the distance from transport hubs and the town centre. The area is considered to be very affordable, particularly for family sized housing, which are in high demand here. The market for flats is relatively new to the area, with a limited supply of stock coming onto the market for sale. This is driven by the shortage of new build flatted developments in the development pipeline. Away from the town centre, towards Beam Park, new flatted developments are rare, with demand considered to be very low as a consequence of poor accessibility to public transport and low sales values impacting viability. Clearly proposals around the introduction of a new station will go a significant way to increasing demand in the area.
- 2.11 The rental market in Romford and Rainham broadly follows the same pattern as the sales market, both in terms of demand from prospective tenants and type of units, target market and need. Flats for rent are considered to be in very high demand in Romford in particular, primarily because of its access to good rail links into Central London, as well as the affordability of flats in the town compared to other commuter towns that are a similar distance from central London.
- 2.12 Similarly in Rainham, there is demand for houses for rent, particularly amongst families moving into the area prior to purchase. However, rental values aren't as strong in the town and immediate surrounding areas as they are in Romford due to the superior offering in terms of local amenities compared to Rainham. Agents have commented that Romford is a growing rental market, and they expect demand to continue to increase in future years with improved transport connectivity coupled with relative affordability.

Financial Analysis

- 2.13 In order to benchmark the financial performance of PRS development, Savills appraised development options. The results of the financial analysis helped inform the identification of priority sites for the HC.
- 2.14 This work established an outline business case for proceeding based on options outlined in Part B of this report, which will follow.

3 OPERATION OF THE HOUSING COMPANY

- 3.1 The HC 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.
- 3.2 The Company, on behalf of the Council, will own the market rent units, and will market and manage the rental of those homes.
- 3.3 Dwellings owned by the Company will be let on Assured Tenancies and will not be subject to Right to Buy, or to the allocations provisions of Part VI of the Housing Act 1996.
- 3.4 The Company would prepare a specification for the marketing and management of these units and outsource this activity. 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.

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- 3.5 The Company will create a name and a brand that will place it firmly in the commercial sector, and one that will appeal to market renting and sale target buyers.
- 3.6 In terms of housing development for larger sites, the Company would seek a development partner in order to share the benefits of capability and share risk, as described in the options appraisal in the part B report which will follow when finalised.
- 3.7 For sites that it is felt appropriate to develop on its own, the Company would secure appropriate development expertise and appropriately tender the construction and delivery of units.
- 3.8 The Company will draw on the Council's resources for its support service's needs. The Council would aim to, as necessary, second to the Company Council officers to support its' operation and the Council would be reimbursed by the Company at an appropriate commercial hourly rate.
- 3.9 It is envisaged that the following human resources would be required both in terms of initial set up and 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 One Source 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.
- 3.10 A business plan for the Company will be prepared annually and presented to the Cabinet for approval, this would describe the proposed operation, performance targets and resources. As stated in recommendation 2 of this report, it is proposed that the approval of the HC's first business plan to be delegated to the Leader of the Council and Cabinet Member for Housing Company & One Source Management.

4 GOVERNANCE

Shareholder Role

- 4.1 The Council's Cabinet will be the prime body acting as the shareholder agreeing the HC's business plan on an annual basis.
- 4.2 The Leader of the Council, Cabinet Member for Housing Company Development & One Source Management, in conjunction with a Senior Finance Manager from One

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Source (who can fulfil S151 officer role) to exercise the Council's rights as shareholder; whose main role is to protect the council's interests as owner of the company ('Shareholder review group')

- 4.3 The above group to meet regularly to review the HC's performance with the HC's 'Managing Director'. These meetings to be attended by the HC's Directors.
- 4.4 The above group to be provided with financial/technical assistance from the Council to assess the Housing Company's performance against its business plan as well as its general commercial operations.
- 4.5 Draft Heads of Terms for the Shareholders Agreement have been prepared and once approved by the Shareholder Review Group, the Group will be asked to delegate to the Group Director for Communities & Resources, in conjunction with the Director of Legal and Governance, the authority to negotiate and finalise the agreement providing that it is broadly consistent with the draft heads of terms.

Directors Role

- 4.6 Group Director for Communities & Resources to have authority to approve the Articles of Association following consultation with the Director of Legal and Governance.
- 4.7 HC's board to consist of the following Council officers, as well as an external, unconnected individual (to be recruited) who has relevant experience in the house building sector:
 - Group Director for Communities & Resources
 - Head of Economic Development
 - Head of Property Services, One Source
 - Assistant Director Business Services, oneSource
- 4.8 The Council would retain the right (under the Companies Articles and any Shareholder Agreement) to dismiss and appoint all of HC's Directors.
- 4.9 The Directors have ultimate responsibility for directing the activities of the company, ensuring that it is well run and delivering the outcomes for which it has been established. Its role includes:
 - Setting and approving the HC's annual business plan for presentation to the Council's Cabinet.
 - Setting budgets, policies and plans and monitoring performance of the HC, and setting a framework for internal controls.
 - Ensuring compliance with the HC's objects, purposes and values. Ensuring the financial strength, solvency and good performance of the HC.
 - Ensuring the HC 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 the HC's objectives.

Funder Role

- 4.10 To provide resilience and deal with potential conflict it is recommended that the Section 151 Officer (Group Director of Communities & Resources) nominates a senior finance officer to discharge the Funder role, together with other nominated senior finance colleagues. In effect the Funder Role will act as a bank credit committee.
- 4.11 The Funder Role's primary task will be to assess the HC'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 the HC.
- 4.12 Regularly monitors and analyses financial information generated by the HC during the lifetime of each loan to ensure that the HC is not in breach of key financial requirements (which will be stipulated as funding conditions in each loan).
- 4.13 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 the HC'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 (by either the HC and/or the Funder Role) that the terms of each loan is State Aid compliant.

Procurement

- 4.14 As a pure commercial entity, not created to further public policy, the HC will not need to follow public procurement rules. However, the company board, acting like any other commercial entity, will determine its own policy in accordance with best practice, the law and bearing in mind their duties as directors. The Council within the shareholder agreement will be insisting on a clear best value process to be followed.

REASONS AND OPTIONS

Reasons for the decision:

The proposition meets the objectives stated in 1.1.2 and the outline business case (to follow in the Part B report when finalised) meets the financial objectives of the Council within the MTFs.

Other options considered:

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

Financial implications and risks:

The proposal will involve the setting up of a company (100% Council owned), with the Council lending to that company. Due to state aid controls, the loans would be at market rates, and would enable the Council to make a surplus on this borrowing, contributing to MTFS targets. The Council will also draw a small dividend on any profits. The approval of any loans – which are effectively capital expenditure – would need to be confirmed by Cabinet and Council.

Each possible scheme should be subject to individual option appraisal.

Risks include the following:-

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.

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.

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.

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.

An increase in void turn round times/relet 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.

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.

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The impact of the above risks can be mitigated by robust testing as part of the viability assessments of potential development schemes and on some schemes adopting a risk sharing strategy through partnering arrangements with other private sector organisations with significant developer experience.

There is political risk of changes to legislation. 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.

Legal implications and risks:

General

Members are asked to agree to establish a wholly owned local authority company limited by shares (HC). The company's business will be the provision of homes for market rent and if required through compliance with planning obligations the construction of affordable homes. Agreement is also sought to provide funding to the HC in the form of loans, and other support and to dispose of council land to it. Delegations to officers are sought to finalise the various agreements that will be required to facilitate the above.

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.

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.

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 HC as it intends to lease or sell to a Registered Provider any affordable homes it may be required by planning to build.

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. HC will be wholly owned by the Council and under Part V will be subject to the Local Authorities (Companies) Order 1995.

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. 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.

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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

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 and the Cabinet Member for Company Development and oneSource management 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

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.

Finance

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

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 the HC.

In accordance with the council’s constitution, any capital funding requirements for the HC project in 2015-16 will need to be allowed for in the council’s budget strategy which needs to be approved by full council. This will need to be reviewed and updated in subsequent years.

However the Group Director of Communities & Resources should ensure that if required by the Council’s constitution and its Financial Regulations all sums in this proposal which are to be released to HC to be included in the Budget Framework for approval by Council prior to the release of those funds to HC.

If the Council intends to borrow to lend to HC 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 HC) towards expenditure (e.g. works on a

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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 HC in connection with revenue funding is not permitted.

Land disposal and financial assistance

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.

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).

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.

The finance which Members are requested to approve (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.

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

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

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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.

Fiduciary Duties

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.

Members in making the decisions concerning the formation of HC, investment and 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 HC became insolvent and/or defaulted on its loan(s).

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 HC became insolvent or otherwise defaulted on loans it had taken from the Council.

HC as a company

The report proposes that HC be created as a company (one limited by shares). There are other company structures but this is considered to be the most suitable vehicle for the council under the current legislative framework. The Articles of Association need to be drafted. The council is the only shareholder and the company's memorandum and articles will need to reflect this. If Officers are appointed to HC's board of Directors they will in that role owe their principal duty to HC.

State Aid

The council is required to provide funding and ensure it and HC 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.

It is important that any loans/credit or other support provided to the HC are state aid compliant. Loans/credit which the Council generally makes available to HC must be made

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on commercial terms and at a commercial interest rate. If the Council subsequently chooses to make an equity investment into HC it 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.

If the Council subsequently choose to provide funding or support to HC in connection with any affordable homes it may be able to do so on non-commercial terms even providing grants or subsidised loans. However, it will be necessary for the Council to comply with State Aid law/conditions which apply where public support is given to what is termed under State Aid law *Services of General Economic Interest* (SGEI).

In these circumstances it would be necessary for the Council and HC 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.

Procurement

It is intended that HC operates as a business and as such it is not intended for it to be a contracting authority or subject to public contract procurement requirements. This has a number of implications.

Other things that will need to be considered when establishing the HC are how Corporation and Value Added Tax will affect trading and how any financial commitments to the company in terms of funding affect the council's borrowing limits.

The Council has considered carrying out an Equalities Impact Assessment and has decided at this stage in the process a full EIA is not required, due to the overall positive impact of the project. Council Officers will however continue to review the impacts of the project as it progresses and will complete a full EIA if required, as noted in section 13 of this paper.

Human Resources implications and risks:

There is no immediate or direct impact on any existing Council employees envisaged at this point.

There will be a requirement for oneSource HR resources to support the initial company set up and recruitment of the Company's employees. Set up support will also be required from various other oneSource services e.g., Asset Management, Finance, Legal, IT and Transactional services.

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.

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

Equalities implications and risks:

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

As the Company is being established by the Council, its development must be compliant with the Public Sector Equality Duty and the Equality Act 2010 (EA10).

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

Note of Advice – Powers, Procurement and State Aid for the Proposed Housing Company, Trowers & Hamlins LLP, April 2015.