POLICY AND PROJECT ADVISORY BOARD

Meeting held on Wednesday, 26th September, 2018 at the Council Offices, Farnborough at 7.00 pm.

Voting Members

Cllr A.R. Newell (Chairman)

Cllr J.B. Canty
Cllr A.H. Crawford
Cllr R.L.G. Dibbs
Cllr Mara Makunura
Cllr M.J. Roberts
Cllr P.F. Rust
Cllr J.E. Woolley

Apologies for absence were submitted on behalf of Cllr Sophia Choudhary, Cllr P.I.C. Crerar and Cllr Marina Munro.

16. **DEVELOPING THE BUSINESS CASE FOR A LOCAL HOUSING COMPANY - FINANCIAL AND MANAGEMENT CASE**

The Chairman welcomed Members to the meeting, the purpose of which was to continue the Board's consideration of the business case and set out the Financial Case and Management Case for the creation of a wholly owned local housing company. The strategic, economic and commercial case for establishing a local housing company had been considered by the Board on 30th August, 2018. The Board considered the Executive Director (Customers, Digital and Rushmoor 2020) Report No. ED1806 and received a presentation from Karen Edwards, Executive Director (Customers, Digital and Rushmoor 2020), Sally Ravenhill (Housing Enabling and Development Manager) and Martin Dawson (Project Accountant).

(1) **Financial Case**

The Board was advised that the Financial Case considered the likely funding and affordability issues for both the Council and the housing company. This had been undertaken by building a model based on a set of assumptions (14 potential sites, 52 potential units – land and properties currently in the ownership of the Council). This notional portfolio of development and rental properties had then been fed through that model. Members were advised that the actual programme that the company would deliver could be very different. Some sites might drop out of the programme and some new sites might be added, the company could also sell some existing properties or purchase additional units.

The initial modelling had been based on all units being for private market rent and this had been considered the option most likely to provide the best level of financial return to the company. The Board had identified at the previous meeting that it would wish to see the impacts of a range of tenure mix and, therefore, modelling had been undertaken on a range of tenure mixes to demonstrate the effect of developing some units as affordable and/or social housing.

The development of the model had involved a range of Council officers, who had been supported by external advisors with housing development, financial and tax expertise. The modelling assumptions and principles had been subject to review throughout the preparation of the business case. The key areas considered included: annual projected cash flow, corporation tax and accounting implications for the wholly owned company. The cash flow implications for the Council's General Fund had also been modelled alongside the wholly owned company cash flows. It was noted that once Members had finished their consideration of the business case and officers had prepared the initial business plan, it was intended to test both of these externally with an organisation familiar with the operation of similar companies prior to consideration by the Cabinet.

The model worked on the basis that the Council would invest in the company by transferring land and a small number of completed homes from its General Fund in return for shares in the company. The Council would also loan money to the company to finance its development activities. It was noted that the Council would take security over the company's assets to protect its investment. The Report set out the key commercial aspects of this. The key financial assumptions underlying programme modelling were also set out in the Report and had been based on information provided by property and financial consultants utilising industry benchmarking and data. It was noted that the Council's General Fund would receive three different types of revenue return from the housing company: interest payments on loans, potential dividends and payments for contracted staff. It was also noted that the Council would benefit from additional income through Council Tax generated from dwellings and from the New Homes Bonus.

The Board was advised of eight options of tenure mix which had been run through the model. All options would deliver a return to the Council. The performance indicator that had been chosen for the purposes of the financial model was that the company could repay its loans within 30 years. It was felt that the elimination of debt within such a target period was a good indicator of company financial health and helped the company eventually to generate cash towards the end of the modelled period that could be used to pay dividends. It was noted that all options, excluding the option for 100% social housing, indicated that the company would operate with a decreasing debt over the 30 year period modelled. However, the only options to demonstrate full or nearly full repayment of debt over the 30 year period were those that were predominantly for private market rent.

The Report explained that, although the business case demonstrated that the company was viable, there remained a risk that the principal sums transferred to the housing company by the Council's General Fund would not be returned in full. This would require adverse movements in a number of assumptions used in the business plan, but was nevertheless a risk. This risk was significant during the first five years of the company and at times when the asset base was below or close to its debt liabilities. Sensitivity analysis had been undertaken in relation to the financial projections. The analysis considered changes in some of the key financial assumptions on which the model was based. These sensitivities considered largely the impact of downside movements on key input variables against the key metrics of the base case.

It was felt that a balance would need to be struck between financial advantage to the Council and risks for the company. As the company would be wholly owned by the Council, any adverse effects on the company could cause difficulties for the Council and it would be the responsibility of the company board to run the company prudently and within the expectations and requirements of the Companies Act.

Based on the minimal sample portfolio, the housing company would be viable and return a profit to the Council if the tenure mix were based on either 100% private market rent or 25% affordable rent and 75% private market rent. In addition, the company's position could be improved by the allocation of grant in relation to affordable units.

During discussion, Members raised questions regarding the margin rate to be charged, the revaluation of properties and the future of the Public Works Loan Board.

(2) **Management Case**

The Management Case covered the governance arrangements for the company. It also showed how the Council would undertake the project, detailing the decision-making process, staffing arrangements, consultancy support and budgets.

The Report advised that the company would be set up and governed as a wholly owned company of the Council. An appropriate governance structure would be required to ensure sound and robust management of the company alongside protection of the Council's financial and reputational investment in the company. It was noted that the Council would own 100% of the shares of the company. As shareholder, the Council would agree and approve the company's annual business plan and funding arrangements and monitoring progress against the business plan on behalf of the Council. There would be a range of matters reserved to the Council which meant the company had to have the Council's consent to actions relating to these matters. Outside of this, the management of the company would be the responsibility of its board of directors. The Report gave examples of matters that would require Council consent and these and other items requiring consent would be contained in a shareholder agreement.

A decision would be required on how the Council would exercise its role as shareholder. Possibilities were the Licensing, Audit and General Purposes Committee acting as shareholder or a sub-group of the Licensing, Audit and General Purposes Committee. Both of these would require powers to deal with the decisions required. Consideration would need to be given to whether some matters would need Cabinet approval. It was noted that the need for the Shareholder to allow the company to react quickly in a commercial way would be a critical factor when considering the best structure. Legal advice provided by Freeths recommended that a member of the Shareholder committee or sub-group should not also be a director of the company.

A Board of Directors would have responsibility for the day to day running of the company under the Companies Act 2006. It was proposed that the company would have up to five directors, appointed by the Council, which could be a mix of Members, officers or independent persons to provide external expertise. It was noted that advice from the Council's legal advisers was that Members of the Cabinet could be on the Board of Directors but that they would need to declare an interest and they should not hold the portfolios related to the business of the company (i.e. Major Projects and Property). It was noted that training would be provided for members of the Board of Directors regarding their roles and responsibilities.

As a company under the control of the local authority, it was likely that the company would be required to comply with the relevant provisions of the Local Authority (Companies) Order 1995, in terms of accounting for debts, etc. The Council would also need to take its fiduciary duties into account by ensuring that it had minimised the risks and potential costs to it if the housing company became insolvent and/or defaults on any loans and then ensure that it achieved an appropriate return for the lending it provided. Another consideration which had to be taken into account was the compliance with State Aid, which imposed an obligation to deal with the company on commercial terms.

The Board was advised that, in the initial set up stage, Council staff would be contracted to the company to carry out the work necessary to deliver and review the company's business plan. Formal contractual agreements would be entered into between the Council and the company in relation to such staff. The contracted staff would run the day to day management of the company. The company would have a contract with the Council through a series of service level agreements for HR and finance services and legal advice, etc and would be charged by the Council at the appropriate rate.

Due to the relatively limited volume of transactions within the company for the initial years, it would be practical to maintain and complete the accounts within a spreadsheet. The alternatives for doing this would be to either utilise capacity in the Rushmoor Integra 2 system or for the company to purchase a software package. The company would require its own bank account.

The Board was advised that, subject to Cabinet and full Council approval to set up a housing company, it was currently proposed that the housing company would be treated as a project as part of the Council's regeneration programme and would be managed and governed in accordance with the processes set up for that programme.

The Director's Report concluded that consideration of the desired outcomes against the delivery vehicle options had led officers to the conclusion that a wholly owned company, limited by shares, was the best way forward to assist the Council in meeting its housing objectives. Examination of this option had established that the Council had powers to create a company and to provide funding. Financial modelling had demonstrated the potential to make a return on investment in the company from three principal sources: dividends derived from surpluses; interest on loans to the company; and, charges for services provided to the company by Council staff. A company would give the Council the freedom to participate in the housing market to meet housing needs and to achieve greater financial sustainability.

During discussion it was felt that a sub-group of the Licensing, Audit and General Purposes Committee would be the best vehicle going forward regarding exercising the Council's role as shareholder. This view had received the support of Members of the Licensing, Audit and General Purposes Committee at a recent meeting. Two different views were expressed by the Board in respect of membership of the housing company's Board of Directors and these would be reported to the Cabinet. One view was that that membership should comprise three Members (one from each political group, one of which could be a Cabinet Member); 1 officer (or possibly 2 officers – depending on expertise available within the Council); and, 1 independent expert (if only one officer to be appointed to the Board). The other view was that membership should comprise three Members (one from each political group and with no representation from the Cabinet); 1 officer (or possibly 2 officers – depending on expertise available within the Council); and, 1 independent expert (if only one officer to be appointed to the Board).

The Board's recommendations on the way forward would be presented to the Cabinet. It was agreed that the Chairman would present the views of the Board to the Cabinet in addition to a report from the Board, which would include the notes of the relevant meetings.

The meeting closed at 8.15 pm.

CLLR A.R. NEWELL (CHAIRMAN)
