

**30<sup>th</sup> AUGUST 2018**

**REPORT NO: ED 1803**

**DEVELOPING THE BUSINESS CASE FOR A LOCAL HOUSING COMPANY -  
STRATEGIC, ECONOMIC AND COMMERCIAL CASE**

**1.0 INTRODUCTION**

- 1.1 The Council Plan sets out a priority to establish a local housing company as a vehicle to allow the Council to participate directly in the provision of housing. It was envisaged that the housing company would provide homes for private market rent, improving supply and quality in this sector, and enable other housing tenures, either directly or in partnership.
- 1.2 A business case is required to underpin any decision to set up a company. A draft business case has now been prepared. The Policy and Projects Advisory Board have a role in considering this.
- 1.3 The business case has been prepared using the HM Treasury Green Book five case model. The Five Case Model is a framework for “thinking” in terms how interventions can be best delivered. In this sense, it is just as relevant to the development of policies and strategies in terms of three basic questions:
  - Where are we now?
  - Where do we want to be?
  - How are we going to get there?
- 1.4 The Five Case Model evaluates whether a business case can be made for continuing with a project or proposal considering five key areas.
  - The strategic case
  - The economic case
  - The commercial case
  - The financial case, and
  - The management case
- 1.5 The conclusions reached at the end of the first case, determine whether the business proposal or project continues to the next case and so on through each of the five cases.

**2.0 PURPOSE OF REPORT**

- 2.1 This report sets out the Strategic Case, Economic Case and Commercial Case for the proposal to set up a local housing company to promote discussion and enable Members to ask questions and discuss key issues. It provides Members with information on the business case process up to the point where a preferred option is chosen and the commercial case is made. If Members are content with the first three

cases, then the Financial Case and Management Case will be considered in a future report.

- 2.2 The business case has been reviewed by the Council's legal advisors, Freeths. This gives comfort that the Council's proposal to set up a company is within its powers. Freeths have also provided tax and VAT advice.

### **3.0 SUMMARY AND ASSUMPTIONS**

- 3.1 The business case set out to confirm that there was a case for the Council to establish a company which would enable the Council to hold existing properties; acquire and develop rented homes; respond to housing needs in the Borough and provide additional social and economic benefits such as jobs and training opportunities during construction, stimulating economic growth and regeneration. The income and capital growth generated could be reinvested in the housing company or transferred back to the Council to support the delivery of other Council services.
- 3.2 The development of the business case has been based on the assumption that 94 homes could be constructed on 15 sites. These assumptions were selected some months ago on the situation considered 'most likely' at the time of commencing the business case. The actual numbers of sites and dwellings will change over time and will be set out in the annual business plan of the Housing Company once established. The underlying financial model, which will be considered at a future meeting, can be adjusted to reflect the number of dwellings and different mix of tenures.
- 3.3 To facilitate acquisition and construction, the Council is likely to provide finance to the company by borrowing within the terms of the prudential code from the Public Works Loan Board ("PWLB"), unless an alternative that is more financially viable to the Council is identified. The business case enables the Council to establish the scope and size of the company's planned activity and to assess its funding requirements. Again, these would be set out in the annual business plan for the company.
- 3.4 For the purposes of this meeting of the PPAB, this report covers the work done to establish the Strategic, Economic and Commercial Case for the proposal to set up a housing company. The financial case and the management case will be considered at a future meeting.

### **4.0 STRATEGIC CASE –THE CASE FOR CHANGE**

#### **4.1 Introduction**

- 4.1.2 The Strategic Business Case (SBC) considers the opportunity to establish a new housing delivery vehicle as a mechanism to help improve quality and choice in the Borough's housing offer.

#### **4.2 Fit with the Council's objectives**

##### ***Regeneration Priorities***

- 4.2.1 The creation of a new Housing Delivery Vehicle links to the Regenerating Rushmoor Vision 2018 -2028, in particular, it directly contributes to the

delivery of the following place making strategic objective, which underpins the Vision:

- **Great Places to Live** – to make Aldershot and Farnborough town centres great places to live with a wide variety of quality new homes attractive to a diverse range of people;

#### **4.3 Fit with the Council's wider priorities**

##### ***Housing and Homelessness Strategy***

- 4.3.1 The Council's Housing and Homelessness Strategy 2017 examines the local housing market and housing need. It identifies the challenges faced in seeking to provide residents with housing that is affordable and appropriate to their needs, and sets out a number of strategic objectives to help meet these challenges. Those to which a Housing Delivery Vehicle could contribute are:

Theme One: Objective Two – Maximise housing delivery

Objective Three – Deliver housing to support regeneration and the economy

Objective Four – Deliver housing to help those most in need

Theme Four: Objective Three – Improve housing conditions in the Borough

##### ***Rushmoor 2020***

- 4.3.2 In addition to regeneration of the town centres and meeting housing need, the Council has a wider priority to achieve financial sustainability and develop new revenue streams to support its on-going service delivery. It is envisaged that the development of a housing delivery vehicle will enable the Council to both bring forward small site housing developments across the Borough whilst securing a revenue stream to contribute to the Council's financial sustainability.

#### **4.4 National Housing Crisis**

- 4.4.1 There is widespread agreement that long term undersupply of housing has created unaffordable house prices and rents with a quarter of young adults still living with their parents, and long waiting lists for social housing( Shelter). It is estimated that the country needs from 225,000 to 275,000 or more homes per year to keep up with population growth and to start to tackle years of under-supply. Since 1939, delivery at these levels has only been achieved as a result of major public sector housebuilding programmes.

- 4.4.1 In 2017, the government published a white paper<sup>1</sup> setting out its analysis of the national housing market together with measures designed to improve housing delivery.

- 4.4.2 It identified three principle reasons for undersupply:

- Not enough local authorities planning for the homes they need;

---

<sup>1</sup> <https://www.gov.uk/government/publications/fixing-our-broken-housing-market>

- House building that is simply too slow; and
- A construction industry that is too reliant on a small number of big players.

4.4.3 As a consequence of under supply the ratio of average house prices to average earnings has more than doubled since 1998. For many people that means a safe, secure home of their own is unattainable.

4.4.4 The government identified other consequences of what they term the “broken housing market”:

- Reduced labour mobility as high house prices prevent people moving to where the jobs are with consequences for individuals, companies and the economy;
- Less work for everyone involved in the construction industry – architects, builders, decorators and manufacturers of everything from bricks to kitchen sinks;
- Less money spent in the wider economy as a greater proportion of people’s income is spent on housing costs.

4.4.5 In addition to these effects, other commentators point to increased levels of overcrowding and homelessness.

4.4.6 Alongside the trend of under-supply, there has been a change in tenure mix in the housing stock with many more households living in private rented homes, and a decline in the amount of social housing.

## 4.5 Local picture

### *Housing Need*

4.5.1 The principle source of data on the local housing market is the Strategic Housing Market Assessment (SHMA) covering a defined housing market area (HMA) that includes the administrative areas of Rushmoor, Hart and Surrey Heath. The three Councils jointly commissioned the SHMA to assess future housing need across the HMA.

4.5.2 The SHMA (November 2016) identifies a housing need of 1,200 homes per annum across the HMA between 2014 and 2032. Of these, 436 homes per annum are identified as being required within Rushmoor, which equates to a total need of 7,850 dwellings to be provided in the Borough by 2032.

4.5.3 The SHMA identifies that in Rushmoor:

- There has been net in-migration of younger people in their early 20s and net out-migration of older age groups and families. However, the population is still ageing;
- The current housing stock contains a high proportion of semi-detached and terraced houses, with significantly fewer detached properties (17%) than the wider housing market area (22%) and south east region (28%);

- The proportion of home owners is below that of the south east region but in line with England as a whole;
- Average house prices increased by 27% between 2010 and 2015;
- The household income required to purchase a property in the lowest quartile of house prices (£197,000) would be £41,600;
- Households need an income of £26,000 to afford one of the lowest priced (lower quartile) private rented properties;
- One-fifth of private and social rented dwellings are overcrowded, that is, lacking in one or more bedrooms. This means that as families grow, they often spend a long time waiting to be rehoused, and many will never be rehoused because of the lack of larger social rented properties available.

4.5.4 These findings underpin the new Rushmoor Local Plan that has now been through its examination in public and is expected to be adopted during 2018. A strategic objective within the Local Plan is to address housing needs by planning for at least 7,850 new homes of an appropriate housing mix and tenure, including specialist housing needs, between 2014 and 2032.

4.5.5 The SHMA has also informed the Rushmoor Housing and Homelessness Strategy 2017-2022 that examines the challenges faced in seeking to make sure residents have housing that is affordable and appropriate to their needs. Affordability is identified as a key issue. Although, compared with neighbouring districts, household incomes to house price ratios are lower in Rushmoor, they are still high enough to be a barrier to residents buying a property or renting privately. Affordability is a particular issue for those on lower incomes, and is likely to become more acute because the welfare benefit cap has been reduced to £20,000 a year. Council data on average income levels indicates many households are likely to be paying more than 35% of their gross income on housing costs.

#### ***The private rented sector***

4.5.6 Rushmoor has seen the proportion of homes rented by private sector landlords' increase from 6% of the total housing stock in 2001 to 18% in 2011 due to the increased number of Buy-to-Let landlords.

4.5.7 Demand for privately rented homes has increased significantly since the financial crash in 2008. The key driver being that homeownership has become unattainable for those on average incomes due to high prices and stricter criteria applied by mortgage lenders. Many of those who previously would have become homeowners are now renting in the private sector.

4.5.8 Other sources of demand for this tenure include young professionals who like the flexibility offered by privately rented properties, recent migrants and those supported in the sector by housing benefit.

4.5.9 There are concerns about conditions in the sector and this led to a 2016 Council survey focussed in 12 areas of the borough. It identified issues of disrepair, overcrowding and small, non-licensable houses in multiple occupation.

4.5.10 Affordability in this sector remains a difficulty, particularly for those on lower incomes. Benefit assistance in the form of Local Housing Allowance is of decreasing value and is currently, on average, 4% lower than lower quartile rents and 13% below median market rent levels. LHA increased by 1% over the last four years whereas median market rents have increased by around 8%. These difficulties are a contributor to homelessness. Local housing statistics show that loss of a private sector tenancy is a principle cause of homelessness in the borough.

4.5.11 The level of demand has led to rising rents, indicating demand is not matched by supply. In view of the important role this sector plays in the local housing market, the Council wants to make sure these properties are in good condition and remain accessible to local households.

4.5.12 The Council wishes to intervene in the market to increase the supply of homes in this tenure and also to raise standards and improve the quality of accommodation. This could be achieved through a housing delivery vehicle that would also create an income stream.

### ***Affordable Housing***

4.5.13 The need to provide affordable housing for those who are vulnerable and on lower incomes remains a Council priority and is a key objective of Rushmoor's Housing and Homelessness Strategy. Currently this is achieved through partnership work with Registered Providers of Social Housing (RPs). Changes in the funding regime for new affordable housing have forced RPs to find alternative sources of funding such as charging higher rents ("Affordable Rent" of up to 80% market rent) and an increasing emphasis on shared ownership and "build for sale" to provide cross subsidy. Analysis of "Affordable Rents" and the income levels of those in the Council's housing allocations pool indicates affordability issues, particularly for low income, working households that need a three or four bed property.

4.5.14 There is concern about the ability and willingness of RPs to help the council meet its more specialist housing needs or to provide larger properties at truly affordable rents. As an alternative and to provide a product that meets local needs, the Council could consider alternative delivery vehicles for producing new affordable housing.

### ***Temporary Accommodation***

4.5.15 The Council currently has 151 units of temporary accommodation. More than half of these will no longer be available by 2021. It is not expected that levels of homelessness will decline in the short term, therefore, a review of the temporary accommodation and the services provided as well as a programme of re-provision will be required. This need must be factored into the Council's work to meet housing need.

### ***Property and Assets***

4.5.16 The Council has a small portfolio of property assets. The Council wants to make best use of this portfolio to meet its policy objectives including its objective to achieve financial sustainability.

### **Questions for PPAB**

- a) Do members agree that there is a strong strategic case for establishing a housing company?
- b) Do members consider that the housing company should include a mix of types and tenures of housing or for example, focus predominantly on higher income generating options such as PRS?
- c) Do members think the company should operate predominately within Rushmoor or across a broader area such as our Strategic Housing Market for example?

## **5.0 ECONOMIC CASE**

### **5.1 Introduction**

- 5.1.1 The Economic Case identifies and evaluates a 'long list' of options for delivering housing that contributes to the improvement of the overall quality and choice in the Borough's housing offer and assesses them against the policy objectives for the project. It demonstrates that there is a preferred way forward, which meets the existing and future needs of the Council and is likely to optimise Value for Money (VFM).

### **5.2 What the Council wishes to achieve: Policy objectives**

- 5.2.1 To meet its policy objectives, the Council is looking to:

1. Provide a mechanism for holding existing residential properties;
2. Provide a mechanism for creating a future residential property portfolio by development/acquisition;
3. Provide a mechanism that allows income generation and trading;
4. Make best use of the council's existing property assets to meet housing needs and create an income stream;
5. Initially to provide quality homes for market rent, and contribute to improvements in the condition in this sector of the stock;
6. Address difficulties in affordable housing delivery through registered providers of social housing;
7. Help address the need for temporary accommodation and the council's desire to deliver differently;
8. Have control over outputs e.g. Type of housing, rents, returns to the council.

- 5.2.2 A housing company could support and assist with meeting these aspirations.

### **5.3 Long Listed Options**

- 5.3.1 The following options have been identified as potentially enabling the Council to meet the objectives outlined above:

- Do Nothing
- Hold and develop a limited portfolio in the General Fund

- Re-open the Housing Revenue Account
- Site by site disposal with development agreements
- Wholly Owned Company
- Other corporate structures
- Investment Partner/ Joint Venture)
- Joint Venture with a Registered Provider

Each of these options is examined in detail below.

## **5.4 Examination of Options**

### **5.4.1 Do nothing – General Fund**

5.4.2 Under this option, the Council would cease work on further residential development on its own sites and acknowledge the risks of holding residential properties within the General Fund.

5.4.3 It will continue to rely on s106 agreements and partnership working with registered providers of social housing to deliver new affordable housing with robust negotiation on the requirement for truly affordable rents or more specialised accommodation with the risk that this cannot be achieved.

5.4.4 It will work in partnership with registered providers of social housing to secure re-provision of existing temporary accommodation and move toward a more preventative approach and seek to mitigate the risk of rising Bed and Breakfast costs.

5.4.5 It will rely on existing powers to improve conditions in the worst of the private rented sector and will be dependent on the private sector to deliver significant supply of private rented properties e.g. Wellesley.

5.4.6 The consequences of taking the 'doing nothing' approach are:

#### Benefits

- Income generation from limited housing stock that the Council retains

#### Burdens and Risks

- The Council would be exposed to the 'Right to Buy' risking the loss of an asset at a discounted market value (reduced capital receipt) and the loss of revenue income.
- Lack of control over the development of affordable housing due to developers' viability arguments and the ability of RPs to provide affordable rents and specialised housing without grant funding.
- New private rented sector stock will continue to be provided mainly by small landlords and the stock will be of variable quality. The worst housing conditions will continue to be dealt with by the Council's private sector housing team.



- To increase the quantity and quality of private market rent the council will rely on the operation of the market and the willingness of institutional investors and professional landlords to develop in Rushmoor.
- Rising B&B costs as a consequence of losing Clayton Court and North Lane Lodge without re providing accommodation and support
- Repairing responsibilities and other property ownership costs e.g. grounds maintenance and fly tipping.

## **5.5 Hold and develop housing in the General Fund**

- 5.5.1 When local authorities hold or develop housing they are required to account for the housing through a Housing Revenue Account. Two sources of guidance indicate it may be possible to hold properties without opening a Housing Revenue Account.

### ***50 dwelling units***

- 5.5.2 Under the Housing Revenue Account Subsidy Determination 2011-2012, 50 dwellings are de minimis for the calculation of HRA subsidy. This has been interpreted as meaning it is possible to hold up to 50 dwellings without having to open housing revenue account i.e. that these can be held in the general fund.

- 5.5.3 Under this option, the Council could develop its own sites/acquire properties up to a total of 49 units.

- 5.5.4 The properties would need to be let on secure tenancies at social or affordable rents.

### ***200 dwelling limit***

- 5.5.5 A parliamentary statement on the need for a Housing Revenue Account to hold residential properties (see below) has been suggested as authority to hold up to 200 units

“The Government’s policy is that where a local authority is developing or acquiring and retaining new social or affordable homes for rent, that they should be brought forward using the powers available to them under part II of the Housing Act 1985 and that housing accounted for through the Housing Revenue Account. Where the numbers of units are very small – up to 200 units - the Secretary of State will consider, on application, issuing an exemption from the requirement to hold a Housing Revenue Account in line with one of the recommendations made by Natalie Elphicke and Keith House in their independent review into the role of local authorities in housing supply. If an authority is retaining more than 200 units for rent it should reopen its Housing Revenue Account and discuss with the Department the setting of a new indebtedness limit.”

- 5.5.6 This statement only explains the position if the properties are new social or affordable homes for rent. It does not make it clear what happens if the housing to be accounted for is private market rent. To take advantage of this guidance, properties would need to be let under social housing tenancies.

### Benefits

- A number of social or affordable could provide a modest income stream

### Burdens and risks

- Repairing responsibilities and other property ownership costs.
- Risk that the ability to hold up to 50 units or up to 200 units is challenged leading to a requirement to open an HRA or to dispose of the properties. This can be mitigated by obtaining Secretary of State consent to hold properties without an HRA.
- Risk of Right to Buy because any tenancy granted by the Council is deemed a secure tenancy.
- Rental can only be Housing Act "Secure Tenancy" terms, i.e. the tenant benefits from security of tenure which can be passed down to family members.
- The Council's current VAT partial exemption percentage measurement is beneath the 5% threshold at around 4% each financial year. Ongoing maintenance and any further capital expenditure associated with the units would make ensuring the Council does not exceed the stipulated 5% VAT partial exemption more challenging.

## **5.6 Housing Revenue Account**

- 5.6.1 The Council has powers under Section 9 of the Housing Act 1985 to provide housing accommodation by erecting houses, converting buildings to homes or acquiring houses.
- 5.6.2 S74 of the Local Government and Housing Act 1989 requires local authorities to keep a housing revenue account for houses and other buildings that have been provided under the Housing Act 1985.
- 5.6.3 Following the transfer of the Council's housing stock in 1995, its Housing Revenue Account was closed.
- 5.6.4 The legislation indicates that if the Council owns and manages housing in its own name, it should open a housing revenue account. The implications of this are:

### Benefits

- There is no ambiguity about the ability of the Council to hold residential assets

### Burdens

- The current subsidy system does not generate any subsidy in relation to a dwelling stock of less than 50 units.
- The system of grant support is subject to annual redistribution and produces unpredictable fluctuations in income.
- Accounting processes are complicated and the Council would need to acquire the skill set to provide robust finance support.

- All dwelling units constructed by the Council, contained within an HRA or not would become subject to “right to buy”, effectively reducing the overall stock holding value.
- There could be initial difficulties in arrangement of essential self-financing of the HRA in relation to the application of a required debt cap. The cap is utilised to ensure that the extra income and flexibilities under self-financing are not used to support an increase in public borrowing.

## **5.7 Site by site disposal with development agreements**

- 5.7.1 Under this option, the Council would sell sites it owns with development agreements in place to provide some control for the Council over outcomes. Disposal would be via conditional contracts. There is a trade-off between the degree of control over outcomes and the sale price. Greater control generally results in a lower sale price.

### Benefits

- Once the process for setting up the development agreement has been established, this can be rolled out for a number of sites at low cost and risk.
- Some limited control over outcomes such as timing of development, house type and tenure mix.
- Capital receipts for the Council to reinvest.

### Burdens and Risks

- Council cannot hold residential assets, therefore, desire to become a good quality landlord cannot be achieved.
- No revenue income stream.
- Control over rents, house types and tenure results in decrease in capital receipts.
- Could be unattractive to the market for low value opportunities.
- Potentially development agreements may be subject to the need to follow the Public Procurement Regime, which can create delays.

## **5.8 Wholly owned companies (WOCs)**

- 5.8.1 Councils can use the General Power of Competence in the Localism Act 2011 to provide housing within a 100% Council-owned company as the Act provides local authorities with "the legal capacity to do anything that an individual can do that is not specifically prohibited".

- 5.8.2 The flexibility granted by the general power of competence has seen increased use of WOCs as councils have sought to meet housing needs by providing quality and choice in the rental sector and to achieve financial sustainability. Their use has also focused on minimising leakage of profits to the private sector and the desire by Councils to have some control on outputs. The role of WOCs are varied and have included development of housing, holding housing assets, or both, or acquisition of dwellings in the open market

without development. As a result, the structures vary between single WOCs and structures with a holding company and subsidiaries.

- 5.8.3 The interpretation of the general power of competence in the Localism Act 2011 is that where a council is doing something for a commercial purpose and is making a profit, it should do so through a company. For this reason, a company is the most appropriate form of corporate body through which to operate a housing business producing an income stream.
- 5.8.4 If a Council has complete control over delivery through a WOC then it should be able to move as quickly or as slowly as its own constraints allow, particularly in relation to decision making and resourcing. It is not dependent on third party discussions and creates opportunity for control over quality and product. This structure can also be a good way to generate general fund income streams or other revenue benefits through trading, e.g. through the margin made through on-lending, dividends from the WOC and service provision to the WOC.
- 5.8.5 It is recommended that the company would be a company limited by shares and that the Council would hold 100% of the shares. This model would allow the Council to pass to the company by way of share equity as well as loan debt, i.e. it would make loans into the WOC on broadly “commercial” terms.

#### Benefits

- Allows the Council control over the selection of the type of properties the company will develop, acquire and hold; and over the rents and standards of accommodation.
- Can enter into joint ventures
- Can take units from JV once completed.
- Can hold residential properties and benefit from an income stream.
- Where income exceeds costs and interest payments the company will generate surpluses that can (subject to tax) be payable to the Council as a dividend.
- Rental housing could be on a variety of terms, e.g. Assured Shorthold Tenancies.
- Can buy staff resources/expertise from the Council

#### Burdens and risks

- The Company needs to be properly resourced; funding and staffing
- Agents, consultants and staff to provide specialist skills will be required in the short term
- Financial risk rests with the Council
- State Aid issues – while the Council can charge out staff to do work for the company, the charges will need to be commercial to avoid being seen to provide State Aid.
- The impact of VAT, SDLT and corporation tax on the returns made by the company. This can be mitigated by careful tax planning.

- Building for rent carries debt for a longer period than building for sale. Therefore, the portfolio is subject to market influences and pressures for up to 30 years.
- The WOC, as an arms-length entity, will need to pay market value to acquire land from the Council.

## 5.9 Other Company Structures

5.9.1 There are other company structures that could be used by the Council. These are:

- LLPs
- Companies Limited by Guarantee
- Community Interest Companies

### ***Limited Liability Partnerships (LLPs)***

5.9.2 LLPs were introduced in 2000 to provide protected liability to partnerships that was previously only available to limited companies. They are typically used by professional partnerships such as accountants, solicitors, surveyors and architects etc.

5.9.3 LLPs are not as common as limited companies and may not be suitable for many types of business due to the way they are managed and taxed. In general terms LLPs are used by professions where each member's financial contribution and generated income is clear. The main benefit of using this structure is limited liability. For tax purposes, an LLP is treated as a partnership; each partner being assessed for tax on their share of the LLP's income or gains. To form an LLP there must be two members, therefore for a local authority wanting complete control over the activities of the business this can be an issue. A recent High Court case determined that a Limited Liability Partnership can be an appropriate corporate vehicle for use by local authorities in certain circumstances.

### Benefits

- Limited liability
- Transparent for tax purposes

### Burdens and Risks

- The Council requires a partner that may be inconsistent with wishing to have overall control of the activities of the LLP.
- May not be suitable for all purposes for which the Council wishes to establish a company

### ***Companies Limited by Guarantee***

5.9.4 A company limited by guarantee (LBG) is an alternative type of corporation used primarily for non-profit organisations that require legal personality. A company limited by guarantee does not usually have a share capital or shareholders, but instead has members who act as guarantors.

### Benefits

- Limited liability
- Suited for not for profit organisations

### Burdens and Risks

- Does not allow for distribution of profits as there are no shareholders. This would not achieve an income stream for the Council.

### ***Community Interest Companies (CIC)***

- 5.9.5 CICs are a type of limited company for establishing a business to trade with a social purpose (social enterprises), or to carry on other activities for the benefit of the community.
- 5.9.6 CICs must provide evidence that they will meet the community interest test set by their regulator.
- 5.9.7 The community must benefit either from the activity itself or the profits of the activity (or both).
- 5.9.8 CICs are subject to an Asset Lock designed to ensure that the assets of the CIC (including any profits or other surpluses generated by its activities) are used for the benefit of the community. Assets can only be sold to other asset locked bodies.
- 5.9.9 CICs limited by shares are also restricted in the amount of dividends they can pay. Currently only 35% of profits can be paid as dividends, the remaining profit must be reinvested back into the company or used for the community it was set up to serve. This restriction aims to strike a balance between encouraging people to invest in CICs and the principle that the assets and profits of a CIC should be devoted to the benefit of the community.

### Benefits

- Could be appropriate for providing affordable / social housing where a community benefit can be demonstrated.

### Burdens and Risks

- There are restrictions on disposals of assets that could limit the ability of a property based company to trade.
- Restrictions on the distribution of dividends could limit the ability of the Council to benefit from surpluses made by the company.

## **5.10 Investment Partner/Joint ventures**

- 5.10.1 Creating a Joint Venture (JV) involves engaging with the private sector to benefit from private sector finance, expertise, and economies of scale. It involves a sharing of control, risks and rewards. JVs have been used by local authorities including Rushmoor for a variety of different purposes. The local authority's role is usually in provision of land for development and some investment.

5.10.2 In order to achieve a commercially successful model, a JV would typically have a high proportion of Market Sale Housing / rental properties available only at market rates.

5.10.3 The JV model was considered by the Council for larger residential schemes in the borough connected with regeneration initiatives. The Council has now selected a JV partner. These schemes have a sufficient number of units to make it possible to secure a private sector partner. A housing company may acquire units from the JV. A JV might take the form of a Limited Liability Partnership (LLP), which is not subject to tax with profits or a more traditional limited company structure.

#### Benefits

- Private sector expertise, investment and risk sharing.
- Access to finance from partner / external borrowing.
- Private sector should bring expertise in terms of cost control and marketing of completed units.

#### Burdens and Risks

- JVs usually require scale and complex arrangements for small sites are unlikely to be attractive to the market.
- The Council would be able to exercise some influence, but not full control without the JV becoming subject to local authority accounting and procurement obligations.

### **5.11 Joint Venture with a Registered Provider of Social Housing**

5.11.1 Housing Associations are now experienced in joint ventures. Vivid our LSVT housing association and largest stockholder in the borough has participated in JVs with a variety of organisations including local authorities. RPs have diversified and many now have experience of delivering private market rent, properties for outright sale as well as their core business of affordable /social housing. The partnership arrangements can be established through an LLP with individual schemes brought forward through Special Purpose Vehicles. There is no overall control for the Council but this may be less of an issue where the aims of the partners are aligned i.e. in increasing housing supply and providing a mix of tenures.

#### Benefits

- Expertise, investment and risk sharing with the RP. Access to finance from partner / external borrowing.
- Expertise in terms of cost control and marketing of completed units.
- Housing management capability.

#### Burdens and Risks

- RPs no longer receive the amount of grant they once did and have had to become very commercial in their activity. For this reason, they are interested in larger schemes that can generate numbers and achieve

economies of scale. The larger more capable RPs may not be interested in a portfolio such as the Council has to offer.

- RPs that might be interested in smaller scale more specialist schemes are generally smaller and less experienced in development and have more limited access to finance.

## 5.12 Analysis of Options

5.12.1 The ability of the long-list options to meet the critical success factors for this project identified above have been assessed by the officer project team and are summarised in the table attached in appendix one.

5.12.2 The analysis in appendix one identified that a **Wholly Owned Company** provides the best fit against policy objectives.

5.12.3 The remainder of the business case therefore focusses on the housing company being established as a wholly owned company.

### Questions for PPAB

- a) Are members satisfied that we have considered a wide enough range of options?
- b) Are members comfortable with the business case conclusion that a WOC is the best option?

## 6.0 COMMERCIAL CASE (for the preferred option)

6.1 A wholly owned company (WOC) is the preferred option identified from the options set out in appendix 1. The commercial case outlines the key considerations for setting up a company and examines its ability to provide a commercial response to meeting housing need.

### 6.2 Introduction

6.2.1 The Commercial Case outlines the procurement and commercial aspects of the preferred option, together with a risk analysis.

6.2.2 Setting up a delivery vehicle has both legal and commercial considerations.

6.2.3 Any such delivery vehicle will need to be financially viable and operate efficiently to ensure it receives sufficient rental income to meet all its costs including financing, housing management, property maintenance and administration.

6.2.4 A company limited by shares is currently the most appropriate form of vehicle for a local authority housing company because:

- A company limited by shares is the most common corporate vehicle used in England for profit distributing bodies. It is a very tried and tested model; and



- The Council can participate in the company by way of share equity as well as loan debt, subject to entering into formal lending documentation.

6.2.5 The company will be set up under the Companies Act 2006

6.2.6 The Council will hold 100% of shares in the company and will have full ownership allowing the Council to retain control of the selection of properties, standards of properties, allocations and rents.

6.2.7 A clear governance structure will be required to enable the Council to have control of the strategic direction of the company while allowing the directors of the company (to be identified) discretion to carry out effective operational management.

6.2.8 A shareholder agreement will be needed to set out the parameters within which the company must operate and to clarify the extent of control by the Council. This would typically include such things as what powers are reserved to the Council as shareholder, the business planning process and board meeting requirements.

### **6.3 Powers to form the Housing Company**

6.3.1 The Council can rely upon the general power of competence within the Localism Act 2011 to form the Housing Company for operating a business to let homes at market rent or to provide homes for sale either on market or sub market terms.

6.3.2 In the exercise of its powers under the Localism Act for a commercial purpose, the Council is obliged, under the Act, to do so via a company.

### **6.4 Powers to fund the Housing Company**

6.4.1 The Housing Company will need significant funding to acquire land and develop properties. Therefore, as well as the Council having the powers to form the Housing Company it must also be able to provide it with the necessary loan and equity funding.

6.4.2 The Council has the power to borrow under the Local Government Act 2003 for the purposes of the prudent management of their financial affairs, or in connection with any of their functions. The borrowing must be affordable, prudent and sustainable and comply with the Prudential Code.

6.4.3 The Council intends to borrow monies and in turn support the Housing Company through the provision of loans and subscription to share capital. Section 24 of the Local Government Act 1988 specifically allows the Council to provide financial assistance in connection with the provision of privately let accommodation provided it has the consent of the Secretary of State. In practice, this is provided under a general consent issued by the Secretary of State.

- 6.4.4 Any housing made available for sale by the Housing Company would not be covered by the 1988 Act. However, the Council can rely upon the general power of competence under the Localism Act 2011 to fund the Housing Company for the purpose of the company operating a business to provide homes for market sale.

## **6.5 Power to transfer land to the Housing Company**

- 6.5.1 In the future, the company will develop new homes using land currently owned by the Council. The Council is entitled to dispose of land held by it in its General Fund provided it complies with Section 123 of the Local Government Act 1972. The key point is that consideration should be not less than the best that can reasonably be obtained.
- 6.5.2 Having established the powers under which the Council can set up a company consideration needs to be given to the Company's objectives and the documentation needed to establish the company

## **6.6 Objectives of the Company**

- 6.6.1 To meet the needs identified in the Strategic Case and the Economic Case the key objectives of the company would be:
- To take a transfer of existing residential properties owned and let by the Council;
  - To develop/acquire property to assemble a residential property portfolio that may contain a range of tenures;
  - Provide quality homes for rent in the private rented market to meet housing need, and create a revenue stream;
  - To remain financially viable;
  - To assist the Council in meeting requirements for affordable housing and temporary accommodation where a company is the best means of achieving the required outcomes;
  - To provide an efficient landlord service including housing management and maintenance; and
  - To maintain its properties to a standard that meets tenants reasonable expectations and protects the Council's investment in the company

## **6.7 Requirements for establishing a company**

### ***Company Documentation***

- 6.7.1 To establish the Housing Company the following will be required
- Memorandum of Association and Articles of Association
  - Shareholder Agreement or SLA including "reserved matters", i.e. those matters that can only be decided by the Council as shareholder
  - Loan agreements setting out details of the funding arrangements between the Council and the Housing Company

- 6.7.2 In addition, there will be a number of operational documents controlled by the Council through the shareholder agreement.

***Business Plan***

- 6.7.3 The business plan will cover a rolling 3 year period of activity and outline the company's planned operations. It will include the following

- Company objectives
- Governance arrangements
- Operational plans
- Financial modelling and assumptions
- Rents, sales and development assumptions
- Fees
- Cashflow and requirements for funding
- Funding profile and sensitivity analysis
- Projected profit
- Roles within the company

***Operational Policies***

- 6.7.4 Policy documents will be required including the following:

- Rent setting
- Letting policy
- Rent arrears and debt recovery
- Other general policies e.g. Health and Safety, Data Protection

***Property Management***

- 6.7.5 The Housing Company will need to provide housing management and property maintenance services to its tenants. Initially it is likely that this will be undertaken through agents (some RP's will undertake this role on a commercial basis) and through use of some Council staff. Costs for Council staff will need to be recharged in a transparent way having regard to state aid rules.

- 6.7.6 Tenants of the Housing Company would be granted Assured Shorthold Tenancies except in the case of any supported housing schemes that will be let on licences. In some circumstances, it may be appropriate to offer homes on a shared ownership basis.

***Stamp Duty Land Tax (SDLT)***

- 6.7.7 The Council is a Local Authority owning 100% of the Housing Company and therefore group relief should be available on the purchase of land. This means that currently no SDLT should be chargeable whether land was sold or transferred in exchange for shares to the company. Some due diligence will need to be undertaken to ensure that the conditions for SDLT group relief can be applied in appropriate circumstances. Further advice on this will be sought if the business case is approved.

### ***Corporation Tax***

- 6.7.8 Generally, limited companies are considered not to be the most tax efficient vehicles for local authorities, as local authorities do not pay corporation tax whilst a limited company pays corporation tax on its profits and can only declare dividends out of its net-of-tax profits.
- 6.7.9 For the purposes of financial modelling, corporation taxation incurred on company profits will be shown at the rate of 19%.
- 6.7.10 The Council will be able to make management charges to the company, for staff time and costs and the company will be able to deduct such reasonable and commercial costs from profits before tax

### ***VAT***

- 6.7.11 The Housing Company must register for VAT and this should be done as soon as possible to eliminate the risk of incurring unrecoverable VAT charges on cost associated with scheme developments. The company will be unable to recover any ongoing VAT inputs, as its entire income will be raised from housing rental streams that are classed as VAT exempt. It is advisable to have a design and build contract in place for the construction of new properties as this would reduce the irrecoverable VAT on professional fees (construction of new houses is zero-rated).
- 6.7.12 For financial modelling it is assumed that VAT is payable on inputs but not recoverable through rents.

## **6.8 Council Tax**

- 6.8.1 The company will be liable for council tax on any void periods.

### ***Contracting Status and Procurement***

- 6.8.2 The Housing Company will be a body required to follow the Public Contracts Regulations 2015 (PCR). However, as a wholly owned subsidiary of the Council, the Housing Company such, any contracts let between the Council and the Housing Company would not be subject to the EU procurement regime. Issues for decision in these circumstances would include lettings, management & maintenance, administrative, legal and accounting services.
- 6.8.3 The contracting status defined in the preceding paragraphs is proposed on current European procurement rules. Suitable adaption and revision may be required when the UK achieves Brexit on 29<sup>th</sup> March 2019. It is currently too early to determine what the changes to procurement and other matters affecting the company may be.

### **Questions for PPAB**

- a) Are members comfortable with the objectives of the company?
- b) Do members have any questions about the requirements to establish a company?

## **7. FUTURE MEETING - FINANCIAL AND MANAGEMENT CASE**

- 7.1 It is proposed that a further meeting of the PPAB be arranged (or time set aside at a scheduled meeting) to consider the financial and management case and proposed governance arrangements
- 7.2 Following full consideration the PPAB's comments and any recommendations will be summarised in a report that will be made available to Cabinet in advance of Cabinet considering the business case making a decision on establishing a housing company.