

Wiltshire Council

Cabinet

15 January 2019

Subject: Establishing a Local Housing company and local development company

**Cabinet Member: Cllr Richard Clewer - Cabinet Member for Corporate Services, Housing, Heritage, Arts and Tourism.
Cllr Philip Whitehead - Cabinet Member for Finance, Procurement, ICT and Operational Assets**

Key Decision: Key

Executive Summary

The purpose of this report is to seek consideration of the establishment of a Council owned local housing company and a local development company.

Proposal(s)

Cabinet are being asked to confirm:

1. The establishment of a local housing company as a company limited by shares initially set up as a wholly owned subsidiary of the Council
2. The establishment of a local development company as a company limited by shares initially set up as a wholly owned subsidiary of the Council
3. That the Council nominates the cabinet member for Corporate services, Housing, Heritage, Arts and Tourism and the cabinet member for Finance, procurement, ICT and operational assets, a member from the opposition party and the Corporate Director of Growth, investment and Place to the boards of both companies.
4. That the Council recruits an independent nominee to each board who has the requisite skills for each company
5. That the Council provides short term loan start up funding or services for the companies
6. That the Council provides loan finance of up to £ 50 million from 2019/20 to 2023/24 to the local housing company
7. That the Council agrees a provision of up to £ 5 million to fund equity investment and loan finance to the local development company from 2019/20 to 20123/24
8. That the provision of loan finance to the Local Housing company is subject to a nominations agreement with the Council.
9. That the Council will offer services to both companies.
10. That the detailed arrangements to establish the company and contracts for services provided by the Council is delegated to the Corporate

Directors, other than Corporate Director Growth, investment and place, in consultation with the Director of Legal and Democratic services (Monitoring Officer) and the Director of Finance and Procurement (section 151 Officer).

Reason for Proposal(s)

The proposal to establish a local housing company is aimed at providing residential accommodation in Wiltshire that can meet the wider strategic housing needs of the Council as well as generating a return for the Council. The proposal to develop a local development company is aimed at enabling Council land assets to be developed to meet the strategic economic and social needs of Wiltshire whilst maximising the return for the Council.

Alistair Cunningham - Corporate Director Growth, Investment & Place

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Purpose of Report

1. The purpose of this report is to seek consideration of the Council supporting the establishment of a local housing company and a local development company.

Relevance to the Council's Business Plan

2. The Council's business plan seeks to grow the economy and protect vulnerable people. The proposals in this report will provide the framework to enable the Council to meet the residential accommodation needs in Wiltshire in a flexible way as well as supporting development of the Council's assets to support the local economy.
3. The proposals directly support the Council's objective to operate in an innovative and effective way employing a commercial approach.

Background

4. There are a range of strategic housing needs facing the Council that cannot be easily addressed by the Council's current approaches. The lack of key worker accommodation is impacting on the availability of services in parts of Wiltshire. Accommodation to meet the needs of specific vulnerable households in a timely manner from the existing housing stock in Wiltshire is not a priority for the Council's registered provider partners. The Council procures accommodation for homeless households that is costly and the quality and cost could be improved by private rented sector accommodation provided by a local housing company.
5. The Council has a successful programme of asset disposal. Over the next three years the Council estimates that it may be able to offer to the market sites capable of residential development which subject to planning permission could deliver over 500 units of accommodation. If the Council were to establish a local development company not only would it enable the strategic housing needs across the County to be better met it would also

increase the potential return that could be generated from the developments.

6. A number of Local Authorities have established wholly owned local housing companies and development companies and there is a track record and body of professional advice to help establish such bodies.

Main Considerations for the Council

Local Housing company

7. The Council has received professional advice as to the viability of a local housing company in Wiltshire. Due to the commercial nature of the assumptions and modelling the detail is contained in appendix one in the exempt part of this agenda. However, in summary the model is based on;
 - £ 10million loan finance from the Council per year for the next five years
 - Acquisition of existing properties across the county but split 40% of acquisitions in Salisbury, 30% in Trowbridge and 30% in Chippenham.
 - Rent set at Local housing allowance levels plus 10%
 - Management costs set at those achieved by the Council in managing its housing revenue account properties.
 - Industry standard allowances for maintenance, company administration.
8. The loan finance provided by the Council will be below commercial rates as rents to be charged by the company will be sub market and as such a state aid exemption can apply. The Council's loans would be secured by charges against the properties the company purchases. The Council will receive a margin on the loan finance provided. It may be that the Council will wish to provide services to the Company at start up safe in the knowledge that it could receive dividends in return as the company trading position improves. In addition, the Council may need to provide short term loan finance at start up of the company until the company's cash flow is sufficient to meet its costs.
9. The modelling shows that the Council's total loan can be repaid over a 50-year period based on a revolver loan arrangement employing surplus income to repay debt as shown in appendix one.
10. It is recommended that the Company structure is a company limited by shares wholly owned by the Council. There are standard model articles of association that can be considered and if appropriate can be used with or without modification as required. The Council will nominate directors to the Company board and care should be taken in avoiding conflict of interest for the nominees due to their position in the Council and their role as furthering the interests of the Company. The model articles allow for five directors. The recommended structure will allow the company to trade for profit and thus pay a dividend to its shareholder. It is recommended that the cabinet member for Corporate services, Housing, Heritage, Arts and Tourism and the cabinet member for Finance, procurement, ICT and operational assets, a member from the opposition party and the Corporate Director of Growth, investment and Place are nominated to the boards of both companies.

Given the nature of the company it is recommended that the Council should seek to recruit and nominate an independent director who has the relevant skills required for the company. The model articles provide the shareholder the ability to appoint and remove Directors. The model articles allow for remuneration of Directors as approved by the shareholder.

11. The Company will require a start-up funding loan from the Council before the properties are purchased and rents charged. In addition, the Council will provide services to the company at cost until it is economic for the company to contract or employ staff to undertake functions.
12. The Council will enter a nomination agreement with the company which will provide the Council with the ability to specify the type of property it would wish to nominate households for as well as first refusal on the letting of each property. The Council will wish to nominate households which will best achieve its overall strategic housing needs.
13. It will be for the company to determine rents to be charged albeit the Council's loan agreement will require rents to be sub market so as to provide protection from any state aid challenges.
14. The benefits for the Council in setting up the local housing company are;
 - The margin on loan finance
 - The sale of services from the Council to the company
 - The equity growth in the properties the Company purchases
 - The ability to meet accommodation needs for groups that are not easily addressed in the Council's allocation policy such as key workers or households with specific housing needs.
 - The proposal will relieve pressure from the Council housing register.

Local development company

15. The Council's asset disposal programme seeks to maximise the return for the Council by offering sites to the market for development. Although the Council employs mechanisms to ensure maximum return is secured the Council is limited in its ability to secure an element of development profit.
16. The Council has received professional advice concerning the viability of a local development company undertaking the development of Council owned assets. Due to the commercial nature of the assumptions and modelling the detail is contained in Appendix one in the exempt part of this agenda.
17. If the Council provided its assets to the company for development the Council would receive market value for its asset. Due to the commercial nature of the company the Council would provide loan finance to the company at commercial rates as no state aid exemption would apply. In addition, the Council has been advised that to protect any challenges of the provision of state aid to the Company from the Council it will be necessary for the Council to invest at least 40% equity into the company as that is the industry standard level of equity investment in residential developments. If

the value of the Council's land assets do not equate to the 40% equity there will be a need for the Council to directly invest in the development. The Council would receive a return from the development equivalent to its overall equity investment after the company's tax liabilities have been met as well as a margin on the loan finance. It will be necessary for the Council to consider the economics of supporting the development company to develop Council owned sites on a site by site basis compared to the return that could be generated from disposal on the open market. Appendix one contains a viability assessment setting out the added benefit that could be delivered if two Council owned sites were developed by the local development company as opposed to those sites being disposed on the open market.

18. It will be for the development company to determine the way in which the best return can be generated from the development and the Council's control will be limited to its statutory planning function. In the early life of the company it may want to purchase services from the Council which could be reflected in the equity investment.
19. It is recommended that the company structure is the same as for the local housing company and therefore it will be necessary for the Council to nominate at least five directors to the company board on the same basis as that recommended for the Local housing company.

Overview and Scrutiny Engagement

20. A briefing was provided to the Financial planning task group on the 8th January 2019 concerning the proposals contained in this report.

Safeguarding Implications

21. There are no immediate safeguarding implications from this report.

Public Health Implications

22. The flexibility offered by a Local housing company in meeting the accommodation needs of vulnerable people may offer public health benefits.

Procurement Implications

23. The report proposes establishing companies and as such there will be no procurement by the Council taking place. The companies will have to establish their own procurement and contracting arrangements.

Equalities Impact of the Proposal

24. It is not considered that there is a direct equalities impact because of this report. The nominations to the local housing company will need to consider alongside the Council's ability to meet the housing needs via the Council's own housing stock and nominations to registered providers.

Environmental and Climate Change Considerations

25. It is not considered that there is a direct environmental and climate change impact because of this report

Risks that may arise if the proposed decision and related work is not taken

26. The proposal to establish a local housing company is aimed at meeting the strategic needs of the Council in terms of housing that are not currently met by existing approaches. In addition, the development company proposal aims to meet the Council's development ambition to strategically meet needs as well as maximise the return the Council can achieve from its assets.

Risks that may arise if the proposed decision is taken and actions that will be taken to manage these risks

27. The proposals contained in this report aim at balancing risk and reward for the Council. For the Local housing company the risk facing the Council is that the company will not be able to repay the loan to the Council from its business plan. As the Council, will place a charge on each property that it provides loan finance for the risk is mitigated in that the Council could redeem its debt by the sale of the property. However, that action would be at the expense of the tenants and the Council would have to intervene to help them avoid homelessness.
28. The risk posed by the Local development company is that the development it undertakes does not realise a return which repays the Council's equity investment due to a downturn in the market. This risk could be mitigated by the local development company disposing the units to the Council to be contained in its housing revenue account if viable or leasing the development to the local housing company for market rent until the market conditions improve.
29. The Council has sought external professional advice on the viability of the companies, and legal implications.

Financial Implications

30. The Council has sought professional advice as to the viability of a Local Housing Company and a Local Development Company.

Assumptions were developed with Savills based upon extensive market analysis and input into the models based on Wiltshire Council experience from its own Housing Stock, New Build programmes, Industry standard allowances and Savills experience.

The Local Housing Company has been modelled on the assumption of Loan Finance of £50 million over five years, circa £10 million per year from 2019/2020.

The model demonstrates that the Local Housing Company can repay the Loan to the Council over a 50 year period based on a revolver loan arrangement employing surplus income to repay debt.

The Council will receive a margin on the loan finance which will be provided to the Local Housing Company below commercial rates and secured against the properties the company purchases.

The Council may choose to provide services to the Local Housing Company either through sale of services or in return for future dividends.

The Council will need to provide start-up funding loan to set up the company and assist the company's cashflow until properties are purchased and leased at a level whether the company can cover its costs.

The major risk to the Council of setting up a Local Housing Company is that the company is unable to repay the loan. This will be mitigated by a charge against the properties.

The modelling undertaken has demonstrated that the Local Housing Company will be successful and repay the Loan over the 50 year period. This will generate an annual revenue return to the Council in the way of Loan margin.

Market factors outside of the Council and Company's control will need to be managed and rent strategy and service trading adjusted accordingly to ensure sustainability.

The Local Development Company has been modelled on the assumption of Loan Finance/Equity Investment of £5 million over five years.

The aim of setting up the Development Company is to ensure maximum return is generated for the Council's surplus sites, the Council through the Local Development Company will undertake development and secure an element of development profit in the form of a dividend.

The Council will provide assets to the Local Development Company at market value, and will receive a return from the development equivalent to its overall equity investments after the companies tax liabilities.

The Council will provide Loan Finance to the Local Development Company at commercial rates, generating a margin on the Loan Finance.

If the Land Value is less than 40% equity the Council will invest in the development up to this level to avoid any state aid issues.

The Local Housing Development Company may choose to purchase services from the Council either through sale of services or as part of equity investment.

The major risk to the Council, of setting up a Local Development Company is that the Development undertaken do not realise sufficient return to

repay the Councils equity investment due to downturn in the market or unexpected costs. This risk can be mitigated by disposing of the units to the Council to be held in either the Housing Revenue Account or Local Housing Company for market rent.

Savills and The Council modelled the review of two council owned sites.

The model showed an overall benefit of circa £2m from establishing a Local Development Company and developing the sites compared to land receipt.

The detailed arrangements for both companies will need to be developed and entered into ensuring the most efficient tax and return arrangements for the Council.

Legal Implications

31. The General power of competence provides a wide power to the Council however it is subject to any existing statutory restrictions. Therefore, formation of a local Authority Company must have regard to the Ministerial oversight prescribed in Part V of the Local Government and Housing Act 1989 and the Local Authorities (Companies) Order 1995 and any borrowings must have regard to Part 1 of the Local Government Act 2003.

The formation of a development company to realise a return to the shareholder (by way of a dividend) also carries with it a risk of a loss which the Company must make up.

It is therefore recommended that specialist external legal and finance advisors are retained to ensure that these risks are minimised and that the final approval of documentation be taken in consultation with the Monitoring Officer and the section 151 Officer.

Options Considered

32. The Council could provide loan finance to registered providers to meet specific housing needs in Wiltshire. However, the Council would not benefit from the ownership of the properties as is the case with a company which it wholly owns. Moreover, the Council would have to nominate households from its housing register in line with its allocation policy thus preventing more flexible allocations to meet specific housing needs such as those of key workers or those households with urgent housing need.
33. The alternative to the Council establishing a local development company to undertake development of its assets would be to procure a joint venture partner to undertake development. The Council has sought advice on this approach and the nature and size of the assets the Council will dispose is unlikely to be attractive to a partner and moreover a JV partner development, by its very nature would return a percentage of developer profit related to the equity the Council held in the partnership. The development company offers the Council the opportunity to receive dividends based on its equity investment net of tax. It is for these reasons a development company is proposed.

Conclusions

34. The report recommends the establishment of a local housing company to; offer a flexible way to meet strategic housing needs of the Council, and generate a margin on loan finance offered. It also recommends establishing a local development company to; maximise the return from the disposal of Council assets including equity investment and generate a return on loan finance whilst meeting strategic development objectives.

Alistair Cunningham - Corporate Director Growth, Investment & Place

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11th December 2018

Appendices

Appendix One – modelling of LHC and LDC.

Background Papers

The following documents have been relied on in the preparation of this report:

Report from Savills on viability of Local housing company and local development company.