

Appendix A: Full Business Case for the Establishment of a Housing Development Company wholly-owned by Forest Heath District Council, St Edmundsbury Borough Council and Suffolk County Council

1. Background

- 1.1 Increasingly, local authorities are looking to act more commercially in order to generate revenue income to meet local priorities, particularly since the Localism Act 2011 has given greater freedoms and flexibilities to Councils wishing to establish companies. This is in keeping with West Suffolk's Strategic Plan.
- 1.2 With specific regard to acting more commercially in the housing market, the recent national Elphicke-House report (2015) set out how Councils could and should become Housing Delivery Enablers. The report suggests that a move towards Councils acting as developers and private landlords would be a positive shift, helping to ensure that the local housing needs and demands of an area can be best met.
- 1.3 In a recent Ministerial Housing Statement on 20th March 2015, Brandon Lewis MP signaled the Government's support for Councils setting up local housing companies. This includes developing new homes for market sale and private rent. It must be noted that the Government does not support the setting up of such companies where this is done to deliberately avoid the right to buy or Housing Revenue Account debt caps.
- 1.4 The rationale for exploring and proposing the setting up of a company was set out within the West Suffolk Housing Strategy 2015-18 (see paragraph 1.7 below). To summarise:
 - Forest Heath District Council and St Edmundsbury Borough Council are facing significant reductions in government grant funding and so are looking to be more innovative and behave in more commercial ways to address revenue shortfalls while addressing local issues. Establishing a housing development company would contribute toward generating revenue and capital income at a greater level than simply selling the land assets
 - direct investment by the Council, which may involve further prudential borrowing, would be on a commercial basis generating an internal rate of return as targeted within the Medium Term Financial Strategy
 - the ability to operate on a commercial basis coincides with addressing certain demand in the housing market, notably the demand for good quality private rented housing
 - 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 and the New Anglia Local Enterprise Partnership (LEP) are encouraging this activity
 - it is widely recognised that housing growth and development are key drivers to stimulating wider economic growth and community regeneration

- there is thus an opportunity for Forest Heath District Council and St Edmundsbury Borough Council acting together with Suffolk County Council to offer good quality, well managed PRS homes while delivering income streams to the Councils to invest in protecting and supporting other services.
- 1.5 Given the above rationale, the primary aim of the Company would be to provide quality homes for private rent and/or private sale and thereby generate a financial return to the Councils.
- 1.6 Pursuance of this aim would have a series of wider beneficial impacts, including:
- contributing to remedying housing supply issues in West Suffolk which jeopardise the economic and social well-being of residents and can undermine growth in the local economy
 - meeting Forest Heath District Council’s and St Edmundsbury Borough Council’s planning policies relating to the provision of affordable housing, rented and/or low cost home ownership, and in doing so contributing to addressing local affordable housing needs
 - acting as an exemplar of good practice in housing development, for example by offering apprenticeships, training and lifetime homes, with the aim of deriving reputational and commercial benefits for the Councils as Shareholders
 - developing, so long as a clear commercial financial case can be demonstrated, housing of a specialist nature such as keyworker housing, temporary accommodation and retirement housing and in doing so, along with other private developers already active in the housing market, contributing to a reduction of longer term social and care costs associated with the occupation of properties that are inappropriate to a resident’s needs.
- 1.7 The West Suffolk Housing Strategy 2015-18, adopted by Forest Heath’s Council and St Edmundsbury Borough Council on 8 October 2014 and 23 September 2014 respectively, set out eight principles against which alternative options for investing in new housing should be assessed. Table 1 below assesses the proposed Housing Development Company against these principles.

Table 1: Consideration of the proposed Housing Development Company against the principles established in West Suffolk’s Housing Strategy

Principle	Housing Development Company
Any direct investment the Councils make will need to be on a commercial basis generating an internal rate of return as targeted within the Councils Medium Term Financial Strategy	State Aid regulations dictate that loans from a Council to a wholly owned company must be at commercial rates. Interest rates in line with the requirements of the Councils’ Medium Term Financial Strategy are being used when preparing the business case for the Company
Priority will be given to developing schemes that lead to a reduction in	West Suffolk Councils’ need for short-term temporary accommodation has been taken

<p>ongoing revenue costs associated with the Councils' statutory housing responsibilities – in particular, the use of short-term temporary accommodation and B&B</p>	<p>forward through the acquisition of a number of specialist units which, if the business case can be established, could be transferred into the Company once established. The Councils will work with the Company to define within planning policy requirements the most appropriate affordable housing mix which could include homes to minimise the need for high cost temporary accommodation.</p>
<p>There will need to be a balance in the type of housing developed, both in terms of tenure, private and social, urban and rural, property size and type. Needs data will be used to demonstrate the size and mix of homes required in new locations</p>	<p>The Company will develop housing across a mix of tenures, with the market housing meeting local demand, and affordable housing developed to comply with planning policies meeting local need</p>
<p>Any funding provided to registered provider partners / private developers would need to deliver additional benefits for West Suffolk compared to those delivered through funding they could access through the Homes and Communities Agency or private finance</p>	<p>The Company would find it difficult, at least in the immediate term, to access finance in the market place. Therefore, loans made by the Councils to the Company on a commercial basis would not be supplanting funding the Company could access elsewhere. Over time, as the Company's track record becomes established, it may be able to secure alternative funding</p>
<p>Any options developed need to support projects and programmes that will help to stimulate wider economic growth, educational attainment, sustainable communities and health and wellbeing</p>	<p>As an obligation of developing market housing in West Suffolk, the Company would be required under Forest Heath District Council's and St Edmundsbury Borough Council's planning policies to provide affordable housing and s106 contributions to infrastructure wherever financial viability allows, unless the development is so small that it does not trigger contributions. So long as financially viable, this would see the Company contributing to West Suffolk's key priorities of promoting '<i>resilient families and communities that are healthy and active</i>' and providing '<i>homes for our communities</i>'</p>
<p>The Councils will work in partnership with other public sector partners and seek support from them where they could directly benefit from the development of a specific option</p>	<p>The proposed approach is predicated on partnership working between Forest Heath, St Edmundsbury and Suffolk County Councils and the proposed company structure enables other public sector partners to become Shareholders in the future</p>
<p>Certain approaches may require investment on a scale that would require the Councils to enter into partnerships that cover more than just West Suffolk</p>	
<p>A number of the options will require long implementation and payback timescales in order to deliver positive outcomes, so the Councils will need to take a long-term strategic view with regard to the financial appraisals- considering the bigger picture</p>	<p>Section 5 of this appendix gives an overview of the financial modelling. The exemplar schemes considered create a revenue stream. The Housing Development Company should be viewed as a medium-to-long term investment, rather than a source of significant income in the very short term</p>

1.8 Since early 2015 officers of West Suffolk and Suffolk County Council (the Councils), supported by specialist external support, have been assessing the potential of the Councils participating in the development of market rent and homes for sale across West Suffolk.

1.9 The Company would make a significant contribution to West Suffolk's three key priorities in the following ways:

- *Increased opportunities for economic growth.* Most notably the construction of new homes will provide (a) direct employment in construction, (b) employment through the supply chain and (c) skills development, for example training and apprenticeships
- *Resilient families and communities that are healthy and active.* Most notably access to high quality homes will improve the well-being and both the mental and physical health of local residents who currently struggle to secure suitable accommodation or live in accommodation that is unsuitable for their needs
- *Homes for our communities.* The Company will provide new homes for sale, private rent, affordable rent and low cost home ownership. Adherence to planning policies will ensure the affordable homes meet the specific needs of local people, including provision of specialist accommodation. In addition, should certain accommodation be viable, for example specialist housing, this is likely to stimulate movement within the housing market, freeing up larger homes in all tenures.

2 Case for establishing a Housing Development Company

2.1 The proposal to establish the Company is based on a high level options appraisal conducted to determine the most appropriate means by which the West Suffolk Councils' objectives, as set out above, could be met.

2.2 The alternatives explored were:

- 'do nothing' beyond supporting new housing through traditional means, including disposing of land and/or providing financial grants to housing associations. **REJECTED** – the development company approach affords a better use of scarce financial resources and is in line with the Councils' commercial approach
- the Councils to build directly. **REJECTED** – local authorities do not have powers to directly undertake commercial activity but can do so through a company
- joint venture model with a private developer. **REJECTED** – this option would take significant time to establish, the structure would compromise flexibility, notably the Councils and partner would have to agree to dissolve the company, and revenue income would have to be shared.

The benefits of Forest Heath, St Edmundsbury and Suffolk County Council working together

2.3 The three authorities working together to establish a Housing Development Company is undoubtedly in keeping with the transformation agenda across Suffolk, in particular the principles of devolution. The Company is based on

working across organisational boundaries while respecting the individual sovereignty of partners. Furthermore, it furthers the county-wide drive for efficient, joined up ways of doing things that 'look right for Suffolk'. The approach being adopted is flexible and adaptable enough for other authorities to be able to join at a later date if appropriate.

2.4 The complementary experience, skills and powers of the three Councils mean there are tangible commercial and operational benefits to all authorities coming together. Notably:

- there are key development sites or packages of sites where the constituent Councils have land-holdings on which joint working would ease site assembly
- the County Council has other land holdings in West Suffolk that could be made available to the Company
- the West Suffolk Councils as both the planning authorities and strategic housing authorities have expertise that can facilitate development
- the West Suffolk Councils have insight into and experience of acting in the private rented market through the West Suffolk Lettings Partnership
- Suffolk County Council's social care teams can assist West Suffolk Councils' strategic housing team determine specialist housing needs that could be met by the Company when discharging its planning obligations regarding affordable housing
- all of the Councils could support commercial loans to the Company.

The benefits of operating through a Company

2.5 A company is a particularly good way to operate for the following reasons:

- by clearly asserting the Company's commercial character, it is unlikely to be considered by any parties as being a 'body governed by public law', this means that it would not be obliged to follow European Union procurement regulations, therefore the Company would act on the same basis as its competitors, although it could opt to follow these if, on a scheme-by-scheme basis, this was considered beneficial
- a company vehicle can potentially extend its operations to wider trading functions related to housing development, subject to Shareholder approval. For example, the Company could develop commercial buildings where this makes a commercial return and is integral on any particular site and supports the Company's primary purpose of providing housing
- a company structure affords flexibility for the future in that it would allow other district authorities or public bodies operating in Suffolk and beyond to be admitted as Shareholders in the proposed Company.

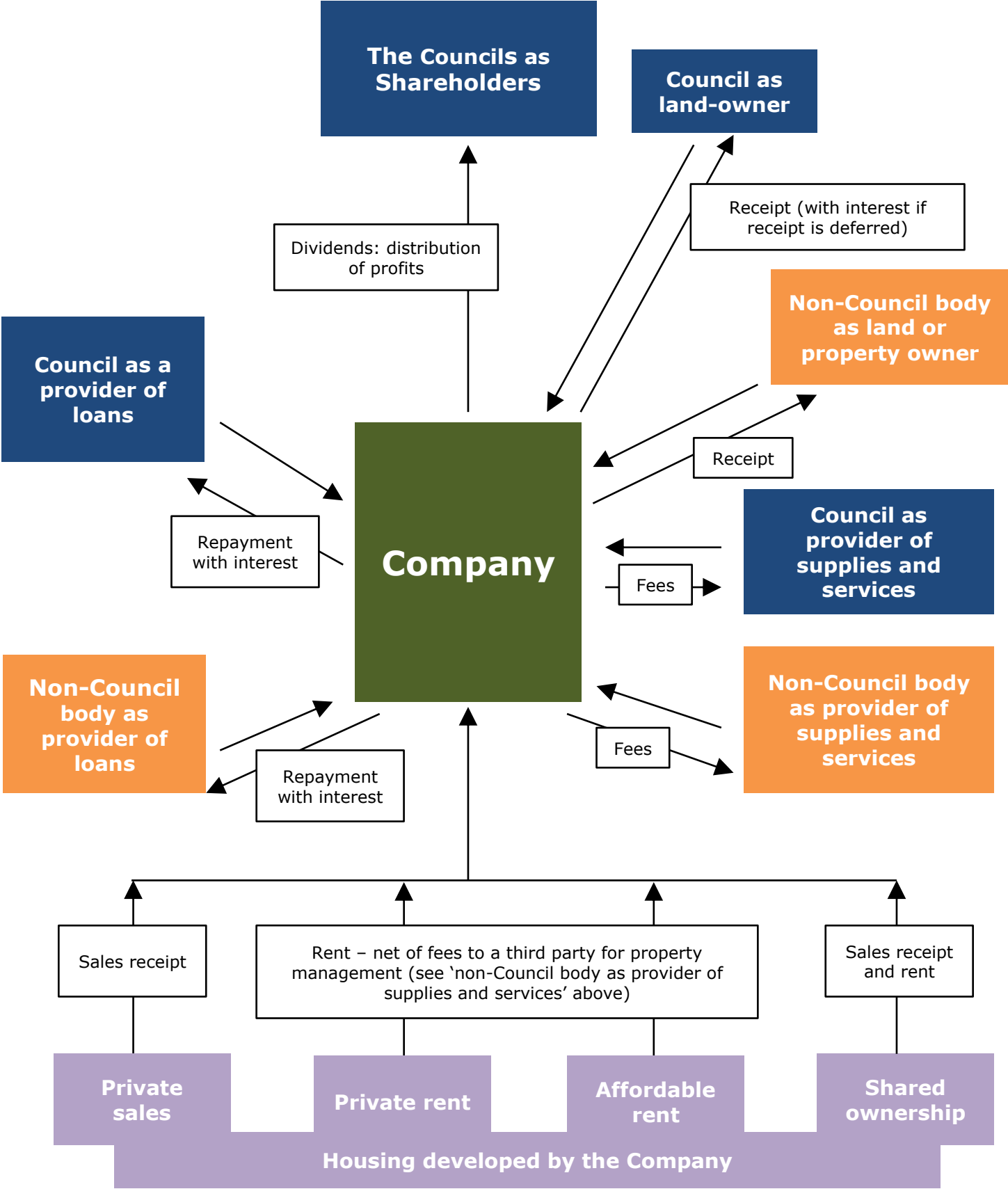
The financial benefits to the Councils of establishing a Housing Development Company

2.6 There are a series of ways in which the Councils will be able to generate financial income through a wholly-owned company. Notably:

- **receipts from land sold by the Councils to the Company.** Land would be sold at market value, in line with State Aid regulations. For modelling purposes, the assumption made is that the land-owning Council would derive a receipt plus an 'interest' payment in respect of the time between disposal of the land to the Company and actual payment for the land, this would typically be once properties have been sold and/or sufficient rental income generated. However, as noted in the main body, decisions about loans will be made at a later date and the Councils will need to consider suitable structures, taking account of factors such as loan policy compliance and risk appetite regarding loan security, as well as ensuring compliance with state aid rules
- **interest on loans to the Company.** The Councils have the power to make loans; commercial rates would need to be applied to be compliant with State Aid regulations. This could attract a margin over the Councils' own cost of (internal) borrowing
- **distributions of profit made by the Company through dividends.** The Company will derive an income from (a) ground rents, (b) rental income, net of management and maintenance costs, and/or (c) sales and uplift in the capital value of its assets, net of any overage agreements in place. These profits, net of tax, would be distributed to the Shareholders (the Councils)
- **purchase of services from any of the Councils.** The Company may wish to purchase services such as housing development expertise, legal, HR or IT support from any of the Councils at a market rate. At this stage the assumption has been made that the Councils will be able to support these services from within existing staff resources.

2.7 Diagram 1 below shows the possible financial flows between the Company and the Councils. In addition, it shows the Company's potential interactions with other organisations. Other non-Council bodies would include the contractors building the properties and any owners of private land or properties which the Company acquires. This could also include other sources of loan funding available in the future.

Diagram 1: Financial flows between the Company and its creditors and suppliers (Council and non-Council) and the housing developed



3. Legal Considerations and Governance of the Company

Legal context

- 3.1 Trowers and Hamlins lawyers have provided detailed advice on the legal aspects of establishing a Housing Development Company. The information in this section of the report has been taken from the advice they have provided.
- 3.2 Section 1 of the Localism Act 2011 provides local authorities with the power to do anything an individual may do, subject to a number of limitations. This is referred to as the general power of competence. A local authority may exercise the general power of competence for a commercial purpose.
- 3.3 Section 95 of the Local Government Act 2003 is also of relevance. The associated regulations, Regulation 2 of the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009, require a business case to be prepared and approved by the Council before a company starts trading. This report constitutes that business case for the Housing Development Company.
- 3.3 Section 4 of the Localism Act 2011 requires that where a local authority exercises the general power of competence for a commercial purpose it **must** do this through a company. The form of company recommended by Trowers and Hamlins is a company limited by shares. It is Trowers and Hamlins' view that the Councils can rely upon the general power of competence to form the Housing Development Company for the purpose of that company operating a business to sell and let homes at market rates.
- 3.4 In order to gain planning permission for development of private sector housing on sites of more than 10 homes, the Company will need to have regard to Forest Heath District Council's and St Edmundsbury Borough Council's Planning Policies, in particular the requirement to provide 30% of the homes as affordable housing.

Form of company

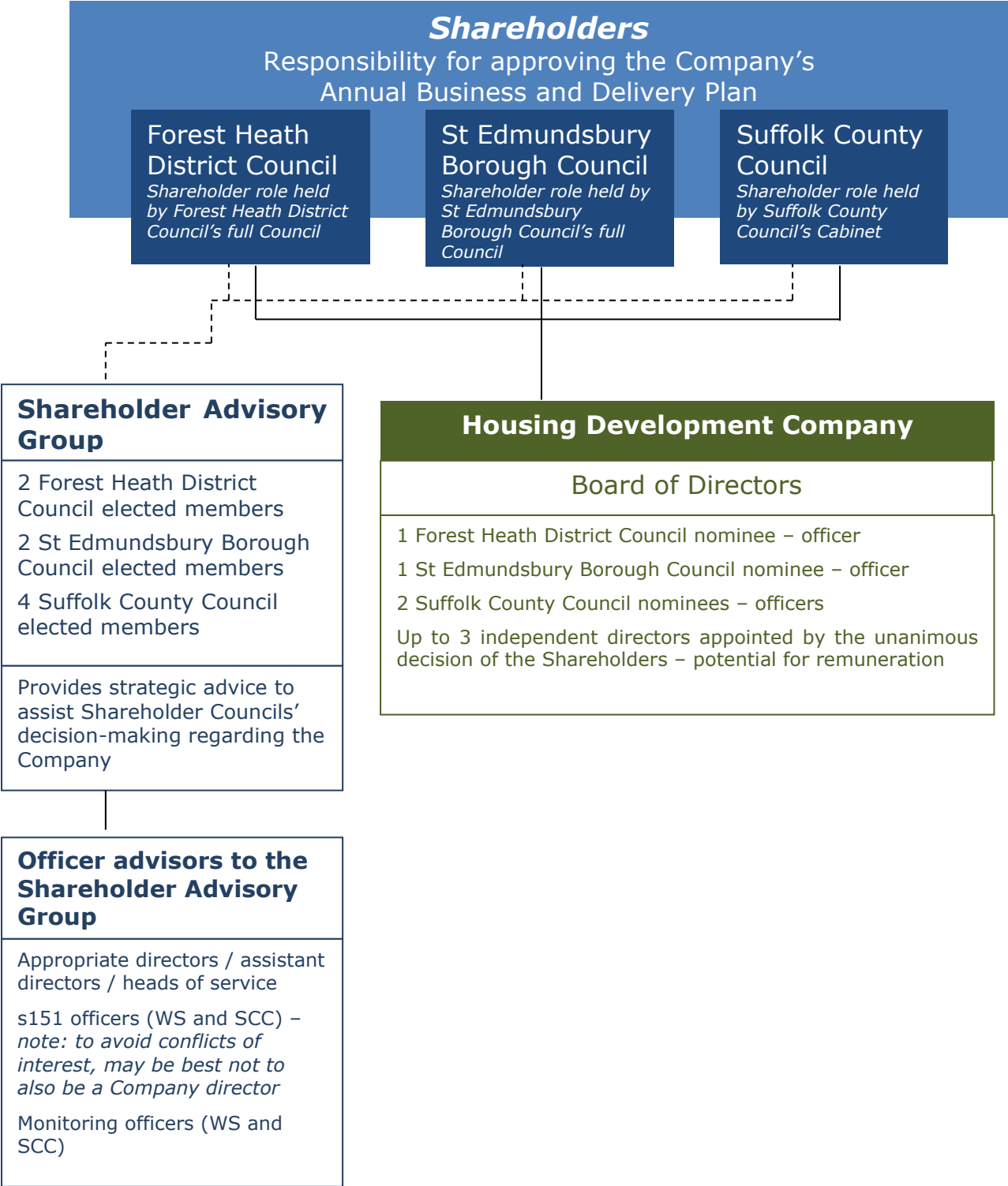
- 3.5 As noted above, the legal advice provided by Trowers and Hamlins is that the Company should be a company limited by shares. This form of company complies with the ability to trade provisions set out within the Localism Act 2011. Forest Heath District Council, St Edmundsbury Borough Council and Suffolk County Council will between them own the entire share capital. There are certain requirements that will apply to the Company, some of which are statutory such as the obligation to file annual returns and accounts, while others the Councils will be able to determine themselves, including the governance arrangements.
- 3.6 The proposed governance structure detailed below is viable from both a regulatory and constitutional perspective.

Governance structure

- 3.7 The proposed governance structure for the Company is set out in Diagram 2 below. There are three key components of this structure:

- the three Councils, each being a Shareholder – see paragraphs 3.8 – 3.9 below for a fuller discussion of this role
- the Shareholder Advisory Group – an elected member only group which exercises scrutiny of the Company’s reports and performance, provides strategic guidance and advises the Councils when exercising their rights and responsibilities as Shareholders – see paragraphs 3.10 – 3.23 for more details
- the Company’s Board of Directors – the body which manages the affairs of the Company on a day-to-day basis. The Board will have a majority of directors nominated by the individual Shareholder Councils. All nominees will be officers. In addition, there is provision for up to three additional directors unanimously approved by the Shareholders – see paragraphs 3.24 – 3.28 for more details.

Diagram 2: Proposed Governance Structure for the Housing Development Company



The Councils' Shareholder Role

- 3.8 Forest Heath District Council's full Council, St Edmundsbury Borough Council's full Council and Suffolk County Council's Cabinet will each hold a Shareholder role.
- 3.9 Acting in their Shareholder roles, these bodies will be charged with protecting the Councils' interests as owners of the Company. Most notably, each body will be required to consider and approve the Company's Business and Delivery Plan each year.

The Shareholder Advisory Group

- 3.10 To ensure Shareholder oversight of the Company, it is considered appropriate to establish a smaller body of elected members to more regularly consider matters relating to the Company. To this end, it is proposed to establish a Shareholder Advisory Group consisting of elected members from the three Councils. Such groups, albeit with slightly different names and roles, have been established by a number of authorities that have set up housing development companies, including Thurrock Council where the first site is now in development. In addition, Suffolk County Council has developed a similar governance approach regarding their wholly-owned companies.
- 3.11 The detailed arrangements concerning the operation of the Shareholder Advisory Group will be enshrined in the Shareholders Agreement.
- 3.12 It is proposed that elected members join the Shareholder Advisory Group rather than the Board of Directors so as to minimise members' exposure to conflict of interest situations which can carry significant penalties under the law.
- 3.13 Members may feel the requirements of directors under the Companies Act 2006 conflict with their roles as elected members and representatives of their communities.
- 3.14 Members taking up a directorship would be required to abide by the seven duties of directors codified in the Companies Act 2006. Directors failing to observe these duties are open to prosecution and there are cases of directors being fined and/or stripped on their ability to be a company director in the future. These duties include directors personally exercising reasonable care and diligence over the Company's dealings, confining themselves to what the Company was set up to do, not fettering their decision-making, and, where there is one, declaring an interest in a proposed transaction with the Company.
- 3.15 The Shareholder Advisory Group would consist of elected members only, in the following proportions:
- Forest Heath District Council – two members
 - St Edmundsbury Borough Council – two members
 - Suffolk County Council – four members.
- 3.16 The members from Forest Heath District Council and St Edmundsbury Borough Council would be selected by the Leader of each Council respectively acting in consultation with West Suffolk's Lead Member for Housing.

- 3.17 The roles of the Shareholder Advisory Group would be as follows:
- advise on the overall strategic direction of the Company
 - receive and scrutinise reports on the performance of the Company on a regular basis, including meeting directors of the Company
 - consider, comment on and suggest content for and amendments to the draft Annual Business and Delivery Plan produced by the Company
 - consider how the Company could further the priorities of the Shareholder Councils, while not at any time undermining the Company's primary commercial focus.
- 3.18 The Shareholder Advisory Group would be provided with financial and technical assistance from senior officers of the Shareholder Councils to assess the Company's performance against its business plan as well as its general commercial operations. It is anticipated that the officers providing advice would include each Council's section 151 officer and monitoring officer so long as these officers were not themselves directors of the Company.
- 3.19 It is proposed that the Shareholder Advisory Group would appoint a Chair and Vice-Chair. The Chair and Vice-Chair posts would always be held by members from different authorities, that is, Suffolk County Council and Forest Heath District Council *or* Suffolk County Council and St Edmundsbury Borough Council.
- 3.20 In addition, there would be an open invitation for members of the Shareholder Advisory Group to attend the Company's Annual General Meeting to directly put forward and represent the Shareholders' views and priorities.
- 3.21 It is anticipated that the Shareholder Advisory Group will meet between two and four times a year.
- 3.22 Integral to the remit of the Shareholder Advisory Group is the detailed consideration of the Company's draft Annual Business and Delivery Plan each year. The Shareholder Advisory Group will discuss its contents with representatives of the Company and seek to satisfy itself of its viability and robustness. As noted above, the elected members on the Group will be assisted in this by senior officers from the Councils. The Shareholder Advisory Group will be in a position to recommend, or otherwise, approval of Annual Business and Delivery Plan by Forest Heath District Council's full Council, St Edmundsbury Borough Council's full Council and Suffolk County Council's Cabinet when these bodies are carrying out their role as Shareholder of the Company. Any recommendations require majority support *and* the support of both the Chair and Vice-Chair. It is envisaged that the Chair would have a casting vote should there be a 50/50 split of votes, but the support of both the Chair and Vice-Chair would still be required, however the implications of this approach are still being considered as part of the drafting of the Memorandum and Articles of Association and shareholders' agreement. A quorum would be achieved by the presence of four members, including the Chair *and* Vice-Chair.
- 3.23 The Shareholder Advisory Group would not be a formal committee of any of the Shareholder Councils as defined in the Local Government Act 1972. As such, there would be no requirement for agendas, papers and minutes to be

published, nor for the meetings to be open to the public. The Shareholder Advisory Group would not be included within the Constitution of any of the Shareholder Councils.

The Board of Directors

3.24 The Company's Board of Directors would consist of:

- one nomination by Forest Heath District Council. This nomination would be a senior officer of West Suffolk Councils
- one nomination by St Edmundsbury's Borough Council. This nomination would be a senior officer of West Suffolk Councils
- two nominations by Suffolk County Council. These nominations would be senior officers
- up to three additional directors unanimously approved by the three Shareholder Councils. These may either be 'independent' individuals selected for the relevant expertise and experience in relation to housing development, or other officers.

3.25 The Company would have the discretion to pay any director who does not already receive a salary from one of the Shareholder Councils. The Councils would, however, be able to charge the Company for costs covering the time the officers nominated as directors spend on Company business.

3.26 The Councils as the Shareholders will retain the right under the Company's Articles of Association to appoint and dismiss the Company's Directors.

3.27 The Directors will 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. Directors would act in line with the Memorandum and Articles of Association and the Shareholder Agreement, with their roles including:

- drawing up the Company's annual business plan for onward submission to the Councils, acting as Shareholders, to consider and approve
- setting budgets, policies and plans and monitoring performance of the Company, and setting a framework for internal controls
- ensuring compliance with the Company's objects, purposes and values
- ensuring the financial strength, solvency and good performance of the Company
- ensuring the Company complies with all relevant regulation and laws
- dealing with the appointment and appraisal of staff, should any be directly employed by the Company
- procuring services necessary for the execution of the Company's objectives.

3.28 The very light overall structure of the Company reflects the fact that day-to-day operations are envisaged to be provided by staff within the Councils through a

Service Level Agreement for which the Company would pay or via third party agency or consultancy arrangements until such time that the Company is of sufficient size that it may be more practical and tax efficient to employ staff directly. Any staffing implications would need to be considered at that point in time.

Does the Councils' interest in the Company compromise its commercial character?

- 3.29 As made clear when discussing the Company's objectives above, the Housing Development Company's primary purpose is to act as a commercial entity and make a financial return from developing housing for sale or private rent. A necessary consequence of such activity undertaken by any private house-builder, and indeed a beneficial one from the Councils' perspective, is that affordable housing is also provided. Councils acting as planning authorities and promoters of the well-being of local communities and the local economy require private companies to provide affordable homes in line with local needs, as reflected in their planning policies. Requiring the Company to adhere to local planning policies does not compromise the Company's commercial aims. Indeed, it is an everyday occurrence for successful private house-builders to fund planning contributions and affordable housing requirements within their business plans.
- 3.30 The Councils have a number of ways in which they can legitimately guide the activity of the Company, including:
- as a Shareholder – appointing and removing directors, signing off the Company's annual business plan, and signing off any changes to the Company's Memorandum and Articles of Association
 - as a land owner – making available land to the Company, and deciding whether or not to dispose of particular sites to the Company. Note: disposal must be at market value so as not to contravene State Aid regulations and to satisfy the Councils' Local Government Act 1972 Section 123 duty to obtain the best consideration that can be reasonably obtained
 - as a funder – deciding whether or not to make loans to the Company. It is considered that it would be difficult for the newly formed Company to secure affordable loans by any other means. Note: loans must be at commercial rates so as not to contravene State Aid regulations
 - as a strategic housing authority – as when working with any housing developer, directing the required affordable housing mix and/or the need for specialist housing on sites in line with the relevant planning policies
 - as a planning authority – as with any housing developer, assessing whether a particular proposal by the Company meets planning requirements.

The Councils as Funders

- 3.31 The primary task when acting as a Funder will be to assess the Company's viability as an entity and the viability of each project for which loan funding is being sought. Consideration of a number of factors will be taken into account

to determine whether to release loan funding to the Company such as the value of assets available to be used as security, state aid compliant equity versus debt ratios for the Company, policy compliance and acceptable level of risk exposure for the Shareholders.

- 3.32 The Funder Role also incorporates regularly monitoring and analysing financial information generated by the Company during the lifetime of each loan to ensure that the Company is not in breach of key financial requirements which would be stipulated as funding conditions for each loan.
- 3.33 The key areas the Councils in their Funder Role will want to be satisfied with prior to providing funding for a development are likely to include:
- that the financial modelling demonstrates that the loan will be repaid
 - that any loans accord with the Councils' approved loan policies, notably with regard to security considerations
 - there is confidence that the projected rental stream can be maintained
 - that base level sensitivities, which would in turn trigger warning signals, for the Company's general performance and the performance of each proposed development are properly set and that a sufficient margin is added to the base level to provide reassurance
 - that the loan is State Aid compliant.

Procurement

- 3.34 As discussed above, the Company as set up would be unlikely to face a challenge that it is a body governed by public law and so would not need to follow public procurement rules. The Company's Board, however, acting like any other entity, would need to determine its own procurement policy in accordance with best practice and relevant legislation. The Articles of Association and Shareholder Agreement will oblige the Company to establish and follow its own set of financial regulations and standing orders which demonstrate best value.

4. Name of the Company

- 4.1 The name of the Company is an important issue. To stress its commercial aims and remit across West Suffolk and beyond it is considered beneficial to select a name that is not immediately linked to any one or other of the Shareholder Councils. It is proposed to delegate the selection of an appropriate name to the Head of Housing acting in consultation with the Service Manager (Corporate Communications), West Suffolk's Lead Member for Housing and Suffolk County Council's Director of Resources.

5. Financial Case

Financial viability of site development – financial appraisal by GVA Consulting

- 5.1 The financial viability of market-led housing development by a wholly-owned company as detailed in this report has been modelled and tested by GVA Consulting, a leading financial consultancy with expertise in this field.

5.2 The Councils provided GVA with four exemplar sites across Forest Heath and St Edmundsbury and in different Councils' ownerships. GVA conducted a detailed financial appraisal of these four exemplar sites – see Appendix B for GVA's full report. Appendix B is exempt from consideration in public as it contains valuation details for sites in the Shareholder Councils' ownership, publication of which could fetter the achievement of best value.

5.3 In outline terms, the financial operating model is as follows:

Funding the purchase of land and the building the homes

- the Company builds homes of all tenures on land it purchases from Forest Heath District Council, St Edmundsbury Borough Council and/or Suffolk County Council and also, if viable, purchases can be made on the open market
- the Company has no assets or financial resources with which to buy the land at the beginning of the development, so the land-owning Council agrees to defer the need for the Company to pay a receipt for the land, but in return, the Council charges interest for the period of the deferment
- furthermore, the Company has no financial resources to pay for the construction of the homes, and so the Councils lend the Company money. The Council charges an interest rate commensurate with market rates. This is higher than the Councils' (internal) rate of borrowing or the interest it earns on reserves, and so this represents an income to the Councils

Paying for the land and repaying loans

- a large proportion of the homes built will be sold on the open market or through shared ownership arrangements. The Company will use the income from sales to pay for the land and repay the loans for the construction of these homes
- there will be a profit made as the sales prices will exceed the cost of the land and construction of the homes sold. This will be available as a dividend payment to the Shareholders (the Councils) and/or could be used to cross-subsidy the construction of the rental homes – see below

Paying for retained rental properties

- the cost of the land and construction of the properties that the Company retains and rents out will be met from two possible sources – (a) as noted above, the profit on the homes that are sold and (b) a loan taken out against the value of the retained properties, essentially a mortgage that is paid off over thirty years

Making a profit

- the Company makes a profit on each home sold and uses this to make a dividend payment and/or cross-subsidise the construction of the rental homes. The profit is, of course, net of paying the Councils for the land,

repaying the loans made by the Councils and paying the interest on the deferred land receipts and loans

- the Company’s ongoing profit is the difference between the rent it receives, net of the cost of managing and maintaining the homes, and the principal and interest repayment of the mortgage on those homes. The profits net of any Company running costs and tax payable are available as dividends to the shareholding Councils – Forest Heath District Council, St Edmundsbury Borough Council and Suffolk County Council
- in the future, some or all of the rental properties could be sold with the values achieved, net of repayment of any mortgage still attached to those homes, available as dividends to the shareholding Councils.

5.4 In summary – see the tenure mix in Table 2 and financial analysis in Table 3 below – GVA’s analysis indicates that all four exemplar development sites are able to support financially viable schemes, that is, each scheme:

- provides a market value receipt to the land-owning Council
- achieves sufficient income from sales to pay for the land, on a deferred basis, and the repayment of the cash loan to fund the development, along with interest in respect of the deferred payment and loan, by year four of the scheme
- supports 30% affordable housing provision in line with the Forest Heath District Council’s and St Edmundsbury Borough Council’s planning policies
- with a secured loan provided on a 30 year term, essentially a mortgage covering the retained private rent and affordable rent homes, provides a steady revenue income
- retains a portfolio of rented properties which can be sold on at a later date to achieve a capital receipt.

Table 2: Tenure mix modelled for the four exemplar sites	
Tenure	Total homes across the four exemplar sites
Homes for sale	84
Private rented homes	46
Affordable homes	56
TOTAL	186

Table 3: Financial analysis based on development of the four exemplar sites		
	West Suffolk £'000s	Suffolk County £'000s
Capital receipts from land	4,843	4,876
Interest on deferred capital receipts and loans to the Company	1,565	1,670
Profit on 84 house sales	1,011	1,011
Annual rental income from 102 properties – average of years 6 to 10 (net of corporation tax)*	147	147
<i>Funded by repayable loans by the Councils</i>	<i>11,316</i>	<i>11,283</i>

* Rental properties will increase in value over time. If all/some are sold, this would generate a capital receipt that would be returned to the Councils as shareholders

- 5.5 The modelling by GVA is based on a series of assumptions. GVA's full report is attached at Appendix B; see paragraph 2.5 of the Appendix B for full details of the assumptions used. The table in Appendix C provides a summary of the anticipated profit and loss for the Housing Development Company across the four sites modelled for the first 10 years. Appendix C is exempt from consideration in public as it contains commercially sensitive financial information.
- 5.6 In the early years the Company will run at a loss, with outgoings covering interest payable and construction costs. Upon completion of the sites the properties for private sale will be sold on the open market, causing a spike in profits before the Company moves to making a steady profit from the retained rental portfolio, private rented and affordable. This rental profit will be derived from ground rents and rental income, net of management, maintenance and borrowing costs.
- 5.7 These profits, net of tax, would be available to be distributed to the Shareholders – Forest Heath District Council, St Edmundsbury Borough Council and Suffolk County Council. Tax advice was not included within the scope of GVA's work, so for the purposes of the modelling a 20% corporation tax rate has been used, with no adjustment for allowable (including capital allowances) and non-allowable expenses. See Appendix C for estimated profit and loss figures.
- 5.9 Appendix B provides the Housing Development Company financial model in detail across 40 years. At year 15 (after the scheme development phase) the financial modelling assumes the sale of all private rented properties. As a result

the profits of the Housing Development Company show a further spike around the 15th year post completion followed by a reduction in profits in future years as the net rental income from those private rented properties are no longer generated for the Company. The affordable housing element of the portfolio has been modelled to be retained by the Company for 40 years and then the model assumes their disposal, hence the further spike in profits in the last two years of the model; the net rental income then ceases.

The Financial model - capital and revenue flows to and from the Housing Development Company

5.10 The current financial modelling performed by GVA has the following medium to longer term capital and revenue financial implications for the Shareholders.

Capital

5.11 The Shareholders are assumed to be the main funders (see funder's role at paragraphs 3.31 – 3.33) to the Housing Development Company and as such Table 4 below includes the likely loan cash flows to the Company and their repayment profile.

Table 4: Capital Financial Implications based on the four exemplar sites

Council - Capital Financial implications **(Cashflow basis)**

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
	£000's	£000's	£000's	£000's	£000's	£000's	£000's	£000's	£000's	£000's
	16/17	17/18	18/19	19/20	20/21	21/22	22/23	23/24	24/25	25/26
<u>By inflows/(outflows) category</u>										
Capital Receipt from Land (unsecured)	0	0	0	6,370	0	3,349	0	0	0	0
Cash Loan to Company (unsecured)	(826)	(2,472)	(3,784)	(1,647)	(991)	0	0	0	0	0
Cash Loan Repayment (unsecured)	0	0	1,301	5,071	1,146	2,202	0	0	0	0
Cash Loan to Company (secured)	0	(400)	(443)	(626)	0	0	0	0	0	0
Cash Loan Repayment (secured)	0	0	656	814	0	0	0	0	0	0
Long Term Loan to Company (secured)				(7,599)	0	(3,308)	0	0	0	0
Long Term Loan Repayment (secured)				160	165	239	246	254	261	269
Total	(826)	(2,872)	(2,270)	2,542	320	2,482	246	254	261	269

West Suffolk Councils

Capital Receipt from Land (unsecured)	0	0	0	2,716	0	2,127	0	0	0	0
Cash Loan to Company (unsecured)	(826)	(1,998)	(1,089)	(601)	(362)	0	0	0	0	0
Cash Loan Repayment (unsecured)	0	0	1,301	2,353	418	804	0	0	0	0
Cash Loan to Company (secured)	0	(200)	(222)	(313)	0	0	0	0	0	0
Cash Loan Repayment (secured)	0	0	328	407	0	0	0	0	0	0
Long Term Loan to Company (secured)				(3,799)	0	(1,654)	0	0	0	0
Long Term Loan Repayment (secured)				80	82	119	123	127	131	134
Total	(826)	(2,198)	318	842	139	1,396	123	127	131	134

Suffolk County Council

Capital Receipt from Land (unsecured)	0	0	0	3,654	0	1,222	0	0	0	0
Cash Loan to Company (unsecured)	0	(474)	(2,695)	(1,046)	(629)	0	0	0	0	0
Cash Loan Repayment (unsecured)	0	0	0	2,718	728	1,398	0	0	0	0
Cash Loan to Company (secured)	0	(200)	(222)	(313)	0	0	0	0	0	0
Cash Loan Repayment (secured)	0	0	328	407	0	0	0	0	0	0
Long Term Loan to Company (secured)				(3,799)	0	(1,654)	0	0	0	0
Long Term Loan Repayment (secured)				80	82	119	123	127	131	134
Total	0	(674)	(2,589)	1,700	181	1,086	123	127	131	134

5.12 It should be noted that the Forest Heath Medium Term Financial Strategy includes a provisional capital allocation of £3 million for support delivery of the Housing Strategy, primarily through the Housing Development Company, and

the St Edmundsbury Medium Term Financial Strategy includes a capital provision of £2.4m for this purpose. (This is net of other commitments in St Edmundsbury, notably purchasing property to ease bed and breakfast liabilities relating to assisting homeless people.) The total value, its profile and its revenue return will be established through the development of the Company's Business and Delivery Plan which will be presented to the Council early in 2016.

Land

5.13 The land-owning council would receive a receipt for the land transferred to the Company. The land has been assumed to be sold to the Housing Development Company at market value. Payment for the land would be deferred and so its value would be converted into an unsecured short term loan and will accrue a 10% rate of return up until the loan is repaid by the Housing Company. This loan agreement repayment is assumed to take place following the sales programme at around year 3-4 of each scheme.

Loan(s) – short term

5.14 In order to equalise the position of Shareholders, it is assumed that the non land-owning council will make a cash loan, for the same sum as the land value, as an unsecured short term loan agreement. This unsecured loan will accrue a 10% rate of return up until the loan is repaid by the Housing Development Company. This loan repayment is assumed to take place following the sales programme at around year 3-4 of each scheme.

5.15 Where additional funds are required for the development phase, over and above those provided through the above cash loans, these are assumed to be available from the Shareholders on an equal basis (West Suffolk Councils 50% and Suffolk County Council 50%) as secured loans. These will accrue a 6% rate of return up until the loan is repaid by the Housing Development Company. Again these loan repayments are assumed to take place following the sales programme at around year 3-4 of each scheme.

Loan(s) – long term

5.16 The model currently assumes that following the sales programme and at the point of repayment of all the loans referred to above, a long-term loan will be entered into by the Housing Development Company for the retained portfolio so refinancing will take place. Again it is assumed that the Shareholders will provide that long term (30 year) loan (although as the loan could be secured against the retained properties the Company may be able to access alternative funding). Interest will be payable at a rate of approximately 3% on a secured basis. Further consideration will be required by the Housing Development Company on the loan security value of the retained properties against the loan value required – for the purposes of the model the security value is assumed to be sufficient across the private rented and affordable housing portfolios.

Working capital loan(s)

5.18 It is likely that provision is required for working capital balances for the Housing Company and as the Shareholders are assumed to be the main funders, it is assumed that a working capital loan facility will be made available by the

Shareholders. This working capital will take the form of an unsecured loan agreement and will accrue a 10% rate of return. It is proposed that a facility of £500,000 is provided to enable the Housing Development Company to start transacting.

- 5.19 As it is unknown what working capital is required and that it would be a loan facility that can be called upon when required, the revenue table below excludes the interest receivable. Initial modelling suggests around £150,000 costs in the first year in advance of requiring the monies for payment of construction contractors – see Appendix D for further details.

Summary of Loans

- 5.20 Table 5 summarises the total loan facilities between the Shareholders and the Housing Company modelled across the four sites. The value between secured and unsecured loans will need to be considered by the Housing Company and the Shareholders prior to entering into loan agreements. The modelling is for illustrative purposes only at this stage as a number of factors will need to be taken into account when agreeing the unsecured and secured ratio. Considering such factors as the value of assets available to be used as security, state aid compliant equity versus debt ratios for the Company, and policy compliance and acceptable level of risk exposure for the Shareholders.

Table 5: Summary of Loans based on the four exemplar sites

Loan type - for modelling purposes only	West Suffolk Councils	Suffolk County Council
Land - short term loan (unsecured)	4,843	4,876
Loan(s) - short term (unsecured)	4,877	4,844
Loan(s) - short term (secured)	735	735
Loan(s)- long term (secured)	5,454	5,454
Working capital loan(s) (unsecured)	250	250
Total potential loan values	16,159	16,159

- 5.21 Table 5 represents the total value of loans that could be required over the life of the Housing Development Company based on the four sites modelled, however the cash flows of these loans means that the Shareholders would not be exposed to this total value at any one moment in time. It is envisaged that the short term loans will be repaid prior to any long-term loans being negotiated.

Revenue

- 5.22 Table 6 below details the impact on the Council’s revenue budgets for the next 10 years.

Table 6: Revenue Financial Implications based on the four exemplar sites

<u>Council - Revenue Financial implications</u>	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
	£000's	£000's	£000's	£000's	£000's	£000's	£000's	£000's	£000's	£000's
	16/17	17/18	18/19	19/20	20/21	21/22	22/23	23/24	24/25	25/26
By income category										
Land Interest Repayment	151	400	719	717	371	158				
Cash Loan interest margin (unsecured)	16	97	215	188	154	34				
Cash Loan interest margin (secured)		1	11	4						
Long Term Loan interest margin (secured) *										
Dividend ...										
Total	167	498	945	909	525	192	0	0	0	0
West Suffolk Councils										
Land Interest Repayment		88	297	441	236	100				
Cash Loan interest margin (unsecured)	16	89	147	74	56	12				
Cash Loan interest margin (secured)			6	2						
Long Term Loan interest margin (secured) *										
Dividend ...										
Total	16	176	451	517	292	113	0	0	0	0
Suffolk County Council										
Land Interest Repayment	151	312	422	276	135	58				
Cash Loan interest margin (unsecured)		8	68	114	98	22				
Cash Loan interest margin (secured)			5	2						
Long Term Loan interest margin (secured) *										
Dividend ...										
Total	151	321	494	392	233	79	0	0	0	0

* see para 5.26 ** see para 5.30

Land – interest on cash loan

5.23 The land-owning council would receive a receipt for the land transferred to the Company. This receipt value will be recorded as an unsecured short term loan and will accrue interest at 10% (unsecured rate) up until repayment takes place.

Loan(s) – interest margin

5.24 All short term cash loans will accrue interest of either 10% for unsecured or 6% for secured loans.

5.25 In line with the Medium Term Financial Strategy and investment framework all business cases are being considered on the basis of prudential borrowing and therefore only a 7% (unsecured) or 3% (secured) interest margin has been factored into the revenue modelling below, that is the 10% and 6% rates paid by the Company net of an estimated 3% cost to the Councils to borrow the money which is on-lent.

5.26 For the purpose of modelling no interest margin has been assumed on the long term loan. An assessment would need to be made as to whether a margin would be available given the commercial rate for a 30 year loan against the Council's rate of internal borrowing.

5.27 The assumption is that a minimum revenue provision for all loans will not be required however, this assumption is still being considered and to be agreed with external auditors.

Working capital loan(s) – interest margin

- 5.28 Any short term working capital cash loans will accrue interest of 10% for unsecured loans.
- 5.29 As it is unknown what level of working capital is required and given that the allowance is for a 'loan facility' that can be called upon when required, Table 5 excludes the interest margin the Council would receive.

Dividend

- 5.30 The Housing Development Company's profits, net of tax, would be available to be distributed to the Shareholders and this would be revenue income for the Shareholders (the Councils). There is an expectation that the Shareholders will receive dividends annually, however the amount and timing (when these come to fruition) will need to be set out as part of the annual business planning process and confirmed annually in the Annual Business and Delivery Plan and as part of the Annual General Meeting of the Company.

Purchase of services from any of the Councils

- 5.31 The Company may wish purchase services such as housing development expertise, legal, HR or IT support from any of the Councils at a market rate. At this stage the assumption has been made that the Councils will be able to support these services, however this will need to be considered on a case-by-case basis. The revenue modelling current excludes any income with regards to these services.

Sensitivity testing by GVA Consulting

- 5.32 GVA were asked to model the impact of negative movement on a number of key assumptions within the model. In summary, the sensitivity testing indicates that the four exemplar schemes would all remain viable with positive, albeit reduced, profits available for distribution as dividends to Shareholders even if:
- building cost inflation rose to and remained at 5.5% a year for the duration of the build phase, *and*
 - house price inflation dropped to just 1% a year for the duration of the build and sale period, *and*
 - rental inflation was only 1.5% for each of the 15 years the private rented portfolio is modelled to be held and for each of the 40 years that the affordable rented portfolio is modelled to be held, *and*
 - 5% of private and affordable rented properties were standing empty throughout the 15 years of the private rented properties are modelled to be held, and for the full 40 years the affordable rented portfolio would be held, *and*
 - land receipts were at a lower, yet still market, value than in the base case.
- 5.33 Although negatively impacted, in all cases profits are still available. It is also important to note that as development schemes will be brought forward on a

site-by-site basis, they will always be subject to a detailed financial appraisal based on current market conditions, inflation rates and the like. Should at this point the return not being considered viable, or felt to be too low in relation to the risk involved, the Shareholder Councils will be under no obligation to proceed. In this way, the Shareholder Councils can make pragmatic decisions regarding the level of risk involved.

Detailed financial appraisals on a scheme-by-scheme basis

- 5.34 In order to maximise Shareholder oversight of site development by the Company, detailed financial appraisals will be carried out by Company on a scheme-by-scheme basis. This analysis will be formally presented to Shareholders each year in the Annual Business and Delivery Plan. Only once Shareholders have satisfied themselves of the robustness of the appraisal will they approve the Annual Business and Delivery Plan.
- 5.35 The Shareholder Agreement requires the Company to provide the draft Annual Business and Delivery Plan to Shareholders in October each year. This affords the Shareholder Councils sufficient time to scrutinise the proposals, seek any clarifications and/or amendments and factor in the capital and revenue implications to each of the Councils' coming year's capital programme and revenue budget, as well as incorporating the longer term implications in each Councils' Medium Term Financial Strategy.
- 5.36 Throughout the year, the Shareholder Advisory Group will receive regular reports from the Company on its performance against the Annual Business and Delivery Plan and it is expected that the Company will discuss any potential new schemes with the Shareholder Advisory Group as they arise.
- 5.37 The Company will not be able to act outside of the financial caps and limits set in the approved Annual Business and Delivery Plan without Shareholder consent.

6. Operation of the Housing Company

- 6.1 The Company will primarily develop a portfolio of homes for market rent and sale, with a portfolio of affordable homes also developed to meet Forest Heath District Council's and St Edmundsbury Borough Council's planning requirements.
- 6.2 The Company will own the market and affordable rent homes. It is envisaged that both portfolios will be managed and maintained by third parties under contract, with the affordable homes in all probability managed by a housing association. Financial provisions for meeting these contract costs have been included GVA's financial modelling.
- 6.3 Both the private and affordable rented dwellings owned by the Company will be let on Assured Tenancies and will not be subject to the Right to Buy, or to the allocations provisions of Part VI of the Housing Act 1996, although the Company will have due regard to West Suffolk's Tenancy Strategy with regard to the affordable properties' rents, length of tenancies and means of allocation.

- 6.4 The Company would secure appropriate development expertise and would appropriately tender the construction and management of units. As noted above, the Company would not be required to follow European Union procurement regulations, although it could choose to. In order to maximise access to the necessary skills and expertise, and minimise costs, it is envisaged that the Company would employ, either directly or through an SLA with one of the Shareholder Councils, an employer's agent to oversee the drawing up of construction specifications, the lettings of contracts and the management of development. Financial provision for fees has been included in GVA's modelling and would be included in the detailed scheme appraisals carried out as sites come forward. In addition, the Company may choose to select technical consultants and construction contractors from established frameworks such as those held by the Homes and Communities Agency (HCA).
- 6.5 Officers have discussed the proposed way forward with the HCA which is very supportive of the approach to establishing and operating this housing development company.