

Extraordinary (Informal Joint) Cabinet



St Edmundsbury
BOROUGH COUNCIL

Title of Report:	Business Case to Establish a Housing Development Company	
Report No:	CAB/SE/15/070	
Report to and dates:	Extraordinary Cabinet	27 October 2015
	Extraordinary Council	17 November 2015
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Lead officer:	Simon Phelan Head of Housing Tel: 01638 719440 Email: simon.phelan@westsuffolk.gov.uk	
Purpose of report:	To present to Members the business case for establishing a commercial company limited by shares for the purpose of developing housing for sale and private rent, and affordable rent and low-cost home ownership in line with the Councils' existing planning policies. The company would be wholly-owned by Forest Heath District Council (25% of shares), St Edmundsbury Borough Council (25%) and Suffolk County Council (50%) and will provide a revenue income to all Councils.	
Recommendations:	It is <u>RECOMMENDED</u> that Cabinet approves: <ol style="list-style-type: none"> 1. The establishment of a Housing Development Company incorporated as a company limited by shares that will be jointly owned by Suffolk County Council (50% of shares), Forest Heath District Council (25% of shares) and St Edmundsbury Borough Council (25% of shares). 2. St Edmundsbury Borough Council's full Council assumes the role of Shareholder in St Edmundsbury. 	

3. A Shareholder Advisory Group be established with the purpose of advising each Council when exercising its role as Shareholder consisting of two elected members from Forest Heath District Council, two from St Edmundsbury Borough Council and four from Suffolk County Council, with advice provided by senior officers of all Councils. The identification of St Edmundsbury Borough Council's nominations to the Shareholder Advisory Group be delegated to the Leader of St Edmundsbury Borough Council acting in consultation with West Suffolk's Lead Member for Housing.
4. the composition of the Company's Board of Directors to be one director from Forest Heath District Council who shall be an officer of West Suffolk Council, one director from St Edmundsbury Borough Council who shall be an officer of West Suffolk and two directors from Suffolk County Council (anticipated to be officers of Suffolk County Council), with up to an additional three directors appointed by the unanimous decision of the Shareholders.
5. The recommendation of St Edmundsbury Borough Council's Overview and Scrutiny Committee held on 15 October 2015 that the criteria for selection of the three additional directors as specified in the fourth bullet of paragraph 3.24 in Appendix A be amended to read "*up to three additional directors unanimously approved by the three Shareholder Councils. These will be 'independent' individuals selected for their relevant expertise and experience*".
6. Authority to nominate St Edmundsbury's director be delegated to the Joint West Suffolk Chief Executive
7. That the approval of the Memorandum and Articles of Association be delegated to the Head of Housing and the Monitoring Officer acting in consultation with West Suffolk's Lead Member for Housing and Suffolk County Council's Director of Resources, who will act in consultation with Suffolk County Council's Cabinet Member for Finance.
8. Authority to negotiate and finalise the Shareholder Agreement be delegated to the Head of Housing and the Monitoring Officer, acting in consultation with the West Suffolk's Lead Member for Housing and Suffolk County Council's Director of Resources, who will act in consultation with Suffolk County Council's Cabinet Member for Finance.

	<ol style="list-style-type: none">9. That the naming of the Housing Development Company be delegated 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, who will act in consultation with Suffolk County Council's Cabinet Member for Finance.10. Authority to complete and submit the necessary documentation for incorporation be delegated to West Suffolk's Monitoring Officer acting in consultation with West Suffolk's Head of HR, Legal and Democratic Services and Head of Housing and officers from Suffolk County Council.11. That <i>in principle agreement</i> is given to the disposal of St Edmundsbury Borough Council's assets (land and/or buildings) to the Company at market rates.12. That <i>in principle agreement</i> is given to provide to the Company funding through state aid compliant loans in line with St Edmundsbury Borough Council's existing Loans Policy.13. A contribution of £125,000, funded from St Edmundsbury Borough Council's Strategic Priorities and Medium Term Financial Strategy reserve, to a total working capital loan of £500,000 subject to contributions from all Councils in the following proportions; Forest Heath District Council (25%), St Edmundsbury Borough Council (25%) and Suffolk County Council (50%).14. That authority to negotiate and approve any staffing or TUPE matters arising in the future in connection with the Company's operations be delegated to the Head of HR, Legal and Democratic Services acting in consultation with the Head of Finance and Resources (s151 officer) and appropriate Suffolk County Council officers.15. Once the Company's first Annual Business and Delivery Plan has been submitted to Shareholders (Forest Heath District Council, St Edmundsbury Borough Council and Suffolk County Council) and approved by the Shareholders (Forest Heath District Council's full Council, St Edmundsbury Borough Council's full Council and Suffolk County Council's Cabinet), the Company may start trading.
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	16. Cabinet notes the detailed financial modelling contained in the exempt Appendices B, C and D, and notes the financial viability of the exemplar sites appraised.
Key Decision: <i>(Check the appropriate box and delete all those that do not apply.)</i>	<i>Is this a Key Decision and, if so, under which definition?</i> Yes, it is a Key Decision - <input type="checkbox"/> No, it is not a Key Decision - <input checked="" type="checkbox"/> As it is a full Council decision and not a Cabinet decision.
<i>The decisions made as a result of this report will usually be published within 48 hours and cannot be actioned until five clear working days of the publication of the decision have elapsed. This item is included on the Decisions Plan.</i>	
Consultation:	<ul style="list-style-type: none"> • Homes and Communities Agency • Internal – Finance, Legal, HR • Suffolk County Council
Alternative option(s):	<p>The alternatives explored were:</p> <p>'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 limited financial resources and is in line with the Councils' commercial approach</p> <p>The Councils to build directly. REJECTED – local authorities do not have powers to directly undertake commercial activity but can do so through a company.</p> <p>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 reach a mutual agreement to dissolve the company, and revenue income would have to be shared.</p>
Implications:	
<i>Are there any financial implications? If yes, please give details</i>	Yes <input checked="" type="checkbox"/> No <input type="checkbox"/> Refer to: <ul style="list-style-type: none"> • Section 2 and • Appendix A, Section 5.
<i>Are there any staffing implications? If yes, please give details</i>	Yes <input type="checkbox"/> No <input checked="" type="checkbox"/> Refer to: <ul style="list-style-type: none"> • Section 3.
<i>Are there any ICT implications? If yes, please give details</i>	Yes <input type="checkbox"/> No <input checked="" type="checkbox"/> None arising from this report.

<i>Are there any legal and/or policy implications? If yes, please give details</i>		Yes <input checked="" type="checkbox"/> No <input type="checkbox"/> Refer to: <ul style="list-style-type: none"> • Section 5 and • Appendix A, Section 3. 	
<i>Are there any equality implications? If yes, please give details</i>		Yes <input checked="" type="checkbox"/> No <input type="checkbox"/> Refer to: <ul style="list-style-type: none"> • Section 6 and • Appendix E. 	
Risk/opportunity assessment:		<i>(potential hazards or opportunities affecting corporate, service or project objectives)</i>	
Risk area	Inherent level of risk (before controls)	Controls	Residual risk (after controls)
	Low/Medium/ High		Low/Medium/ High*
Business case insufficiently robust / not tested	Medium	Employment of specialist financial consultants Sensitivity analysis carried to test impact of negative movement on key assumptions Scrutiny of external modelling by Finance staff	Low
Insufficient expertise to ensure achievement of best value in property construction	Medium/High	Include within the business modelling of the costs of an Employer's Agent to oversee the development process Provision for recruiting Company directors with background in development Use of Homes and Communities Agency's framework agreements for technical consultants and construction	Low/Medium
Adverse movements in the housing market, such as property sales and/or rental price deflation, higher than anticipated building cost inflation leading, leaving the Company committed to unviable schemes	Medium	Consideration of viability on a site-by-site basis so that if a scheme is not modelled to be viable, commencement is delayed or cancelled With assistance of the Employer's Agent, keep up-to-date with building costs and the like	Low
Ward(s) affected:		Potentially all wards	
Background papers: <i>(all background papers are to be published on the website and a link included)</i>		None	

Documents attached:

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

Appendix B – **EXEMPT** GVA's Site Appraisal Report – September 2015

Appendix C – **EXEMPT** First ten years' estimated profit and loss for the Company based on the four exemplar schemes

Appendix D – **EXEMPT** Estimated Company expenditure in its first year

Appendix E – Equalities Impact Assessment

1. Strategic Case

- 1.1 St Edmundsbury Borough Council, like Forest Heath District Council, is facing significant reductions in government grant funding and so is 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 Council's land assets.
- 1.2 The rationale for exploring and proposing the setting up of a company was set out within the West Suffolk Housing Strategy 2015-18, see paragraphs 1.4 – 1.9 of Appendix A for further details.
- 1.3 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. Commercial and Financial Case

Financial Viability Modelling of Site Development by a Company

- 2.1 In order to establish the commercial and financial case, or not, for establishing a company, for the purpose of developing housing for sale and private rent, GVA Consulting were commissioned by the Councils (Forest Heath, St Edmundsbury and Suffolk County Council), to provide modelling for the viability of four exemplar sites identified as part of this project.
- 2.2 In summary, GVA's analysis indicates that all four exemplar development sites are able to support financially viable schemes. Sensitivity testing carried out by GVA further indicates that the four exemplar schemes would all remain viable with positive, albeit reduced, profits available for distribution as dividends to Shareholders even if build cost inflation rose above assumptions, house price inflation dropped to just 1% a year for the duration of the build and sale period, rental inflation fell considerably, and as many as 5% of private and affordable rented properties were standing empty at all times, with land receipts, while remaining a market value, being slightly lower than assumed in the base model. See section 5 of Appendix A for greater detail of the financial modelling.

The Councils as Funders

- 2.3 The Company will have no financial resources to pay for the construction of the homes, and so the assumption is that the Councils lend the Company money. The primary task for the Councils when acting in the Funder Role will be to assess the Company's viability as an entity and the viability of each project for which loan funding is being sought.
- 2.4 It should be noted that the modelling contained with Appendices A, B, C and Appendix D assumes a certain loan structure, with some loans linked to security, and interest return. However no loans will be granted until a full business plan is established by the Housing Development Company and presented in the first Annual Business and Delivery Plan and approved by the Shareholders. The Councils as funders will at this point need to consider loan policy compliance and their risk appetite when it comes to loan security as well as ensuring compliance with state aid rules, taking into account that the Company will have limited assets or security.
- 2.5 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.

Financial Benefits of the Councils 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 Appendix A details the capital cash flows and revenue benefits for the West Suffolk Councils (and Suffolk County Council). This project will be referred to within the Council's Medium Term Financial Strategy (MTFS) as a key strategic project for generating additional income in 2017/18. However no value will be assumed within the MTFS for these returns until a full business plan is established by the Housing Development Company and approved by the Shareholders – section 6 provides the timetable and next steps to establish this business plan.

Provision of working capital

- 2.8 As the Company will not have any resources at the outset, it is likely that provision will be required for working capital balances for the Housing Development Company. Initial modelling suggests around £150,000 costs in the first year in advance of requiring the monies for payment of construction contractors. It is proposed that this is funded from the Council's Strategic Priorities and Medium Term Financial Strategy reserve.
- 2.9 This would be an unsecured loan agreement and would accrue a 10% rate of return. It is proposed that a facility of £500,000 – split Forest Heath District Council (25%), St Edmundsbury Borough Council (25%) and Suffolk County Council (50%) – is provided to enable the Housing Development Company to start transacting.
- 2.10 Appendix D includes a breakdown of the anticipated activities of the Company within the first year, with the attached costs.

Revenue resources to complete the feasibility work prior to incorporation of the Company

- 2.11 A provision of £90,150 (equally split between Forest Heath District Council and St Edmundsbury Borough Council) has been made to fund the feasibility and legal costs up to incorporation. Suffolk County Council has subsequently agreed to meet 50% of feasibility works that are not solely for the benefit of West Suffolk Councils.
- 2.12 At the end of September, £43,600 had been spent (net of Suffolk County Council contributions). Thus, there is £46,550 available for completion of the necessary legal works for incorporation and final GVA works. These remaining works are estimated to cost around £40,000 (West Suffolk Councils' share), thus no additional budget is being sought in this report.

3. Human Resources Implications

- 3.1 It is not anticipated that any officers will be eligible for TUPE transfer to the Housing Development Company.
- 3.2 If, at a future time, there are any employment-related costs, these will be shared on the following basis; Forest Heath District Council (25%), St Edmundsbury Borough Council (25%) and Suffolk County Council (50%).

4. ICT Implications

- 4.1 None arising from this report. However the Housing Company will need to consider its ICT requirements.

5. Legal Implications

- 5.1 Expert legal opinion has been provided by Trowers and Hamblins. Their advice is that the Councils can rely on the general power of competence as defined in the Localism Act 2011 to provide market housing subject to the Councils forming a Company through which to trade. In order to provide market housing, the Company like all housing developers will need to comply with St Edmundsbury Borough Council's (and Forest Heath District Council's) planning policies, most notably the requirement that 30% of homes on sites of 10 or more properties must be affordable housing.
- 5.2 The Localism Act 2011 requires that a trading company should be a company limited by shares or a company limited by guarantee. Trowers and Hamblins have advised that the former structure is the more appropriate and this is the company structure now proposed.
- 5.3 The Company will require a Memorandum and Articles of Association to be drawn up, with an optional Shareholders Agreement also proposed here. Trowers and Hamblins are assisting in the drafting of this documentation. The Company will be required to register with Companies House. Delegations are sought in this report to proceed to registration and incorporation of the Company.
- 5.4 See section 3 in Appendix A for further details.

6. Equalities Implications

- 6.1 A detailed Equalities Impact Assessment has been completed - see Appendix E.
- 6.2 Of note, the analysis has found that providing some affordable housing in compliance with planning policies will particularly assist disabled people and those over-represented on the Housing Register and/or having lower level earnings, including people from some black and minority ethnic backgrounds.

7. Overview and Scrutiny Committee Recommendations

- 7.1 St Edmundsbury Borough Council's Overview and Scrutiny Committee considered this Cabinet Report in draft form at its meeting held on 15 October 2015.
- 7.2 The Committee discussed the governance arrangements and in particular the criteria for the selection of the three directors of the Company's Board that would be additional to those nominated by each of the Councils (Forest Heath, St Edmundsbury and Suffolk County Council). The Committee made the recommendation that the criteria specified in the fourth bullet of paragraph 3.24 in Appendix A be amended to read "*up to three additional directors unanimously approved by the three Shareholder Councils. These will be 'independent' individuals selected for their relevant expertise and experience*".

8. Timetable and next steps

8.1 The overall timetable and next steps to incorporate the Company and commence the first development are as follows.

27 October 2015	Forest Heath District Council Cabinet St Edmundsbury Borough Council Cabinet
10 November 2015	Suffolk County Council Cabinet
17 November 2015	Forest Heath District Council full Council St Edmundsbury Borough Council full Council
December 2015	Completion of Memorandum and Articles of Association and Shareholders Agreement
January 2016	Incorporation of the Company
February 2016	First draft of Company's Annual Business and Delivery Plan produced
March – April 2016	Approval by the Shareholders (the Councils) of the first Annual Business and Delivery Plan
April – May 2016	Submission of Planning Application for first site
Spring 2016	Procurement of Employer's Agent for first site
Summer 2016	Procurement of construction contractor for first site
Autumn 2016	Start on site at first site