

Overview and Scrutiny Committee



St Edmundsbury
BOROUGH COUNCIL

Title of Report:	Barley Homes – Five Year Business Plan	
Report No:	OAS/SE/16/028	
Report to and dates:	Overview and Scrutiny Committee	09 November 2016
	Cabinet	08 December 2016
	Council	20 December 2016
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Purpose of report:	<p>In November 2015 the Council approved the establishment of a Housing Development Company, limited by shares for the purpose of developing housing for sale, private and affordable rent.</p> <p>In principle approval was given for the Council to provide the Company with funding through state aid compliant loans in line with the Council’s Loans Policy. This in principle funding was subject to the approval of a Business Plan by the Shareholders (Forest Heath District Council’s full Council, St Edmundsbury Borough Council’s full Council and Suffolk County Council’s Cabinet).</p> <p>In December 2016, full Council will be asked to consider Barley Homes initial five year Business Plan and approve the funding mechanism required to deliver the plan. Prior to consideration at Cabinet and Full Council, this committee is asked to scrutinise the content of the Business Plan.</p>	

<p>Recommendation:</p>	<p>It is <u>RECOMMENDED</u> that, the Committee:</p> <ul style="list-style-type: none"> (1) Considers the initial Barley Homes five year Business Plan; and (2) Recommends to Cabinet, subject to full Council: <ul style="list-style-type: none"> (a) Any amendments and approval of the five year Business Plan attached at Exempt Appendix A; (b) Approval of a £3m revolving investment facility, to be added to the Council's capital programme, financed from the reallocation of the 'Housing Company' pending capital budget of £2.35m and an additional £0.65m from the Strategic Priorities and MTFS reserve; (c) Delegation to the S151 Officer and Monitoring Officer, in consultation with the Portfolio Holders for Resources and Performance and Housing, to issue equity and loan funding from the revolving investment facility (set out in 2b above), subject to state aid requirements; (d) The S151 Officer and Monitoring Officer, in consultation with Portfolio Holder Resources and Performance, be authorised to negotiate and agree the terms of such loans with Barley Homes and the funding and necessary legal agreements, taking into consideration the Council's loans policy and state aid requirements; (e) Note the sale of the Council owned land as detailed in the five year Business Plan (Exempt Appendix A), with outline planning permission, subject to approval by the planning authority and with Section 123 best value obligations, with the costs of planning permission being approximately £35,000 being funded from the Strategic Priorities and MTFS reserve. (f) Note that approval of this Business Plan will constitute consent for Barley Homes to issue shares and enter into debt financing, in line with the Business Plan.
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Consultation:		<ul style="list-style-type: none"> • Barley Homes Shareholder Advisory Group • Suffolk County Council • Internal – finance, legal and Human Resources 	
Alternative option(s):		<ul style="list-style-type: none"> • None – a Business Plan is required in order for funding to be approved. 	
Implications:			
<i>Are there any financial implications? If yes, please give details</i>		Yes <input checked="" type="checkbox"/> No <input type="checkbox"/> <ul style="list-style-type: none"> • Refer to section four of this report 	
<i>Are there any staffing implications? If yes, please give details</i>		Yes <input type="checkbox"/> No <input checked="" type="checkbox"/> <ul style="list-style-type: none"> • None directly but Barley Homes will be appointing a Development Manager to take the developments forward, all the costs have already been included the development appraisals. 	
<i>Are there any ICT implications? If yes, please give details</i>		Yes <input type="checkbox"/> No <input checked="" type="checkbox"/> <ul style="list-style-type: none"> • None arising from his 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"/> <ul style="list-style-type: none"> • Refer to section six of this report 	
<i>Are there any equality implications? If yes, please give details</i>		Yes <input type="checkbox"/> No <input checked="" type="checkbox"/> <ul style="list-style-type: none"> • None arising from this report. An Equality Impact Assessment (EqIA) was undertaken prior to consideration of the establishment of the company. Paper OAS/SE/15/014 refers 	
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*

<p>Business Plan insufficiently robust / not tested</p>	<p>Medium</p>	<p>Utilising the expertise of specialist financial and property consultants</p> <p>Sensitivity analysis carried out to test impact of negative movement on key assumptions (see section 2.5 of Business Plan)</p> <p>Scrutiny of external modelling by Finance staff and tax advisors.</p> <p>Detailed site appraisals and costings to be undertaken on obtaining planning permission(s) on the sites</p>	<p>Low</p>
<p>Insufficient regular monitoring of performance of Barley Homes against Business Plan by shareholder councils</p>	<p>Medium</p>	<p>Regular monitoring through Shareholder Advisory Group - made up of Councillors from shareholding councils, supported by S151 and Monitoring officers</p>	<p>Low</p>
<p>Insufficient expertise to ensure achievement of best value in property construction</p>	<p>Medium/High</p>	<p>Costs of Development Manager to oversee the development process included within the business plan modelling</p> <p>Provision for future appointment of independent Company directors with a background in housing development</p> <p>Option to use Homes and Communities Agency's framework agreements for technical consultants and construction</p>	<p>Low/Medium</p>

Adverse movements in the housing market, such as property sales and/or rental price deflation, higher than anticipated building cost inflation, 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 Development Manager, keep up-to-date with building costs and sales market	Low
Uncertainty over the impact upon the construction and housing market post EU referendum	Medium/high	Sensitivity analysis included in Business Plan (see exempt Appendix A section 2.5)	Low
Failure of Barley Homes and loss of shareholder capital and loans	Medium	Business Plan has tested the viability of sites and profitability of Barley Homes. Loans to be secured against assets of Barley Homes such as land and retained properties. Shareholder capital level to be regularly reviewed to minimise overall shareholders exposure	Low
Barley Homes is challenged over its financial make up in the market	Medium	Funding proposals are based on advice obtained around state aid and HMRC rules compliance. Barley Homes is structured as a commercial company.	Low
Council receives less than market value for the land	Medium	Site viabilities have been tested within the development of the Business Plan (still subject to planning and site investigations). Council to ensure land is sold at market value to Barley Homes to comply with its S123 best value obligations.	Low

Council relies on returns from Barley Homes which are not sustainable in the future	Medium	Continue to review (rolling) five year business plans for Barley Homes and seek stable returns in the longer term. Reflect any reduced returns in the medium term financial projections as part of reviewing the five year business plan.	Low
Ward(s) affected:		All Ward/s	
Background papers: <i>(all background papers are to be published on the website and a link included)</i>		CAB/SE/15/070 COU/SE/15/031 OAS/SE/15/014	
Documents attached:		EXEMPT – Appendix A - Barley Homes Five Year business plan and appendices	

1. Key issues and reasons for recommendation(s)

1.1 Background

1.1.1 Following approval by both Forest Heath and St Edmundsbury in November 2015 (report COU/SE/15/031 refers) Barley Homes (Group) Limited was incorporated in March 2016 as a company limited by shares, jointly owned by Forest Heath District Council (25%), St Edmundsbury Borough Council (25%) and Suffolk County Council (50%). The primary function of Barley Homes is to generate capital and revenue income for the councils through the development of new housing for sale and rent, on land owned by one of the councils initially in west Suffolk. The establishment of the housing company is one of the many ways that the council is using to generate income to become self-sufficient as central government grants are reduced and eventually removed.

1.1.2 Financial returns to the councils will be generated through a combination of, the councils' role as a:

1. **Landowner through land sale receipt** – with Barley Homes paying market value for the land it buys with planning permission from the landholding council
2. **Funder through interest receipts** – on loans provided to Barley Homes at commercial rates
3. **Shareholder through dividends** – from profits generated by Barley Homes
4. **Service provider through contracts** – from services contracted by Barley Homes from the council

1.1.3 All funding provided to Barley Homes by the councils will be provided in a form to satisfy both HMRC tax and state aid regulations. Further information is contained in sections six and seven of the Business Plan (**Exempt Appendix A**).

1.1.4 Shareholder oversight of Barley Homes activities is undertaken via the Shareholder Advisory Group, which consists of eight elected members drawn from the three Councils, supported by the Section 151 and Monitoring officers. The group meets regularly with the directors of the company to scrutinise the performance of the company and to represent the interests of the shareholders.

2. Five year business plan –key issues

2.1 Since its establishment in March 2016, Barley Homes has focussed on the development of its first Business Plan. The Business Plan is based on the delivery of initial sites over the first five years of activity.

2.2 Following an open quotation process, Savills were commissioned by Barley Homes to assist in the development of the initial five-year Business Plan, a copy of which is attached to this paper (**Exempt Appendix A**). The Business

Plan contains details of the initial developments, the amount and type of funding required to complete the developments and the expected returns generated for the councils. Section 2 of the Business Plan contains an executive summary of all the key financial information, with the rest of the plan going into greater detail.

- 2.3 To aid presentation and an understanding of the overall Barley Homes operation and to provide transparency on the investment and returns from the different activities, the financial analysis and modelling has been separated into the two distinct business activities: (i) development; and (ii) investment.
- 2.4 Since the Business Plan was produced a further review of the advice given by Deloitte (as part of the initial Housing Company business case), has confirmed that it would be most tax efficient to separate the various activities of Barley Homes into separate entities to reflect the nature of the activity i.e. development and investment. This would likely require Barley Homes (Group) Ltd to act as the holding company. The exact nature of the company structure will be discussed with the Shareholder Advisory Group in due course. Regardless of the company structure, the value, type and timing of this funding is detailed in the Business Plan (**Exempt Appendix A, section 2.2**) with an overview provided in section four below.

3. Initial sites

- 3.1 In preparation of the Business Plan, a total of 43 development sites (under the ownership of the three councils) were identified and rated as to their suitability and deliverability within the timeframe. Following this assessment four "initial sites" have been prioritised for delivery in the first five years. In addition to the initial sites, an outline programme of activity for a number of "secondary sites" has also been drawn up, with work also starting on identifying a portfolio of longer-term pipeline sites. Information relating to the sites is contained in the Business Plan (**Exempt Appendix A**).
- 3.2 In order to maximise the return from the sale of the land to Barley Homes it is assumed that the landholding authority secures outline planning permission for residential development on the land prior to its sale. In this instance, St Edmundsbury Borough Council owns one of the sites and will be required to seek outline planning permission before sale to Barley Homes and ensure that its best value obligations have been met. These costs are estimated to be in the region of £35,000 and will be funded by the Strategic Priorities and MTFS reserve.
- 3.3 As the development of housing through Barley Homes is a new venture for the shareholding councils and in order to limit the potential exposure to risk, it was agreed by the Shareholder Advisory Group to concentrate on those sites that were the most straightforward to develop and readily available. The advice from Savills is that the proposed development programme is a realistic and deliverable one for a new company the size of Barley Homes to be able to deliver over the life of the five-year business plan. As knowledge and expertise is gained within the company from developing the initial sites, there would be scope to increase the scale and ambition of development.
- 3.4 The initial five-year business plan will be revised on a regular basis as new sites are identified and brought forward. In accordance with the Shareholder

Agreement an annual delivery plan will be presented to the Shareholder Advisory Group and presented to the councils for approval.

4. Investment opportunity and financial returns

- 4.1 The investment required to deliver the four initial sites and the expected returns to be achieved are summarised on pages 7-11 of the Business Plan (**Exempt Appendix A**). It is important to note that all of the figures contained in the business plan are based on the current modelling and without detailed site investigations so there may be variations in both the costs and receipts in the final scheme delivery. A sensitivity and risk analysis has been undertaken and is included within the Business Plan (sections 2.5 and 3.7).
- 4.2 The total funding required for the five year plan, with a peak funding requirement of £11.1m in 2019/20, equates to an investment (through a combination of equity and debt) of £2.782m, rounded to £3m to allow some flexibility, for both St Edmundsbury and Forest Heath reflecting the individual councils' 25% shareholdings. It should also be noted that the current approved Capital Programme for St Edmundsbury includes an allocation of around £2.365m towards investment in Barley Homes (report COU/SE/16/003 refers), so a further £0.635m is proposed to be funded from the Strategic Priorities and Medium Term Financial Strategy Reserve.
- 4.3 As detailed in the Business Plan all of the development loan funding will be repaid by Barley Homes. However, there will be a long term funding requirement for investment of £1.23 million from St Edmundsbury (£4.9m in total from the three councils) in order to be able to purchase the rental portfolio if this is felt to be financially beneficial (see paragraph 4.6 below).
- 4.4 The revenue returns expected for the shareholders, from investment in the short term development period and long term property investment across the five year business plan total £3.8m, to the period 2021/22. This equates to £954,000 each for both St Edmundsbury and Forest Heath. The long term property investment return will of course continue beyond the 5 year period contained within the report.
- 4.5 In addition to the revenue returns, the councils will receive full market value payments for land sales in their ownership and will benefit from the longer-term growth in the value of the investment properties retained.
- 4.6 An option also exists for the councils not to build the private rented units, but to replace them with open market properties nor to retain the affordable rented units within the investment company, but to sell them to a suitable registered provider. This option would not require the on-going £4.9m capital investment across all the shareholders, but would result in the loss of the on-going revenue income. Further analysis will need to be undertaken as to the viability of both options and will be presented to Shareholder Advisory Group for their consideration.
- 4.7 In order to comply with state aid and HMRC tax rules the investment modelling for the shareholders, contained in the Business Plan (**Exempt Appendix A**), works on an equity investment (as unsecured shareholder capital) of around 35% and a loan investment (attracting a commercial interest rate) of 65%. It

is this funding that will be used by the investment company to purchase the rental properties for investment, should it wish to do so.

- 4.8 This investment opportunity is in line with the internal rate of return within the Council's Medium Term Financial Strategy of 10% and therefore meets the desired return when appraised on the basis of being funded by prudential borrowing. Actual borrowing will only take place when the Council's treasury management activities identify such a need, for example, the Council's cash flow management activities project that an external cash injection is required to maintain the appropriate level of cash balances for the Council to operate and fulfil its budget and service delivery requirements.
- 4.9 The Council currently manages funds in excess of this and therefore external borrowing is not expected during the life of this investment for this investment in isolation. The proposal is that the funding for this investment is financed (albeit it will be a revolving fund so is financing on a cash flow basis) from a pending capital programme allocation and a strategic revenue reserve therefore it is proposed that the full revenue returns of this investment opportunity is realised to support the general fund budget.

5. Monitoring of progress and future development decisions

- 5.1 In order for Barley Homes to operate flexibly in the commercial market, it is proposed that a revolving investment fund of £3m (covers equity share capital and loan facility) is agreed by full Council with the necessary delegations to the statutory S151 and Monitoring Officer to negotiate, sign and implement the loan agreements between Barley Homes and the Council to deliver the business plan.
- 5.2 Each development scheme will require detailed project and financial management and the Shareholder Advisory Group will be responsible for scrutinising the Company's development appraisals. In addition, each year the Councils will receive an Annual Report detailing progress made and future development plans.
- 5.3 During the delivery of the five year business plan it is recognised the commercial opportunities may arise which would benefit the councils. In order to maximise these opportunities, Barley Homes will be able to access the capped loan fund. However, any investment decision would only be made in line with the financial delegation, subject to the scrutiny of the Shareholder Advisory Group and reported as part of the annual report to the councils. Any further sums of money required over and above the capped load would be requested from full Council.

6. Delivery of the Business Plan

- 6.1 Barley Homes requires support to deliver the four initial sites, and develop potential future sites. This support is likely to be in the form of a Development Manager whose role would be to prepare a detailed delivery plan and provide leadership, management and procurement of a professional team to deliver the sites. An allowance to meet these costs has been included within the Business Plan (see section 3.3.3)

7 Legal implications

- 7.1 Expert legal opinion was sought by Trowers and Hamlins during the development of the business case to establish the company and they have supported the preparation of the company's Memorandum and Articles of Association and Shareholder Agreement.
- 7.2 In terms of state aid, the councils must show that they are **not** providing state aid and this has been reflected in the loan terms and market interest rate used. State aid, in whatever form, which could distort competition and affect trade by favouring certain undertakings or the production of certain goods, is incompatible with the common market. Having sought independent advice on this, the Council is satisfied that the equity/loan split does not constitute state aid.
- 7.3 It is for Barley Homes to ensure that it complies with all the necessary tax rules, particularly relating to thin capitalisation (a company is said to be thinly capitalised when the level of its debt is much greater than its equity i.e. its gearing, or leverage, is very high). If HMRC believe that the rules around thin capitalisation, and other matters are not met then the amount of interest the company can offset against its profits will be restricted. In turn this means the company paying higher corporation tax and less profit being available as distribution to the shareholders. The company will continue to seek tax advice throughout its operations and report to the Shareholder Advisory Group as appropriate.

8. Next steps

- 8.1 Following discussion at this Committee, the Business Plan will be considered by Cabinet and full Council in December (with the other councils also seeking the appropriate approval in December). Delivery of the Plan will then begin with construction and completion dates as outlined in the Business Plan (**Exempt Appendix A**). During this period the Shareholder Advisory Group will continue to monitor progress and performance as appropriate.