

**Report to:** Cabinet  
**Date of Meeting:** 8 March 2017  
**Public Document:** Yes  
**Exemption:** None  
**Review date for release:** None



**Agenda item:** 13

**Subject:** **Establishing a Local Housing Company for East Devon District Council.**

**Purpose of report:** This report sets out the business case for setting up a Local Housing Company to be wholly owned by the Council with the purpose of providing housing in the general market (so outside of the Housing Revenue Account) and to generate a profit to provide income to the Council's general fund.

The report covers the purpose, benefits, legal position, risks, and considerations of operating a Local Housing Company, and specifically what this housing delivery vehicle could do that we currently are unable to.

An outline business case considers how the Local Company could operate, its objectives and sets out due diligence considerations.

**Recommendation:**

**That Cabinet;**

- (1) Approve the establishment of 'East Devon Homes', a (a wholly owned) Local Authority Housing Company to be incorporated and registered at Companies House as a private company limited by shares;**
- (2) Agree the shareholder function of the Council be delegated to a sub-committee of the Cabinet, to be called the 'Housing Company Sub-Committee' and comprising the Leader, Deputy Leader and Portfolio Holders for Finance, Sustainable Homes and Communities and Corporate Business;**
- (3) Agree the remit and Terms of Reference of the Housing Company Sub-Committee attached at Annex 2;**
- (4) Agree the Housing Company Sub-Committee in consultation with the Strategic Leads for Finance, Governance and Licensing and Housing, Health and Environment be authorised to finalise and document the following arrangements between the Council and the Company;**
  - (a) The Memorandum and Articles of Association for the Company;**
  - (b) Shareholder Agreement between the Company and the Council;**
  - (c) Appointment of Directors, Auditor and (if required) a Company Secretary;**
  - (d) Receive and approve the Business Plan prior to the Company commencing trading (noting that Council approval will be required for any borrowing the Council may do on behalf of the Company);**

- (e) Resourcing Agreement for the Company to use Council staff and facilities in furtherance of its business;**  
**(f) Agree appropriate loan and draw down facilities to the Company with associated agreements.**

**Reason for recommendation:**

To establish a vehicle to accelerate housing delivery and the flexibility to undertake a more diverse range of housing development, including market rented properties.

**Officer:**

John Golding Strategic Lead – Housing, Health & Environment.

[jgolding@eastdevon.gov.uk](mailto:jgolding@eastdevon.gov.uk)

**Financial implications:**

Finance have been involved in the preparation of this report, with the report and annexes highlighting the main financial issues. This report sets out the principles and procedures for establishing a wholly owned Local Authority Housing Company which will be a subsidiary of the Council and will be fully consolidated into the Council's financial statements. Once the documentation outlined in this report relating to the formation of the Company have been produced and presented for approval it is not until that stage the Council will be asked to consider any investment and/or borrowing requests.

It is likely that the Council's Chief Finance Officer (S151) will be part of the Company Board, this will be with a clear understanding of the separation of functions being a board member and the role of advising the shareholder/Council. It is not expected that conflicts will emerge but as stated in the report his will be kept under review and arrangements reviewed and modified if necessary should such a conflict arise.

**Legal implications:**

Legal have had input in to the preparation of the report and it is considered that the report and Outline Business Case identify the main legal issues. The principle of establishing the Company on the basis of the general power of competency and for the purposes specified seems perfectly permissible. The documentation that governs the relationship between the Council and Company and the running of the Company is crucial to ensure appropriate safeguards for the Council are in place (primarily these are the Shareholders Agreement, Articles of Association and the Business Plan). In addition there are a number of legal issues (identified in headline terms in the report) that will require further consideration as part of the establishment of the Company and as the Business Plan and activity of the Company develops. Advice will be given at the relevant stages to ensure that the relevant legal obligations are appropriately considered and addressed.

**Equalities impact:**

Low Impact

**Risk:**

Medium Risk

The report contains a risk assessment and considers the Council's appetite for risk as a consequence of working in new markets and adopting a more commercial approach.

**Links to background information:**

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**Link to Council Plan:** Continuously improving to be an outstanding council.

## **1. Introduction**

- 1.1 For some time I have been researching changes and trends in the social housing sector relating to new models for delivering housing to meet the seemingly insatiable demand for good quality housing. Despite promises of freedoms and flexibilities our ability to deliver a significant development programme through the Housing Revenue Account is compromised by borrowing restrictions, rent and tenancy controls.
- 1.2 In January 2017 I reported and presented to the **Housing Review Board** a report that considered options for arrangements that could operate alongside the Housing Revenue Account (HRA) and our social housing activities, but that would enable us to operate in a more commercial way. Done well this would complement our social landlord activities and benefit from the experience and infrastructure we have to manage and maintain Council homes.
- 1.3 At the Housing Review Board we explored two main options - a Joint Venture partnership and a Local Housing Company. The desire for control and full ownership favoured the Local Housing Company option and the Board invited me to work up an outline business case and perform some initial risk assessment and due diligence work.
- 1.4 I am reporting my findings to the Cabinet because the model I am proposing would sit alongside the landlord activities, but falls outside of the remit of the Housing Review Board.

## **2. Outline business case for a Local Housing Company**

- 2.1 I have explored the reasons and benefits of setting up a new housing delivery vehicle and why other councils have gone down this route. The key drivers are typically to play a more active role in the local housing market and providing a more diverse housing offer, including market renting and sales. For many there is a view that councils can do a better job than private landlords and developers and provide a housing product that is right for their area rather than what the market seeks to provide. Some see this as a valuable investment model with good returns for the council, whilst fulfilling a useful intervention in the housing market.
- 2.2 I have looked at the drivers and benefits of establishing a Local Housing Company and concluded that if we wish to play a more significant role in the local housing market and diversify our housing offer, then we need a suitable vehicle with which to deliver this ambition. I have taken the view that with the limitations placed on the Housing Revenue Account we need something different and flexible to make a step change in housing delivery.
- 2.3 In 2012 following the self-financing of council housing (with taking on of debt to buy our housing stock) we devised and undertook a soft launch of **East Devon Homes**, which was largely put in place to signal the change to a regime where we were anticipating freedoms and flexibilities. However, this has not materialised and government are continually interfering with our rent setting, tenancy conditions, Right to Buy, sale of high value stock etc. The Local Housing Company presents the opportunity to operate outside these constraints and we could use the East Devon Homes label (as not currently registered at Companies House).
- 2.4 Following the Housing Review Board meeting and support from Strategic Management Team I have explored the case for establishing a Local Housing Company in more detail, including a careful consideration of the drivers, benefits, a SWOT analysis, risks, legal position and due diligence issues. I have produced an outline business case which is reproduced in **annex 1**.
- 2.5 I am suggesting that the high level objectives of a Local Housing Company would be:

- To increase housing supply in the area to address existing demand and meet the needs of a growing population, and help boost growth in the local economy;
- To act as a stimulus for change to improve the quality of rented sector accommodation across the district;
- To set standards for good housing design and management in the local housing market;
- To generate General Fund income for the Council through returns from Private Rented Sector housing and sales receipts from market housing sales and affordable homes;
- To act as a development vehicle for the Housing Revenue Account and deliver affordable housing.

2.6 Complimenting these objectives the benefits of a new form of housing delivery vehicle would be:

- The ability to offer a wider variety of tenure types (including private rented sector);
- Profits from the company can be returned to the Council's General Fund via dividend payments;
- No restriction caused by the HRA borrowing cap (headroom);
- Freedom from the HRA rent regime and the implications of the 'limit rent subsidy' (if properties with higher rents are introduced to the HRA then not all housing benefit costs can be reclaimed);
- Avoids potential stock losses through the Right to Buy.

2.7 The Company can start small and build over time. Being entirely under the control of the Council we can operate at a pace that we are comfortable with, managing risk and exploring opportunities for development that are viable and provide a return on our investment. This might include acquisitions of existing homes, purchasing from developers, and/or development of land in our ownership or purchased through the market. I envisage the Local Housing Company undertaking work for the Housing Revenue Account and providing affordable homes as well as a more commercial activities being housing for sale and market rent.

2.8 It is essential that we establish the company so that it is flexible and agile, and free of much of the local authority bureaucracy. Whilst remaining accountable and owned by the Council to be effective the company needs to be able to react quickly to opportunities, take calculated risks, and operate in the commercial environment.

2.9 I have considered the contents of the recently published **Housing White Paper** in relation to the proposal and concluded that with the government seeking ways to accelerate house building, and promoting home ownership models, this would only serve to increase the need for a new delivery vehicle that can operate outside of the constraints imposed by Housing Revenue Account rules. The drivers for establishing a Local Housing Company are consistent with the growth agenda being promoted and can benefit from the reshaping of national housing policy being advanced through the initiatives outlined in the Housing White paper.

2.10 The Housing White Paper also states "the government asks local authorities to be as ambitious and innovative as possible to get homes built in their area" and under the section listing proposals and concerned with diversifying the market it says government will be "supporting housing associations and local authorities to build more homes".

2.11 Under a section titled backing local authorities to build the Housing White paper states "Increasingly and across the country local authorities are using innovative new models to get homes built in their area. There are a number of good examples of Local Development Corporations local housing companies and/or joint venture models building mixed sites, which include new market housing for sale or private rent, as well as affordable housing. We welcome innovations like these, and want more local authorities to get building. To that

end we will seek to address the issues that hold them back. However, we want to see tenants that local authorities place in new affordable properties offered equivalent terms to those in council housing, including a right to buy their home”.

### **3. Specific Considerations**

- 3.1 The Outline Business Case details the legal framework and identifies that the general power of competence (S.1 Localism Act 2011) should be relied upon. In carrying out a 'commercial purpose' under the general power of competence, it is a legal requirement that this is carried out through a company.
- 3.2 The proposal is to establish a wholly owned private company limited by shares. This will mean that the Council is the sole shareholder and as such the company would be a controlled company for the purpose of the Local Government Act 1989 and the related Local Authorities (Companies) Order 1995. This places obligations on the company to ensure that those it deals with are aware that it is local authority owned but also it is restricted in terms of political and certain other activity. These requirements will be taken into account and appropriately addressed during formation and operation of the Company.
- 3.3 Governance arrangements are clearly an important aspect to the setting up of the Company. While acknowledging the desire of the Company to be flexible and agile, there does need to be sound and robust management of the Company, and equally there does need to be adequate protection of the Council's financial and reputational investment in the Company. This will be achieved through the documentation and arrangements that set up the Company as detailed in the Recommendations and in more detail below.

#### Shareholder Agreement

- 3.4 The ultimate control of the Company rests with the shareholder, while operationally the Company is run by the Board of Directors with potentially a senior manager / managing director. Generally speaking the Board of Directors of a company is its main decision making body and is free to act as it thinks are in the best interests of the Company. The shareholder can reserve certain activities to ensure that the Company cannot take certain decisions or carry out certain activities. Accordingly it is recommended that there is a shareholder agreement which would seek to ensure that only the shareholder (so the Council) can undertake certain activities. It is suggested that this reserves the following, as a minimum, to mitigate risk to the Council:
  - 3.4.1 Issuing new shareholder capital (to ensure Council retains control of the Company)
  - 3.4.2 Borrowing of money (as the Company's borrowing forms part of the Council's debt profile)
  - 3.4.3 Access to information about the Company (as shareholders are not automatically entitled to detailed financial and operational information)
  - 3.4.4 Agreement of the Business Plan (to set out the performance levels expected of the Company and the tolerances – both financial and decision making)
  - 3.4.5 Enshrining 'controlled company' requirements to ensure Board of Directors comply
  - 3.4.6 Changing Directors and the Company Secretary (if appointed)
- 3.5 The Shareholder Agreement will provide a framework for governance but otherwise the Board can operate the Company as it sees fit. In terms of how the Shareholder function is carried out, the intent is for a sub-committee of Cabinet to exercise this role on behalf of the Council. The terms of reference for this sub-committee are attached (**Annex 2**) and details how the function will be exercised. There will be at least two meetings annually, one of which will be the annual meeting where an annual report and the annual accounts are

presented. Other meetings will be on an 'as required' basis. The sub-committee, as the Shareholder, will effectively hold the Directors to account.

### Directors

- 3.6 The Board of Directors will be responsible for delivery of the expected outcomes of the Business Plan. They have oversight of the performance, financial and operational management of the Company within the parameters agreed with the Shareholder.
- 3.7 The Board of Directors will be appointed by the Housing Company Sub-Committee and on the basis of the Director Appointment documentation. It is expected that the Board will comprise most of the Council's Senior Management Team (Deputy Chief Executive and Strategic Leads for Housing, Health and Environment; Finance; Governance and Licensing and Organisational Development and Transformation) but not the Chief Executive. As noted in the Outline Business Case, the Shareholder may wish to appoint further directors to add further commercial experience to the Board, which is entirely permissible and will be covered by the Shareholder Agreement.
- 3.8 Whilst the Council's Chief Finance Officer (S.151) and Strategic Lead for Governance and Licensing (also the Monitoring Officer) will be part of the Board, this is with a clear understanding of the separation of functions between all officers on the Board of Directors and officers providing advice to the Shareholder (and also Council when acting in its funding capacity) on behalf of the Council. It is not expected that conflicts will emerge but this will be kept under review and arrangements (or directorships) kept under review and modified if necessary to accommodate changes in circumstances.
- 3.9 Directors are subject to their own statutory duties (for which see the Companies Act 2006) along with other legal duties. The Directors will be advised of their collective and personal responsibilities and liabilities. It is expected that the Council will indemnify and / or insure the Directors in accordance with provisions of the Local Authorities (Indemnities for Members and Officers) Order 2004.
- 3.10 Any Director who is an employed officer will not be remunerated in their position as Director.

### Memorandum and Articles of Association

- 3.11 These are effectively the Company's Constitution setting out the rules governing the running of the Company by the Directors. There are standard template articles that can be used and adapted as necessary. In general terms, the articles will ensure a company limited by shares; there will be one shareholder (East Devon District Council), the liability of the Council will be limited to the nominal value of its share; if a Director ceases to be employed as an officer of the Council then they will, ordinarily, cease to be a Director; it will cover procedures for meetings and voting; requirements as to signing documentation; rules surrounding being a wholly owned local authority company and the requirements for auditing of accounts, amongst others.

### Business Plan

- 3.12 This document will determine the operational parameters of the Company and, while it will evolve over time, it is likely to cover some or all of the following:
  - 3.12.1 Operational plans
  - 3.12.2 Financial model and assumptions
  - 3.12.3 Investment Strategy
  - 3.12.4 Rents, sales and development assumptions

3.12.5 Distribution Policy – is all profit returned to the Shareholder or is some retained for future investment and / or running capital

3.12.6 Fees, on-costs and tax

3.12.7 Funding profile and sensitivity analysis

- 3.13 The Shareholder retains input in to the Business Plan to ensure that the Company is delivering to the Shareholder's aims and the Company Directors can be held accountable in respect of it. There will need to be a business plan approved prior to the Company beginning to trade.

#### Resource Agreements

- 3.14 It is anticipated that many of the support services (both advisory and service provision) are likely to be contracted out by the Council (e.g. legal and finance advice and maintenance services). There may be other related costs too, such as accommodation and goods. All of these will be the subject of appropriate legal documentation and services will be charged at normal commercial rates to the Company.

#### Loan agreements

- 3.15 These will depend on the nature of what the Company is doing. Most likely the Company will ask the Council to borrow from the Public Works Loan Board (as detailed in the Outline Business Case). It is possible though that the Council could loan from capital reserves. All borrowing / loans will need proper documentation. Consideration will be given to imposing legal charges in respect of property to protect the Council's investment where appropriate.

### **4. Other matters (including Tax, State Aid, EU Procurement)**

- 4.1 As a company, the Company will be liable to pay corporation tax in the normal manner on profits. It will also have a different position in respect of VAT and also stamp duty land tax in terms of property transactions.
- 4.3 The Outline Business Case also identifies that there are potentially issues surrounding State Aid (so ensuring that the Company is not subsidised by public money) in terms of loans, use of staff / resources and provision of services and EU Procurement (ensuring public bodies trade fairly, openly and get best value). The issues are explained in the Business Case as is the potential ways of overcoming / addressing them. The Company may not be subject to EU procurement, but even if it is there are rules that mean the letting of contracts by the Council to the Company would not be subject to EU procurement rules.
- 4.3 There are also a number of other legal issues that the Council will need to consider, depending on what assistance the Council is to give the Company and what the Company intends doing. These primarily revolve around the funding of or providing lending to the Company (in the context of the purpose of the funding / lending) and the transferring of land (different considerations apply to general fund land compared to housing revenue account land) or other assets for the Company to use including the duty to secure best value for land, although noting the ability to sell for an under-value in certain circumstances. There are a number of other considerations, including the intention to help deliver affordable housing and the responsibilities on the Council as Housing Authority.
- 4.4 Ultimately all of the above will be considered on a case by case basis. Advice on the issues and consideration of the implications and the best way forward for both the Company and the Council will be given as appropriate. Essentially each party will receive specialist advice on the relevant issues as it affects their decision making to ensure that informed and lawful decisions are taken.

## **5. Risks**

- 5.1 While the Company is likely to consider a variety of different opportunities to deliver its purpose, options under consideration will be subject to appraisal and due diligence to ensure sound decision making. Ultimately the Business Plan, once approved, will dictate that the Company will operate within clearly defined parameters which will be overseen by the Shareholder.
- 5.2 The Outline Business Case identifies and analyses specific risks in Section 6. However, and in addition, it is worth highlighting the following to demonstrate that there are appropriate controls in place:
  - 5.2.1 The Shareholder Agreement will set out controls around the way the Company can be run and its dealings;
  - 5.2.2 The Articles of Association will further set out the powers available to Directors;
  - 5.2.3 The Business Plan sets clearly defined parameters and the Housing Company Sub Committee are able to hold the Directors to account for the delivery of the Business Plan;
  - 5.2.4 Funding provided by the Council will be subject to approvals by the Housing Company Sub Committee and (depending on the circumstances) Council;
  - 5.2.5 Asset transfers will be subject to the requirement to obtain best value for land (although subject to the ability to dispose of at an undervalue in appropriate circumstances);
  - 5.2.6 Possible use of legal charges to protect the Council's interests;
  - 5.2.7 The Company will be subject to its own auditors and will be subject to the requirements of company law and filing at Companies House.

## **6. Housing Revenue Account**

- 6.1 It is important to note that the Outline Business Case explains that the Housing Revenue Account and HRA Business Plan will continue to operate as it does currently to ensure compliance with our legal obligations in respect of social housing. There is likely to be opportunity for the Council (acting through the HRA) to work alongside the Local Housing Company but their functions are distinct and the HRA responsibilities will continue to be delivered by the Council.

## **7. Next steps**

- 7.1 Assuming the principle of establishing a Local Housing Company is accepted the next steps involve producing articles of association and a shareholder agreement, establishing a Board, detailing the scope of the company business and setting up the company as a legal entity.
- 6.2 A Business Plan is required setting out the ambitions and operating principles of the new company. I envisage this developing over time as we realise the full potential for business expansion and if we like what is being delivered.
- 6.3 If the recommendation is supported I will work with Legal and Finance colleagues to establish the company and report back on progress, and provide an indication of the first projects to be delivered together with the Business Plan.