



# Cabinet

30 JANUARY 2012

**CABINET MEMBER FOR HOUSING**

***Councillor Andrew Johnson***

**HOUSING DEVELOPMENT COMPANY – DELIVERING AFFORDABLE HOUSING**

**Ward(s): All**

The Council has established a local housing development company structure to undertake development of new affordable housing in the borough. This report sets out the proposals for undertaking development of a pilot phase of seven sites to deliver 25 new affordable homes in the borough. Section 3 of the report sets out how these schemes will be delivered through this structure.

**CONTRIBUTORS**

EDFCG  
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**Recommendation(s):**

1. Consider and approve the business case referred to in this report (noting the general approach previously approved by the Cabinet on 18<sup>th</sup> April 2011), for the purposes of section 95 of the Local Government Act 2003, and approve the commencement of trading activities on the part of H&F Development Limited (HFD) and H&F Housing Limited (HFH) in accordance with the provisions of Section 95 of the Local Government Act 2003.

2. Subject to satisfactory outcome of consultation and equalities assessments that approval is given to develop new affordable housing on the sites specified in section 4 of the report, and to transfer on long leases at nil consideration the relevant sites to HFD and enter into agreement with HFD regarding the use of the land; where relevant, disposal being subject to the Secretary of State's approval, or where the Secretary of State's approval is not required, where the Cabinet is satisfied that the purpose of the disposal is likely to contribute to the promotion or improvement of economic, social or environmental well-being in respect of the whole or part of the Council's area or of any people in the area, having regard to the Council's community strategy.

3. That approval is given for expenditure of £2.7 million for the purposes of undertaking development of new affordable housing on the sites specified in section 4 of the report from the Decent Neighbourhoods Fund; and that approved funds be

**HAS AN EIA BEEN COMPLETED?  
YES**

**HAS THE REPORT CONTENT BEEN RISK ASSESSED?  
YES**

expended directly by the Council and as a loan to HFD at a commercial interest rate (loan amount to be determined based on detailed appraisal of the development sites to the maximum amount of £2.7 million), provided that:

(a) where such funding is pursuant to the Council's powers under section 2 of the Local Government Act 2000, the Cabinet is satisfied that the new build housing to be developed by HDF will assist in improving or promoting the environmental, social or economic well-being of the area, considering the objects and priorities contained in the Council's community strategy and how the proposed outcomes for the project fit in with that strategy, and

(b) where such funding is pursuant to section 24 of the Local Government Act 1988, the Secretary of State's consent is obtained.

The loan is to be drawn down by HFD based on the approval of development appraisals for each site by the Executive Director of Housing and Regeneration and by the Deputy Director of Finance as part of the project governance structure.

4. That approval is given for £37k per annum funding for a half time development finance officer to be employed by the Council and recharged to HFD.

5. That approval is given to appoint solicitors Browne Jacobson and accountants Grant Thornton at a total cost of up to £30,000 for the Council to seek legal and tax advice in relation to disposal of the sites which will be funded from the Decent Neighbourhoods Fund.

6. That authority be delegated to the Cabinet Member for Housing in conjunction with the Executive Director of Housing & Regeneration to:

(a) Make any changes to the selected sites for the pilot phase following due consideration by them of the outcome of consultation and equalities assessment and detailed feasibility and financial appraisals.

(b) Appoint specialist consultants for additional services through a competitive procurement process to undertake due diligence work prior to transfer of land and approve the funding of these consultants from the Decent Neighbourhoods Fund.

(c) Consider and take into account the results of all

such consultation and equalities assessments (reporting back to Cabinet only if they consider necessary).

7. That authority be delegated to the Cabinet Member for Housing, in conjunction with the Leader, the Executive Director of Housing & Regeneration, the Executive Director of Finance and Corporate Governance, and the Assistant Director (Legal and Democratic Services) to determine (prior to vesting of sites to HFD) the final legal and financial development structure (including any necessary documentation, either generally or for particular cases) and agree submission of applications for Secretary of State's consent to transfer agreed sites into HFD at nil consideration.

## **1. Background**

The Council recognises that there is an imbalance of housing tenures in the borough. With a high proportion of social and private rented accommodation and a low percentage of homeownership and a lack of intermediate housing for those on low to middle incomes.

The Council is concerned that the option to dispose of land to developers, be they housing associations or private sector developers, fails to maximise the financial return to the Council and provides limited control over what is built on the site.

In April 2011, Cabinet approved the establishment of a local housing development company structure to allow the Council to undertake direct delivery of new affordable homes. Similar approaches to delivery of new affordable housing has been successfully implemented in Westminster.

Through the local housing development company structure the Council will be able to maximise its financial return, retain the benefit of any affordable housing that is developed and maintain greater control over the design of the new housing schemes.

## **2. Local Housing Development Company Structure**

Following the Cabinet decision in April 2011 two companies have been registered with the Companies House:

- H&F Development Limited (HFD) - a wholly owned subsidiary company that will be able to undertake building of new homes on Council owned land that will be vested in it for the purpose. This company has three person Board and these are H&F senior officers and the Cabinet Member for Housing.
- H&F Housing Limited (HFH) - a company with charitable aims, established under the Industrial and Provident Society rules, that will be able to access grant, provide housing management, and accept gift aid to achieve greater tax efficiency. The charity is currently being registered with the Financial Services Authority (FSA) and the Tenant Services Agency (TSA). The process of registering with the FSA and the TSA is expected to take between three and six months. Under the rules this company can be run initially with an interim Board which has now been set up with Officers as Board Members. Within the next few months members of the full board will be recruited to replace the interim Board Members.

## **3. How This Approach Will Operate**

To deliver new affordable housing through this structure the approach adopted will vary according to the nature of the site concerned. Officers proposed approach for the sites considered in this report is as follows:

*Becklow Gardens, Lakeside Road and William Church Estate Sites*

- These sites will be developed by the Council funded through the Decent Neighbourhoods Fund.
- On completion new long leases will be granted at nil consideration to HFD who will sell the new properties as Discount Market Sale (DMS) through the Council's Home Buy scheme.
- The Council will enter into an agreement with HFD which covers the use of the land, use of any surpluses and retained equity.
- The profit from the sales units will in so far as is possible be gift aided to HFH.
- The retained equity will be covenanted to the HFH.

#### *Other Sites*

- The Council will transfer the selected sites, subject to Secretary of State's consent, on a long lease basis at nil consideration to HFD and enter into an agreement with HFD which covers the use of the land, the timing of the transfer, the tenure mix and size of units, use of any surpluses and nominations rights.
- The Council will grant a loan at a commercial interest rate (to be repaid at the completion of development), funded from the Decent Neighbourhoods Fund, to HFD for the construction of new affordable housing on the selected sites and the company running costs (annual audit fees, etc) until sales income is received.
- The loan will be paid to HFD in tranches linked to the development phasing programme. HFD will provide monthly accrued management accounts to the Council. Through the loan agreement the Council will have the ability to call in the loan at anytime if not completely satisfied with the HFD development programme.
- HFD will undertake the development and on completion will sell the new properties as Discount Market Sale through the Council's Home Buy scheme.
- The profit from any sales units will in so far as is possible be gift aided to HFH.
- The retained equity will be covenanted to HFH.

Through these approaches the schemes can be developed in a tax efficient manner, with surpluses being gift aided to the charitable company to re-invest in the provision of affordable housing and regeneration.

The Council is currently seeking detailed tax and legal advice from accountants Grant Thornton and solicitors Browne Jacobson to ensure the proposed legal and financial structures are practical and tax efficient and able to discharge all legal obligations. It is proposed that authority be delegated to the Cabinet Member for Housing, in conjunction with the Leader, the Executive Director of Housing & Regeneration, the Executive Director of Finance and Corporate Governance, and the Assistant Director (Legal and Democratic Services) to determine (prior to vesting of sites to HFD) the final legal and financial development structure (including any necessary documentation, either generally or for particular cases) and agree submission of applications for Secretary of State's consent to transfer agreed sites into HFD at nil consideration.

It is estimated that the costs for legal and tax advice will be up to £30,000, which will include putting in place the necessary legal agreements between the Council, HFD and HFH.

#### 4. Pilot Phase Development Sites

In 2007 the Council appointed CB Richard Ellis to undertake a review of all Housing Revenue Account (HRA) properties to determine their potential for additional housing development. The study identified a wide range of schemes that varied from small conversions of existing properties to larger redevelopment sites.

Following the Cabinet decision to set up the local housing development company structure officers and the Council's property advisors have further analysed the 2007 study and have shortlisted development sites for the pilot phase that can now be taken forward.

These sites are primarily undercrofts, bin stores, pramsheds and garages that can be converted, subject to consultation and planning, to create new affordable homes. An initial planning assessment has been undertaken for each of the sites that supports the possibility for development. Lambert Smith Hampton, the Council's retained property consultant, have also completed initial development appraisals of the sites which show the sites as being financially viable (see section 6 of the report).

##### *67-68 Becklow Gardens, W12 (former health clinic premises)*

The first shortlisted site in the pilot phase is a former health clinic premises that comprises part of the ground floor of a five storey Council owned ex-GLC block within the Becklow Gardens Estate. The health clinic use has ceased and the facility is considered surplus to requirement. The property has been void since 2006.

The proposal is to convert the premises to create two new one bedroom flats. This will require a change of use planning application to be completed to enable the property to be converted to residential. An assessment from the Council's planning department has suggested that this would be acceptable.

See Appendix A for the proposed layout of the two flats.

##### *Other Sites*

The Council has identified six further sites that, subject to consultation, planning and detailed technical surveys, can deliver up to 23 new additional Discount Market Sale units. A summary of the sites is set out in the table below and further site details are included in Appendix B:

<b>Site</b>	<b>Current use</b>	<b>Proposed use</b>	<b>Reason for intervention</b>
Verulam House Undercroft, W6	Pram sheds, bike storage and amenity space.	5 new properties and re-provision of enhanced communal facilities	Address ASB issues affecting the ground floor amenity area.
William Church Undercrofts, W12	Pram sheds and amenity space at the base of two tower blocks	4 new properties.	Address ASB issues affecting the ground floor amenity area.

Ground Floor 1-48 Sulgrave Gardens, W6	Pram sheds, storage and former community facility	2 new properties and an enhanced community facility	Support the wider regeneration programme on the Sulgrave Gardens estate
Ground Floor Jepson House, SW6	Pram sheds, amenity space and garages	8 new properties and re-provision of enhanced communal facilities	Enhance the amenity space on the estate and maximise land use.
Ground Floor Lytton Estate (the Grange), W14	Pram sheds	2 new properties and re-provision of pram sheds	Enhance the amenity space on the estate and maximise land use.
Lower-Ground Floor 1-9a Lakeside Road, W14	Undercroft and amenity space	2 new properties	Enhance the amenity space on the estate and maximise land use.

Baily Garner, the appointed Development Agent, are currently undertaking detailed feasibility and development appraisals, including scheme plans, for each of the sites. It is expected that this work will be completed by the end of January 2012. In addition they are developing dialogue with the Planning Department to confirm the planning application process/content and have started to obtain feasibility designs on the projects further to the conclusion of the topographic surveys on site.

It is proposed that authority be delegated to the Cabinet Member for Housing in conjunction with the Executive Director for Housing and Regeneration to make any changes to the selected sites for the pilot phase following due consideration by them of the outcome of consultation and equalities assessment and detailed feasibility and financial appraisals.

## 5. Housing Tenure

It is anticipated that all new properties built by the HFD as part of the pilot phase will be affordable housing products and will comprise of a mixture of one and two bed properties. Definition of affordable housing is based on that set out in Planning Policy Statement 3 Annex B (Nov 2011) which states that Affordable Housing includes Social Rent, Affordable Rent and Intermediate Housing, provided to eligible housing applicant whose needs are not met by the market.

Intermediate Housing is preferred for the provision of affordable housing as an analysis of income and housing costs highlights a severe lack of affordable housing for sale in the borough. At present only 2% of the housing stock in the borough is Intermediate Housing.

The Council prefers to see Intermediate Housing delivered as Discount Market Sale (DMS) which is preferable to Shared Ownership as no rent is charged to the purchaser on the unsold portion of the equity which can in some cases allow the purchaser to buy a bigger percentage share of a property. A requirement of the DMS properties is that it must be available in perpetuity, which means that the unsold equity will be covenanted to HFH. If at a future date the purchaser wishes to buy-out the remaining equity HFH

can consider this request and any receipt would be ring-fenced for affordable housing purposes.

House prices and market rents are high in the borough which means that Intermediate Housing needs to be affordable to a broad range of incomes. It also needs to be on average affordable by the midpoint income set by the Mayor in the London Plan (currently £39,950).

The H&F Home-Buy register has around 3,770 local residents and workers on its database and analysis shows us that around two thirds of these have incomes of between £20,000-£40,000. As a result the Council expects that a third of Intermediate Housing developed by HFD to be affordable to households with an annual gross incomes of £30,000, a third to be affordable to households with an annual gross income of £40,000 with the remaining third to be developed for annual gross household incomes up to the current Regional Housing Board maximum of £64,000 for one and two bed properties and from April 2012 £74,000 for properties with 3 or more bedrooms.

## 6. Financial Business Case

Baily Garner have undertaken initial development appraisal for the shortlisted pilot phase sites. It has been estimated that the costs of construction, professional fees, sales/marketing and contingency for the pilot phase sites is £2.7 million.

The council has also received advice from Lambert Smith Hampton on the estimated sales values for the new flats, informed by research with local agents and the sales values in the area.

The outcome of the development appraisal demonstrates that by building and selling these properties through the local housing development company structure the potential return is estimated to be:

Expenditure (construction, fees, sales, etc)	£2.7 million
Income (sales)	£5.78 million
Return	£3.08 million

For the purpose of the development appraisal the new units have been modelled as Discount Market Sales. Under this model the total return of £3.08 million would be split into:

Equity retained (i.e. the value of the discount to make properties affordable to low to middle income households)	£1.96 million
Profit for reinvestment	£1.12 million

It is proposed that the development cost of £2.7 million for the pilot phase programme is funded from the Decent Neighbourhoods Fund, which in part has been ring fenced for the development of new affordable homes.



## **7. Programme**

The completion of the full pilot phase will take between 12 – 24 months as detailed in the attached Gantt chart at Appendix C. Becklow Gardens will be the first scheme with expected completion by May 2012.

## **8. Allocation, Sale and Marketing**

The Council's Home Buy division offers a service to identify and enable individuals to move into Low Cost Homeownership in the Borough, through acting as the mediator between the housing provider and residents seeking affordable home ownership. It is anticipated that HFD will use this service to market and sell the DMS properties.

H&F Home Buy will be able to undertake the process of identifying suitable applicants from the Home Buy register. Applicants will then have the opportunity to view properties. Once an applicant demonstrates a firm interest in the property, by paying an initial deposit, the individual or household will be required to undertake a financial assessment. This can be carried out by JDC, an independent financial adviser registered with the FSA, which specialises in mortgage brokering for DMS and shared ownership products. A number of developers operating in the borough currently utilise services provided by JDC to assist buyers in securing mortgages. Similarly, JDC will be able to provide these services to households looking to buy properties developed by HFD.

JDC have advised the Council on the viability of obtaining mortgages for the pilot phase sites and have confirmed it would be possible for households to obtain mortgage whilst complying with the levels of affordability proposed. The Council has also sought mortgage advice from Halifax who provided a similar level of assurance.

## **9. Stakeholder/Resident Engagement**

The provision of new affordable housing and in particular affordable home ownership has been identified as a key objective for the Council. The implication of this process will see existing residents, living on the identified estates, impacted both during and after the delivery of the new properties. Therefore, before any scheme can be undertaken (and a legal title vested in HFD) it will be important for the Council to carry out a resident consultation exercise on each of the sites and for the results to be properly assessed.

The individual nature of each site prevents a 'one size fits all' approach to resident consultation. A range of consultation approaches will be used which may include:

- Ward Councillor briefing
- TRA engagement
- Resident newsletter,
- Additional letter to leaseholders,
- Drop-in session to enable residents to engage in site design
- Presentations to the Borough Forum

This standardised approach will be tailored where required to ensure a satisfactory level of consultation is achieved for each site.

## Leaseholders

It will be necessary to amend the service charge apportionment percentage where new units are added to an existing block. The variation will apply to the charge apportioned to the affected block and to the estate as a whole. This process is likely to require resourcing from legal and Home Buy team within the Council. No further variation would generally be required to the lease, as under the current standard form Right to Buy lease the Council is entitled to alter the amenity space on an estate without the leaseholders consent.

## 10. Appointment of Contractors/Consultants

In September 2011, the Cabinet approved the appointment of Baily Garner to undertake initial site feasibility study to shortlist sites for the pilot phase and provide Development Agent services. Moving forward specialist consultants and additional services will be required for each of the selected sites prior to transfer of land into the HFD that are set out below:

### A. Specialist Consultants and Additional Services

- Site plans
- Party wall survey
- Asbestos survey
- Daylight/ sunlight survey
- Rights of Light envelope study
- Topographic & levels survey
- Flood risk assessment
- Utilities & services capacity study
- Ground condition/ geo-environmental survey
- Architect drawings
- Ecology assessment
- Transport impact study

These services will be procured through competitive tender process which will be managed through the London Tender Portal. It is proposed that (where appointment is prior to vesting in HFD) the authority to appoint specialist consultants for additional services be delegated to Cabinet Member for Housing in conjunction with the Executive Director of Housing & Regeneration (subject to compliance with Contracts Standing Orders).

### B. Building Contractor

To accelerate the delivery of 67-68 Becklow Gardens the Council will be commissioning the construction works for these two properties through the Council's term voids contract with Wilmot Dixon, with the work to be delivered by their Major Projects Division.

For the additional pilot phase sites HFD will appoint the building contractor through a competitive procurement process. It is envisaged that this will be undertaken using Construction Line and managed using the London Tenders Portal.

## **11. Risk Management**

The Housing Development Company work programme will be included on the corporate risk register. The risks and opportunities will be managed, as this is a departmentally led project, through the Housing & Regeneration Departments Risk Register.

## **12. Equality Implications**

As per the Equality Act 2010, the Council must consider its obligations with regard to the Public Sector Equality Duty (PSED). It must carry out its functions (as defined by the Human Rights Act 1998) with due regard to the duty and its effect on the protected in a relevant and proportionate way. The duty came into effect on 6th April 2011.

An Initial Equality Impact Analysis (EIA) has been undertaken and made available electronically. It shows that the development of sites, when reviewed against the profile of those on the HomeBuy, to be of medium relevance to, have a positive impact on the following groups:

- Age (especially younger age groups)
- Disabled people (and the Council recognises that some disabled people may require more assistance to benefit)
- Race groups (BME in particular)
- Women

There will also be impacts on women and men, as set out in the EIA, where tram sheds will be moved. This is because this will cause disruption and the degree to which this occurs will vary from site to site. However, there will be no loss of the facility and so this will be mitigated by the re-provision of the facility.

## **13. Comments of the Executive Director of Finance and Corporate Governance**

### **13.1 Sites to be disposed of to HFD pre works commencing**

#### **13.2 Transfer of the properties to HFD at nil value**

13.2.1 The properties are transferring at nil consideration, therefore no capital receipt is created in the Council. The value of the land being transferred will nonetheless need to be determined to indicate the public subsidy involved. In addition the difference between value and consideration can be classified as expenditure for the purposes of increasing the Council's Capital Allowance (a mechanism which reduces the Council's pooling liability).

13.2.2 Transfer of the land at nil consideration also has the added benefit of providing HFD with a buffer against insolvency, however it should also be noted that a transfer at nil consideration will result in higher taxable profits in HFD and therefore in a higher corporation tax liability and gift aid payment to the charity.

13.2.3 The disposal of property would normally create a Stamp Duty Land Tax (SDLT) charge based on market value however where two companies are in a group, it is possible to make transfers of property between them without an

immediate SDLT charge arising. A group exists as LBHF owns 100% of the shares of HFD and is entitled to 100% of dividends and assets on a winding up of the company. Therefore no SDLT liability arises on the transfer of the sites to the HFD.

### 13.3 The Loan to HFD

- 13.3.1 The payment of a loan to HFD would be accounted for as a capital expenditure by the Council. This would be funded from Decent Neighbourhoods receipts and would not increase the Council's borrowing, Given that the loan is underpinning the creation of affordable housing it is anticipated that it can be counted as expenditure for Capital Allowance purposes (enabling the allowance to increase).
- 13.3.2 The interest payable on the loan is likely to be tax deductible for HFD provided it complies with transfer pricing rules, these mean that the amount of the loan must not exceed what would have been paid / lent if H& F and HFD had been independent third parties.
- 13.3.3 The payment of loan interest by HFD to the Council would create a General Fund revenue receipt in the Council's accounts. No withholding tax would have to be applied to the interest payment as there is an exemption for interest paid to Local Authorities [ITA 2007 s936]. The Council should not be taxed on the interest received as Local Authorities are generally exempt from income and corporation taxes.
- 13.3.4 The loan is likely to be drawn down in tranches and draw downs will be based on the formal approval of the development appraisal for each site by the project Board, signed off by the Executive Director of Housing and Regeneration and the Deputy Director of Finance. These development appraisals will include both sensitivity analysis and a cash flow forecast for HFD that would show HFD could afford to repay the debt .
- 13.3.5 The repayment of the principal of the loan would be a capital receipt for the Council. It is intended that the funds would return to the Decent Neighbourhoods Fund.

### 13.4 VAT

- 13.4.1 It may be possible for the contractors to zero rate the construction works on some of these projects on the basis that new dwellings are being created. However, where new dwellings are not created or there is a conversion from commercial to residential, VAT at 20% or 5% will be incurred by HFD. Any professional fees incurred will also be subject to VAT at 20%.
- 13.4.2 In order to qualify as a new dwelling and therefore for construction costs to be zero rated, the following conditions must be met;
- it is built from scratch and before work starts any pre-existing building is demolished completely to ground level (cellars, basements and the ground level slab may be retained)
  - the new building makes use of no more than a single facade (or double facade on a corner site) of a pre-existing building and the facade is retained as planning requirement
  - a new building is constructed against an existing building so that they share a party wall but there is no internal access between them

- an extension or enlargement to existing building creates an additional dwelling/dwellings

13.4.3 In most cases, work will not qualify if there is any internal access to an existing building.

13.4.4 From a review of the site details it appears that three sites (Jepson House, Verulam House and Lytton Estate), may qualify as the construction of new dwellings, subject to more detailed plans being reviewed. In relation to Becklow Gardens and Sulgrave Gardens, the works may qualify for VAT at the reduced rate of 5% on the basis that existing commercial properties are being converted into new dwellings. The remaining two sites (Lakeside Road and William Church Estate) are likely to be classified as refurbishment and will incur VAT at 20%.

13.4.5 This VAT will be reclaimable in full by HFD to the extent that it relates to taxable outputs. Should any outputs be exempt from VAT a partial exemption calculation would be created and VAT paid would only be partially recoverable to the extent it related to taxable outputs.

13.4.6 The principal planned outputs of HFD are receipts from the disposal of the completed units as Discounted Market Sales (DMS). The grant of the interest in the completed units by HFD will be zero rated where the interest is the first grant of a major interest (freehold or lease of 21 years or more) by the person constructing new dwellings or by the person converting a commercial building to a new dwelling. Where new dwellings are not created, that is the refurbishment of existing residential dwellings, the supply by HFD will be exempt from VAT, in these circumstance VAT would not be recoverable. Our investigations have shown that, excluding Lakeside Road, Becklow Gardens and William Church Estate site which are dealt with separately below, none of the proposed sites involve the refurbishment of buildings which are or have previously been in residential use. Therefore it is likely that the sales of the initial tranche of equity in the completed units on these projects will be zero rated, thus enabling HFD to reclaim any VAT paid on costs associated with these sites in full. It should be noted that the sale of any retained equity that has been gifted to the Charity at a later date by the charity would be exempt from VAT.

### 13.5 Accounting for the transaction within HFD

13.5.1 As the properties are being developed for sale they are likely be current assets (Stock and Work in progress) in HFD until they are sold at which point the costs will become the cost of sale within the Profit and Loss Account.

13.5.2 It will be critical to the projects success to have high quality business planning, financial appraisals of developments and monthly management accounts including accurate cash flow forecasting for HFD in order to ensure the predicted profits are achieved and that cash is available when required.

### 13.6 Corporation Tax and Gift Aid

13.6.1 As the new properties are sold they are likely to create a taxable profit within HFD which would give rise to corporation tax. As noted above transferring the properties to HFD at nil consideration will create higher taxable profits within HFD, with a higher resultant corporation tax liability before Gift Aid necessitating a higher Gift Aid payment to the charity.

- 13.6.2 If HFD makes a gift payment to the charity, subject to meeting certain conditions, the payment is deductible from the HFD's taxable profits for the tax period in which the payment is made. The conditions require that, broadly, the donor does not receive any benefit as a result of making the gift, and that the payments is not regarded as a distribution for tax purposes.
- 13.6.3 As the charity is not the parent of HFD, any gift aid payments must be made in the accounting period in which the tax deduction is required. It will therefore be necessary to estimate what the taxable profits will be before the year end in order to make an appropriate payment.
- 13.6.4 This may give rise to timing difficulties as the company's profits are not normally known until after the end of the period, while the payment has to be actually paid during the period to be deductible. It is therefore critical as noted above to have comprehensive accurate monthly management accounts for HFD that are prepared on a full accruals basis and that contracts are let in such a way as to enable accurate, timely estimates of costs for each year to 31<sup>st</sup> March to be made. There is a significant risk that there will on occasion be a small corporation tax liability within HFD due to this timing issue.
- 13.6.5 The gift payment is deducted from taxable profits only after all other tax reliefs have been used (other than group relief of losses from other group companies). If the gift payment exceeds available taxable profits, the excess is wasted and cannot be used in a different period.

### **13.7 Becklow Gardens, Lakeside Road and William Church Estate Sites**

- 13.7.1 It is proposed that these properties are converted/refurbished by the Council. This is a capital cost for the Council and is allowable for capital allowance purposes. VAT will apply to the works as noted above, this VAT should be recoverable in full by the Council, however this will require monitoring of the impact on our partial exemption limit so there is a risk of unrecoverable VAT.
- 13.7.2 The properties will then be transferred under a lease at nil value to HFD.
- 13.7.3 In the case of Becklow Gardens the grant of the interest in the completed units by the Council to HFD will be zero rated as the interest is the first grant of a major interest (freehold or lease of 21 years or more) by the person converting a commercial building to a new dwelling.
- 13.7.4 In the case of Lakeside Road and William Church Estate the grant of the interest in the completed units by the Council to HFD is likely to be exempt from VAT as the building was previously classified as residential.
- 13.7.5 This means that the sale of these units as DMS by HFD will be exempt from VAT, this means that HFD will not be able to reclaim VAT on any fees associated with the sale of these properties.
- 13.7.6 Accounting for the transaction in HFD, corporation tax and gift aid will be as described above for the other sites.
- 13.7.7 It should be noted that this approach will result in major taxable profits within HFD and therefore higher gift aid payments to HFH.

## **14 Comments of the Assistant Director (Legal and Democratic Services)**

14.1.1 HFD and HFH have been incorporated, but may not carry out trading activities until such time as the Cabinet has considered and approved a business case in accordance with the 'best value' provisions of Section 95 of the Local Government Act 2003. While the Cabinet approved the business case on 18<sup>th</sup> April 2011 to set up HFD and HFH, it must specifically consider the business case for the purposes of section 95 approval.

i. Section 95 of the Local Government Act 2003 will allow the Council to do for a commercial purpose anything which it is authorised to do for the purpose of carrying on any of its ordinary functions. The trading power permits the Council to trade in function related activities only (i.e. the Council needs to have the power to engage in an activity before it can trade in it), so the power to trade does not confer a general power to trade but a power that is governed by a criteria designed to protect the numerous interests and stakeholders.

ii. The power conferred by section 95 may only be exercised by the Council through a company within the meaning of Part 5 of the Local Government and Housing Act 1989 and after a business case has been prepared and approved as required by Regulation 2 of the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009 ("the Trading Order").

14.1.2 While the companies themselves have been set up prior to the requirements of section 95 being satisfied, section 95 power and the Trading Order do not prevent the setting up of a company which may be a vehicle for commercial activities, only the carrying out of those activities themselves. As neither company has carried out any trading activity requiring reliance on section 95 so far, there has been no restriction upon the Council setting up the two companies.

14.1.3 The Trading Order requires the business case to deal with:-

- a) The objects of the business (dealt with in the 18 April 2011 Cabinet report);
- b) The investment and other resources required to achieve those objectives (dealt with in recommendation 4 and sections 4 & 6 of the report);
- c) Any risks the business might face and how significant these risks are (dealt with in the Risk Register in Appendix D); and
- d) The expected financial results of the business (dealt with in section 6 of the report),

together with any other relevant outcomes that the business is expected to achieve. The business case for the section 95 approval is that previously approved by the Cabinet on 18<sup>th</sup> April 2011 and the Cabinet is referred to that business case. The Trading Order requires the business case to be a "comprehensive statement". A detailed business plan (as opposed to a business case) for the two companies is desirable at a later stage, building upon the existing business case prepared for the purposes of this section 95 approval.

**14.2 Powers to fund HFD in connection with the provision of housing accommodation which is to be let**

14.2.1 To the extent that the Council's loan to HFD is for the purposes of, or in connection with, the acquisition, construction, conversion, rehabilitation, improvement maintenance or management of any property which is or is intended to be privately let as housing accommodation, then it has the power to do so under section 24 of the Local Government Act 1988. The Council may only be able to exercise that power if it obtains the Secretary of State's consent pursuant to section 25.

**14.3 Powers to funding HFD in connection with the provision of housing accommodation which is to be sold**

14.3.1 The Council's powers under section 24 of the Local Government Act 1988 only apply where the housing accommodation is to be let. They will not apply to financial assistance provided by the Council to HFD in connection with land to be developed by HFD for outright sale.

14.3.2 To the extent that the Council's loan to HFD is for housing accommodation to be sold, the Council must rely on its wellbeing powers under section 2 of the Local Government Act 2000 and the subsidiary power of local authorities under Section 111 of the Local Government Act 1972. The wellbeing power is wide and includes (but is not limited to) incurring expenditure, providing financial assistance to any person, entering into arrangements or agreements with any person and providing staff, goods or services.

14.3.3 To exercise this power the Council must be satisfied that the new build housing to be developed by HFD will assist in improving or promoting the environmental, social or economic well-being of the area for which the Council is responsible, having regard to the Council's community strategy.

14.3.4 Section 2 is a power to do things and does not provide a power to improve the Council's financial position. It is not a power by means of a business enterprise. It is not concerned with how a Council finances its activities, saves money or generates income and returns. The Council must carefully consider and justify the use of the section 2 power (particularly by considering the objects and priorities contained in the Council's community strategy and how the proposed outcomes for the project fit in with that strategy).

**14.4 Disposal of Land**

14.4.1 The Secretary of State's consent will be required under Section 32 of the Housing Act 1985 to dispose of sites to HFD which are currently held for housing purposes under Part II of that Act. It is likely that individual application will need to be made on each occasion. The Secretary of State will want to know that all proper consultation has taken place.

14.4.2 Under Section 32, there is no express obligation to get best consideration on disposal and the grant of consent by the Secretary of State for a disposal at nil consideration should satisfy any residual obligation arising under the common law general fiduciary duty.

14.4.3 Most of the sites are held under Part II of the Housing Act 1985 and therefore it will be important that disposal is structured so as not to trigger an obligation



(under national pooling rules) to account to the Secretary of State at DCLG for 50% of the capital receipt derived from disposal. This should be possible if the new build dwellings are taken outside the subsidy system of the HRA (by an agreement with the Secretary of State at DCLG under Section 80B Local Government and Housing Act 1989 prior to disposal to HFD) and the receipt is covered by an equivalent amount of Available Capital Allowance (i.e. amounts, whether in money or in kind, which the Council has resolved to contribute towards projects of affordable housing or regeneration).

14.4.4 Land which is held for non housing purposes may be disposed of to HFD in accordance with section 123 of the Local Government Act 1972. Unless the disposal is for the best consideration which can be reasonably obtained (which is not the case here) then the Secretary of State's consent is required. However, the general consent (General Disposal Consent 2003) will apply if the purpose of the disposal is likely to contribute to the promotion or improvement of economic, social or environmental well-being in respect of the whole or part of the Council's area or of any people in the area and the difference between the unrestricted value of the land to be disposed of and the consideration for the disposal does not exceed £2 million (i.e. the undervalue element for each parcel of land). When making its considerations, the Council should have regard to its community strategy.

#### **14.5 State aid**

14.5.1 Both the transfer of land to HDF at an undervalue and other funding to both HFD and HFH amount, on the face of matters, to state aid but can be taken outside the state aid regime on the basis that the activities to be carried out by HFD and HFH amount to services of general economic interest. The criteria to meet the relevant test require certain protections to be put in place, including the Council entering into appropriate contractual arrangements with HFD and HFH.

#### **14.6 Decisions by HFD's board**

14.6.1 It is important to appreciate that HFD is a separate legal entity and its Board must take decisions independently but subject to the terms imposed in any agreement with the Council or any lease or transfer from the Council.

14.6.2 Once the sites have been vested in HFD they will carry out the development and its Board take the decisions (albeit that the Council may need to act as guarantor in relation to contracts let). The Council's control will be by means of the persons the Council has nominated to be directors of HFD (albeit they must act primarily in the interests of HFD).

#### **14.7 Property related issues**

14.7.1 As most of the sites are or were amenities for housing estates, it will generally be necessary to conduct a consultation with secure tenants under Section 105 of the Housing Act 1985 before any decision is taken with regard to a particular site. To comply with Section 105 the Council should use its published consultation procedures and provide adequate opportunity for secure tenants to know what is proposed and to have a reasonable time and opportunity to comment. No final decision on a site should be taken without first considering and taking into account the responses. Similarly due regard must be had to the impact a proposal in relation to any site may have on

persons with “protected characteristics” under the Equality Act 2010 e.g. impact on women or particular minorities from loss of estate amenities.

- 14.7.2 Variation of the service charge provisions in existing leases is not a simple or inexpensive matter in the case of leaseholders. Fortunately, in most cases service charge percentages will be reduced (albeit that the reduced percentage will apply to increased overall costs), so that few leaseholders might be expected not to co-operate (the standard Right to Buy lease contains no provision entitling the Council to alter service charge percentages). Variation can be agreed individually with leaseholders (a laborious process in which leaseholders’ lenders would need to be involved, involving separate deeds of variation with each leaseholder). Alternatively (especially where some leaseholders do not co-operate) application can be made to the Leasehold Valuation Tribunal under Section 37 Landlord and Tenant Act 1987 for an order varying all leases in a particular block or related blocks. The Tribunal can only do this, however, if (broadly) 75% of leaseholders consent and not more than 10% actually oppose (where not more than 8 leaseholders are affected, either all must consent, or all but one must consent). If the Tribunal is prevented from acting, as a last resort it seems that the court has inherent jurisdiction (in cases such as these) to order variation of service charge provisions (though the scope of this jurisdiction is a little uncertain).
- 14.7.3 It must be appreciated that the higher returns and other benefits of operating through the medium of a subsidiary development company come at the expense (for practical purposes) of shouldering developer’s risk and the Council could find that it loses money if properties do not sell as anticipated at prices sufficient to cover development costs. Although HFD is a separate legal entity (so that its debts are not the responsibility of the Council) nonetheless it is likely that contractors and others doing business with HFD will seek a guarantee from the Council. If the Council acts as agent for HFD (e.g. in letting the building contract) it will anyway be directly liable under the contract.
- 14.7.4 Right to Buy and other leases have been granted over a period in excess of 30 years and not all leases are in exactly the same form. This means the leases of leaseholders liable to be affected by the development will need to be checked, in case special action needs to be taken to ensure that the Council/HFD can carry out development without material risk of challenge.

## **15. Comments of the Assistant Director Procurement (if relevant)**

Advice has been sought from the Corporate Procurement Team.

The Council and H&F Development Limited, being an wholly owned subsidiary of the Council, are required to undertake any procurement exercise in an open and transparent manner in accordance with the Public Contracts Regulations 2006 (as amended) and their Contract Standing Orders.

**LOCAL GOVERNMENT ACT 2000**  
**LIST OF BACKGROUND PAPERS**

<b>No.</b>	<b>Description of Background Papers</b>	<b>Name/Ext of holder of file/copy</b>	<b>Department/ Location</b>
1.	Housing Development Company Cabinet Report	Matin Miah - 3480	HRD
2.	Appointment of Development Agent to Support the Delivery of New Affordable Homes	Matin Miah – 3480	HRD
<b>CONTACT OFFICER:</b>		<b>NAME: Matin Miah</b> <b>EXT. 3482</b>	