

Cabinet

18 APRIL 2011

**CABINET MEMBER
FOR HOUSING**

Councillor Lucy Ivimy

HOUSING DEVELOPMENT COMPANY

This report sets out proposals for setting up Council controlled subsidiary vehicles that could undertake development of Council owned land for the provision of new affordable housing.

**Wards:
All**

CONTRIBUTORS

DFCS
ADLDS
Housing &
Regeneration

Recommendations:

1. To approve the setting up of:
 - a. A wholly owned subsidiary company (Development Company)
 - b. A Charitable company
2. That approval be given to the draft company documentations set out in Appendices 2 – 6, and that authority be delegated to the Director of Housing and Regeneration in conjunction with the Assistant Director (Legal and Democratic Services) and the Cabinet Member for Housing and the Leader to finalise.
3. That a detailed business case be developed for suitable Council-owned land for development through the Development company for further consideration by the Cabinet.
4. That approval be given to consultancy spend of up to £50,000 towards the cost of legal, property and tax/financial advice in relation to setting up the company structures and developing detailed business cases for the first phase delivery sites.

HAS THE REPORT
CONTENT BEEN
RISK ASSESSED?
YES

HAS A EIA BEEN
COMPLETED?
YES

1. INTRODUCTION & BACKGROUND

- 1.1 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 home ownership and lack of intermediate housing for those on low to middle incomes.
- 1.3 The Council is concerned that the option of disposal of land to developers, be they housing associations or private sector developers, fails to maximise its financial return, gives it limited control over what is built on the site and takes away control of any affordable housing on the site.
- 1.4 However, under the current legislation the Council is unable to undertake commercial operations such as development of housing directly. Therefore, in order to be able to build homes directly it is necessary for the Council to establish subsidiary vehicles to overcome the potential vices issues. This would also ensure that commercial, legal and financial risks are not all contained within the Council.
- 1.5 Officers and Members of the Council have investigated other local authority housing delivery vehicle models, in particular Westminster City Council and Woking Borough Council models. These have helped to inform the recommendations of the report; however the Council has taken legal and financial advice to ensure that the proposed structure is fit for LBHF purposes.

Objectives

- 1.6 The key Council objective is that any sale/development of land/properties will:
- a. Enable the Council to maximise its financial return.
 - b. Enable the Council to retain any affordable housing that is developed in such schemes within its portfolio.
 - c. Give the Council greater control over the design of the scheme and ensure it delivers what the Council and local community want in the built environment.

2. POTENTIAL HOUSING DEVELOPMENT COMPANY STRUCTURES

- 2.1 The Council has considered a range of options for achieving its objectives and has concluded that they can be achieved by setting up a range of corporate vehicles that could:
- a. achieve directly controlled housing delivery on Council owned land;
and

- b. provide a housing management company that could manage the affordable housing

Development Company

2.2 In order to meet these requirements it is necessary for the Council to set up a wholly owned subsidiary company to undertake the building of new homes. How the development company could operate is set out below:

- a. Council Land

Council could transfer land into the development company. This will always be leasehold so that the Council continues to own and control the freehold interests. The length of the leases will vary according to the type of scheme. If the scheme includes units for market or intermediate sale a period of up to 125 years will need to be granted.

This land could be transferred at nil value, discounted value or full value according to the viability of the particular scheme or programme. In most instances the land transfer will require the Secretary of State's consent which is normally provided within 14 days of application.

- b. Loan Agreements

The development company could take on short term development funding sufficient to build out the sites. The peak debt could be reduced by sales income and any HCA funding.

The lenders could be high street banks, pension funds, major developers with cash assets or through prudential borrowing.

External lenders will want to understand the business, gauge the risk and know that this has been covered off, wherever possible. They will also have a keen interest in who the contractor is and that they are financially sound. For these reasons the selection process for the lenders should take place either prior to or simultaneously with the selection of the contractor.

Subject to acceptable financial and legal advice one alternative which could help to simplify the lending and in all likelihood lower the overall costs would be to make the borrowing through the Public Works Loan Board.

- c. Agreements with Contractor

The development company could enter into agreements with contractor to build out the individual schemes and market any outright sales units. These areas represent the biggest areas of financial risk and in view of this the Council could require the development company to ensure that the contractor takes out a Bond to:

- i) Protect against the effect of the builder going into receivership or not meeting the development timescales or standards required either statutorily (Building Control, Planning etc) or those required by the HCA.
- ii) Guarantee the minimum sales prices of any market sales units in order to provide certainty over the minimum level of sales income that will be generated and that this level fits within the overall financial model for the scheme. In instances where higher sales values are achieved these could be shared between the development company and the contractor on a pre agreed basis.

Profits and Investment Portfolio

2.3 Four potential development structures have been investigated that could hold the new affordable housing built (including retained equity under any Shared Equity arrangements) and any profits generated from the development. The options are set out below:

- Structure 1: The development company could retain the affordable properties and the post-tax development profits distributed to the Council
- Structure 2: The development company could gift to the Council the affordable properties and any post-tax development profits
- Structure 3: The development company could gift to the Council the affordable properties and gift to a charitable entity any post-tax development profits
- Structure 4: The development company could gift to a charitable entity the affordable properties and any post-tax development profits.

See diagram in Appendix 1 for an overview of the potential structures.

2.4 There are various tax implications associated with each of the above options, which are set out below:

Summary of main tax differences between the structures	DevCo retains properties and profit	DevCo gifts properties & profits to LBHF	DevCo gifts properties to LBHF & profits to Charity	DevCo gifts properties & profits to Charity
No SDLT ¹ on transfers of land between the entities in the structure	✓	✓	✓	✓
No VAT on costs of constructing residential properties	✓	✓	✓	✓

¹ Stamp Duty Land Tax

Summary of main tax differences between the structures	DevCo retains properties and profit	DevCo gifts properties & profits to LBHF	DevCo gifts properties to LBHF & profits to Charity	DevCo gifts properties & profits to Charity
Profits from sale of completed properties not subject to Corporation Tax	x	x	✓	✓
Profits from sale of further equity in shared equity properties not subject to Corporation Tax	x	✓	✓	✓

Charity

- 2.5 Under two of the structures above it would be necessary to establish a separate charitable entity to work alongside the development company. This could be a company with charitable aims established under the Industrial and Provident Society rules and registered with the Financial Services Authority. The charity would be well placed to be able to apply for Registered Provider status through the Tenant Services Agency (TSA) and this will open the way for this company to receive HCA grant funding towards the provision of affordable homes.
- 2.6 It is evident from the above table that there are likely to be numerous options for how any properties and any profits could be held for tax efficiency purposes. It is likely that the choice of final structure will be dependent on individual schemes, including variables such as land values, level of profit, tenure mix, etc.
- 2.7 It is advisable that in order to gain tax efficiency and maximise return for the Council both the development company and charity would need to be in place, however the use of the charity will need to be determined on a case by case basis in light of details of each scheme. As part of development of detailed business cases and implementation plans detailed tax advice will be sought from suitably qualified tax lawyers.

3. GOVERNANCE ARRANGEMENTS

- 3.1 The governance of the two companies will be essential to the Council in order to protect the assets that are transferred and to minimise risk. There will be numerous options available to the Council to exercise control over the companies. The following paragraphs set out how these could be applied:

Development Company

- 3.2 The development company could have only two board members (appointed by the Council) and one shareholder (Council). Through this arrangement

the Council can completely control the decisions made by the company and the agreements it enters into with lenders and contractors.

Draft company Articles of Association attached in Appendix 2.

Charity

3.3 The charity would have to be independent of the Council. The charity's decisions would have to be made in the interest of the company and in pursuit of its charitable interests. However, as the Council may decide to make considerable investment in the charity it would be appropriate to seek to ensure that these are protected and continue into the future to support the Council's overarching housing & regeneration strategies. In order to ensure this is achieved, while not breaching any company or charitable rules, the Council could put in place following set of "controls":

a. The Shareholders

There could be 4 shares held by the shareholders, 3 by the Council and 1 by an independent.

b. The Board

The Board could comprise of 7 members, 4 nominated by the Council plus 2 residents and 1 independent selected by the Council. The independent could act as the chair of the board.

The Rules of the Charity could give the Council the right to appoint a majority of the board of directors and provide that a board meeting would not be quorate unless a majority of the directors present were Council representatives.

c. Registered Rules of the Company

Aside from the shareholding and board composition as set out above the Council could also exert controls over the business of charity through the Registered Rules.

Notwithstanding the number of shareholders from time to time in the charity, the Council could always have sufficient voting rights to block any resolution to change the rules or anything else requiring a special resolution of the members.

Draft Registered Rules of the charity attached in Appendix 3.

d. Individual funding agreements

In order to protect the Council's various investments, individual funding agreements could be required between the Council and the charity on any scheme on which land, grants or loans are made available through the Council. Where loans are made available a charge could also be registered on the title for the property concerned.

These agreements and charges would ensure that in the unlikely event of default by the charity that the Council will have priority over the assets, subject to any step in rights agreed with lenders or HCA conditions applied on HCA grant funded schemes.

e. Intra Group Agreement

In a similar manner to Registered Providers the Council, as the parent organisation, could agree an Intra Group Agreement (IGA) with the charity in order to ensure that the significant Council investment is safeguarded and that the charity and the Council continue to work in partnership to deliver schemes which complement and contribute towards the delivery of the Council's and the charity's housing and regeneration strategies now and in the future.

This key agreement could provide the Council with considerable control over the day to day operations of the charity, including the requirement that parent approval is obtained for:

- i) All reports considered at the board
- ii) For any meeting at which a board member including the chair is to be removed, and has right of veto
- iii) For any changes to board composition
- iv) Shareholder meetings could only be quorate if the parent is represented
- v) In all matters the Intra Group Agreement takes precedence

Draft Inter Group Agreement attached in Appendix 4.

f. Board Member Undertakings

The Council and the charity could agree that board members can only be appointed once they have signed the Board Members Undertaking which in outline covers board Members general conduct and what is expected of them, and requires board members:

- i) To acknowledge the precedence of the Intra Group Agreement
- ii) Not to bring the parent into disrepute
- iii) To constructively contribute towards the setting, adoption and delivery of the charity's housing strategy

Draft Board Member Undertakings is attached in Appendix 5.

g. Chair's Agreement for Services

The Council and charity could agree that the chair is selected by the parent under the rules and should be required to sign an Agreement for Services prior to being formally appointed to be chair. This Agreement could also reflect the requirements set out for board members above but also highlight these other areas:

- i) Role as leader of the board to ensure compliance with the Registered Rules, Intra Group Agreement and delivery of the Council/charity's housing and regeneration strategies
- ii) Confidentiality both when in post and beyond
- iii) Time commitment and attendance at board meetings and other events as requested
- iv) Acknowledgement of parent selection for 3 years

Draft Chair's Agreement for Services is attached in Appendix 6.

- 3.4 Council has taken advice from legal firm Brown Jacobson in drafting the various company documentations to ensure they could create the correct levels of control to protect the significant input the Council could make while still allowing the charity to meet its independent charitable and company requirements.

4. IMPLEMENTATION PROGRAMME

- 4.1 If approval is given officers supported by external advisors will commence on the following work programme:

a. The Company/Companies

- finalise and submit rules for company/companies
- register the company/companies
- finalise the appropriate levels of governance
- apply for charitable status for the charity
- work up and submit application to TSA for Registered Provider status for the charity
- submit application for approved housing manager status with TSA

b. Business Plans

- work up detailed business plan for initial site for development through the housing companies.

Timetable

- 4.3 Subject to the Cabinet approval it will be possible to set-up and register the development company and charity in May 2011, including submission of

application to the FSA for charitable registration and application to TSA/HCA for Registered Provider status.

Resources

- 4.4 Cabinet previously approved a report in March 2010 through which Section 106 unallocated funds were ring-fenced in order to fund the strategic regeneration programme consultancy in feasibility exercises, legal and finance work and other specialist areas which cannot be undertaken by the Council itself. This report requests approval to appoint professional finance/tax advisors, property/planning and legal advice to the value of £50,000, which will be met from the Watson House s106. A sum of £30,000 has been spent on consultancy services in developing the structures and drafting company documents.

5. COMMENTS OF THE DIRECTOR OF FINANCE AND CORPORATE SERVICES

- 5.1 The report sets out the reasons why it is proposed to set up two housing companies (a wholly owned subsidiary and a charitable company). They potentially offer a more financially advantageous way, rather than traditional disposal or provision through the Housing Revenue Account, of taking forward the Council's objectives regarding the sale and development of properties and land. They may also enable the Council to keep greater control over the design of schemes and future use of the new dwellings.
- 5.2 The decision on whether to take forward developments through either company, or a standard disposal/redevelopment through the HRA, will be taken on completion of a detailed business case for each potential site. The option selected will require Cabinet approval. It is understood that potential schemes will now be subject to the preparation of a detailed business case.
- 5.3 As well as bringing benefits there are important issues that the Council needs to be comfortable with when proceeding with either company:
- There is more inherent financial risk. Traditional disposal delivers an upfront receipt with risk passing to the purchaser. Risk would remain with the council under the company model which would need to be carefully managed/shared.
 - Significant development finance, both short and long-term, may be required. This may come from the decent neighbourhoods pot (receipts generated from the sale of expensive voids etc), developer contributions or borrowing. Should borrowing be required it would be shown on the Council's balance sheet. Whilst financed by charges to the appropriate housing company this would count as council debt.
 - Any profits that pass to the company with charitable aims can only be used for such charitable purposes. The Council would not have a free choice on how such money is used and needs to be satisfied that the charitable purposes are appropriate. Long-term control of the assets, and underlying equity, would reside with the charitable company.

- 5.4 Subject to Cabinet approval, it is now proposed that delegated authority be given to the Director of Housing and Regeneration and the Assistant Director (Legal and democratic Services) in conjunction with the Cabinet Member for Housing and the Leader, to finalise the company documentation and structures.
- 5.5 Individual business plans will need to be developed for taking forward new initiatives and costs will be incurred on financial and legal advice regarding setting up the company structures. It is proposed that a budget of £50,000 be approved for these purposes funded from an appropriate section 106 agreement.

6. COMMENTS OF THE ASSISTANT DIRECTOR (LEGAL AND DEMOCRATIC SERVICES)

Consent for the disposal of land

- 6.1 The proposal is to transfer vacant properties or land to the development company. Most of these may be held for housing purposes under Part 11 of the Housing Act 1985. Under section 32 of the 1985 Act, the Council has power to dispose of land held for housing purposes but only with the consent of the Secretary of State. The specific consent of the Secretary of State will not be required if any of the general consents contained in the Consent for the Disposal of Part 11 Dwelling Houses 2005 apply. In particular, there is a general consent (Consent E3.1) which applies on the disposal of land for the best consideration which can be reasonably obtained where any dwelling houses included in the disposal are vacant, will not be used as housing accommodation and will be demolished. This general consent would therefore appear to be appropriate to the development sites the Council is currently considering, where the land would be transferred to the development with vacant possession and the development company does not let any of the property as housing accommodation but instead demolishes all of the existing buildings for redevelopment.
- 6.2 If the land in question is held for non housing purposes, then this can be disposed of in accordance with section 123, Local Government Act 1972. Provided that the disposal is for the best consideration which can be reasonably obtained then the Secretary of State's consent is required but a general consent (Local Government Act 1972, 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.

Consent for the provision of financial assistance

- 6.3 If the Council is to provide any financial support to the development company, it will be necessary to obtain consent under section 25, Local

Government Act 1988. The Council is only able to exercise its power to give financial assistance in accordance with a consent given by the Secretary of State. Again, a number of general consents have been issued but, in the case of this section, it does not appear that any of the consents currently available would be applicable to this project.

Consent for the appropriation of land to the general fund.

- 6.4 The receipt from the initial transfer of any Council's housing land will go to the HRA unless the HRA land is appropriated to the General Fund prior to transfer to the development company but if this was to be carried out, the prior consent of the Secretary of State would be required under section 19, Housing Act 1985.

Council vires

- 6.5 The Council has a general fiduciary duty to its tax payers to ensure that it achieves value for money in connection with the disposal of its assets. Assuming the Council transfers its land to the development company for the best consideration obtainable, value for money will be achieved. However, if a transfer at an undervalue is contemplated, then the state aid rules may need to be complied with.
- 6.6 Following the case of LAML (Risk Management Partners Limited v the Council of the London Boroughs of Brent and Harrow, the importance of the need for councils to report on the particular powers being used to carry out any particular scheme was highlighted. In the case of development company, the two principal powers to establish and participate in a proposed LHC are the "well-being power" contained in section 2, Local Government Act 2000 and the power under section 111, Local Government Act 1972. The well-being power prohibits the raising of money by borrowing so if it was proposed for the Council to on-lend to the development company, it is likely that consent from the Secretary of State would be required under section 24, Local Government Act 1988

EU Procurement

- 6.7 A simple disposal of land by the Council to the development company would fall within the "land exemption" and would not be subject to advertisement under the EU procurement rules. However, if the transfer to the development company also includes specific requirements of the Council to be delivered by the development company then there is the possibility of these amounting to a public works contract and caught by the procurement rules.

Security of Tenure

- 6.8 Both of the options described lead to the ability to let on assured shorthold tenancies. However, in both instances this will be in relation to tenancies that are excluded from the definition of "secure tenancies" as provided by the Housing Act 1985 as amended. As such, the accommodation is likely to be provided as temporary accommodation for the homeless or for introductory tenants

Future Risk

- 6.9 It should be noted that if the development company is to attract funding, then there is the likelihood of the Council being required by the funder to stand in the position as a guarantor. Whilst the land itself may be sufficient security in some instances, it may not always be the case especially if there are considerable construction costs.

Summary

- 6.10 These comments refer to a number of the consent and vires issues which the Council would face in the setting up and running of a development company. It is therefore important that specialist legal advice is available to ensure that the Council operates within its powers. A tender exercise has already been carried out and the firm of Browne Jacobson has been appointed from the panel of the London Borough's Legal Alliance.

7. RISK MANAGEMENT COMMENTS

- 7.1 The proposals outlined to Members identify a number of legal, financial, procurement and taxation risks that require further detailed exploration before proceeding. There are distinctly benefits to be gained from the options and risks need to be carefully managed as the project evolves. The Corporate Risk Register will be updated to include details of this new emerging risk.

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

No.	Description of Background Papers	Name/Ext of holder of file/copy	Department/ Location
1.	None		
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