

ADDRESSING UNMET HOUSING NEED – OUTLINE BUSINESS CASE TO ESTABLISH A WHOLLY OWNED LOCAL HOUSING COMPANY

Responsible Officer Mark Barrow

e-mail: mark.barrow@shropshire.gov.uk

Tel: 01743 258919

1. Summary

1.1 On the 7th November 2018, the report 'Meeting Housing Need in Shropshire' was presented to Cabinet, with the three recommendations listed below approved.

- 1) Develop a viable outline business case to address Shropshire's unmet housing and development needs.
- 2) Develop detailed proposals and options for appropriate arrangements to deliver the outline business case: either delivery of housing by the Council itself or: to form a company to undertake this work.
- 3) Present a report to the 13th December 2018 meeting of Full Council for decisions to implement the outline business case.

1.2 In response, this report and outline business case (with supporting legal advice) has been produced. It seeks 'in principle decisions' to set up a Council wholly owned Local Housing Company and provides background information to support recommendations. This is intended to confirm the specialist legal and commercial advice received and ensure that Members are supportive of proposals at this stage before more detailed work is progressed.

- 1.3 The primary purpose of such a company would be use Council owned land, and acquire land and property, to develop housing and wider redevelopment in areas where we see unmet need or to address local pressures. For example, this may be in the form of developments for sale, affordable rent, shared ownership, starter homes, later living or key worker housing.
- 1.4 New development will need to include a portfolio of including both open market properties for sale and rent. Currently 13% of the county's housing stock is classed as affordable / social housing and 87% private sector housing with approximately 17% privately rented.
- 1.5 If approved, the intention is to return Cabinet and Council with more detailed fully costed proposals, a full business case and business plan. It is at that stage final approval to setup and register a company will be sought.
- 1.6 The report outlines the background aspects of unmet housing and development. Detailed analysis of the existing housing stock, recent new builds, housing demand and the unmet need will form part of the full business case. A further Council objective, in addition to addressing unmet housing need, is to provide an opportunity to generate a financial return.
- 1.7 The legal advice from Trowers and Hamlins (Appendix B p.2 para.2.4), confirms that, should we wish to operate for a commercial return for open market rents and sales, a company structure is required. It is important to allow this flexibility, so we can create a mixed portfolio of development also allowing profit to be made in some cases and investment to made where development would otherwise be unviable.
- 1.8 As the market is not delivering the homes we need, the remaining main option is for the Council is to set-up a company itself to address this need and work in partnership where possible, to encourage the market to do the same. Subsequently, this report recommends and focuses on setting up a Council wholly owned local housing company. It is important to recognise that Registered Housing Providers (Housing Associations) are also developing mixed tenure housing, however this is not countywide and not at a scale to meet future demand.
- 1.9 The Council owns allocated and unallocated land (within the Local Plan) primarily in the north and centrally. Development in the south of the County is likely to require acquisitions.

- 1.10 To demonstrate the viability of this proposal at a higher-level, the Outline Business Case is in accordance with the HM Treasury Green Book Five Case model and it reviews the Strategic, Economic, Commercial, Financial and Management case for the preferred model. At this stage it is based upon 3 potential sites to demonstrate the model in principle. The intention is for the Company to begin with, to develop some proof of concept sites. The Final Business Case will address more detailed issues including borrowing costs, start-up capital, organisational capacity etc.
- 1.11 An initial analysis has identified Council owned land suitable for the development of circa 700 dwellings across 9 sites within the first 5 years and 1,300 plus dwellings across 12 sites from year 5 onwards. Further work on other potential development sites and the Councils Asset Management Strategy is ongoing.
- 1.12 This would include open market housing owned and managed by the Company and affordable housing sold / transferred at a fair market rate to the Housing Revenue Account (HRA) managed by the Council's arm's length management organisation (ALMO) STaR Housing, and possibly to local Registered Providers (housing associations). As the intention is to over-deliver on affordable housing planning requirements whenever viably possible, the expectation is the Company will develop some sites jointly with other providers.
- 1.13 The full business case will also be based upon detailed assumptions on housing numbers, percentage of affordable housing, number of properties retained for open market rent, and numbers of sales. The financial modelling will also take into consideration land values, construction costs, potential rents and house sales. Strategic aims, revenue forecasts, savings, cashflow and portfolio growth estimations will all be used to assess how best to viably meet the County's needs. Savings opportunities to Council departments such as Adult Social Care and Children's Services budgets will be a major factor for consideration.
- 1.14 It is essential that strong cross-party political working shapes the establishment and operation of the Company. Feedback from member briefings has already informed proposals, and a Performance Management Scrutiny Committee Rapid Action Task and Finish Group for pre-decision scrutiny is being planned, which will inform the final report.
- 1.15 The remainder of the report contains recommendations and information to inform and support decisions.

2. Recommendations

It is agreed:

- In principle that a Council Wholly Owned Local Housing Company be formed.
- The outline governance and constitutional arrangements for the Company detailed below are agreed.
- A full business case, business plan, financing and governance arrangements be developed by the Executive Director of Place in consultation with the Portfolio Holder for Planning & Housing Development; and be brought back for final approval.

REPORT

3. Background

- 3.1 Legal advice from Trowers & Hamlins has confirmed Local Authority Powers automatically enable provision of housing where there is a statutory duty or for emergency housing. However, where trade is undertaken for a commercial purpose, then a company structure is required.
- 3.2 As potential affordable housing grant funding and HRA borrowing alone are not a viable option to meet Shropshire's unmet housing and development needs, a new company is legally required and proposed, which can operate commercially to support future development and assist the Authority to be more financially self-sufficient.
- 3.3 Subsequently, the following report, outline business case (appendix A) and legal advice (appendix B) detail proposals to establish in principle a Council wholly owned Local Housing Company.
- 3.4 The Company's role will be to acquire, develop and manage homes, utilising a proactive asset and land management approach to maximise opportunities. It will help address specific local housing supply and market deficiencies and generate income to assist the Council to be more financially self-sufficient and help fund wider goals and ambitions.
- 3.5 The Company will also seek to address and enable broader public-sector savings; encourage economic growth, employment and skills development; promote innovation and development in housing related technologies and practices; and become a leader in improving and redefining UK housing provision.

- 3.6 Property development will be both market and affordable housing, with accompanying place shaping, regeneration and community infrastructure projects. Working with private sector partners and Private Registered Providers (housing associations); the Company's proposal is to support objectives outlined in the Council's Corporate Strategy, Commercial Strategy and those to be approved in the upcoming Housing Strategy. It is expected that the Council's Arm's Length Management Organisation (ALMO) 'STaR Housing' (managing the Council's homes within the HRA) and other Registered Providers in the county could manage the affordable homes built and subsequently also qualify to apply for Homes England grant funding.
- 3.7 Whilst addressing where possible demographic pressures in both the open market and affordable housing sectors; the Company's full business plan will complement any outcomes from the 'Council Housing Stock Options Review' to assist in increasing the amount and quality of affordable housing in the County. There is a separate stream of work underway exploring the availability of mortgages for shared ownership housing. This may result in a further report to Cabinet / Council.
- 3.8 This will include delivering housing to support and empower independence. For example; younger and older people, disabled people, wheelchair users, people with a learning disability, people with a mental health condition, and people with an impairment.
- 3.9 All carried out and in conjunction with other existing housing programmes, such as the Council's award winning Buy2Live scheme.
- 3.10 A decision on a Company name and branding will be delegated to the Executive Director of Place in consultation with the Portfolio Holder for Planning & Housing Development.
- 3.11 Subject to viability tests, it is suggested the Company will, to begin with, be financed by the Council through a combination of 40% equity funding and 60% loan arrangements; in strict compliance with State Aid rules as detailed below. The full business case will confirm the amounts required and this in turn will inform Council procedures needed for evaluating this level of investment against the Council's Capital and Investment Strategy.
- 3.12 The fundamental principle of the financial modelling is to ensure that over the lifetime of the business plan, there is no cost to the Council, the Company provides a good income stream, and enables major savings to be made to Shropshire Council and other public-sector budgets.

- 3.13 Income is expected to be achieved in multiple ways, for example through possible future dividends from the Company, capital growth in the value of the property portfolio, a premium for on-lending from the General Fund, increased Council Tax base and New Homes Bonus (for as long as it is available). Assessing the implications for the removal of the so called 'borrowing cap' for social housing will form part of this work.
- 3.14 It is also anticipated that several Service Level Agreements / Contracts with Council Departments and the Council's ALMO STaR Housing, will be required. Property development will also provide many other opportunities for additional income streams as described below.
- 3.15 Councils traditionally have developed housing (primarily) directly funded by Government borrowing, held by law within the Housing Revenue Account (HRA). Subsequently they are legally required to let homes on Secure tenancies at Social and Affordable Rent levels and bound by public procurement regulations.
- 3.16 Council house building had largely ceased from the 1980s until recently. During this period, Private Registered Providers (housing associations) became the main developers of social housing and evolved to increasingly operate commercially.
- 3.17 Although HRA Reform in 2011 introduced self-financing principles, enabling long-term asset management and capital strategy planning over 30 years, many of the constraints and concerns remain. Examples include Right to Buy and central government control over rent levels and tenancy types. The recent removal of the HRA borrowing cap, will however provide an opportunity to fund part of the planned additional affordable housing, through joint development. Early financial modelling suggests that with Homes England funding this could be as many as 1,000 new affordable homes.
- 3.18 Many councils wishing to have greater place shaping control and in response to financial pressures, have in recent years sought an alternative solution by creating Local Housing Companies. In effect to attempt to take the best operational elements from the private and public sectors and integrate them. It is currently estimated that over half of all local authorities have either set up or are in the process of creating their own Local Housing Company.

- 3.19 A full business case will develop the strategic case to establish the Company. In essence, our intent is to address market failure and increase the availability of affordable rented and for-sale housing and to develop housing types that the private sector developers are not building. Underpinning this is the need for a robust commercial and financial case to ensure that this helps improve the financial sustainability of the Council.
- 3.20 The Shropshire Strategic Housing Market Assessment (2014) set out a range of pressures and challenges. Within Shropshire the ratio of house price to average income is 8.39 and only 50% of the population can afford private rental values.
- 3.21 The Council's current social housing waiting list is 5,300 and the average waiting time for a 3-bed social rented house for those successful is 13 months.
- 3.22 The Local Plan Review of 2017 identified the need to build 28,750 new homes by 2036. Whilst in 2017/18 1,876 new homes were built, private sector developers are focussed on profit maximisation in the 3-5 bed 'for sale' market. The evidence is that the market is not, and will not, build the housing we need to meet the broad future needs of our communities.
- 3.23 By way of illustration, roughly one third of new household formation is due to the growth in our older population. By 2030, Shropshire will comprise of almost 33% people aged over 65.
- 3.24 There is a wealth of research that demonstrates how developing purpose designed housing promotes longer and more productive independent living which is better for residents and helps offset growing pressures in local health and care systems.
- 3.25 Whilst council companies have existed for many years, with trading powers set out in Section 93 of the Local Government Act 2003, the recent diversification of new companies was prompted by the General Power of Competence introduced in the Localism Act 2011.
- 3.26 Whereas councils could previously only trade their existing activities, this legislation enables a local council to undertake any commercial activity that an individual or private company can lawfully undertake, provided this activity is not explicitly ruled out or constrained for councils by another piece of legislation. This provides for purely commercial trading in services not provided by councils before, such as building homes for market sale and rent.

- 3.27 There are also wider strategic objectives to support the establishment of a Local Housing Company.
- 3.28 New homes, property developments, refurbishments, progression of stalled developments, office conversions, all support economic growth, with immediate employment and the longer term associated benefits for local businesses by providing a larger percentage of workers to live in the county.
- 3.29 Investment in new homes has a multiplier effect in the local economy, with residents working in local businesses and spending in local shops and on local services. It also provides an opportunity to adopt key worker policies to encourage key workers in health, education, social care and other public services to remain or move to the County.
- 3.30 A commercial company can respond quickly and directly to demographic trends from an increasing population and an ongoing long-term shift towards smaller households.
- 3.31 Development can target where the market is under-performing or failing to provide sufficient housing supply to meet demand. The local context is evidenced from the sub-regional Strategic Housing Market Assessment which summarises projected levels of housing need and demand, including the required mix between property sizes, bedroom numbers, tenure types and rent levels versus incomes.
- 3.32 Overall, the establishment of a Local Housing Company presents an opportunity to support wider Council goals and aims, whilst in the process, to become more financially self-sufficient.
- 3.33 This assessment is informed by the original scoping work carried out, research from other Local Housing Companies, and specialist advice from Savills and Trowers & Hamblins.

4. Financial Implications

4.1 Finance

- 4.1.1 The outline business case (appendix A) is (as will be the full business case) predicated on the Company to begin with, being fully financed through the Council's General Fund (subject to the Council's Treasury Strategy and Prudential Indicators).
- 4.1.2 The Council can access funding from various sources including the Public Works Loan Board (PWLB) through the UK Debt Management Office. The Council is then able to on-lend capital funding to the Company.

The full financial implications for the Council's General Fund and required investment will be considered more fully once the full business case has been developed.

- 4.1.3 Early indicative financial modelling for the Company has been carried out by specialist consultants Savills. For illustration and simplicity this has been based upon delivery across three developments, totalling 160 properties. It should be noted that the outline business case currently considers the direct return from developing properties and does not highlight potential overheads arising from running a Company. These will be examined in more detail in the full business case, where informed projections of gross and net returns will be considered.
- 4.1.4 A full business case to inform the business plan will be completed and carried out in conjunction with a review of the Council's land and property assets with the assistance of Savills.
- 4.1.5 Projections of potential savings to other Council budgets will be intrinsic in business planning.
- 4.1.6 Company funding is in two parts. The first part is in the form of equity for shares in the Company. The second and larger portion, as an interest payable loan from the Council.
- 4.1.7 It is not possible to finance the Company completely through a loan as HMRC may challenge it to be a non-commercial arrangement and a way to charge unnecessary excessive interest payments to avoid a tax liability.

4.2 Taxation

The tax and VAT implications will be assessed by qualified specialist consultants.

4.3 Corporation tax

Corporation taxation will be calculated in line with current Government Taxation Policy on revenue surpluses and sales.

4.4 VAT

The new Company will register for VAT.

4.5 Stamp Duty Land Tax (SDLT)

As the Council is a local authority, group relief should be available on the purchase of land from the Council. This means that no SDLT should be chargeable from Council owned land. Due diligence will be undertaken to ensure that the conditions for SDLT group relief applies.

4.6 Equity & Loan Arrangements

The business plan will confirm agreed borrowing arrangements and amounts. It is expected this will be a split between 40% equity and 60% loan.

4.7 Financial Impact on the General Fund

4.7.1 The General Fund will primarily potentially receive six different types of income from the Company.

I). Loan Interest

The Council will finance the Company with an appropriate rate determined. The rate will need to be commercial to ensure State Aid provisions are not triggered, but also not excessive.

II). Capital Growth

From the Property Portfolio.

III). Dividends

The Company's profits may be made available for distribution to the Council as the sole shareholder.

IV). Increased Council Tax base.

V). New Homes Bonus.

VI). Other.

Potential income generating opportunities from provision of products and services. Examples include, lettings and estate agency; home improvement and property maintenance; energy and microgrids; construction; technology; insurance; and financial services, such as equity loans / mortgages.

4.7.2 The Council is currently researching and assessing these business opportunities and on how best to maximise receipt from s106 and Community Infrastructure Levy (CIL) funds, for the benefit of local communities.

5. Risk Assessment and Opportunities Appraisal

5.1 The key risk associated with the establishment of a Local Housing Company is the significant on-loan funding from the General Fund. However, this is expected to be fully mitigated with detailed financial modelling and business planning.

5.2 The Company is being set up to ensure there is no overall cost to the Council, and will generate profits and savings as outlined above.

- 5.3 A full risk assessment appraisal is being carried out as part of the business case and business planning.
- 5.4 Our proposal is to develop the outline business case into a full business case. This will again be to HM Treasury Green Book Standards and will outline our strategic, commercial, financial, economic and management cases for the establishment of a company.

6. Additional Information

6.1.1 Advice & Consultation

The Council has sought advice from property specialists Savills and law firm Trowers & Hamblins. Both organisations have detailed knowledge and experience of Shropshire. They are currently assisting with the 'Council Housing Stock Options Review' and have advised many other councils on the formation and management of Local Housing Companies. Officers have also researched, met and spoken to other councils who have already established or are setting up their own companies.

- 6.1.2 Within their recommendations, Trowers & Hamblins have advised, Members will need to evidence that they have taken reasonable steps to discharge their fiduciary duty when considering:

- I). Whether the business case for the Local Housing Company is viable.

- II). The risks and rewards of investing / lending.

- III). The wider (possibly alternative) interests of local tax payers (e.g. what else could the money have been spent on / the risk it will have to increase council tax).

- 6.1.3 To support and evidence this, an outline business case (appendix A) has been developed and a full business case and business plan (again assisted by Savills and Trowers & Hamblins) will be written and brought back to inform the final decision on whether to establish a company.

6.2 Company structure and Governance Arrangements

- 6.2.1 Trowers & Hamblins have advised that a company limited by shares (CLS) is the most appropriate vehicle for the Housing Company for the following reasons.

I). A CLS is the most common corporate vehicle used in England for profit distributing bodies and is a very tried and tested model.

II). The CLS model is a typical form of commercial vehicle established with a view to making a profit.

III). The ability for the Council to invest in the company by way of share equity as well as loan debt.

6.2.2 The Company will be set up in accordance with the Companies Act 2006, including the appointment to the Board of the Company. The Memorandum and Articles of Association and any other documentation required will be written under professional advisement from Savills and Trowers & Hamlins. The Council will hold 100% of the shares in the Company and have full ownership. This provides the Council with full control.

6.2.3 The Council and Company will ensure that appropriate governance arrangements (with further detailed advice from Trowers and Hamlins) are put in place to enable the Council, as the sole shareholder to set and oversee the strategic direction of the Company whilst allowing the Directors of the Company discretion to carry out the operational management effectively, efficiently and with clear targets and milestones.

6.2.4 This will require a clear decision-making framework to ensure the Council as sole shareholder makes the appropriate decisions reserved for them; and give sufficient authority to the Directors to make decisions in relation to the day to day activities of the Company.

6.2.5 Governance arrangements must ensure accountability whilst not hindering operational activity.

6.3 Proposed Governance Structure

6.3.1 To provide the strategic direction and oversight of the Company, a 9 person politically balanced Shareholder Committee of Members will be established including Chair and Vice Chair roles.

6.3.2 The second tier of governance will cover the day to day operational matters of the Company and be the responsibility of the Company's Directors. It is proposed that the Executive Director of Place, Executive Director of Adult Services & Housing, Head of Business Enterprise & Commercial Services, and Housing Development Manager are appointed as Directors, with one chosen as the Managing Director of the Company. In addition, to ensure good governance, 2 independent Non-Executive Directors be recruited to bring wider experience to the board. A total of 6 Directors.

- 6.3.3 Directors of the Company will be subject to the provisions of the Companies Act 2006 regarding duties and obligations of Directors. Any actions against the Company will stay with the Company and there would be no recourse to the Council or individual directors, save in certain defined cases for example, fraudulent or wrongful trading. Additionally, the Directors will be indemnified by the Company for personal liability except in the cases of unlawful actions or fraudulent or wrongful trading.
- 6.3.4 The establishment of a Shareholders Agreement between the shareholders and the Housing Company, will set out the parameters the Company must operate within and ultimately provide the Council with control over the Company.
- 6.3.5 This structure avoids any potential conflict of interest for Members between their role as an elected Member of the Council and the day to day operational management of the Company. However, Members still control the Company at a strategic level with Officers tasked with managing the Company within an agreed framework and through delegated authority. Wider governance structures required within the Council will be considered with proposals, diagrams and responsibilities detailed within the final report to Full Council.
- 6.3.6 In addition to the Directors, the Company will need to be appropriately staffed as it grows. It is anticipated that where advantageous, some support services will be contracted out. Where provided by Council staff (and re-charged to the Company), it will need to be evidenced that all costs of utilising Council staff are recovered and that there is no actual or hidden subsidy to avoid challenge that the Council is providing State Aid.

6.4 Documentation Required

The following documentation will be required to complete the establishment of the Company and governance arrangements. All will be produced with the advice of Savills and Trowers & Hamblins.

I). Memorandum of Association and Articles, the governing document for the Company.

II). Shareholder Agreement, to regulate how the Company is to be governed.

III). Shareholder Committee Terms of Reference.

IV). Updated Constitution.

V). A dynamic business plan.

VI). Loan Agreements, setting out the details of the funding arrangements between the Council and the Housing Company and how they are drawn down.

VII). Individual site development business cases.

VIII). Operational policies.

6.5 Development Identification & Assessment

6.5.1 The Council is carrying out a series of extensive reviews of Council owned land and assets, along with potential opportunities from within The One Public Estate Programme.

6.5.2 The identification and selection of early developments is being carried out with the advice of Savills and Trowers & Hamblins. The intention is to prioritise and begin with a small number of developments.

6.6 Site Acquisitions & Disposals

Careful consideration will need to be given to the transfer of any land held by the Council to the Company. In particular, the requirements of s123 of the Local Government Act 1972 (in relation to land held in the Council's General Fund) and s32/43 of the Housing Act 1985 (in relation to land held in the Council's HRA) will need to be met. As above site-specific advice will be taken for each development assessment.

6.7 Property Management

The Company will need to provide housing management and property maintenance services to its portfolio. To begin, it is expected that the Company will utilise the services of the Council's Housing Department, Property Services Group (PSG) and ALMO STaR Housing, with all costs re-charged and transparent. Specialist external support will be used as necessary.

6.8 Procurement

The Company will not be subject to the Public Contracts Regulations 2015, as it will be set up as a commercial company with operational independence as described above.

6.9 State Aid Compliance

6.9.1 If the Council is acting in a way that a private lender and / or investor would not act in similar circumstances in a market economy, for example by providing a loan on uncommercial terms and at an uncommercial interest rate, and / or was making an equity investment on the terms and for the return which a private investor would not do, then such activity could constitute unlawful State Aid within the meaning of Article 107 of the Treaty on Function of European Union (TFEU.)

- 6.9.2 As such, when the Council establishes the detailed loan arrangements with the Company it will need to ensure that an analysis of the relevant risk in relation to the loan is undertaken and confirm that the interest rate applied is consistent with that which a private lender would require in the same circumstances and that the non-financial element of the loan complies with the terms and conditions which a private lender is likely to require, so not to constitute unlawful State Aid.
- 6.9.3 State Aid will need to be continually kept under review to ensure that the support from the Council is able to continue to be provided throughout the loan period.
- 6.9.4 It is also important that any services provided by the Council to the Company are provided at commercial terms, as uncommercial terms could also constitute unlawful State Aid.

7. Workshops & Consultation

- 7.1 No formal consultation is required. However, workshops, meetings and briefings are ongoing with Cabinet and Members.
- 7.2 Strong cross-party political working is considered essential to development of proposals and future operation of the Company. A Performance Management Scrutiny Committee Rapid Action Task and Finish Group has been established to inform the final report and recommendations.
- 7.3 A full communications strategy will be implemented for engagement with wider stakeholders, businesses and communities.

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information)

Cabinet Member (Portfolio Holder) Cllr. Robert Macey

Local Member All

Appendix

(A) Local Housing Company Outline Business Case

(B) Legal Advice