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SLOUGH BOROUGH COUNCIL

REPORT TO: Cabinet **DATE:** 5 September 2016

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WARD(S): All

PORTFOLIO: Housing & Urban Renewal - Cllr Zaffar Ajaib
Leader of Council - Cllr Sohail Munawar

PART I
KEY DECISION

PROPOSAL TO ESTABLISH HOUSING COMPANY GROUP STRUCTURE

1 Purpose of Report

- 1.1 The purpose of this report is to seek Cabinet's approval to establish a company group structure that would see the introduction of two new wholly Council owned subsidiary housing companies.
- 1.2 The objectives of each company are described in sections 5.6 – 5.12, however the overriding aim is to improve choice, increase quality, and meet varying forms of housing need in the Council's area and to generate independent income streams that will improve the financial resilience of the Council.

2 Recommendation(s)/Proposed Action

The Cabinet is requested to resolve:

- (a) That it be agreed that officers build a business case and structure for two subsidiary housing companies: a) **Herschel Homes**, which will provide market rent properties and b) **Slough Homes**, which will provide homes which are affordable to local people and assist the Council better discharge its duties to homeless and other groups of people - these homes will be part of the assets of the Companies and their acquisition will be funded by the Council from the General Fund.
- (b) That it be noted that both Herschel Homes and Slough Homes will be companies that are limited by shares with the Council being the sole shareholder.
- (c) That the Strategic Director Housing, Regeneration and Resources be given delegated authority to establish a project team to progress the realisation of the proposed company structures.
- (d) That the list of 'next steps' as set out in section 5.33 of this report be noted.
- (e) That it be noted that an update report on Herschel Homes and Slough Homes will be presented to Cabinet by December 2016, which will be supported by a detailed business plan and indicative programme.

3. **The Slough Joint Wellbeing Strategy, the JSNA and the Five Year Plan**

Funding the delivery of new homes will improve the quality of the built environment and the image of the town whilst providing much needed housing accommodation. Providing quality private rent and sub-market rented accommodation through the subsidiary companies will help cater for a huge area of housing need which is occupied by people who cannot access traditional social housing whilst not being in a position to purchase a home.

3b **Five Year Plan Outcomes**

Increasing the supply of well managed quality private rented accommodation address the five year plans outcomes through:

- The introduction of HH and SH will increase choice and encourage people who work in Slough to also live in Slough, which will in turn help businesses of all sizes to locate, start, grow, and stay,
- Increasing the supply of quality accommodation will contribute towards children and young people in Slough being healthy and resilient,
- Borrowing Public Works Loan Board funding to lend to the subsidiary vehicles whilst ensuring net profits are covenanted back to the Council will ensure SBC's income is maximised, and
- The introduction of Slough Homes will increase the supply of rented homes which are affordable to local people, will help prevent homelessness where possible and also help reduce the current financial burden of temporary housing costs.

4 **Other Implications**

(a) **Financial**

The start-up budget for the Group Structure is envisaged to be in the region of £100,000. It is assumed that these costs will be capitalised against the individual SHC's where possible.

The precise funding arrangements adopted for **each** SHC will result from an assessment of the alternative funding streams, such as borrowing arrangements and equity investment by the Council and potentially a third party (e.g. a pension fund). The assumption is that, initially, each SHC will be funded through a loan and equity investment by the Council, itself utilising Public Work Loan Board ("PWL") finance.

Each SHC would be subject to corporation tax on the profits of its activities. The financial modelling for the business plan will contain a detailed tax analysis.

If Cabinet approves the proposals in this report, future proposed loans to **each company** for each development will be submitted to the Cabinet for consideration and approval (subject to funding provision having been approved for that purpose in the Council's strategic budget).

(b) Risk Management

Risk	Mitigation	Opportunity
Collapse of Housing Market - Failure of a SHC	A slim, low cost structure is proposed, which the Council would control; either one or both companies could be wound up relatively easily if necessary. If a group structure is introduced, each company will be independently registered and will be fire walled.	The properties could be sold, realising the appreciation on capital value to repay loans and generate a profit
Finance - The assumptions in the financial model are not robust or the financial model is flawed	The Business Plan model will be rigorously tested. Assumptions will be challenged and set at prudent levels. Sensitivity analysis and testing will be undertaken and a mitigation strategy for each scenario will be developed.	
Finance - Initial rental values are lower than forecast.	Scheme viability and affordability will be based on up to date and market information and regularly monitored. Advice taken by lettings agents before construction starts on site.	
Finance/Management - Failure to collect all legally recoverable monies	The lettings policy will require the use of direct debits and rental deposits/ credit checks prior to the letting of property.	The Council could enter into an agreement with a Lettings Agent to deliver the service – this will transfer risk, but reduce profitability.
Finance/Management Failure to make available for re-letting or to re-let in timescale	A bad debt and void provision in the Business Case will be monitored carefully, as will the cost of void turnover repairs and time taken to re-let properties.	The Council could enter into an agreement with a Lettings Agent to deliver the service – this will transfer risk, but reduce profitability.
Development Programme - Suitable land sites cannot be identified and / or planning approval is not granted	An initial programme of site has already been identified and is included in the SUR development programme.	Work is underway to find a pipeline of suitable sites.
Tax - The accounting and tax treatment set out in the Business Case is challenged	Expert external tax advice will be obtained and considered as part of the Business Plan.	
Governance – The Governance structures do not allow appropriate decision making and/or enable the project to be	Expert legal advice will be sought to introduce appropriate governance structures. Final Governance arrangements will be finalised	

properly set up or delivered	as part of the business case.	
Demand - Properties prove difficult to rent and impact on the financial projections/profitability	Thorough market research will be undertaken to inform the financial projections and external expertise will be commissioned to support the development of a robust marketing plan.	The Council is potentially establishing a group of SHC's. Should one company fail, properties could be sold between companies at the relevant market value and/or properties could be sold to repay debt.
Capacity – the Council does not have the internal capacity to introduce the company without negatively impacting on business as usual.	Enter into agreements with a local lettings agent for the early years of the company, allowing the focus to concentrate on business development.	Second SBC staff to the Lettings Agent with a view to developing in-house expertise before bringing the company in-house.
Capacity - the Council has inadequate financial, legal and technical resources to support the day to day administration and management of the Company.	Enter into agreements with a local lettings agent for the early years of the company, allowing the focus to concentrate on business development.	Work on the basis that the company will develop in-house capacity within three years.

(c) Human Rights Act and Other Legal Implications

The Council have a general power of competence under Section 1 of the Localism Act 2011 to do anything that individuals generally may do. Accordingly the Council may own shares in companies, make loans to companies, dispose of assets to companies and receive dividends from companies.

This general power of competence is, however, subject to the limitations that the Council cannot do anything which they were not able to do by virtue of any statutory restriction on their powers which applied before the Localism Act 2011 came into force and they cannot do anything which may be prohibited in the future by any statutory limitations which may be imposed on this general power of competence specifically or on all their powers generally or on all their powers with exceptions which do not include this general power.

Furthermore, if the Council wish to do anything for commercial purposes under this general power of competence, they must do so through a company.

Accordingly, in connection with its relations with the proposed companies, the Council will still be subject to rules on public procurement and EU Rules on State Aid until these rules are changed by new legislation in the case of the former and by the UK leaving the EU in the case of the latter. Also, in relation to any disposal of any assets to the proposed companies, the Council will be subject to the rules which currently apply to the Council in relation to the disposal of any of its assets.

Under the Public Contracts Regulations 2015 the Council will be able to award contracts to the proposed companies without breaching those regulations provided

the Council exercise over the companies control which is similar to that which they exercise over their own departments, provided the companies carry out more than 80% of their activities in the performance of tasks entrusted to them by the Council or another legal person controlled by the Council, and provided that there is no direct private capital participation in the companies unless the forms of such private capital participation are “non-controlling” or “non-blocking”.

Under State Aid Rules the Council will not be permitted to give the companies any form of financial assistance or unless they do so on terms which are generally available in the market place or unless the Council are able to rely on exemptions contained within the those rules.

Though owned by the Council, the companies are legally separate bodies and therefore they not local housing authorities. The companies, like comparable entities, will be subject to those laws which apply to companies and those engaged in letting homes.

(d) Equalities Impact Assessment

There are no identified needs for an EIA at this juncture.

(e) Property

See Section 5 below.

5 Supporting Information

Previous options considered and reasons for discounting

5.1 Slough Borough Council (“the Council” or “SBC”) has previously explored two options for the introduction of a Subsidiary Housing Company¹:

- a) Develop and let both market rent and affordable properties (the **multi-tenure option**); and
- b) Develop market rent and possibly market sales (the **market option**).

The previous options would have been General Fund companies. The Council would have lent to those companies on *market terms* for the market homes. The Council would have made a margin on the difference between the interest on money it borrowed via the Public Works Loan Board (“PWLB”) and what it lent at (market rates). The Council would have had the option to offer grants or subsidised loans/free land for the affordable homes.

5.2 Under either of these options the company, though owned by the Council, would not itself be a local authority and therefore not subject to the local authority statutory framework for housing. Those companies would also have been free to decide market rent charges and subject to the Housing and Regeneration Act 2008 (the **2008 Act**) they would have had a wide margin to determine the affordable rents. Despite ministers' concerns that local authority housing companies have been created to avoid rent and right to buy requirements they have chosen not to extend

¹ Subsidiaries are separate, distinct legal entities for the purposes of taxation regulation and liability, and for this reason, they differ from divisions, which are businesses fully integrated within the main company, and not legally or otherwise distinct from it.

restrictions to such companies. The Housing and Planning act 2016 (the **2016 Act**) has not altered this.

- 5.3 To date, the only key decision that has been made is to discount the potential for the Council to act as a property developer. This was deemed to be an unnecessary risk for SBC, when it can transfer development risk and benefit from the expertise Slough Urban Renewal (“SUR”). In making this decision, a significant consideration was the capacity of the Council to operate in a commercial environment as well as manage the introduction of a group structure within the context of competing priorities.

Current Position

- 5.4 The Council is embarking on a pipeline of HRA development schemes to increase the supply of affordable housing and has previously agreed that these should be constructed by SUR. Simultaneously; SUR is delivering a programme of commercial schemes on General Fund sites. Whilst the commercial schemes allow the Council to receive 100% of the land value plus 50% of net profit, increasing budgetary pressures and a renewed emphasis on revenue generation has resulted in the Council reviewing this operating model. Instead of realising short-term profits, SBC is re-focussing its approach with a view to retaining and/or acquiring completed properties to benefit from a long-term income stream and capital appreciation.
- 5.5 Officers are now considering alternative proposals for two housing companies. Both companies would acquire homes (and not develop them) and each company would have a different focus:
- 5.5.1 One would focus on market rents (**Herschel Homes**); and
 - 5.5.2 The other would seek to provide homes for people who are homeless or otherwise fall within policy objectives. The objective is to apply a discount on rents for these homes with some cross-subsidy being provided from homes let at market rents (**Slough Homes**).

Herschel Homes

- 5.6 Herschel Homes would acquire completed units (either from SUR or from private developers) to provide high quality housing for market rent. This could include planned developments of SBC-owned sites at Alpha Street, Maria Cowland Centre, 150-160 Bath Road and Wexham Nursery as well as sites developed by third parties.

The fact that the Council already has a well defined list of regeneration sites and an approved delivery vehicle (SUR) in place to construct new build housing in Slough has the potential to provide reassurance that Herschel Homes (“HH”) will realise its business objectives.

- 5.7 The HH proposal (market rent activity) is, except for the lack of development activity, identical to the previous *market option*. It would largely share the same risks and requirements of that previous option. In summary:
- The Council must articulate its purpose - that this is a business/income activity (and refrain from statements about RTB/rents etc.);
 - Ensure that state aid risk is managed by ensuring loans, services and property transfers to it (from the Council) are made on market terms;
 - Company governance arrangements should be structured to reflect that it is a business which needs to succeed on those terms;

- Seek to attract business expertise – potentially through part time non-exec Directors;
- Ensure accountability to the Council through a shareholder's agreement to ensure control over key financial and strategic matters;
- Avoid conflicts of interest through internal Council protocols – especially concerning viability/loans/performance.
- Test the business model to ensure that acquiring/renovating homes and letting them is financially viable/including its cash flows – the Council will be limited in its ability to rescue a failing *market company*;

5.8 It is envisaged that:

- The Board of HH would consist of a mix of suitably experienced senior officers and Cabinet members with relevant portfolios.
- The Company will enter into agreements with SBC to acquire services as required.
- In the early years (1-2) of the company, the day-to-day lettings, management and marketing will be managed on behalf of HH by a lettings company. This will allow SBC staff acting on behalf of HH to concentrate on business development (i.e. building the portfolio).
- Whilst selected 'second hand' properties could be acquired if they reflected the operating model of HH and were deemed to represent a good investment, HH will primarily focus on acquiring and leasing new build properties within Slough.
- The business plan will assume that the service will be brought completely in-house by year 3.
- To reduce tax liabilities, all net profits will be transferred back to the Parent Company (the Council) in the most tax efficient manner.
- An individual business plan will need to be approved by the board and SBC.

Slough Homes

- 5.9 Slough Homes ("SH") would focus on providing homes to a wider range of people than those who have traditionally been council or housing association tenants. Local market housing failure means that an increasing number of residents are unable to afford decent homes in the area. This failure not only has an adverse effect for individuals but also threatens the local economy. Further it will assist the Council to more easily discharge its responsibilities to homeless residents and others and in containing or reducing the cost of expensive temporary accommodation such as Bed and Breakfast hotels. It would also be possible for Slough Homes to secure accommodation for specialist purposes such as housing for care leavers. The Company will sit for accountancy purposes within the Council's General Fund.
- 5.10 Over the next two years SBC will build 23 new build properties for rent at Ledgers Road, 34 at Wexham Nursery, 11 apartments at Eschle Court, 19 specialist properties at Rochford Gardens and 5 individual units, providing a total of 92 new social rented properties by March 2018. Whilst these projects will address a proportion of the need, there is still a significant shortfall, which is exacerbating demand for temporary accommodation and increasing pressure on the General Fund. At the same time, the pace of investment in new affordable housing struggles to counter the losses in the HRA stock base through Right to Buy ("RTB") sales. Government proposals requiring the sale of valuable council assets will only lead to greater imbalance.² The proposed introduction of Slough Homes is therefore a proactive approach to address several drivers.

- 5.11 SH could be structured on similar lines to Herschel Homes. However, its target tenant groups need to be carefully considered to ensure that the Council is able to justify its activities to avoid a potential judicial challenge that it is improperly using its powers. As with the previous options and Herschel Homes the Council will operate/fund SH through its General Fund.
- 5.12 It is envisaged that:
- The Board of SH would consist of a mix of suitably experienced senior officers and Cabinet members with relevant portfolios.
 - The Company will enter into agreements with SBC to acquire services as required.
 - Unlike HH, all day-to-day business activities (allocations, property management and marketing) will be managed on behalf of SH by SBC, operating under an agreement to provide services.
 - SH will seek to acquire lower valued properties and will purchase a mix of 'second hand' and new homes within Slough.
 - To reduce tax liabilities, all net profits will be transferred back to the Parent Company (the Council) in the most tax efficient manner.
 - An individual business plan will need to be approved by the board and SBC.

Relationship Agreement between SBC and Subsidiary Companies

- 5.13 The Council's relationship with each company will primarily be governed by the Council's rights under the Memorandum and Articles; a Shareholders Agreement to be entered into by the Council and **each company** and future credit/funding financial agreements. In this report the following terms are used:
- The Funding Role,
 - The Shareholder Role, and
 - The General Role.

Each of these roles are described in detail in sections 5.14 – 5.23 below.

- 5.14 **The Funder Role** is where the Council acts as a funder and would in determining whether to lend money to HH and SH. To provide resilience and deal with potential conflicts of interest it is recommended that the Funder Role is discharged by the section 151 officer. In effect the Funder Role will act as a bank credit committee. The Funding Role's primary task will be to assess viability (as an entity) for each project which loan funding will be used for and using this analysis to determine whether to release loan funding.
- 5.15 It will also be necessary for the Funder Role to regularly monitor and analyse financial information generated by each company during the lifetime of each loan to ensure that they are not in breach of key financial requirements (which will be stipulated as funding conditions/covenants in each loan). For State Aid reasons the Council and its Funder Role will need to establish that for each loan a notional private lender would make that loan in identical circumstances to the Council.
- 5.16 The Funder Role also will have to satisfy itself that each particular loan is made in compliance with State Aid requirements and that any statutory or constitutional changes (e.g. a change in the Secretary of State's consent regime and internal

² The actual RTB sales in 2013/14 and 2014/15 were 67 and 65 respectively. The projected completions in 2015/16 are 46, providing an average of 60 per year. Using this as a basis for comparison, if the HRA builds 67 new homes by 31/3/18, there will still be a net loss of 53 units.

changes to the Council's constitution and procedures) would not render a proposed loan and/or proposed development ultra vires. For these assessments the Funder Role is likely in part to rely upon the Council's General Role and functions such as legal services.

5.17 **The Shareholder Role** is the Council acting as the shareholder in HH and SH and ensuring (as a shareholder would) that they deliver. It will be concerned with HH and SH maximising their economic performance. It will also be interested in HH and SH:

- Complying with good company governance, financial management/audit practices;
- Having due regard for "brand"/reputation the consequences of their business practices; and
- It may at some point have to make difficult decisions such as whether to sell all or part of its interest to a private sector organisation, cease expansion of either company's activities and/or in extreme circumstances consider dissolution/winding one of the companies.

5.18 Whilst the Shareholder Role is not a vehicle for the Council to remotely manage HH or SH, it provides a framework within which HH operates and runs its business. This will include approving the annual business plan.

5.19 This particular Shareholder Role may be very different from those which the Council typically operates. This is because the involvement of Officers and Members in other entities may focus more on policy and community outcomes rather than be purely commercially driven. The Shareholder Protocol could include a statement which sets out why exercising the Shareholder Role for HH is different.

5.20 To minimise conflict of interest the person appointed to undertake the Shareholder Role in the Council should ideally not be a Director of either company. This is because part of the Shareholder Role will be to hold each company's performance to account and a Director of HH or SH will be responsible for that performance.

Avoiding Conflicts of Interest

5.21 As set out above, if an officer or Member is required to make decisions about approving funding to either HH or SH or hold performance to account (either through the Shareholder Role or monitoring) then there will be a conflict in that same individual acting as a Director for either company. This is because as a Director, that individual must in that role put the interests the company first. This would prove difficult and create the potential for conflicts of interests in number situations (where the named post is also a Director) including:

- An officer or Member considering whether to agree a loan from the Council for a development;
- An officer or Member monitoring/reviewing financial/commercial performance (as a Director they would be responsible for that performance);
- An officer or Member or member reviewing a business plan in the Shareholder Role (such a plan may seek expansion which could conflict with other Council funding priorities).

- 5.22 To avoid these potential conflicts, the Council could avoid appointing individuals responsible for the Funder Role, the Shareholder Role or 'scrutinising' the performance of either HH's or SH's performance as a Director of either company.
- 5.23 **The General Role** is the Council's ordinary governance (including financial governance) role.

Business Plans

- 5.24 A comprehensive business plan will be developed for **each** company. The individual plans will include financial modelling and assumptions; land and development assumptions; rental income projections; cash flow; fees, costs and tax, funding profile, sensitivity analysis and resources.
- 5.25 The business plans will identify the:
- a) Aims and objectives of **each** SHC,
 - b) Investment and other resources required to deliver those objectives,
 - c) Appropriate mix of units for each site based on the current shape of demand to avoid potential over-supply which might impact on let up rates, void rates and rent levels,
 - d) Anticipated rates of capital growth,
 - e) Likely business risks, the appropriate mitigation and how significant these risks will be managed,
 - f) Expected financial results (including sensitivity analysis), and
 - g) Anticipated contribution that each company will make the 5 Year Plan.
- 5.26 A specialist external advisers will be appointed on behalf of each company to assist with this process.

Staff Resources/Capacity – Development and Implementation

- 5.27 To be efficient, Cabinet should agree broad parameters/outcomes for **each** company. This will involve: setting a budget for a company (what sums will be available to lend/invest), confirmation of target tenants, an appraisal of the cost and quality of homes to be purchased and assessing local market rents.
- 5.28 The above highlights the skillset that the Council's internal project team will require. The team will include a:
- Person with experience of local housing – knowledge or understanding of services/quality that non-council tenants expect,
 - Person who understands tenancy management/maintenance services (this could be the same officer as above),
 - Finance Officer – key to ensure any business plan works, **and very importantly**
 - Senior Officer who acts as champion and oversees the project team. It is anticipated that this role will be undertaken by the Strategic Director of Regeneration, Housing and Resources.
- 5.29 There will be a significant amount of work involved and project team members' available time will need to reflect this.

- 5.30 The introduction of a group of SHC's will involve a requirement for expert tax and legal advice. This report suggests that these work streams should be outsourced.
- 5.31 Looking forward (and as set out above), It is envisaged that staff from SBC will provide services to **Slough Homes** and manage the services in-house based on an agreed set of fees.
- 5.32 With regards to **Herschel Homes**, staff from SBC (probably Asset Management) will oversee the performance of the company in years 1- 2 and manage the relationship between HH and a lettings company. Thereafter, the company will be brought in-house. As above, all services provided to HH will be recharged accordingly.
- 5.33 The anticipated next steps and associated costs are as follows:

Item	Cost	Comment
Commission independent market research and business planning support	Estimated at £25,000-£30,000	To identify levels of demand across the borough (the number, type, location, timing and value of properties that will be acquired) A business cases for each company for the Cabinet's approval – requirement of section 95 Local Government Act 2003; A business plan for each of the businesses; and provide an independent opinion on market rents and use this information to develop a robust business plan including costs associated with the establishment of the company
Appoint a specialist tax advisor	Estimated at £10,000	To provide advice on the most tax efficient process to minimise Stamp Duty Land Tax (SDLT) and minimise payments of corporation tax.
Initialise a cross department project team	Estimated at £20,000	A team will be established with representatives from Housing, Asset Management, Finance and initially Legal Services. Where possible, these internal staff costs to be capitalised
Additional Legal/Governance advice	Anticipated £40,000	Work with legal and governance advisors to establish: <ul style="list-style-type: none"> the articles of association; Shareholder agreements between the companies; Facility/loan/equity funding agreements; State aid compliant funding agreement (affordable homes); Entrustment Deed for the homes which are affordable; Debenture/security agreement; Form of tenancy agreements for each company the terms of funding, tax and VAT considerations etc.

6 **Conclusions**

- 6.1 As mentioned above, both Slough Homes and Herschel Homes would be separate legal entities that would be wholly owned by the Council. Both companies would have the power to undertake anything a company can do and in particular to acquire and hold land and properties
- 6.2 Each company would be run by its Directors but their decision making would be constrained by a Shareholders Agreement which would define the limits the Council wants to place on the ability of the Directors to make decisions and in particular the decisions that would need shareholder consent. The Council would be the sole shareholder and as such decisions as to how to exercise its shareholder powers would be determined by the Council.
- 6.3 The introduction of Slough Urban Renewal has helped to provide a pipeline of General Fund sites that could be acquired upon completion. If approved, this would provide a scenario where in addition to the Council receiving 100% of the land value and 50% of the net development profit, it would benefit from:
- The long-term income stream created via the net profits returned from each company,
 - Reduced expenditure on temporary accommodation through the provision of new affordable housing created by SH, and
 - Spread its fixed-costs by leasing space and providing services to both companies.
- 6.3. The activities of the company would in the early years be funded by the Council through the provision of State Aid-compliant loans to the company. The Council would fund these loans either through borrowing from the Public Works Loan Board or from other financial institutions, where preferable (or when money is available by lending money the Council would otherwise hold on deposit). The margin on these loans would generate additional surpluses for the General Fund whilst offering the housing company competitive loans secured against its housing stock.
- 6.4 The introduction of Herschel Homes and Slough Homes will allow the Council to generate independent income streams that will improve its capacity to operate in a self financing environment and contribute towards the ambition of making Slough a place where people want to live, work and do business.

7. **Appendices Attached**

None

8. **Background Papers**

There are no background papers