

 <b>Brent</b>	<p style="text-align: center;"><b>Cabinet</b></p> <p style="text-align: center;">15 November 2016</p> <p style="text-align: center;"><b>Report from the Chief Finance Officer</b></p>
For Action	Wards affected: ALL
<p style="text-align: center;"><b>Establishing a Wholly Owned Investment Company</b></p>	

## 1.0 Summary

- 1.1. Cabinet approved Brent's investment strategy at its meeting of 11 April 2016.
- 1.2. This strategy was designed, *inter alia* to set the framework through which the capital programme will help to deliver the council's long-term vision to "*make Brent a great place to live and work...*" and to help deliver the five Brent 2020 priorities. It explicitly signalled a shift away from short-term solutions to long-term public investment, and envisaged a council embracing more innovative and agile corporate structures to enable a more enterprising culture focused on seizing opportunities and managing rather than eliminating risks.
- 1.3. By definition many of the actions in the investment strategy are therefore long-term. However, one explicit short-term action was to establish a local authority controlled company, referred to in this paper as a wholly owned company (WOC). This company was originally envisaged to enable speedy delivery of the temporary accommodation reform plan. This report therefore includes a focus on how the WOC will help deliver the Council's targets for the development of new affordable homes and why establishing a Company will offer the Council flexibility to intervene strategically to ensure that new housing development can contribute fully to strategic priorities.
- 1.4. However, whilst that remains the initial purpose of the proposed WOC the report also sets out more broadly the various options for the Council to establish an investment vehicle to be operated as a Wholly Owned Company (WOC), to help increase the pace of regeneration, the development of new homes to meet the needs of people across the Borough, and the investment in necessary infrastructure within Brent.

- 1.5. Initially the company will be set up to purchase and manage a target portfolio of 300 properties in and around the London Borough of Brent. These properties will be let to tenants for whom Brent has a homeless duty to and the company will discard the duty under the provisions of the Housing Act 1996, Part VII as amended by the Homelessness Act 2002 and the Localism Act 2011. In doing this homeless families are housed at a less expensive cost than many temporary accommodation options.
- 1.6. Critically, the creation of a company involves vital decisions about how the company is to be owned, governed and managed to ensure that the right balance is struck between democratic and senior managerial oversight of the company and giving it the operational flexibility which is a core part of the business case for establishing it.

## **2.0 Recommendations**

- 2.1. That Cabinet approve the establishment of the wholly owned company, to be called “Investing 4 Brent”, for the objects and purposes set out in this report
- 2.2. That Cabinet agree to appoint the following as Directors of the Company, with all the responsibilities under the Companies Act that flow from that:
  - 1 Councillor George Crane;
  - 2 The Strategic Director of Community Wellbeing (Phil Porter); and
  - 3 The Director of Policy, Partnerships and Performance (Peter Gadsdon).
- 2.3. That Cabinet note that the Board of the Company will be chaired by an independent voting Director, and that Martin Smith, the former Chief Executive of Ealing Council is proposed for this role.
- 2.4. That Cabinet approve the Articles of Association and Shareholders Agreement as set out at Appendices One and Two.
- 2.5. That Cabinet approve the company’s initial business plan, which is set out at Appendix Three.
- 2.6. That Cabinet authorise the loan facility between the council and the company, as summarised in this report, and authorise the chief finance officer to finalise the legal documentation accordingly and thereafter to authorise loans on the terms set out in this report.
- 2.7. That Cabinet delegate to the deputy Leader, in consultation with the Chief Finance Officer, the precise mix of loan and equity funding, for the reasons set out in paragraph 6.8.
- 2.8. Approve the provision of an initial loan of £1m to meet the working capital (cash flow) requirements of the company on terms as summarised in this report and delegate authority to the Chief Finance Officer to finalise the legal documentation accordingly.

- 2.9. That Cabinet note that the company is intended to be incorporated by the end of the calendar year, and as soon as practicably possible following expiry of the scrutiny call-in period.
- 2.10. That Cabinet delegate to the deputy leader, in consultation with the chief finance officer, authority to finalise the Articles of Association and other legal documentation required formally to incorporate the Company in accordance with the requirements of the Companies Act 1985.

### **3.0 Detail**

- 3.1. There are various forms of subsidiary companies and other arrangements that local authorities (or indeed private companies) can enter into. The complexity of the company structure is driven by the public purpose which the council wishes to achieve rather than, as is often perceived of some private sector structures, as a means to achieve particular tax treatments and to facilitate more aggressive accounting practices.
- 3.2. The proposal is for Brent Council to form a Company under its General Fund powers, which will be 100% owned by the Council. Its initial principal aim will be to assist in the delivery of the Council's ambitious regeneration plans and housing development objectives, but it is envisaged that this aim will be developed over time.
- 3.3. The rationale for using a WOC, as opposed to developing direct through the General Fund, includes:
- Isolation of some financial risks, which would be borne in the first instance by the Company rather than the Council;
  - More focused management of these complex risks, such as cash flow, tax, land development and market appraisals, many of which are not typical of most council services;
  - Specifically within the initial focus on housing, absolute clarity that any housing properties delivered will not be council HRA properties and thus will not impact on the HRA borrowing cap. Right to Buy (RTB) does not apply to homes developed through a WOC, as the Company forms a distinct legal entity from the Council.
  - Strong and onerous personal obligations placed on the Directors of the company, through the Companies Act, to ensure that the activity receives the appropriate management focus;
  - Flexibility to act more commercially and at greater speed than the council can, which is essential in acquiring property and striking development deals and hence emphasises why governance and control are so important; and
  - Flexibility to develop the company, once established, into another structure, if so required, allowing for example the development of other companies within the Brent umbrella or sharing of the equity in the company with another partner if that becomes desirable.

## 4.0 Company Structure

### The Council's Strategic Role

- 4.1. It is proposed that the WOC would be constituted as a company limited by shares. The Council will own the entire share capital and will therefore have ultimate control of the Company. The Company would be a subsidiary of the Council in terms of its technical legal status. In order to be flexible enough to deliver on the increasing variety of Council objectives the WOC may create from time to time other subsidiaries, if so authorised, which could take a different legal form such as charity or other 'not for profit' entity company. However, as any such subsidiaries would still be owned by the Company they too would be subject to strategic direction and control by the Council, in the terms set out in this report.
- 4.2. The WOC constituted as a company limited by shares has several key advantages:
- It ensures that the Directors of the company are personally liable for meeting the onerous obligations of the Companies Act. Whilst the council will indemnify them against reasonable matters it is beyond the lawful power of the council to do so in certain circumstances, such as for example as could arise from an HSE prosecution. These obligations provide a strong incentive for the Directors to ensure that the particular requirements of running a company are met.
  - It is a structure familiar to the private sector, and therefore gives the council the option, at its sole discretion, of subsequently changing the structure, for example to establish joint venture arrangements if thought desirable.
  - It explicitly allows the generation of profits (or surpluses) and whilst these give rise to tax considerations it enables a more transparent cross-subsidy to be provided to other council activities.
  - It ensures that the Directors of the company can act with commercial freedom, maximising the potential operational effectiveness of the company.
- 4.3. It follows from this that the governance of the company is of paramount importance. There is no intention whatsoever, and it would be highly undesirable, for the company to be able to act entirely independently of the Council. Its activities and freedom to act must therefore be carefully prescribed to balance the need for operational freedom against the equally important need for democratic oversight.
- 4.4. The following governance structure is therefore proposed, in summary:
- **Cabinet** – sets overall strategic direction and retains control of key activities;
  - **Corporate Management Team** – acts as senior 'client' overseeing the activities of the Company; and

- **Directors** – operate with commercial freedom in the best interests of the company (as required by the Companies Act).

4.5. Cabinet would be the strategic supervisory body with ultimate responsibility for ensuring governance of the Company and approval and delivery of its business plan. This role would be without prejudice to Cabinet's normal decision making powers as set out in the Council's constitution. The following key powers would be reserved to Cabinet:

1. Agree the articles of association and shareholder agreements;
2. Agree the Annual Business Plan;
3. Agree any loan facility to the Company and the terms of them;
4. Appoint and dismiss the Directors and Company Secretary;
5. Agree any expansion of the remit of the WOC;
6. Have powers to wind-up and dispose of the WOC on behalf of the Council;  
and
7. Provide general strategic direction and democratic oversight.

4.6. In addition, the council's audit committee would have a clear role in overseeing the company and ensuring that its activities were being conducted in accordance with its defined objectives.

4.7. As governance is more than usually critical in this context each of these is discussed in turn below. The key point to note is that the structure proposed will enable the Directors of the company to act with commercial freedom and with indemnities from the council against their obligations under the Companies Act, but if and only if the actions of the Directors are within the framework of activities already agreed by Cabinet. In other words, the framework gives the council, through the company, all the advantages desired in terms of operational flexibility, whilst retaining democratic control over all of the key strategic decisions.

*Agree the articles of association and shareholder agreements*

4.8. The articles of association are attached as Appendix One. These are perhaps best described as the rules by which the company will conduct its business, and in that sense somewhat analogous to the Council's constitution. They are therefore an important part of the overall governance of the company, and contain detailed clauses covering, for example, the quorum for Directors' meetings, voting at those meetings, how Directors must discharge their obligations as regards conflicts of interest and many other matters besides. Importantly, they give effect to the council's power to control the composition of the board, so that the company cannot appoint or dismiss any Director (although of course individual Directors are entitled to resign).

4.9. The shareholders agreement is attached as Appendix Two. This is perhaps best described as the rules that the council sets as to what the company can and cannot do (which it must then do in accordance with the articles of association). It is therefore an essential element of the council retaining strategic control of the company, whilst allowing it considerable operational freedom. Probably the most pertinent part of the document is Schedule A, the

“shareholder reserved matters”. The company cannot, as a matter of law, make decisions on “reserved matters”: it must seek the council’s consent, which is a function that the cabinet would discharge. Examples of the “reserved matters” include

- a. vary in any respect its articles of association or the rights attaching to any of its shares [this is necessary as the company could otherwise, in theory, amend its own rules about appointment of Directors to exclude or diminish the council’s role]
- b. engage in any business other than as contemplated by the Business Plan [this is necessary to give legal force to the business plan as the way in which the council sets the strategic framework for the council]
- c. create or permit to be created any mortgage, charge, encumbrance or other security interest whatsoever on any material asset or its business in whole or in part or any of its shares [this is necessary to secure the council’s ultimate ownership of all of the company’s assets]

- 4.10. Both documents are fairly standard in this context, but the documents are nonetheless an essential part of the governance framework. They have been drafted by externally commissioned lawyers, specialising in company formation, and reviewed by the council’s legal department. The documents attached are almost final, but will need minor amendments so that they can be legally executed, such as for the completion of the date of incorporation and other important but entirely routine matters. These will be dealt with under the delegated authority proposed at 2.9, with any material matters brought back to Cabinet if required.

*Agree the annual business plan*

- 4.11. The annual business plan would describe in more detail the planned activities of the company in a given period of time (usually a year). For example, in the context of planned housing work, Cabinet could restrict the company to purchase of properties up to a specified maximum, or only those that met certain criteria, such as by geographic area, or to achieve certain standards in lettings and so on. The annual business plan for the PRS element of the WOC is included as Appendix Three.

*Appoint the Directors and Company Secretary*

- 4.12. The Directors of the company are vitally important, and whilst constrained by the articles and business plan they would have to have considerable operational freedom in order to make the company effective. It is therefore essential that Cabinet retain the sole power to appoint and dismiss the Directors. As the WOC may establish, in time, subsidiary companies, focusing on specific council desired programmes, the Directors of these companies would similarly be appointed by the Council, although the normal presumption would be that they would be the same as those appointed by the Council to the main company.

*Agree any expansion of the remit of the WOC*

- 4.13. Cabinet retains the power to agree any change in the fundamental activities of the company. To be effective, this could not extend down to operational details (such as, to go to an extreme, the appointment of professional staff or advisers to help the company fulfil its functions) but it ensures that the company cannot choose to change its own scope of activities in more fundamental ways. For example, the initial scope could be constrained to housing activity, and any change to that would require Cabinet approval.

*Have the powers to wind up and dispose of the WOC*

- 4.14. In extreme cases the Directors might legally be required to wind up the company, for example if it was insolvent. However, in such extreme cases, if the decision was reserved to Cabinet then there would be no practical choice in the matter anyway. However, it is vital that Cabinet retain the power to 'dispose' of the company, for example to sell part of the equity to another party, so that the Directors could not act in this way themselves.
- 4.15. Of course, in a healthy professional working environment there ought not to be any significant divergence of views between Cabinet and the Directors of the Company. However, the above control framework is proposed as essential, as without it Cabinet would not be able to exercise sufficient control over the activities of the company in the event of some major disagreement arising.
- 4.16. Cabinet would be supported in fulfilling this role by the council's corporate management team. As the activities of the company could be drawn widely with the potential to impact on all areas of the council's business this is the only logical client function, which it is envisaged would be discharged, initially at least, through a quarterly monitoring report.
- 4.17. Within this overall structure it is now necessary to turn to the question of who should fulfil particular roles. In understanding this it is first necessary to set out some specific definitions, particularly as they relate to the Companies Act.

**Appointment of Directors**

- 4.18. The Director of a company established under the Companies Act is under an absolute duty to act in the interests of that company. Properly defined, in the way envisaged in this report, furthering the interests of the proposed company would necessarily entail delivering council priorities, but in practice conflicts can and will arise and Directors have a duty to manage these and, if necessary, avoid them, including by resigning either their Directorship or their other activity giving rise to the conflict (e.g. in this context their role within the Council).
- 4.19. Conflicts can either be situational (those that arise by virtue of the general situation) or transactional (where a particular transaction is proposed). This is best illustrated by an example. It would not be possible for the Chief Finance Officer, being the statutory s151 officer of the council, to be a Director of the Company. Each conflict would arise, for example:
- The company would require loan finance from the council to purchase properties. A very clear transactional conflict would arise with the Chief

Finance Officer advising Cabinet on the terms of that loan if that officer were also the Director of the company intended to receive the loan. In other words, the transaction could not proceed, in this situation, until either one role or the other was resigned, and as this situation could be envisaged at the outset the conflict would have to be avoided by preventing the CFO being a Director of the company.

- A situational conflict arises when a Director of the company occupies a position of such influence in the council that they could not reasonably be expected to separate this from their role on the company.

4.20. In practical terms this makes it impossible for the Chief Finance Officer or Chief Legal Officer to act as a Director of the company. Although it could be argued that the situational conflicts could be managed a number of transactional conflicts would arise regularly, and, as illustrated above, these would be fundamental.

4.21. Similarly, Cabinet members would be caught by situational and transactional conflicts. The minimum requirement for managing this conflict would be for any Cabinet member, if they were to be a Director of the company, to excuse themselves from any Cabinet or PCG discussion about the company and the policies it was pursuing, and hence create conflicts between their role as elected Members and their obligations to the company. There is not an absolute legal bar to Cabinet Members fulfilling this role, and in some other Councils Cabinet Members are appointed to such Directorships. However, officers' advice is that the potential for conflict would be significant, and that this should be mitigated by not appointing any Cabinet Members to be Directors of the Company.

4.22. Directors are also required to have the skills necessary to undertake the role. This has a particular legal implication in the context of the Companies Act. In the event of, for example, a prosecution by the HSE, a defence of not understanding the issues is not permissible, and would not be covered by the council's indemnity. Directors would therefore be required to undertake specific training, most probably via an accredited route, as well as ensuring generally that they have appropriate leadership and management experience. Directors are not necessarily required to have specific professional qualifications, for example in accountancy, but are required to ensure that they take and pay due regard to appropriate professional advice.

4.23. As a matter of good governance, and to strengthen the board of Directors, and to assist the Board to operate with sufficient freedom it is proposed that the Board should be chaired by a senior independent Director. The Chair of the WOC would need to demonstrate considerable experience of delivery of multi-year multi-agency investment in housing and infrastructure, commercial acumen and a deep knowledge of the complexities of funding, tax, company law and risk management. It is not an absolute legal requirement, but it is strongly recommended as a matter of good governance.

4.24. A range of potential candidates with the likely experience have been approached, and it is proposed that Martin Smith, the former chief executive of Ealing council, is appointed to the role. It is proposed that the chief finance



officer be authorised to agree the precise contractual terms and, for the avoidance of doubt, the role would be remunerated.

- 4.25. The council nominated Directors of the company would not be remunerated for undertaking the role. However, they would be indemnified in the council's standard terms. There are three broad options, each with various pros and cons, as to who those Directors should be, as set out below.
- 4.26. The first option is that the other Directors of the company should all be officers, possibly supplemented by another independent Director. This maintains the clearest possible separation between the role of elected Councillors in setting policy and the officer role of executing it. This is not an academic distinction. It provides clarity of focus and enhances the company's freedom to act commercially (within politically defined parameters). In the event that allegations of conflict of interest arise, whether perceived or actual, this model provides the strongest general rebuttal of such allegations. As against this, there is no direct involvement of elected Councillors in the day to day activities of the company.
- 4.27. Any officers appointed to the Board should, it is proposed, be either Strategic or Operational Directors, given the significance of the role. In theory anyone at this level could do the role. They do not need functional knowledge of or experience in the particular activities of the company, just good general management skills, knowledge and experience, allied to good commercial skills.
- 4.28. The second option is that the other Directors of the company (besides the independent chair) should be elected Cabinet Members. This provides the greatest level of political oversight but presents a number of significant challenges. The conflicts of interest become real, rather than perceived, and any Cabinet members on the board would have to recuse themselves from Cabinet decisions and PCG discussions about the company. As the activities of the company are potentially very wide ranging this could prevent the Cabinet members from fulfilling part of their political role.
- 4.29. As an illustration of this, if the Cabinet Member for Housing were a Director of the company, it is difficult to see how they could play a normal part in decision making on key issues around housing policy, given the initial proposed remit of the company. Obviously, this degree of conflict reduces if the Cabinet member proposed as Director has no direct day to day oversight of the policy areas that the company is delivering against, but as Cabinet policy is developed collectively this merely reduces the conflict somewhat, and certainly does not eliminate it
- 4.30. Some councils do have companies with Cabinet members as the Directors, so it is not unlawful per se. However, given the wide ranging role of the proposed investment company, there are good reasons to be cautious about adopting this approach, and certainly a board with a majority of Cabinet members would carry significant governance risks.

- 4.31. The third option would be for non-executive (back bench) Councillors to be Directors of the company. This clearly reduces the potential for conflict. It does not eliminate it, and the same considerations apply, so, hypothetically, participating in a scrutiny review of housing might become more problematic for the elected member in question. However, as the conflict could never be “transactional” (because non-executive Members do not authorise transactions) then the conflict becomes much more capable of being managed.
- 4.32. This also clearly provides a greater degree of political oversight of the day to day activities of the company than the first option.
- 4.33. Finally, the Directors of the company could be drawn from a mixture of roles – elected Members and senior officers. Various combinations of this could be devised, and sharing roles helps to dilute conflicts of interest. However, it is important to note that this model does not eliminate the conflicts; to repeat the hypothetical example above, the Cabinet member for Housing would still, if appointed as a Director, have a significant conflict with his substantive political role.
- 4.34. It is recommended that the final option permits some elected member representation on the Board, albeit the elected member would be acting formally in the interests of the company, with two senior officers and an independent Chair. Therefore it is proposed, taking all of the foregoing into account, that the Directors of the company should be:
- One elected member - Councillor George Crane is proposed for this role;
  - Two senior officers - The Strategic Director of Community Wellbeing (Phil Porter); and The Director of Policy, Partnerships and Performance (Peter Gadsdon) are proposed for these roles; and
  - One independent voting Director as Chair - Martin Smith, the former Chief Executive of Ealing Council is proposed for this role.
- 4.35. It is not intended that the WOC would have a high profile identity separate from the Council, and that, operationally, it would be a “light” organisation with many activities, particularly development, undertaken via consultancy support, contracts and management agreements or via secondment of Council staff. It is expected that by setting up and running the Company in this way the impact on staffing capacity would be low but equally would improve efficiency and maintain employment whilst providing a motivating opportunity for staff to develop new skills. Some direct appointments might be necessary in relation to, for example, management of core functions such as Board papers, audit, insurance, accounting and tax.
- 4.36. The conclusion of this report is that the WOC has significant potential to support the delivery of housing, infrastructure and regeneration strategies directly (i.e. through site development) and indirectly (providing the catalyst for further private sector investment or maintaining the momentum of change). For example, the potential for the Council to be able to directly deliver housing on land that it owns is of clear benefit to the wider regeneration of Brent as it will provide an alternative route to private sector delivery which has been constrained by prevailing economic conditions.

- 4.37. A draft shareholders agreement and articles of association are attached. Subject to final legal drafting these are the documents that would give legal force to the general and specific proposals set out above.

## **5.0 Delivering Housing through a Wholly Owned Company (WOC)**

- 5.1. As regards housing development, the WOC would not replace development within the HRA but rather complement it, developing a mix of tenures.
- 5.2. Cabinet approved the Temporary Accommodation Reform Plan in March 2016, which sets out a number of actions to improve the quality of accommodation for homeless households at a reduced cost to the Council and to create more opportunities to end the council's homelessness duty.
- 5.3. One of these actions was for the council, via the WOC, to acquire properties which will be let as long term Private Rented Sector (PRS) properties at Local Housing Allowance (LHA) levels to prevent homelessness and end homelessness duty to families helped. The properties would need to be either in Brent or sufficiently close to Brent to be able to end a homelessness duty in compliance with the Homelessness Suitability of Accommodation Order of 2011. A good rule of thumb is the property is within 90 minutes public transport travel time from Brent civic centre.
- 5.4. The advantages of utilising a company owned by the council outside the HRA include that it could let properties within the Private Rented Sector, while drawing on the council's borrowing capacity and give the council greater control of the investment compared to entering into a joint venture or contract with an external organisation, allowing better management of risk and potential reward. There are tests which the PRS properties must achieve to ensure the Council's housing duty can be ended, which primarily relates to the PRS tenants having a tenancy agreement with the company and not the Council. However, the mechanisms for the council's strategic control as raised earlier in this paper remains and additional mechanisms such as 100% nomination rights provides the Council with added comfort.
- 5.5. Additional benefits of the WOC would be its impact in creating growth in the local construction sector, expanding the provision of quality homes and providing exemplar developments which might generate interest by developers and others in building in Brent. By directly delivering housing on Council land, both General Fund and HRA, the WOC would provide an impetus to private sector delivery. The WOC would be a vehicle that demonstrates the Council's commitment to using all its powers and assets to deliver transformation whilst allowing for flexible delivery over time by the market.
- 5.6. Housing could be provided on Council owned land, from either General Fund or HRA, with funding primarily provided through General Fund prudential borrowing on-lent to the WOC at an increased interest margin, and complimented with any grants or third party contributions that can be secured. Note that this borrowing could either be from the PWLB or from other external financing.

- 5.7. As an investment company, the WOC would retain the majority of properties developed by the Company for letting under new tenures such as assured and assured short-hold at affordable rents. Some properties could be sold for low cost home ownership and/or private sale or to other housing providers, including the HRA. Note that the Right to Buy does not apply to these rented homes and outside the Right to Buy provisions.
- 5.8. There are various scenarios that could be modelled to show how decisions made by the WOC would benefit the Council and the wider community. For instance, net rental income after the deduction of operational costs could be used to service and repay borrowings. However, the WOC could also decide to sell properties to assist in the repayment of debt. If properties were sold to registered providers they would continue to contribute to the local stock of affordable housing. Any surpluses generated either from net rental income or sales of properties would generate an overall return to the Council (General Fund) on its equity ownership.
- 5.9. Over time, some housing developed by the WOC might be purchased by the HRA. This would secure some housing as secure tenancies, if the Council so wished. This could be done using surplus cash flows generated in the HRA Business Plan and would maximise leverage of the HRA resources.

### **The Business Plan**

- 5.10. This sets out what the company can do and therefore, what it cannot do. It also contains the company's financial plans, which are discussed in the financial implications.
- 5.11. In summary, the company is at this stage being authorised to acquire properties, and let them at LHA rates to discharge the council's homelessness duty. It will operate as a responsible and fair landlord for these purposes. It will not normally acquire properties outside of the key areas defined in the business plan, where the infrastructure and commuting times provide opportunities for employment, public services and lifestyle choices. The company may let some properties above LHA rents, for example at sub market rents, defined as rents at below the market rents for that area, to key workers or households as part of their transition plan to permanent housing, or even at market rents if appropriate. It will only do so if financially necessary, and may not have more than 25% of its portfolio above the LHA rate without explicit Cabinet approval.
- 5.12. The company will also carry out general business development activities, to identify new opportunities for the council, but it will not act on these without further explicit approvals following a robust business plan and investment appraisal.

## **6.0 Financial Implications**

- 6.1. A WOC can be set up to deliver a number of opportunities/programmes within a balanced property portfolio. Following Cabinet's approval of the Temporary Accommodation Reform Plan in March 2016, where a key action to address the

needs of households being placed in temporary accommodation was the acquisition and development of a substantial portfolio of long term PRS accommodation which can be let to homeless households at Local Housing Allowance (LHA) rates.

- 6.2. Detailed consideration has been given to a business case and financial plan for a WOC to manage a PRS portfolio on behalf of Brent. This business case for establishing this WOC assesses the risks and impacts on the Authority, whereas the Business Plan (appendix three) models the revenue and cost flows for the company, and assesses its commercial viability.

### **The Business Case For The Operating A PRS Portfolio Through a WOC**

- 6.3. The Temporary Accommodation Reform Plan identified that an assessment of the viability of a wholly owned PRS company would be undertaken. The advantages of managing the PRS portfolio through a company are:
- Discharge of the duty for Brent to comply with its responsibility under the Homelessness Suitability of Accommodation Order of 2011
  - Discharge of its duties under section 193, Housing Act 1996
  - Reduction in the costs associated with placing households in more expensive alternative settings
  - Being able to 'on lend' existing financial balances at PWLB rates, as an alternative to traditional investments which are not performing well in the current financial market
- 6.4. The company will be funded from a mixture of a long term debt and an equity holding. The relative amount that will be funded by debt held as equity is informed by the company business plan, and the availability of the company to cover interest payments on borrowing.
- 6.5. Brent will provide funding for the acquisitions of the company as part of its wider investment strategy from prudential borrowing. The initial financial plan will not require the company to repay the loan debt to the council, until such time as the council specifies and requires this. This is a fundamental assumption about the financial structure of the company. Its initial function, as set out in the business plan, is to acquire and manage properties for the council to let to alleviate housing pressures, in line with the temporary accommodation reform plan. Meeting interest costs in the early years of operation would not be affordable for the company, and if it were required to do so the effect on the council would simply be to require it to hold a larger equity stake.
- 6.6. Instead, the assumption is that at a future date to be determined the council will require the company to dispose of some of the assets it has acquired to finance the loan repayment. As the council can afford to be a long-term investor it will have a reasonable degree of assurance that it will be able to manage this at the more advantageous time of the property market cycle, taking advantage of the likely long-term rise in prices. Even if there were to be an unprecedented long-term decline in the property market the council could still manage the risk by letting at market rates instead, although this would clearly not have the same

social benefit as the model intended. In short, there are risks, as there are in any property transactions, but there are reasonable mitigations for these.

### **Impact on the General Fund**

- 6.7. Investing in these properties will provide an alternative housing option for families who would otherwise be housed in more expensive Temporary Accommodation. The TA reform plan report identified that there would be an expected cost saving / cost avoidance of £0.86m per annum arising from this provision.
- 6.8. The interest costs to the council of the investment required to fund this will be at least met by interest payments from the company, as the on-lending will include an appropriate margin. This is built into the company's business plan and is affordable within that. Offsetting this saving is an additional cost of borrowing to invest in the company. The company will principally be financed by loans in this way, but a small element of the financing will be equity to represent the council's ownership of the company and so comply with HMRC guidance. The precise mix of loan and equity finance will be determined by the chief finance officer.
- 6.9. The repayment of the loan and equity debt would be made at the time when it is appropriate to dispose of such assets as are held by the company. Using prudent measures for cost and property inflation, an indicative positive rate of return for the investment is 5.41% over a 30 year return.
- 6.10. In addition, an analysis of the returns generated by the projections against comparable recent transactions in the local market has been carried out so that the Council is able to demonstrate that they do represent both best value to the Council and a structure which is state aid compliant. This means that funding to the WOC must be on market terms (except for the explicit purpose of affordable housing) and comply with HMRC requirements in relation to tax treatments. The Council would charge a premium on all loans approved to the WOC in excess of PWLB rate, providing a revenue income stream to the Council. All lending to the WOC would be subject to a loan agreement and would include pre-conditions on draw down, as well as scrutiny of delivery of agreed development schemes.

### **The Sustainability of the Company**

- 6.11. The company will be set up to purchase and manage a target portfolio of 300 properties in and around the London Borough of Brent. Properties will not normally exceed ninety minutes travel time by public transport from Brent Civic Centre and ideally be less than sixty minutes. These properties will be let to tenants for whom Brent has a duty under the Housing Act 1996, Part VII as amended by the Homelessness Act 2002 and the Localism Act 2011 to provide housing option who would otherwise have required more expensive TA options.
- 6.12. The modelling is based on the company letting at LHA rates. The company will have limited flexibility to let to tenants at sub market rents or commercial rates.

This flexibility shall be no greater in value than 25% of the overall delegated company budget, without specific Cabinet authority

- 6.13. Initial modelling has presented a sustainable business plan for the company provided that a number of key targets are met, the key ones being:
1. Purchasing a portfolio of properties that generates sufficient income from letting to tenants at sub market rents to cover the costs of operating the company and interest on debt owed to Brent
  2. Properties are managed in such a way as the costs of operation are optimised and the revenues lost through void and bad debts are minimised
- 6.14. The premise of this company is that it has been established to provide quality housing options at sub market rents. Key to the sustainability of this company is its ability to operational surpluses. However, the ability to make significant surpluses is restricted through sub market rental income. Section 6 of the business plan gives more detail on the critical and other variables that the directors of the company will need to manage to ensure a sustainable, successful and profitable company.
- 6.15. Providing that these key targets are met, the financial profile of the company is that it becomes profitable during the second year, and retains surpluses from which to operate until end of the 30 year business plan period.
- 6.16. It should also be noted that incorporation of a company exposes the operation to liability for corporation tax and VAT. Payment of these taxes has been included in the financial modelling exercise.
- 6.17. Given the target variables as defined above, the company will require a cash flow / working capital facility of up to £1m during the first 4 years of operation. The need for a working capital facility arises from the time it takes from the acquisition of the property to first let. The financial profile for the company is for the company to make a loss in the first year of operation, turn from profit to loss during the second year and to make accrued profits from year 4 onwards.
- 6.18. For the avoidance of doubt, this is a loss within the company. As it forms part of the council's overall group it is not a loss to the council; indeed, the company will be a part of the council's plans to reduce its overall costs in managing homelessness. By way of analogy, describing the company as making a loss in its early operation is the same as describing any operational budget as a 'loss' which would be meaningless for practical purposes. However, the early loss in the company has a specific meaning within the Companies Act, which is why it is necessary to demonstrate that the company will over time be profitable.
- 6.19. From year 4 onwards the company is self-sustaining, with losses made in later years being offset by further profits made in the earlier years. This is detailed in the appended company business case.

- 6.20. There are risks of setting up a company, the primary one being that due to unforeseen market changes it may become insolvent. This risk should be mitigated by suitable monitoring arrangements as set out above. It is important that the company maintain the flexibility to set rents and if necessary dispose of properties to meet any shortfalls. The company should not be authorised to borrow or incur long-term liabilities without prior Council approval.
- 6.21. To support the viability of the company and protect the interests of the company a commercial arm will operate alongside the PRS affordable housing. This commercial element will permit greater opportunity to deliver sub market and commercial housing to create a strong and sustainable business and offer accessible housing products to key workers amongst others.

### **Conclusion**

- 6.22. The PRS landlord is an example of how the Council through the WOC facilitates more varied programmes of housing and regeneration. The WOC provides the structure to drive financial, economic and social benefits for the residents of Brent and through its business focus deliver results. The WOC operating within an agreed business plan, delivering sub market rental properties, is a commercial viable option for Brent. The additional costs of operating in a company structure, such as liabilities for taxation, are offset by the focus of a dedicated company and operational board of Directors, delivering a supply of quality and affordable homes and facilitate the discharge of homelessness duty for Brent.

## **7.0 Legal Implications**

- 7.1 The Council has the power to establish and operate the company to develop homes to be let for rent and sold on the market or for low cost home ownership using the general power of competence under section 1 of the Localism Act 2011.
- 7.2 In exercising this power the Council is still subject to its general duties, such as its fiduciary duty, and must exercise the power for a proper purpose. The power is also limited where it overlaps with a power which pre-dates it (section 2 Localism Act 2011). Accordingly in setting up a trading company the Council must comply with section 95 of the Local Government Act 2003 and the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009.
- 7.3 Under section 4 of the Localism Act 2011 where, as is proposed here, that the general power is used for a commercial purpose, that commercial purpose must be carried out through a company.
- 7.4 Under sections 1 and 12 of the Local Government Act 2003 the Council may borrow money or invest for any purpose relevant to its functions or for the prudent management of its financial affairs. The borrowing must be prudent and comply with the Prudential Code.



- 7.5 The Council has the power to provide financial assistance (loan) for housing purposes under section 24 of the Local Government Act 1988 where the immediate landlord of the occupier is not a local authority. In this instance the landlord will be the Company. This power is subject to consent of the Secretary of State. The Secretary of State has set out pre-approved consents in the "General Consents 2010" (July 2011) and the "General Consents 2014" (April 2014). The Council can provide financial assistance to the Company under Consent C of the General Consents 2010
- 7.6 Any housing made available for sale by the Company would not be covered by the 1988 Act. However the Council may rely upon the general power of competence under section 1 of the Localism Act 2011 to fund the Company for the purpose of the company operating a business to provide homes for market sale. The Council may also use this same power to provide loans to the Company for working capital.
- 7.7 It is proposed that Council lending to the Company will be structured and provided at market terms and rates (except for lending for affordable housing) and so would not constitute State Aid. The issue of State Aid will be kept under review and considered on a scheme-by-scheme basis.
- 7.8 The Council may also secure its lending to the Company with legal charges on the property acquired or developed by the Company.
- 7.9 The Council has the power to dispose of land by lease to the company under section 123 of the Local Government Act 1972 and obtain best consideration for the land. Sale at an undervalue may require consent from the Secretary of State and/or may constitute unlawful State Aid.
- 7.10 The Council is entitled to dispose of land held in its Housing Revenue Account providing it complies with section 32/43 of the Housing Act 1985. Although these consents for HRA land normally require the consent of the Secretary of State, there are general consents that have been issued. These powers are complex and as such, site-specific advice will be obtained for any disposal.
- a. If the Council were to transfer land to the company and impose specific requirements as to what will be developed on that land then this is likely to be a public works contract. However, providing the company remains wholly in the ownership of the Council (or is otherwise wholly publicly owned) then, subject to the relevant tests a) being met, such a contract would still be compliant with the Public Contracts Regulations 2015.

## **8.0 Diversity Implications**

- 8.1. None. The company would continue to adopt Council diversity requirements.

## **9.0 Staffing/Accommodation Implications (If Appropriate)**

- 9.1. Remuneration is not proposed for the existing Members/officers as Directors of the company, but would be expected for the independent chair and any other independent members.
- 9.2. The WOC will be efficient on administration and use contracts with private companies and with the council to deliver its service.

## **10.0 Implementation Plan**

- 10.1. An implementation plan has been prepared for the next phases of the work. It proposes three main strands of activity in order to finalise matters. These are:
  - 1) Obtaining all necessary consents, clearances and sign off from, for example, external audit, HMRC.
  - 2) Further consideration and determination of the management and operational arrangements, including site identification and development proposals.
  - 3) Drafting and agreement of the various legal agreements which would be required for the establishment of the WOC.
- 10.2. All these matters are detailed in the Final Business Case which found at appendix 1.

## **Background Papers**

### **Contact Officers**

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