

# ESTABLISHING AN ENTITY TO DELIVER PAN-LONDON MODULAR HOUSING

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LONDON COUNCILS

**19 December 2017 (DRAFT)**



## 1. EXECUTIVE SUMMARY AND RECOMMENDATIONS

- 1.1. The London Authorities are considering whether to establish a new entity (**SPV**) to procure and deliver modular housing units for use by the London Authorities on meanwhile sites.
- 1.2. The London Authorities have the power to set up and participate in the SPV through the General Power of Competence under the Localism Act 2011 (see paragraph 3).
- 1.3. Given the London Authorities intend the SPV to be not for profit and desire a fairly straightforward method of becoming and ceasing to be an SPV Member, we recommend that the SPV is established as a company limited by guarantee under the Companies Act 2006 (see paragraph 4).
- 1.4. We advise that: bespoke Articles of Association are developed to set out how the SPV will operate in line with the SPV Members' intentions and in compliance with public procurement law; and that the SPV and the SPV Members enter into a Governance Agreement with further detail on the relationship between the SPV and SPV Members and between the SPV Members. The SPV Members will need to consider what decisions they do not want the SPV Board of Directors to take alone (see paragraph 5).
- 1.5. We would suggest that SPV Member appointed directors should be Officers rather than Elected Members due to the ability to manage conflicts of interest. Elected Members should instead lead on decision making within the SPV Members on their interests in the SPV (see paragraph 5).
- 1.6. We consider that the proposed SPV arrangement and relationship with the SPV Members would comply with the Teckal requirements under Regulation 12, Public Contracts Regulations 2015. The SPV Members would be able to contract with the SPV without running a public procurement process. The SPV would be subject to the Public Contracts Regulations 2015 and so would need to procure the Modules in compliance with these regulations (see paragraph 6).
- 1.7. Where the SPV is not trading beyond the SPV Members then we do not consider it is an undertaking for State aid purposes. This means that the SPV Members can provide support to the SPV including financial investment (see paragraph 7) although in the case of investment the SPV Members must act in accordance with their borrowing and investment powers under the Local Government Act 2003 (see paragraph 3).

- 1.8. Where the SPV decided to expand and trade beyond the SPV Members then further legal advice should be taken to ensure that the Teckal status is maintained and that State aid is dealt with in advance (e.g. cross subsidies between Teckal activities and trading).
- 1.9. Subject to State aid, the SPV Members can make funding available to the SPV. Where the SPV Members are passing on grants received by them then they: must consider the terms of each grant to ensure the proposed use fits within the terms; and consider whether any agreement on liability sharing (e.g. where one SPV Member as acted as a “lead” to obtain finance) is required (see paragraph 8).
- 1.10. The SPV will not be acting as a landlord and so would not need to consider registration with the Homes and Communities Agency.
- 1.11. The SPV Members are not considering, at this stage, granting any interest in land to the SPV. The SPV would be capable of taking any such interest in which case the SPV Members would need to ensure that they comply with the duty to obtain best consideration under Section 123, Local Government Act 1972.

## 2. INTRODUCTION AND OUR INSTRUCTIONS

- 2.1. We are instructed by London Councils (**LC**) to advise on the establishment of an entity for the delivery of modular housing across London.
- 2.2. LC is a representative group for the 32 London Boroughs and the City of London (the **London Authorities**). It operates through two local authority joint committees established under the Local Government Act 1972 and the Local Government Act 2000.
- 2.3. Our instructions come from the Leaders' Committee established pursuant to a Governing Agreement dated 13 December 2001 (the **Joint Committee**).
- 2.4. The Joint Committee is instructing us on behalf of its member London Authorities. The London Borough of Tower Hamlets (**LBTH**) is the lead authority for the modular housing proposals.
- 2.5. The London Authorities are seeking to reduce their expenditure on nightly paid temporary accommodation and to drive innovation in the modular housing construction sector. They also seek to make better use of land that may be developed in the future – **meanwhile sites** – to help alleviate housing pressures in London.
- 2.6. An options appraisal has been undertaken as part of the development of a strategic business case for the London Ventures' Capital Ambition Board (**LV**) to secure initial seed investment. Having considered the options appraisal, London Councils would like to develop further the work around establishing a single entity (the **SPV**) jointly owned by those London Authorities wishing to participate (**SPV Members**).
- 2.7. We are instructed that:
  - 2.7.1. The SPV should be established on a not for profit basis. Any surplus generated from its activities is to be reinvested back into those activities to increase housing supply;
  - 2.7.2. The governance arrangements should allow SPV Members to join and leave the SPV easily;
  - 2.7.3. The SPV Members wish to be able to contract with the SPV without the need to conduct a public procurement process;
  - 2.7.4. The SPV will procure demountable modular housing units (**Modules**) from the market – funnelling engagement with the market through the SPV should allow

- for economies of scale to be achieved compared to individual London Authorities contracting with the market and will allow for joint ownership of the Modules through the SPV;
- 2.7.5. The SPV will make the Modules available to the SPV Members. Initially this will just be on land owned by the recipient authority. Separate discussions are ongoing about land held by Transport for London. In the future land owned by private developers could be used. It is initially envisaged that the relevant SPV Member would hold any relationship with third party land owners and, at this stage, that the SPV will not hold any land (freehold or leasehold) for the Modules to be sited on. However, the SPV Members may wish the SPV to hold land directly in the future and so the SPV setup should allow for this;
- 2.7.6. In addition to procuring the Modules the SPV may also procure the installation services and SPV Members will be able to access these through the SPV. The SPV Members are most likely to be responsible for any land preparation/remediation rather than the SPV but in time this may change and the SPV may take on this role (including via procuring additional contractors).
- 2.7.7. The SPV will be funded principally by the SPV Members (or some of them) either from their own funds, PWLB borrowing or funds obtained from the GLA (a current grant application has been made to the GLA Innovation Fund for £11million to invest in pilot scheme of 200 homes) or other funds. The London Authorities are also considering whether SPV Members could transfer any affordable housing funds to the SPV. It may also be the case in time that the SPV will bid for funds directly from third parties.
- 2.8. Once a Module has been sited it is not currently envisaged that the SPV would have a continuing role other than ownership of the Module itself (and eventual removal from the site). The relevant SPV Member will be responsible for letting the Module home to occupiers, all housing management and the maintenance of the Module/site. However, in the future the SPV Members may wish to expand the remit of the SPV so that it undertakes housing/tenancy management – which may or may not include it acting as the landlord.
- 2.9. The focus by the SPV Members will be on providing temporary accommodation but we also note in the LV options appraisal that the SPV Members might also look at mixed tenure options including private rented (albeit low income/sub market rent) in the future.

- 2.10. Modules will be in place for several years before being taken down and moved to another site. We understand that Modules could be in place on a site for between 4 and 12 years but that 5 years is likely to be the minimum financially viable period that a Module would remain in place.
- 2.11. We are instructed to advise on:
- 2.11.1. The powers of the London Authorities to establish and participate in the SPV;
  - 2.11.2. The most appropriate corporate vehicle;
  - 2.11.3. Governance arrangements;
  - 2.11.4. Public Procurement;
  - 2.11.5. State Aid;
  - 2.11.6. The ability of the London Authorities to make funding available to the SPV;  
and
  - 2.11.7. Housing regulatory matters.

### 3. VIRES

- 3.1. The London Authorities provide temporary accommodation in accordance with Part VII, Housing Act 1996.
- 3.2. The London Authorities' main relevant functions in relation to the setup and operation of an SPV are:
  - 3.2.1. The General Power of Competence (**GPOC**) – section 1, Localism Act 2011 (“LA11”);
  - 3.2.2. The **Incidental Power** – section 111, Local Government Act 1972;
  - 3.2.3. The **Borrowing Power** under section 1, LGA03; and
  - 3.2.4. The **Investment Power** under section 12, LGA03.

#### *Commercial Purpose and Trading*

- 3.3. The use of the SPV for the purposes outlined in paragraph 2 do not, in our view, amount to trading or acting for commercial purpose because the SPV will be focussed on providing a service (including potentially some works) and goods to the SPV Members.
- 3.4. However, we would note that:
  - 3.4.1. If the activities of the SPV expanded and involved the SPV providing services to the market/non-SPV Members (including offering “private rented” accommodation even at below market rates) then there may be procurement implications (for which see further below) and the SPV Members would need to ensure they were in compliance with their commercial/trading powers<sup>1</sup>; and
  - 3.4.2. Where individual SPV Members develop proposals to use Modules for “private rented sector” lettings including at a sub-market rent then further consideration should be given at that stage to whether the individual authority was trading and the housing law implications of this type of activity. This aspect would not directly affect the SPV.

#### *GPOC*

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<sup>1</sup> Principally GPOC and Section 95, Local Government Act 2003

- 3.5. GPOC authorises the London Authorities to do anything that an individual with full capacity may do. As an individual with full capacity is able to set up and participate (including borrowing/investment/provision of loans) in a company this would, prima facie, provide the powers for the London Authorities to do likewise.<sup>2</sup>
- 3.6. GPOC can be used even if there is another power that overlaps with it. GPOC is limited by any limitations on the powers of the London Authorities that existed prior to GPOC coming into force and by any new limitations that are stated to apply specifically to GPOC or to all of the London Authorities' powers (unless GPOC is specifically excluded).<sup>3</sup> GPOC can be used for commercial purposes.<sup>4</sup> All restrictions on the powers at paragraphs 3.2.2 to 3.2.4 would also apply where they overlap with what the London Authorities want to authorise through GPOC.
- 3.7. The use of GPOC can be restricted by the Secretary of State<sup>5</sup> but to date no restrictions relevant to the establishment and operation of the SPV have been put in place.

#### *Incidental Power*

The Incidental Power authorises the London Councils to “to do any thing (whether or not involving the expenditure, borrowing or lending of money or the acquisition or disposal of any property rights) which is calculated to facilitate, or is conducive or incidental to, the discharge of any of their functions”.<sup>6</sup> The Incidental Power combined with the Part VII, Housing Act 1996 functions potentially authorise the establishment of the SPV to facilitate the delivery of those functions under the Housing Act.

#### *Borrowing Power*

- 3.8. The London Authorities are authorised to borrow money<sup>7</sup> for any purpose relevant to their functions or for the prudent management of their financial affairs. The borrowing power is constrained by borrowing limits imposed by the Council itself (the duty to determine an affordable borrowing limit) and the Secretary of State (none currently).

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<sup>2</sup> Section 1, LA11

<sup>3</sup> Section 2, LA11

<sup>4</sup> See also the additional restrictions in the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009/2393 that apply by virtue of the overlap with Section 95, Local Government Act 2003.

<sup>5</sup> Sections 5 to 7, LA11

<sup>6</sup> Although it should be noted that the ability to raise funds is restricted by powers such as the Borrowing Power.

<sup>7</sup> Sterling only unless Secretary of State consent is obtained



- 3.9. In setting the affordable borrowing limit each London Authority must have regard to the “Prudential Code for Capital Finance in Local Authorities” published by CIPFA (current version dates from 2011 but a new version is due for publication in January 2018).<sup>8</sup> Furthermore the Council must have regard to any guidance issued by the Secretary of State.<sup>9</sup> The current document is “Guidance on Local Government Investments” (DCLG, April 2010) which includes statutory guidance and “informal commentary”.<sup>10</sup>
- 3.10. Where a London Authority was to borrow to finance the SPV for the purposes set out in paragraph 2, we do not consider there is anything in the current legislative framework that would prevent this provided that the authority can demonstrate that it is acting prudently and within its borrowing limit.

*Investment Power*

- 3.11. The Investment Power authorises the Council to invest for any purpose relevant to any of its functions or for the purposes of the prudent management of its financial affairs. The Investment Power when coupled with the Incidental Power could, in our view, authorise the Council to set up and participate in a particular vehicle. The Investment Power would also authorise investment into the SPV.

*Disposal Power*

- 3.12. The Disposal Power authorises a London Authority to dispose of any land (or an interest in land) held by the authority but requires best consideration to be obtained.<sup>11</sup>
- 3.13. Based on the model detailed in paragraph 2, it is not immediately anticipated that there will be any interest in land granted to the SPV. We, therefore, have not considered this further at this stage. However, where future proposals are developed that involve a London Authority disposing of an interest in land to the SPV then the relevant London Authority must ensure that it complies with the Disposal Power and that, notwithstanding that the Disposal Power may be satisfied, there is no State aid (see paragraph 7 below).

*Vires Recommendation*

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<sup>8</sup> Regulation 2, Local Authorities (Capital Finance and Accounting) (England) Regulations 2003.

<sup>9</sup> Section 15, LGA03

<sup>10</sup> DCLG is currently consulting on new guidance - <https://www.gov.uk/government/consultations/proposed-changes-to-the-prudential-framework-of-capital-finance>

<sup>11</sup> Section 123, Local Government Act 1972

3.14. We consider that:

3.14.1. The London Authorities can use GPOC to set up and participate in the SPV.

3.14.2. A London Authority is able to borrow from PWLB (or another source) or use other funds that it holds to finance the SPV but must do so in compliance with the prudential borrowing regime – i.e. the authority must show that the borrowing is for a prudent investment and not something that is purely speculative. This can be viewed as part and parcel of the Council's fiduciary duty to its council tax payers.

3.14.3. Where funds have been granted for a particular purpose then they must be used in accordance with the terms of the original grant.

3.15. Any investment in the SPV must be in accordance with the investing London Authority's investment strategy adopted from time to time.

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## 4. CORPORATE STRUCTURES

### *Company limited by shares ("CLS")*

- 4.1. This is the most common form of corporate vehicle and is established under the Companies Act 2006 ("CA06"). It is governed by the principles of company law.
- 4.2. A CLS is managed on a day to day basis by a board of directors who report to the shareholders. An SPV Member's liability (as a shareholder) would be limited to the value of its shares and any sums remaining unpaid on those shares.
- 4.3. The directors have a number of core statutory duties<sup>12</sup> in addition to those owed elsewhere in statute and at common law and equity. Directors are generally not personally liable for debts but they can become liable if they give personal guarantees (we would anticipate that this is extremely unlikely in these circumstances). Directors might also incur direct liability where there is fraudulent trading, wrongful trading,<sup>13</sup> misfeasance or breach of fiduciary duty to the company.<sup>14</sup>
- 4.4. The main constitutional documents are the Memorandum of Association (which is a standard form document) and the Articles of Association. Whilst there are model Articles<sup>15</sup> that can be used we advise that bespoke Articles should be created to reflect exactly how the London Authorities would like the CLS to operate (including where the shareholders wish to exercise control over the activities of the board of directors).
- 4.5. A CLS is regulated by the Registrar of Companies (Companies House) and is required to file an annual confirmation statement<sup>16</sup> and accounts. These are public documents generally available via the Companies House website.
- 4.6. Formation of a CLS is fairly straightforward and requires an application to Companies House (again a standard form), payment of a registration fee and submission of the Memorandum and the Articles of Association. The application form includes a

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<sup>12</sup> See Sections 171 to 177, CA06 – act within powers; promote the success of the company; exercise independent judgment; exercise reasonable care, skill and diligence; avoid conflicts of interest; not accept benefits from third parties; declare an interest in a proposed transaction/arrangement with the company.

<sup>13</sup> Trading before commencing winding up when you know or ought to have known the company cannot avoid entering into insolvency.

<sup>14</sup> E.g. assets or monies of the company being transferred to the director.

<sup>15</sup> Schedule 1, CA06.

<sup>16</sup> Previously the annual return.

statement of capital and initial shareholdings. The company is established when a certificate of incorporation is issued.

- 4.7. Assets of the CLS are held by the CLS corporately but may be distributed to shareholders.
- 4.8. A CLS is generally used where the intention is to make a profit. That profit is then either re-invested back into the activities of the CLS or distributed back to shareholders by way of dividends. It is therefore a good vehicle for providing a means of generating income for the shareholders.

*Company limited by guarantee (“CLG”)*

- 4.9. Established under the CA06, a CLG is similar in how it is established and governed to a CLS but there are important differences. The members of the CLG are not shareholders. On becoming members, the SPV Members would agree to be liable for the debts of the CLG up to a specific amount should the CLG be wound up whilst they are a member (or in the period of one year after they cease to be a member). This is usually a nominal amount. There are model Articles<sup>17</sup> and at establishment the application form includes a statement of guarantee. As with the CLS we would recommend bespoke Articles are prepared.
- 4.10. Assets are still held by the CLG but the Articles of Association usually restrict what can be done with them. A CLG is normally used where the intention is to set up a non-profit – whether charitable or otherwise – i.e. where there is no intention to distribute profits to the members of the CLG.

*Limited Liability Partnership (“LLP”)*

- 4.11. LLPs provide some of the benefits of a company in respect of limited liability but provide more management and operational flexibility than a company. Unlike a normal partnership an LLP is a legal person that is able to hold assets and contracts. An LLP is established under the Limited Liability Partnerships Act 2000 with additional provisions contained in the Limited Liability Partnerships Regulations 2001 (“LLP Regulations”).

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<sup>17</sup> Schedule 2, CA06.

- 4.12. LLPs are regulated by the Registrar of Companies in a very similar way to a company. Establishment of an LLP is by way of paper application (a standard form LLIN01) to Companies House with the appropriate fee. Once the certificate of incorporation is issued the LLP is established. LLPs must submit an annual confirmation statement and accounts. There must be a minimum of two members of the LLP.
- 4.13. Where in a company there is a distinction between the shareholders/members and directors, the same is not automatically the case for an LLP – the partners in the LLP are both the owners and the managers of the enterprise. However, it is possible to structure the LLP so that some members (“designated members”) have enhanced duties to comply with certain administrative obligations, such as the appointment of an auditor, signing the accounts and confirmation statement, and/or notifying Companies House of changes to the LLP. Alternatively, all the LLP’s members can be designated members. This is common in an LLP with a small number of members.
- 4.14. Members are agents of the LLP and are liable to the extent of their investment in the LLP but might have to contribute further in certain circumstances where there has been particularly bad behaviour or where any agreement between the members requires a further contribution.
- 4.15. There is no obligation to have a constitutional document (e.g. a members’ agreement) but there are default provisions on how the LLP will operate in the LLPR. Any members’ agreement is a purely private document and will not be published by Companies House. When establishing an LLP we would strongly advise putting in place a members’ agreement – in particular to cover potential liability situations.
- 4.16. LLPs can also be more tax advantageous than a CLS/CLG. The latter are directly liable to tax. However, an LLP is usually<sup>18</sup> treated as tax transparent – i.e. the activities are carried on by the members in partnership rather than the LLP legal entity.
- 4.17. As noted above an LLP requires a minimum of two partners/members.
- 4.18. Local authority use of LLPs is further curtailed from a vires perspective. LLPs are intended to make profits and so are established for commercial purpose. A local

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<sup>18</sup> LLP must be carrying on a trade, profession or business with a view to profit.

authority therefore cannot use GPOC to participate in an LLP because it expressly requires a company to be used when acting for commercial purpose.<sup>19</sup>

- 4.19. The London Authorities could directly participate in an LLP where they show they have the vires elsewhere. This could be the case where the London Authorities combined their functions under the Housing Act 1996 and the Incidental Power. In the case of property investment this could be the Incidental Power combined with the Investment Power (and the property powers under the Local Government Act 1972 such as the Disposal Power).
- 4.20. The alternative employed by some local authorities in joint venture scenarios is to establish a company first and then that company participates in the LLP.

#### *Charitable Entities*

- 4.21. Gaining charitable status confers certain tax benefits but in establishing a charitable entity the London Authorities would have to accept that that entity is set up for charitable purposes. A charitable entity must be independent of the London Authorities and so they must accept less control. In the past the Charity Commission has been reluctant to register new charities where these are wholly or majority held by a local authority – mainly due to independence concerns.
- 4.22. Examples of possible vehicles include:
- 4.22.1. Charitable Incorporated Organisation (“**CIO**”) – these are established under the Charities Act 2011 and regulated by the Charity Commission. They are only open to charities. A CIO has separate legal personality and the liability of its members and charity trustees is limited. There is a specified form of constitution which does permit a limited level of amendment. Rather than the usual company accounting scheme a CIO is subject to the charity accounting scheme which is less onerous.
- 4.22.2. Co-operative Society (“**CS**”) and Community Benefit Society (“**CBS**”) – these are established under the Co-operative and Community Benefit Societies Act 2014 as replacements for industrial and provident societies. They are both legal entities with limited liability for members. They must be established to

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<sup>19</sup> Section 4, Localism Act 2011

carry on an industry, business or trade. A CS cannot be carried on with the object of making profits. A CBS is established for the benefit of the community. There must be at least three members. Where the CS or CBS is charitable then there are additional requirements.

4.23. Having considered the requirements of the London Authorities set out in paragraph 2 and in particular the public procurement needs (as further outlined below) a charitable entity is not going to be appropriate and we have not considered the models further.

#### *Community Interest Company ("CIC")*

4.24. A CIC is a variant of the "standard" company models (CLS or CLG), and is a form promoted for use by social enterprises. They are subject to company law and additional provisions<sup>20</sup>. Key characteristics of a CIC include:

4.24.1. Registration and regulation by the CIC Regulator – CICs must show that they operate for the benefit of the community, and are required to produce an annual Community Interest Report;

4.24.2. Standard provisions must be included in a CIC's Articles, including an asset lock which operates to ensure that assets are not disposed of for less than full value unless the disposal is to another CIC or to a charity. This is intended to guarantee that assets are used for the long term benefit of the community served by the CICs.

4.25. CICs do not benefit from the tax advantages that charities do.

4.26. CICs limited by shares can distribute profits by way of dividends to shareholders, subject to the following restrictions:

4.26.1. Any dividends require an ordinary or special resolution of the members (whereas the directors of a non-CIC CLS would determine what dividends would be payable);

4.26.2. Following the Community Interest Company (Amendment) Regulations 2014, CICs are subject to a maximum aggregate dividend, currently 35% of distributable profits. This preserves the principle that the CIC's assets should

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<sup>20</sup> Under the Companies (Audit, Investigations and Community Enterprise) Act 2004 and the Community Interest Company Regulations 2005

benefit the community by ensuring a proportion of distributable profits are reinvested in the CIC or in the community it serves.

#### *Structures Recommendation*

- 4.27. We discuss below in detail the requirements for *Teckal* compliance. These requirements must be met in order for the SPV Members to contract freely with the SPV without a public procurement process. The key requirement is “control”. As a result any charitable vehicle will not be appropriate.
- 4.28. The SPV Members are not focussed on acting for profit and when coupled with the *vires* restrictions we consider this means an LLP is not appropriate.
- 4.29. Although the SPV will be facilitating the London Authorities to increase the supply of housing, we do not consider there is anything in the London Authorities’ proposals that would warrant utilising any form of CIC.
- 4.30. We would recommend that the SPV is established as a CLG rather than a CLS. This is because:
- 4.30.1. The London Authorities do not intend the SPV to be profit making and so there is unlikely to be a need for dividends to be distributed. If in the future the SPV Members did want to expand into trading the SPV activities with non-SPV Members then this might be best achieved by a sibling CLS sitting along the SPV (in the event the authorities wanted profits distributed back to them directly) or by a subsidiary of the SPV (in the event profits were to be invested back into the SPV activities as an alternative to third party or SPV Member investment or to reduce costs for the SPV Members).
- 4.30.2. The London Authorities require a relatively easy process to allow authorities to join and leave the SPV. We consider this can be better achieved through a CLG.
- (a) In a CLS shares would have to be issued and allotted to a new SPV Member or sold by an existing SPV Member from its shareholding to the new member (this latter option can have stamp duty implications depending upon value). When an SPV Member sought to leave they would then have to sell their share(s) back to the SPV or to another SPV Member.



- (b) With a CLG a process can be set up that allows potential SPV Members to make an application to become a member of the CLG and this is then considered by the Board of Directors/existing SPV Members as to whether to admit them. The Articles and other governance documents would set out the process for ceasing to be a SPV Member.

4.30.3. We would also comment at this stage that London Authorities who consider their involvement might be shorter term than other SPV Members should consider whether their need for the SPV – in the foreseeable future – is fully met before they decide to terminate their membership of the SPV in order to avoid having to become a member multiple times.

4.30.4. A CLG is the model that we have adopted for other non-profit local authority companies and it is possible to draft the Articles and Members' Agreement to have different classes of member, for example:

- (a) Class A – core members who each appoint a director;
- (b) Class B – other members who might only be members for the purpose of accessing Modules for a site and envisage a shorter term involvement. This Class could collectively appoint a certain number of directors to represent them.

4.31. We are not aware that London Councils itself would seek to be an SPV Member. Given London Councils acts through joint committees it is important to note that a joint committee (like any committee of a local authority) does not have separate legal personality from its authority and so cannot enter into contracts or hold property other than through one of its member authorities. This, however, does not prevent the London Councils membership being reflected in the SPV Members and Board of Directors through the participation of the individual London Authorities.



## 5. GOVERNANCE

### *General*

5.1. The SPV Members will understandably want robust governance mechanisms in place to protect their interest in the SPV (and any sums due to them from the SPV) and ensure they are compliant with the Teckal requirements relating to control (see paragraph 6 below) but the governance should not be so onerous that the day to day operation of the SPV is made difficult or slow.

5.1.1. We advise tailoring the Articles of Association to reserve certain (major) decisions to the SPV Members. The Articles should then be supplemented by a Governance Agreement (similar to a shareholder/member agreement) between the SPV and the SPV Members covering matters including

- (a) The involvement of the SPV Members in the preparation and approval of business plans/cases for the SPV;
- (b) Any provisions for how the SPV Members consider they would work together to facilitate SPV Member decision making;
- (c) Situations where the SPV Members need to be consulted before decisions are taken;
- (d) Accounting requirements and access to financial information by the members;
- (e) Confidentiality requirements;
- (f) Freedom of Information – both cooperation between the SPV Members/SPV but also how the SPV will deal with FOI requests (local authority companies are subject to the same FOI requirements);
- (g) Relationship between the SPV and SPV Member council meetings (e.g. executive meetings, scrutiny meetings):
- (h) Requirement to assist the member authorities with compliance with the Transparency Code and Ombudsman investigations; and
- (i) Dispute resolution.

5.1.2. The London Authorities therefore should consider at the outset what decisions they would not want the SPV to take alone and these matters will form the basis of the reserved decisions referred to at paragraph 5.1.1 above.

5.1.3. In respect of new SPV Members joining in the future then once they become an SPV Member they would be bound by the Articles. We would suggest some form of supplemental Governance Agreement is entered into where the new SPV Member agrees to be bound by the terms of the Governance Agreement.

#### *The Board of Directors*

5.2. The Board is ultimately responsible for running the SPV and we set out above at paragraph 4.3 the duties that the directors owe to the SPV.

5.2.1. The Board can comprise Officers, Elected Members and independent non-executive directors (for example individuals who bring a particular skill set). The SPV could also directly employ executive directors (engaged full time in running the company). The appointment of directors should be made by the member authorities and as noted above whether a member authority has a right to appoint their own director would depend upon the rights attaching to their class of membership.

5.2.2. There is no legal requirement to have a Managing Director or a Finance Director but the SPV Members may wish to consider allocating portfolios of responsibility to particular directors and clearly someone needs to have responsibility for leadership and for making necessary decisions about the work of the company. We would recommend a minimum of three directors on the Board to avoid deadlocks.

5.2.3. Where any Elected Member is appointed as a director then care needs to be taken with conflicts of interest between the duty to act in the best interests of the SPV and the duty to act in the best interests of their London Authority. Neither of these duties can be avoided or delegated. We would advise the SPV Members to consider whether member involvement is better suited at the SPV Member decision making level (for which see below) where such conflicts should not arise because the SPV Members are only required to act in their own best interests.

- 5.2.4. Officer directors will, of course, owe duties to their employing London Authority. However, these duties arise from their terms and conditions of employment. As such, it is possible for their employer, to amend these to say that the Officer may act as a director of the SPV and that where they so act the Officer should put the interests of the SPV first, as the law relating to directors requires.
- 5.2.5. Where Officers are appointed then consideration should be given to their position and responsibilities within their London Authority. Officer directors should not advise the authority as an SPV Member or commissioner of the SPV on action or decisions to take relevant to the company. We generally also advise against Section 151 officers being appointed to Boards where they may be making recommendations in the Budget that benefit the company although this can happen where the authority is happy for a deputy Section 151 officer to deal with such recommendations.
- 5.2.6. In practice, there are a good number of Officers who serve as directors of council companies without any problem. What is of most importance when setting up a company is that the directors will provide the qualities and experience needed by the company; and that the authority is satisfied that its interests as an SPV Member are being properly served.
- 5.2.7. It is however important that a consideration of the practical points and potential conflicts of any appointment is undertaken beforehand, and advice taken, as it is frustrating to all if a director is frequently prevented from acting due to potential conflicts.
- 5.2.8. Furthermore, of course, the existence of apparent bias or predetermination towards the SPV by an SPV Member when decisions are made (whether by Officers or Elected Members) can give rise to actions for judicial review.
- 5.2.9. Another relevant point which sometimes has a bearing on board membership concerns any payment for acting as a director.
- (a) Elected Member directors are limited by the Local Authorities (Companies) Order 1995 as to the level of remuneration and expenses they can receive (allowances must be comparable to an equivalent role

under the Scheme of Allowances and any payment by the company reduces any allowance due to the Elected Member from their authority);

- (b) The Local Government Act 1972 prevents Officers from accepting any direct remuneration from a company, although nothing prevents their authority from directly remunerating an Officer for taking on additional responsibilities on its behalf and at its request, even though those additional duties are through and with the company.

5.2.10. Officers and Elected Members should be aware that when they are acting as directors they are not normally protected by their usual statutory immunity, or by their authority. The London Authorities should:

- (a) Consider whether the nature of the company in question provides protection and whether this covers the personal liability of directors.
- (b) Take particular care in granting any indemnity to an Officer or Elected Member and ensure that they are acting within their powers as set out in statute. We would advise that any indemnity/insurance should be taken out by the SPV.

5.2.11. The Board should be able (and the Articles would need to reflect this) to delegate down their powers to individual directors, employees (whether directly employed or seconded) and committees of the Board. Decision making would still be constrained by any arrangements for reserved decisions.

#### *SPV Member Decision Making Function*

- 5.3. Each SPV Member will need to have in place arrangements for making SPV Member decisions. For those SPV Members operating executive arrangements under the Local Government Act 2000, then we consider that making SPV Member decisions is an executive matter.
- 5.4. For maximum flexibility we would advise delegating some SPV Member decision making to Officers following consultation with the appropriate Elected Members. As with any delegation the relevant Officer is free to refer the matter back to Elected Members and Elected Members can require a matter to be referred back to them.
- 5.5. Each SPV Member would also need to designate a representative for general meetings. This could be included within the delegations to Officers. The

representative is the person who goes to the general meeting and actually votes at it, in accordance with their authority's agreed position.

- 5.6. In addition to compliance with local government decision making requirements, from a company law perspective, decision making by the SPV Members will also need to be undertaken and documented either in general meeting or by SPV Member written resolution.
- 5.7. Each SPV Member will also need to consider where the SPV Member decision making sits with its role in commissioning the SPV to provide Modules. These are two different roles and all participants need to be clear what "hat" they are wearing when making decisions.

#### *Managing Conflicts of Interest*

- 5.8. We note above the issue of conflicts for both Elected Member and Officer directors between their obligations to the SPV company they are a director of and their obligations direct to their authority. These Officer conflicts can more easily be managed through terms and conditions of employment.
- 5.9. The risk of outside conflicts can be a concern. This should not be an issue with Officers (who generally should not have outside interests). However, it may be an issue with Elected Members (whether as directors or acting as a SPV Member decision maker for their authority) and non-executive directors where they have other occupations – e.g. property developers in their own right, estate agents.
- 5.10. We strongly advise analysing the outside interests of any Elected Member, Officer or non-executive who will take a role in managing the SPV at the outset. If they have interests that are very likely to conflict then it should be considered whether they have any involvement at all.
- 5.11. Directors should be required to declare all outside interests in the company's register of directors' interests.
- 5.12. The usual rules for Elected Members on declaring interests when participating in authority meetings or authority decision making on SPV matters apply.
- 5.13. In all cases we recommend training at the outset for all directors on their duties and what they need to declare as interests. This should ensure that everybody knows what is expected of them and what they need to do if a conflict arises.

### *Company Secretary*

5.14. No private company is required to have a named Company Secretary. The company secretarial duties can be undertaken by anybody. In our experience most local authorities do appoint company secretaries and the person is typically a member of the legal services team or the Monitoring Officer of one of the member authorities. This allows a secondary check on the activities of the company. Provision of company secretarial services would be dealt with through any support arrangements between the SPV Members and the SPV.

### *Controlled Companies*

5.15. For now the provisions of Part V, Local Government and Housing Act 1989 apply. We consider that the SPV would be a controlled company within the meaning of the Act because only London Authorities will be SPV Members and the main decisions will likely be reserved to the SPV Members. As such the authorities and the SPV must comply with the requirements of the Local Authorities (Companies) Order 1995. This means the SPV must:

- 5.15.1. Mention on all company business letters, notices and other documents that it is controlled by the member authorities;
- 5.15.2. Adhere to limitations on pay and expenses of directors who are also Elected Members;
- 5.15.3. Not publish material in support of any political party;
- 5.15.4. Provide information to the SPV Member auditors;
- 5.15.5. Provide information (other than where it would breach any enactment or obligation owed to another person) to Elected Members of the SPV Members reasonably required by the Elected Member for the proper discharge of their duties;
- 5.15.6. Make available minutes of general meetings for four years (save where it would breach any enactment or obligation owed to another person);
- 5.15.7. Obtain appropriate consent to the appointment of the SPV's auditor – the reference in the Order is the Audit Commission. Unfortunately following the abolition of the Audit Commission the Order has not been updated.



## 6. PUBLIC PROCUREMENT

6.1. The London Authorities are all subject to the Public Contracts Regulations 2015 (**PCR15**) as contracting authorities. The PCR15 would govern any procurement of the Modules directly by the authorities.

6.2. Where:

6.2.1. The SPV is jointly controlled by the SPV Members in that:

- (a) They jointly exercise a decisive influence over the strategic objectives and significant decisions of the SPV;
- (b) The decision making bodies of the SPV are composed of representatives of the SPV Members (there can be joint representatives); and
- (c) The SPV does not pursue any interests contrary to those of the member authorities;

6.2.2. The SPV carries out more than 80% of its activities in the performance of tasks entrusted to it by its member authorities; and

6.2.3. There is no direct private capital participation in the SPV;

Then we consider that the SPV's relationship with the SPV Members is governed by Regulation 12, PCR15 (**Teckal**) and any contracts awarded to the SPV for the Modules would not need a prior public procurement process.

6.3. On the basis of the current proposals, as we understand them, there is no immediate intention for trading beyond the SPV Members. That makes the activity test set out at paragraph 6.2.2 easier to satisfy. There is no requirement to provide activities to all SPV Members all of the time – this does mean that a London Authority can remain an SPV Member in between needing any Modules.

6.4. Where this changes and there is a suggestion that the SPV will trade more widely then we advise that further legal advice is sought to ensure that the Teckal status of the SPV is maintained. Depending upon the scale of the trading this may mean setting up a further company as a sibling or subsidiary.

6.5. As a result of the SPV being a Teckal vehicle it is itself a contracting authority. It is not prevented from contracting with any of the SPV Members (e.g. for an SPV Member to provide back office support). However, where the SPV is going to the market for the



Modules and any other services, goods or works then it would need to follow a PCR15 compliant procurement process.

- 6.6. It is perhaps useful at this stage to discuss the way in which the SPV would make the Modules available to the SPV Members on the initial proposal that land would remain with the SPV Members and not with the SPV. From our perspective:
  - 6.6.1. The SPV could purchase the Modules outright and procure ongoing installation/maintenance/support for the life of the Modules;
  - 6.6.2. The SPV could lease the Modules from one or more providers along with procuring services from those providers for installation/maintenance/support. Consideration would need to be given as to whether the Modules were leased en masse for a defined period or whether they were leased as and when required;
  - 6.6.3. As noted above either of 6.6.1 or 6.6.2 would need to be structured in compliance with the PCR15. In either of the scenarios, the SPV would then seek to lease the Modules on to those SPV Members that require them;
  - 6.6.4. On our current understanding we do not consider these leases would be an interest in land but rather either a finance or operating lease. This is on the basis that the Modules are demountable and so we believe are attached to the land rather than forming part of it. Whether a finance or operating lease exists will depend upon the terms developed although given there is no intention for the SPV Members to directly own the Modules it may be more likely that an operating lease is what would be used.
- 6.7. If the SPV was to directly hold land (freehold or leasehold) then there would not be an onward finance or operating lease to the SPV Members.
  - 6.7.1. If the SPV was to act directly as landlord then consideration would need to be given as to the type of contract in place between the SPV and the SPV Members to enable this to happen but still be Teckal compliant (e.g. a services contract to offer temporary accommodation).
  - 6.7.2. If the SPV Member was to act as landlord then there would most likely need to be a leaseback to the SPV Member of the land and the Module(s). Tax advice should be sought about this type of structuring.

- 6.8. Where the SPV directly offers private market rentals then that would likely constitute trading and as noted above would prompt a reconsideration of how the SPV is structured to ensure that any Teckal activities could continue.

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## 7. STATE AID

- 7.1. State aid will exist where aid (which could include a grant, loan, use/ownership of assets (including land) and guarantees):
- 7.1.1. Is granted from state resources;
  - 7.1.2. Confers a selective advantage on one or more undertakings carrying on economic activity (putting goods or services on a market);
  - 7.1.3. Distorts competition or has the potential to distort competition; and
  - 7.1.4. Affects trade between Member States or has the potential to affect trade between Member States.<sup>21</sup>
- 7.2. All of the elements must be present for State aid to exist. The European Commission takes a very wide interpretation of 7.1.3 and 7.1.4.
- 7.3. Exemptions do exist under:
- 7.3.1. [The General Block Exemption Regulation](#)<sup>22</sup> – sets out detailed exemptions to be used in very particular circumstances;
  - 7.3.2. [The De Minimis Regulation](#)<sup>23</sup> – 200,000 euros of aid in any three financial year cycle of the recipient;
  - 7.3.3. [Services of General Economic Interest](#)<sup>24</sup> – these are economic services identified as being of particular importance to the public. They are characterised by an entrustment of a public service mission by a public authority and the universal/compulsory nature of the service delivery. Examples include public postal services and electricity supplies.
- 7.4. State aid that does not fall within an exemption must be notified to the European Commission for prior approval. Unlawful State aid must be repaid (with interest). The EU Commission enforces this and can pursue recipients of unlawful State Aid for up to ten years from receipt of the aid.

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<sup>21</sup> See Article 107, Treaty on the Functioning of the European Union

<sup>22</sup> Commission Regulation (EU) No 651/2014

<sup>23</sup> Commission Regulation (EU) No 1407/2013

<sup>24</sup> There is an absolute exemption where aid falls within the Altmark decision (Case C-280/00 Altmark Trans GmbH v Nahverkehrsgesellschaft Altmark GmbH [2003]); a block exemption issued by the European Commission (Commission Decision 2012/21/EU); and a de minimis exemption of 500,000 euros in any three financial year cycle (Commission Regulation (EU) No. 360/2012).

- 7.5. It should be noted that the State aid legislation does not categorically exclude Teckal entities (to the extent not trading beyond its members) such as the SPV from State aid.
- 7.6. We would argue that non-trading Teckal entities are viewed for competition purposes (from a public procurement perspective) as not distorting the market because they are just like an in-house division.
- 7.7. As such where support is provided to the SPV and is specifically linked/restricted to the Teckal activities then we do not consider that the tests for State aid would be met and the SPV Members could provide that support whether it is funding or services.
- 7.8. Alternatively support could be provided on purely market terms and so State aid would not arise. Market terms would need to be objectively evidenced.<sup>25</sup> This could be through demonstrating equivalent lending in the market on the terms/interest rate proposed. Where it is not possible to evidence an interest rate in the market then the EU Commission provides reference rates calculated through the use of a base rate and then adding a certain number of basis points based on the credit rating and the collateralisation of the recipient.
- 7.9. Any *Teckal* entity that is trading beyond its members would be an undertaking in respect of its trading and so where the proposed activities expand to trading with non-SPV Members further advice should be obtained to structure the trading in a way that minimises the risk of State aid arising (the most relevant being market terms – see paragraph 7.8) or to identify a relevant exemption. As noted in paragraph 6 it may be necessary, depending upon scale, to separate out the trading into another vehicle.
- 7.10. There is the possibility that both procurement and State aid rules will be affected in the future by the Brexit vote. However, whilst this may be a consideration eventually it is some way ahead at present and we do not consider that matters are likely to change in the timescale envisaged to set up the SPV.

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<sup>25</sup> R(Sky Blue Sports & Leisure Limited) v Coventry City Council and others [2016] EWCA Civ 453 and Commission Notice on the notion of State Aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016/C 262/01) at paragraphs 98 and following.

## 8. MAKING FUNDING AVAILABLE TO THE SPV

- 8.1. We note in paragraph 7 the potential application of the State aid rules.
- 8.2. We do not consider that the restrictions on financial assistance for privately let housing under sections 24-26, Local Government Act 1988 would apply because the SPV itself is not on the initial proposals letting any property and on the current temporary accommodation plans only the SPV Members would be letting the homes. Where this changes and the SPV will be letting property directly then any financial support for that privately let housing (which is anything not let by a local authority) would need to comply with sections 24-26.
- 8.3. The SPV Members may wish to pass funds on an investment basis to the SPV that they have received (including from the GLA). These funds may include affordable housing grant. Whether these funds can in fact be passed to the SPV will depend upon the purposes for and terms upon which the funds are held by the particular London Authority – these would need to be examined in each case.
- 8.4. In the case of the current GLA application funding, we note that the use of the funds by the SPV has already been highlighted to the GLA and so would form part of the terms. In any event the London Authority in receipt of the GLA funds will, we imagine, remain directly liable to the GLA pursuant to the grant arrangements.
- 8.5. Where a London Authority is acting as “lead” to obtain funding and pass it on to the SPV then consideration would need to be given about whether there are existing arrangements (perhaps through London Councils), or if new arrangements tailored to the SPV are needed, about liability sharing between SPV Members where one of them incurs direct liability to the party providing funding.
- 8.6. In respect of affordable housing grant, further consideration would need to be given as to the definition of affordable housing used in the grant<sup>26</sup> and whether the Modular homes would be let on tenures by the SPV Members that constitute affordable housing within that definition. We are instructed at this stage that the eventual tenancy arrangements will be determined by each SPV Member individually.

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<sup>26</sup> This might be the planning definition of affordable housing under the NPPF.

## 9. HOUSING REGULATORY CONSIDERATIONS

- 9.1. The SPV will not be acting as a landlord but effectively as a provider of goods, works and services to the London Authorities as landlords. As such the SPV itself would not be in a position where it needs to consider registration with the Homes and Communities Agency.
- 9.2. Where the proposals develop so that the SPV does become a landlord then consideration will need to be given as to what tenures it wishes to offer and whether this would necessitate registration with the Homes and Communities Agency as a registered provider (i.e. some tenures of affordable housing – as defined for planning purposes – can only be offered by local authorities and registered providers but the definitions are likely to widen following the proposals in the Housing White Paper).
- 9.3. Registration with the Homes and Communities Agency is voluntary.

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