


<b>Cabinet</b> 7 February 2017	 <b>TOWER HAMLETS</b>
<b>Report of:</b> Aman Dalvi, Corporate Director - Place	<b>Classification:</b> Part Exempt (Appendix 3 Exempt)
<b>Establishing Housing Delivery Vehicles</b>	

<b>Lead Member</b>	<b>Councillor Rachel Blake, Cabinet Member for Strategic Development</b>
Originating Officers	Mark Baigent, Interim Divisional Director – Housing and Regeneration.
Wards affected	All
<b>Community Plan Theme</b>	<b>One Tower Hamlets</b>
Key Decision?	Yes

By virtue of section 100A of the Local Government Act 1972 and paragraphs 3 and 5 of Schedule 12A of the Local Government Act 1972 the Trowers and Hamlins Report (Appendix 3 to this report) is Exempt as it contains information relating to the financial or business affairs of the authority and information in respect of which a claim to legal professional privilege could be maintained in legal proceedings. Specifically, the Report relates to the business affairs of the Council and legal advice given in relation to such. The Report is exempt to the extent that, in all the circumstances of the case, the public interest in maintaining the exemption outweighs the public interest in disclosing the report as it could have an adverse impact on those business affairs.

### Executive Summary

The report seeks approval to establish two housing delivery vehicles, in order to expand the range of options available to the Council to deliver new supply across tenures, both permanent and temporary homes, with the two vehicles designed to operate in tandem:

- A Wholly Owned Company (WOC) with a commercial purpose to provide homes for rent and sale, returning a dividend to the Council from long term profit-making activities; and
- A charitable Community Benefit Society (CBS) to provide homes for sub-market rent, subsidised by grant of land and retained Right To Buy receipts, made possible by governance arrangements within which the Council holds a minority position.

The report explains how these two vehicles will complement the Council's existing housing delivery approaches, within the Housing Revenue Account (HRA) and the General Fund (GF).

Specifically, the report proposes the following actions:

- Establishing a Wholly-Owned Company Limited by Shares with a Board of Directors comprised of Council officers;
- Investing up to £6M from capital reserves as shareholder equity in the Company;
- Prudentially borrowing up to £24M and on-lending to the Company on commercial terms;
- Initially it is proposed that the company acquires up to 100 properties to be let at market and intermediate rents. Subsequently the Company will acquire land and carry out new build development activity. Acquisition and investment decisions will be made by the Board of Directors and reported to the Council as shareholder in accordance with a control framework to be set out in a shareholder agreement to be entered into between the Council and the Company;
- Establishing a minority-interest Community Benefit Society with a Board comprised of two Council nominees and three independents;
- Entering into a Deed of Covenant with the CBS in relation to ongoing governance, limiting rule changes and use of resources provided to the CBS by the Council;
- Further Cabinet decisions will be needed to grant land to the CBS to enable development activity to commence;
- Granting up to £9M of retained Right To Buy receipts and £2.5M s106 commuted sums to the CBS;
- Prudentially borrowing up to £18.5M and on-lending to the CBS; in recognition of the CBS's delivery of sub-market housing, it is proposed that the Council would not charge a full commercial rate on monies lent to it;
- Initially it is proposed that the CBS acquires up to 100 properties to be let at social and intermediate rents. Subsequently the CBS will receive land and carry out new build development activity. Acquisition and investment decisions will be made by the Board of Directors and reported to the Council as lender.

## **Recommendations**

The Mayor in Cabinet is recommended to:-

1. Agree to establish Seahorse Homes Limited, a Wholly Owned Company Limited by Shares, and Mulberry Housing Society, a Community Benefit Society, and delegate to the Corporate Director Place after consultation with the Corporate Director Resources and the Corporate Director Governance authority to take all necessary steps for this purpose including but not limited to approving the Rules of the Society and Articles of Association of the Company.
2. Agree that the officers identified in section 4 of the report be appointed as directors and members of the Wholly Owned Company (WOC) and Community Benefit Society (CBS) respectively.
3. Authorise the Corporate Director Place to recruit three independent members to the CBS, after consultation with the Mayor and Statutory Deputy Mayor and Cabinet Member for Housing Management and Performance and Cabinet Member for Strategic Development.
4. Authorise the Corporate Director Resources to agree and sign off the final business case.

5. Authorise the Corporate Director Resources to
  - a) make equity investments up to £6M in the WOC
  - b) grant up to £9M of retained Right To Buy receipts and £2.5M of s106 commuted sums to the CBS with appropriate grant conditions;
  - c) make available to the WOC a commercial loan facility up to £24M;
  - d) make available to the CBS a loan facility up to £18.5M charged below a full commercial rate;
  - e) enable both loan facilities by use of reserves and prudential borrowing within the General Fund as necessary;subject to the above being in line with the Council's Budget framework, where required, the negotiation and finalisation of the loan agreements and decision to release funding subject to satisfactory due diligence delegated to the Corporate Director Resources.
6. Authorise the Corporate Director Resources to approve the WOC and CBS's first business plan.
7. Agree to provide the WOC and CBS with a credit facility of up to £50,000 each for use as working capital and delegate to the Corporate Director Resources the negotiation and finalisation of the necessary agreements.
8. Delegate authority to the Corporate Director Place after consultation with the Mayor, Statutory Deputy Mayor and Cabinet Member for Housing Management and Performance and Cabinet Member for Strategic Development, the Corporate Director Resources and the Corporate Director Governance to approve the Shareholder Agreement, Deed of Covenant and any other necessary agreements required between the Council and the WOC and CBS respectively.
9. Authorise the Chief Executive to exercise the Council's rights as Shareholder.
10. Authorise the Corporate Director Governance to execute the agreements referred to in recommendations 5, 7 and 8 above.
11. Agree that, subject to final sign off of the business case as specified in 4 above and the Council and the WOC entering into the ancillary agreements referred to in recommendations 5, 7 and 8 above, the Company may commence trading.

## **1. REASONS FOR THE DECISIONS**

1.1 The Council is pursuing a range of housing delivery routes to achieve its strategic objectives, as recently set out in the Borough's new Housing Strategy. In summary, this report proposes a four-fold delivery approach, comprising:

- Housing Revenue Account (HRA) new build and acquisition of permanent accommodation;
- General Fund (GF) new build and acquisition of temporary accommodation;
- Wholly Owned Company (WOC) new build and acquisition of permanent homes on a commercial basis;
- Community Benefit Society (CBS) new build and acquisition of permanent homes on a charitable basis.

In this approach, the WOC and CBS vehicles would work together in tandem on key development sites. The report sets out the rationales and criteria for delivering any given opportunity that arises through one or more of the four housing delivery routes.

1.2 This combined housing delivery strategy is designed to achieve the following aims:

- Increase housing supply across tenures.
- Meet housing needs of the most disadvantaged.
- Deliver an affordable range of homes including at Social and Living Rents
- Secure a long term supply of suitable temporary accommodation, as well as reducing overall numbers in temporary accommodation.
- Make use of retained RTB receipts.
- Make use of available land and regeneration opportunities.
- Invest in assets that deliver a long run financial return to the Council.
- Make short term savings in revenue expenditure on temporary accommodation.
- Avoid unnecessary complexity whilst focusing on speed of delivery.

## **2. ALTERNATIVE OPTIONS**

2.1 There is a wide range of housing delivery players including private developers, Registered Providers (RPs) / housing associations and local authorities. Between them these players deliver a range of new homes across tenures – social rents, “affordable” rents, shared ownership, market rents and market sale.

2.2 Rather than establish new housing delivery vehicles, the Council could rely on other partners in the private developer and RP sectors to deliver new homes, providing land and financial resources (including retained RTB receipts) to secure delivery and negotiate long term access arrangements to new homes for Council nominees.

2.3 However, despite considerable efforts over the last year, the uptake of partnership offers to RPs has not materialised. Moreover, the advantage of Council-sponsored vehicles is the closer alignment with strategic purpose, the greater level of security and certainty over access arrangements, and the scope for long term revenue and capital return to the Borough, with assets and return on investment more closely protected.

- 2.4 In particular, the acquisition and development of new housing through a CBS will enable delivery of further social and intermediate rented homes making use of retained RTB receipts, without impacting on the HRA borrowing headroom.
- 2.5 In summary, the proposed WOC and CBS vehicles should be seen as complementary and enhancements rather than as alternatives or replacements for other delivery approaches such as through the HRA and GF.

### **3. FOUR-FOLD DELIVERY APPROACH**

3.1 In order to achieve the strategic aims set out in 1.2 above, officers propose the following four delivery routes should be pursued in parallel:

- Housing Revenue Account (HRA) new build and acquisition of permanent accommodation;
- General Fund (GF) new build and acquisition of temporary accommodation;
- Wholly Owned Company (WOC) new build and acquisition of permanent homes on a commercial basis;
- Community Benefit Society (CBS) new build and acquisition of permanent homes on a charitable basis.

The following sections set out the rationales for each delivery route, the constraints, advantages and specific circumstances for implementation.

#### **3.2 Housing Revenue Account (HRA) new build and acquisition**

The Council is already pursuing this approach with a substantial HRA-funded new build programme. This approach makes use of retained RTB receipts, limited to 30% of total scheme costs. HRA land is used at nil value. The 30% retained RTB receipts must be match-funded with 70% of costs met from HRA capital expenditure, typically through borrowing. The significant challenge with this approach is the Government-imposed HRA debt cap, a ceiling on borrowing which limits the headroom within which LBTH can invest in both new build and capital repair and improvement works to existing Council homes.

Whilst continuing with the planned new build programme, officers recommend reviewing future HRA infill and estate regeneration opportunities for their potential to deliver higher numbers, more quickly through the complementary use of the other delivery routes set out below.

#### **3.3 General Fund (GF) new build and acquisition**

The Council has recently agreed to purchase and potentially to build homes specifically to provide higher quality and better value temporary accommodation for statutory homeless households. This approach can make use of retained RTB receipts (again at 30% of overall capital costs), in this case with 70% of costs funded by GF prudential borrowing. There is no requirement to hold homes within the HRA where they are owned exclusively to provide temporary accommodation. The main restriction on this activity is that this portfolio must be managed on a break-even basis within the Council's overall statutory homelessness budget. (Where property acquisitions are being undertaken for a commercial purpose, the Localism Act 2011 would require the Council to undertake the activity within a subsidiary trading vehicle.)

### **3.4 Wholly Owned Company (WOC) new build and acquisition**

A growing number of local authorities have established trading companies in recent years using the “general power of competence” under the Localism Act 2011, including many housing development and management companies. Whilst the Government has stated that it does not support councils doing so in order to provide social housing, and/or to avoid the Right To Buy and circumnavigate HRA borrowing constraints, there is tacit Ministerial support for local authority companies that provide temporary accommodation for the homeless and boost the supply of market rented housing. This is now a tried and tested approach that can deliver both savings and income to the General Fund, including via a commercial lending arrangement between the Council and its profit-making subsidiary.

At this stage, officers recommend establishing a Company Limited By Shares with open purposes in its Articles of Association, thus enabling a wide scope of activity without restricting the company to a particular sector of housing delivery. However, the initial ambition and business plan for the company is proposed to be modest and relatively low risk, focused on property acquisition in order to build an asset base from which to commence new build development activity.

Officers propose an initial equity investment of up to £6M coupled with a loan facility of up to £24M to acquire up to 100 properties, with the commercial arrangements to be delegated to the Corporate Director – Resources.

### **3.5 Community Benefit Society (CBS) new build and acquisition**

The restrictions on use of retained RTB receipts prevent the Council transferring these resources into a company in which it holds a controlling interest (i.e. more than 50% shareholding). Given the HRA borrowing cap, the only remaining route for use of RTB receipts is via an independent social housing provider, outside of direct Council control. Officers recommend establishing and sponsoring a new Community Benefit Society to take RTB receipts along with a loan facility. This would be a charitable corporate body, registered with the Financial Conduct Authority. The Council would appoint the initial Members or Trustees of the CBS and determine the rules and purposes of the organisation. The Council would retain the ability to directly appoint two Members of the CBS; the other three Members would be independent positions, appointed according to the rules of the organisation. A deed of covenant would require that the rules of the CBS could not be changed without the Council’s consent. The Council would have no other control mechanisms over decision-making by the CBS, but could impose additional controls through covenants and conditions on any land, grant or loan facilities.

Officers propose an initial grant of up to £9M of RTB receipts and £2.5M s106 commuted sums coupled with a loan facility of up to £18.5M to acquire up to 100 properties, with the commercial arrangements to be delegated to the Corporate Director – Resources. In recognition of the CBS’s delivery of sub-market housing, it is proposed that the Council would not charge a full commercial rate on monies lent to it.

### **3.6 Combined delivery approach**

In this approach, the WOC and CBS vehicles would work together in tandem on key future development sites. The Council will determine the rationales and criteria for delivering any given opportunity that arises through one or more of the four housing

delivery routes. At this initial stage, officers propose that the two vehicles undertake acquisition activity to establish an asset base and trading track record, prior to commencing new build development activity at a subsequent stage.

### **3.7 Summary evaluation of the four-fold delivery approach**

Appendix 1 sets out a detailed analysis of the four delivery routes against a range of key evaluation criteria, demonstrating the value of taking a combined four-fold approach. This Appendix also contains a diagram showing the Council's key financial flows in relation to the four delivery approaches.

## **4. RESOURCING IMPLEMENTATION PLAN**

In order to implement the recommended approach, the following actions are needed:

### **4.1 Finalise and execute legal documents:**

WOC Articles of Association  
WOC Shareholding Agreement  
CBS Rules of the Society  
CBS Deed of Covenant  
WOC & CBS loan agreements

### **4.2 Governance appointments:**

Directors of WOC – Mark Baigent, Ann Sutcliffe and Neville Murton  
LBTH Members of CBS – Mark Baigent and Ann Sutcliffe  
Recruitment of three independent Members of CBS – to be recruited by the Corporate Director of Place in consultation with the Mayor and Lead Members

### **4.3 Start-up resources**

An initial injection of working capital is needed to commence operations of the two delivery vehicles, for example, to cover legal and financial advice. Up to £50,000 is recommended to be approved as required by the Corporate Director Resources.

### **4.4 Business case**

A detailed Business case is being developed for each of the proposed Housing delivery vehicles to ensure that all relevant considerations have been taken into account and that the approaches are financially viable. It is recommended that the Corporate Director of Resources approve these business cases once she is fully satisfied that all relevant consideration have been made. The business cases are being developed in accordance with the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009.

### **4.5 Timescale**

Appendix 2 sets out the proposed implementation plan.

## 5. COMMENTS OF THE CHIEF FINANCE OFFICER

- 5.1 This report seeks approval to establish two housing delivery vehicles to deliver new housing supply - both permanent and temporary accommodation. These will take the form of a Wholly Owned Company (WOC) acting on a commercial basis to provide homes for rent and sale, and a charitable Community Benefit Society (CBS) supplying homes for sub-market rent.
- 5.2 Although the report seeks approval for the establishment of the two vehicles and their access to Council funding and borrowing, ultimately the release of financing will be subject to the Corporate Director – Resources being satisfied with the business plans for the two organisations (recommendation 6). Initial modelling has been undertaken on the options and further detailed business cases are being prepared for review. It is essential that any models that are established are not only financially viable but that they also comply with all necessary legislation. Depending on the sustainability of the business plans, it might be necessary to incorporate property sales or shared ownership schemes within the models in order to provide the required income to ensure that the organisations and their acquisition and development projects are viable.
- 5.3 It is proposed that the two organisations are established with access to funding of £30 million each, with the initial intention of each vehicle acquiring or developing 100 properties. The proposed financing of the organisations is summarised in the table below and further detail is provided in paragraphs 5.4 to 5.7.

	<b>Council Capital Investment £m</b>	<b>Prudential Borrowing £m</b>	<b>Retained 'One for One' Right to Buy Receipts £m</b>	<b>Section 106 Affordable Housing Commuted Sum £m</b>	<b>Total £m</b>
<b>Wholly Owned Company</b>	6.00	24.00	-	-	<b>30.00</b>
<b>Community Benefit Society</b>	-	18.50	9.00	2.50	<b>30.00</b>
<b>Total</b>	<b>6.00</b>	<b>42.50</b>	<b>9.00</b>	<b>2.50</b>	<b>60.00</b>

### 5.4 Council Capital Investment

- 5.4.1 It is proposed that the Wholly Owned Company will be established with the council, as sole shareholder, investing £6 million of capital resources as equity in the company. The council will utilise existing uncommitted capital resources for this purpose which have been identified and reported though the Capital Strategy and Programme approval as



part of the 2017-2020 MTFS process. Alternatively prudential borrowing can be used where a return sufficient to cover the cost of that borrowing can be demonstrated i.e. the affordability test can be satisfied. If borrowed, the revenue implications of the debt management costs (i.e. interest and principal repayments) together with the associated return on investment will need to be incorporated into the General Fund budget.

- 5.4.2 As the owner of the WOC, dividends will be payable to the council in respect of any profits being earned from its activities. This would generate investment income within the General Fund which is useable for any purpose including in support of the debt payments.
- 5.4.3 Provision for the initial investment of £6 million has been incorporated into the Council's capital programme that is being considered in a report elsewhere on this agenda prior to being referred to the Council's budget meeting on 22<sup>nd</sup> February 2017.

## **5.5 Prudential Borrowing**

- 5.5.1 It is proposed that the Authority grants loans to the Wholly Owned Company and Community Benefit Society. The resourcing of these loans will be determined as part of the capital strategy. As such, provision has been incorporated in the budget report that will be referred to Council on 22<sup>nd</sup> February 2017 after being considered at this meeting.
- 5.5.2 The terms of the loans from the Council will differ between the two organisations, however compliance with all appropriate legislation and the state aid regulations is essential. It is therefore proposed that the loan to the Wholly Owned Company is made at commercial rates, while the loan to the CBS can be at a reduced rate to reflect its provision of sub-market cost housing. All loan terms will be determined in accordance with the prevailing rates when the loans are granted.

### **Benefits to the General Fund from the Commercial Loan to the WOC**

- 5.5.3 Borrowing and then lending on to the WOC at a higher interest rate will result in a net revenue surplus being made by the council. Based on a £24 million loan, each 1% of interest charged above the borrowing rate paid by the council will equate to net revenue income of £240,000. This income will be credited to the General Fund.

### **Repayment of Loan / Minimum Revenue Provision**

- 5.5.4 The basis for the repayment of the loans granted by the council to the WOC and CBS needs to be determined, as does the level of Minimum Revenue Provision (MRP) set aside by the council to repay the total loans of £42.5 million on maturity. Any MRP payments would be a cost to the council until the WOC and CBS generated sufficient profit and liquidity to start repaying the debt.

## **5.6 Retained Right to Buy 'One for One' receipts**

- 5.6.1 The council is currently holding substantial levels of retained Right to Buy receipts which must be used for the supply of new social housing. These currently exceed £69 million. Retained receipts can only be used to fund a maximum of 30% of a scheme's capital costs with tight time constraints applying to the use of these resources (they must be spent within three years of receipt). If they are not utilised they must be paid to the Government with significant interest penalties falling on the council. It is therefore

essential that delivery mechanisms are put in place as soon as possible to ensure that these resources are not lost to the council.

- 5.6.2 Currently it is assumed that £49.6 million of the retained receipts will be used within the Housing Revenue Account. The Mayor in Cabinet on 10<sup>th</sup> January 2017 approved the “*One for One’ Right to Buy Receipts Usage - Purchase of Additional Homes Out of Borough’* report and consequently the adoption of a capital estimate of £30 million for the purchase of up to 100 properties outside the borough. This is being financed by £9 million of retained ‘one for one’ Right to Buy Receipts (30%) and £21 million of other council capital resources.
- 5.6.3 Approval of the proposals in this report will commit a further £9 million of ‘one for one’ receipts for the supply of replacement social housing.
- 5.6.4 Retained receipts cannot be used to provide replacement housing funds to a body in which the authority holds a controlling interest. This precludes the use of any of these capital resources by the WOC but, as outlined in the report, receipts can be allocated to a CBS provided that the council does not hold a controlling interest. The report proposes that the council has a 40% representation on the CBS board (two council members and three independents) but legal advice will be required to ensure that the structure meets all requirements for the use of retained receipts.
- 5.6.5 In addition, detailed accounting advice will be sought to establish that the conditions for consolidation are followed (which are different to establishing or avoiding a simple controlling interest).

## **5.7 Section 106 Affordable Housing Commuted Sum**

- 5.7.1 As at December 2016, the council held a total of £2,676,000 of Section 106 contributions that are to be used solely for the delivery of affordable housing in accordance with their respective Section 106 agreements. These contributions have been received by the council as commuted sums from developers in lieu of the provision of affordable units on their development sites. It is proposed that £2,500,000 of these funds are allocated to the CBS towards the funding of the sub-market rented housing units.
- 5.7.2 All decisions in relation to Section 106 allocations must be made in accordance with the Infrastructure Delivery Framework that was approved by the Mayor in Cabinet on 4<sup>th</sup> October 2016. The approval of the Commissioners may also be necessary in relation to any funding that is allocated to the CBS.
- 5.8 As part of the decision making process, various factors need to be considered in addition to those outlined above. These include:

- **Transfer of Land from the Authority to the WOC / CBS**

The process by which land (either held under HRA or General Fund powers) will be transferred or disposed of by the council to the WOC or CBS will need to be determined, and all legal requirements met to ensure that the council is meeting its duty to make the best use of its resources. The disposal method is fundamental to how the Capital Financing Requirement (CFR) will be calculated for both the General Fund and the Housing Revenue Account, and if necessary the appropriation of land between the HRA and General Fund might be necessary. The approval of the Commissioners to any land disposal might also be required.

- **State Aid**

Under State Aid rules, in order to avoid the distortion of competition and trade within the European Union, no advantage should result from funding that is granted by public authorities on a selective basis to any organisations. It is essential that all legislation concerning State Aid is met, in particular in respect of the interest rate that the council will charge the WOC and CBS.

- **Accounting treatment of loans to the WOC**

The basis of the council's ability to borrow to invest in the WOC is contained within two legislative powers:

S.12 of the Local Government Act 2003 (investment power); or  
S.25 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003

Section 12 would involve a change to the investment strategy, a non-executive decision reported to Full Council. Section 25 is more straightforward, as it includes a definition of capital expenditure as 'the acquisition of share capital or loan capital in any body corporate'.

The preferred option would be to define the equity in the company as capital expenditure under section 25. This would be represented as a long term investment in the Council's balance sheet.

- **Tax Implications**

The tax position and potential liabilities of the various organisations will need to be considered. This will include Value Added Tax (VAT) and SDLT (Stamp Duty Land Tax) in the case of both organisations and the council. Corporation Tax implications must also be assessed in relation to the WOC.

- **Capital Need**

In addition to the assumptions surrounding the on-going revenue costs (see below) there will be an on-going capital investment need over the lifecycle of the project e.g. cyclical kitchen and bathroom replacements within the acquired or developed properties. Provision for this and any other expenditure requirements will need to be included within the final business plan that is considered.

5.9 In addition to the capital costs and implications outlined above, the modelling will include various initial assumptions which will need reviewing.

- **Average purchase price**

An average purchase price will be assumed for each unit, to include all associated fees and taxes.

- **Rents**

Rents have been assumed at market rates for the WOC and a mixture of social and affordable rents for the CBS. Void and bad debt allowances have been incorporated into the modelling.

- **Annual Management and Maintenance Costs**

Annual Management and Maintenance costs will be assumed for both the WOC and the CBS.

5.10 In terms of other council implications, as a result of the combination of the increasing numbers of applications to the homelessness section, the scarcity of available temporary accommodation and the high levels of rent charged to the council, significant service delivery and budgetary pressures are being faced, particularly in respect of the increasing need to utilise bed and breakfast accommodation and to procure an increasing number of properties outside Tower Hamlets. The proposals in this report in relation to the CBS will increase the supply of temporary accommodation in the longer term and will therefore reduce the need for the council to procure more expensive temporary accommodation from other third parties. General Fund savings should materialise through the avoidance of costs, either against budget or by providing mitigation against a future budgetary pressure.

## **6. LEGAL COMMENTS**

### **General**

- 6.1 Trowers and Hamlins solicitors have provided advice on aspects of the council's proposals. Cabinet is referred to their report which is set out in Appendix 3 (Exempt)
- 6.2 Cabinet is being asked to agree to establish a wholly owned company limited by shares (WOC) and a Community Benefit Society (CBS). The company's business will be the provision of the homes for market rent and sale and through compliance with planning obligations the provision of affordable homes. The Community Benefit society will provide homes at sub-market rent subsidised by grant of land and retained Right to Buy receipts.
- 6.3 Agreement is sought to provide funding to the WOC and CBS in the form of loans and grants and other support. Delegations to officers are sought to finalise the various agreements that will be required to facilitate the above.
- 6.4 Section 1 of the Localism Act 2011 provides local authorities with the power to do anything an individual may do subject to a number of limitation (this is referred to in the General Power). A local authority may exercise the General Power for its own purposes, and/or for the benefit of others. Section 95 of the Local Government Act 2003 provides an almost identical power and the council can rely on one of both of these powers to set up the WOC and the CBS
- 6.5 The operation of a business to let homes at market rent/ sell homes is a commercial purpose. Section 4(2) of the Localism Act requires that where a local authority exercises /uses the general power for a commercial purpose, it must do this through a company.

Because the CBS is not being established for a commercial purpose, Section 4(2) does not apply.

6.6 Section 2 of the Localism Act 2011 limits the exercise of the new general power where it overlaps with a power which predates it, such as Section 95 of the Local Government Act 2003. Whether the council relies on the General power and/or the Section 95 of the Local Government Act, it is prudent for it to comply with the requirements and limitations to which S.95 is subject. These are set out in Regulation 2 of The Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009 (the Order) which requires a business case to be prepared and approved by the council before a company starts trading.

6.7 Regulation 2(4) of the Order defines “business case” as a comprehensive statement of:-

- The objectives of the business;
- The investment and other resources required to achieve those objectives;
- Any risks the business might face and how significant these risks are; and
- The expected financial result of the business, together with any other relevant outcomes that the business is expected to achieve.

Before approving the business case the Corporate Director Resources should satisfy themselves that the document contains the relevant information required by the Order.

## **Finance**

6.8 Section 24 of the Local Government Act 1988 provides the council with the power to provide a wide range of financial assistance to any person for purposes including the acquisition, construction or improvement of “privately let housing” i.e *housing where immediate landlord is not a local authority*. Section 25 of the Act provides that the council must obtain the consent of the Secretary of State to use their powers under S.24. The Secretary of State has set out pre-approved consents in the "General Consents 2010" paragraph C of which allows a local authority to provide financial assistance (other than the disposal of land), in connection with the purposes referred to above. Using these powers, the council may make grants and loans to the WOC and the CBS and as both are corporate bodies, the Council may under Section 24 (2)(d) acquire share or loan capital in them.

6.9 It should be noted that financial assistance under S.24 can only be made available in connection with rented accommodation and not accommodation that is to be sold, as will be the case in respect of some of the accommodation provided by the WOC. In regard to this the Council will need to rely on its general power of competence under S.1 of the Localism Act .

6.10 Section 111 of the Local Government Act 1972, provides councils with the power to do anything whether or not involving the expenditure, borrowing or lending of money or the acquisition of property rights which is incidental, conducive or calculated to facilitate the exercise of any of their functions. This would include the exercise of functions under section 1 of the Localism Act and s.95 of the 2003 Act referred to above. The Council could also rely on this power to provide the company with loans and other support such as providing staff and the use of premises. Any support provided must in respect of the WOC be state aid compliant (see below) and will be the subject of agreements between the Council and the WOC and CBS.

- 6.11 In accordance with the council's constitution, any capital funding requirements for the CBS and WOC will need to be allowed for in the council's budget strategy which needs to be approved by full council. The same applies to any prudential borrowing requirements.
- 6.12 If the Council intends to borrow to lend to the WOC and CBS regulation 25 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (SI 2003/3146) treats the giving of a loan by a local authority to a third party (such as WOC and CBS) towards expenditure (eg works on a new buildings) as capital expenditure providing that if the local authority itself incurred that expenditure (it borrowed to undertake the works itself) it would treat that expenditure (under proper accounting practices) as capital expenditure. It should be noted that the Council borrowing to lend to WOC and CBS in connection with revenue funding is not permitted.
- 6.13 When exercising its powers, the council must as with any other power, have regard to its own procedural rules, the Wednesbury principles of reasonableness and its fiduciary duties. It must also ensure that its powers are used for the proper purpose.

### **Fiduciary Duties**

- 6.14 The Council's fiduciary duties could be briefly summarised as it acting as a trustee of tax and public sector income on behalf of its rate and tax payers. The Council in effect holds money but does not own it, it spends money on behalf of its business rate and council tax payers.
- 6.15 Cabinet in making the decisions concerning the formation of a WOC and a CBS and making investments and loans to these bodies (and similar activities) should give proper consideration to the risks and rewards of approving the recommendations. In practice Cabinet will want to consider whether the Council will achieve an appropriate return for its risk and that the Council has minimised the risk and potential cost to it if the WOC and CBS became insolvent and/or defaulted on its loan(s).
- 6.16 Consideration should also be given to whether the Council's involvement in this arrangement is proportionate and properly balanced against the anticipated benefit as well as the wider interests of its local business rate and tax payers. On a practical basis this means Cabinet should consider whether the monies they are requested to approve for investment/lending to WOC and CBS could be better used by the Council for the wider interests of its local tax payers. This should include considering the impact on the Council (and therefore its local tax payers) if WOC/CBS became insolvent or otherwise defaulted on loans taken from the Council.

### **Land Disposal and Financial Assistance**

- 6.17 Section 32 of the Housing Act 1985 requires the Council to obtain the Secretary of State's consent for the disposal of land held under the Council's HRA. The Secretary of State has issued the General Housing Consents 2013 (the General Housing Consents) which set out circumstances in which he preapproves/pre-consents to a local authority disposing of HRA land and property. Consent A 3.2 of the General Housing Consents permits the Council to dispose of vacant land. Cabinet should note that vacant land means

land where there are no dwellings and/or where any dwellings are no longer capable of human habitation and are due to be demolished.

General Consent A.3.1.1 allows for the disposal of land at consideration equal to market value. Only the first 5 disposals of land within a financial year will fall within the consent if land is being transferred to a body to which the council owns an interest. This will apply to both the CBS and the WOC. The council is unable to dispose of HRA land at an undervalue under the above consents but may be able to provide the WOC and CBS with financial assistance under S.24 of the Local Government Act 1988. ( see below)

- 6.18 The Council is entitled to dispose of land held by its General Fund (including buildings) to a third party provided it complies with Section 123 of the Local Government Act 1972. This requires it to obtain a consideration which is not less than the best it could reasonably obtain. If it disposes of a property at an "under-value" it does require the consent of the Secretary of State (except for limited circumstances such as short term leases).
- 6.19 If the Council was able to sell at an under-value (and remain State Aid compliant) the Council may be able to rely on Circular 06/03 (the Local Government Act 1972 – disposal of land for less than best consideration) which sets out circumstances in which the Secretary of State preapproves/ pre-consent to the disposal of General Fund land at an under-value. If this consent is to apply then the "under-value" (in relation to a disposal) must not exceed £2m and the Council's purpose in making such a disposal must be to contribute to the economic social or environmental well-being of the authority's area and/or its residents.
- 6.20 If either HRA or General Fund land is sold at an undervalue and the disposal is in connection with properties which are *privately let*, the disposal is likely to be caught by S.24 of the 1988 Act.. As stated above Secretary of state consent is required. The Secretary of state has issued a number of General consents which apply to the transfer of land. In the case of HRA land only, the council may rely on General Consent AA of 2014 provided the criteria set out in the consent are met.
- 6.21 The Direction issued by the Minister on 17th December 2014 requires the Council, until 31<sup>st</sup> March 2017, to “..... *obtain the prior written agreement of the Commissioners **before** entering into any commitment to dispose of, or otherwise transfer to third parties, any real property other than existing single dwellings for the purposes of residential occupation.*” Consent of the Commissioners is therefore required prior to any disposal.

### **State Aid**

- 6.22 The Council is required to provide funding and ensure it and WOC operates in accordance with the state aid rules. Article 107 (1) of the Treaty on the Functioning of the European Union (Treaty)('the rules') declares that state aid, in what ever form, which could distort competition and affect trade by favouring certain undertakings or production of certain goods, is incompatible with the common market, unless the Treaty and in practice the European Commission (through regulations and decisions) allows otherwise.
- 6.23 It is important that any loans/credit or other support and transfer of property to the WOC WOC are state aid compliant. Loans/credit which the Council generally makes available to WOC must be made on commercial terms and at a commercial interest

rate. If the Council subsequently chooses to make an equity investment into WOC it must ensure this is done on commercial terms. It will be necessary for the Council to obtain independent confirmation that such arrangements have been made on commercial terms prior to them being entered into.

- 6.24 There is an exemption from state aid for services provided in the general economic interest. Therefore, properties to be developed or acquired by the CBS for letting as social /affordable or intermediate housing will be exempt from the state aid regime

## **Procurement**

- 6.25 It is intended that WOC operates as a business and as such it is not intended for it to be a contracting authority nor subject to public contract procurement requirements. This has a number of implications. Members' are referred to the report prepared by Trowers & Hamlins solicitors which is in Appendix 3 (Exempt).
- 6.26 Other things that will need to be considered when establishing the WOC are how Corporation and Value Added Tax will affect trading and how any financial commitments to the company in terms of funding affect the Council's borrowing limits.
- 6.27 Before agreeing to the proposals in this report, the Council must have due regard to the need to eliminate unlawful conduct under the Equality Act 2010, the need to advance equality of opportunity and the need to foster good relations between persons who share a protected characteristic and those who don't. Information relevant to these considerations is contained in the One Tower Hamlets section of the report.

## **7. ONE TOWER HAMLETS CONSIDERATIONS**

- 7.1.1 When exercising its functions, including housing functions, the Council has a duty under section 149 of the Equality Act 2010 to have due regard to the need to eliminate unlawful discrimination and advance equality of opportunity and foster good relations between those who share a protected characteristic and those who do not. This proposal involves the Council's exercise of its general powers of competence to invest in commercial and charitable activities in the housing market. The homes delivered by the Community Benefit Society will be made available for Council nominees and the allocation and use of those units will be determined in accordance with statutory housing need requirements. The homes delivered by the Wholly Owned Company will be marketed in accordance with equalities legislation in relation to private commercial activities.

## **8. BEST VALUE (BV) IMPLICATIONS**

The Council is required to consider the value for money implications of its decisions and to secure best value in the provision of all its services. It is important that, in considering the application of funding, Members satisfy themselves that resources are allocated in accordance with priorities and that full value is achieved.



This report is concerned with achieving best value with the application of Right To Buy Receipts to schemes resulting in effective use of the funding resource. The strategies and schemes considered will deliver value for money in meeting the Council's duty as a local housing authority.

## 9. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

9.1 There are no specific implications arising from the recommendations in this report.

## 10. RISK MANAGEMENT IMPLICATIONS

10.1 The proposals transfer risk into the WOC and CBS both of which have limited liability and hence do not create significant ongoing liabilities for the Council. Each of the delivery vehicles will be required to put in place their own robust risk management arrangements.

10.2 The following risks and mitigation measures have been identified in the development of the outline business case:

Risk Summary	Mitigation
Lack of suitable properties identified.	To engage someone specifically tasked with assessing the property market and identifying suitable properties. Properties will be considered from outside of the borough (up to a limit).
The portfolio of properties does not reflect need/strategic objectives	Continual monitoring of portfolio with controls and an approvals process regarding what can be purchased.
The properties don't achieve the anticipated yield.	Detailed financial modelling has been undertaken with sensitivity testing to determine the impact of changes in the market.
Maintenance costs are higher than anticipated.	The maintenance and operating costs are based on existing schemes and inflation allowed for. The model has been tested for variations to ensure the yield is positive even with some additional movement in costs.
Rent arrears and bad debts	Allowance has been made in the model for bad debts of up to 4% in both the wholly owned company which will provide homes for rent and sale and the Community Benefit Society which will provide homes for sub-market rent.
Rent inflation	This has been allowed for at CPI + 1% (3%) which is in line with the long term indexation for registered providers and therefore a good indication of inflation on sub-market rents.
Demand falls.	The need for accommodation due to the increasing population, increasing private sector rents and increasing housing prices mean supply is unlikely to outstrip demand however should this happen surplus/vacant property could be sold on the open market.
Governance failures	WOC – as 100% shareholder the Council will be able to influence the membership of the board and comment on their performance. CBS – as main investor the council will be able to influence the performance of the society through conditions on use of the money/and assets passed to the society.
WOC commercial failure	If the WOC fails to deliver a return on investment it may not be

Risk Summary	Mitigation
	able to provide funding for the CBS which in turn may fail.

## 11. CRIME AND DISORDER REDUCTION IMPLICATIONS

11.1 There are no significant implications arising from these specific recommendations.

## 12. SAFEGUARDING STATEMENT

12.1 There are no significant implications arising from these specific recommendations.

### Linked Reports, Appendices and Background Documents

#### Linked Report

#### Appendices

- Appendix 1 – Evaluation of Housing Delivery Routes
- Appendix 2 – Implementation Plan
- Appendix 3 – Trowers & Hamlin legal advice (Exempt)

#### Background Documents – Local Authorities (Executive Arrangements)(Access to Information)(England) Regulations 2012

- None

#### Officer contact details for documents:

- n/a

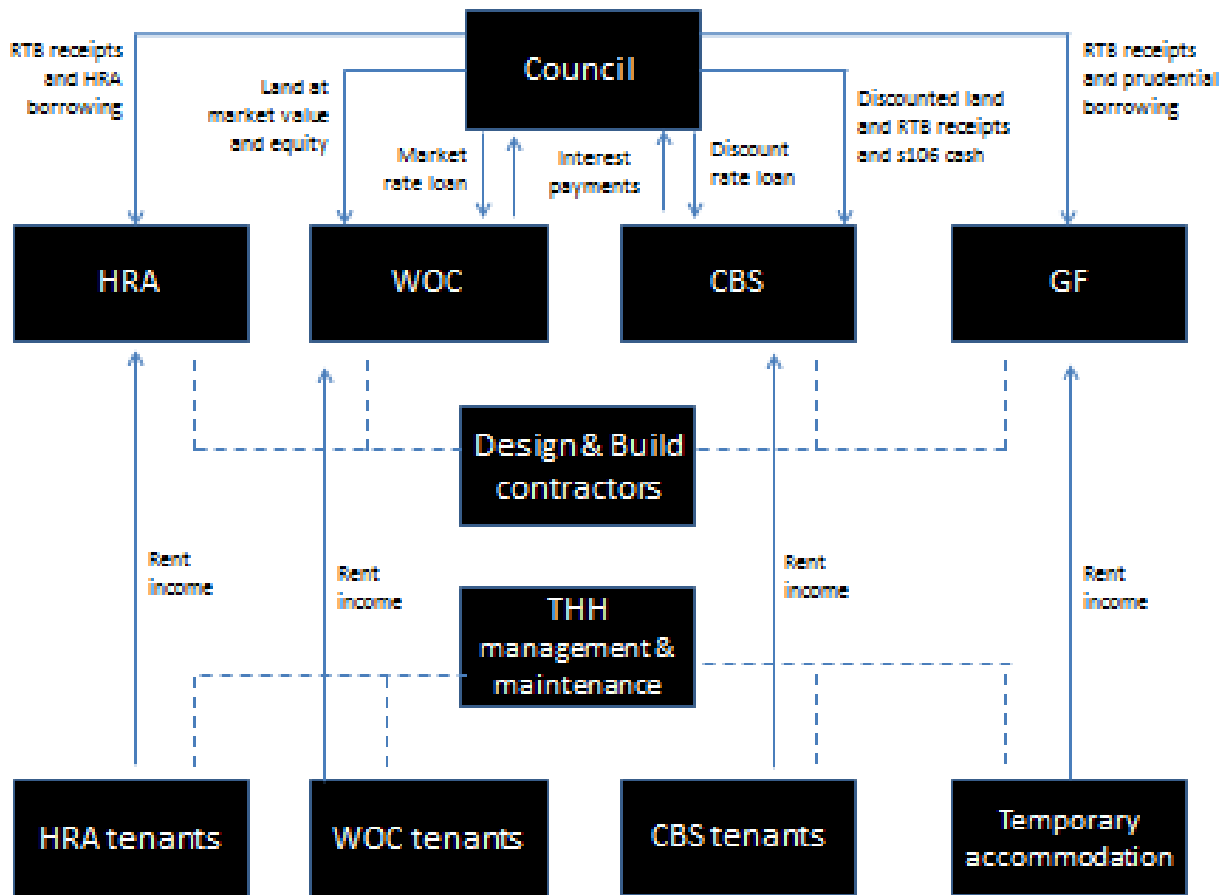
#### Originating Officers and Contact Details

Name	Title	Contact for information
Mark Baigent	Interim Divisional Director – Housing and Regeneration	020 7364 7522

## Appendix 1 – Evaluation of Housing Delivery Routes

<b>Criteria/Route</b>	<b>HRA</b>	<b>GF</b>	<b>WOC</b>	<b>CBS</b>
<b>Purpose</b>	Social	Social	Commercial	Charitable
<b>Land</b>	HRA land used at nil value	GF land used at nil value	HRA/GF land acquired at market value	HRA/GF land acquired, with some scope for discounted or nil value sale
<b>Use of retained RTB receipts</b>	Yes, but very limited due to borrowing cap	Yes, with GF prudential borrowing	No, not allowed under DCLG rules	Yes, provided LBTH has a minority interest
<b>Debt</b>	HRA borrowing (capped)	GF borrowing (prudential code)	GF on-lending at commercial rate	GF on-lending at charitable rate
<b>Equity</b>	Not required	Not required	Required, recommended at least 20% of total investment value	Not required, provided land and RTB receipts are available
<b>Tax status</b>	Exempt	Exempt	Fully taxable	Partially exempt
<b>Public procurement rules apply</b>	Yes	Yes	No, provided commercial purpose	No, charitable body outside public sector
<b>Tenure options</b>	Secure tenancies	Temporary accommodation	Market rents and homes for outright sale	Sub-market rents and low cost home ownership
<b>Allocation of homes</b>	Common Housing Register	Temporary accommodation	Open market and intermediate register	Common Housing Register and intermediate register

Diagram showing key financial flows:



## Appendix 2 – Implementation Plan

<b>Task</b>	<b>Responsible</b>	<b>Timescale</b>
Approve WOC Shareholders Agreement and Articles	Corporate Director D&R	February 2017
Approve CBS Rules and Deed of Covenant	Corporate Director D&R	February 2017
Register WOC at Companies House and appoint Directors	Corporate Director D&R	February 2017
Appoint Council CBS Members	Corporate Director D&R	March 2017
Recruit and appoint independent CBS Members	Corporate Director D&R	March 2017
Register CBS with Financial Conduct Authority	Corporate Director D&R	March 2017
Agree WOC policies and procedures	WOC Board of Directors	March 2017
WOC commercial loan facility approved	Corporate Director Resources	April 2017
WOC commences acquisitions	WOC	April 2017
Agree CBS policies and procedures	CBS Board Members	April 2017
CBS loan facility approved	Corporate Director Resources	April 2017
CBS commences acquisitions	CBS	April 2017
Acquired homes advertised and let	WOC & CBS	July 2017
Draw up development plans for WOC and CBS	Corporate Director D&R	July 2017
Recommend to Mayor & Cabinet further funding and land transfer to facilitate development plans	Corporate Director D&R	September 2017
New build development plans commence delivery	WOC & CBS	January 2018