CABINET
27 MARCH 2018

*PART 1 – PUBLIC DOCUMENT	AGENDA ITEM No. **6A**

TITLE OF REPORT: ITEM REFERRED FROM CABINET SUB-COMMITTEE (LOCAL AUTHORITY TRADING COMPANIES' SHAREHOLDER): 15 MARCH 2018 – OPTIONS FOR HOUSING INVESTMENT COMPANY

The following is an extract from the Draft Minutes of the Cabinet Sub-Committee (Local Authority Trading Companies' Shareholder) meeting held on 15 March 2018.

6. OPTIONS FOR HOUSING INVESTMENT COMPANY

[Note: this item was considered after Minute 8.]

[Prior to the consideration of this item and Minute 8 below, Councillor David Levett made a Declarable Interest in that he was a director of a property letting company which was currently dormant, but that he had applied to Companies House to wind up this company.]

The Deputy Chief Executive presented a Part 1 report setting out the investigations that had been undertaken with regard to the potential options for investing in residential property on a buy to let or development basis. The following appendix was submitted with the report:

Appendix A – Proposed Scheme of Delegation.

The Deputy Chief Executive advised that the Overview and Scrutiny Committee had requested to see this report and accompanying Part 2 report at its meeting to be held on 20 March 2018, and so the views of that Committee may be referred to Cabinet for consideration at its meeting to be held on 27 March 2018.

The Deputy Chief Executive stated that the Sub-Committee had considered the Outline Business Case (OBC) for a Housing Investment Company appended to the Part 2 report (See Minute 8 below). In summary, the OBC showed that the return on investment would be marginal and less than other potential ways in which the Council could invest its capital. There are a number of reasons for this, including:

- The cost of property in North Hertfordshire;
- A mature rental market;
- The cost of buying in the necessary expertise; and
- Small size of the likely property portfolio meaning costs were not spread/diluted.

The Sub-Committee noted that the findings of the Outline Business Case suggested that the Council should cease work on buying existing residential property on the open market for private rental and should instead focus on other housing options which could provide greater returns. Additionally, the model of buying existing residential properties would not provide the community benefits of bringing new housing stock into circulation, whereas conversion/development options could provide new housing for the area.

The Sub-Committee therefore supported the proposed recommendation that no further work be undertaken to investigate buy to let investment options.

The Deputy Chief Executive referred to the £3Million allocation in the Capital Programme for Housing Investment. Although purchasing existing residential properties for renting did not provide sufficient return to be an attractive investment option, the Council currently owned property which could potentially be rented out as residential lettings to generate income. The Council owned the bungalow adjacent to Town Lodge in Gernon Road, which was vacant and could be rented out in order to generate an income, thereby ensuring the Council was obtaining value from its asset. Alternatively, the site could be redeveloped as part of any proposals for the wider Gernon Road site. The Council also owned the current Careline offices in Harkness Court, Hitchin which would be vacated later this year when Careline relocated to the District Council Offices. Options had been explored for the conversion of the building to residential flats for letting on the private rental market.

In addition to letting existing assets, the Deputy Chief Executive explained that the Council could explore options for developing its land holdings, where appropriate, either on its own or in partnership with others. These would need to be considered on a site by site basis and would be subject to individual business cases in due course. Any housing developed could be retained for letting through the trading company, or sold to generate a capital receipt, or a mixture of both.

The Deputy Chief Executive advised that, where it carried out an activity that was primarily for a commercial purpose, the Council was required to do this through a trading company. In order to facilitate any future letting opportunities it was proposed that the Council established the relevant company structures now. Under the terms of the Council's Constitution, the setting up of a company required a decision from Cabinet. It was proposed that a typical structure be adopted of a parent holding company with the potential for a number of separate trading companies operating in different markets. The proposed breakdown of responsibilities (between the Cabinet, Cabinet Sub-Committee, Officers and Board of Directors) was attached at Appendix A to the report. Going forward, the Sub-Committee would act as the Council's shareholder in the company, with the Directors taking day to day decisions. It was proposed that Cabinet be recommended to delegate authority to the Chief Finance Officer and Executive Member for Finance and IT to determine the detail of the company structure.

Members noted that initially the Council would set up the holding company and one trading company for letting residential property at market rent. Further work would need to be undertaken on the best mechanisms for the company to acquire the property and providing a return to the Council. This would be subject of a further report in due course.

In response to a Member's questions, the Chief Executive and Deputy Chief Executive confirmed that investigation of the potential development of commercial property would be a task for the new post of Commercialisation Service Director, as would the formulation of a Commercialisation Strategy.

The Sub-Committee supported the recommendations in the report, and felt that it was appropriate to set up both the proposed parent company, and two subsidiary trading companies. The Sub-Committee therefore amended the recommendation to Cabinet to incorporate reference to "trading companies" and "development; and letting", as set out below.

***RESOLVED**:*

(1) That it be agreed that no further work be undertaken to investigate buy to let investment options; and

(2) That further work be undertaken to investigate potential conversion/development opportunities, subject to future consideration of the business plan for specific proposals.

RECOMMENDED TO CABINET: That the principle of setting up a wholly owned holding company and trading companies for the purposes of development; and letting existing and future assets as residential dwellings be approved, and the Chief Finance Officer and Executive Member for Finance and IT be given delegated authority to determine the detail of the structure.

REASON FOR DECISION: To explore the options for making best use of existing assets.

[Note: Item 19 – the Part 2 report considered by the Sub-Committee – should be read in conjunction with this referral.]

The following is the report considered by the Cabinet Sub-Committee (Local Authority Trading Companies' Shareholder) at its meeting held on 15 March 2018.

TITLE OF REPORT: OPTIONS FOR HOUSING INVESTMENT COMPANY

REPORT OF THE DEPUTY CHIEF EXECUTIVE
EXECUTIVE MEMBER: EXECUTIVE MEMBER FOR FINANCE AND IT
COUNCIL PRIORITY: ATTRACTIVE AND THRIVING / PROSPER AND PROTECT

1. EXECUTIVE SUMMARY

The budget set by Full Council on 11 February 2016 included sums in the capital programme for 2017/18 and 2018/19 to provide housing at market rates. This report sets out the investigations that have been undertaken with regard to the potential options for investing in residential property on a buy to let or development basis.

2. RECOMMENDATIONS

2.1 That the Sub-Committee agrees that no further work will be undertaken to investigate buy to let investment options.

2.2 That the Sub-Committee authorises further work to be undertaken to investigate potential conversion/development opportunities, subject to future consideration of the business plan for specific proposals.

2.3 That the Cabinet be recommended to:

Approve the principle of setting up a wholly owned holding company and trading company for the purposes of letting existing and future assets as residential dwellings, with the Chief Finance Officer and Executive Member for Finance and IT delegated authority to determine the detail of the structure.

3. REASONS FOR RECOMMENDATIONS

3.1 The outline business case has established that there is insufficient return on investment to pursue the originally conceived option of buying property on the open market within the District and then renting it out, so the recommended way forward is to explore the options for making best use of existing assets.

4. ALTERNATIVE OPTIONS CONSIDERED

4.1 The alternative options for buy to let investment are set out in the outline business case. The Council could also choose not to invest in residential property and instead explore other avenues for investing its capital, for example commercial property or leisure facilities or property funds. However it is considered that there is merit in looking at specific buildings or sites on a site by site basis to establish whether there are opportunities for providing more housing whilst obtaining an acceptable return on investment. Those site by site considerations can include whether the Council seeks to deliver a scheme on its own, or in partnership with others.

5. CONSULTATION WITH RELEVANT MEMBERS AND EXTERNAL ORGANISATIONS

5.1 An initial briefing with the members of the Sub-Committee took place on 20 December 2017 in order to inform Members of the issues being considered and potential options being explored.

6. FORWARD PLAN

6.1 This report contains a recommendation on a key decision that was first notified to the public in the Forward Plan on the 10 November 2017.

7. BACKGROUND

7.1 An article in Public Sector Executive magazine, October/November 2017 issue, referred to a survey of local authorities carried out by Solace which revealed one in four respondents had set up a wholly owned company and almost one in five had set up other types of joint ventures, in order to deliver housing development. A number of other respondents indicated that there were in the process of setting up a housing company or joint venture, or considering their options. The article estimated that there were in the range of 50 local authority housing companies in operation last year.

7.2 The budget set by Full Council on 11 February 2016 included sums in the capital programme for 2017/18 and 2018/19 of £550k and £2.3m respectively for provision of housing at market rents. The most recent budget set by Full Council on 8 February 2018 reprofiled that expenditure to £200k in 2017/18, £2.65m in 2018/19 and £150k in 2019/20.

7.3 At the time of the original budget allocation the Council projected a significant shortfall in its revenue budget which needed to be met by 2019/20. The model for housing investment under consideration therefore needed to be able to quickly convert capital investment into revenue income. That model was to buy existing housing within the District and let out to the private rental market. An external consultant was therefore instructed to investigate that model and develop an outline business case, based upon the assumption that the Council's revenue budget would continue to be very challenging. Whilst the outline business case was being developed the goalposts moved somewhat on the Council's financial projections for the next few years. In short the new waste contract and other savings/income opportunities improved the revenue position markedly. In light of that the Council does not need to generate income as quickly as initially envisaged and therefore is able to consider other options rather than the quick option of buying existing properties. Additionally, whilst the sums set out in 7.2 above are allocated in the capital programme the Council will need to generate capital receipts in order to deliver all of its existing (and any potential future) capital programme. An option to generate capital receipts could be housing development.

8. RELEVANT CONSIDERATIONS

Outline Business Case

8.1 The Outline Business Case is appended to the Part 2 report. In summary it shows that the return on investment would be marginal and less than other potential ways in which the Council could invest its capital. There are a number of reasons for this, including:-

- The cost of property in North Hertfordshire

- A mature rental market
- The cost of buying in the necessary expertise
- Small size of the likely property portfolio meaning costs are not spread/diluted

8.2 The findings of the Outline Business Case suggest that the Council should cease work on buying existing residential property on the open market for private rental and should instead focus on other housing options which could provide greater returns. Additionally the model of buying existing residential properties would not provide the community benefits of bringing new housing stock into circulation, whereas conversion/development options could provide new housing for the area.

Letting Existing Assets

8.3 Although purchasing existing residential properties for renting does not provide sufficient return to be an attractive investment option, the Council currently owns property which could potentially be rented out as residential lettings to generate income. The Council owns the bungalow adjacent to Town Lodge in Gernon Road. This property is vacant and could be rented out in order to generate an income, thereby ensuring the Council is obtaining value from its asset. Alternatively the site could be redeveloped as part of any proposals for the wider Gernon Road site. The Council also owns the current Careline offices in Harkness Court, Hitchin which will be vacated later this year when Careline relocate to the District Council Offices. Options have been explored for the conversion of the building to residential flats for letting on the private rental market.

Establishing a Trading Company

8.4 Where it carries out an activity that is primarily for a commercial purpose, the Council is required to do this through a trading company. In order to facilitate any future letting opportunities it is proposed that the Council sets up the relevant company structures now. Under the terms of the Council's Constitution, the setting up of a company requires a decision from Cabinet. It is proposed that a typical structure is adopted of a parent holding company with the potential for a number of separate trading companies operating in different markets. The proposed breakdown of responsibilities is attached at Appendix A. Initially the Council would set up the holding company and one trading company for letting residential property at market rent. Further work would need to be undertaken on the best mechanisms for the company to acquire the property and providing a return to the Council. This would be subject of a further report in due course.

Opportunities for development

8.5 In addition to letting existing assets the Council could explore options for developing its land holdings, where appropriate, either on its own or in partnership with others. These would need to be considered on a site by site basis and would be subject to individual business cases in due course. Any housing developed could be retained for letting through the trading company, or sold to generate a capital receipt, or a mixture of both.

8.6 Hertfordshire County Council, through its Herts Living Limited trading company, is entering into a joint venture with a private sector developer to deliver housing. As part of the procurement process the option for the District/Borough Councils to join the arrangement has been left open. It is understood that the successful partner will be announced in the middle of

April 2018 and the Council could explore whether delivery of development through this joint venture might be an attractive proposition as part of its considerations of how to bring forward specific sites for development.

9. LEGAL IMPLICATIONS

9.1 The Cabinet Sub-Committee's terms of reference are concerned with the Council's actions as shareholder of local authority trading companies. It is within the spirit of the terms of reference for the Sub-Committee to consider the available options for commercial activities that necessarily would have to be undertaken via a local authority trading company. The Sub-Committee has within its terms of reference '*to represent the Council's interests as shareholder in wholly owned and other companies'* and '*to make recommendations to Cabinet on the investment, loans, resource arrangements and asset transfers to companies'.* Within this framework, it is also fitting for the Sub-Committee to make recommendations to Cabinet as to the creation of any such companies.

9.2 Section 1 of the Localism Act 2011 gives local authorities the power to do anything that individuals generally may do including power to do it for a commercial purpose or otherwise for a charge. This power is limited by section 4 of the Localism Act 2011 which provides that where a local authority does things for a commercial purpose pursuant to this power, the authority must do them through a company.

9.3 The Housing Act 1985 provides local authority tenants with a 'right to buy' in certain circumstances. Were NHDC to enter directly into a letting agreement with residential tenants then it would be at risk of the right to buy being exercised and the asset being acquired by the residential tenant. A wholly owned local authority company would not be subject to the right to buy, and this provides an additional reason why residential letting should take place via such a company.

10. FINANCIAL IMPLICATIONS

10.1 Whilst the Council has already received some legal and financial advice on the way the company will operate, there are likely to be some further revenue costs incurred in finalising the set-up (e.g. further professional advice). These costs will be met from the revenue funding that was allocated for this purpose. Whilst there will be future revenue costs of running the company, these will be met by the company and should be covered by the income that it generates, at least in the medium term. Where the company makes use of Council resources (e.g. loan financing, staff time) then this will be charged to the company and provide an income to the Council. When the company makes a profit this will be subject to Corporation Tax.

10.2 The majority of the expenditure that is expected to be incurred (e.g. property renovation, refurbishment and acquisition) will be capital. There is capital budget of up to £3m allocated for this purpose. The Council is getting towards a position where it will have used up its set-aside capital receipts, which means that it will need to borrow for capital investment in the future. Therefore any use of capital to generate an income should be assessed as though it was necessary to fund it from borrowing, which means incorporating interest and minimum revenue provision costs.

10.3 The Chartered Institute of Public Finance and Accountancy (CIPFA) and the Ministry of Housing, Communities and Local Government (MHCLG) have issued updated guidance on capital investments for a commercial purpose.

This requires Authorities to consider the security and liquidity of any investments. In the context of a housing company this would include the extent to which the value of the investment can be secured against property, and the ease with which that property could be sold if required. For existing property, the liquidity is reasonably high. However, for property development, the liquidity could be very low (i.e. it would take a long time to sell).

10.4 It is also prudent for the Council to consider its investment in a housing company from a treasury management perspective. This would include the overall exposure to the housing market, given that the Council already holds a significant proportion of its cash in building society deposits. Any investment should also be compared to investment opportunities that already exist. For example, the Council could choose to invest in a property fund. Features of these funds include:

- They have similar entry and exit costs to buying and selling property (e.g. stamp duty), although they are more liquid
- They provide a combination of income (historically they have been around 5% per year) and capital growth (or decline)
- They are diversified across a wide range of property types and locations, which means that there would be little (or possibly no) investment in North Hertfordshire
- They need to be held for a similar time period to property purchases (i.e. at least 5 years)

11. RISK IMPLICATIONS

11.1 The yield from property investments is subject to market conditions and can vary over time. If the company is primarily holding the property to generate income, then the capital value will not be too relevant. Whilst the capital value of property does tend to go up over time, this is not guaranteed and over a shorter time horizon there is definitely the potential for values to fall.

11.2 Current legislation and guidance does not put any significant limits on Authorities investing in property, especially of the type being looked at here. However this area has received a lot of attention and there is still the potential for legislation that would limit the way that Authorities can act.

11.3 The specific risks of any project would be considered as part of the business case for that particular project.

12. EQUALITIES IMPLICATIONS

12.1 In line with the Public Sector Equality Duty, public bodies must, in the exercise of their functions, give due regard to the need to eliminate discrimination, harassment, victimisation, to advance equality of opportunity and foster good relations between those who share a protected characteristic and those who do not. There are no equalities implications in this report.

13. SOCIAL VALUE IMPLICATIONS

13.1 The Social Value Act and “go local” policy do not apply to this report. However any building works undertaken to convert existing properties or develop new housing could be subject to the “go local” policy or Social Value Act requirements, depending on the value of those contracts. This would need to be considered at the time that specific proposals come forward.

14. HUMAN RESOURCE IMPLICATIONS

14.1 The senior management restructure proposals currently being consulted on include a proposal for a Service Director – Commercial role, which would be responsible for the housing/property development company. Once in post the Service Director will be tasked with ensuring that the capacity and skills of staff to deliver the company's objectives are met. The potential Directors of the company would be identified from across existing staff and their appointments would be subject of approval by the Sub-Committee acting as shareholder. Those staff would be provided with the necessary training and support to fulfil their role as director.

15. APPENDICES

15.1 Appendix A – Proposed Scheme of Delegation.

16. CONTACT OFFICERS

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17. BACKGROUND PAPERS

17.1 None.