Business Case for Hinckley and Bosworth Borough Council on establishing a Wholly Owned Company (WOC)

DRAFT 7

25.11.15
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1 Executive Summary

1.1 Introduction and objectives for setting up a development company

The role of councils in meeting the housing and commercial needs of their districts is changing. Local authorities are increasingly looking at the role they can play in stimulating the local economy through increased employment and delivering new local housing investment. The drivers for taking a leading role in housing and commercial investment are to directly address local housing supply shortfalls, and to generate additional revenue to support other identified priorities.

This business plan sets out how the Council, utilising a wholly-owned company vehicle, will seek to establish a key role in delivering new housing that will meet the needs of the district going forward whilst making sound financial investments which will support the provision of council-services going forward. The objectives in setting up a Company are as follows:

- To increase housing supply in the area to address existing demand and meet the needs of a growing population, and help boost growth in the local economy;
- To act as a stimulus for change to improve the quality of rented sector accommodation across the district;
- To set standards for good housing design in the local housing market, helping to protect the character of the district, and;
- To generate general fund income for the Council through returns from Private Rented Sector ("PRS") housing and sales receipts from market housing sales and affordable homes.
- To develop commercial properties to rent at market rents.
- To set standards for good commercial design in the industrial and retail sector.

The use of a wholly owned company has the advantage over developing property in-house in that:

- Housing held for market rent sits outside of the HRA, so returns flow to the General Fund.
- Housing is not subject to the constraints of the Housing Act and secure tenancy regime.

The WOC will operate as a business and as such has a separate Business Plan in place which outlines how it will operate and the resources required to meet these aspirations.
“ Buyers can’t buy – with the average age of an unassisted first time buyer continuing to rise and families struggling to ‘trade up’

• Lenders are not lending enough – with high deposit requirements excluding young people and families from home ownership

• Builders are not building – without consumers ready to buy and without enough land for development or access to finance

• Investors are not investing – without the right framework or incentives in place

• Affordable housing can do more – to deliver new homes and support the social mobility and aspirations of tenants and communities

• Tenants are struggling – as pressures increase in the private rented sector”

This combination of new powers, along with a local challenge that requires a proactive solution, presents a significant opportunity for Hinckley & Bosworth Borough Council who is well placed to rise to this challenge. The Council has access to land, finance and housing expertise. The Council understands local housing needs, and is well placed to make the necessary decisions and investment that will contribute towards ensuring that these needs are met.

1.2 Summary of the arrangements and process

The diagram below summarises the key features of the proposed arrangements between the Council and the Company for the majority of sites. The Council will sell land at market value (determined by an independent valuer) to the Company and advance to it financing in the form of equity and loans. The Council will borrow, either from the Public Works Loans Board (PWLB) or through the Local Government Association (LGA) consortium to provide the financing.

The Company will use the funds to develop homes on the transferred land and to make acquisitions of existing homes for rent and market sale. The exact mix of rented and sale will be considered on a site by site basis. The cash inflows of the Company will therefore comprise market rents and the proceeds of property sales. These cash flows will be used to service the financing provided by the Council, providing one of the financial returns to the Council.

The properties will be designed and developed by an external provider, procured by the Company. In developing and maintaining these homes, the Council and the Company will seek to provide opportunities for local suppliers and contractors wherever possible.

In all cases maintenance and management as well as professional services (e.g. legal and finance) will be provided by the Council. Where the Council delivers services for the Company, these will be charged at market rates in line with a service level agreement (SLA).
The loans from the Council to the Company will be on commercial terms, therefore addressing State Aid concerns. Since the Council can source from PWLB/LGA Consortium are below commercial rates, the Council is likely to make a 'spread' on the interest payments received from the Company and those it makes itself to PWLB. The nature of the loan arrangements and categorisation of debt repayments from the Company as capital receipts in the Council's finances means Minimum Revenue Provision requirements in relation to the PWLB loans can be met. In addition, the Council is forecast to benefit from dividend payments from the Company when the availability of funds allows.

1.3 Financial Returns to the Council

The Council will earn a return to the General Fund from the Company from three sources:

- A margin earned on services performed for the Company (set at between 10-17% of the cost of those services)
- A margin on debt interest charged to the Company in excess of the Council’s cost of those funds (as per previous page)
- A return on equity invested (through dividends), which reflects profits back to the Council from the Company’s operation of the following activities - market sales from housing development, market rental from housing development and market rental from housing acquired

The table below shows the target returns to the Council’s General Fund over the next three years. The General Fund is forecast to benefit by £2m over the first three years, including a spike of return due to profits from sales of units made in the Company. Beyond three years, the Council will receive a steady inflation linked income plus further spikes of income from sale of units.

Table 1: Headline Financial Returns

<table>
<thead>
<tr>
<th></th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Margin on loan interest *</td>
<td>190,000</td>
<td>200,000</td>
<td>-</td>
<td>390,000</td>
</tr>
<tr>
<td>Interest on working capital funding **</td>
<td>35,000</td>
<td>35,000</td>
<td>105,000</td>
<td>175,000</td>
</tr>
<tr>
<td>Management Fee</td>
<td>260,000</td>
<td>260,000</td>
<td>175,000</td>
<td>695,000</td>
</tr>
<tr>
<td>Dividend (after tax) ***</td>
<td>-</td>
<td>-</td>
<td>600,000</td>
<td>600,000</td>
</tr>
<tr>
<td></td>
<td>484,000</td>
<td>495,000</td>
<td>880,000</td>
<td>1,860,000</td>
</tr>
</tbody>
</table>

* Assumed company will become self-funding or borrow on open market
** Company will be more reliant on working capital funding from the Council
*** Assumed dividend level equivalent to marginal value of 15 properties

1.4 Structure of this business plan

The remainder of this indicative business plan is as follows:

- **Background on Council-owned housing companies** – details of alternative housing vehicles considered and recent trends in Councils setting up housing companies
- **Funding and Development site details**
- **Steps in setting up the new housing company** – legal implications, financing and staff requirements, tax considerations, and the impact on the Council’s Housing Revenue Account (HRA)
- **Risk and governance** – including a risk register for the construction and operational (management of rental properties) phases
- **Business development strategy** – further growth opportunities for the Company beyond the initial scope
2 Background

2.1 Objectives and Rationale

Hinckley & Bosworth Borough Council (“HBBC” or “the Council”) has set up a new housing vehicle to meet a number of social and economic objectives. These are to:

- To increase housing supply in the area to meet existing and future needs of a growing population, and help boost growth in the local economy;
- To develop affordable homes for sale;
- To act as a stimulus for change to improve the quality of rented sector accommodation across the district;
- To set standards for good housing design in the local housing market, helping to protect the character of the district, and;
- To generate general fund income for the Council through returns from Private Rented Sector (“PRS”) housing and sales receipts from market housing sales and affordable homes.
- To develop commercial properties to rent at market rents.
- To set standards for good commercial design in the industrial and retail sector.

2.2 Current position

As outlined later in this report, there is a demand within the Borough for additional rental accommodation and provision of properties for a variety of demographics. The Council has a land supply, however, developers are not coming forward to deliver new housing at the rate required by the market.

Therefore, the Council believes it requires a new solution, by setting up a new housing vehicle to deliver high quality housing, making use of its unique position in respect of the following:

- The land the Council currently holds and the related opportunities associated with this land.
- The Council has access to low cost borrowing.
- The Council has a willingness to take a longer term return than the private sector.
- The Council has an existing in-house housing team, combining property lettings, management, repairs and improvements.

2.3 Benefits of a wholly owned housing company

The Council considered various options for a council led housing investment strategy. These are set out below.

On the advice of external legal advisors, the Council has decided to go with the option of setting up a wholly owned housing company. This structure provides a number of benefits which include:

- the ability to offer a wider variety of tenure types (including Private Rented Sector – “PRS”)
- profits from the company can be returned to the Council’s general fund via dividend payments
- no impact on the HRA borrowing cap
- freedom from the HRA rent regime and the implications of the “limit rent subsidy” (if properties with higher rents are introduced to the HRA then not all housing benefit costs can be reclaimed)
- avoids potential losses through Right To Buy
The table below outlines the advantages and disadvantages for the Council associated with each of the options considered:

<table>
<thead>
<tr>
<th>Option</th>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Do nothing</td>
<td>Continues to deliver much needed affordable housing (albeit at a limited volume). Unlikely to have a borrowing requirement in excess of the borrowing cap. The HRA can operate without VAT or Corporation Tax issues.</td>
<td>No benefit to the general fund. New dwellings would need to be let under secure tenancies, which include the Right To Buy.</td>
</tr>
<tr>
<td>2. Increase delivery of housing under HRA</td>
<td>The HRA can sustain an increased programme of new housing within its business plan – particularly if the additional &quot;headroom&quot; borrowing is made. The HRA can operate without VAT or Corporation Tax issues.</td>
<td>No benefit to the general fund. New dwellings would need to be let under secure tenancies, which include the Right To Buy. Any financing within the HRA counts towards the overall HRA borrowing, which is subject to a borrowing &quot;cap&quot;. Would not generate as significant a return given the lack of flexibility over tenure types (particularly PRS).</td>
</tr>
<tr>
<td>3. Establish a Council owned development company</td>
<td>Avoids HRA rent regime and implications of the &quot;limit rent subsidy.&quot; Avoids losses through Right To Buy. Can create a revenue income to the Council through dividend payments. Potential to create a further revenue stream to the General Fund through loan arrangements. A Company Limited by Shares is unlikely to incur any liability for Stamp Duty and Land Tax (SDLT) on property transfers between the Council and the Company. Ability to offer a wider variety of tenure types than the HRA (including PRS). No impact on the HRA borrowing cap.</td>
<td>Would be liable for payment of Corporation Tax on profits. There would be VAT implications in a company model which differ to the Council (which is able to recover VAT). There is a potential &quot;opportunity cost&quot; of not building purely affordable homes on HRA land – i.e. if a site can accommodate 30 new homes which would all be affordable if delivered through the HRA, there would only be one third of this number provided as affordable homes under this route.</td>
</tr>
<tr>
<td>4. Develop in partnership (Joint Venture or Asset Backed Vehicle)</td>
<td>Shared expertise amongst partners. Sharing of risk amongst partners. Sharing of investment need.</td>
<td>Complex arrangements needed to establish such a vehicle. Not fully under the Council’s control. Tax implications. There is a potential &quot;opportunity cost&quot; of not building purely affordable homes on HRA land – i.e. if a site can accommodate 30 new homes which would all be affordable if delivered through the HRA, there would only be one third of this number provided as affordable homes under this route.</td>
</tr>
</tbody>
</table>

It is considered that Option 3 will meet all of the objectives identified by the Council.
### 2.4 SWOT analysis on using a wholly owned housing company

<table>
<thead>
<tr>
<th><strong>Strengths</strong></th>
<th><strong>Opportunities</strong></th>
</tr>
</thead>
</table>
| • Addresses need to increase housing supply in the district. | • Potential to expand  
  o Within Hinckley & Bosworth  
  o Within the County  
  o Outside the County. |
| • Increase flow to General Fund. | • Potential to develop a partnership  
  o With other Councils  
  o With private providers. |
| • Flexibility in product offering between market sale and market rent. | • Wider options for raising new capital.  
  The Company can issue new share capital.  
  • The Company will better use existing Council assets (both land and buildings).  
  • Operate other commercial services. |
| • Strong Council control will ensure it is acting for the Council’s best interests. |  |
| • The Council’s liability is limited to the funds invested. |  |
| • Freedom and flexibilities to act commercially. |  |
| • Expertise and experience of Directors and Non-Executive Directors from the private sector |  |
| • Ability to access H.C.A. and other external funding. |  |

<table>
<thead>
<tr>
<th><strong>Weaknesses</strong></th>
<th><strong>Threats</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Would be liable to corporation tax payments.</td>
<td>• Displaced residents may give the new housing company a bad reputation.</td>
</tr>
<tr>
<td>• VAT implications in a company model which differ to the Council (the Council is able to recover VAT).</td>
<td>• Demographic changes</td>
</tr>
<tr>
<td>• “Opportunity cost” of not building purely affordable homes on HRA land – i.e. if a site can accommodate 30 new homes which would all be affordable if delivered through the HRA, there would only be one third of this number provided as affordable homes under this route.</td>
<td>• Migrant workers becoming more affluent and moving outside of [Hinckley &amp; Bosworth] area.</td>
</tr>
<tr>
<td>• Development and operational expertise is not there for market rent and sale properties.</td>
<td>• Mobile workers becoming more affluent and wishing to buy rather than rent. Market analysis shows that this is already happening.</td>
</tr>
<tr>
<td>• Council branding may not be appealing to the private sector.</td>
<td>• Economic activity often attracts migrant workers. If this changes in [Hinckley &amp; Bosworth] it may affect number of migrant settlers.</td>
</tr>
<tr>
<td>• Lack of necessary skills and experience at a director level.</td>
<td>• Potential increases in interest rates and/or rate of returns for the Council.</td>
</tr>
<tr>
<td>• Additional overhead costs such as external audit fees, registrations with HMRC, and with Companies House.</td>
<td>• Reduced demand caused by increased cost of mortgages from higher base rates.</td>
</tr>
<tr>
<td></td>
<td>• There may be competitors planning to access the demand for housing in the Hinckley &amp; Bosworth area.</td>
</tr>
<tr>
<td></td>
<td>• Potential lack of access to land for future expansion.</td>
</tr>
<tr>
<td></td>
<td>• Increasing market construction costs.</td>
</tr>
<tr>
<td></td>
<td>• Struggling ownership affordability undermining ability to sell if there is a further economic downturn.</td>
</tr>
<tr>
<td></td>
<td>• State aid and procurement rules may effect intended operations, legal advice is being taken.</td>
</tr>
<tr>
<td></td>
<td>• There may be legislation changes which could be unfavourable to the current arrangement (e.g. HRA, Council land disposals/transfers).</td>
</tr>
<tr>
<td></td>
<td>• Bad press for the Council from any tenants removed from properties, even if under the terms of the tenancy.</td>
</tr>
<tr>
<td></td>
<td>• Competition from private sector who may be able to achieve greater economies of scale.</td>
</tr>
<tr>
<td></td>
<td>• Change in government policy on Right to Buy which may be extended to the affordable elements of developments</td>
</tr>
</tbody>
</table>
2.5  Trend towards Councils setting up housing companies

Aims and examples of other Councils

Setting up a new local Council owned housing company as a delivery and ownership vehicle for housing and development activity has become increasingly popular in recent years due to:

- Councils seeking alternative sources of income in the face of budgetary pressures.
- Political pressure to build new houses due to an acknowledged shortage of housing.
- Access to good quality housing becoming recognised as an important driver of the labour market which in turn drives economic growth.

From what we are aware of, companies have already been established in Newham, Broxbourne, Sheffield, Greenwich, Ashford, Ealing, Wokingham, South Cambridgeshire and Enfield. Shepway, Tendrige, Thurrock, Mansfield, Southwark and Hounslow are examples of Councils that are currently making plans to develop a similar vehicle. This list is not exhaustive and a recent article in the LGA stated that there are around 26 such vehicles already set up.

Newham Council

Newham Council launched its new company, Red Door Ventures, in April this year, with plans to build 3,000 new homes and acquire a further 500 homes.

Broxbourne

Broxbourne Borough Council has approved proposals to establish a new company to develop housing for market rent. The new company, Badger BC Investments, will secure a loan of £5 million from the Council’s capital budget over 4 years to acquire land to build new homes, charging a rate of 5% interest on the loan.

Sheffield Housing Company

The Sheffield Housing Company is a partnership between Sheffield City Council, Keepmoat Ltd., and Great Places Housing Group. The company has plans to build 2,300 new homes over 15 years. The initial phase of development has started, with some homes already sold and occupied. The second phase has also now started.

Current press around housing and councils

There have been a number of reports published that encourage Council involvement in their local housing market.

The Elphicke-House report, published in January 2015, is supportive of Councils taking a more active role in housing development, using their own assets and knowledge to unlock housing opportunities to increase the housing supply.

The Montague Plan, published in August 2012, makes a series of recommendations including a suggestion that councils use flexibilities in the planning system to plan for and enable developments of privately rented homes where they can meet local need.
2.6 Market analysis

A Strategic Housing Market Assessment was carried out in 2014. The Strategic Housing Market area covers the whole of Leicester and Leicestershire and the Assessment was commissioned jointly by the 7 district and 1 unitary council in this area. Evidence for the projected housing need was modelled for 2 periods: up to 2026 and up to 2031, using the latest population data on household formation rates.

The need identified in the SHMA for Hinckley and Bosworth Borough Council is:

To 2031, between 375 and 450 dwellings per annum

The lower figure would meet the demographic projections, whilst the higher figure would support stronger delivery of both market and affordable housing and support proportionate economic growth.

**Market Housing**

The mix of property types for market housing is broadly similar across the HMA and for Hinckley and Bosworth is suggested as:

<table>
<thead>
<tr>
<th>Bedroom Type</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 bedroom</td>
<td>5 - 10%</td>
</tr>
<tr>
<td>2 bedrooms</td>
<td>40 - 45%</td>
</tr>
<tr>
<td>3 bedrooms</td>
<td>40 - 45%</td>
</tr>
<tr>
<td>4+ bedrooms</td>
<td>5 - 10%</td>
</tr>
</tbody>
</table>

The expectation is therefore that for the focus of new market housing provision to be on 2 and 3 bedroomed properties.

Evidence shows there is a large number of older people under-occupying market housing, and that specialist accommodation for older people is concentrated in the affordable housing sector. The SHMA therefore identifies a need for bungalows as a way of meeting the needs of the ageing population.

**Affordable Housing**

Modelling for affordable housing need took into account an estimate of newly forming households in need and existing households falling into need over the plan period. It assesses the shortfall in affordable housing assuming all of those in housing need are housed in affordable homes. These assumptions lead to a projection of 66% of all housing needing to be affordable in order to meet the need up to 2026, or 69% up to 2031. It is for each local authority to set affordable housing policy at a level that is achievable taking into account other factors such as site viability, and the level at which such need can be met through other routes such as the private housing sector.

The mix of property types for affordable housing differs from the market housing projection and is concentrated on smaller property types. The suggested mix for Hinckley and Bosworth is:

<table>
<thead>
<tr>
<th>Bedroom Type</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 bedroom</td>
<td>35 - 40%</td>
</tr>
<tr>
<td>2 bedrooms</td>
<td>30 - 35%</td>
</tr>
<tr>
<td>3 bedrooms</td>
<td>20 - 25%</td>
</tr>
<tr>
<td>4+ bedrooms</td>
<td>5 - 10%</td>
</tr>
</tbody>
</table>

Affordable housing consists of social rented, affordable rented and intermediate housing. It is suggested that as the company is to operate for commercial profit that the minimum percentage of 20% be applied for affordable housing.
3 Overview of Development Sites

3.1 Overview of Sites

The information below is based on the involvement of the Council in each of the identified sites. Further detail on procurement/development etc. is provided in the Business Plan for the Company.

<table>
<thead>
<tr>
<th>Ownership</th>
<th>Middlefield Lane (Former Depot Site)</th>
<th>Middlefield Place</th>
<th>Trinity Lane (Current Leisure Centre Site)</th>
<th>Middlefield Quarter</th>
<th>Sketchley Brook</th>
</tr>
</thead>
<tbody>
<tr>
<td>HBBC (HRA)</td>
<td>HBBC (General Fund)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Site Size</td>
<td>1.4 hectares</td>
<td>1.2 hectares</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Potential number of homes</td>
<td>45</td>
<td>55</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ownership</td>
<td>Freehold (HRA Land)</td>
<td>Freehold (General Fund Land)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sale position</td>
<td>To be sold to Company</td>
<td>To be sold to Company</td>
<td>To be sold to Company</td>
<td>To be purchased by Company</td>
<td>To be purchased by Company</td>
</tr>
<tr>
<td>Market Value</td>
<td>£1.6 million</td>
<td>£1.8 million</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost of development</td>
<td>7.5m</td>
<td>8m</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total financing required from Council</td>
<td>£7.5m</td>
<td>£8m</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
4 Setting up the new housing company

Summary

- The set up of the Company has been managed by the Council
- Ongoing governance arrangements will be put in place to ensure the effective operation of the Company
- The Council has and will continue to consider the legal implications of operating this company, in particular around structuring and State Aid issues.
- The Council has taken tax advice, in particular around SDLT and VAT issues, and will ensure that the Council and Company will continue to be ensure compliance with tax legislation. The application of tax in the financial model reflects the advice received.

4.1 Set up of the Company

Initial set up of the Company has been managed by the Council and has involved the following key tasks:

- Gaining relevant approvals from Council for set up
- Obtaining legal and tax advice where required
- Set up of the Company, including incorporation with Companies House
- Registering the Company for tax purposes, upon commencement of operations
- Setting up bank accounts for the Company
- Acquiring insurance for directors
- Setting up internal governance arrangements

4.2 Internal Governance

A Council Project Board has been established during the formation of the Company with the following Terms of Reference:

Purpose

The purpose of the Local Housing Company Project Board (the Board) is to support the set up and subsequent delivery of a Local Housing Company for delivery of market for the delivery of market rented housing for rent/sale.

Vision

The vision of the Board is to deliver housing in order to meet the following objectives.

- To meet local housing need in Hinckley
- To allow the Council to act as a key player in housing provision in the Borough and potentially further afield
- To facilitate wider stimulation of the economy through delivery of more housing
- To provide a more commercial dimension to the Council’s delivery model
- To maximise the benefits of the Council’s borrowing power and access to cheap finance

All of the above objectives were approved by Council in a report on this subject matter on 17th March 2015.

Role and Objectives

The role and objectives of the Local Housing Company Project Board are:

- To provide support in the set up and subsequent delivery of a Local Housing Company
- To oversee the sourcing of specialist assistance (e.g. tax and legal advice) to support set up and delivery of the Company
- To support the procurement and appointment of any private sector development partner
To identify and maximise financial resource (e.g. internal reserves and borrowing opportunities) to invest into the delivery mechanism
To provide guidance to the company on the wider housing market in order to ensure the most effective product
To identify further opportunities for expansion of the Company
To be responsible for the effective management of the Project in accordance with the Council’s Project Management Framework
Report on progress quarterly to SLB/COB and member committees as required

Role of the Board Members

The role of the individual members of the Board includes:

- Understand the strategic objectives, implications and outcomes of initiatives being pursued
- Understand the risk appetite of the Board and what level of risk is not acceptable
- Appreciate the significance of the objectives for all major stakeholders
- Be an advocate for and committed to the agreed outcomes
- Bring specialist knowledge to the Board, whilst at the same time taking collective responsibility for the outcomes
- Provide effective and appropriate challenge to delivery to ensure assurance is gained
- Alert the board to initiatives and opportunities coming forward to assist in the delivery of the programme such as new government initiatives

Frequency of Meetings

The Board shall meet quarterly and in line with the agreed meeting schedule.

The frequency of meetings may need to increase during key periods of the Project or when issues arise.

Agenda Items

All agenda items must be forwarded to the project manager by close of business five (5) working days prior to the next scheduled meeting.

The agenda, with attached meeting papers will be distributed at least two (2) working days prior to the next scheduled meeting.

The minutes of each meeting will be recorded and distributed by the project manager within five (5) working days of the meeting.

4.3 Legal implications

Structuring Considerations

The council has sought legal advice on establishing a local housing delivery vehicle to provide a mix of housing provision predominantly market rent and market sale units with the potential for delivery of a limited number of affordable housing units. The rationale for this is identified as:

- To make a profit
- To access a revenue stream to supplement general fund income
- To “commercialise” service delivery
- To access general fund borrowing headroom
- To complement HRA development which will continue
- To assist in meeting housing need in the area by offering a different housing product to that offered by the Council traditionally

The Council has the power to establish a wholly owned company through the general power of competence under s. 1 Localism Act 2011, which allows the Council to do anything that a private individual can do (subject to restrictions in any pre-existing legislation). This includes the carrying out of commercial activities and includes the development of housing for market rent through a company.
This would allow the Council to provide housing, particularly where it differs from the Council’s HRA general need housing through a local housing delivery vehicle. It is not the intention to use the local housing delivery vehicle to provide general needs housing at social rent levels. Given that the rationale is a “commercial purpose”, then the only way this can be achieved is through a company. Thus creating a local housing delivery vehicle would achieve this ambition.

**Structuring Options**

Given the aim is for a profit making vehicle, this can be achieved in three ways:

a) Company limited by shares 

b) Company limited by guarantee 

c) Limited liability partnership 

Consideration was given to a Community Benefit Society model, but this would be inappropriate given the Council’s obvious focus on “profit” distribution. A Limited Liability Partnership was also considered, however the company exception for “commercial purposes” for the use of the general power of competence under s. 1 explained above, simply doesn’t apply to such a partnership. Therefore the Council is left with two choices: Company limited by shares or Company limited by guarantee. The preferred option is the former, a company limited by shares. The reason for this is the advantageous stamp duty land tax position. Such land tax can be avoided on the land value of any transfer. This is because a wholly owned company (where 75% or more of the paid up shares are owned by the transferor) has the potential to benefit from group relief Stamp Duty Land Tax. Furthermore, the commercial flexibility means the company can be sold through its shares and without property transfer complications.

Council approval was given on the 17th March 2015 to create a wholly owned company by the Council limited by shares, to build houses for sale and rent.

**Governance arrangements**

As a wholly owned company, the sole shareholder will be the Council. The company will operate through a Board of Directors, who will be making the strategic decisions.

Members will be able to hold the Board of Directors to account through the Council’s Scrutiny function. This will be an important role for the Members who will be overseeing the business case, business plans, checking on performance and deliverables via regular reports of the Board to Scrutiny commission.

**State Aid**

The Council has given serious consideration to the question of State Aid and has sought specific legal advice on this point.

State Aid is where a public body provides financial or tax-payer funded resource support or assistance to one or more organisations thereby conferring an advantage or has the potential to distort competition.

The factors considered:

- What assistance is being given to the company by the Council?
- Does the assistance confer an advantage to one or more organisations?
- Does the assistance distort or have the potential to distort competition?
- Does the assistance affect trade between EU member states?

To ensure “state aid” is avoided the Council considered the above factors. The assistance afforded to the company by the Council is the transfer of land from the Council to the company. In order to avoid a state aid issue, the transfer will be at market value.

Consideration has been given to the following which can be seen as advantages. The table below shows how these perceived advantages are to be mitigated:
### Potential advantage

| The rate at which money is loaned to the Company should not place it in a better position than private competitors | A market rate will be charged for loans to the Company. |
| The return to shareholders, (i.e. the Council) will need to be considered, and should reflect what a private shareholder would expect from the Company | Current expected rate of return excluding margin on services provided and interest spread is [xx]% on investment. |
| If Council staff are to undertake work on behalf of the company, a contract for loaning the staff should be drawn up | Resourcing arrangements between Company and Council will be administered through formal resourcing or procurement contracts. Work performed by Council staff will be charged at commercial rates with a 10 to 17% % mark-up. |
| If Council buildings are to be used for office space, the Company will be deemed as a tenant to the Council and they should pay rent at market rate | Council may seek further legal advice in the future and seek independent valuation advice as to the rent |
| Council is planning to transfer land from the HRA to the Company | Market value will be paid for the land |

In relation to the competition point, the company will be acting as a private company, a separate legal entity from the Council and will be treated as such. The company cannot and will not benefit from a preferential borrowing rate from the Council, but rather at the appropriate fiscal market rate. Any Council resources used by the company (particularly staff) will be covered by properly constructed contractual arrangements at the current market values.

The articles and memorandum of association will be covered by the Companies Act 2006.

All Directors are personally liable for certain functions of the company; and to this end each Director has received a note advising on their collective and personal responsibilities and liabilities.

## 4.4 Financing

The Council will provide all initial financing to the Company, either in the form of equity or debt (including a working capital facility).

**Equity**

The current structure is for the Company to be wholly owned by the Council, i.e. the Council will be the sole equity provider of the Company.

- The Council will receive returns in the form of dividends, at levels which will reflect what a private shareholder would expect from the Company.
- Should the Company seek an external equity provider in the future, the Council’s control will reduce.
- Equity funding is riskier, if the Company defaults, the equity providers will be the last to get their money back.

**Debt**

The Council will provide financing to the Company, through borrowing at the most competitive rates available from the Public Works Loan Board (PWLB), LGA Consortium or/and the private sector e.g pension funds. The cost of financing to the Company will be a market rate to avoid State Aid implications. It is intended that debt funding will finance the majority of the acquisition and development of the housing units during the construction phase.

**Working capital facility**

The Company will have access to a short term working capital facility provided by the Council to fund any shortfalls. The working capital facility will incurs interest and will be paid down when the Company has available funds, without a fixed repayment profile.
Detailed Funding & Operational relationship between Company & Council

<table>
<thead>
<tr>
<th>Type of loan</th>
<th>Assumed PWLB rates</th>
<th>Interest charged to the Company</th>
<th>Margin spread earned by the Council</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short term loans</td>
<td>1.45%</td>
<td>6%</td>
<td>4.55%</td>
</tr>
<tr>
<td>Long term loans</td>
<td>3.56%</td>
<td>7.50</td>
<td>3.94%</td>
</tr>
</tbody>
</table>

* Assumed company will become self-funding or borrow on open market
** Company will be more reliant on working capital funding from the Council
*** Assumed dividend level equivalent to marginal value of 15 properties
The two different loan facilities are intended to match the two distinct activities of the Company - the 3 year loan for the development phase (specifically sale units), and the long term loan (or evergreen loan) for the operation / investment phase (specifically rental units).

Proceeds from the sales units (affordable housing and market sales) will be used to pay off the full principal of the short-term loan within 3 years. This means the Company should have sold off all properties intended for sale within 3 years to ensure there are sufficient funds to repay the principal.

The evergreen loan reflects the expected long term nature of the Company’s rental business. The interest rate of 7.50% ensures that the Council receives an interest margin from lending to the Company, whilst ensuring the Company is able to meet its repayments. An evergreen loan does not require the principal to be repaid within a specified period of time, the expectation is that the loan will be repaid once the rental units are sold.

The form of investment into the Company must be made at a market rate to avoid potential State Aid issues. The Company must also have sufficient equity held to avoid transfer pricing issues (i.e. interest on loans being disallowable for tax deductions). This means that some of the profits of the Company will be subject to Corporation Tax.

Should there be any short term funding shortfalls; the Council will provide the Company with a working capital facility in order to fund this shortfall. Current financial projections estimate a working capital facility of £1m to £3m is expected to be drawn down in the first three years of trading as lifecycle costs increase, and projected to be fully repaid in the following year.

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- For Phase 1, 3 sites are planned for development: Middlefield Lane, Middlefield Place and Trinity Lane. These sites will be sold by the Council to the Company at market value.
- For Phase 2, 2 further sites are planned for development: Middlefield Quarter and Sketchley Brook. Funding will be provided from the Council to the Company to purchase these sites. This funding will be structure; 20% Equity and 80% Debt.
- Currently it is expected that **110 to 120 units will be developed** across these sites; 88 to 96 units for maket rent and 22 to 24 affordable housing units for resale.
- Additional units may be directly acquired for market rent in order to generate immediate revenue returns.

Funding: For the first 2 phases i.e. development of Middlefield Lane, Middlefield Place and Trinity Lane, it is estimated that the following funding will be required by the company:

- **Middlefield Lane and Place**: £9m
  This includes land purchase, cost of construction, transport infrastructure, public realm works and all other development costs
- **Trinity Lane**: £8m
  This includes land purchase, cost of construction, transport infrastructure, public realm works and all other development costs.

- The total cost of the first two Phases will be structured as 20% equity funding, i.e. £3.4m and 80% Loan i.e. £13.6m.
- The Council will borrow at the most beneficial rates from PWLB, LGA Consortium and the private sector e.g pension funds.
- Any working capital requirement will be provided on a rolling agreement basis with interest charged on the outstanding amount at open market rates

The Council is aware that its roles as equity provider and debt lender have conflicting interests. As an equity provider, the Council would expect the Company to be profitable and remain solvent. As debt lender, the Council will want to ensure debt (including interest) is repaid on time, without any delays or defaults. The Council will seek legal advice upon establishment of the Company to draft a document / agreement that formalises and clearly distinguishes the Council’s roles as equity provider and debt lender.
4.5 Resource Requirements

The Council has identified the following roles required at the establishment of the Company:

- **A Board of Directors** will be responsible for key strategic decisions of the Company. Across the Board, members should have a breadth of experience in the housing sector in the local area and in managing a private company.

- **Company Executives** to perform day to day operations.

The structure and make-up of the Board is at the discretion of the Council, as the sole shareholder. It is however important that the Board members hold the necessary skills and expertise to discharge their responsibilities and run the company. It is also important that the Board of Directors act completely independently from the Council and therefore have no elected member representation. As agreed by Council and the Chief Executive, the following Council officers have been appointed as Directors of the Company:

- Deputy Chief Executive (Corporate Direction)
- Chief Officer (Housing, Community Safety & Partnerships)
- Estates and Asset Manager

In addition to the above, the Board will also appoint two non-executive directors (NEDs) to the Board in due course. Both roles will be advertised externally to ensure they have the appropriate experience and insight to develop the company further.

Following the advice of the Council’s lawyers, it is not proposed that any elected members be appointed as Executive Directors to the Board. Instead it was agreed that one member from the Executive will act as a non-Executive Director and the company will be held to account through the Council’s Scrutiny function and by the Executive of the Council. Regular reports will therefore be presented to the Scrutiny Commission and the Executive by the Directors with an end of year report to full Council.

As with many newly formed Council owned companies, the Council may not have the capacity or sufficient in-house expertise to undertake the development of housing. As such, the Company may procure outside services on an “as and when necessary” basis.

4.6 Tax Position

As part of the planning for the set-up of the Company, the Council has obtained independent tax advice from KMPG to inform the operation and business planning of the Company’s operations. A high level summary of the advice provided has been detailed below:

**Corporation tax**

The Council, as a local authority, is not subject to corporation tax. Consequently, if this regeneration and rental activity were carried out by the Council, any income received would not be taxable in the hands of the Council. A wholly owned subsidiary company of the Council however, is not covered by this corporation tax exemption and will therefore be chargeable to corporation tax (currently 20%) on any profits generated.

The Company will be treated for corporation tax purposes as having a property rental business with income primarily from rents, which will be liable to corporation tax. A number of factors will be taken into account in calculating the taxable profits of the Company. Certain deductions will be allowable, whilst other costs will not be deductible in reaching the taxable profit.

Corporation tax will also be due on any profits/gains on future sales of the developed properties. Should the Company acquire land (be that from the Council or third parties) with the intention of developing properties for sale, then the Company will be treated as having a trade that is separate from its rental business and there will be some differences in the corporation tax treatment, particularly in relation to the utilisation of losses. The tax rules around loss relief are complex however, broadly, property rental business losses may be utilised against any other profits (including
capital gains) in the current period, and where unutilised, they are carried forward for use against any 
profits in future periods. Ordinary trading losses however, may be utilised against any profits in the 
current period, however losses carried back to the preceding 12 month period, or carried forward may 
only be utilised against profits from the same trade.

Depending on the investment strategy, the funding structure provided by the Council will determine 
the deductions that can be taken in the Company when calculating its corporation tax liability. Should 
the Council invest through equity, distributions made by the Company to the Council would not be 
deductible in calculating the taxable profits of the Company. Funding through loans on the other hand 
would allow the Company to deduct interest payments from their profits. However, in order to secure a 
tax deduction in the Company for interest payments, it is important that any loan funding provided by 
the Council to the Company is on arm’s length terms. More detailed work is required to determine the 
appropriate arm’s length interest rate and loan amount. We understand that the Council has taken 
legal advice on this matter.

Any equity distribution or interest paid to the Council would not be taxable as income due to the 
Council’s exemption from corporation tax.

VAT

The Company will have a limited ability to recover the VAT it incurs at either the standard rate of 20% 
or possibly at the reduced rate of 5%, as it will be making VAT exempt supplies. If the land transferred 
to the Company is for a payment or non-monetary consideration, the Company will need to establish 
whether the Council has opted to tax the land that it will be transferring to the Company. If the land is 
to be gifted or transferred for a £1 or peppercorn the Company will not incur VAT on the acquisition of 
the land.

The Council may wish to opt to tax the land, in the event that the land does transfer for a 
consideration, if it wants to protect its partial exemption de minimis limit. The Council may need to do 
this if it has incurred a significant amount of VAT in respect of the acquisition or development of the 
land (such as demolition costs or professional fees).

If the Council decides to transfer the land to the Company for a consideration then, if the Council has 
also opted to tax the land, it will need to charge VAT at the standard rate to the Company. This VAT 
will represent an additional cost to the Company as its primary supplies will be the exempt letting of 
residential property.

VAT on the land acquisition and other costs for the Company such as the construction of new homes 
can be mitigated in certain circumstances, see below. If the Council will be providing staff to the 
Company the VAT treatment will need to be considered as this could represent an additional VAT cost 
to the Company.

As the Company will be developing new housing it may want to consider setting up a separate 
company in order to remove the potential additional cost of VAT incurred on professional fees, 
including, potentially, VAT incurred on the land if the Council opts to tax, in the construction of the new 
housing. This VAT cost arises where the Company intends to let out some or all of the housing. It is 
likely that the most straightforward approach would be for the Company to set up a separate 
subsidiary that will be the property letting Company and this will carry out the letting of the housing. 
There are alternative structures that could also be considered.

Stamp duty land tax ("SDLT")

The acquisition of land by the Company will prima facie be subject to SDLT (most likely at 4%). The 
initial sites acquired from the Council will be deemed to take place at market price (even though it’s 
gifted to the Company). SDLT would be chargeable on this transfer but as it would be an intra-group 
transfer, the Company may be able to make an SDLT group relief claim to HMRC if the Council 
qualifies as a “body corporate”. We will need you to confirm this with your lawyers. There are also 
complex tax avoidance rules that could apply to group relief claims. It would be sensible to look at 
each purchase individually and obtain advice where necessary.
On other acquisitions, the Company may be able to benefit from multiple dwellings relief (“MDR”) to reduce the applicable rate if the site acquired comprises of existing residential properties. Further advice will be sought if and when multiple dwellings are acquired to establish if MDR will apply and whether it would be beneficial for the company to make a claim for relief.

5. Risk and Governance

5.1 Risk Analyses

Summary

- The Council has considered the potential risks associated with setting up the Company, and identified ways to mitigate these risks, which span across both the development and operating phases, as well as other non-phase related risks such as financial and legislation risk.
- The Company will maintain a risk register and discuss any risk issues in meetings with the Board of Directors.
- The Company will practise good governance, ensuring the right reporting structures and monitoring regimes are in place, in the best interests for the Council, as the owner, funder, operator, and service provide of the Company.

a) Risk analysis

A risk register will be maintained and discussed in meetings with the Board of Directors. Company management will be responsible for risk management, risk reporting and ensuring regular reporting to the Board.

<table>
<thead>
<tr>
<th>Risk</th>
<th>Role</th>
<th>Consideration</th>
<th>Mitigants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Development</td>
<td>Design</td>
<td>Risk the designs do not pass planning requirements.</td>
<td>Pre-application Planning advice to be sought prior to schemes being included in works programme. Key sites already hold planning brief for residential development</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Risk of appointing low standard architects or overpaying architects for services.</td>
<td>The Council will procure a design and build contract ensure as part of tender evaluation that appropriately qualified architects are employed on any contracts.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Risk of inappropriately designed houses for the current target market.</td>
<td>Properties built by the Company will be flexible depending on tenants Advice will be taken from local agents etc to ensure that spec submitted by developers is fit for purpose</td>
</tr>
<tr>
<td>Development</td>
<td>Planning</td>
<td>There is a reputational risk of the Company not obtaining planning permission from the Council or planning permission not being obtained on a timely basis</td>
<td>Pre-application planning advice will be sought. The decision to grant planning permission will sit with the planning committee. Ensure that all steps are taken to ensure planning permission is granted in advance of intended start date of construction.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Insufficient community facilities (such as pharmacies, schooling) may undermine demand or social</td>
<td>The Council should consider if additional housing gives rise to additional demand for other infrastructure in the area. This should</td>
</tr>
<tr>
<td>Risk</td>
<td>Role</td>
<td>Consideration</td>
<td>Mitigants</td>
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</tr>
<tr>
<td></td>
<td></td>
<td>objectives.</td>
<td>be considered in terms of a wider community plan.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Risk of unforeseen ground/site conditions which may delay demolition or construction.</td>
<td>Ground investigation work will take place prior to tender process</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>A site conditions report will be provided with ground report in tender documentation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Construction price risk may cause construction costs to be much higher than anticipated – impacting the profitability and cash flow requirements of the vehicle</td>
<td>Ensure there is a buffer/contingency available in business plan to cover any overall price increases.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Services/utilities are unavailable or lack capacity</td>
<td>Utilities enquiries will be undertaken to ensure availability and capacity</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Specifics regarding legal title may adversely affect development costs and timescales</td>
<td>Council legal team will be requested to perform an early title review for all sites proposed in the development</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Risk in overpaying in the procurement process</td>
<td>The Council will use experiece of in house procurement and legal officers, outsourcing where necessary to ensure contracts are robust</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Defective design and/or construction causes delays and additional costs</td>
<td>Appropriate warranties/performance bonds will be written into contracts</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Construction costs are higher than estimated</td>
<td>Post letting of contracts effective contract management processes will be put in place</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Insolvency of contractor</td>
<td>Financial checks performed as part of procurement process and guarantees taken out where required</td>
</tr>
<tr>
<td></td>
<td>Sale/rent</td>
<td>Estimated sale price may not be achieved – risk of housing prices falling in the future</td>
<td>Undertake sensitivity analysis to assess impact of demand changes on the Company’s accounts.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Risk that the Council does not have the time or expertise to run a sales/rental process</td>
<td>Use of an estates agent to market properties. They will have relevant expertise</td>
</tr>
<tr>
<td>Operating</td>
<td>Sale/rent</td>
<td>Inability to find tenants and/or sell properties leading to loss of income and delay in Company repaying debt – potential risks to Council in repaying debt</td>
<td>Use of an estates agent to market properties. They will have relevant expertise Any short term funding arrangements should be arranged over a longer time period then needed to allow for any lags. The Council may wish to consider constraints on debt service ratios such that there is an equity buffer.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Failure to comply with rental deposit scheme requirements</td>
<td>Suitable procedures will be put in place to ensure that the necessary notification requirements are procided to tenants in a timely fashion</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Failure to collect rent</td>
<td>The rent collection will be managed by the Council who have experience in collection of commercial and residential rents. Debt</td>
</tr>
<tr>
<td>Risk</td>
<td>Role</td>
<td>Consideration</td>
<td>Mitigants</td>
</tr>
<tr>
<td>------------</td>
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<td>-------------------------------------------------------------------------------</td>
<td>----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>Risk of overpaying for housing units.</strong></td>
<td>Using a real estate specialist/valuer can ensure the right properties are purchased at the right price.</td>
</tr>
<tr>
<td>Purchase of</td>
<td>Risk of unexpected delays with</td>
<td>Assumed timescales for completing the purchase of unit/s will be based on past</td>
<td></td>
</tr>
<tr>
<td>units</td>
<td>completion of the purchase.</td>
<td></td>
<td>experience of the Council/Company.</td>
</tr>
<tr>
<td>Capacity &amp;</td>
<td><strong>The Council is unable to support</strong></td>
<td><strong>The Board will agree a governance and management arrangement which provides</strong></td>
<td>A managing director will be hired to the Company to ensure effective support to day to day operations</td>
</tr>
<tr>
<td>Capability</td>
<td><strong>the overall management of the</strong></td>
<td><strong>for strong governance and a good interface</strong></td>
<td>In the implementation stage, a Project Board has been set up within the Council to ensure that all areas are considered</td>
</tr>
<tr>
<td></td>
<td><strong>Company</strong></td>
<td><strong>with Council governance</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>The Council has inadequate</strong></td>
<td><strong>The Council currently deems it has sufficient</strong></td>
<td>The Council will recruit an external managing director to the Company to support procurement and management of developers. The Job Description for this post will require prior development experience</td>
</tr>
<tr>
<td>Operating</td>
<td><strong>housing and legal resource to</strong></td>
<td><strong>resource and expertise to provide this support in finance. Legal requirements</strong></td>
<td>A design and build contract will be procured to transfer development risk to the contractor.</td>
</tr>
<tr>
<td></td>
<td><strong>support the day to day</strong></td>
<td><strong>are more specialist and therefore external advice will be procured where required</strong></td>
<td>The Council already operates management and maintenance services to own Council stock and therefore is deemed to have adequate resource and expertise.</td>
</tr>
<tr>
<td></td>
<td><strong>administration and management of</strong></td>
<td></td>
<td>An SLA will be put in place to cover roles and responsibilities</td>
</tr>
<tr>
<td></td>
<td><strong>the Company</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maintenance</td>
<td>Risk of insufficient maintenance/insurance spend</td>
<td>Lifecycle costing has been built into the Business Plan and should be reviewed</td>
<td>The use of Integrator (system currently used for stock condition of HRA properties) will be rolled out to the Company properties to ensure adequate ongoing investment</td>
</tr>
<tr>
<td></td>
<td><strong>The sites and buildings should be</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>kept in good condition to attract</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>future tenants and minimise</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>maintenance spend.</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Tenant damage leading to</strong></td>
<td></td>
<td>Recharge policies and rental deposits will mitigate against the risk</td>
</tr>
<tr>
<td>Risk</td>
<td>Role</td>
<td>Consideration</td>
<td>Mitigants</td>
</tr>
<tr>
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<td>-------------------------------------------------------------------------------</td>
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</tr>
<tr>
<td></td>
<td></td>
<td>A prudent void loss % has been included in the Business Plan</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Damage to dwellings are caused by commercial risks</td>
<td>The Company can take out material damage insurance and loss of rent insurance. The Company will still be exposed to uninsured excesses</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Failure to carry out undertake gas, electrical and fire safety checks</td>
<td>The Company will institute an inspection regime similar to that used in current owned HRA properties</td>
</tr>
<tr>
<td></td>
<td>Governance</td>
<td>Failure to source appropriate Directors to Board</td>
<td>Governance structure has been considered and approved by Council. Initial interest in non-executive director roles has been high</td>
</tr>
<tr>
<td></td>
<td></td>
<td>The Council’s constitution may not permit set up of a Company</td>
<td>Council approved obtained</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Conflicts of interest may arise between the Council and the Company due to involvement of officers</td>
<td>Legal advice has been provided to all Directors on their roles and responsibilities with regards to conflicts of interest</td>
</tr>
<tr>
<td>Financial</td>
<td>Financial</td>
<td>Treatment of Company financials may be challenged</td>
<td>External advice has been sought on financial/tax treatment of Company. Early sign off will be sought from both the Council and Company auditors of treatment</td>
</tr>
<tr>
<td>Financial</td>
<td>Financial</td>
<td>The Company may not meet forecasts and therefore may not be able to service debt or pay forecast dividends. There may be low or negative returns on investment. If the Company is unable to service it's debt it will result greater exposure in the Council's balance sheet. The Council will still be liable to pay the PWLB interest rates</td>
<td>Regular budget monitoring will be carried out and reports taken to the Board and the Scrutiny Commission. The Council will ensure that adequate reserves are in place to plan for any foreseen issues with loan repayments</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Change in inflation rates which may not fully be passed on to tenants (risk of rental inflation lagging behind cost inflation).</td>
<td>The Company could raise rents in line with market rate. Market research should be undertaken to establish rate of increase in rental payments and if this differs between tenures Undertake sensitivity analysis to assess impact on the Company’s accounts if rates cannot rise in line with inflation in cost base.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Risk that the Company will not be able to secure financing.</td>
<td>The Council will loan to the Company and will have sufficient funds to loan to even if funding requirement increases. The Council will provide a working capital facility to fund unforeseen short term deficits</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Changes in base tax rates and capital allowances</td>
<td>Undertake sensitivity assessment to assess the impact on the Council’s accounts.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>The Company does not have the resource and expertise to understand tax implications</td>
<td>External tax advisors have been sourced to support Company</td>
</tr>
<tr>
<td></td>
<td></td>
<td>The Council is unable to provide</td>
<td>The Council is generally able to borrow</td>
</tr>
</tbody>
</table>
### Risk | Role | Consideration | Mitigants
---|---|---|---
--- | --- | --- | ---
--- | --- | --- | ---
--- | --- | --- | ---
--- | --- | --- | ---
--- | --- | --- | ---
--- | --- | --- | ---
--- | --- | --- | ---
--- | --- | --- | ---
--- | --- | --- | ---
--- | --- | --- | ---
--- | --- | --- | ---

**Legal**

<table>
<thead>
<tr>
<th>Risk</th>
<th>Role</th>
<th>Consideration</th>
<th>Mitigants</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Legal</td>
<td>The Council is acting outside of its powers (ultra vires) in establishing the Company or delivering its operations.</td>
<td>Legal advice has been taken. Powers to invest and/or undertake commercial activity have been established.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>State Aid with regards to the structure of the loan and land transfer arrangements – A challenge could be made by the European Commission</td>
<td>Legal advice has been taken. Land will be sold at market value to the Company and a loan provided at commercial rates to mitigate any risk of State Aid</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Relevant consents cannot be gained for transfer of land</td>
<td>Legal advice has been sought and consents understood. Any requirement to apply to Secretary of State will be planned early</td>
</tr>
</tbody>
</table>

**Political**

<table>
<thead>
<tr>
<th>Risk</th>
<th>Role</th>
<th>Consideration</th>
<th>Mitigants</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Political</td>
<td>Change in government policy</td>
<td>Currently there is a commitment to housing development as part of the UK Growth Strategy</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Lack of support from Council</td>
<td>Early and ongoing conversations have been held to ensure support from Council</td>
</tr>
</tbody>
</table>

### 5.2 Governance Arrangements

To ensure the risks identified in Section 5.1 are managed and monitored, the Council should establish appropriate governance arrangements and a corporate reporting framework for the Company.

**Key principles**

The Council and the Company will enter into a Shareholder’s Agreement. This is designed to ensure the Company complies with good private sector governance practice.

Given the scale and complexity of the business proposal, specialist legal advice has been commissioned to provide Articles of Association which have been agreed by Council. These include the ability to appoint and dismiss board directors. The Board will have to approve plans for the future of the business.

The duties and responsibilities of directors are governed by Company Law. This outlines a number of responsibilities that we be outlined to directors on appointment:

<table>
<thead>
<tr>
<th>Duties - Companies Act 2006</th>
<th>Practical duties</th>
</tr>
</thead>
<tbody>
<tr>
<td>Duty to act with powers</td>
<td>Ensure that company business plan is delivered</td>
</tr>
<tr>
<td>Duty to promote the success of the company</td>
<td>Submission of the annual return to Companies House</td>
</tr>
<tr>
<td>Duty to exercise judgement</td>
<td>Production and submission of annual accounts to Companies House and HMRC. Arrangement of the annual audit of accounts</td>
</tr>
<tr>
<td>Duty to exercise reasonable care, skill and diligence</td>
<td>Notification of any changes in the company’s officers or personal interests</td>
</tr>
<tr>
<td>Duty to avoid conflicts of interest</td>
<td>Notification of a change to the companies registered address</td>
</tr>
<tr>
<td>Duty not to accept benefits from third parties</td>
<td>Allotment of shares</td>
</tr>
<tr>
<td>Duty to declare interest in proposed transaction or arrangement</td>
<td>Registration of charges</td>
</tr>
</tbody>
</table>
The Company’s accounts will be independently audited on an annual basis prior to presentation to the shareholder (the Council).

Members of the Board will hold delegated authority for various activities as will certain key staff. The Board will be responsible for key strategic decisions of the Company.

Stakeholders

The key stakeholders to the Company are:
- Hinckley & Bosworth Borough Council as owner/funder/operator and service provider
- Contractors employed by the company
- Professional advisors employed by the company
- Communities the company develops within
- Tenants

The Council will enter into separate monitoring regimes for each of its stakeholder roles, by way of contractual agreements with the Company. This will help steer the Company to be able to act independently from the Council, whilst meeting the best interests for the Council.

Reporting structures

The Company will follow convention with periodic board meetings and reporting. The Company will update the Business Plan annually and will set targets and budgets for the following year in the context of the Company’s overarching objectives. The Company will analyse current trading performance compared to previously set budgets and targets in its Annual Shareholder Report to Scrutiny Commission.

Current management information systems will be used to generate periodic accounts for reporting purposes and track the Company’s performance against budget. The proposed reporting structure will encourage this.

The Project Board

The Project Board will sit in the Council and will act as a sounding board to help manage the relationship between the Council and the Company. As the Council is the equity and debt provider, and shares resources, the Project Board will carefully consider all of the Council’s interests when making decisions.

The Board of Directors

The Board of Directors act on behalf of the shareholders (i.e. the Council) in running the business. The Board will look at the Company from a strategic perspective, the initial objectives of the Company will be considered when making decisions. The directors of the Board will provide a report to the Council on the performance of the company, as well as its future plans and strategies at the annual general meeting (AGM).

The Company will appoint 2 independent non-executive directors (NEDs). Independent NEDs should have no association with the Council, and ideally the NEDs should have relevant and adequate experience in the private housing market sector. NEDs offer objectivity and provide valuable industry knowledge which the Company requires, given the relative inexperience of the Council in dealing in the private housing market.

The Council will ultimately make the final decision whether to appoint non-executive directors (NEDs) or not.
6. Business development strategy

<table>
<thead>
<tr>
<th>Summary</th>
</tr>
</thead>
<tbody>
<tr>
<td>■ In anticipation of further growth opportunities for the Company, the Council has identified three factors the Company will need to consider in the future: increasing housing stock, resourcing requirements, structure of subsidiary.</td>
</tr>
<tr>
<td>■ The Council has then identified potential options for each factor, which will be looked into in further detail when further expansion is considered.</td>
</tr>
</tbody>
</table>

6.1 Expansion

Assuming the Company is successful in delivering Phases 1 - 3, the Company will look to expand and consider the following:

- How and where will the housing stock increase?
- What additional resources will the Company need?
- Should the structure change through mergers or acquisitions?

These considerations are shown below.
Revenue growth methods

The Company could grow through a number of methods – some of which may be more achievable for the Council, such as increasing market penetration within the Borough. However, this is offset by the level of population and housing needs in the local area, and therefore the Company will also consider product diversification and geographic expansion further down the line.

<table>
<thead>
<tr>
<th>Method</th>
<th>Options</th>
<th>Considerations?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase volumes</td>
<td>Market penetration within Borough</td>
<td>Will there still be demand in the Borough?</td>
</tr>
<tr>
<td></td>
<td></td>
<td>The Company will need to continually monitor absorption rates across the local housing market to ensure the supply of new homes to the market is managed effectively, reflecting market demands.</td>
</tr>
<tr>
<td>Geographic expansion outside the Borough</td>
<td>Will the Company be competitive outside the Borough (where it does not have access to Council owned land)?</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>If another Council is developing plans to create a new company and requires expertise, the Company could enter into a Joint Venture agreement with the other Council to develop the houses together.</td>
</tr>
<tr>
<td>Product diversification into other accommodation types or other services</td>
<td>This is different to the Company’s current remit. Would the existing expertise be sufficient to expand into a new product offering?</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>As this is new to the Company it presents a higher risk.</td>
</tr>
</tbody>
</table>

Future resourcing requirements

The Company will consider having the functionality to scale up operations. This will include resourcing the appropriate staff, getting sufficient financing and having adequate reporting systems to enable the Company to grow without critical issues.

<table>
<thead>
<tr>
<th>Resource</th>
<th>Options</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land</td>
<td>In Phase 1 and 2 land within Hinckley &amp; Bosworth will be used. In Phase 3 the Company could acquire other Council owned land or the Company could acquire privately owned land.</td>
</tr>
<tr>
<td>Staff</td>
<td>As the Company expands the need for a commercial director with an understanding of the housing market on the Board will increase. The need for independent non-executive directors may also be greater. Additional staff may be required if expansion occurs</td>
</tr>
<tr>
<td>Financing</td>
<td>The Company may need to seek additional financing, the Company could borrow more money from the Council or potentially take on external debt/equity financing.</td>
</tr>
<tr>
<td>Systems</td>
<td>The current systems leverage of the Council’s existing systems. These may be adequate to support future growth, if not the existing system may need updating or replacing. As operations grow there may be a need for more office space.</td>
</tr>
<tr>
<td>Marketing</td>
<td>An appropriate marketing strategy should be in place for the Company that looks to develop the Council’s brand as a housing provider. It may be cost efficient to have an in-house marketing strategy team, however as the Company expands it may be beneficial to hire a specialist marketing consultant.</td>
</tr>
</tbody>
</table>
Structures

There are three main structures which could underpin future expansion plans for the Company. These are as follows:

- **Organic growth**: Retain existing structure
- **JV/Partnerships**: Enter into a JV or Partnership to provide the company a strategic advantage. The company could enter into a JV with other parties such as a private developer
- **Acquisition**: Purchase a similar company or a company in a related field that would enable both parties to benefit from synergies

The table below assesses the advantages and considerations of each potential structure.

<table>
<thead>
<tr>
<th>Method</th>
<th>Organic growth</th>
<th>JV/Partnerships</th>
<th>Acquisition</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Advantages</strong></td>
<td>Control remains intact.</td>
<td>Access to expertise in other areas without need to buy in.</td>
<td>Control should remain intact</td>
</tr>
<tr>
<td></td>
<td>Culture and objectives remains intact.</td>
<td>Less risk if venture fails. Some risk can be transferred to the partner – each partner should manage risks and have an aligned attitude towards managing risks.</td>
<td>Speed of growth: fast Synergies.</td>
</tr>
<tr>
<td><strong>Considerations</strong></td>
<td>Capital requirements to be able to grow organically.</td>
<td>Control will be diluted. Shared ownership of assets may not be desirable.</td>
<td>Capital requirements for an acquisition might be high. Integration costs.</td>
</tr>
<tr>
<td></td>
<td>May need to source experienced staff (consider contracted or permanent staff).</td>
<td>Culture and objectives could be influenced by partner. Incentives will need to be aligned between partners.</td>
<td>Culture and objectives may differ in company to be acquired – potential culture shock.</td>
</tr>
<tr>
<td></td>
<td>Speed of growth: slow.</td>
<td>Different return requirements between public and private sector. Consider how this will be balanced. If incorrect strategic fit may harm the Company’s brand.</td>
<td>If incorrect strategic fit may harm the Company’s brand.</td>
</tr>
</tbody>
</table>

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