SCRUTINY COMMISSION – 12TH MARCH 2015

HOUSING DEVELOPMENT COMPANY
REPORT OF DEPUTY CHIEF EXECUTIVE (CORPORATE DIRECTION)

Hinckley & Bosworth Borough Council
A Borough to be proud of

WARDS AFFECTED: ALL WARDS

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1. PURPOSE OF REPORT

1.1 To request endorsement from Scrutiny Commission of the set up of Hinckley and Bosworth Development– a company wholly owned by the Council for development of property for sale and rent.

2. RECOMMENDATION

That Scrutiny endorse the following recommendations to be made to Council:

2.1 That a housing development company (the company), wholly owned by the Council is created to build houses for sale and rent as outlined in the report issued by the Council's external legal adviser Trowers and Hamlins LLP (Appendix 1)
2.2 That the name of the company be Hinckley and Bosworth Development Limited
2.3 That the company be incorporated and be limited by shares.
2.4 That approval of the business plan be delegated to the Chief Executive in consultation with the Chief Officer (Finance, Customer Services and Complaince).
2.5 That any loan requirement, as set out in the business plan be repaid to the Council at a market rate of interest
2.6 That agreement of the rate of interest for any loans be delegated to the Chief Executive in consultation with the Chief Officer (Finance, Customer Services and Complaince) depending on market conditions at the time of the transaction
2.7 That the Articles of Association for the company as attached in Appendix 2 be approved
2.8 That members approve the in principal gift at nil value of the land at Middlefield Lane (the former depot site) to the company once incorporated at nil value subject to the prior approval of the Secretary of State being obtained to the disposal and confirmation that no State Aid issues arise as a result of the transfer. A further report will follow on the current leisure centre site.
2.9 That the Prudential Indicators for 2015/2016 be amended to take account of the gift of Middlefield Lane and the loan to the company (i.e. increase of the Authorised Borrowing Limit)
2.10 That delegated authority be approved to the Chief Executive to appoint up to four officers on the Board of Directors for the company
2.11 That a supplementary budget of £100,000 be approved to meet costs associated with the set up of the company. This budget will be financed from the existing Transformation Reserve

3. BACKGROUND TO THE REPORT

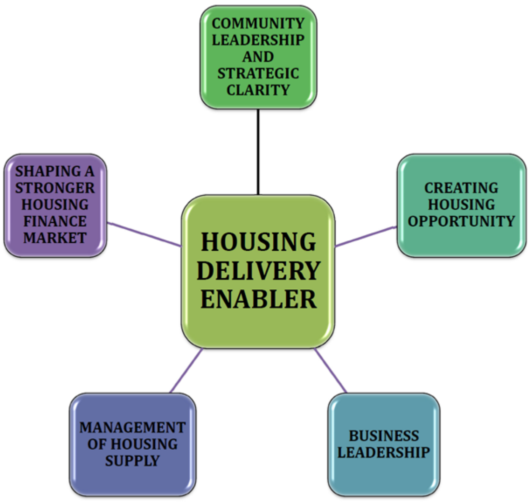
Background

3.1 In November 2011, the Government published "Laying the Foundations: A Housing Strategy for England", which set out the Government's actions to address the housing shortage, boost the economy, create jobs, and give people the opportunity to get on the housing ladder. Within the document the following issues were highlighted with the current housing market:

- "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” [1]

3.2 The role of local authorities in delivering the vision of improving the housing market has recently been outlined in the Elphicke-House Report[2] which was published in January 2015. This report emphasises the changing role of local authorities in becoming “housing delivery enablers” rather then just “statutory providers” One of the key recommendations contained within the Elphicke-House report was that “Councils should consider setting up local housing delivery organisations”.



Benefits/Incentives

3.3 The benefits and incentives of setting up a local housing delivery organisation (LHDO) are related to meeting a local housing need, finances and service delivery. The following have been identified as the benefits that would be seen by this Council and were outlined to Executive at a meeting held on 17th December 2014:

- **Ability to meet local housing need -** As outlined in section 3.4-3.7, there is a need in the Borough to deliver housing that meets the requirements of the wider population.
- **Council as a key player in housing provision –** Development of a LHDO will allow the Council to compete with developers in being a key player in the local housing market. In addition, if the Council is able to use its own land and contract through a LHDO, more control is retained over the provision and product, which is lost if land is sold to a developer.
- **Wider stimulation of the economy-** The benefits of housing are wider reaching. The Elphicke-House report identified the following wider benefits to the local and national economy:

[1] “Laying the Foundations: A Housing Strategy for England”, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/7532/2033676.pdf
[2] The Elphicke-House Report https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/398829/150126_LA_Housing_Review_Report_FINAL.pdf

  - “Every £1 spent on construction generates a further £2.09 on economic activity, higher than the return to most other sectors including advanced manufacturing and finance
  - 50,000 new homes create 75,000 new jobs
  - 100,000 new homes could equate to more than £15 billion in additional housing value each year
  - More affordable homes cuts waiting lists/ more homes for sale helps more first time buyers
  - Economic growth– averaging around 3% of Gross Domestic Product at a national level”
  - Smaller schemes developed by District Councils are more attractive to local/smaller builders who are not able to compete with national developers on larger development schemes
- **Expansion to other services –** In the longer term, the LDHO can be expanded to other services to be delivered on a commercial basis. Examples could include waste, recycling, ground care and catering.
- **Access to cheap finance and borrowing capacity –** The Council is able to borrow at preferential rates from the Public Works Loan Board (PWLB) which can in turn be lent to the LDHO to carry out development. The Council itself may govern the level of debt that is held within the General Fund, as outlined in Prudential Code. This level of flexibility is not permitted within the HRA, which is subject to a “cap” set by Government.
- **Financial benefits –** The financial benefits for the Council (General Fund) arising from set up of a LDHO are outlined in more detail in section 3.28. These include:
  - A margin on interest, being the difference between the interest charged to the LDHO for any loans (which is required to be of a commercial level) and the preferential interest rate paid to PWLB for this borrowing
  - Payments for services charged to the Council for the provision of services provided (e.g. support services support)
  - As the sole shareholder, the Council will receive dividends from the LDHO at the point profit is realised
  - Increased levels of Council Tax and New Homes Bonus from properties built
- **Eliminates Right to Buy (RTB) risk for properties developed through the company -** What is very clear is that the incentive to set up a LHDO cannot be directly linked to constraints of the Housing Revenue Account. That said, there are a number of outcomes of such an arrangement that will benefit the Council. Any properties built within the HRA are eligible, after a period of time for RTB. The disadvantage of this for stock holding authorities is that good quality stock may be lost and the Council is only allowed to retain a small element of the receipt for future investment. Any properties built within a LHDO are not subject to RTB with the exception of any properties which are required on a development to be provided as Affordable Housing under a s.106 agreement pursuant to a planning permission. Members should note that such planning policy will apply to ay developments by the LHDO as it would any other developer. .

<u>**Housing Need**</u>

3.4 In considering the option to set up a vehicle for the delivery of housing, it is important to understand the housing needs that should be served by the vehicle. This will ensure that the product delivered is fit for purpose.

3.5 The recommendations for the number of dwellings to meet overall housing need in Hinckley and Bosworth to 2031 is between 375 and 450 dwellings per annum. The lower figure would support demographic projections, where the higher figure would support market and economic growth and take account of the need for affordable housing. For the assessment of affordable housing need, much is affected by the period over which it is expected to meet the backlog need. The Strategic Housing

Market Assessment (SHMA) assumes a 25 year timescale to clear the backlog and therefore calculates a net need of 245 affordable dwellings per annum, which equates to 69% of overall housing need.

3.6 The SHMA also suggests a proposed mix of dwelling sizes to best balance the housing market. This differs considerably between market and affordable mix, but the profile for both types of housing is roughly equivalent over the LLHMA. The particular mix for Hinckley and Bosworth is as follows:

	1 bedroom	2 bedrooms	3 bedrooms	4+ bedrooms
Market housing	5 – 10%	40 - 45%	40 – 45%	5 – 10%
Affordable housing	30 – 35%	35 – 40%	20 - 25%	5 – 10%

3.7 The SHMA is an evidence base to be used for policy setting; it is a “policy off” approach which needs to be tempered by factors such as the potential for economic growth within the district and the need to meet unmet needs from adjoining authorities through the duty to cooperate. As it is a snapshot in time, changing economic and market factors will need to be considered when negotiating the housing and affordable housing on individual sites.

Land Availability

3.8 The Council has identified two principle sites which are recommended to be transferred to the LDHO for housing development

	Middlefied Lane (Former Depot Site)	**Trinity Lane (Current Leisure Centre Site)**
Ownership	HBBC (HRA)	HBBC (General Fund)
Site Size (hectares)	1.4	1.2
Potential number of homes	45	55
Ownership	Freehold (HRA Land)	Freehold (General Fund Land)
Planning position	Planning brief for residential development. Consent expected 2015	Planning brief for residential development. Consent expected 2015 or 2016
Market Value of site	£2.3million	£2million

3.9 Council is asked to approve the transfer of the Middlefield Lane site into the LDHO at nil cost (i.e as a gift). A further report will follow on the Trinity Lane site. The legal advice attached in Appendix 1 outlines how these transfers could legally take place based on the current “fund” ownership. In summary:

The Middlefield Lane site (HRA land)

- This land could be transferred to the LDHO at less than the market value provided that the land is to be developed within three years and used as privately let accommodation. Under the current proposals it is anticipated that both of these requirements can be satisfied.
- Disposal will still require the consent of the Secretary of under the Housing Act 1985 and subordinate regulations. This will need to be obtained prior to any disposal of the land on this basis.

The Trinity Lane site (General Fund land)

- This land could be transferred to the LDHO provided that its application is likely to contribute to the "promotion or improvement of economic, social or environmental well being" of the Borough. The provision of additional housing will satisfy this requirement. In addition, the difference between the value of the land and the disposal must not exceed £2million. Where the value is over £2million we will need prior consent of the Secretary of State.
- Currently the land is valued at £2million based on a valuation in August 2014.
- A disposal of the land of this market value would require consent from the Secretary of State, but as it would require a reevaluation prior to disposal this may change.
- In order to be able to be disposed of to the LHDO the land would need to be disposed of without condition as to development to avoid procurement issues prevent the disposal (see paragraph 3.11 below).
- It should also be noted that the title report to the land is currently being prepared by Legal Services and therefore there may be additional restrictions on the land which will need to be addressed prior to any disposal as a large proportion of the land was previously owned by the Church and often there are restrictions on what the land can be used for

3.10 As well as the above the council must note that State Aid considerations will need to be addressed. State Aid guidance provides that authorities that dispose of land for less than best consideration or provide loans at below market rate need to comply with the State Aid rules set down by the EC Commission. No specific advice has yet been sought on this point and again, it will need to be considered and address prior to any disposal.

3.11 As per the full advice from Trowers and Hamlin there are also procurement disposals on the transfer of the land to the LHDO. If the land is gifted, to avoid the need for procurement, it will need to be transferred without any conditions as to what must be undertaken on the site, i.e. it cannot be transferred on the basis it must be developed for housing. Further, for the exemption identified in paragraph 8 of the legal report to apply, the LHDO must be entrusted to carry out essential activities on behalf of the council – this will include the LHDO being the landlord for any properties developed, and not the authority.

3.12 In addition, the Estates and Asset Manager has identified the following land that is in the Council's ownership which could be considered for transfer going forward:

Address	Current Position	Size
Land adjacent to 147 Wykin Road, Hinckley	Outline planning permission obtained for single dwelling	0.092
Land adjacent to 2 Thornfield Avenue, Stoke Golding	Development potential for single dwelling	0.07 acres
Land to the east of Middlefield Place, Hinckley	Potential for sale in conjunction with Depot site	0.55 acres
Land adj 87 St Martins Drive, Desford	Potential for single dwelling	0.05 acres
Swallows Green, Harwood Drive, Hinckley	Potential for development. To be considered as a part of a partner development adjoining Normandy Way	1.8 acres
Land to the west of Sewage Treatment Works, Mill Lane, Earl Shilton	Forms part of SUE site. Potential for development – scope dependant on possible STW sewage treatment relocation	3.8 acres

3.13 All the above sites will need to have a title check undertaken and it will need to be confirmed how the land is held before any decision as to whether to dispose of the land is taken. It may there are other disposal requirements due to the way the council holds the land which will restrict any disposal, for example advertising requirements.

3.14 Finally, in the longer term, the LDHO may want to consider approaching developers for land in their ownership to consider if a package could be devised to bring forward development in the Borough e.g the developer bringing forward the land and the Council providing all or part of the funding.

Proposed Delivery Model

3.15 In order to understand the options available for delivery of new housing, the Council has sought legal advice from Trowers and Hamlins LLP who have produced a summary of the legal issues for the Council as attached at Appendix 1.

3.16 What is clear from the advice provided is that the rationale for setting up a LDHO must be clearly defined and agreed. The rationale identified for this Council includes the following:

- To make a profit
- To access a revenue stream which will supplement the General Fund
- To "commercialise" service delivery
- To access General Fund borrowing headroom and rates
- To complement development of new affordable housing within the HRA which will continue regardless
- To assist in meeting the housing need in the Borough by offering a different housing product to that offered by the Council traditionally
- To establish a commercial model which may be able to be used for other service provision going into the future

3.17 It is important to emphasise that the LDHO will not and cannot deliver social housing. The Housing Revenue Account and the Housing Revenue Account Investment Plan will continue to operate alongside any LDHO to deliver investment into new and existing social housing in the Borough. LDHO can however and may be required to deliver affordable housing which could be sold to HRA at a point in the future through either planning consent or an agreement with the council in another capacity, though the latter would pose issues with procurement (see paragraph 3.11).

3.18 The different models for delivery of this rationale are outlined in the Trowers and Hamlins report in section 3. The model recommended for this Council is a Wholly Owned Company Limited by Shares (the company). If approved, the company will be "incorporated" with Companies House, the main requirements of this process including:

- Agreement of a company name. As outlined in section 2.2 it is proposed that the name of the company be Hinckley and Bosworth Development
- Agreement of a registered address for the company. This will be the Hinckley Hub postal address
- Agreement of the company directors (see governance section of this report)
- Completion of an application form
- Agreement of memorandum/articles of association. These documents have been prepared by Trowers and Hamlins LLP and attached in Appendix 2
- Filing of all documents – the cost of the process depends on the method of filing (e.g. by post or web) but is less then £100 in all cases. Once received, companies can be incorporated in less than 24 hours

3.19 Once approved, the company will be issued with a certificate of incorporation.

Governance

3.20 The company would be governed by a Board of Directors (the Board). The responsibilities of the Board are outlined in the Companies Act (2006). In addition, there are a number of practical responsibilities which must be executed:

Duties - Companies Act 2006	**Practical duties**
Duty to act with powers	Ensure that company business plan is delivered
Duty to promote the success of the company	Submission of the annual return to Companies House
Duty to exercise judgement	Production and submission of annual accounts to Companies House and HMRC. Arrangement of the annual audit of accounts
Duty to exercise reasonable care, skill and diligence	Notification of any changes in the company's officers or personal interests
Duty to avoid conflicts of interest	Notification of a change to the companies registered address
Duty not to accept benefits from third parties	Allotment of shares
Duty to declare interest in proposed transaction or arrangement	Registration of charges

3.21 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. It is therefore recommended that four officers be appointed as directors on the Board:

3.22 In addition to the above, the Board will also appoint two non executive directors (NEDs) and a Managing Director of the company to the Board. Both roles will be advertised externally to ensure they have the appropriate experience and insight to develop the company further.

3.23 It is envisaged that the Managing Director, once appointed will be employed by the company directly. The company will also require support from the Council for day to day operational matters (e.g. finance, payroll, HR). In these cases, elements of the officers salary will be recharged to the company to cover costs. In order to ensure objectivity, Council officers will report to Managing Director of the company when engaged on company "business".

3.24 Following the advice of Trowers and Hamlins LLP it is not proposed that any elected members be appointed to the Board. Instead it is recommended that members operate through the Council's Scrutiny function to hold the company to account. Regular reports will therefore be presented to the Scrutiny Commission by the Managing Director.

3.25 There are a number of factors relating to independence and personal liability that arise as a result of introduction of a Board. All officers and NEDs appointed to the Board will be reminded of these risks during set up and prior to agreeing to act as a Director for the company.

Financial Considerations

3.26 The financial position of the company will be outlined in a business plan that will be drawn up and approved by the Board upon incorporation. The business plan will be based on a financial model developed by the Chartered Institute of Housing (CIH) and will reflect the rent received from the properties, along with the expenditure incurred in running the company. Alongside this revenue business plan will be a capital plan which will outline how the capital build of the stock will be expended and financed.

3.27 The financial position of the company will be impacted by the mix of properties built upon any transferred sites and the rent charged on these properties upon completion. In addition, the company may choose to sell some of the properties on the open market to generate capital receipts for further investment. Decisions on the mix will be taken by the Board (subject to any planning requirements), utilising the knowledge of the Directors, however initial calculations provided by MRP Developments show that the company should be solvent and profitable.

3.28 The financial position of the company will also need to take into account the implications of tax. The company will be subject to corporation tax on its profits, as well as VAT on applicable services. As outlined by Trowers and Hamlins LLP (section 7.1), the company may be eligible for group relief from Stamp Duty Land Tax (SDLT) depending on decisions on the final vehicle. The subject of tax is complicated and therefore the Council has sought quotes from tax advisors to examine the impact on the company.

3.29 In order for the company to finance its operations, the Council will look to prudentially borrow and on-lend this financing to the company. In order to ensure this arrangement does not qualify as State Aid, the Council must lend to the company at a commercial rate as in accordance with the legislative provisions. The Council will also consider treatment of this borrowing for Minimum Revenue Provision purposes and put forward the argument that as the transaction does not relate to capital expenditure, no provision is required. This treatment will require approval by the Council's External Auditors.

3.30 As outlined in section 3.3, one of the key incentives for setting up the company is the financial benefit that the Council will obtain from the arrangement. These include:

- A margin on interest, being the difference between the interest charged to the company for any loans and the preferential interest rate paid to PWLB for this borrowing
- Payments for "arms length" services charged to the Council for the provision of services provided (e.g. support services support)
- As the sole shareholder, the Council will receive dividends from the company at the point profit (after corporation tax) is realised
- Increased levels of Council Tax and New Homes Bonus from properties built

3.31 The Council will incur a number of costs associated with setting up the company. (e.g. legal, financial advice, recruitment fees). In order to fund these costs, a supplementary budget of £100,000 is requested for approval, to be funded from the existing Transformation Reserve. It should be noted that Council approved a transfer to this reserve of £100,000 as part of the 2015/2016 budget for this purpose.

4. <u>FINANCIAL IMPLICATIONS [KP]</u>

4.1 Outlined in the "Financial Considerations" section of the report

5. <u>LEGAL IMPLICATIONS [EH]</u>

5.1 Outlined within the body of the report and also contained within the appended advice from Trowers and Hamlins LLP.

5.2 It should be noted that the advice within the report is very high level, it establishes the principles of law that the council may utilise to allow it to implement the recommendations contained within the report, however each decision will require further advice and legal analysis to ensure that the high-level advice is applicable in each case. In particular, as outlined in the Trowers and Hamlin report members and officers should be aware that *"The consent regime is complex and would need to be worked through in respect of any particular disposal envisaged by the Council to the LHDV".*

6. CORPORATE PLAN IMPLICATIONS

Set up of a company will meet the following Corporate Plan priorities:

- Sustain economic growth
- Provide decent and affordable homes
- Improve confidence, perception and pride in communities
- Efficient, effective and pro- active services

7. CONSULTATION

7.1 Members of the Executive and Scrutiny Commission have been consulted in the proposal to set up a company

8. RISK IMPLICATIONS

8.1 It is the Council's policy to proactively identify and manage significant risks which may prevent delivery of business objectives.

8.2 It is not possible to eliminate or manage all risks all of the time and risks will remain which have not been identified. However, it is the officer's opinion based on the information available, that the significant risks associated with this decision / project have been identified, assessed and that controls are in place to manage them effectively.

8.3 The following significant risks associated with this report / decisions were identified from this assessment:

Management of significant (Net Red) Risks		
Risk Description	Mitigating actions	Owner
The company will not remain financially solvent.	A business plan will be drawn up in conjunction with financial and tax advisors. Performance against the plan will be reviewed on a periodic basis and the year end accounts be subject to external audit.	S Kohli
The structure of the company poses legal issues to the Council.	Legal advice has been taken from external advisors who will continue to be consulted throughout the set up and operation of the company	E Horton

9. KNOWING YOUR COMMUNITY – EQUALITY AND RURAL IMPLICATIONS

9.1 The development of new houses will benefit the wider community in the affected areas

10. CORPORATE IMPLICATIONS

10.1 By submitting this report, the report author has taken the following into account:

- Community Safety implications
- Environmental implications
- ICT implications
- Asset Management implications
- Human Resources implications
- Planning Implications
- Voluntary Sector

Background papers:	Trowers and Hamlins LLP Report Elphicke-House Report Draft Financial Model
Contact Officer:	Sanjiv Kohli, Deputy Chief Executive (Corporate Direction) Katherine Plummer, Chief Officer (Finance, Customer Services and Complaince) and Sharon Stacey, Chief Officer (Housing, Community Safety and Partnerships)
Executive Members:	Cllr K Lynch