

## BRIGHTON & HOVE CITY COUNCIL

### ADVICE ON HOUSING PROJECTS

#### 1 OVERVIEW

- 1.1 Brighton & Hove City Council (**Council**) is considering establishing a vehicle wholly owned and funded by the Council to fund and provide housing in a range of ways including acquiring developed housing off-plan for rent at local housing allowance levels (**Housing Market Intervention (HMI) Proposal**).
- 1.2 The HMI Proposal follows a reasonably established legal model for local authorities wanting to provide housing outside of the traditional social housing framework. The Council has the power to implement the proposal as envisaged in the HMI Proposal. The structure would provide the Council with the legal framework to fund and provide housing in a range of ways and would provide commercial flexibility for future operation, ownership and funding.
- 1.3 This is a summary paper providing headline advice on the legal viability of the proposal highlighting key areas that will require further advice if either proposal is developed further. This is an updated version of an initial draft issued 3<sup>rd</sup> June.

#### 2 HMI MODEL

- 2.1 The Council is also considering a proposal for a wholly owned vehicle to fund and provide housing in a range of ways including purchasing new developed properties from the market to provide tenancies at local housing allowance (**LHA**) levels, to households to whom the Council owes a duty to accommodate. This is a reasonably common model. The outline proposal is:
  - 2.1.1 a company limited by shares wholly owned by the Council;
  - 2.1.2 funded by the Council through a mix of debt and equity;
  - 2.1.3 potential for housing to be funded and provided by a range of ways, including the vehicle using the funds to directly purchase the properties off-plan and letting to tenants at LHA rent levels;
  - 2.1.4 the vehicle would contract out management to either the Council or an agent on the market.
- 2.2 It would be possible for the Council to carry out the proposed activity directly without use of a vehicle – i.e. purchase the properties directly and provide tenancies to households to whom it owes a duty to accommodate. Such activity would be outside of the HRA.
- 2.3 The use of a vehicle would provide greater flexibility around future funding / investment, would be required if there was an element of providing housing for commercial purposes, would provide more options around tenancies including ability to enter into assured shorthold tenancies and would provide greater clarity that the housing is not being held within the HRA.

#### 3 CORPORATE STRUCTURE

- 3.1 The Council has the power to establish the proposed structure and fund the company. It is expected that the funding to the vehicle would be on market terms to mitigate state aid risk.
- 3.2 It is likely that given the function of the vehicle is facilitating the Council meeting its statutory duties that the vehicle would be subject to the procurement legislation in the same way that the Council is. The vehicle could be structured to comply with the Teckal exemption, meaning the Council and the company could contract with each other without any need for competitive procurement processes.

- 3.3 There is flexibility as to the exact level of control that the Council would have over the company's operation. The framework and typical levers for authority control are through the governance arrangements (see section 4 below) and the funding and associated security documentation.
- 3.4 The company will be subject to corporation tax on profits earned from its activities. The company is to be partly funded by debt from the Council. Interest payment on the debt should be deductible for corporation tax purposes provided that the interest paid (and the level of debt) is market rate, on an arm's length basis.
- 3.5 The supplies to be made by the company are all supplies of residential property, which is generally exempt from VAT. As such, the company is unlikely to be able to recover VAT incurred on costs, particularly any VAT charged by the Council or agent for management services and ongoing costs of maintenance etc. The acquisition of the properties is likely to be either zero-rated or exempt from VAT, so that there should not be substantial VAT involved in acquiring the housing stock. The company will be subject to SDLT on property purchases from the market.

#### **4 FLEXIBILITY OF MODEL**

- 4.1 The proposed model would have flexibility to be used for a range of purposes including other housing activity, for example development of new units, as well as non-housing activity such as owning other general fund property / assets.
- 4.2 The vehicle would be established with unrestricted objects meaning from the company's perspective it could undertake any lawful activity. The shareholder agreement with the Council would restrict the company's activity to what was approved by the Council in the business plan. Therefore it would be for the Council to set the remit of the company's activity and the Council could set this as broadly or narrowly as it would like and would be able to change the approved remit over time as it wished. It would be normal for any substantive alteration of the company's business to be referred back to councillors either through the business plan or, if in year, as a reserved matter (see paragraph 5.2 and 5.3).
- 4.3 Whilst the company would be capable of taking on a very wide range of activity the Council will need to consider in respect of each new activity whether the company would be the most appropriate vehicle. For example, if the Council was looking at bringing in third party investment the Council may want to limit the third party's security to specific assets rather than subjecting a broader range of assets to the security.
- 4.4 Where the vehicle is to be used the most effective way of using it will vary depending on the particular circumstances of activity being considered. For example, on new developments of residential property it is often more VAT efficient for the Council to undertake the development and to then transfer or lease the property to the vehicle. It will therefore be important that the Council retains a flexible view as to how the vehicle could be used and assess that on a case by case basis.
- 4.5 Appendix 1 provides some examples of the different ways in which local authorities are using wholly owned housing / property development vehicles.

#### **5 GOVERNANCE**

- 5.1 The governance of the vehicle will be based around the two roles of shareholders and directors.
- 5.2 The Council would be the sole shareholder, and retain overall control over the company through:
  - 5.2.1 its statutory rights as shareholder;
  - 5.2.2 right to appoint and remove the board of directors;
  - 5.2.3 rights created under the shareholders' agreement, importantly the right to approve a business plan and the requirement that certain listed decisions, referred to as "reserved matters", must be referred back to the Council.

- 5.3 The shareholder function is normally undertaken by members. The board of directors then have the remit and discretion to implement the business plan subject to the reserved matters. The level of discretion given to the board depends on the framing of the business case – i.e. how prescriptive or flexible it is – and what the reserved matters are.
- 5.4 It is generally easier to manage conflicts of interests issues for an "officer board member" than for an elected member as the Council can agree to the officer continuing to act as an officer despite potential conflicts and agree not to take action against the individual where the individual is required to act contrary to the interests of the Council due to the person's role as a board member.
- 5.5 Where a board member is a councillor, the person must disclose any potential conflicts of interests and observe the requirements of the Code of Conduct of the Council. The board member must also be careful (when undertaking their Council role) to behave in ways which avoids suggestions of bias or predetermination.
- 5.6 Whilst the Council could grant a dispensation under the Code of Conduct to allow a councillor to continue to take decisions relating to the company within the Council, it is not possible for the Council to avoid accusations of bias or predetermination, especially if the councillor is particularly senior. Participation on the board of the vehicle could therefore preclude a councillor from being involved in decisions within the Council relating to the joint venture.
- 5.7 The risks around conflicts for officer board members are hard to manage where officer directors are responsible within the Council for decisions materially affecting the vehicle. This risk is best mitigated by not putting Council officers who are directors of Council vehicles or joint ventures in roles where they have to make decisions relating to those vehicles. For this reason we would advise against statutory officers (monitoring officer, s.151 officer and the head of paid service) being appointed as board members as they may be required to undertake their statutory roles in relation to the vehicle at some point which would raise difficult conflicts. If this is a requirement we advise careful thought and further advice is taken on how to mitigate the impacts.
- 5.8 For these reasons the Council's proposal is that the board of directors are officers of the Council. This reflects the proposed position on the corporate joint venture with Hyde for the Living Wage project.

## 6 IMPLEMENTATION

- 6.1 The steps for establishing the HMI vehicle as a company limited by shares are quite straightforward. The following documentation would be required.

Document	Summary
Articles of association and shareholder's agreement	Governance documentation setting out the governance arrangements for the company and the control of the Council as well as terms of equity investment.  Areas covered include board composition, basis of funding, reporting obligations, business plan process and reserved matters
Resourcing contract	Contract for the provision of support services and resources to the vehicle in order for it to operate, for example, secondment of staff, assets (including premises from which to operate) and back office services (HR and ICT);
Capital funding agreement including security	Loan for capital required to make purchases / developments as well as security over the vehicle and its assets. Likely to be on a draw-down basis.
Working capital funding	Facility to provide cash flow resource for the vehicle.

- 6.2 Key issues that will need to be worked through in order to feed into these documents include:
  - 6.2.1 level of independence for the vehicle / level of control by the Council;
  - 6.2.2 governance arrangements for the vehicle's board;
  - 6.2.3 basis of funding, including mix of debt and equity;
  - 6.2.4 approach to security for funding documents;
  - 6.2.5 resourcing of the vehicle.
- 6.3 The above documents would establish the vehicle as an entity capable of operating. The more substantive task is determining and agreeing the business plan for the vehicle and the detail of what activity it will undertake. In relation to specific activity, there will be a further phase of documents and considerations, including:
  - 6.3.1 property documentation – e.g. leases and / or transfers;
  - 6.3.2 tax advice on most appropriate approach.
- 6.4 In practice these two phases can be progressed in parallel. To take forward the establishment of the vehicle we could prepare draft documentation for the vehicle together with key issues papers to provide a platform for more detailed consideration of the structure and discussion within the Council. This could then form the basis of a workshop or meeting with the Council to work through the issues and develop an agreed approach to the structure and finalising the documentation. We can of course be flexible as to how the Council would like to take this forward.

**[draft] August 2016**

**APPENDIX 1 – EXAMPLES OF LOCAL AUTHORITY WHOLLY OWNED HOUSING / PROPERTY VEHICLES**

<b>Local Authority</b>	<b>Activity / Purpose of Vehicles</b>	<b>Governance Arrangements</b>
London Borough of Harrow	<ul style="list-style-type: none"> <li>• Flexible remit</li> <li>• Purchase of Properties from market for rent to meet temporary accommodation demand.</li> <li>• Ownership of newly developed affordable housing</li> <li>• Ownership of newly developed units for private rent as investment activity</li> </ul>	Board of three, all officers
Runnymede Council	<ul style="list-style-type: none"> <li>• Ownership of private rent stock as investment activity</li> </ul>	Board of three, all officers
Portsmouth City Council	<ul style="list-style-type: none"> <li>• Ownership of general fund assets for development</li> <li>• Ownership of units for private rent</li> </ul>	To be determined
Bournemouth Council	<ul style="list-style-type: none"> <li>• Purchase of units from the market for rent to meet temporary accommodation demand</li> <li>• Purchase of units for private rent to generate return to general fund</li> <li>• Potential for development</li> </ul>	One councillor with remaining officers
London Borough of Hounslow	<ul style="list-style-type: none"> <li>• Ownership of units for private rent for return to general fund</li> <li>• Wide range of broader commercial activity for purpose of generating return to Council</li> </ul>	Two officers and executive director (i.e. chief executive of company)
Teignbridge Council	<ul style="list-style-type: none"> <li>• Direct development of new sites</li> <li>• Route for facilitating self-build</li> <li>• Potential for private rent units</li> </ul>	To be determined

