

## BRIGHTON & HOVE CITY COUNCIL

### ADVICE ON JOINT VENTURE WITH HYDE HOUSING

#### 1 OVERVIEW

- 1.1 Brighton & Hove City Council (**Council**) is considering a proposal by Hyde Housing (**Hyde**) to enter into a corporate joint venture for the purposes of acquiring and developing property for the provision of sub-market rent products linked to living wage and shared ownership housing (**Living Wage Proposal**).
- 1.2 This is a summary paper providing headline advice on the legal viability of the proposal highlighting key areas that will require further advice if the proposal is developed further.
- 1.3 The Living Wage Proposal is a legally viable structure. The joint venture could be structured so that the Council could enter into the arrangements with Hyde without a competitive procurement process. Whilst there is no legal requirement to undertake a competitive procurement process the Council should satisfy itself as to the appropriateness of Hyde as a partner and the commercial terms being proposed.
- 1.4 It is likely to be preferable for the Living Wage Proposal to be in a specific vehicle rather than as part of a vehicle also undertaking other regeneration developments. This is to provide ring-fencing of risk and greater flexibility for alternative investment and exit options in the future.

#### 2 LIVING WAGE PROPOSAL

- 2.1 The proposal is:
  - 2.1.1 a 50 / 50 corporate joint venture between the Council and Hyde established as a limited liability partnership (**LLP**);
  - 2.1.2 that a joint venture is established for the Living Wage Proposal with potential for other regeneration schemes;
  - 2.1.3 that the Council and Hyde each contribute 50 per cent of the LLP's required capital (estimated by Hyde to be £54m each);
  - 2.1.4 the LLP purchases identified sites from the Council for 500 homes at market value or potentially at an undervalue of up to £2,000,000 per site;
  - 2.1.5 that the LLP appoints:
    - (a) contractors and professional team for development, from Hyde's frameworks where possible;
    - (b) Hyde's trading company (**HNB**) as development manager on a costs incurred basis;
    - (c) Hyde as housing and asset management services on a costs incurred basis;
    - (d) the Council to provide corporate and financial services.

#### 3 CORPORATE STRUCTURE

- 3.1 The Council has the power to enter into the proposed structure, but would not necessarily need to set up a Council-owned intermediary trading company to do so.
- 3.2 A company is required where the Council is relying on the general power of competence (s.1 Localism Act 2011), as is proposed here, and is doing something for a commercial purpose. There is

a question as to whether the purpose of the joint venture is commercial. If an activity's primary purpose is to make profit, either immediately or in the longer term, then it is reasonable to conclude that it is being performed for a commercial purpose. If the primary purpose is something else, but profit may be realised as an ancillary or incidental benefit, then that should not require the use of a company.

- 3.3 The Council has a strategic objective to increase affordable housing both within the housing revenue account (**HRA**) and also outside of it by using housing delivery vehicles. The Living Wage project is being established for the purposes of achieving this. It is reasonable to conclude that a company is not required and an LLP would not breach the requirement to use a company where something is done for a commercial purpose. There will be a residual risk of a court concluding otherwise as there does not seem to be any case law on the point even though the LLP model has been used this way before, for example, see [Matrix Homes](#) in Manchester, which was incorporated as an LLP.
- 3.4 If the joint venture is established for a commercial purpose, for example increased elements of private sale then the use of a company would be a lower risk approach. If a company is used, the company could be used for other purposes as well as holding the Council's LLP membership, for example being the vehicle for the separate wholly owned housing vehicle project.
- 3.5 An LLP would be a viable vehicle for the joint venture and would offer tax transparency meaning tax is assessed in the hand of the members. This would be particularly advantageous if the Council enters into the LLP directly as the Council's share of revenue would be assessed for tax within the hands of the Council which would then be able to benefit from its advantageous tax position, e.g. exemption from corporation tax.
- 3.6 The proposal is for a single joint venture to deliver the Living Wage Proposal as well as potentially other future regeneration schemes. We recommend that separate commercial projects are kept in separate vehicles, either separate joint ventures or separate subsidiaries under a single overarching joint venture vehicle, which could be the LLP proposed for the Living Wage Proposal. This will allow for more effective "packaging" of risks and obligations, and in particular:
  - 3.6.1 provide greater flexibility to the Council to realise a return and an exit route in relation to the assets associated with an individual scheme through sale of the interest in the vehicle;
  - 3.6.2 provide greater flexibility to obtain third party investment against some of the assets without subjecting all of the assets within what could be a wide programme of activity to security and obligations associated with funding;
  - 3.6.3 provide scope for parties to have different levels of control over the different proposals, both as between the two parties and as between the parties as owners and the joint venture vehicle.
- 3.7 For these reasons having separate vehicles would de-risk the position for the Council. It is unlikely to cause material additional cost as if there was one vehicle it is likely the parties would need to try and construct more complicated contractual arrangements to try and achieve the objectives above (paragraph 3.6) within a single vehicle. It is intended that the vehicles would not be substantive entities with significant employees so the presence of an additional company would not represent the presence of an additional organisation; the vehicles are being used as a legal and financial tool for sharing in the control of a programme of activity and ring-fencing assets and liabilities.

#### **4 PROCUREMENT / SELECTION OF HYDE**

- 4.1 The Council is subject to procurement legislation that requires it to run competitive tenders when awarding contracts for goods, works or services. The Living Wage Proposal involves the Council selecting Hyde without a tender. There are a number of grounds that could justify the Council doing so and present a low risk procurement position, namely:
  - 4.1.1 there is no public contract in place between the Council and Hyde – entering into the joint venture itself need not involve the awarding of a contract for goods, works or services;

- 4.1.2 this is public sector co-operation that is permitted under the procurement rules – both parties are public bodies for procurement purposes and could make use of inter-public body exemptions;
- 4.1.3 public contracts that do exist can be awarded without a procurement process in light of what is known as the Teckal exemption – this allows entities controlled by and delivering activity for public bodies to be awarded contracts without a competitive procurement process.

*Contracting authority status and contracting between the entities*

- 4.2 The LLP is likely to be classified as a contracting authority under the Regulations. This is because it will fall within the definition of "bodies governed by public law". Corporate bodies set up by local authorities or other contracting authorities are often classified this way even though there is the potential to structure them so that they do not do so. The Regulations permit a controlling authority to contract directly (without a tender) with a controlled person and vice versa.<sup>1</sup>
- 4.3 In order to meet the requirements in respect of the LLP any intermediate companies should also be structured to be contracting authorities. This point, and HNB's contracting authority status, will need to be considered further with Hyde. It would not be an issue if a joint venture model involving direct ownership by Hyde and the Council is taken forward.
- 4.4 Although there are no plans in the current proposed structure for either the Council or Hyde to purchase goods, works or services from any of the other parties in the arrangement, the potential for them to do so will therefore exist.
- 4.5 Where there is only one controlling authority, the Regulations also explicitly permit the controlled person to award contracts directly to the controlling authority, known as "reverse" Teckal after the case the exemption was originally based on. However, the Regulations do not explicitly permit or prohibit an award by a controlled person where there is more than one controlling authority, as will be the case here. This may be relevant as the LLP may contract with the Council for corporate, finance and lending services, and with Hyde and HNB for housing management and development management services.
- 4.6 In our view it would be difficult to challenge successfully the award of such contracts on these grounds, particularly as they will be related to the wider Living Wage project, and will enable the LLP to meet the objectives for which it was established rather than to pursue alternative aims, perhaps competing with others on the market. The use of competitive procurement routes to appoint providers of services and works relating to the development, such as the frameworks as considered below, would mitigate risk as the market would still be engaged with the opportunity.
- 4.7 The appointment of Hyde for development and management services is to be done on a costs incurred basis rather than for profit which supports the applicability of the procurement exemptions outlined above.

## **5 STATE AID**

- 5.1 The state aid rules prohibit the Council from transferring its resources to a third party in a way that could distort competition and affect cross-border trade in the European Union. This will need to be considered in relation to the selection of Hyde and the transfer of assets (e.g. land and funding) to the LLP or Hyde.
- 5.2 Where an advantage is being given to the LLP or Hyde the Council's best approach to mitigate state aid risk is likely to be relying on the market economy investor principle. This provides that if the Council can demonstrate that it is acting as a rational private sector investor in similar circumstances would, then the activity is not a breach of the state aid rules. To rely on this the Council should provide funding and any other resources transferred to the Living Wage LLP on market terms. This is what is being proposed in the Living Wage Proposal save for the potential, but not obligation, for the

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<sup>1</sup> Regulation 12.

Council to provide general fund land at a discount of up to £2m in line with the general consent that allows below market disposition where the Council considers it promotes economic, social or environmental well-being (see section 6.5 below). This would be at the Council's discretion as is the case with any land disposition.

- 5.3 There is also an exemption in the state aid rules for support given to services of general economic interest, which include social housing. This is potentially relevant if any resources will be transferred by either the Council or Hyde at below market value, and will require additional terms to be included in the transfer documents to ensure that the requirements of the exemption are met. Structuring the transaction to comply with the SGEI exemption could be the best way of mitigating state aid risk in relation to any transfers of land at undervalue.

## 6 LAND TRANSFERS – MARKET VALUE, CONSENTS AND SDLT

- 6.1 The Council will transfer land to the LLP as part of the Living Wage Proposal. In addition the LLP could purchase land from the market. The proposal for Council land to be transferred needs to be considered in light of the consent framework that exist for:

- 6.1.1 disposal of HRA property;
- 6.1.2 disposal general fund property; and
- 6.1.3 financial assistance, which could include both the funding of the vehicle and any gratuitous benefit such as transfer of land at undervalue.

### *HRA Land*

- 6.2 Any disposal of HRA land will need to either have prior consent of the Secretary of State or compliance with one of the more general consents issued under s.32 Housing Act 1985. There is a general consent available in respect of disposal of vacant land which could be used.
- 6.3 Disposal of vacant land at less than market value is likely to constitute a financial assistance for the purposes of s.24 Local Government Act 1988 (**1988 Act**) requiring specific consent from the Secretary of State or compliance with one of the general consents under s.25 1988 Act. There is a general consent for disposal of vacant land which would require transfer of the freehold or leasehold of over 99 years and would prohibit the Council from maintaining or managing the housing.

### *General fund land*

- 6.4 The Council has a broad power to dispose of property held in the general fund in any manner it wishes subject to an obligation to do so for the best consideration reasonable obtainable (s.123 Local Government Act 1972).
- 6.5 The Council can dispose of property held in the general fund for less than market value provided that consent is obtained from the Secretary of State. The Local Government Act 1972 General Disposal Consent (England) 2003 (**General Consent 2003**) is a wide reaching consent that allows disposal at an undervalue to promote economic, social or environment wellbeing. The difference between the market value and the consideration must not exceed £2 million, and a "professionally qualified valuer" must give a view as to the likely amount of the undervalue. If open space will be disposed of then there are additional publicity requirements.
- 6.6 In determining what the value of the land is for this purpose it is the unrestricted value that is considered, i.e. the amount which would be received for the disposal of the property where the principal aim was to maximise the value of the receipt. Voluntary restrictions imposed by the Council, such as a restriction in the proposed lease to use the land for social housing, would not be taken into account.
- 6.7 If one of the general consents is not applicable then the Council would need to approach the Department for Communities and Local Government to obtain Secretary of State consent to the

disposal on the proposed terms. There is not a statutory framework for this process so it would be uncertain as to how long it would take and whether it would be given.

- 6.8 Where land is appropriated to planning purposes then it would need to be disposed of for market value unless the Council obtained SoS consent to an undervalue disposal. This requirement overrides the General Consent that allows a disposal at an undervalue of up to £2m (as considered in paragraphs 6.5 to 6.7).
- 6.9 This has the potential to be a significant factor given the Council would need to appropriate to planning to benefit from s.237 Town and Country Planning Act 1990 which allows for override of easements or interests annexed to land, such as right to light or support which is common with developments.

#### *SDLT*

- 6.10 The entity/entities will be subject to Stamp Duty Land Tax (**SDLT**) on land purchases, including the acquisition of land from the Council as the transaction.
- 6.11 The deemed market value rules for SDLT purposes apply on a transfer to a connected company or on a transfer by a partner to a partnership so, regardless of whether the joint venture entity is a company or an LLP, the market value rules could apply. The mechanism for determining market value follows the capital gains tax mechanism, which considers (in effect) what the consideration would be in a hypothetical sale at arms length (there are more details in the RICS Valuation Professional Standards).
- 6.12 The valuation would take any covenant imposed by the Council on the use of the land, e.g. restriction for social housing, into account – assuming that it affected the property at the transfer date. However, HMRC are unlikely to accept that there is *no* market value, although they may be prepared to agree that the market value is *de minimis* and potentially below the threshold, if a valuation following the RICS standards would determine that the market value was below threshold.
- 6.13 In *IRC v Gray (Executor of Lady Fox decd.)* it was held that valuation must be based on the assumption that the property *could* be sold in the open market, even if it was in fact inherently unassignable or held subject to restrictions on sale. The relevant question to value the property is what a purchaser would have paid to enjoy whatever rights were attached to the property at the relevant date, assuming such a hypothetical sale.
- 6.14 The SDLT payable is based on a formula which - effectively - means that the market value of the share that is allocable to the other partners (i.e.: other than the one contributing) is subject to SDLT. So, in a 50/50 partnership, a contribution of land by one partner to the partnership would result in an SDLT charge on 50% of the market value of the property.
- 6.15 Group relief will not be available for acquisitions from the Council as the Council's interest in the joint venture will be below that required for SDLT group relief to be available and, in the case of an LLP, an LLP cannot be a qualifying subsidiary for SDLT group relief in any case as it has no share capital and so cannot meet the definition.

## **7 GOVERNANCE**

- 7.1 The governance structure for the joint venture will be framed by the Council's role and rights as a member of the LLP, even if this is indirectly through a company. There would also be a board charged with management of the LLP.
- 7.2 The members of the joint venture will retain strategic control over the operation of the vehicle through the right to approve, and monitor delivery of, a business plan and the requirement that certain listed decisions, referred to as "reserved matters", must be referred back to the owners rather than being within the discretion of the board. The principle is that the joint venture partners approve the business plan and the board then have the remit and discretion to implement it 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.

- 7.3 The board of the LLP would be given a role equivalent to role of a board of directors on a company. Although a board member of an LLP is not the same as the director of a company, it is common in the governance documents to treat the position as the same meaning the individual will have duties to act in the best commercial interests of the LLP for the benefit of both parties. The Living Wage Proposal suggests a board of six, three to be appointed by Hyde and three by the Council with the preference being for senior officers to be appointed. It would be possible for members or officers of the Council to be board members. On a joint venture of this nature focused on delivery of operational matters an officer board would typically be recommended with strategic and significant control retained to members via the shareholder or LLP member rights.
- 7.4 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.
- 7.5 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.
- 7.6 Whilst the Council could grant a dispensation under the Code of Conduct to allow a councillor to continue to take decisions relating to the joint venture 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 joint venture could therefore preclude a councillor from being involved in decisions within the Council relating to the joint venture.
- 7.7 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.

**12<sup>th</sup> September 2016**