

This report will be made public on 10 December 2013

Report Number **C/13/58**

**To:** Cabinet  
**Date:** 18 December 2013  
**Status:** Non-Key Decision  
**Corporate Director:** Susan Priest, Economic Regeneration  
**Cabinet Member:** Councillor Alan Clifton-Holt, District Economy  
Councillor Keren Belcourt, Housing and Environmental Health

**SUBJECT: REGENERATION AND HOUSING COMPANY – PURPOSE AND OPTIONS**

**SUMMARY:** This report considers the powers that the Council has to establish a local trading company to undertake regeneration and housing activities and to trade for profit. It considers the purpose for such a company and examines the potential options.

In particular the report considers the approach that has been agreed by the neighbouring district of Ashford Borough Council, and assesses the suitability of this model for the needs and aspirations of Shepway.

The report recommends that the Cabinet agree the principle and purpose of establishing a wholly owned trading company, and that it authorises officers to prepare detailed proposals, seek appropriate external legal and financial advice and develop business cases for this work and report back to Cabinet.

**REASONS FOR RECOMMENDATIONS:**

Cabinet is asked to agree the recommendations set out below because:

1. A wholly owned company would be able to trade for profit and pay dividends back to the Council, so creating new alternative sources of funding for the Council.
2. It would enable a broader offer of housing tenure options including market rented housing
3. It would enable the Council to choose to sell shares in the company to raise investment
4. It would enable joint ventures for specific investment projects
5. The Council would have full control over the company's activities and assets, including the option to transfer company assets to the Council
6. It would enable new activities to support the Council's wider aspirations for the district, including more homes, new employment opportunities and alternative sources of funding.
7. Other options for the delivery of housing or regeneration projects would not facilitate the outcome of generating alternative sources of funding.

**RECOMMENDATIONS:**

1. To receive and note the contents of report C/13/58.
2. To agree the principle and purpose of the proposed trading company as set out in paragraphs 6.2 and 6.5 of this report, subject to further work and specialist advice.
3. To authorise the Corporate Director (Economic Regeneration) to prepare detailed proposals for the new company, as detailed in paragraph 6.3 of this report.
4. To agree the proposed timetable for this activity as set out in paragraph 6.6 of this report.

## **1. INTRODUCTION**

- 1.1 Cabinet agreed, at its meeting on 31 July 2013, to 'authorise officers to explore the potential to establish a Local Regeneration and Housing Company in Shepway and report back to Cabinet' (Decision number 13/020 refers). The report to Cabinet included reference to similar work being undertaken by Ashford Borough Council (ABC) to establish two trading companies, including a housing and regeneration company to deliver housing and regeneration outcomes. It also suggested that joint working or joint ventures might be facilitated by replicating some or all of the Ashford model in Shepway.
- 1.2 A small group of officers consisting of the Head of Communities, Director of Policy and Strategic Initiatives, Corporate Director (Economic Development) and Head of Finance have investigated the potential benefits and issues of establishing a Local Regeneration and Housing Company in Shepway. A brief review of activities in other local authorities across the country has identified a number of possible options, including the proposals that have been agreed by Ashford Borough Council (ABC) (see appendix 1). The most appropriate model depends upon the outcomes that the Council would like to achieve from the establishment of a company. This report therefore considers the benefits and objectives of establishing a company and considers the potential options.
- 1.3 The officer group has paid particular attention to the proposals agreed by ABC and considers that replicating the broad approach would be particularly relevant to the aspirations of Shepway District Council

## **2. LOCAL AUTHORITY POWERS TO ESTABLISH A TRADING COMPANY**

- 2.1 Powers to establish a trading company are contained within the Local Government Act 2003. The legislation establishes the principle that local authorities can trade, through a company, with other companies, authorities or individuals, either within or beyond the district council boundaries. Within this legislation however trading can only be in relation to an existing function of the local authority.
- 2.2 These powers were further extended by the Localism Act 2011, allowing local authorities to participate in trading activities not necessarily related to any existing functions of the authority.
- 2.3 Importantly, both legislative frameworks require local authorities to establish a company structure in order to generate a source of income. A local authority trading company would have the power, for example, to trade for profit. The legislation also requires that a detailed business case is considered and approved before trading can commence.
- 2.4 It is also important to recognise that without a trading company the Council is restricted in its powers to offer cross tenure rented housing; in particular can only offer housing for rent where the rents set at either social or affordable levels. The establishment of a trading company would extend the range of potential options to include market rented housing.

### **3. PURPOSE AND OUTCOMES**

3.1 Before agreeing to establish a Local Regeneration and Housing Company in Shepway it is essential to consider the objectives of any company and the outcomes that could potentially be achieved. These objectives and outcomes needed to be framed within the context of the Council's agreed Corporate Plan. In preparing this report the following objectives have been considered:

- The generation of a new alternative source of income to support the Council's wider activities.
- The provision of new homes
- The creation of new commercial and employment opportunities

3.2 The potential models have been evaluated using these objectives as a guide.

### **4. POTENTIAL OPTIONS**

4.1 In preparing this report officers have considered, at a high level, the potential alternative approaches that are already being used or considered by local authorities around the country. This work has identified four broad options for consideration. The advantages and disadvantages of these options are summarised within the table attached at appendix 1. The four options are:

- Wholly owned company
- Community Interest Company
- Joint Venture, including Local Asset Backed Vehicles (LABVs)
- Private Finance Initiative (PFI)

4.2 This report recommends that the Council further investigate the establishment of a wholly owned regeneration and housing company based upon the model agreed by ABC. The benefits of this approach are set out in paragraph 6.4 below. The initial high level review of options indicates that a wholly owned company would best fit with the Council's aspirations to deliver housing and employment outcomes and to generate new sources of income. The further investigations will need to include detailed external advice on the following matters:

- The most appropriate model of any company for the delivery of the Council's ambitions and corresponding objectives.
- The governance arrangements required to properly control the company's activities and fully protect the Council's interests.
- The financial arrangements and implications.

4.3 The approach that has been agreed by Ashford Borough Council (ABC) is a variation of a wholly owned company. This approach is considered in more detail below.

### **5. THE ASHFORD MODEL**

5.1 ABC's Cabinet agree to establish two local trading companies (a housing and regeneration company; and a building consultancy company) at their

meeting held on 13 June 2013. This report focuses on the housing and regeneration company. Budget proposals, including set up costs of the two companies and the provision for capital loans to the property company were subsequently agreed by a meeting of the ABC full Council on 18 July 2013. Although the principle of the two companies, along with detailed business cases and financial arrangements, has been approved the companies have yet to be incorporated and start trading.

5.2 When approving the proposals for the Housing and Regeneration Company, ABC identified the following potential opportunities:

- The provision of affordable and market homes for the people of Ashford borough.
- The cross-subsidy of market and affordable homes and the ability to provide new homes without Government subsidy.
- The use of council assets for the delivery of housing.
- The delivery of environmental regeneration and improvement schemes.

It is notable that these identified opportunities are specifically housing focused and do not include opportunities to deliver economic regeneration projects with a focus on employment creation. ABC have adopted this approach as they have a strong understanding of business planning for housing and considered this to present a lower risk in the first instance. There is no reason however why the work of the company could not also include economic regeneration outcomes, provided they have been the subject of a detailed business case.

5.3 ABC's companies will be registered as companies limited by shares, with the Council owning 100% of shares. This approach will ensure that ABC retains full control over the companies' activities, through a shareholder agreement. This includes decisions about the appointment and removal of directors as well as the commencement or winding up of trading activities. This structure also provides the flexibility to both sell shares and receive dividends on their share ownership. In order to effectively oversee these activities ABC has established a new Cabinet sub-committee, known as the 'Trading and Enterprise Board'. This board is tasked with considering requests from each of the companies in respect of matters under the shareholder agreement, although some matters such as the approval of business plans and financial plans have been reserved to Cabinet and Full Council respectively.

5.4 Directors of the new ABC companies are drawn from both officers and members of ABC, together with independent advisors drawn from the business sector. ABC has taken the decision not to make any payments to these directors for the role. ABC has taken independent legal advice on the governance structures for the new companies and given particular attention to the need to avoid any conflict of interests for any officers or members that have dual roles for both the Council and the company. Within this the role of the Council's statutory officers also needs careful consideration.

5.5 ABC's companies will have the powers to employ staff directly when appropriate, but will initially use and pay for the time of existing ABC officers. The companies will be required to operate as going concerns and fund these costs from their trading activities. In order to establish the company's activities in the first instance ABC made a small set up grant of £20,000.

5.6 As part of the arrangement ABC intends to borrow funds from the Public Works Loans Board using its prudential borrowing powers within the general fund. It intends to on-lend this funding to its housing and regeneration company to provide a capital resource for investment into housing and regeneration projects. ABC has initially agreed to on-lend £10m over 5 years in this way. These loans are to be secured against company owned assets and their repayment must be funded by the company's trading activities.

5.7 Careful consideration to the interest rate attached to the on-lending to the company is required. European State Aid regulations require the loans to be provided at a rate that the company could otherwise obtain from the financial markets, in order to prevent any unfair advantage over other companies providing similar services. If Shepway District Council were to decide to adopt a similar approach it would be essential that it commissioned its own independent financial and legal advice on these matters. Any uplift in the interest rates between the Council's PWLB borrowing and its on-lending to the company would generate a revenue income for the Council's General Fund.

5.8 The flow chart below illustrates the financial relationship between the local authority and its wholly owned trading company. It shows the potential for a revenue stream back to the Council from both interest payments and dividends from the company. In addition to this the Council would have the opportunity to transfer company assets or sell some or all of its share holdings, if it chose to do so.

## Model of Cash Flows

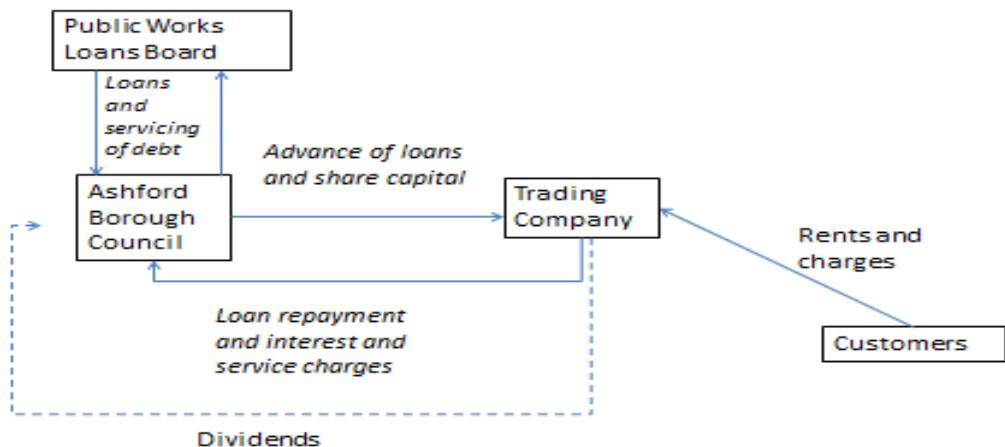


Chart 1: Cash flow between council and its wholly owned trading company.

## 6. RECOMMENDED APPROACH FOR SHEPWAY

6.1 This report has considered, at a high level, the potential options for establishing a regeneration and housing company for Shepway. Potential options have been considered and summarised in appendix 1. From this work officers have concluded that the approach that would best fit with Shepway's regeneration and housing aspirations would be the establishment of a wholly owned trading company. This report therefore recommends that Cabinet consider and agree the principle of establishing a regeneration and housing company as set out below, subject to further investigation and appropriate external advice. Cabinet is asked to authorise officers to develop detailed proposals and report these back to a future meeting of Cabinet.

6.2 The principle features of the proposed company are recommended as follows:

- A company wholly owned by Shepway District Council and established as a company limited by shares.
- The activities of the company would be controlled by the Council through a share holder agreement.
- The company would trade for profit and operate as a going concern. Its activities would be subject to the approval of detailed business cases that can clearly demonstrate financial viability and appropriate management of risk. The company would have the ability to pay dividends to the Council.
- The company would focus on activities that:
  - a) Generate alternative sources of income.
  - b) Provide homes to meet the needs of the district.
  - c) Create new commercial and employment opportunities.

6.3 If these principles are supported, this report recommends that officers are authorised to develop detailed proposals and report back to Cabinet. This work would include consideration of the following factors:

- Appropriate external advice on the potential options for any trading company.
- Detailed proposals for governance, including appropriate external advice.
- Detailed business planning of the company's potential activities.
- Evaluation of the funding and accounting arrangements for the company, including detailed external advice about the arrangements.
- Consideration of the risks to the company and the Council and any mitigation measures needed.
- Development of a detailed communications strategy.

The cost of this work can be met from existing budgets.

6.4 The benefits of this approach are considered to be as follows:

- The company will have the ability to trade for profit and pay dividends, generating a source of income for the Council.

- A broader offer of housing tenure options to include market rented housing.
- The option to sell shares to raise investment.
- The option to transfer company assets to the Council.
- The ability to develop new activities to support the Council's wider aspirations for the district.

6.5 The details of the company's activities are required by legislation to be subject to a detailed business case. In addition, the Council will want the assurance that this work has been completed and demonstrates that activities are financially viable and that risk factors and due diligence have been fully considered for all projects. At this stage however, it may be helpful to consider the potential range of activities that the company could undertake, for example:

- Purchase of homes for market renting, including empty homes.
- Construction of new homes, for rent or sale.
- Provision of services to the private market, such as grounds maintenance or building control.
- Conversion of retail space to residential accommodation.
- Development and/or management of retail, commercial or employment sites.
- Unlocking of strategic sites.
- Development of joint ventures.

6.6 It is proposed that officers should work to the following timeline and report back to Scrutiny Committees, Cabinet and Council as indicated in the table below:

Activity	Date
Officers to work up detailed proposals including financial modelling, governance, risk assessment and external legal, financial and accounting advice	January/February 2014
Scrutiny Committees to consider detailed proposals and business cases	March 2014
Cabinet to consider detailed proposals and business cases	April/May 2014
Council to consider funding options, budget requirements and any loans to the company	June 2014
Company and Governance structures set up.	July 2014
Company commences trading activities	July 2014 onwards

## 7. RISK MANAGEMENT ISSUES

7.1 The risks considered in this report are risks to the Council, and focus on both financial and reputational risks. The company will be required to

consider its own risks and incorporate these into detailed business cases covering all of its activities. The company will be required to trade as a going concern and as a consequence will be unable to take on high levels of financial risk. In addition the Council will want confidence in the ability of the company to repay any loan funding provided. A summary of the perceived risks follows:

<b>Perceived risk</b>	<b>Seriousness</b>	<b>Likelihood</b>	<b>Control action</b>
The company undertakes activities that are financially unviable and is not a going concern as a result.	High	Low	All activities will be subject to the approval of a detailed business case that will be required to demonstrate their financial viability.
The Council is challenged over the operations of the company, including the question of state aid.	High	Low	Detailed legal advice will be taken on this issue before any final decision is taken about the company.
Project risks, such as development costs or demand risks, materialise that generate financial losses to the company.	High	Low	All projects will maintain a thorough register of risks and mitigation measures. The Council's exposure to financial risk will be limited to the value of its shares and investments in the company.
Company unable to repay loans made to it by the Council.	High	Low	Projects subject to approval of detailed business case and any loans to the company secured against company held assets.
The company may create a conflict of interest for officers and members who have roles for both the Council and the company.	Medium	Medium	Detailed legal advice will be taken on this issue before any final decision is taken about the company and appropriate governance structures will be established.

The company will not have access to appropriate resources or skills for any news activities.	High	Medium	All business cases will include an assessment of the skills and resources required and how they will be procured.
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## 8. **LEGAL/FINANCIAL AND OTHER CONTROLS/POLICY MATTERS**

### 8.1 **Legal Officer's Comments (EC)**

The Local Government Act 2003 enables councils to trade in activities related to their functions on a commercial basis with a view to profit through a company. This act enabled councils to extend their trading activities to provide services to other users beyond the 'defined public bodies' listed in the Local Authorities (Goods and Services) 1970 Act. This includes the wider market, private individuals and other bodies or organisations. The legislation uses the term 'commercial purpose' to describe trading activities. Government guidance suggests 'commercial purpose' means having a primary objective to make a profit from the trading activities in question.

The Localism Act 2011 extended opportunities to trade for a commercial purpose much further. For example the General Power of Competence (GPC) does not require councils to identify a statutory function upon which to 'hang' their trading activity. In other words, local authorities are allowed to expand their trading activities into areas not related to their existing functions.

Under both the Local Government Act 2003 and Localism Act 2011, the power to trade must be exercised through a company.

The Council, generally, cannot make a profit through charging powers. In addition the geographical scope of the company would not be constrained by the area of the district; in other words there would be no impediment to trading anywhere in the country (or indeed outside it).

The company would operate using a different type of tenancy for any rented homes provided and would offer assured shorthold tenancies with market rents. Whilst there would be flexibility on rent level the company would still be constrained by the market and the need to make a profit. There is no right to buy for assured shorthold tenancies. Without a company the Council would be constrained by statute to introductory, flexible or secure tenancies at affordable or social rents, i.e. not assured shortholds.

### 8.2 **Finance Officer's Comments (OC-W)**

In considering the establishment of a local trading company to undertake regeneration and housing activities and to trade for profit it is essential that the financial risks for each different type of company structure are considered. In terms of associated set up costs the council needs to be

clear about what costs are to be funded by the general fund with appropriate funding identified, and what costs will be charged to the trading company. There will also need to be a clear financial boundary between the trading company activities and the council's activities.

It is essential when looking at the financing arrangements of the trading company, state aid is considered. This is set out in the main body of the report.

A detailed business plan for the trading company must be prepared which includes financial modelling on items such as the financial viability of the company, risks and relevant sensitivity analysis. Proposed activities and schemes would need to be modelled to ensure that they are financially viable before the company progresses an activity or scheme. The implications for the general fund would need to be considered if the company were to make a potential loss or could no longer demonstrate it was a going concern. Such risks include the inability of the trading company to repay loans and other outstanding company liabilities which may fall on the general fund especially if the company is wholly owned by the council.

Further specialist advice will need to be commissioned and considered prior to any decision to establish the company is made. The costs of this work can be met from existing budgets.

### **8.3 Diversities and Equalities Implications (BP)**

This report does not have any diversities or equalities implications at this early stage. However, should the Council decide to proceed with establishing a trading company there may be implications that arise from the company's activities. The detailed business cases for the company's activities will need to include the completion of a detailed Community Impact Assessment.

## **9. CONTACT OFFICER AND BACKGROUND DOCUMENTS**

Councillors with any questions arising out of this report should contact one of the following officers prior to the meeting:

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The following background documents have been relied upon in the preparation of this report:

None

**Appendices**

Appendix1: Table of potential options