

Report to Cabinet

21 March 2019



By the Cabinet Member for Community and Wellbeing

DECISION REQUIRED

Exempt information in the Business Case and Appendices B - H
Not for Publication – Exempt under Paragraphs 3, 4 & 5 of Part 1 of Schedule 12A to the Local Government Act 1972

Proposal to set up Development and Management Companies to provide affordable rented housing in the District

Executive Summary

Horsham District Council is committed to delivering affordable housing to support its residents and provide affordable rented homes for households on its housing register. We have a record of high delivery in this area which enables households to secure decent standard homes.

Horsham District Council has:

- Delivered the highest number of affordable homes in Sussex during the past three years (2015 – 2018)
- Supported Registered Providers with funding in excess of £9 million to deliver 1,107 affordable homes since 2010
- Invested in excess of £5.5m in temporary accommodation. This investment will see the provision of 34 properties to prevent households that are managing the challenges of homelessness from having to be accommodated in bed and breakfast accommodation.
- Of these 34 properties, 17 have been built with the remaining two sites due to be completed and open Summer and Winter 2019. Local accommodation within the district provides an improved solution for households enabling them to maintain employment, children's schooling in addition to medical and family/social support networks

The next step, building upon this track record, will see the Council invest £10 million to deliver its own permanent affordable housing through an Affordable Housing Company model.

This funding will support the delivery of up to 70 units in some of the District's most in demand areas and reduce the number of households on the Council's Housing Register. Alongside providing additional affordable rented homes, this will also build an asset base that could enable delivery of affordable homes into the future. An option not currently available to the Council.

The proposal to create the affordable housing company model provides another option for the Council to use on sites that lend themselves to affordable housing and further demonstrates the Council's commitment to the continued delivery of affordable housing.

Recommendations

Cabinet is recommended to:

- I. Approve the Business Case and agree to the set-up of the Property Development and Property Holding companies as proposed in the Business Case appended to enable the delivery of affordable rented homes in the Horsham District.
- II. Delegate to the Director of Community Services, in the consultation with the Cabinet Member of Community and Wellbeing, the drafting and agreement of:
 - a. The Articles of Association of the Companies, the Shareholders Agreement between the Council and the Companies and any other necessary agreements required between the Council and the Companies.
 - b. The appointment of the initial Company Directors of both companies
 - c. All further legal documentation necessary to the set-up of both companies.
- III. Agree that the Property Development and Property Holding companies may undertake commercial activities that is to develop affordable housing for rent and to manage, subject to approved site specific business cases.
- IV. Request that Full Council approve £500,000 equity funding to be provided to the Property Development company.
- V. Note that decisions will need to be made on the following issues by Council later in 2019:
 - a. The approval to dispose of Council owned land to the Development Company
 - b. Allocation of S106 funds to the Property Holding Company to acquire the completed affordable housing units

Reasons for Recommendations

- i. To increase the delivery of affordable housing
- ii. To make the best use of Section 106 Commuted Sums
- iii. To provide a financial return to the Council for reinvestment in the District

Background Papers

All background papers are exempt from publication and include:

Business Case of Property Development and Property Holding Companies
Appendices of the Business Case

Wards affected: All wards affected.

Contact: Rob Jarvis – Head of Housing & Community Services

Background Information

1 Introduction and background

- 1.1 The Council has an increased level of Section 106 commuted sum funds for a number of reasons which are detailed within the Affordable Housing Investment report attached as Appendix A to the business plan.

These include a spike in the collection of funds coinciding with a reduction in use of the grants made available for Registered Providers due to the rent cuts of 2015 and a significant reduction in Government grant available for rented homes.

The level of commuted sums provides the Council with an opportunity to review the way these funds were used and to build on its already impressive record of delivery and do even more to support the delivery of new affordable rented homes in the district.

- 1.2 Cabinet members considered the Affordable Housing Investment report in November 2017. The report set out the future direction for the Council as it continues to invest in affordable housing and make the best use of commuted sums.
- 1.3 It recommended that we continued to work with Registered Providers and invested in good quality temporary accommodation. It also proposed that the Council undertook further work to assess the case for the creation of a vehicle to enable the direct delivery of affordable housing.
- 1.4 In response to the November 2017 Affordable Housing Investment paper a project team made up of representatives from Housing, Finance, Legal, Property and Corporate Performance was created to investigate the options available to the Council to deliver permanent affordable housing. A number of options were investigated and reasons for progressing or dismissing them are detailed with Appendix F of the proposed business case.

These options included:

- Reinstating the Council's Housing Revenue Account
- General fund delivery
- Affordable Housing Company
- Joint Venture with a Registered Provider

The conclusion of this work identified an Affordable Housing Company as the preferred method to meet the Council's objectives to:

- Increase the delivery of affordable homes
- Make the best use of section 106 commuted sums
- Provide a financial return for the Council

- 1.5 The project team have created a business plan which maximises the opportunities the affordable housing model option provides and proposes the creation of a Property Development Company and a Property Holding Company to deliver affordable rented homes in the district.

The initial proposals were sense checked and appraised by independent consultants 31Ten who stress tested the proposals and undertook an early sensitively analysis.

- 1.6 Since this date the team have created a detailed business plan using legal advice from Bevan Brittan law firm to ensure the proposal is sound. Advice from Bevan Brittan

confirmed the model's suitability to meet the Council's objectives and is attached as appendix G to the business plan.

- 1.7 The creation of the Affordable Housing Company model provides the Council with another method of delivery for any development opportunity. The creation of this model also doesn't preclude any existing method of delivery, it is simply an addition to them.
- 1.8 We will still continue to support Registered Providers to maximise rented homes on their own sites and S106 sites and deliver additional temporary accommodation if required.
- 1.9 The number of affordable housing completions between 2013/14 and 2017/18 are set out in table below and demonstrate an average number of affordable homes per year of 221.

| | 2013/14 | 2014/15 | 2015/16 | 2016/17 | 2017/18 |
|--------------------|---------|---------|---------|---------|---------|
| Affordable Housing | 239 | 245 | 150 | 224 | 249 |
| Market Housing | 637 | 653 | 1100 | 584 | 954 |

- 1.10 Despite this high level of delivery, when considered in conjunction with Council's housing register, the levels of delivery are merely maintaining a consistent average number of households on the Housing Register rather than reducing it.
- 1.11 It is expected that this level of delivery will be maintained but that the creation of the Affordable Housing Company model will provide an additional 65-70 homes in some of our areas of greatest demand and reduce the average number of households on the Housing Register.

2 Relevant Council policy

- 2.1 This report accords with the objectives of the Corporate Plan as it will help:
 - Support the delivery of housing to meet local need
 - Provide access to appropriate and affordable housing
 - Reducing the number of households placed in Bed and Breakfast accommodation

3 Details

- 3.1 The proposal sees the Council approving a two company model. A Property Development company and a Property Holding company.

The two company have been proposed as they have two clear different functions. One develops the accommodation and the second holds the stock and manages the tenants within its homes.



3.2 The two company model has been selected for a number of reasons including:

- Separation of risk between development and managing functions
- Separation of assets
- VAT efficiencies
- Tax efficiencies through group tax relief

Council staff will be directors of both companies with three directors proposed for the development company and four for the holding company. Legal advice recommends members and statutory officers should not be directors of the company to prevent conflicts of interest that could arise. The additional director required for the holding company incorporates a council officer with responsibility of managing residential council accommodation.

3.3 The Council will be the sole shareholder of the parent (development) company with the property holding company being a subsidiary. Specific decisions will need to be made by both Council and Cabinet.

Council are required to approve funds for the companies to operate. These are loans and equity within the development company. Council will also be required to consider any land disposals to the development company that would trigger Secretary of State Sign off requirement.

Cabinet are required to consider each individual development business case and approve the allocation of S106 commuted sum funding to enable the property holding company to acquire the built units from the development company.

3.4 The property development company will operate at a loss of £210k over the first four year (based on current estimations) and the property holding company is estimated to return a pre-tax profit of £325k in year four. Costs for legal services, audit services, procurement, staffing and facility recharges alongside staff training and compliance have all been factored into the running costs of both companies.

Collectively they will generate an income to be returned in dividend to the Council. The full impact on the Council's finances is detailed within section 7 – Resource comments.

- 3.5 65 – 70 homes are proposed to be delivered using this model in the first four years. Land owned by the Council or with development restrictions will be used initially.

The first two sites have been identified in Billingshurst and Henfield. These are smaller sites that will enable the delivery team to build upon experience gained through the delivery of temporary accommodation schemes to deliver permanent affordable homes.

A number of criteria will be considered when a decision is made to dispose of land to the property development company. These include:

- Location
- Planning
- Affordable housing demand
- Viability
- Residual value
- Use restrictions
- Site specific issues

- 3.6 The model has the flexibility to acquire land not owned by the Council but at this stage this option is not deemed to be required.

- 3.7 The property holding company will set its rents at the Local Housing Allowance rent levels. Capping rents at this level ensures households that may be entitled to support with rent costs can receive assistance with their full rent if their circumstances allow. I.E, the rents proposed do not exceed the maximum amount a household could receive in housing benefit of the housing element of universal credit.

- 3.8 A nominations agreement will be entered into between the property holding company and the Council which ensures the Council's Housing team allocates households from the housing register to 100% of the holding companies new properties.

- 3.9 The structure, governance and finance arrangements proposed will see the delivery of 65-70 homes to be allocated to households with an identified housing need on the Council's housing register. The rents will be set at an affordable level and support the reduction in the number of households in housing need in the district.

4 Next steps

- 4.1 Following approval of this model, the structure can be incorporated reasonably quickly.

The operational structure will be set up early in the 2019/20 financial year. Key documents will be prepared, circulated and then amended so that they reflect the Council's preferences, in for example, the level of control it would like to exercise and the definition of reserved matters that must revert to the Council for a decision.

- 4.2 Key documents required to implement the proposed model include:

- Articles of association and shareholders agreements
- Resourcing contracts
- Capital funding agreements
- Working capital funding
- Transfer documents

- Development documentation
- Grant agreement
- Nomination agreement
- Assured Shorthold Tenancy (AST) agreement

The requirement of these documents is detailed further within the legal advice obtained from Bevan Brittan and contained within Appendix H of the business plan.

5 Views of the Policy Development Advisory Group and outcome of consultations

- 5.1 A presentation of the proposal was given to a joint Community & Wellbeing and Finance & Assets Policy Development Advisory Group 4th March 2019. This focused upon the governance, structure, decision making and financial detail of the companies. A number of points were raised, discussed and clarified. The group support the proposal.
- 5.2 An all member briefing was held 26th February 2019 in which the outline of the proposal including governance, structure and finance were highlighted. Members were supportive of the proposal.
- 5.2 Council's Monitoring Officer has been involved in the bringing of this proposal to Cabinet and has commented in paragraph 8 'Legal Consequences' of this report.
- 5.3 Council's S151 Officer and Head of Finance have been involved in the bringing of this proposal to Cabinet and has commented in paragraph 7 'Resource Consequences' of this report.

6 Other courses of action considered but rejected

- 6.1 Alternative options for the delivery of permanent affordable housing were considered prior to the proposal to create the affordable housing company model. These included:
- Reinstating the Council's Housing Revenue Account
 - General fund delivery
 - Affordable Housing Company
 - Joint Venture with a Registered Provider

The consideration of these options is detailed within Appendix F of the attached business case.

7 Resource consequences

- 7.1 Whilst holding unspent section 106 (S106) money, the Council generates interest as part of the Council's treasury management investments, which the Council currently uses in its revenue fund.

Using the S106 will therefore cause the income of the Council to reduce. Therefore, the Council will need to use reserves or make further savings to replace this. The capital strategy currently factors in the following spends of S106 on housing totalling £12.5m across the four-year period.

| | 2019/20 | 2021/22 | 2022/23 | 2022/23 |
|--|---------|---------|---------|---------|
| Estimated use of S106 housing related p.a. | £2.5m | £2m | £3m | £5m |

The S106 spend in 2019/20 includes £1.5m on the completion of temporary accommodation at Peary Close, Horsham and Rowan Drive, Billingshurst.

It also includes an estimated £0.8m to Saxon Weald to help deliver a further 57 units of affordable rented accommodation across three sites in Horsham and one in Rudgwick – which is also on the Cabinet agenda on 21 March 2019. A further £0.8m would also pass to Saxon Weald in future years on the completion of these sites.

Spending S106 within the Council's Housing Company has the benefit of retaining the land and the asset within the group, and generating a financial return (dividend) to help offset the loss of interest to the Council.

The Council currently generates approximately £0.25m of interest annually on the £10m held in the bank. This would be lost to the Council should the Council choose to passport the S106 to Registered Providers (RPs) or have to return expired S106 to the developers without using it.

Within the estimates used in the modelling, the Affordable Housing Company project would reduce this reduction to revenue to approximately £40k to £50k per annum once the initial build phase has been completed.

However, this is based on three key assumptions in the modelling:

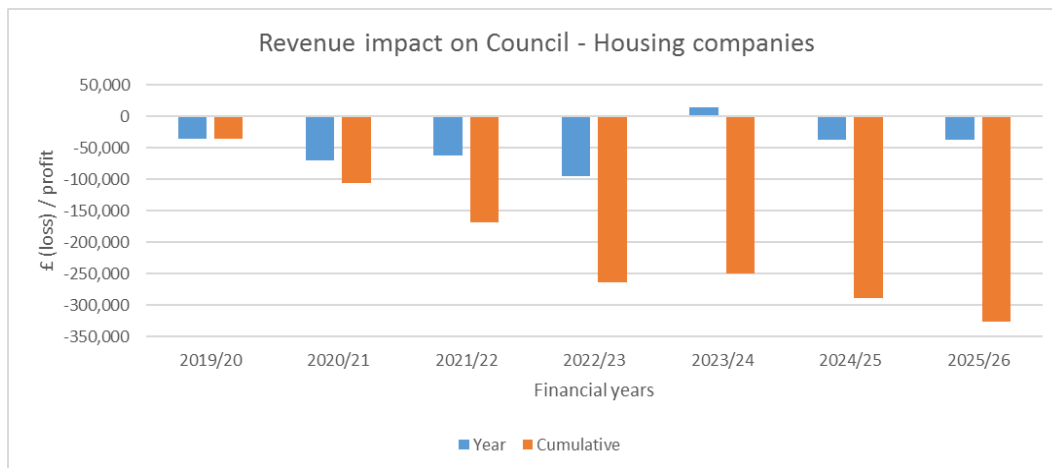
1. There are no enhancements to the builds above the optimal building regulation compliant standards.
2. There are no significant issues found during demolition and build that increase the build costs above the costs and contingency allowed.
3. At least 80% of the profits from the Property Holding Company are paid back to the Council as a dividend.

If any of points above change, the Council's finances would be adversely affected and the Council would have to seek alternative savings elsewhere to cover the losses.

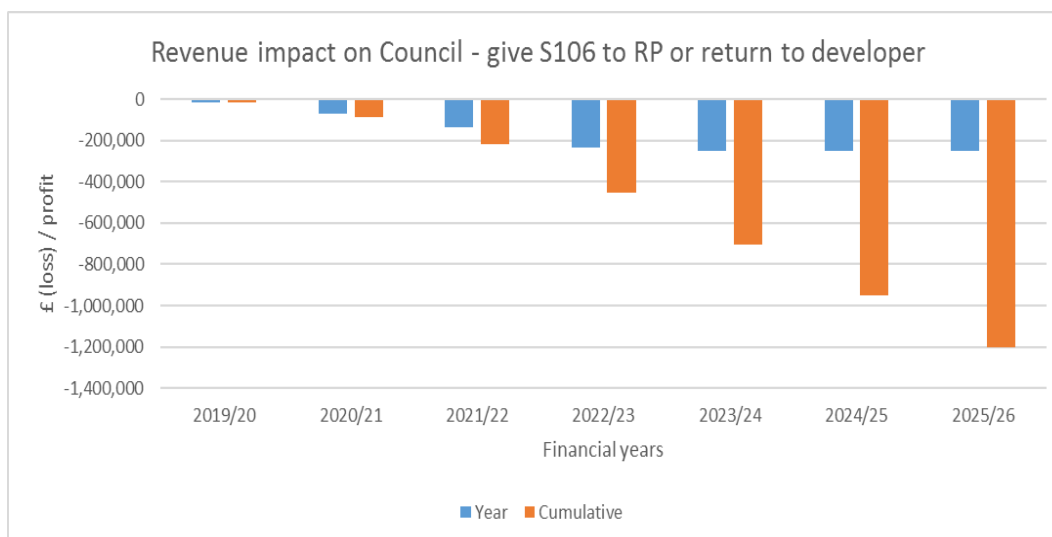
As part of the anticipated costs to the Council, the Council will have to introduce group accounts and pay enhanced audit fees for the audit of group accounts.

If potential Council owned sites that have been identified are transferred to the company, the sale of the land for less than market value, which seems inevitable if this land is used, will lead to a loss in the Consolidated Income and Expenditure Account and a reduction in the Balance Sheet assets in the year of land transfer. This will even out in the group accounts, which will reflect the gain in the Company Accounts. This issue will also arise again with any other piece of land with more than a nominal value on our Balance Sheet.

None of these additional costs to the Council have been quantified in the business case, which solely relates to the companies. The costs to the Council are anticipated to reach around £250,000 cumulatively by 2023/24 and then by £40k to £50k each year after that. By 2025/26 this would reach £325k.



7.2 The proposed model compares favourably however, with an estimated cumulative loss in revenue of £1.2m by 2025/26 should the S106 monies be passed to Registered Provider's or returned to the developers when the time restrictions of funds are reached.



8 Legal consequences

8.1 Local authority use of wholly owned companies for housing purposes is increasingly common, and would be a legally viable model for the Council to use to meet its objectives.

The model proposed within the business case reflects legal advice obtained from Bevan Brittan LLP. They have worked alongside a number of other Local Authorities to set up housing companies for both the development and holding of affordable housing and have a successful track record.

The Council has the power to set up and fund the companies in the ways proposed. Each company's operation would be overseen by a board of directors, but with strategic control retained by the Council. Support and other services could be provided by the Council so that there would be no need for either company to employ staff directly.

The Council should consider potential conflicts for officers and Members appointed as directors of either company. Advice recommends that there will be fewer risks of conflicts of interest if Members and statutory officers are not appointed. We have followed this advice within the proposal.

This advice will be confirmed as each development proposal is developed and a business case put forward. It includes, inter alia, advice regarding:

1. powers available to the Council to set up the Companies
2. powers to dispose of land to the Property Development company
3. powers to fund and use s106 commuted sums for the transfer of built units to the Property Holding company
4. state aid issues

Advice has also confirmed that each company will only be liable for its own debts. There are however two circumstances in which one could potentially be liable for the other, although these are only likely to occur in exceptional circumstances. The first is where the court “pierces the corporate veil” because, for example, a company was deliberately used to avoid liability, and the second is where one acts as a shadow director for the other. Our model proposes sufficient governance in place to mitigate this risk.

If a decision is made to cease company activities the model is such that the companies can become dormant. Any stock held by the proposed PropHold company could be disposed of to a Registered Provider at best possible price which ensures the affordable housing element is retained in perpetuity.

9 Risk assessment

- 9.1 Risks are detailed within the business case.

10 Exempt Appendix

- 10.1 Category exemptions 3, 4 and 5 have been considered in determining that the Affordable Housing Delivery Business case and its appendices are exempt from publication.