

Report to: **Executive**
Date: **6th February 2020**
Title: **Housing Company**
Portfolio Area: **Homes- Cllr Bastone**
Wards Affected: **All Wards**
Urgent Decision: **N** Approval and clearance obtained: **Y**

Date next steps can be taken:
Full Council 13 February 2020

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Recommendations:

- 1) That the Executive endorse the setting up of a Housing Company in the form of a Community Benefit Society (CBS).**
- 2) That the Executive approves a spend of up to £40,000 funded from the Affordable Housing Earmarked Reserve, to set up the CBS.**
- 3) That the Executive recommends to Council to:**
 - a) Form a Community Benefit Society (CBS)**
 - b) Delegate all authority needed to undertake full due diligence and establish the CBS in the form set out in this report, to the Director of Place and Enterprise, S151 Officer and Monitoring Officer, in consultation with the Leader of the Council.**

1 Executive summary

- 1.1 This report sets out the options before the Council for the formation of a Wholly Owned Company to support the Council own and manage rented housing stock.
- 1.2 It looks at the different company structures, finance and governance position and confirms the legal powers available to undertake the work.

- 1.3 It recommends the formation of a Community Benefit Society, which as a result of its charitable status does not have to pay Stamp Duty Land Tax or Corporation Tax, but can't pass profits back to the Council.
- 1.4 The CBS would be capable of holding the affordable housing developed by the community housing programme and also that purchased from developers.

2 Background

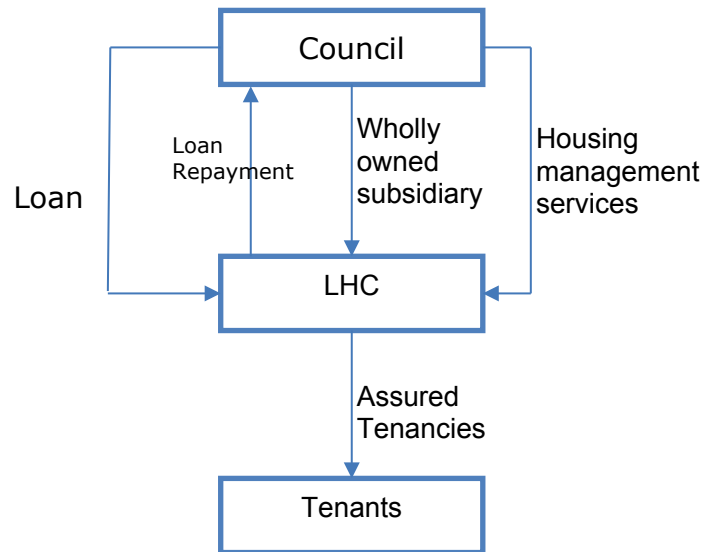
- 2.1 Following a report to the Overview & Scrutiny Panel in November 2019 discussing the challenges of the housing market in the South Hams, this report sets out why the formation of a housing company would be of benefit to the Council in tackling these challenges and recommends the form it should take.
- 2.2 Such a company would be wholly owned by the Council and closely controlled by it. Councils have the legal power to set up wholly owned companies under their general power of competence (under the Localism Act 2011).
- 2.3 Councils are able to provide finance (lending) to wholly owned companies under their investment powers (set out in the Local Government Act 2003); and
- 2.4 In the case of a Local Housing Company (LHC), the power to provide financial assistance (set out in Section 24 Local Government Act 1988 (Section 24)).

3 The Strategic Case – Does the Council need an LHC?

- 3.1 The Community Housing Team have a forward delivery programme for 2020 – 2025. On 21 March 2019, Council approved (Minute CM 74/18) Community Housing Development expenditure of up to £8.5 million, to build out four Community Housing schemes, delivering 55 residential units (as detailed in the report to the Executive on 14th March 2019). Houses will be constructed during 2020/21 and will be offered to the market in a range of tenures, affordable rent, discount sale and open market sale.
- 3.2 Separately the Council is considering the acquisition of affordable rented homes from developers on a case by case basis where it delivers improved place making and home delivery outcomes.
- 3.3 It is anticipated therefore that in 2020 the Council will become the owner of new rented housing stock, which will need managing, maintaining and letting to tenants.
- 3.4 The Council is better placed to manage into the long term rented housing stock if it is held in a housing company.
- 3.5 The Council will develop the community housing schemes in-house and transfer only the completed rental units to the LHC and sell the market and sub-market sale homes itself.

- 3.6 The benefits of holding rented stock in a housing company are:
- 3.6.1 The Council would otherwise be required to form a Housing Revenue Account once more than 50 units are developed
 - 3.6.2 Development activity and financial returns are ring fenced (in the company)
 - 3.6.3 Easier to form an exit strategy or sell in the future
 - 3.6.4 Less susceptible to difficulties due to central government policy
 - 3.6.5 Profit making activities are permitted
 - 3.6.6 A company structure can create the ability to lever in additional financing, skills or resources.
 - 3.6.7 Any additional resource / activity does not have to be paid for from existing Council revenue budgets (although some costs may be capitalised).
 - 3.6.8 Procurement is likely to be less onerous than in other delivery models
 - 3.6.9 The company can be structured so that it does not need to pay Stamp Duty Land Tax (SDLT).
 - 3.6.10 A Company can also be structured such that it does not need to pay corporation tax.
 - 3.6.11 It can still be closely controlled by the Council
- 3.7 In some company structures any profit has to be retained within the company and can only be spent furthering the aims of that company (housing delivery). This in effect protects any future capital and reserves from being used for other Council functions and maximises its ability to make a positive difference in the sections of the housing market that need the most help.
- 3.8 This would align with our developing housing strategy which sets out a desire for this Council to proactively seek to deliver houses in the affordable sector to supplement and improve the choice and quality of life for communities in need of affordable housing.

3.9 The strategic case therefore exists and would take the following form:



4 The Economic Case – Is it value for money and what are the options?

4.1 The LHC itself can take a number of forms:

4.1.1 Company Limited by Shares (CLS)

4.1.2 Company Limited by Guarantee (CLG)

4.1.3 Community Benefit Society (CBS)

4.2 There is a fork in the road at this stage which is defined by the philosophy of the Council in its approach to direct housing delivery. Is it primarily driven by the desire to improve the housing outcomes of the communities it serves or is it driven by the desire to make a profit, or perhaps both?

4.3 If:

4.3.1 the Council wants the LHC to be capable of distributing profits generated by its activities, a CLS would be the corporate form of choice;

4.3.2 if the ability to distribute profit to the Council is not an imperative but delivery of housing outcomes is a priority, the options of a CLG and a CBS warrant closer scrutiny.

4.4 Both a CLG and a CBS are suitable corporate forms for not-for-profit entities – i.e. entities that are incapable of distributing profits to their members/shareholders. Both forms are commonly employed in the social housing sector.

4.5 CBS's are registered with the Financial Conduct Authority and their objects must be focused on the benefit of the community.

4.6 A CLG, like a CLS, only requires registration at Companies House. As such, the administrative burden (and the cost of establishment) associated with a CLG tends to be less than that for a CBS.

- 4.7 As a CBS, it will be required to submit an annual return each year which sets out its activities and demonstrates, to the FCA's reasonable satisfaction, that it is complying with its community benefit purpose.
- 4.8 There are only two circumstances in which a CBS or CLG would be recommended over a CLS for the housing company. Those are:
- 4.8.1 Where the Council is minded to seek registration of the LHC as a Registered Provider. A Registered Provider is a provider of social housing that is registered with the Regulator of Social Housing. This is because of the restrictions, imposed by the Regulation of Social Housing (Influence of Local Authorities) (England) Regulations 2017, on the ability of a local authority to exert influence over a for-profit Registered Provider; and/or
- 4.8.2 Where the LHC is to seek charitable status. Charitable status for the LHC would offer it an exemption from stamp duty land tax on land acquisitions and an exemption from paying Corporation Tax in relation to its charitable activities; but it would restrict the activities of the LHC – a charity may only undertake activities that are necessary or expedient to enable it to further its charitable objects.
- 4.9 If charitable status for the LHC is to be sought, one of the advantages that a CBS offers over a CLG is that a CBS does not require to be registered with the Charity Commission. It should be noted that once an entity has been established as a charity, it cannot cease to be one. Accordingly, the assets of a charitable entity are often referred to as asset-locked. On dissolution, a charity may only transfer its assets to an entity with similar purposes.
- 4.10 It is recommended that the Council progress with the LHC in the form of a CBS, so as to give it every competitive advantage to deliver high quality, low cost homes to its communities .

5 The Commercial Case – How would it be done?

- 5.1 The power to form a company rests with the Council. It can rely on the powers granted under the Local Government Act (2003) which enable the creation of Local Authority Trading Companies, and the general power of competence granted under the Localism Act (2011) which enables local authorities in England to do "anything that individuals generally may do." It is an intentionally wide power which permits, for example, the Council to:
- Acquire, develop and dispose of land;
 - Establish legal entities; and
 - Subscribe for shares and/or providing loans.
- 5.2 It is necessary under the Council's Constitution for the formation of an LHC to be granted permission by the Council, there are no delegated powers to officers to do it.

- 5.3 Should the Council, following an Executive recommendation, approve the formation of an LHC in any form and give officers delegated authority to proceed the following steps would be taken:
- 5.3.1 Devonshires / Altair (our legal and housing advisors) would be commissioned to draft the detailed "rules" of the LHC (see section 7 – the management case) setting out the powers of the LHC and what it can and can't do.
 - 5.3.2 They would also undertake the legal and administrative work required to actually form the company and start it running. The cost of this would be funded from the Affordable Housing Earmarked Reserve, of up to £40,000.
 - 5.3.3 The Company would then remain "dormant" until such time as the first affordable house or flat is developed at which time the Company would buy it, using money loaned to it from the Council.
 - 5.3.4 The Council has already approved £8.5 million in its capital programme for the delivery of Community Housing in line with its forward programme (see 3.1 of the Strategic Case). It is part of this money that will be lent to the LHC.
 - 5.3.5 The LHC can not simply take on debt from the Council, unless the Council has already approved it.

6 The Financial Case

- 6.1 The LHC will require funding to support its activities. The Council is able to rely upon:-
- 6.1.1 its investment powers (set out in the Local Government Act 2003); and
 - 6.1.2 in the case of the LHC, the power to provide financial assistance (set out in Section 24 Local Government Act 1988 (Section 24)), to justify the provision of funding.
- 6.2 The power to provide financial assistance under Section 24 is subject to a requirement that the relevant local authority obtains the Secretary of State's consent (under Section 25 of the same Act). Financial assistance (for the purposes of Section 24) includes the subscription for shares, a loan, a grant, a guarantee and/or a land disposal at an undervalue.
- 6.3 The Secretary of State has issued a number of General Consents which, if capable of being relied upon, obviate the need to seek specific consent. Paragraph C of the General Consents permits a local authority to provide any form of financial assistance to an entity for the purpose of providing privately let accommodation other than any related to a disposal of land. Accordingly, the grant

of a loan by the Council and/or any subscription for shares in a LHC established as a CLS would be covered by this consent.

- 6.4 Assuming that any land to be transferred from the Council to the LHC is to be transferred at market value, there will be no further consent required under Section 25. A disposal at an undervalue by the Council to its LHC would require specific Secretary of State's consent under Section 25 (as none of the General Consents will assist in these circumstances). Government's stated policy is that it will not support applications for consent which are designed to circumvent Government policy (which includes its commitment to home ownership).
- 6.5 In addition to the consideration of the vires for the provision of funding to the LHC by the Council, the question of compliance with state aid rules must be considered.
- 6.6 State aid may come in many guises and can include the provision of loans at a rate below a market rate, grant funding, lenient taxation regimes, sale of assets at an under value or the provision of certain types of guarantees. If unlawful state aid is deemed to have been provided, the powers of the EC Commission are extensive. Notably, it has the power to stop further transactions and order the repayment of any aid already paid, with interest.
- 6.7 There are two exemptions which are noteworthy in the context of this report:-
 - 6.7.1 Where financial assistance is provided on terms which are regarded as no more favourable than those that a private lending institution would supply (where there is a market for such lending) the provision of such investment may not be regarded as state aid. This is known as the Market Economy Investor Principle (MEIP). This asserts that a public body is not providing state aid when it is acting like a private investor in the market economy. The test is whether a private investor (who would want to make a financial return) would invest on those (or comparable) terms.
 - 6.7.2 Where the financial assistance is provided to facilitate the provision of assets which are services of general economic interest ("SGEI"), that assistance may constitute permitted state aid. There is no formal definition of SGEI in the EC Treaty but it is generally understood to mean services which the market does not provide or does not provide to the extent or at the quality which the state desires and which are in the general interest. Social (or affordable) housing, provided that the

assistance is no more than is required to make the activity viable (allowing for a reasonable element of developer profit), is capable of benefitting from this exemption.

- 6.8 Accordingly, the LHC funding will be capable of being structured on state aid compliant terms.
- 6.9 In practice, this means that the Council will lend money to the LHC at a market interest rate and on an acceptable term, which it will then use to purchase property from either the market (affordable housing from developers) or from the Council following development from community housing projects.
- 6.10 The LHC will receive the rent from tenants which will allow it to pay back repayments (capital plus interest) on the loan from the Council and manage the property.
- 6.11 The selection of tenants for these properties will be in line with the Council's allocation policy and Devon Home Choice. Management of the property will be undertaken by the Council's in house ethical letting agents SeaMoorLettings. Maintenance contracts will be set up to keep the property in good condition. These contracts will be commissioned by the LHC and may well utilise the Council's in house maintenance capacity.
- 6.12 A financial example is included in Appendix A, setting out how the finances could work between the Council and the LHC. The principle of this will be adopted for housing within the LHC.
- 6.13 Specialist tax advice would also need to be taken from tax advisers in advance of finalising the structure.

7 The Management Case (including Governance arrangements)

- 7.1 As explained above, the LHC would be a separate legal entity with its own directors.
- 7.2 The Council will retain control, through its shareholding / membership of the LHC, the right to appoint and/or remove all of the directors. It is this control mechanism that makes each LHC a subsidiary of the Council.
- 7.3 It is recommended that the Council looks to supplement those controls with an intra-group agreement which would, amongst other matters impose:
 - 7.3.1 A requirement for the LHC to submit its business plan for approval each year and an obligation to operate within those approved business plans;

- 7.3.2 Reporting requirements and compliance with audit arrangements;
- 7.3.3 Covenants not to bring the Council's reputation in to disrepute and to ensure compliance with all laws;
- 7.3.4 Covenants restricting the activities of the LHC including prohibitions on:
 - 7.3.4.1 acquiring subsidiaries or participating in joint ventures without consent;
 - 7.3.4.2 the appointment of a company secretary or employees (or only senior employees) without prior approval;
 - 7.3.4.3 accepting any form of indebtedness without approval; and
 - 7.3.4.4 entering into contracts that are material in nature without prior approval (unless such contract(s) are in the ordinary course of business or are compatible with the approved business plan).
- 7.3.5 A requirement for the LHC to adopt standing orders approved by the Council and to operate within them.

7.4 It is recommended that the board of the company is kept small and recognising the existing skill set in the housing sector within the Council, kept to existing employees only. The proposal for the Board is therefore:

- The S151 Officer
- The Director of Place and Enterprise
- MD of the LHC – Head of Housing

7.5 The LHC Board would commission services from the Council and the market to run the LHC. This would include accountancy services from the Council.

7.6 The Council would also have to account for the LHC submitting annual returns.

8 Proposed Way Forward

8.1 It is recommended to create a wholly owned local housing company structured as a Community Benefit Society. For the reasons set out above this type of charitable structure will not require separate registration with the Charities' Commission.

- 8.2 The CBS will be capable of holding the affordable housing developed via the community housing programme and also that purchased from developers¹.
- 8.3 So as to set up the CBS it is proposed to procure legal assistance from Devonshires LLP who have advised us to date. They would draft the articles of association and advise and prepare all necessary company documentation so as to form the CBS. Detailed tax advice and accountancy advice on Group Accounts would also need to be procured. These costs are recommended to be funded from the Affordable Housing Earmarked Reserve, up to £40,000.
- 8.4 The delegation set out in this report would then allow the formation of the LHC, such that rented housing stock can be transferred into it.

9. Implications

Implications	Relevant to proposals Y/N	Details and proposed measures to address
Legal/Governance		<p>The Council has powers to set up a wholly owned company as detailed in the report.</p> <p>The proposed Governance Arrangements of the Local Housing Company (LHC) are set out within Section 7 of the report.</p> <p>The LHC will require funding to support its activities. The Council is able to rely upon:-</p> <ul style="list-style-type: none"> • its investment powers (set out in the Local Government Act 2003); and • in the case of the LHC, the power to provide financial assistance (set out in Section 24 Local Government Act 1988 (Section 24)), to justify the provision of funding.
Financial implications to include reference		A simple financial example is included in Appendix A, setting out how the finances would work between the Council and the LHC.

¹ The Council's standard s106 wording is such that "**Affordable Housing Provider**" means a registered provider as defined in the Housing & Regeneration Act 2008 who is registered with Homes England or any other provider of Affordable Housing first approved in writing by the Council.

to value for money		<p>So as to set up the CBS, it is proposed to procure legal assistance from Devonshires LLP who have advised us to date. They would draft the articles of association and advise and prepare all necessary company documentation so as to form the CBS</p> <p>Detailed tax advice on the structure and accountancy advice on Group Accounts would also need to be procured. These costs are included within the amount recommended to be funded from the Affordable Housing Earmarked Reserve, up to £40,000.</p>
Risk		<p>There are no risks to setting up a LHC, the legal powers are set out in this report.</p> <p>Risks from housing delivery, purchase, management and maintenance will need to be managed by the LHC. The Council will need to manage housing delivery risk, as it currently does and have oversight of the LHC in the future.</p>
Supporting Corporate Strategy		Homes
Climate Change - Carbon / Biodiversity Impact		To be reconciled as part of the Housing Strategy
Comprehensive Impact Assessment Implications		
Equality and Diversity		N/A
Safeguarding		N/A
Community Safety, Crime and Disorder		N/A
Health, Safety and Wellbeing		N/A
Other implications		N/A

Supporting Information

Appendices:

Appendix A – Housing financial example

Background Documents

Executive March 2019 – Community Housing Programme