

CORPORATE VEHICLE FOR PROPERTY HOLDING PURPOSES: GREEN BOOK BUSINESS CASE.

1 INTRODUCTION

- 1.1 The Council has resolved to set-up of a local housing company as a vehicle to allow the Council to participate directly in the provision of housing. The form of company agreed by Council is a company that is wholly owned by the Council and limited by shares. The Council has now prepared a business case to underpin any decision to set up a company in line with the approach recommend in the HM Treasury Green Book Five Case Model.
- 1.2 The Business Case is made up of five key elements:
- The Strategic Case
 - The Economic Case
 - The Financial Case
 - The Commercial Case
 - The Management Case

2 THE STRATEGIC CASE

- 2.1 The District is primarily rural, covers some 21,500 hectares (83 sq. miles) and is situated in north–east Hampshire, bordering both Surrey and Berkshire. The main centres of population (i.e. Fleet, Yateley and Blackwater/Hawley) are in the north and east of the District and form part of a larger ‘Blackwater Valley’ urban area with other nearby towns including Farnborough, Aldershot, Camberley and Sandhurst.
- 2.2 The District is bisected by the main line railway from Waterloo to Southampton and east to west by the M3. These enable good access to London, Southampton and other key employment areas such as Basingstoke, Camberley and Farnborough. However, movement patterns are complex and vary with the purpose of the journey. Some key services such as main hospitals and larger shopping centres are provided outside the District, particularly in Basingstoke, Guildford, Reading and Camberley.
- 2.3 The District is a popular place to live as it benefits from low unemployment, low crime rates and good schools. It has a healthy, active population with high participation in sports and leisure. Due to its good connectivity and popularity, property values are very high.
- 2.4 There are approximately 94,250 residents in the District with an increasing ageing population. The District has a complex geography comprising a collection of diverse and distinct settlements. The larger settlements are suburban in character and have grown significantly in the last 30 years, largely through relatively low density, ‘greenfield’ development. There are an estimated 35,500 homes in the District with 30% of the population living in rural areas.
- 2.5 Having regard to the above context and characteristics of the District, the following Key Issues for the (not in any order of priority) are important to the Council¹:
- To make provision for the new homes needed in the area, including affordable housing particularly for social/ affordable rent;
 - For housing to meet the needs of all sectors of the community particularly for older people and/or the disabled.
 - To facilitate sustainable economic growth in the context of the wider Enterprise

¹ [Hart Local Plan \(Strategy and Sites\) 2032:](#)

M3 Local Economic Partnership area, and the Functional Economic Area within which Hart sits, and the need to provide for healthy town, district and local centres to serve the needs of residents.

- (iv) To ensure that the impacts on infrastructure (including waste water, transport, education, and community leisure facilities) arising from new development are adequately mitigated where necessary through infrastructure improvements.
- (v) To promote a healthy rural economy, and to maintain the viability of rural communities.
- (vi) To deliver development, where possible, which respects the separate character and identity of Hart's settlements and landscapes.
- (vii) For development to be well-designed, creating safe, inclusive and cohesive environments where new housing is successfully integrated with existing communities.
- (viii) To promote and improve sustainable transport particularly given the relative lack of sustainable transport options in what is a largely rural area, the pressure on highway infrastructure including the M3 motorway and its junctions in Hart (4a and 5) and a railway network at capacity at peak periods;
- (ix) To deal with climate change both in terms of mitigation and adaptation.
- (x) For development to be safe from flooding and not to increase the risk of flooding from all sources.
- (xi) To protect and enhance water quality and the ecological status of water bodies in accordance with the Water Framework Directive.
- (xii) To protect and enhance biodiversity including the protection of sites designated for their ecological importance. This includes the need to ensure that new development does not adversely affect the Thames Basin Heaths Special Protection Area (TBHSPA).
- (xiii) To protect and enhance the District's green infrastructure and the public rights of way network; and
- (xiv) To conserve and enhance the significance and special interest of the District's heritage assets and their settings.

3 THE ECONOMIC CASE

- 3.1 As part of the approval to set up the Company a number of delivery structures were investigated which had the potential to deliver the Council's objectives for the Edenbrook apartments in Fleet. These were approved by the Council in January 2021. The options were taken from best practice delivering similar projects developed by other Local Authorities and taking legal and financial advice.
- 3.2 The wholly owned company (WOC) approach has been agreed as the most appropriate method of delivering the project and whilst other options had their merits, the WOC offers less potential risk and more flexibility.
- 3.3 The WOC will be an organisation utilising existing resource where possible from within the Council to undertake the management of the property portfolio charging the WOC for its services at a commercial level. This has been incorporated within the financial modelling and will utilise existing staff resources within the Council, supporting the base budget position.
- 3.4 There is currently one site that has been identified to sit within the assets of the company. This is the Edenbrook site where 41 apartments are in the final stages of completion and will be available for affordable rent from the end of April 2021. It is also anticipated that once its longer-term future is resolved the former Swan Public House may potentially also become a residential asset for the company to hold.

4 THE FINANCIAL CASE

- 4.1 The Financial Case considers likely funding and affordability issues for both the Council (impact on the general fund) and the company.
- 4.2 The Financial Case models the Edenbrook development.

The number of units used for the purpose of the Business Case is set out in below.

Number of potential sites	1
Number of potential units	42

The actual program the company delivers could however, differ. Currently, there is only one site being developed for affordable market rent but further sites, like the Swan PH for example, will be added. The Financial Case modeling therefore only relates to the Edenbrook development. In accordance with the planning S106 Planning Obligation the modeling for Edenbrook is based on all units being for private market rent at affordable rental levels (i.e at 80% of the full market rental levels).

Developing the model

- 4.3 The development of the model has involved a range of council officers supported by external advisors with housing development, financial and tax expertise. The assumptions underlying the inputs are detailed below and have been subject to review throughout the preparation of the business case. The key areas considered included projected cash flow, corporation tax (at the applicable rate) and accounting implications for the WOC. The cash flow implications for the Council's General Fund have also been modelled alongside the WOC cash flows. Once the business case has been agreed a business plan will be prepared for Cabinet approval in April. The plan will be tested externally with an organisation familiar with the operation of similar companies prior to consideration by Cabinet.

Modelling assumptions and principles

- 4.4 The model works on the basis that the Council will invest in the WOC by transferring funding for either land or completed homes from its General Fund in return for a share in the WOC. Whilst the overall intention is to use the WOC simply as a property holding/management company, the option will be retained to allow the Council to also loan money to the WOC to finance possible future development activities.
- 4.5 It is also important to note that the Council will take security over the WOC's assets (specifically the land) to protect its investment.
- 4.6 The key commercial aspects are currently reflected in the modelling as follows:
 - 4.6.1 The Council will prudentially borrow in order to finance the WOC's development / construction activities. The financing of the WOC activities has been structured (in conjunction with external professional advisors) as a mix of loan finance (WOC Loan) and share equity in order to optimise the equity returns generated by the WOC and to broadly match the capital structure of a typical private sector developer.
 - 4.6.2 The WOC will access funding through the Council, likely to be prudentially borrowed and provided to the WOC through a mixture of debt and equity.
 - 4.6.3 To ensure the commercial structure is state aid compliant, the Council will be required to include a margin over the PWLB interest rate when pricing the WOC

loan.

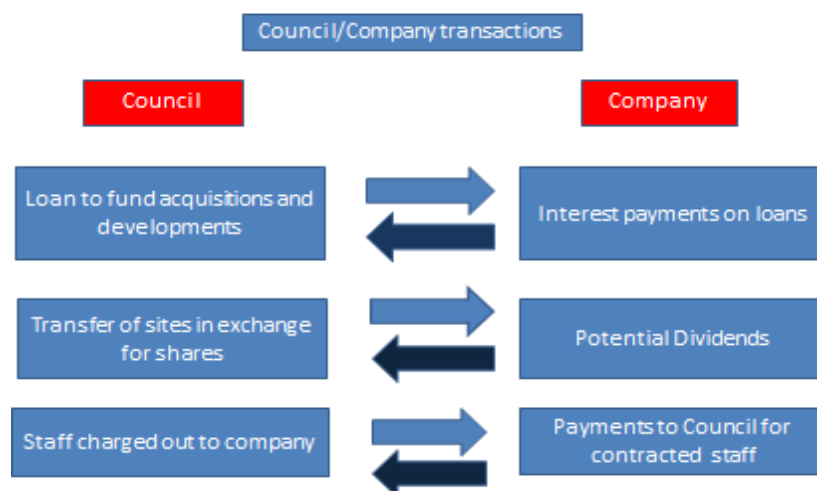
- 4.6.4 The Council will transfer funding or land from its General Fund in return for shares in the WOC. The WOC will be constituted as a company limited by shares in which the Council will own the entire share capital.
- 4.6.5 The servicing of the WOC loan is achieved through the generation of net rental income and the receipts arising from potential future sales of the properties by the WOC at the end of the 30 year period. The WOC will rent the houses out in order to repay the debt interest.
- 4.6.6 Net rental income after operating costs will be used to repay interest and the surplus will mainly be returned to the Council by way of interest charged on loan notes.
- 4.6.7 The WOC will act as an investment company, retaining the properties developed by the WOC for letting under new tenures at a mix of affordable and private rents in accordance with the agreed business plan.
- 4.6.8 The WOC will be consolidated into the Council's accounts. Group accounts will have to be prepared for this purpose. The WOC will be recognised in the Council's accounts partly as an investment in company shares, and also as a long-term debtor in relation to the issue of loan notes.
- 4.6.9 The acquisition of equity by the Council and the provision of loans to a third party are both defined as capital expenditure by legislation. They are specifically determined in the statutory instrument SI 2003/3146 (acquisition of equity; paragraph 25(1)(d) and loans; paragraph 25(1)(b)). Because such expenditure is funded by borrowing, there could be a requirement to make prudent provision for the repayment of such debt. However, the assumption has been made that the Council would expect repayment of the loan debt element in full, therefore, there is no requirement to make a provision for repayment of the loan.
- 4.7 The key financial assumptions underlying program modelling are shown in the following table. The assumptions have been based on information provided by property and financial consultants utilising industry benchmarking and data.

Item	Assumption
Funding rate/term	<i>50 years, 2.8%</i>
WOC Funding rate	<i>50 years, 3.8%</i>
Land cost	<i>Based upon negotiated purchase price.</i>
Construction costs	<i>Based upon negotiated purchase price.</i>
Rents/ letting profile	<i>Rents are based upon 80% of current market rents, uplifted to the letting date and then uplifted at 3% per annum</i>
Annual maintenance/ operating costs	<i>Management, maintenance, client management and lifecycle costs reflect analysis of Council/local Registered provider costs and benchmarked data,</i>

	<i>uplifted at 3.0% per annum.</i>
Void Rate/ Bad debts	<i>5% of gross rental per annum. Based upon benchmark information.</i>
Management fee	<i>12.5% of gross rental income per annum. Based upon benchmark information.</i>
Maintenance charge	<i>£588 per unit plus service costs per annum. (RPI indexed). Based upon benchmark information.</i>
WOC operating costs	<i>Full cost recovery</i>
House Price inflation	n/a as no disposals planned

- 4.8 The General Fund will receive three different types of revenue return from the Housing Company

Revenue Returns to the General Fund



Dividends

- 4.9 In some cases the financial modelling for the Housing Company demonstrates, on the current assumptions, that the initial loan debt can be repaid and that the Company is able to make both all interest payments on the total loan values as they fall due. The company could provide the Council with an annual dividend from year 2 whilst generating a surplus position for the company.

Other returns

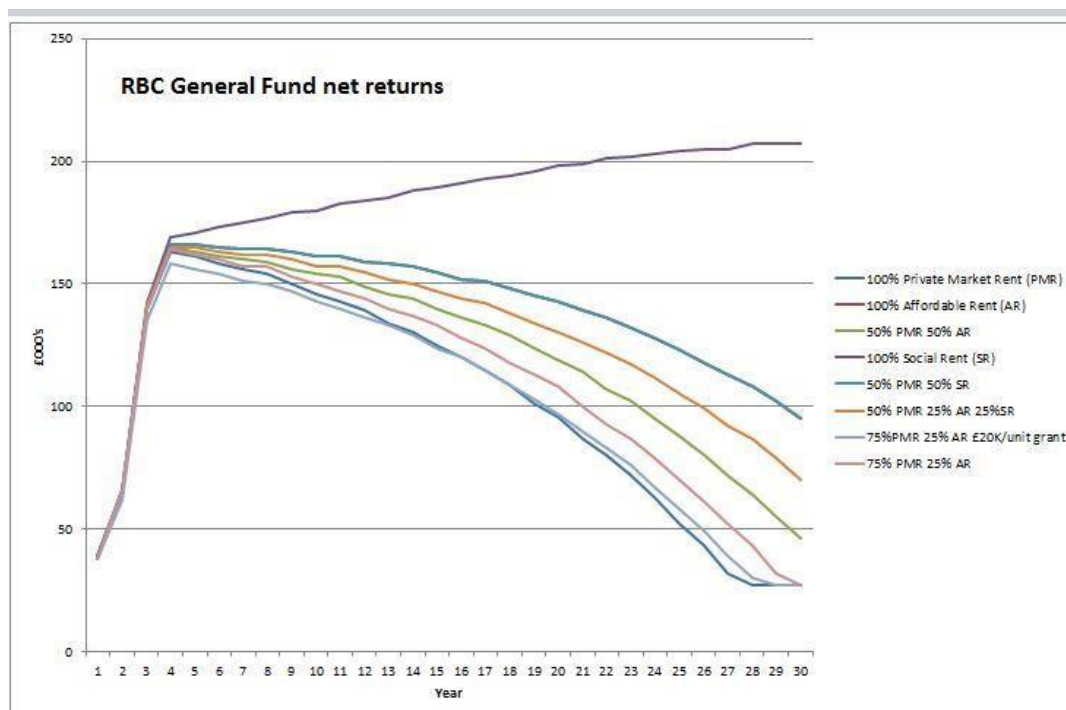
- 4.10 In addition to the returns to the General Fund as set out above, the Council will benefit from additional income through Council Tax generated from dwellings. The potential to generate income will also result from the provision of Council services and by contracting staff to the Housing Company subject to available capacity.

Options modelled

4.11 A total of eight options of tenure mix have now been run through the model.

Option 1	100% Private Market Rent (PMR)
Option 2	100% Affordable Rent (AR)
Option 3	50% PMR 50% AR
Option 4	100% Social Housing (SR)
Option 5	50% PMR 50% SR
Option 6	50% PMR 25% AR 25% SR
Option 7	75% PMR 25% AR
Option 8	75% PMR 25% AR £20K/unit grant e.g. commuted sums

4.12 All options deliver a return to the Council. All options excluding option 4 indicate the WOC would operate with a decreasing debt over the 30 year period modelled. However, only options 1,7 and 8 demonstrate full/nearly full repayment of debt over the 30 year period. This is shown graphically below and the supporting financial tables (exempt) will be available for consideration by members at the meeting along with the theoretical balance sheet and profit and loss information for the Company and the Council balance sheet and General Fund impact.



4.13 The performance indicator that was chosen for the purposes of the financial model was that the company could repay its loans in 50 years. The elimination of debt within this target period is a good indicator of company financial health and helps the company eventually to generate cash toward the end of the modelled period that could be used to pay dividends.

Risks and sensitivities

- 4.14 The current financial modelling indicates that, based on the initial 42 unit model for the Company, the Council would make a return on its investment in the Housing Company. However, although the business case demonstrates that the Housing Company is viable, there remains a risk that the principal sums transferred to the Housing Company by the General Fund are not returned in full. This would require adverse movements in a number of the assumptions used in the business plan but is nevertheless a risk.
- 4.15 Sensitivity analysis has been undertaken in relation to the financial projections. The analysis considers changes in some of the key financial assumptions on which the model is based. These sensitivities consider largely the impact of downside movements on key input variables against the key metrics of the base case.
- 4.16 Whilst the WOC is an investment vehicle, the drivers behind a number of key metrics are centred on various capital elements such as development costs, sale values and house price Inflation (HPI). To reflect this point the impact of reducing rental income inflation to zero for a period of 6 years does have a materially adverse effect as the reduction in rental income results in lower company performance impacts on the Council's ability to achieve a buoyant financial return.
- 4.17 However, an increase in rental income inflation to 3% provides a significant increase on the rate of return. The business case assumptions on rental income inflation and HPI can be considered prudent given current housing market trends.
- 4.18 A balance will need to be struck between financial advantage to the Council and the risks for the company. Because the company is wholly owned by the Council any adverse effects on the Company could cause difficulties for the Council and it will be the responsibility of the Company Board to run the WOC prudently and within the expectations and requirements of the Companies Act.

5 THE COMMERCIAL CASE

- 5.1 The rationale for setting up a WOC has both legal considerations and commercial considerations. The legal considerations were fully considered as part of the option analysis approved by Council. This section therefore analyses the commercial considerations for the program.

The Delivery Vehicle

- 5.2 The key consideration of a delivery vehicle is to create a legally sound structure for the Council to deliver new housing. This was discussed in the option analysis approved by Cabinet and Full Council.

The Funding Route

- 5.3 The two main options for the Council to consider include the use of S.106 contributions and the drawdown of PWLB funding. Essentially the tenure of the property and level of PWLB rates will drive the source of funding to be used. Information on PWLB rates is regularly reported to Cabinet and Overview and Scrutiny Committee as part of the Council's Treasury reporting arrangements.

The local rental market

- 5.4 Hart District has a very strong rental market and is a fast-growing sector. High deposits and mortgage restrictions alongside recently furloughed workers has led to increased demand for rental properties.

Company Business Plan

- 5.5 The Business Plan will act as a living document which is regularly reviewed by the Company and the Council. This Business Case contains the initial programme and assumptions that will inform the Business Plan. The Business Plan will be formally reviewed by the Company Directors at least every 12 months and reported to the Project Board, Overview and Scrutiny Committee and Cabinet. The Business Plan will contain Risk Analysis and confirmation of procurement rules and levels of delegated authority.

6 MANAGEMENT CASE

Introduction

- 6.1 The Management Case covers Governance Arrangements for the Company It also shows how Council will undertake the project, detailing the decision-making process, staffing arrangements, consultancy support, and budgets.
- 6.2 The company will be set up and governed as a Wholly Owned Company (WOC) of the Council. An appropriate governance structure is required to ensure sound and robust management of the company alongside protection of the Council's financial and reputational investment in the company. The governance must not hinder the company and must allow it to act swiftly and pro-actively as a separate legal entity.
- 6.3 The Council will own 100% of the shares in the company. As shareholder the Council will among other things, agree and approve the company's annual business plan and funding arrangements and monitoring progress against the business plan on behalf of the Council.
- 6.4 There will be a range of matters reserved to the Council which means the company must have the Council's consent to actions relating to these matters. Outside of this the management of the company will be the responsibility of its board of directors.
- 6.5 Examples of matters that would require Council consent are:
- 6.5.1 Borrowing outside the funding agreements entered into with the Council,
 - 6.5.2 Creation of a subsidiary
 - 6.5.3 Adoption or amendment of the Business Plan
 - 6.5.4 Acquisition of land or dwellings above a given value
 - 6.5.5 Entering into contracts above a certain value

These and other items requiring consent will be contained in a shareholder agreement.

- 6.6 Full Council will exercise its role as shareholder. Consideration will need to be given to whether some matters will still need Cabinet approval.
- 6.7 The need for the Shareholder to allow the company to react quickly in a commercial way will be a critical factor when considering the best structure.

The Board of Directors

- 6.8 The company will have up to five directors, appointed by the Council, who are officers.

They will need training to explain the extent of their formal duties under the Companies Act 2006 and their need to disclose their interests. The Council has agreed that no elected Members may serve on the Board.

- 6.9 The Council will need to provide indemnity insurance cover for officers of the Council serving on the board.
- 6.10 Although the company is wholly owned by the Council, as far as company law is concerned, the directors have duties to exercise independent judgement in the governance of the company and are accountable in terms of their duties under the Companies Act 2006. For example, they have to:
- act within their powers;
 - carry out their role for a proper purpose;
 - have a duty to promote the success of the company; and
 - exercise independent judgement / exercise reasonable care, skill and diligence/ avoid conflicts of interest / declare an interest on any proposed transaction / to declare interests in existing arrangements.
- 6.11 To avoid potential Conflicts of Interest the Council have decided that officers rather than Members will fulfill roles on the company board. The Local Government and Housing Act 1989 deals with companies under the control of local authorities and subject to local authority influence. The Housing Company is likely to fall within one of these categories and will therefore be required to comply with the relevant provisions of the Local Authority (Companies) Order 1995, in terms of accounting for debts etc.
- 6.12 The Council's fiduciary duties can be briefly summarised as acting as a trustee of tax and public sector income on behalf of its rates and taxpayers. The Council in effect holds money but does not own it and spends that money on behalf of its business rate and council taxpayers. Taking these fiduciary duties into consideration, the Council's primary objectives when making investments/loans are the repayment of the principal and interest on time, then ensuring adequate liquidity, with investment return being the final objective. The Council therefore will need to ensure that that it has minimised the risks and potential costs to it if the Housing Company becomes insolvent and/or defaults on any loans and then ensure that it achieves an appropriate return for the lending it provides.
- 6.13 If the Council is acting in a way that a private lender and/or investor would not act in similar circumstances in a market economy, for example, by providing a loan on uncommercial terms and at an uncommercial interest rate, and/or was making an equity investment on the terms and for the return which a private investor would not, then such activity could constitute unlawful State Aid.
- 6.14 When the Council establishes the detailed loan arrangements with the Housing Company it will need to ensure that an analysis of the relevant risk in relation to the loan is undertaken and also confirm that the interest rate applied is consistent with that which a private lender would require in the same circumstances and that the non-financial element of the loan complies with the terms and conditions which a private lender is likely to require, so not to constitute unlawful state aid.
- 6.15 State Aid will need to be continually kept under review to ensure that the support from the Council is able to continue to be provided throughout the loan period.
- 6.16 It is also important that any services provided by the Council to the Housing Company are provided at "arm's length" on a commercial basis.

Staffing

- 6.17 In the initial set up stage, council staff will be contracted to the company to carry out the work necessary to deliver and review the company's business plan. Formal contractual agreements will be entered into between the Council and the Housing Company in relation to such staff. The contracted staff team would run the day to day management of the company. Working as a team, they would need to oversee the design, planning, procurement and construction process through strong project management processes and monitoring the performance of contracts such as letting and management agents.
- 6.18 The staff team would commission specialist consultants and contractors to undertake the detailed design, planning and implementations work ensuring that such matters conform to the company's procurement requirements.
- 6.19 The Housing Company will contract with the Council through a series of service level agreements for HR, finance and legal advice etc. The company will meet the cost of staff and specialist support. The Council will charge the company for contracted staff including VAT at the appropriate rate. It is unlikely that the company will be able to recover the VAT charged in these circumstances.

Proposed Accounting arrangements

- 6.20 Due to the relatively limited volume of transactions within the company for the initial years, it would be practical to maintain and complete the accounts within a spreadsheet. The alternatives are to
- (i) utilise capacity in Hart Integra 2 system (setting up a new company within), or
 - (ii) the company purchases a software package.
- The company will also require its own bank account.

Project Management

- 6.21 It is currently proposed that this will be treated as a project as part of the Council's Corporate Project list and will be managed and governed in accordance with the processes set up for Corporate Programme management.

7 CONCLUSION AND NEXT STEPS

- 7.1 Consideration of the desired outcomes against the delivery vehicle options has led the Council to conclude that a wholly owned company limited by shares is the best vehicle to assist the Council in meeting its housing objectives. Examination of this option has established that the Council has powers to create a company and to provide funding. Financial modelling demonstrates the potential to make a return on investment in the company from three principle sources: dividends deriving from surpluses, interest on loans to the company, and charges for services provided to the company by Council staff. A company will give the Council the freedom to participate in the housing market to meet housing needs and to achieve greater financial sustainability.

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