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OXFORD CITY COUNCIL

To: **City Executive Board**

Date: **17 March 2016**

Report of: **Head of Housing and Property Services**

Title of Report: **A Housing Company for Oxford**

Summary and Recommendations

Purpose of report: To present the business case and seek approval for the establishment of a Council owned housing company, and to seek approval for the Council to enter into such agreements as are necessary to enable the company to acquire the affordable housing at Barton Park in place of the Council

Key decision *Yes*

Executive lead member: Councillor Mike Rowley, Councillor Ed Turner

Policy Framework: Housing Strategy 2015-18

Recommendations: That the City Executive Board resolves to:

1. Agree the principle of setting up a Local Authority wholly owned housing company structure ('the company') with the overarching aim of increasing housing supply, noting that there are a range of work-streams which the company structure can pursue, including:-

- The purchase and management and management of the affordable rented homes at Barton Park;
- The development of new affordable housing with a range of tenures;
- The purchase and management and management of high value void properties from the Council to re-provide affordable housing; and
- The undertaking of Estate regeneration schemes

2. Delegate authority to the Executive Director, Housing and Regeneration in consultation with the Council's statutory officers, Deputy Leader and portfolio holder for Housing, to do anything necessary to set up an appropriate company structure, including:

a. Selection of the name of the company
b. Approval of the type of company, the articles of the company and the size and composition of its board
c. Appointment of Directors and Company Secretary of the company
d. Approval of a shareholders agreement to be entered into between the company and the Council
e. Ensuring that the company will hold appropriate insurances and/or benefit from insurances that the Council holds

3. Authorise the entry into discussions with Barton Oxford LLP and Hill Residential Ltd to enable the novation/assignment (and variation to the extent necessary) of the Overarching Agreement and the Conditional Development Agreement and all or any associated agreement warranties etc so that the company may acquire the affordable housing at Barton Park in place of the Council and the delegation to the Executive Director, Housing and Regeneration in consultation with the Council's statutory officers of all necessary steps to achieve this, including:

a. approval of the final terms of any proposed agreements with Barton Oxford LLP and Hill Residential Ltd to give effect to the above
b. the decision whether or not to offer a Council guarantee to Barton Oxford LLP and/or Hill Residential Limited in order to enable the company to acquire the housing at Barton Park and approval of the terms of any such guarantee
c. approval of the terms of any contracts to be entered into between the company and the Council in relation to the management and maintenance of the Barton Park affordable homes
d. approval of the terms of any nomination/allocation agreement to be entered into between the Council and the company
e. approval (in exercise of the housing and regeneration function but not so as to affect the planning function of the Council) of any proposed variation to the Barton Park s.106 agreement.

4. Recommend Council to amend the Treasury Management Strategy to enable the making of loans to the wholly owned Housing Company on State Aid compliant terms of up to £12,250,000 to fund its purchase of the Phase 1 affordable housing at Barton Park and to delegate to the Chief Finance Officer approval of the terms of the loan and the terms of the facility agreement(s) and any associated documentation.
5. To recommend to Council the inclusion of an amount of £12,250,000 in its General Fund Capital Programme in 2017/18 funded by Prudential Borrowing.
6. To recommend to Council the provision of a loan facility to the Company of up to £250,000 to fund the set up costs and provide initial working capital

and delegate to the Chief Finance Officer approval of terms of the loan and the terms of the facility agreement.

7. To recommend to Council the adoption of the Local Authorities (Indemnities for Members and Officers) Order 2004 in respect of officers of the Council appointed to the Housing Board in accordance with paragraph 40.
8. To recommend to Council a General Fund revenue budget of £40,000 in 2016/17 for the setting up of the Company funded from reserves.

Appendices

Appendix 1 Risk Register
Appendix 2 Equalities Impact Assessment
Appendix 3 Barton Park financials

Background

1. Oxford's housing crisis is acute with the city identified as the most unaffordable housing market in the UK. The lack of housing supply, quality and choice are a constraint on economic growth and a significant barrier to our ambition to be a world class city for everyone.

2. A Local Authority housing company can enable the additional delivery of housing supply across a range of tenures. Over 50 Local Authorities have set up or are considering establishing a housing company. Some companies are commercially driven and being set up to deliver additional funding for the Council's general fund; others are set up with more of a focus on affordable housing provision.

Purpose for establishing a housing company in Oxford

3. The overarching purpose of the housing company is to increase the supply and range of affordable housing and it is envisaged that there will be four main strands of activity namely:

   - The purchase and management of the affordable rented homes at Barton
   - To develop new affordable housing with a range of tenures
   - The purchase and management of high value void properties from the Council that need to be sold to help Government fund the RTB for Housing Association tenants and to re-provide affordable housing
   - To undertake estate regeneration schemes.

   The potential additional benefits of a local housing company include:

   - The development of its services offer to the private sector, for example property management and repairs.

- A direct role in providing homes for the key workers Oxford needs, for example through sub-market rent or shared equity tenures
- Influencing the pace and type of house building though site acquisition and development.
- The provision of a longer term private rental offer giving households increased stability
- The development activity will provide direct employment, jobs through the supply chain and the opportunity to grow local skills especially through apprenticeships.
- The provision of a revenue stream for the Council through the servicing of the loan funding it has received. This will exceed the Council's costs in providing the capital and generate a surplus.
- The initial structure will result in a need to procure a range of services, including development management, finance, repairs, housing management, from the Council, providing an income stream to support service provision.
- Acting as a catalyst for the regeneration of Council estates by generating value to provide gap funding for development.
- Acquiring empty homes that the Council CPOs.
- Support the Council to CPO land allocated for housing from landowners reluctant to develop and sell it to the company to bring forward development more quickly.

Company characteristics

4. The company would be a separate legal entity wholly owned by the Council. It would have the power to undertake anything a company can do and in particular to acquire and hold land and properties. The company would be run by its Directors but their decision making would be constrained by a shareholders agreement which would define the limits the Council wants to place on the ability of the Directors to make decisions and in particular the decisions that would need shareholder consent. The Council would be the sole shareholder and as such decisions as to how to exercise its shareholder powers would come back to the Council's City Executive Board.

5. The activities of the company would in the early years be funded by the Council through the provision of State Aid-compliant loans to the company. The Council would fund these loans either through borrowing from the Public Works Loan Board or from other financial institutions, where preferable (or when money is available by lending money the Council would otherwise hold on deposit). The margin on these loans would generate additional surpluses for the General Fund whilst offering the housing company competitive loans secured against its housing stock.

6. As a matter of law the housing company can only offer assured or assured shorthold tenancies. Its tenants if they require benefit to cover their rent would receive it as Local Housing Allowance (or through

Universal Credit when this applies). Where the Council is financing or transferring land to the company the Council could decide either in its capacity as lender or through the shareholders agreement to set the parameters for the tenancies to be offered, rent levels and allocations/nominations agreements. As the law stands Right to Buy would not apply to the tenants of a company like this, although Government may introduce legislation extending Right to Buy to tenants of Council controlled housing companies.

7. The Directors of the company have a fiduciary responsibility to act in the best interests of the company and promote its long term success. Under the Companies Act 2006 promoting the success of a company means operating for the benefit of the shareholders, which in this case would be the Council. This is helpful as it minimises potential conflicts of interest for Directors.

8. Most local housing companies have officers appointed as Directors, as is proposed in this case. Some Councils have also appointed non-executive Directors to bring in external expertise, and this might be considered at a later date, if required. It is proposed that CEB takes on the role of making decisions for the Council as shareholder, both in matters that require consent under the shareholders agreement and in monitoring and holding the company to account.

Procurement

9. A company wholly owned by a local authority will have to comply with EU procurement law when procuring its own contracts as in this case it is "established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character" (Public Contracts Regulations 2015).

10. The company's principal objective is to provide additional affordable housing, which is consistent with 'meeting needs in the general interest', but this does not exclude developing market housing in support of this objective. It is possible for a company to be established in the 'general interest' but outside the Regulations if the company has a "commercial character". We are advised that this is a test that relates to how the company is intended to operate, what freedom it will have to choose to take its own risks and if it is competing in the market place generally. We are advised that, given what is being currently proposed, it would be prudent to assume that the company will be subject to the Regulations.

11. The Public Contracts Regulations allow for Local Authorities to let contracts to companies and vice versa in certain circumstances without a procurement process. On the basis that it will be a wholly owned subsidiary of the Council, and the Council is exercising real control over its activities, the company will be able to procure services from the Council (housing management, repairs, insurance etc.), and the

Council can as necessary contract with the company, without going through procurement processes. To qualify, the Regulations 2015 require that at least 80% of the company's activities must be activities entrusted to it by the Council and there must be no third party non-public equity stake in the company that would give an investor decisive influence over the company.

Barton Park Affordable Housing

12. The acquisition of the Barton Park affordable homes is the first step in a broad mix of activity for the company to increase the supply of affordable housing, including the purchase of properties, new development and estate regeneration. The new development at Barton Park will provide 40% of the homes as social rented housing (currently estimated to be 354 homes).The Council has contracted under an overarching agreement with Barton Oxford LLP to purchase all of the affordable housing at Barton, subject to various conditions.
Phase 1 will be developed by Hill Residential Ltd and includes 95 homes. The recent Government policy changes make this purchase uneconomic for the HRA.

13. Assuming successful negotiations with Barton LLP and Hill Residential Ltd, it can afford to buy the Phase 1 affordable housing retaining the homes at social rents to meet local needs with their on-going maintenance and management being seamlessly provided through the Council.

14. Variations to the agreements relating to the Barton Park affordable housing will need to be negotiated. Both Barton Oxford LLP and Hill residential Ltd will have to agree to the novation/assignment of the existing agreements and detailed issues such as warranties/letters of reliance from third parties will need consideration to enable the company to acquire the homes.

15. The Council will lend the finance to the company to enable it to buy the Phase 1 properties. It is envisaged that there would be a formal facility agreement in place with conditions for drawdown and provision for the Council to take security over the properties. The Council should note that Trowers and Hamlins has advised that if a loan is made available to acquire affordable housing then there is no State Aid requirement to lend on market equivalent terms as this is likely to fall within one of the State Aid exemptions. The Council has also taken advice on State Aid compliant loans from Capita. The Council is entitled to set the terms of any loan and to make a return even if State Aid does not require it to.

16. The Council will need in the future to consider what agreements it wants to enter into in relation to future phases of affordable housing at Barton. The overarching agreement with LLP created a conditional contract for the Council to acquire the whole of the affordable housing at Barton. The LLP may seek Council guarantees on funding and

management if the housing company acquires the affordable housing instead of the Council.

Future Developments

17. Details on future developments to be undertaken by the company would come to CEB. The Council has already obtained planning permission for 42 homes on several HRA sites and there is other Council land capable of development which could be transferred to the local housing company. In addition there is the potential for the housing company to acquire the housing land associated with the Rose Hill Community Centre site from the Council giving the company a potential initial programme of 93 homes. The Council can control the tenure of homes on these sites through covenants on the land transfers to the housing company should it so wish, although this would reduce the site values.

18. These initial developments on Council land along with the purchase of the Barton Phase 1 homes would result in an initial development portfolio of 188 homes in Oxford. This would be supplemented by further development sites being identified on Council land including possible regeneration schemes, other sites being acquired in the market and potential s106 deals with developers. There is also the option for the housing company to pursue development opportunities outside Oxford where it was felt it was compatible with the City Council's wider strategic objectives.

Purchase of High Value Council Void Properties

19. To pay for the RTB extension to housing associations, the HRA will need to pay a levy to Government based on a formula assuming the anticipated sales of high value void properties. The housing company may be able to acquire and retain these homes whilst generating the necessary receipts for the Council to pay the levy. However, at present the transfer of more than 5 properties a year to a wholly owned subsidiary company under the 1985 Housing Act and its associated general consents will need the Secretary of State's approval. This issue is under consideration as part of the Council's devolution discussions with Government whilst at the same time the Housing and Planning Bill is progressing through Parliament which will dictate the terms of levy. This uncertainty means that it is not possible at this time to make a clear recommendation to Members. A recommendation will be brought back to Members at the earliest opportunity.

Legal Issues

20. Councils only have the powers given to them by statute and every part of the proposed activities in this report must be analysed to ensure the Council has appropriate powers, and is exercising those powers for proper purposes.

21. The Council has the power to set up a company through the general power of competence in Section 1 of the Localism Act 2011 which provides local authorities with the power to do anything an individual can do. This very wide power is limited by s.2 so that pre-existing statutory constraints are not overridden, so for example the rules that apply to local authority land transfers still apply. Section 4 of the same Act states that Councils can only use the s.1 power to carry out activities for a commercial purpose if they are an activity they could carry out for a non-commercial purpose. Setting up a company is an activity that a Council could carry out for a non-commercial purpose and therefore the Council can use the s.1 power to set up a local housing company. We have been advised that given that pre Localism Act statutory constraints on Councils still apply it would be prudent for the Council also to comply with the requirements of the Local Government Act 2003 (and the associated regulations) that relate to trading. In essence this requires the Council to approve a business case before the company starts trading.

22. The fact that the company may itself carry out activities of a commercial nature does not affect the use of the s.1 power to set up the company. CEB should note that if the Council decided that it wanted to use the s.1 power to enable the Council itself to carry out market sale or market rent development as these are commercial activities s.4 of the Localism Act would require these activities to be carried out through a company.

23. The Council must be satisfied that it is setting up a local housing company for proper purposes such as enhancing the economic and social development of its area, and that in so doing it recognises its fiduciary duty to its tax payers.

24. If the only activity the company was ever going to do was to take on the affordable housing at Barton Park the Council would need to be clear on its reasons for setting up a company. Proper reasons could include the mitigation of the significant liabilities that the Barton Park agreements now create in the light of the changed external environment. However the intention is that subject to future decisions by CEB the company would do more than this, and the rationale for setting it up can properly include intended future activities even though no final decision has been made on these.

25. In terms of the power to borrow in order to on lend to the company the Council would be using its power to borrow prudentially as contained in the Local Government Act 2003 and it must be satisfied that any borrowing is prudential in accordance with the relevant Code. Borrowing to on lend to a Council owned company is general fund borrowing.

26. The Council has power to lend money to the company and to offer guarantees where the loan/guarantee relate to the provision of rented housing under s.24 of the Local Government Act 1985.Use of that power requires a statutory consent but there is a wide general consent which allows the provision of financial assistance "to any person". To the extent that any part of the loan finance is not for rented housing then the council would again be using its power under s.1 Localism Act as described above.

Financial Issues

27. Both the credit agreement selected and the interest rate charged to the company will be determined when the finance is actually required in around 18 months' time and will reflect prevailing risks and economic conditions that exist at that time.

28. However, for illustrative purposes the Council has undertaken financial modelling of three different interest rates that are currently available based on 40 year annuity based loans for an estimated acquisition cost for the first 95 dwellings. A variety of revenue performance assumptions have been equally applied to each option and relate to rent assumptions, inflation, discount rates, management and maintenance costs, void rates etc. Some of the headline outcomes are shown below with more detailed analysis shown in Appendix 3

40 Year Annuity Loan Rate	Total scheme costs	Property value	Payback	Peak debts	Year of Peak Debt	Net present value	Internal Rate of Return	Repayment year	Asset cover when scheme comes into management	Year 110% interest cover acheived
	£	£	£	£		£	%		%	
4.30%	10,815,916	32,506,000	23,986,254	10,904,330	2	5,831,821	71.62%	40	300.54%	2
5.50%	10,815,916	32,506,000	26,073,990	10,877,973	2	3,831,030	14.11%	40	300.54%	6
6.02%	10,815,916	32,506,000	27,788,858	10,880,781	2	2,933,806	10.26%	40	300.54%	8

Basis of calculations

Loans to Company

The loan to the company is based on an annuity basis where interest and principal is repaid over the life of the loan. The loan rates modelled represent

a. The 4.30% reflects the current 40 year PWLB annuity new loan rate +1%.
b. 6.02% reflects current state aid compliant rate loans for high collateral, high risk lending.
c. 5.50% reflects a current state aid compliant loan rate with a lower risk of lending

Property Value - this is the estimated market value of the properties acquired at the date of acquisition.
Payback - this total represents the value of the total loan payments. An annuity option when all the loans are procured will show the same

annual figure until the end of the loan period, namely 40 years in the examples used given they are brand new properties.
Peak Debts - this is the highest level of borrowing for each option. For annuity loans this should always be at the beginning debt is procured as principal is repaid at the start.
Year of Peak Debt - the year when the peak debt level is achieved.
Net Present Value - For each option the NPV discount rate used is 3.50%. The discounted cash flows (including the cost of borrowing) is shown in the above table.
Internal Rate of Return - this is the discount rate which returns a zero NPV. The important aspect to consider when viewing the IRR is that it returns a percentage above the cost of borrowing, which is the case for all 3 annuity interest rates used.
Repayment Year - for annuity loans this will be the year of the annuity i.e. 40 years.
Asset Cover – this represents the market value of the properties acquired as a percentage of their cost of acquisition. This is the same for each option and demonstrates significant cover.
Year 110% Interest Cover Achieved - this is the year when the net income divided by the interest cost equates to 110%. The sooner this occurs then the more financially robust the cash flow projections. The 110% Interest Cover figure is a desired ratio of income to interest (%).

29. In summary :

- Each proposal demonstrates a positive net present value and therefore the proposal is financially viable for the company at all borrowing rates
- Each proposal does eventually provide a significant financial return for the Council as indicated by the payback. This is due to the favourable borrowing rate compared to the state aid compliant lending rate to the company
- There is significant asset cover for the loan estimated at around 300%.
- Interest cover is achieved between 2 and 8 years using the data and rates shown above

30. The initial request for approval of borrowing up to £12.5m allows for both working capital and a significant contingency provision between the estimated cost of acquiring the completed social housing dwellings from the developer, uplifted by the interim BCIS (Building Construction Cost Information service of the Royal Institute of Chartered Surveyors) being the leading provider of cost and price information for the construction industry.

31. The housing company will need to pay corporation tax (currently 20%) on any taxable profits it generates. Careful management of predicted surpluses through timely acquisition of land and property can limit its tax liability, as can the use of appropriate tax reliefs (for example on interest payments), although this does require the identification of

available assets to purchase that fit with housing company objectives. However, it is important that the minimisation of corporation tax does not drive the activity of the housing company.

32. The company will not benefit from the Council's ability to recover VAT so will have to pay VAT on VAT able service supplied to it and will not be able to recover VAT charged on for example repair costs and fees associated with management of rented stock.

33. The Council will need to estimate and charge to the company, services such as housing management, finance, legal and maintenance.

34. As with the Council, Stamp Duty Land Tax (SDLT) would be payable on any land or property acquisitions from third parties. Group company relief may be possible to obtain on transfers from the Council to the company. The company would need to take proper tax advice on each project/transaction.

35. The company must be and remain a viable entity. A rolling 40 year business plan for the housing company will be maintained to support the planning of development activity over the long. It is envisaged that the business plan will be approved on an annual basis by the council as the main shareholder, in accordance with the shareholder's agreement.

36. The housing company will not have funding at the outset and it is therefore necessary that working capital should be made available to ensure it can financially operate from day one. It is therefore proposed that the Council will make available these resources in the form state aid compliant loans as part of the £12.5 million.

37. Given the company will be a wholly owned subsidiary of the Council the VAT planning obligations and structures adopted by the company must at all times be established with a mind to both the company’s taxation responsibilities but also the VAT position of the Council as a whole.

38. Along with corporation tax the company's business plan will need to provide for cyclical and ad-hoc maintenance costs, housing management, rental admin., audit and final accounts obligations as well as any additional procured services needed to oversee its revenue obligations.

39. Future income stream risk obligations created as a result offered by the activity of the housing company will be incorporated into the Council’s Medium Term Financial Plan accordingly, as will the associated risks aligned with the company’s activities.

40. The formation of the Company will require the appointment of officers of the Council to act as Directors of the Housing Company Board. Normally this would require the Council to take out separate insurance

for these officers as indemnity for any decisions made when acting as Board Directors. The Local Authorities (Indemnities for Members and Officers) Order 2004 gives local authorities the power to provide indemnity cover for its members and officers who are working for a local authority-owned company. In effect, this would allow the Council to include this risk on its own insurance policy (and pay for it) should it choose to do so. The use of such an order would require a formal resolution from Council.

41. Start-up costs for the company are estimated to be in the order of £40,000 which paid for from the Councils General Fund for which a recommendation will need to be made to Council to establish the budget in 2016/17. The amount will be funded from reserves.

42. In accordance with the Treasury Management Strategy approved at Council on 17 February 2016 the that the Council will make no Minimum Revenue Provision (MRP), as per Regulations 27 and 28 in the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 3146, as amended] Since it is expected that the investment is repaid in full.

Environmental Impact

43. Environmental sustainability will be a key consideration for all developments undertaken by the housing company.

Equalities Impact– see appendix 2

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