

**READING BOROUGH COUNCIL  
REPORT BY HEAD OF FINANCE**

<b>TO:</b>	<b>AUDIT &amp; GOVERNANCE COMMITTEE</b>		
<b>DATE:</b>	<b>18 JULY 2017</b>	<b>AGENDA ITEM:</b>	<b>10</b>
<b>TITLE:</b>	<b>HOMES FOR READING LTD - ARRANGEMENTS</b>		
<b>LEAD COUNCILLOR:</b>	<b>CLLR LOVELOCK</b>	<b>AREA COVERED:</b>	<b>LEADER (&amp; COMPANY BOARD MEMBER)</b>
<b>SERVICE:</b>	<b>FINANCIAL</b>	<b>WARDS:</b>	<b>BOROUGHWIDE</b>
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**1. PURPOSE AND SUMMARY OF REPORT**

- 1.1 To provide the Committee with information about the arrangements the Council has established in relation to Homes for Reading Ltd (HfR), and ask the Committee to identify any information it needs to fulfil its scrutiny function in relation to Homes for Reading Ltd, the Council's wholly owned company that has been set up to purchase and manage a portfolio of c.500 private sector rented properties over the next 5 years.

**2. RECOMMENDATION**

- 2.1 Audit & Governance Committee are requested to note the set up arrangements associated with Homes for Reading Ltd.
- 2.2 Audit & Governance Committee is requested to note its duty to "provide oversight of governance arrangements and the overall financial position in relation to the company".
- 2.3 Audit & Governance Committee is requested to identify any information it needs to fulfil this responsibility.

**3. BACKGROUND & PROCESS**

- 3.1 During 2015/16 officers researched and made contact with other councils who had or were set(ing) up a housing company. In particular, the possibility of setting up a company that could buy property in the private sector and rent it out was explored. Fairly early in the process specialist legal and property advice was sought from both Trowers & Hamlin and Savills in respect of the legal and financial aspects of the

business case respectively. Both organisations had detailed knowledge and experience of advising a number of Councils about the formation and management of commercial housing companies (and working in partnership with each other). This activity culminated in a report to Council in March 2016, attached at Appendix A. (Confidential papers were also provided to that Council meeting setting out the then business case; these are not attached but remain available for inspection by councillors). **The Council report envisaged that primarily matter related to HfR would be considered by Policy Committee but that Audit & Governance Committee should “provide oversight of governance arrangements and the overall financial position in relation to the company”.**

- 3.2 Council agreed to establish the company and it was formally incorporated shortly after the meeting. During 2016/17 we continued to develop the proposal, which needed to be modified following taxation and other changes. Councillor (non-executive) Directors and officer Executive Directors (the Head of Housing & Neighbourhoods & the Chief Valuer) were appointed and subsequently two independent non-executive directors were appointed (both with considerable expertise) were appointed. A company Managing Director was appointed, and Company Secretarial Services were established. The basic infrastructure (bank accounts and procedures) was put in place to run the company.
- 3.3 In March 2017 Policy Committee received a further report (Appendix B), which set out the final business case (which is confidential). Annex C sets out an extract from the business case showing in graphical form the Council’s forecast financial position, both over the first 6 years, during which time the company will be building its property portfolio. Both graphs show that (with some initial challenges) the proposed operation should generate a profit throughout almost all the 30 planning horizon. The March committee report also formally approved and authorised a funding agreement between the Council and HfR.
- 3.4 The basic business case is that the Council finances HfR using a mix of debt and equity (normally in a 55% loans/45% shares split). HfR pays the Council a high enough interest rate on the debt element of the finance to meet the Council’s full borrowing costs on the whole finance, (as both purchase of shares and loans such as this are treated as capital expenditure, and the Council borrows money to finance its investment in the company). Policy Committee also approved a funding agreement with HfR.
- 3.5 Since the meeting the company has begun to look for properties to purchase, and a few offers have been accepted. The formal funding agreement, as agreed by Policy will shortly be completed and the company will begin to trade. Initially at least, the Company will purchase services to operate on a day to day basis from the Council. The arrangements provide for a proportion of the company’s property to be let at below market value, although initially property will need to be let in the private sector (at market rates).

#### 4. CONTRIBUTION TO STRATEGIC AIMS

- 4.1 HfR will contribute to the service priorities set out in the Council’s Corporate Plan 2015-18; in particular the aim of providing homes for those in most need.
- 4.2 HfR will increase access to safe and suitable housing for homeless households and more widely will help to improve stock condition and promote best practice in the private rented sector.

- 4.3 In due course HfR will let some of its properties at a discounted rent aligned to the Local Housing Allowance (LHA, the level of Housing Benefit payments) and, but the proportion will depend upon how many need to be let at market rent the financial model to remain cost neutral (or positive) to the Council.

## **5. FINANCIAL IMPLICATIONS**

- 5.1 None, directly from this report, though the forecast financial implications to the Council from operating HfR are outlined in Appendix C.
- 5.2 As part of the Internal Audit Plan, there will be a review of the initial operating period of the company towards the end of the present financial year. This report enables the Committee to identify any matters the review might consider.
- 5.3 In time, the company, provided it is successful will have the potential to return a profit to the Council's General Fund through a dividend payment.

## **6. LEGAL IMPLICATIONS**

- 6.1 None directly from this report, though there have been legal issues as reported to Council Policy Committee in the appendices, and there is on-going ILegal work as HfR purchases properties.

## **7. COMMUNITY ENGAGEMENT /EQUALITY IMPACT ASSESSMENT**

- 7.1 None directly from the report.

## **8. BACKGROUND PAPERS**

- 8.1 Internal Audit Plan

### **Appendices**

A - Public Report to Council March 2016 (exc. Appendices)

B - Public Report to Policy Committee March 2017 (exc. Appendices)

C - Edited Extract from HfR Business Plan - Council Financial Implications

## READING BOROUGH COUNCIL

## REPORT BY THE DIRECTOR OF ENVIRONMENT AND NEIGHBOURHOOD SERVICES

TO:	COUNCIL		
DATE:	22 MARCH 2016	AGENDA ITEM:	8
TITLE:	PROPOSAL TO ESTABLISH A COUNCIL OWNED HOUSING COMPANY		
LEAD COUNCILLOR:	CLLR RICHARD DAVIES	PORTFOLIO:	HOUSING
SERVICE:	HOUSING AND NEIGHBOURHOODS	WARDS:	ALL
LEAD OFFICER:	SARAH GEE	TEL:	0118 9372973
JOB TITLE:	HEAD OF HOUSING AND NEIGHBOURHOOD SERVICES	E-MAIL:	Sarah.Gee@reading.gov.uk

## 1. PURPOSE OF REPORT AND EXECUTIVE SUMMARY

- 1.1 This report sets out the business case to create a housing company which will be wholly owned by the Council. The vision is ambitious, with the aim of the company purchasing a total of 500 existing (and potentially new) residential properties to rent over 5 years. The modelling is predicated on there being no overall cost to the Council and as many homes as possible being provided at sub-market rent to homeless households, subsidised by letting a proportion at market rent.
- 1.2 The driver for providing rental properties at discounted market rent levels is to help those households currently in temporary accommodation, in particular, those families living in unsuitable and inappropriate bed and breakfast accommodation. However, it should be noted that the housing company is not a replacement or substitute for the Council's general needs housing stock and is intended to address a broader range of the housing market in Reading.
- 1.3 The housing 'offer' from the company will be separate and different to that of the Council. The housing company will essentially offer responsibly managed private rented accommodation. The company will be like any other new private company in that it will need to be financially viable, operate in line with an agreed business plan and meet all its statutory obligations.
- 1.4 Initially it is proposed that the housing company will acquire a range of property in or near Reading which it will provide as rented residential accommodation. Additionally, the company will also be structured to enable it to develop new housing in the future, both for rent and sale. This will enable the company, and in turn the Council, help people respond to the many challenges they face in the current housing market in the Reading area.
- 1.5 The housing company will be fully financed by the Council through a combination of loan and equity funding. However, the overriding principle of the financial

modelling is that there will be no overall cost to the Council of financing the housing company. In addition, the Council may benefit from any future dividends (profits after tax) from the company and any growth in the value of the property portfolio.

- 1.6 The Council is able to lend funds to the company in order for the company to purchase flats and houses. The housing company lets these and the rental income will be sufficient to cover both the company costs (conveyancing, housing management, repairs and so on) and also the cost of borrowing (interest on the loan).
- 1.7 Based on present market conditions and experience of other authorities, it is proposed that the company will purchase up to 100 existing (and potentially new) residential properties to rent in year 1 and to continue this pattern for the next 4 years with a total portfolio at the end of year 5 of 500 homes. The financial modelling has been developed on this basis.
- 1.8 A proportion of this property will be let at a discounted rent aligned with the Local Housing Allowance (LHA, the maximum level of Housing Benefit payments) and, in order for the model to remain cost neutral to the Council, a proportion will be let at full market rent. Based on the detailed financial modelling carried out for the company it is currently anticipated that the maximum proportion of the homes able to be provided at discounted market rent levels is 40%. Should the need for discounted market rent properties reduce in the coming years, then the housing company will have the potential to return a profit to the Council's General Fund from letting a greater number of properties at full market rent.
- 1.9 Creating the company and purchasing existing property offers the Council a relatively swift remedy to contribute towards tackling the very current problem of households in inappropriate accommodation and the risk of escalating temporary housing costs adding to the Council's budget pressures.
- 1.10 The Council has taken both legal and financial advice from specialist consultants to ensure that it has the powers and capability to create and fund the company in line with legislation and Government policies, to assist the Council in developing robust governance arrangements, and to develop a financial model underpinning proposals. Discussions have been held with other Councils who have already established companies to benefit from their experiences and to ensure a sound understanding of the practicalities of managing the company's activities. Finally, market research has been undertaken with local Reading-based property agents to better understand both the sale and rental housing markets in Reading.
- 1.11 As a company wholly owned by the Council it is imperative that an appropriate governance structure is put in place to ensure the sound and robust management of the company alongside protection of the Council's financial and reputational investment in the company. It is proposed that the Shareholder function of the Council is primarily executed through Policy Committee, and that Directors of the Board would be initially appointed at the Council AGM. The Board of Directors will be responsible for strategic direction and oversight of performance, financial and operational management of the Company within the parameters agreed with the Shareholder. It is proposed that the Board would comprise four councillors; the General Manager of the company (when appointed) and two senior officers of the Council; and in addition that two independent non-executive directors are appointed to bring commercial housing and finance experience to the board.

1.12 The following paper and accompanying appendices set out in detail the business case and proposal for creating the company, including the legal, financial, governance and management aspects of the company.

1.13 The following appendices are attached: -

Appendix 1: Shareholder Agreement

Appendix 2: Articles of Association

## 2. RECOMMENDED ACTION

**Council is recommended to approve:**

- 2.1 The development of a local housing company, limited by shares and wholly owned by the Council, to procure accommodation to provide homes for homeless households and meet wider housing needs including the provision of market rented accommodation;
- 2.2 The proposed governance arrangements for the Housing Company including the shareholder agreement set out in Appendix 1;
- 2.3 The incorporation of the Housing Company based on the Articles of Association set out at Appendix 2, and
  - a) That Sarah Gee, Head of Housing & Neighbourhoods is appointed as the founding director of the company in order to enable the company to be registered (as this requires at least one named director) and basics to be established (such as setting up banking arrangements).
  - b) That the Head of Legal and Democratic Services, in consultation with the Lead Councillor for Housing and the Director of Environment and Neighbourhood Services, are authorised to:-
    - i) commence the incorporation of the housing company;
    - ii) select the company name in order to do so (which will be subject to availability at Companies House) and;
    - iii) complete all necessary documentation as listed in the report at paragraph 4.18.
- 2.4 The draft Heads of Terms for the Facility Agreement for the Council to provide loan and equity finance to the Housing Company (as set out in the report at Section 9 and considered earlier on today's agenda in closed session); and that the Head of Finance, in consultation with the Leadership (and Chair of Audit & Governance Committee) is authorised to finalise the Facility Agreement and to enable up to £30m to be lent to the Housing Company during 2016/17.
- 2.5 That Policy Committee will be responsible for the Council's function as shareholder, and that substantive Directors of the company be appointed at the Council AGM and the position of Councillor directors be considered at the Council's AGM each subsequent year.
- 2.6 That Council approves up to £30m additional capital expenditure to be incurred in 2016/17 to purchase shares in, and make loan advances (secured on property) to the Housing Company and authorises the Head of Finance to make the necessary payments.

- 2.7 That the Director of Environment and Neighbourhood Services and Head of Finance are authorised to agree prices for services provided by the Council (such as housing management), between the Council and the housing company.

### 3. POLICY CONTEXT

- 3.1 Reading's buoyant economy means that housing is in high demand across all tenures. Demand for affordable housing in Reading significantly outstrips supply and private rents are now generally well above Local Housing Allowance (LHA - housing benefit eligible) levels. Landlord concern about the impact of Universal Credit, combined with the rising market, has led to a reduced willingness to let to housing benefit claimants.
- 3.2 There is a limited supply of affordable housing and also low turnover in existing social housing stock. The combination of increasing demand and a lack of move-on housing has created a bottle neck with temporary accommodation being full and turnover slow. Regrettably the Council has been forced to increase the use of Bed and Breakfast but this is unsettling and disruptive for homeless households and is unsuitable for long periods of time. Furthermore, the use of B&B accommodation is very expensive for the Council.
- 3.3 Over the last year, officers have explored various ways to increase the level of affordable housing and in particular, focussed on the Council commencing its own house-building programme within the Council's Housing Revenue Account (HRA). Officers commissioned professional consultants to help explore a range of different delivery options.
- 3.4 However, in addition to pursuing a Council house building programme delivered within the Council's HRA, officers have also scoped the potential of a Council-owned company to meet a broader range of local housing needs, including providing accommodation for homeless households.
- 3.5 The Housing Act 1996 sets out a Local Authority's responsibilities in respect of homeless households who approach the Local Authority for assistance. The legislation specifies that all Local Authorities have a duty to provide accommodation to applicants who are homeless, eligible for assistance, in priority need and not intentionally homeless. The power now exists as a result of the Localism Act 2011 for a Local Authority to bring this duty to an end by a 'suitable offer' of private rented sector (PRS) accommodation and household consent for the duty to end in this way is no longer required. Reading Borough Council is now implementing this power and can therefore fulfil its duty to homeless households through an offer of accommodation provided through the proposed housing company.

### 4.0 THE PROPOSAL

- 4.1 This proposal sets out the business case for creating a housing company, wholly owned by the Council, which will acquire a portfolio of properties (existing and potentially new) to provide as privately rented accommodation. However, a proportion of these properties will be made available at a rent comparable to Local Housing Allowance levels (LHA, which is the maximum amount housing benefit will be paid up to) to ensure they are affordable for local people.

#### 4.2 Key objectives of the Housing Company will be: -

- To purchase a portfolio of property of sufficient size to significantly help reduce the amount of homeless households currently in temporary accommodation by providing good quality and well managed accommodation.
- To remain financially viable and operate efficiently to ensure it receives sufficient rental income to meet all of its costs including financing, housing management, property maintenance and administration.
- To provide an efficient housing management service to its tenants which will need to be clearly differentiated from that provided for the Council's own stock.
- To maintain property to a suitable standard to meet tenant's reasonable expectations and to protect and enhance the financial investment in the properties.

4.3 Initially, it is anticipated that at least 100 properties will be acquired during the first year and 500 homes over 5 years. To achieve financial viability only a proportion of properties can be let at rents comparable with LHA levels. The remaining properties will need to be let at full market rent to ensure the company can cover its costs/liabilities, remaining cost neutral to the General Fund. The current financial modelling is based on a 60%/40% split of market rent and discounted market rent properties although this may change over time as market conditions and other parameters vary.

4.4 In establishing the business case officers have taken specialist legal and property advice from both Trowers & Hamlin and Savills in respect of the legal and financial aspects of the business case respectively. Both organisations have detailed knowledge and experience of advising a number of Councils about the formation and management of commercial housing companies. Officers have also researched and spoken to other councils who have already established or are setting up similar companies.

#### **Governance Arrangements and Company Structure**

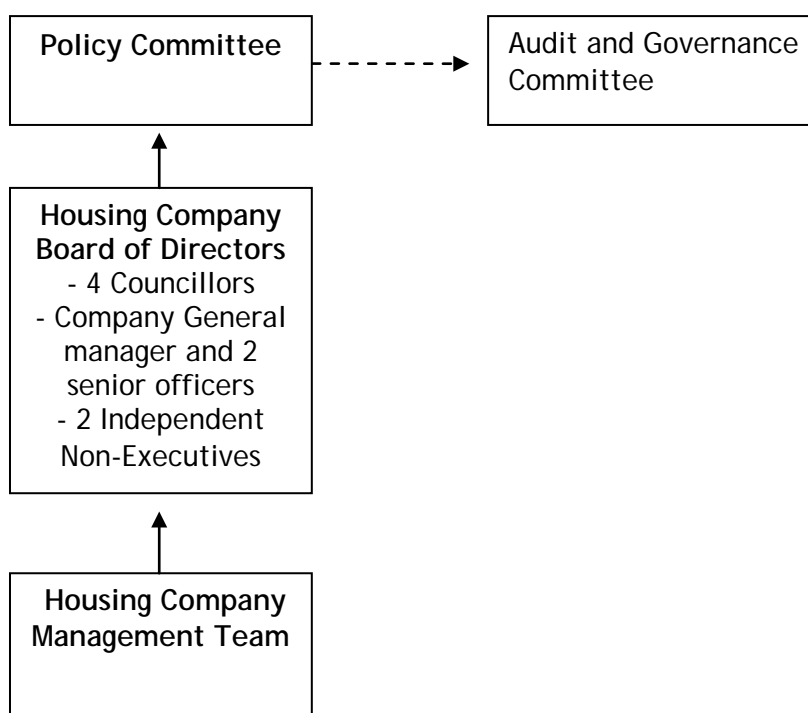
4.5 The Council will hold 100% of the shares in the housing company and as such will have full ownership. This enables the Council to retain control of the company.

4.6 As a company wholly owned by the Council it is imperative that an appropriate governance structure is put in place to ensure the sound and robust management of the company alongside protection of the Council's financial and reputational investment in the company. However, the governance must not hinder the company and must allow it to act swiftly and pro-actively which is essential if it is to compete in acquiring properties in the open market. As sole shareholder, the Council would appoint (and can change) the directors to the company and would approve key decisions and the Company's business plan as set out in the shareholder agreement.

4.7 In order to meet the requirements as set out above it is proposed that the governance arrangements are as per the model below:



FIGURE 1: PROPOSED GOVERNANCE STRUCTURE



### Shareholder Function

- 4.8 It is proposed that the Shareholder function of the Council is primarily executed through Policy Committee, and that Directors of the Board would be initially appointed at the Council AGM and member representatives will be confirmed at the AGM each subsequent year. The appointment of all other directors will need to be agreed through Policy Committee. Additionally Audit and Governance Committee could provide oversight of governance arrangements and the overall financial position in relation to the company. Regular reports on company performance, finance and activity will be submitted to Policy Committee and any matters reserved for shareholders will need to be decided through Policy Committee.

### Board of Directors

- 4.9 The Board of Directors will be responsible for providing strategic direction and setting operational parameters, as well as overseeing and scrutinising operational and financial performance to ensure that business plan targets are met, within the parameters agreed with the Shareholder. To ensure accountability, a clear decision making framework will be required that sets out matters which will be determined by the Board of Directors and delegated authority which will allow the General Manager to make decisions in relation to the day to day activities of the company. In particular, this must allow the company to act swiftly and pro-actively in property acquisition within an agreed purchasing strategy in order that the company can compete in the open market. A performance and financial management framework with clear targets and milestones will also need to be developed.
- 4.10 To ensure that the housing company can operate efficiently and effectively it will be important to have the appropriate balance of skills and experience and, in particular, the right business and commercial financial acumen. The company will be engaged in

both property acquisition and ensuring that landlord responsibilities are fulfilled in the management of the stock and provision of services to tenants.

- 4.11 It is proposed that the Housing Company Board of Directors will consist of a minimum of the following:

- 4 elected members, to include one representative from the main opposition party
- The General Manager of the housing company and 2 senior officers of the Council and
- 2 independent Non-Executive Directors.

The Non-Executive Directors will be recruited to bring commercial housing and finance experience to the board of directors (and they would be expected to attend Board meetings). The Board of Directors would delegate some functions to an operational management team that would include the company manager and officer representatives on the board.

- 4.12 At least one director needs to be appointed in order to enable the company to be registered and basics to be established (such as setting up banking arrangements). The report therefore seeks approval to appoint the Head of Housing & Neighbourhoods as a director of the company to facilitate this. As proposed above further directors would then be appointed at the Council's May AGM.

- 4.13 Any elected member or Council officer appointed as a company director would not normally be remunerated (although it may be appropriate for Non-Executive Directors to receive modest remuneration). Advice received is that the Council's Chief Finance (section 151) Officer and Monitoring Officer should not be appointed as Directors to ensure a clear separation of their roles in their advice to the Council. Equally there will need to be clear separation between all officers on the Board of Directors and officers providing advice to the Shareholder on behalf of the Council.

- 4.14 Consideration will need to be given to ensuring that key expertises (such as Financial and Legal advice) are available to advise both the Council as shareholder and the company.

#### **Company Resources**

- 4.15 It is anticipated that many of the services which will be required will be contracted out with housing management, repairs and maintenance, legal services for property acquisition and accounting services provided by local authority staff (and re-charged to the company). On this basis it is proposed that a General Manager is recruited to manage the company, with some additional resources in internal departments. As the property portfolio grows then additional staffing may be required.

- 4.16 To avoid the burden and costs of setting up systems for the company to employ staff directly (for example payroll, pension etc.), it is proposed that initially the Council will employ the General Manager (and any other staff required) and second them to the housing company initially until the company is more established.

- 4.17 The individual engaged to manage the housing company will need the appropriate skills and knowledge to be able to carry out the following duties:

- Lead the development of a Purchasing Strategy
- Continually monitor and understand the Reading property market and recommend appropriate actions to Directors

- Co-ordinate and oversee the acquisition of a portfolio of properties to let as private rented accommodation, working with internal and external partners
- Control costs and performance in respect of improvements works, initial lettings, and ongoing maintenance (via contract with RBC Housing Building Maintenance)
- Client the housing management contract
- Closely manage and monitor the company's operational finances
- Identify opportunities to maximise the housing company's potential
- Ensure all the statutory requirements for the company are met - audited accounts, VAT returns, Companies House returns, insurance renewals etc. (with RBC Legal and Finance colleagues)
- Prepare and present regular reports to company directors covering property portfolio, housing management, property maintenance, financials (both actuals to date and forward forecasts)

#### Documentation required in establishing the housing company

4.18 The following documentation is required to complete the establishment of the housing company and associated governance arrangements.

1. Memorandum of Association and Articles - setting out the remit and rules governing the running of the company.
2. Shareholder Agreement - this will be a key document as it will capture how the Council/Shareholder will exercise its control over the housing company.
3. Loan Agreements - these set out the details of the funding arrangements between the Council and the housing company.
4. Director Appointments - the identity and role of the council officers who will be appointed as directors to the housing company will need to be agreed. Non-Executive Directors with the appropriate skills will need to be recruited.
5. Appointment of Company Secretary and (if necessary) External Auditor.
6. Business Plan - the business plan will need to be developed to cover a rolling 5-year period of investment activity and will outline the company's planned operations. The Business Plan will be reviewed and agreed annually and covers the following: -
  - Company objectives (as established in the Shareholder Agreement)
  - Governance arrangements
  - Operational plans
  - Financial model and assumptions
  - Rents, sales and development assumptions
  - Fees, on-costs and tax
  - Funding profile and sensitivity analysis
7. Operational Policies including: -
  - Rent setting
  - Letting policy
  - Rent arrears and debt recovery
  - Other general policies e.g.: Health and Safety, data protection

8. Insurances including:
    - Buildings insurance (LA housing stock is not generally insured)
    - Directors insurance
  9. Property purchasing strategy - this sets out the specific criteria for the purchase of property
- 4.19 Key documents are appended to the report to support the proposal to develop a housing company wholly owned by the local authority and in the recommendations Council is asked to agree:
- a) the proposed governance arrangements for the Housing Company including the shareholder agreement set out in Appendix 1;
  - b) the incorporation of the Housing Company based on the Articles of Association set out at Appendix 2
  - c) the draft Heads of Terms for the Facility Agreement for the Council to provide loan and equity finance to the Housing Company to be considered in closed session at Council.
- 4.20 The report seeks delegations to finalise the Facility Agreement and to complete all other necessary documents, policies and procedures (as detailed above) and to select the company name.

#### **The property market**

- 4.21 The Reading property market is currently very buoyant with sale values and rents both showing growth over time. Reading's economic growth and its proximity to London (with both current and future transport links) have attracted numerous investment buyers. There are many, and continually changing, complexities about the housing market in Reading and the housing company will need to be fully conversant with the market conditions and have a clear strategy for the purchase and letting of property.
- 4.22 In researching the housing company, consultation has taken place with local agents. This has given the authority a better understanding of the local housing market and about a range of issues including property values, market rents, availability of property, rental yields (measures the relationship between annual rent and property cost), demand for and pace of sales and lettings, whether these proposals would impact the market, competition and so on. This information will influence the purchasing strategy for the housing company and market intelligence has been used in the financial modelling for the company.
- 4.23 A purchasing strategy will be developed and agreed which will set out a phased approach to the acquisition of properties taking into account market availability, demand and financial viability.

#### **Property Management**

- 4.24 The Housing Company will need to provide housing management and property maintenance services to its tenants. The Company Directors will need to keep under review if it would be cost-effective for the Housing Company to employ its own staff. Consideration has also been given to the company contracting with an external provider (using an established private lettings agency service) or using the services of Reading Borough Council's housing management and maintenance teams.

- 4.25 Taking into account a range of factors including quality of service, costs, ability to deliver and knowledge of tenant requirements it is currently proposed that the company will initially contract with RBC to provide these services. As detailed in the Legal section of this report, the Housing Company is subject to the Public Contract Regulations in relation to procurement. However, as a wholly owned subsidiary of the Council, the housing company would be able to apply the 'Teckal' exemption in terms of any contracts between the Council and the housing company, therefore these contracts would not be subject to the EU procurement regime.
- 4.26 In terms of housing management, it is currently intended that Reading Borough Council will provide the following functions to the company:
- a. Lettings and allocations including:
    - Devising a lettings and rent policy
    - Advertising of property
    - Vetting of potential tenants
    - Allocating properties and deposit management.
  - b. Housing Management including:
    - Property inspections
    - Day to day management of the properties
    - Tenancy sustainment support
    - Management of anti-social behaviour cases
    - Enforcement action and possession proceedings for breach of tenancy
  - c. Property Services including:
    - Advice on property condition before purchase
    - Reactive day to day repairs
    - Planned and cyclical programmes of maintenance
    - Works between lets
  - d. Rent Recovery including:
    - Setting up of rent accounts
    - Tenancy Sign up
    - Payment options for rent payments
    - Recovery of rent arrears
    - Debt and money advice
    - Possession proceedings for issues including rent arrears

#### **Tenancy Agreement - terms**

- 4.27 Tenants of the housing company would be given an Assured Short-hold Tenancy unlike RBC tenants who are initially on an introductory tenancy which becomes secure after 12 months. An assured shorthold tenancy is equivalent to the terms of occupation offered in the private sector.
- 4.28 The properties to be let at LHA rent levels will be utilised for the prevention of homelessness and to make appropriate offers of accommodation allowing the Council to discharge its statutory housing duties.

## **5. CONTRIBUTION TO STRATEGIC AIMS**

- 5.1 This proposal will contribute to the service priorities set out in the Council's Corporate Plan 2015-18:

- Providing homes for those in most need.

- 5.2 The proposal will increase access to safe and suitable housing for homeless households and more widely will help to improve stock condition in the private rented sector.

## 6. COMMUNITY ENGAGEMENT AND INFORMATION

- 6.1 There is no requirement in legislation or in guidance to consult with other agencies or stakeholders on the establishment of a housing company. However, it will be important that members, council staff, applicants, tenants and the wider community understand the role and offer provided by the housing company and how this differs from the provision of Council housing. Information and housing policies will be published in plain English. A communications strategy will need to be developed in due course.

## 7. EQUALITY IMPACT ASSESSMENT

- 7.1 Under the Equality Act 2010, Section 149, a public authority must, in the exercise of its functions, have due regard to the need to—
- eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under this Act;
  - advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it;
  - foster good relations between persons who share a relevant protected characteristic and persons who do not share it.
- 7.2 An Equality Impact Assessment (EIA) does not indicate that recommendations will have a disproportionate impact on any protected group.

## 8. LEGAL IMPLICATIONS

*Specialist legal advisors Trowers and Hamblins have provided legal advice including documentation in respect of the proposal.*

### **Powers to form the Housing Company**

- 8.1 The Council can rely upon the general power of competence within the Localism Act 2011 to form the housing company for operating a business to let homes at market rent or to provide homes for market sale.
- 8.2 Section 1 of the Localism Act 2011 provides local authorities with the power to do anything an individual may do, subject to a number of limitations. This is referred to as the 'general power of competence'. A local authority may exercise the general power of competence for its own purpose, for a commercial purpose and/or for the benefit of others i.e. this includes the setting up of a housing company. In exercising this power, a local authority is still subject to its general duties (such as the fiduciary duties it owes to its rate and local tax payers) and to the public law requirements to exercise the general power of competence for a proper purpose.

### **Powers to fund the Housing Company**

- 8.3 The housing company will need significant funding to purchase a portfolio of properties in the open market. Therefore, as well as the Council having the powers to form the housing company it must also be able to provide it with the necessary loan and equity funding.
- 8.4 The Council has the power to borrow under the Local Government Act 2003 for the purposes of the prudent management of their financial affairs, or in connection with any of their functions. The borrowing must be prudent and comply with the Prudential Code.
- 8.5 As outlined, the Council intends to borrow monies and in turn support the housing company through the provision of loans and subscription to share capital. This is covered by Section 24 of the Local Government Act 1988 (the 1988 Act) as this constitutes financial assistance under the terms of the 1988 Act. Section 24 of the 1988 Act also specifically allows the Council to provide financial assistance in connection with the provision of privately let accommodation.
- 8.6 If the Council exercises its powers under this section, then under Section 25 of the 1988 Act it must also obtain the consent of the Secretary of State to do so. If this consent is not obtained, then any financial assistance given will be void. The Secretary of State has set out pre-approved consents in the "General Consents 2010" (July 2011) and the "General Consents 2014" (April 2014). The General Consents 2010 contains Consent C. and the Council can provide financial assistance to the housing company under this provision.
- 8.7 Any housing made available for sale by the housing company would not be covered by the 1988 Act, however the Council can rely upon the general power of competence to fund the Housing Company for the purpose of the company operating a business to provide homes for market sale. In the short term it is not the intention to provide homes for sale, however, it is proposed to set the housing company up so it has the option to do this in the future.

### **Power to transfer land to the Housing Company**

- 8.8 It may in the future be appropriate for the company to develop new homes using Council owned land. The Council is entitled to dispose of land held by it in its General Fund provided it complies with Section 123 of the Local Government Act 1972 and it is entitled to dispose of land held in its Housing Revenue Account providing it complies with section 32/43 of the Housing Act 1985. Although these consents for HRA land normally require the consent of the Secretary of State, there are some useful general consents that have been issued. However, these powers concerning the disposal of land from the Council to the housing company are complex and as such, site specific advice will be sought in the future for any disposal.

### **Company structure**

- 8.9 Trowers & Hamlin has advised that a company limited by shares (CLS) is the appropriate form of vehicle for the housing company for a number of reasons, including:
  - a CLS is the most common corporate vehicle used in England for profit distributing bodies and is a very tried and tested model;

- the Council may look (in the longer term) to receive a return out of the profits of the housing company and the CLS model is a typical form of commercial vehicle established with a view to making a profit;
- the ability for the Council to invest in the company by way of share equity as well as loan debt;
- the general power of competence, being used for a commercial purpose as is intended here, does not allow for local authorities to participate directly in a limited liability partnership, which would be the other most obvious corporate form for a body established with a view to profit.

8.10 The company will be set up in accordance with the Companies Act 2006, including the appointment to the Board of the company. The Memorandum and Articles of Association and any other relevant document for the setting up of such a company are in a form approved by the Head of Legal and Democratic Services. The statutory duties for directors of a company are set out in sections 171 - 177 of the Companies Act 2006. The statutory duties are in summary:

- i. The duty to act within powers,
- ii. The duty to promote the success of the company,
- iii. The duty to exercise independent judgement,
- iv. The duty to exercise reasonable skill and care,
- v. The duty to avoid conflicts of interest,
- vi. The duty not to accept benefits from third parties,
- vii. The duty to declare an interest in a proposed transaction or arrangement with the organisation.

8.11 The common law directors' duties and the statement of general directors' duties set out in the Companies Act 2006 are not exhaustive in terms of the duties that are owed by a director to an organisation.

8.12 Board members will also be subject to other duties set out elsewhere in law, including a large number of very important legal obligations around making investments, disposing of land, health and safety requirements, and employment laws, to name but a few. In particular, there are very important responsibilities on directors in the event that an insolvency situation seems likely. There are serious consequences for directors (including personal liability) in situations which fall within the statutory definitions of wrongful trading or fraudulent trading.

### **Fiduciary duties**

8.13 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 tax payers. The Council in effect holds money but does not own it and spends that money on behalf of its business rate and council tax payers. Taking these fiduciary duties into consideration, the Council will need to ensure that it achieves an appropriate return for the lending it provides



and that it has minimised the risks and potential costs to it if the housing company becomes insolvent and/or defaults on any loans. Ultimately, should the company be unable to repay the loan in full at the point that it ceases to trade and its assets are liquidated, then any residual loss will sit with the shareholders.

### Procurement

- 8.14 The housing company will be a body required to follow the Public Contracts Regulations 2015 (PCR). However, as a wholly owned subsidiary of the Council, the housing company will be able to take advantage of the "Teckal" exemption set out in the PCR and as such, any contracts let between the Council and the housing company (e.g. in relation to housing management services) would not be subject to the EU procurement regime.

### State Aid Compliance

- 8.15 Trowers & Hamlin and Savills have provided initial advice on how the lending to the housing company should be structured so it is not unlawful State Aid. Effectively, if the Council is acting in a way that a private lender and/or investor would in similar circumstances in a market economy, for example by providing a loan on commercial terms and at a commercial interest rate, properly taking into account risks and/or was making an equity investment on the terms and for the return which a private investor would do, then such activity will not constitute unlawful State Aid within the meaning of Article 107 of the Treaty on the Functioning of the European Union (TFEU).
- 8.16 However, when the Council establishes the detailed loan arrangements with the housing company it will at that time need to obtain an independent report which analyses the relevant risk in relation to the loan 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.
- 8.17 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.

## 9. FINANCIAL IMPLICATIONS

- 9.1 The financial model for the housing company has been developed by consultant advisors Savills with officers providing and agreeing assumptions. The modelling is predicated on there being no overall cost to the Council and as many homes as possible being provided at rents similar to LHA levels, so the company provides accommodation that might be used instead of bed & breakfast for homeless households.
- 9.2 The business case assumes the Council incurs additional capital expenditure in either buying shares in, or making loan advances to the housing company. The interest charges on the loan advances will be sufficient over the life of the company's business plan (and agreed loan period) to at least meet the Council's financing and administrative costs in borrowing money to make these advances. The Council is able to lend funds to the housing company using the powers outlined in the Legal section and as long as the arrangements are deemed to be State-Aid compliant (i.e. effectively this means they do not provide a hidden subsidy to the company). The alternative of directly sourcing external private funding would be significantly more

challenging, time consuming and would pass significant influence and potentially control over the housing company's business activities and decisions to the lenders.

- 9.8 As indicated in the budget report to February's Council meeting, the Council expects to start 2016/17 with just over £300m of actual borrowing, and this was expected to rise to around £350-£360m during 2016/17. This proposal will increase that to around £380m. This is below both the authorised limit and operational boundaries for borrowing agreed by the Council in February during 2016/17, but the further rise in following years will necessitate a need to change these. The current estimated changes needed will be as follows:
- 9.9 **Operational Boundary for External Debt:** The operational boundary is based on the Authority's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the Authority's debt.

Operational Boundary	2015/16 Revised £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
Borrowing (as agreed in February)	400	400	400	400
Borrowing (as now required with Housing Company)	400	400	440	480
<b>Revised Total Debt (inc. other liabilities)</b>	<b>440</b>	<b>440</b>	<b>480</b>	<b>520</b>

- 9.10 **Authorised Limit for External Debt:** The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Authority can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	2015/16 Revised £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
Borrowing (as agreed in February)	410	410	410	410
Borrowing (as now required with Housing Company)	410	410	450	490
<b>Revised Total Debt (inc. other)</b>	<b>450</b>	<b>450</b>	<b>460</b>	<b>450</b>

liabilities				
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### Value for Money (VFM)

- 9.11 See above - the proposal is cost neutral to the authority but will provide a supply of accommodation for homeless households thus contributing to a reduction in expenditure on bed and breakfast accommodation.
- 9.12 Unlike other options to accommodate homeless households, such as the Rent Guarantee Scheme and leasing property in the market, provision of housing through a housing company will be at no net cost to the authority as the company will operate on a commercial basis, cross-subsidising sub-market rent with the provision of full market rent.

### Risk Assessment.

- 9.13 Investing in property does present a number of risks and also opportunities to the housing company and the Council. The more significant factors are outlined below and in particular the risks are identified along with the proposed mitigation.

### RISKS

**Risk 1) The housing company is unable to meet its interest payments to the Council and in turn the Council is not receiving sufficient return to meet its own financing costs.**

- 9.14 Mitigation - With strong financial monitoring and forecasting this situation should not arise, however, if it did the company could realise capital from the sale of a property to cover the shortfall. This situation is not ideal but it would give the company time to then address the root problem of why it was unable to meet its interest payments.

**Risk 2) The reason why the company could not meet its interest payments would mean either its running costs are too high e.g. higher management or maintenance costs or alternatively rental income is lower than expected i.e. higher void or bad debt levels or potentially rents not increasing in line with cost inflation.**

- 9.15 Mitigation
- Establish clear management and maintenance contracts from the start so costs are agreed.
  - Careful selection of properties for purchase to avoid those with excessive maintenance liabilities and re-profile planned maintenance works if required.
  - Take robust housing management action to recover bad debts or better advertising, marketing and lettings action to fill voids.
  - If the rental market in Reading goes into decline and rents do not increase in line with costs, then this will require a re-alignment of the company's strategy which may include starting to sell properties and reduce the size of the portfolio.
- 9.16 It is anticipated that the company will hold properties for a significant time and therefore, over the longer period, property prices will grow and so there should be sufficient value to cover any additional costs as well as cover the Council's original loan and equity investment. Based on an average annual growth increase of 2%, the value of the property stock would increase by 50% over approximately 22 years.

Historical data shows property values have increased by 345% over the last 20 years, 1995 – 2015. Current predictions are that Reading property values will increase significantly over next 5 years, however a 2% inflation allowance has been used in the modelling as it is a very prudent assumption.

**Risk 3) Property values fall which may occur in a recession.**

- 9.17 Mitigation - In the short term the forecast is for strong growth in property values in Reading (between now and 2020). This should insulate the company against any future decline in values. Furthermore, a reduction in the value of the stock only becomes a problem if it falls below the original purchase price and if the company actually has to sell properties. This business case is viewed as a long term investment and so any short term drops in property values should be seen in the context that property values generally increase over the long term.
- 9.18 Part of the company's management responsibility will be to continually monitor the property market and its property portfolio (and costs and incomes) to forecast any changes and adjust its strategy to manage any difficult periods or indeed, take advantage of opportunities.

**Risk 4) there is a risk associated with more dispersed stock and the increased management burden of managing isolated properties in non-estate areas, particularly in flatted blocks.**

- 9.19 Mitigation: This will need to be considered in the acquisition strategy and lettings policy.

## OPPORTUNITIES

### Opportunity 1) - property growth

- 9.20 The major opportunity for the Council/company is that as indicated above, with 2% average property growth, the Council's equity investment (not the loan) would double in approximately 18 years providing a very good return.

### Opportunity 2) - generating profit

- 9.21 Presently, the aim of the company is to remain viable but instead of maximising profits it will be to maximise the number of properties provided for discounted market rent. However, the Council/company may decide to change the priority and it could become to maximise profits for the Council. Therefore, by prioritising the number of properties let at full market rent this can drive a profit (after tax) for the Council. Several other Councils have specifically set their companies up to do this.

### Opportunity 3) - flexibility and control over the portfolio

- 9.22 Over time, the housing challenges local people face may change, however, with the Council/company having complete control over a portfolio of property it can change the use of that property to help people meet those future difficulties. For example, the demand for the discounted market rent properties may have fallen and property values may have increased significantly so that the company may choose to sell properties back to the HRA at a discounted level. Having complete control over the stock (because the Council is the sole funder) is a significant advantage over other

arrangements where external funding is used and those cases the funder has the control and the Council/company is contracted to lease payments.

**Opportunity 4) - ability to develop new homes/diversify**

- 9.23 As previously mentioned, the company will be set up to do a number of things. Therefore, in the future it could develop housing either in the private sector or for mixed tenure developments. It could also be used to go into joint venture arrangements with other partners etc. The company offers the Council a commercial vehicle to consider future opportunities.

**10. BACKGROUND PAPERS**

Appendix 1: Shareholder Agreement

Appendix 2: Articles of Association

## READING BOROUGH COUNCIL

REPORT BY THE DIRECTOR OF ENVIRONMENT AND NEIGHBOURHOOD SERVICES  
AND DIRECTOR OF FINANCE

TO:	POLICY COMMITTEE		
DATE:	13 MARCH 2017	AGENDA ITEM:	10
TITLE:	HOMES FOR READING: MOBILISATION, FUNDING AND BUSINESS PLAN		
LEAD COUNCILLOR:	CLLR TONY PAGE	PORTFOLIO:	LEADERSHIP
SERVICE:	HOUSING/FINANCE	WARDS:	BOROUGHWIDE
LEAD OFFICER:	ALAN CROSS	TEL:	0118 9372058
JOB TITLE:	HEAD OF FINANCE	E-MAIL:	<a href="mailto:Alan.Cross@reading.gov.uk">Alan.Cross@reading.gov.uk</a>

## 1. PURPOSE OF REPORT AND EXECUTIVE SUMMARY

- 1.1 In March 2016 Council agreed to create a housing company wholly owned by the Council with the aim of the company purchasing, over a 5 year period, 500 existing (and potentially new) residential properties to rent. The financial modelling was predicated on there being no overall cost to the Council and a proportion of the homes (as an aggregate over the life of the business plan) being provided at sub-market rent to homeless households, subsidised by letting the remainder at market rent.
- 1.2 This report updates the Committee on the progress made in setting up Homes for Reading Limited as a wholly owned company and Policy Committee is asked to approve the Financial Business Plan attached to this report. The Business Plan sets out the structure of the arrangements between the Council (RBC) and Homes for Reading (HfR); describes the assumptions underpinning the business model; and considers financial viability and risk exposure in that context. The Business Plan has informed the terms of the facility agreement between the Council and HfR which deals with lending money to the company. Both the Business Plan and the funding agreement are the subject of a State Aid report by Savills Financial Consultants which confirms that the proposed loan arrangements reflect a normal commercial arrangement for this type of business.
- 1.3 The report clearly sets out the financial implications of the Business Plan and funding arrangements and highlights some of the potential risks of such property investment. Homes for Reading's Board of Directors have approved a detailed Risk Register setting out the risks to the company and their proposed mitigation.
- 1.7 The following appendices are attached: -
- Appendix 1: Shareholder Agreement (revised)
- Appendix 2: Memorandum and Articles of Association (revised)

In a separate similar PART 2 Report there were 4 further appendices which are relevant to the overall consideration of this item.

- Appendix 3: HfR Business Plan  
 Appendix 4: State Aid Report (Savills Financial Consultants)  
 Appendix 5: Summary of Facility Agreement Terms  
 Appendix 6: HfR Risk Register

These Appendices 3-6 in the Part 2 report are not for disclosure.

2.	<p><b>RECOMMENDED ACTION</b></p> <p>Policy Committee is asked to:</p>
2.1	<p>Approve the revised Shareholder Agreement (Appendix 1).</p>
2.2	<p>Approve the revised Memorandum and Articles of Association (Appendix 2).</p>
2.3	<p>Approve the Business Plan for HfR Ltd (as provided on the Committee agenda in closed session).</p>
2.4	<p>Note the revised principal terms of the proposed Facility Agreement to enable the Council to lend money to HfR Ltd and note the contents of the State Aid Report (as provided earlier on the Committee agenda in closed session).</p>
2.5	<p>Note the HfR Ltd Risk Register (as provided on the Committee agenda in closed session).</p>
2.6	<p>Approve the appointment of Non-Executive Directors (as detailed at paragraph 4.9) and note the amendment to the Memorandum and Articles of Association to extend the appointment of all Directors of HfR Ltd to 3 years (paragraph 4.10 of the report).</p>
2.7	<p>Approve the remuneration of the HfR Managing Director in line with the Council's pay policy at Head of Service/Director Grade.</p>
2.8	<p><b>(1) Authority to Allot</b></p> <p>That, in accordance with section 551 of the Companies Act 2006 (CA 2006), the Directors (Directors) of HfR be generally and unconditionally authorised to allot shares in the Company <u>to the Council</u> up to an aggregate nominal amount of £10,000,000 provided that this authority shall, unless renewed, varied or revoked by the Company, expire on 31 March 2018 save that the Company may, before such expiry, make an offer or agreement which would or might require shares to be allotted and the Directors may allot shares in pursuance of such offer or agreement notwithstanding that the authority conferred by this resolution has expired. (This authority is in addition to the October Policy Committee authority to allocate £5,000,000 shares).</p> <p><b>(2) Disapplication of Pre-Emption Rights</b></p> <p>That, subject to the passing of resolution 1 and in accordance with section 570 of the CA 2006, the Directors be generally empowered to allot equity securities (as defined in section 560 of the CA 2006) pursuant to the authority conferred by resolution 1, as if section 561(1) of the CA 2006 did not apply to any such allotment, provided that this power shall:</p>

be limited to the allotment of equity securities up to an aggregate nominal amount of £15,000,000; and expire on 31 March 2018 (unless renewed, varied or revoked by the Company prior to or on that date), save that the Company may, before such expiry make an offer or agreement which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of any such offer or agreement notwithstanding that the power conferred by this resolution has expired

- 2.9 That the Director of Finance and the Head of Legal and Democratic Services, in consultation with the Deputy Leader and Chair of Audit & Governance Committee) are authorised to act on behalf of the Council in agreeing arrangements with HfR Ltd save for those matters specifically reserved to Policy Committee in the Shareholder Agreement.

### 3. POLICY CONTEXT AND BACKGROUND

- 3.1 In March 2016 Council agreed to create a housing company wholly owned by the Council with the aim of the company purchasing 500 existing (and potentially new) residential properties to rent. The modelling was predicated on there being no overall cost to the Council and a proportion of the homes (as an aggregate over the life of the business plan) being provided at sub-market rent to homeless households, subsidised by letting the remainder at market rent.
- 3.2 The Council further approved a delegation to the Head of Finance, in consultation with the Leadership (and Chair of Audit & Governance Committee) to finalise the Facility Agreement and to enable up to £30m capital expenditure to be incurred to purchase shares in and make loan advances (secured on property) to the Housing Company.
- 3.3 Policy Committee appointed the initial Board of Directors on 25<sup>th</sup> May 2016 comprising four elected members and two senior officers. In October 2016 Committee further agreed arrangements for the initial capitalisation of the company, prior to purchasing its first property, and in particular authorised the board to allot up to 5,000,000 shares. By the end of 2017/18 it should be necessary to allot almost 15,000,000 shares to realise the business plan. Committee are therefore asked to provide authority to allot an additional 10,000,000 £1 shares in this report. 2.9 above provides a general delegation for the formal business arrangements between HfR and the Council to be conducted, essentially authorising the Council's most senior finance and legal officers to act on its behalf in consultation with appropriate councillors (recognising conflicts of interest of councillors who are also directors).
- 3.4 'Homes for Reading Limited' was incorporated as a Private Limited Company on 6<sup>th</sup> April 2016 and Directors have now been registered at Company's House. The HfR Board met for the first time on 29<sup>th</sup> June 2016 and the Board is currently meeting monthly to agree policy and process with the HfR Executive Management Team formed from the Managing Director and the two senior Council officers. A Company Secretary has also been appointed to advise on compliance and statutory responsibilities.
- 3.5 To date excellent progress has been made in developing the company and putting in place the necessary resources, systems, policies and procedures to ensure that mobilisation is thorough and that HfR is given the best chance of successfully



achieving its goals in what is a challenging market place. The work plan includes a wide range of activity from ensuring that HfR has appropriate insurance cover in place for its commercial activity to appointing an online marketing company or agreeing a performance reporting framework. The Company expects to commence acquisitions early in the new financial year once the facility agreement and associated documentation is finalised and company systems are fully established.

- 3.6 As previously reported it has been agreed that to avoid the burden and costs of setting up systems for the company to employ staff directly, the Council will employ the Managing Director and second them to HfR initially until the company is more established. Other services required by the company will all be contracted out in the first instance through Service Level Agreements (SLAs) with Council and external service providers as necessary. As the property portfolio grows, additional resources may be required and employed directly by the company. Service Level Agreements (SLA) are now in place with RBC service providers for legal, financial, housing management, property maintenance and valuation support. These are supplemented by operational processes in respect of acquisition, lettings, management and maintenance.
- 3.7 HfR is starting to look outward and is developing a communications strategy and web site. Ongoing market research as well as starting to build relationships with local agents and developers ensures that we are on track to commence property acquisitions this Spring 2017.

#### 4.0 THE PROPOSAL

##### HfR Business Plan

- 4.1 The Council has been working with advisors from Trowers and Hamlins (Legal advisors) and Savills Financial Consultants (the finance arm of a property company) on the development of the HfR Business Plan. The final draft Business Plan has recently been approved by the HfR Board.
- 4.2 The Shareholder Agreement for HfR sets out matters requiring shareholder consent and this includes consent to adopt or amend the company's annual Business Plan. This therefore requires that Policy Committee approve the final Business Plan before HfR began to trade (i.e. purchase properties and rent them).
- 4.3 The essential features of the Business Plan are that the Council will purchase shares and make loan advances to HfR in the approximate ratio of 45:55 to enable HfR to acquire residential property. Both share purchases and such loan advances are capital expenditure and so approved by Council in February (as part of the budget). Whilst the Council will manage the day to day cash flows associated with such advances within its normal day to day treasury business, ultimately it will be funding those advances using borrowed money.
- 4.4 HfR pays a commercial rate of interest above the Council's borrowing levels such that the overall interest payments should be sufficient to meet the Council's debt financing costs on both the loan and share capital advances. The expectation is that the company has an operating profit from year 2 subject to being able to acquire properties at the rate assumed in the business plan (2 per week on average), and being able to manage them to the cost and income profile assumed, which is dependent on market forces and other variables.

- 4.5 On commercial and governance advice HfR appointed Centrus financial advisors to independently review the proposed loan arrangements and Business Plan on the company's behalf, with a focus on the terms of the facility agreement (a legal document that sets out the arrangements). After some amendments to the initial draft were agreed, in early February, Centrus were able to advise HfR "that the facility agreement is now in a form that is reasonable to enter into." As detailed below, Savills have also provided State Aid advice to the Council in respect of the arrangements (as amended).

### Facility Agreement

- 4.6 Section 5 of the Business Plan summarises the funding arrangements at high level and a precis of the proposed terms of the Facility Agreement was provided as part of the Part 2 report. The State Aid report provides a review and summary of the proposed loan facility agreement in Section 4 and states that the proposed facility is reasonably market standard. (i.e. it would be lawful for the Council to provide loan finance to HfR on the proposed terms).

### Resourcing

#### i) Appointment of Directors

- 4.7 The Board of Directors is responsible for providing strategic direction, as well as overseeing and scrutinising the operational and financial performance of the company to ensure that business plan targets are met, within the parameters agreed with the Shareholder. The company will be engaged in both property acquisition and ensuring that landlord responsibilities are fulfilled in the management of the stock and provision of services to tenants and so the right balance of skills, experience and commercial financial acumen are critical. It was agreed by Council that the Board membership should include two independent Non-Executive Directors to bring commercial housing and finance experience.
- 4.8 The present HfR Board of Directors is currently Councillors Richard Davies, Sarah Hacker, Ed Hopper and Jo Lovelock; Sarah Gee (Head of Housing and Neighbourhood Services); and Bruce Tindall (Chief Valuer). Policy Committee appointed officer and councillor directors in May 2016 and subsequently two Non-Executive Directors have been recruited and Policy Committee approval is sought in order to confirm their appointment.
- 4.9 HfR was successful in attracting an extremely high calibre of candidates for Non-Executive Director roles. Two directors have now been selected and the Board consider that they will bring significant commercial property and financial experience to the company. Darrell Mercer is currently the Chief Executive Officer of A2 Dominion with considerable sector experience both of the private rented sector and residential development. His extensive career in housing includes time at the Housing Corporation. John Higgins is a Chartered Accountant and currently Interim Head of Strategic Finance at East Thames Housing Group one of the largest providers of affordable housing in east London and Essex. Remuneration for NEDs has been agreed by the Board, and is allowed for in the business plan.
- 4.10 Directors have currently been appointed for the period of the Municipal Year 2016/17. It is proposed to amend the Memorandum and Articles of Association to extend this period to an initial appointment of three years - for elected members this will be subject to the Annual General Meeting of the Council confirming their appointment.

## ii) Appointment of Managing Director

- 4.11 A Managing Director for the company has been recruited, whose key task is to work with other officers and the Board to move the company from planning to operation. Alex Jaques is a chartered surveyor with over 15 years experience of managing residential property portfolios in the private sector. The Shareholder Agreement requires that the remuneration package for the HfR Managing Director be approved by the Shareholder and Committee is asked to approve the remuneration of the Managing Director in line with the Council's pay policy at Head of Service/Director Grade. (In line with normal arrangements for such posts the precise placement on the scale will be agreed by the Director of Environment & Neighbourhood Services). It is not currently proposed that the Managing Director is a member of the company board (though she attends the Company's board meeting as does the Council's Head of Finance, as an observer).

## Shareholder Agreement and Memorandum and Articles of Association

- 4.12 RBC will hold all of shares in HfR and as such retains full control of the company. The governance structure in place ensures robust management of the company and protection of the Council's financial and reputational investment.
- 4.13 The final proposed Memorandum and Articles of Association (Appendix 2) and Shareholder Agreement (Appendix 1) are attached and set out how the company will be run and the decisions reserved for shareholders. The shareholder function is primarily executed through Policy Committee. Additionally the Audit and Governance Committee has been authorised to provides oversight of the arrangements and financial position in relation to the company.

## 5. CONTRIBUTION TO STRATEGIC AIMS

- 5.1 This proposal will contribute to the service priorities set out in the Council's Corporate Plan 2015-18:
- Providing homes for those in most need.
- 5.2 The proposal will increase access to safe and suitable housing for homeless households and more widely will help to improve stock condition and promote best practice in the private rented sector.

## 6. COMMUNITY ENGAGEMENT AND INFORMATION

- 6.1 There is no requirement in legislation or in guidance to consult with other agencies or stakeholders on the establishment of a housing company. However, it will be important that members, council staff, applicants, tenants and the wider community understand the role and offer provided by the housing company and how this differs from the provision of Council housing. Information and housing policies will be published in plain English. A communications strategy will need to be developed in due course.

## 7. EQUALITY IMPACT ASSESSMENT

- 7.1 Under the Equality Act 2010, Section 149, a public authority must, in the exercise of its functions, have due regard to the need to—

- eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under this Act;
- advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it;
- foster good relations between persons who share a relevant protected characteristic and persons who do not share it.

7.2 An Equality Impact Assessment (EIA) does not indicate that recommendations will have a disproportionate impact on any protected group.

## 8. LEGAL IMPLICATIONS

8.1 Specialist legal advisors Trowers and Hamblins have provided legal advice including documentation in respect of powers to form and to fund the housing company. This was set out in some detail in the report to Council in March 2016.

8.2 The Housing and Planning White Paper 'Fixing Our Broken Housing Market' published in early February has the potential to impact on both the local housing market and the company's Business Plan. Further analysis will be required and the impact will be subject to the final primary and secondary legislation once enacted. There is reference to the Right to Buy being applied to affordable homes developed by local authority housing companies but there is little detail to enable any potential impact on the HfR proposed business model at this stage. It is also proposed to regulate lettings fees in the private rented sector.

## 9. FINANCIAL IMPLICATIONS

9.1 The financial model for HfR has been developed by Savills Financial Services with officers providing and agreeing assumptions. As previously noted, the modelling is predicated on there being no overall cost to the Council, which intends to borrow money and in turn support the housing company through the provision of loans and subscription to share capital. Both the loans (which will be for more than one year) and share capital will be accounted for as capital expenditure.

9.2 The interest rate on the loans to the company will be set such that the interest paid by the company is forecast to be at least as much as the interest the Council will need to pay on borrowing it undertakes to finance the share & loan finance over the life of the business plan. The treasury risks of the company (as a start up) and Council are different, so whilst in theory it would be possible to achieve this by always undertaking matching borrowing when HfR needs money to buy property, in practice a better overall financial position is likely to be achieved by managing the Council's position in the context of the treasury strategy overall (agreed at Council in February).

### State Aid

9.3 Savills have additionally provided advice on State aid compliance and their report is intended to enable the Council to satisfy itself in respect of both this matter and compliance with UK transfer pricing rules. The Market Economy Operator Principle (MEOP) is a concept that has been developed by the European Commission to determine whether a transaction entered into by a public body gives an advantage to a particular economic undertaking and therefore falls within the State Aid regime. In broad terms, MEOP says that an economic transaction carried out by a public body does not constitute State Aid if it is carried out in line with normal

market conditions. In other words, “does the beneficiary get an advantage they would not normally get from the market?”. For example, if a Council was to provide a loan to a company on commercial terms and at a commercial interest rate, properly taking into account the associated risks, on terms and for a return that a private investor would, then such activity would normally be considered to constitute lawful State Aid. The proposed arrangements meet this requirement.

- 9.4 It is recommended practice for councils to satisfy themselves on this issue by obtaining an independent report setting out that a notional private lender/investor would in the same circumstances make a loan/invest on the terms which the council proposes. In particular, the loan arrangement must comply with prevailing market terms - i.e. be commercial in nature and contain provisions which a private lender would require, have a commercial interest rate which properly reflects the risk and security, and other factors which a private/commercial lender would take into account in calculating an appropriate interest rate.
- 9.5 The intention of this report is to satisfy the Council, (HMRC & regulators) in this respect and on related Corporation Tax issues.

#### Value for Money (VFM)

- 9.6 See above - the proposal is cost neutral to the authority but will provide a supply of accommodation for homeless households thus contributing to a reduction in expenditure on bed and breakfast accommodation.
- 9.7 Unlike other options to accommodate homeless households, such as the Rent Guarantee Scheme and leasing property in the market, provision of housing through a housing company will be at no net cost to the authority as the company will operate on a commercial basis, cross-subsidising sub-market rent with the provision of full market rent.

#### Risk Assessment

- 9.8 Investing in property presents a number of significant risks and also opportunities to the housing company and the Council. The HfR Risk Register is based on the Council model and identifies 27 risks, 10 of which are red and 13 amber before mitigation. After mitigation HfR will manage 13 amber risks. These will be regularly reviewed and updated by HfR Executive Management Team and the HfR Board. Any start up business carries risks and the first year of operation will be most challenging for HfR. Many of the risks are outside the direct control of the company, but where HfR can influence matters it will focus on managing and minimizing risk.
- 9.9 The current residential property market can be characterised as uncertain. In addition to taxation and stamp duty changes, World and UK economic considerations have all had a significant impact on the UK property market over the last year. Many commentators have offered opinion, but it is clear that the impact of the UK leaving the EU is uncertain and likely to be so for several years. The fundamentals of housing in the region remain the same - high demand and a historic lack of supply. HfR continue to monitor the market and will revise assumptions as we start to move towards our first acquisitions.
- 9.10 The key variables which can impact on the viability of the company are market driven and these are not always predictable:

- i) Market rent yield (the relationship between market rent achievable on a property and it's market value). Yields will fall if for instance
  - Rents fall (with no commensurate fall in sales values)
  - Sales prices rise but rents don't rise at the same rate
- ii) Interest rates/Council funding costs rise - and therefore the cost to the company.
- iii) Rate of acquisition of properties - this impacts the ability to cover a fixed cost base.
  - If there are insufficient properties available to purchase above threshold yield - risk re rate of acquisition and ability to cover fixed costs.

Other factors include:

- iv) Performance - control of operating costs. This is controllable to a considerable extent but could be impacted by market forces, for instance, if insufficient demand impacted void periods.
  - v) Legislative and policy risks. For example
    - The current Housing White Paper proposes that affordable homes developed by a Council Housing Company should also be subject to the Right to Buy. There is little detail available as yet.
    - The Government are considering the need for additional disincentives for buy-to-let investors (further to increasing SDLT).
- 9.11 If the company cannot meet its interest payments to the Council and in turn the Council is not receiving sufficient return to meet its own financing costs, if it did the company could realise capital from the sale of a property to cover the shortfall. This situation is not ideal as the company would be a forced seller with a tenanted portfolio - but it would give the company time to then address the root problem of why it was unable to meet its interest payments. However, the Council would be exposed if property values had fallen since purchase - so that sale proceeds would not cover the Council's borrowing and initial investment. As part of the funding arrangements HfR is expected to achieve a property value to loan ratio within 3 years that provides a buffer, and ensure that only the shareholding value remains at risk.
- 9.12 Likewise should the rental market in Reading goes into decline and rents do not increase in line with costs, then this will require a re-alignment of the company's strategy which may include starting to sell properties and reduce the size of the portfolio.
- 9.13 It is anticipated that the company will hold properties for a significant time and therefore, over the longer period, property prices are expected to grow and so there should be sufficient value to cover any additional costs as well as cover the Council's original loan and equity investment. Reading property values are currently expected to increase significantly over the next 5 years. In this context, the Council needs to be able to take a long-term view of the proposal.
- 9.14 Furthermore, a reduction in the value of the stock only becomes a significant problem if it falls below the original purchase price, and is accompanied by significant reductions in rent levels achievable, and if the company actually has to sell properties. This business case is viewed as a long term investment and so any

short term drops in property values should be seen in the context that property values generally increase over the long term.

- 9.15 Part of the company's management responsibility will be to continually monitor the property market and its property portfolio (and costs and incomes) to forecast any changes and adjust its strategy to manage any difficult periods or indeed, take advantage of opportunities. In this context the Company would be expected to report to the Council as shareholder if it foresaw significant risk of problems emerging from a changing property market.
- 9.16 As well as shareholder risks above, the company will carry operational risks of managing a housing portfolio; in many ways these will be similar to those the Council already carries as HRA landlord.

## **10. BACKGROUND PAPERS**

- i) PROPOSAL TO ESTABLISH A COUNCIL OWNED HOUSING COMPANY: Report to Council - 22 March 2016
- ii) APPOINTMENT/NOMINATIONS TO OTHER BODIES FOR THE MUNICIPAL YEAR 2016-17: report to Policy Committee - 25 May 2016
- iii) HFR - BOARD AUTHORITY TO ALLOT SHARES: Report to Policy Committee - 31 October 2016
- iv) Financial model (which is confidential).

### Introduction

As outlined in section 4, whilst HfR is a separate legal entity, it will be entirely owned and funded by the Council. As a result, the financial implications for the Council are primarily based on a comparison of:

- The net rental income generated by the properties which are bought by HfR
- The revenue cost to the Council of providing funding to HfR to acquire the properties

On the basis that sufficient rental income will be generated, then the funding arrangements between the Council and HfR will need to be set up in the most efficient way, subject to HMRC and state aid<sup>1</sup> regulatory requirements.

The {business plan} set out financial forecasts for HfR based on the acquisition, rental and funding assumptions set out in this business plan. This section now looks at the financial implications for the Council as funders of HfR, based on those assumptions.

### Cost of funding HfR

The base viability assessment has assumed that the cost to the Council of funding HfR over the 5 year acquisition period, is based on the following principles:

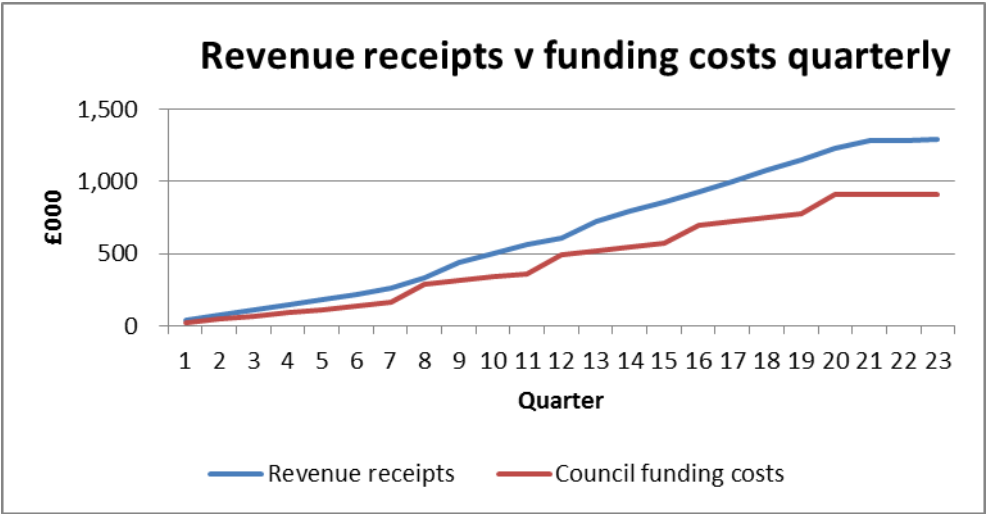
- New borrowing is drawn down by the Council
- Initially, as the portfolio is built up short term funding is drawn down
- As the portfolio builds up, short term borrowing is re-financed in tranches into longer term funding

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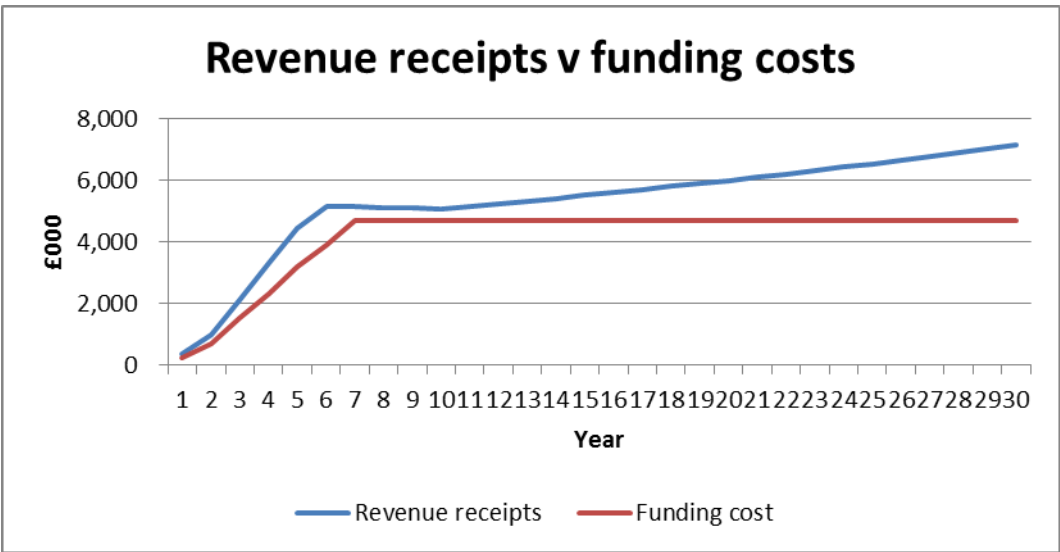
<sup>1</sup> In essence, "State Aid" rules prevent the Council providing subsidised funding to HfR as a private company, so the company pays the council a higher interest rate than the Council can borrow at, and HMRC will need to be assured that the interest rate charged to the company is not artificially high (for taxation reasons). Independent advice has been received to confirm the proposed approach complies with both requirements.



Based on current (March 2017) PWLB interest rates, base case assumptions are 1.2% interest {paid by the Council} for short term funding and 2.9% {paid by RBC} for long term funding. Over the first six years the financial modelling shows



And over the planned 30 year life of the business plan the picture is as below



As these graphs indicate, apart from in the initial year the position appears to be cash positive; however, this does rely on building up the portfolio reasonably quickly.