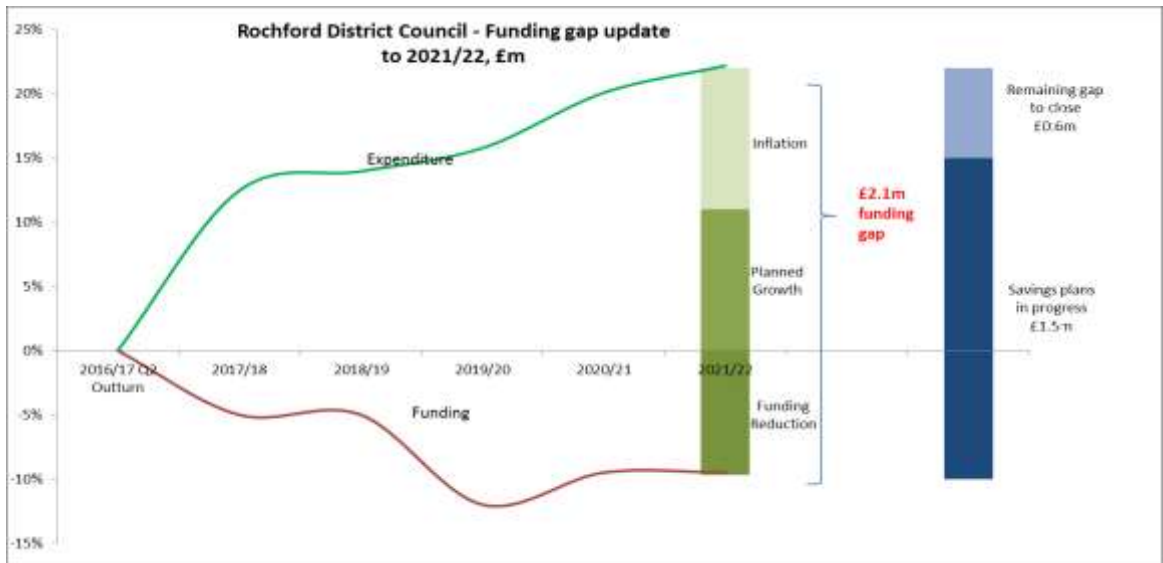

PROPERTY STRATEGY PROJECT/ASSET REGISTER REVIEW PROJECT OPTIONS

1 INTRODUCTION

- 1.1 A report was presented to the Investment Board (“IB”) on 15 March 2017 when the Project Initiation Documents for the Property Strategy Project were approved. The purpose of the property strategy project is to enable the various asset projects to be delivered in a smooth and timely manner by creating a “pathway” which identifies the best use, legal vehicle, financing and management for those asset projects. The intention is to use this approach on all subsequent Rochford District Council property developments that are primarily aimed as financial returns.
- 1.2 The project strategy team has met several times and also held a one day workshop with a facilitator from the city solicitor’s firm Bevan Brittan. At the facilitated session a project pathway was created and agreed by the project team. This pathway relates to the first cohort of sites identified for potential development in the Asset Register Review (“ARR”) and Phase 1 of Project Wyvern, namely 19 and 57 South Street. Larger sites not identified in this report will be the subject of separate reports.
- 1.3 This report firstly sets out to undertake an options appraisal for the potential use of this initial cohort of ARR sites; 19 and 57 South Street and other larger sites will be the subject of a separate report. The second part of the report goes on to provide a business case to proceed with the recommended option for the ARR sites.

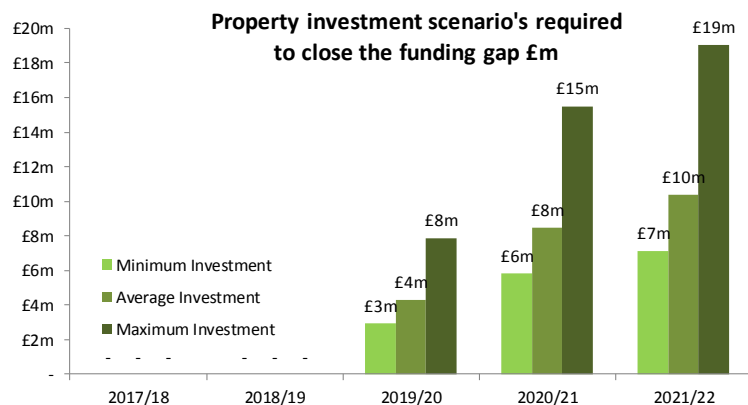
2 WHAT IS THE PROBLEM WE ARE TRYING TO SOLVE? THE MEDIUM TERM FINANCIAL STRATEGY (MTFS)

- 2.1 The MTFS as presented in February 2017 to Full Council showed a £2.1m funding gap by 2021/22, prior to any savings plans being progressed in 2017/18 onwards.
- 2.2 The graph below shows this same MTFS position, but now with the higher certainty savings projects included (looking to save £1.5m annually by 2021/22) and thus a remaining gap to be closed of £0.6m.



2.3 This £0.6m can be met through two potential routes: 1) the fruition of Member ideas from the away day in October 2016 or 2) through additional income via a property investment portfolio or property development, or more likely a combination of the two.

2.4 As an exercise, if the entire gap is to be closed by ongoing income from property (either develop and rent or acquisition and rent, or even just property investment portfolios) then a gauge of the investment required and the time scales are shown below:-



Financial Gap which could be address by Property investment return £	2017/18	2018/19	2019/20	2020/21	2021/22
	-	-	235,995	464,793	571,291

2.5 Therefore, with a modest 3% annual yield, (which is a useful measure of the return Rochford would be likely to receive compared, to say, a treasury management investment), Rochford would be looking to invest circa £19m in property (in whatever combination as discussed above) by 2021/22. This drops considerably to £7m if the entire portfolio manages an annual yield of 8%, bearing in mind that these returns will have to be after we had factored in

borrowing costs, which currently are running at circa 2-3%, meaning a £7m investment portfolio would have to generate close to 10%-11% to close the gap, which is unlikely but not entirely unachievable.

- 2.6 Therefore, the middle ground requires an average investment level of £10m, with a 6% yield (after borrowing costs) which is achievable with a combination of lower yield developments and high yield property acquisitions / investment portfolios.
- 2.7 To put this into context, Rochford District Council's revenue budget for 2017/18 was £9m; the interest costs on a £19m loan would be at least £500,000 per annum, or circa 6% of our overall budget, hence the return needs to be healthy to cover the additional costs.

3 OPTIONS TO CLOSE THE FINANCIAL GAP THROUGH PROPERTY INVESTMENT:

This section of the report is exempt.

4 ASSET REGISTER REVIEW SITES - OPTIONS APPRAISAL:

This section of the report is exempt.

4.1 Housing Demographics

Tenure

The most common form of tenure in Rochford District is owned outright and represents 41% of the District housing stock.

Rochford District currently has a private rented sector of 7.6%; this is 5.8% lower than the regional average. The affordable social housing rented sector is 7.4% compared to the regional average of 15.1%.

Affordability

The average gross pay in Rochford District is £578 compared to the regional average of £539.

Percentage of households priced out of Sales market.

	CANEWDON/STAMBRIDGE	ROCHFORD	CENTRAL RAYLEIGH
FTB* households - Flats	52.59%	69.38%	66.11%
FTB households - Terraced houses	77.35%	91.13%	91.28%
FTB households - Semi-detached houses	80.63%	91.13%	89.68%
FTB households - Detached houses	100.00%	96.00%	100.00%

Owner occupier - Flats	45.69%	62.97%	60.38%
Owner occupier - Terraced houses	69.34%	86.63%	87.64%
Owner occupier - Semi-detached houses	73.68%	89.13%	85.32%
Owner occupier - Detached houses	87.87%	94.09%	91.28%

(*FTB – First Time Buyer)

House price to income ratio for development areas

Area	AFFORDABILITY RATIO BASED DISPOSABLE INCOME	Lower quartile House price to INCOME ratio
Ashingdon/Canewdon	8:1	10:1
CENTRAL Rayleigh	9:1	14:1
ROCHFORD	10:1	16:1

Figures obtained from Hometrack Online Housing Intelligence System (www.hometrack.co.uk).

4.2 Projected Financial Return for the Various Options

This section of the report is exempt.

4.3 Appraisal Methodology:

This section of the report is exempt.

4.4 Summary

This section of the report is exempt.

4.5 Conclusion

This section of the report is exempt.

PART 2

**5 BUSINESS CASE FOR PROGRESSING THE 3 ASSET REGISTER
REVIEW SITES AS THE RECOMMENDED OPTION E PRIVATE RENTED
ACCOMMODATION**

The Council needs a business case in order to take a reasoned rational decision. The following is intended to provide a business case of the key considerations/requirements needed to bring this option forward. A detailed financial appraisal will be considered at an appropriate point once more accurate financial information naturally emerges as part of the development preparation process.

5.1 Introduction

The proposed delivery model is a way of the Council using the assets it currently owns to generate a revenue stream which can be used to fund the gaps in the Council's funding that have been identified in the MTFS. The key points of the plan are laid out below.

5.2 Strategic Fit of the LATCo with the Council's Vision

The 2016 to 2020 Rochford Council District Business Plan identifies as a priority: '*Become Financially Self-Sufficient*', and states that a key approach will be: '*set up a trading arm and increase our traded services to generate investment income and make us more 'self-sufficient'*'. The development of a Local Authority Trading Company (LATCo) to oversee the development and renting of the units from the use of the Council's land assets would be appropriate. This new company would be included within the existing Green Gateway Trading Ltd group company structure.

6 Company Structure

6.1 The creation of an arms-length LATCo reveals a clear strategic alignment with the Corporate Business Plan. There are future opportunities identified for other contracts commissioned by the Council which are also potentially to be delivered by an arms length LATCo. Savings could be achieved in the long term through an arms-length commercial approach, whereby similar terms and conditions are applied to the workforce, but existing profits are returned to the Council as the sole shareholder. Local authorities can only do what they have statutory powers to do. There are three broad categories of statutory powers which can be relied on by authorities wishing to provide goods and services to third parties. These are:-

- the power to trade commercially under section 95 of the Local Government Act 2003 (LGA 2003) and section 4 of the LA 2011;
- the power to provide discretionary services to third parties established in section 93 LGA 2003 and section 3 LA 2011; and

- the miscellaneous powers that existed before the LGA 2003 and the LA 2011; for example, the power to provide goods and services to certain public bodies under section 1 of the Local Authorities (Goods and Services) Act 1970, the power to provide services in connection with the provision of leisure facilities under section 19 of the Local Government (Miscellaneous Provisions) Act 1976, section 38 of the same Act which permits local authorities to provide computer-based services from its computers to third parties on a commercial basis, and the Civic Restaurants Act 1947, which empowers certain local authorities to establish and carry on restaurants and supply meals to the public.

There are a number of reasons why a local authority is required to trade via a LATCo governed by ordinary LATCo legislation and by Part V of the Local Government and Housing Act 1989. Using a LATCo vehicle to trade:-

- Ensures a level playing field between local authorities and private sector companies.
- Means that local authorities do not receive the tax advantage they would otherwise have had over private sector companies.
- Results in greater transparency arising from LATCo law requirements. This is useful for the purposes of state aid and competition law.
- It means that there is greater protection for the council tax payer and the monies paid to the public purse as a result of limited liability.

Will a Company be Required?

The need for a separate company to hold the asset would not be necessary for any project that would result in the Council holding a Commercial property on its own.

In the case of residential properties where the Council is going to retain ownership of the asset whilst looking to generate rental income, the legal opinion that has been received indicates that the Council needs to do this via a LATCo in order to meet the requirements of legislation as the Council is unable to grant Assured Shorthold Tenancies – only other landlords may do that – the Council has a range of tenancies it can offer including secure, introductory etc. and some without security of tenure (e.g. to house the homeless on a temporary basis). The Council does have powers to participate in and provide financial assistance to companies for privately let housing under s.24-26 of the Local Government Act 1988.

Although formation of a LATCo is to enable the 3 ARR sites to be developed and rented for private rent, its creation also paves the way for future development to be operated through the same LATCo. For example, 19 and 57 South Street could be operated through the LATCo should their use be determined to be for private rent. This will have the positive consequence of saving time and money.

6.2 Right to Buy

The 'Right to Buy' is a right given to secure tenants of Council-owned properties under the Housing Act 1985. In order to establish a Right to Buy (RTB) there are two conditions to be satisfied; the interest of the landlord must belong to an authority or body listed within the Act (landlord condition) and the tenant must have held their tenancy for 3 years (tenant condition). The Council meets the landlord condition. However, a LATCo does not fall within this definition. Therefore, RTB does not apply to tenants of properties owned by a LATCo. However, concern has been raised by paragraph 3.28 of the Government White Paper: Fixing Our Broken Housing Market published in February 2017. This states as follows:-

“Increasingly and across the country local authorities are using innovative new models to get homes built in their area. There are a number of good examples of Local Development Corporations, local housing companies and/or joint venture models building mixed sites, which include new market housing for sale or private rent, as well as affordable housing. We welcome innovations like these, and want more local authorities to get building. To that end we will seek to address the issues that hold them back. However, we want to see tenants that local authorities place in new affordable properties offered equivalent terms to those in council housing, including a right to buy their home.”

The risk that RTB will be extended only applies to affordable housing, Option F. For this reason, the recommendation is to prefer Option E 'develop and rent the housing to the private rented sector.'

6.3 Formation of a LATCo

The formation of a LATCo would be easier as the Council already has the group company structure in place. A company will need to be formed and then it can be added to the existing structure. The Directors of the new company would have to complete Deeds of Adherence to the existing Shareholders agreement and Resourcing agreement and separate Memorandum and Articles would need to be drawn up covering the company's activities.

As is already the case for the Grounds Maintenance company, the appointed Directors would have to adhere to the company's business plan that is submitted and approved by Council.

6.4 Rental choice

Currently the private rental sector of the local housing market is very small and accounts for less than 7% of the total housing stock.

In order to ensure that the housing units will be in the name of the LATCo it will be necessary to transfer the assets to them. The Council cannot be seen to favour the LATCo so any assets transferred would need to be at the market rate. Whilst the Council would have to lend the funds to purchase the land to the LATCo at commercial rates the majority of this would purely be a book entry. This transfer would attract stamp duty and this would increase as the value of the land increased. Therefore it would be best to transfer the land to the LATCo prior to any planning permission being granted as this would tend to increase the value of the land and therefore increase the amount of stamp duty that has to be paid.

The Council could then assist with procuring the project manager and developer on behalf of the LATCo with the LATCo paying for this service. In this example the Council would follow the LATCo's procurement procedure rather than its own.

Initially, it would be best to use a local estate agent to market, rent and manage as they have experience and expertise of the market. As numbers increase then it would be necessary to look at whether there was scope for taking this function in house or via a separate company.

6.5 Other Legal implications

State Aid

Any provision of resources from the Council to the LATCo must not fall foul of State Aid. For State Aid to arise the following five tests must be satisfied:-

- It is a measure granted by the State or through State resources
- It confers an advantage on the recipient
- It favours undertakings engaged in economic activity or the production of certain goods
- It distorts or has the potential to distort competition and
- It relates to an activity that is tradable between Member States and the aid has potential to effect trade.

Any assistance, whether it be financial or services in kind, will trigger State Aid concerns. Loans under market terms for assistance would not fall foul of State Aid rules if the terms are commensurate with general commercial terms and interest rates set by the Commission. Alternative options are available to consider but specialist advice would need to be sought.

Procurement

Consideration would need to be given to whether a LATCo has to comply with procurement law. The test as to whether a company will have to procure is whether it is a Contracting Authority.

For a company itself to be a Contracting Authority and subject to public procurement law, it must be a body which is governed by public law. Under Regulation 2 of the Public Contracts Regulations 2015 a body governed by public law is a body that has the following characteristics:-

- (a) It is established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character;
- (b) It has a separate legal personality; and
- (c) It has any of the following characteristics:-
 - (i) It is financed, for the most part, by the State, regional or local authorities or by other bodies governed by public law;
 - (ii) It is subject to management supervision by those authorities or bodies, or
 - (iii) It has an administrative, managerial or supervisory board, more than half of whose members are appointed by the State, regional or local authorities, or other bodies governed by public law.

All three limbs (a)-(c) need to be present to for the company to be governed by public law, although limb (c) can be satisfied if only one of the subsidiary limbs (i)-(iii) is present. A commercial trading company may not be a contracting authority and not therefore governed by public law – this needs to be assessed in each individual case based on what it does.

The Teckal exemption will not apply to a company that is not providing a service to the Council therefore normal procurement procedures would have to be followed to award any contracts to such a company by the Council.

The Council will need to obtain specialist advice in relation to formation of the Company, in particular in relation to the issues of Tax, State Aid and Procurement.

Land Transfer

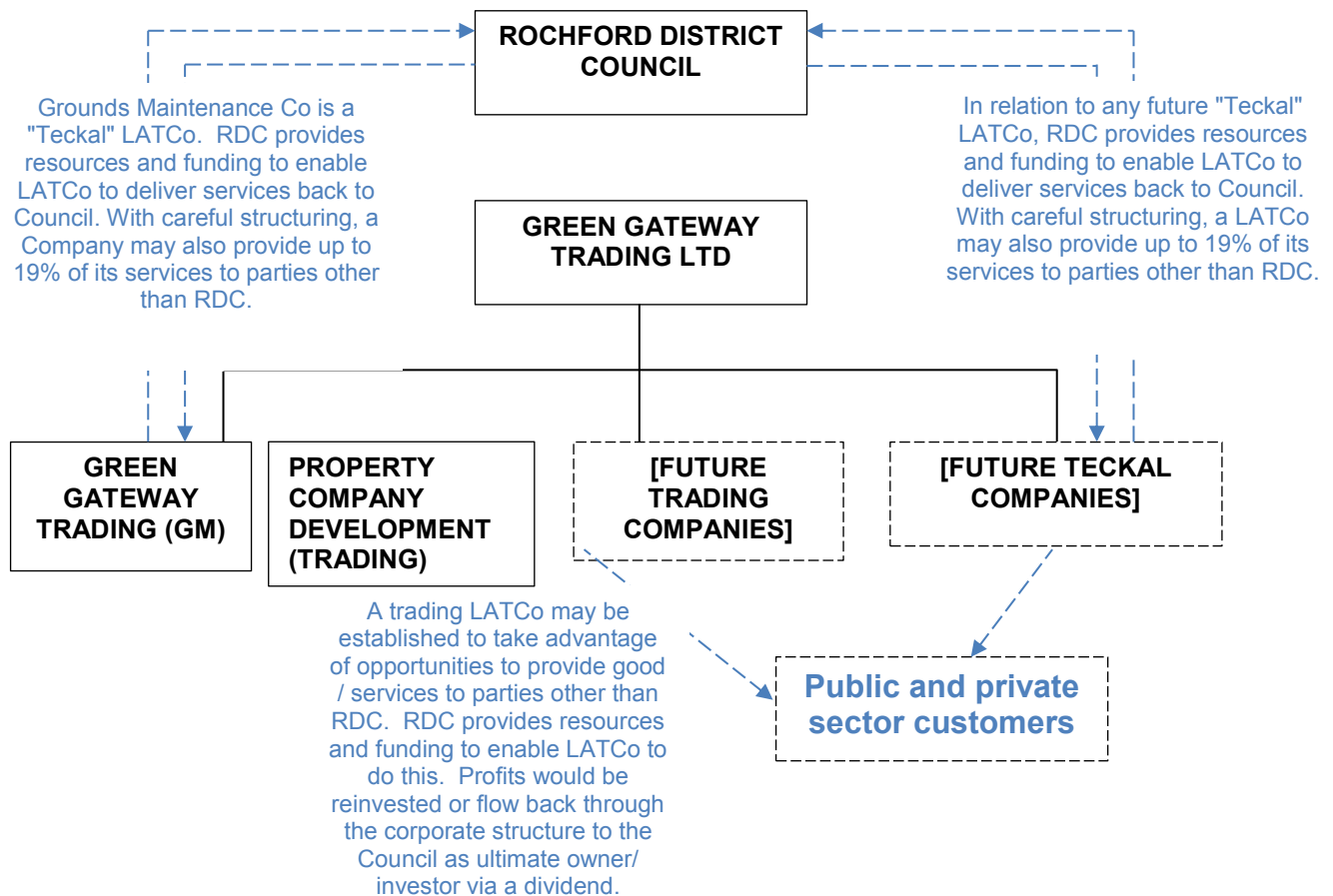
The transfer of land from the Council to the LATCo is a disposal under section 123 of the Local Government Act 1972 (or section 32 of the Housing Act 1985 if it is housing land). The Council must dispose of land for the best consideration that can reasonably be obtained. Land disposals therefore must be at open market value.

The timing of the land transfer to the LATCo would need to be carefully considered as any transfer of land must be at an agreed valuation, in line with

State Aid rules and to comply with best consideration requirements. As such the carrying value of the asset on the RDC balance sheet is an acceptable method before planning is achieved. However, once planning has been achieved, then the value would have gone up and thus the amount of Stamp Duty Land Tax (SDLT) would increase. Any valuation below £125,000 will not be subject to SDLT.

The land for the sites will need to be purchased by the LATCo using funds loaned to it by the Council at commercial rates and terms. The land can be used as security against the loan by placing a charge on the land.

7 Governance arrangements



7.1 Detailed governance arrangements will be established for the new LATCo and it is envisaged that this will be similar to the existing arrangements for Green Gateway Trading (GM) Ltd.

Shareholder governance is essential in order to ensure that the Council, who is the ultimate 100% shareholder, has appropriate control of the LATCo. It is proposed that once established the LATCo's Board will develop and approve an annual and 5 year Business Plan so that it meets the Council's agreed

general investment targets and associated budgets. The LATCo will also report to shareholders at appropriate intervals.

7.2 Structure

The diagram above sets out how the Rochford corporate group looks with the potential addition of the property LATCo. The corporate and resourcing relationships between the Council and its subsidiaries from time to time are governed at a high level by four documents:-

A **Shareholder Agreement** setting out the more "commercial" elements of the corporate relationship between the Council and a given subsidiary, including how decisions are made, the matters reserved to the Council as ultimate owner of the group, how profits are treated, funding, information rights and other Council controls, and termination. The new subsidiary because it will be established after the original Agreement was signed would undertake to adhere to its terms by way of a deed of adherence, thereby creating a more unified governance structure across the corporate group.

Articles of Association for each subsidiary (where structured as a company) are a requirement from a corporate law perspective and set out the more "administrative" provisions in the Council/subsidiary relationship and need to dovetail with the Shareholder Agreement.

A **Resourcing Contract** setting out how a subsidiary would "call down" support from the Council when required. As with the Shareholder Agreement, the new subsidiary because it will be established after the original Resourcing Contract was signed would undertake to adhere to its terms by way of a deed of adherence, thereby aligning the way in which the Council enables each subsidiary to operate. The nature of the resourcing (for example, physical assets, property, IPR, personnel) needs to be priced in a way which complies with state aid principles.

A **Funding Agreement** setting out how the Council would fund a subsidiary, to the extent the Council is not investing by way of equity subscription and/or third party debt is not sought. In any case, the funding arrangements would be agreed for each subsidiary on appropriate terms which are state aid compliant.

These relationships provide a structure by which the group is governed. Within that structure, each subsidiary would have an agreed **business plan** setting out what its purpose and immediate goals are. A business plan would also consider the nature and level of required Council resources as well as any external resources and funding. Where services are being provided to the Council, these would be governed by a **Services Agreement** between the relevant subsidiary and the Council. This would set out what the subsidiary

was providing to the Council, what the Council was paying, how performance would be measured and the implications for non-performance.

7.3 How will it Work

The land will be transferred to the LATCo at its market rate. This transfer will in all likelihood be before any planning permission has been granted so that the Council does not incur any unnecessary stamp duty costs. The Council will have to lend the LATCo funds to purchase the land although this transaction will be more of a book exercise.

Once planning permission has been agreed the Council could procure the developer on behalf of the LATCo for a fee payable by the LATCo, in this example the Council would follow the LATCo's procurement regulations rather than its own. The Council would need to lend funds at commercial rates to the LATCo for the purchase of the land from the Council and for developing the properties. These funds would either come from the Council's reserves.

Once the development is complete then the LATCo will arrange for the various units to be rented out at a commercial rent. This could be via a local estate agent. At an appropriate point the LATCo could decide it's general approach lettings, including dealing with tenant issues and management related matters. The Council would make a loan to the LATCo at commercial rates, previously this has been 14% for the Grounds Maintenance LATCo. The rate may be reduced in relation to money lent to the property LATCo due to the fact the security can be granted over the assets. The interest cost reflects the risk of a new business entrant, but is fundamentally moving money around the Council and the LATCo, rather than generating an overall surplus. The current investment needs of the three ARR sites in question can be met from council reserves without the need to borrow, however, any future proposals will be considered on a case by case basis.

7.4 Development Phase: Project Management

This section of the report is exempt.

Indicative time line of key stages to delivery (Note- items shown in bold relate to the 3 ARR sites, other items listed for ease of reference)

This section of the report is exempt.

8 Financials and Funding

This section of the report is exempt.

8.1 Taxation

The three sites' development would incur VAT and Corporation Tax if a LATCo is utilised and as such expert advice would need to be sought due to the complexities of the VAT system with regard construction and rental purposes.

9 RISK IMPLICATIONS

- 9.1 Refer to Appendix 3. Advice will also need to be obtained with respect to obtaining appropriate insurance cover for Directors of the LATCo, the activities of LATCo itself and its land holdings.

10 LEGAL IMPLICATIONS

- 10.1 The legal implications are set out in the body of this report.

11 PARISH IMPLICATIONS

- 11.1 The affected Parish Councils will be consulted as per the normal planning protocol.

12 RECOMMENDATION

- 12.1 It is proposed that the Board:-

Recommends to the Executive

- (1) That the work in relation to the Property Investment / Acquisition project to date be noted.
- (2) That the remaining financial gap and potential options to close it be noted.
- (3) That the continuation of the three Asset Register Review Sites be approved, subject to full planning permission, based upon Option E of the options appraisal, on the basis that the sites be used as Private Rental.
- (4) That a housing development company LATCo be incorporated, including name, Directors and other matters required and that authority be delegated to the Assistant Director, Legal Services and the Section 151 Officer to progress incorporation.
- (5) **Exempt.**

- (6) **Exempt.**
- (7) That the transfer of the three sites to the LATCo at the currently held asset value as soon practicable be approved, subject to appropriate legal and tax advice, and that authority be delegated to the Assistant Director, Legal Services to action this decision.
- (8) That authority be delegated to the Assistant Director, Commercial Services, in consultation with the Chairman and Vice-Chairman of the Investment Board, to take any other reasonable action required in furtherance of achieving the stated objectives of the three asset register sites' business case, subject to not exceeding any budget identified within this report.

Recommends to Full Council

- (1) **Exempt**
- (2) That authority to approve loans as appropriate to the LATCo, at the appropriate rate and terms, be delegated to the Section 151 Officer in consultation with the Chairman and Vice-Chairman of the Investment Board.



Nicholas Khan
Executive Director

Background Papers:-

None.

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If you would like this report in large print, Braille or another language please contact 01702 318111.

APPENDIX 1 – Table of "Pros & Cons" of the Various Options

This section of the report is exempt

APPENDIX 2 – Option Appraisal Criteria and Assessment

This section of the report is exempt

APPENDIX 3 – Risk Register

Risk	Li	Imp	Rating	Controls
Failure to set up trading arrangement in strict compliance with legislation	1	3	Low	Extensive consultation with other authorities and, appropriate, external advice on governance arrangements
Possibility of trading ultra vires	2	3	Medium	Every new trading activity via the LATCo to consider statutory obligations
Possibility of challenge of state aid	2	3	Medium	Obtain full cost recovery and any loan given to the LATCo to be set at commercial lending rates
Possibility of conflicts of interest arising for members or officers as Directors	3	2	Low	Recommendation not to have Members on the Board to remove the possibility of conflicts of interest. Officers to abide by the Code of Conduct for Employees.
Failure to arrange adequate insurance cover for the LATCo's liabilities/assets	2	4	Medium	Ensure Insurer for the LATCo is kept up to date with any new areas of trading activity
Failure to comply with taxation laws – corporation tax & vat	3	3	Medium	Advice given by tax consultants in relation to taxation generally
Trading LATCo failure	2	3	Medium	Market testing and valuations to be obtained and implementations of tight budgetary controls
Conflict of interest over workload priorities of Council and LATCo projects	4	2	Medium	Effective resource planning and compliance with Corporate Plan. Non-executive Directors on board
Challenge from Council's Auditors	3	2	Low	Follow CIPFA Code of Practice on LA Accounting. All transactions applicable to the LATCo can be identified using unique transaction records and coding structures

Risk	Li	Imp	Rating	Controls
Lack of capacity to manage additional work	4	2	Medium	Careful programming of staff resources
Contractual disputes	1	3	Low	RDC's in house legal section to be employed to check all contracts before they are entered into
Changing market conditions	2	3	Medium	EH monitoring market on fortnightly basis
New area of work for RDC	5	3	High	Expert advisors and member advisory groups being used to manage project effectively.
Unfavourable public reaction to development proposals	3	2	Low	Consultations and public exhibitions/roadshows being arranged
Difficulties in gaining planning consent or possible planning restrictions	2	4	Medium	Consultations and public exhibitions/roadshows being arranged
Unable to raise relevant investment funding	2	4	Medium	
Political or Government intervention	2	3	Medium	Member briefings and Government policy watch
Non-compliance with affordable homes policy	1	2	Low	Ensure compliance
Issues raised by Registered Social Landlords	2	2	Low	Liaison with RSLs
Potential "Right to Buy" issues	2	3	Medium	Appropriate legal structures
Project plan still evolving	5	3	High	Continual Risk evaluation
Protected Species found on site	3	3	Medium	Ecological Study to be undertaken as part of detailed design and planning phase
Cost tenders exceed	2	2	Medium	Memorandum of Understanding –

Risk	Li	Imp	Rating	Controls
Cost Plan				Fixed Cost