Agenda Item No: 5

ESTABLISHMENT OF A COMPANY AS A HOUSING DEVELOPMENT VEHICLE (HDV) FOR PROPERTY DEVELOPMENT

To:	**Assets and Investment Committee**
Meeting Date:	**27th May 2016**
From:	**Chief Finance Officer, Cambridgeshire County Council & Director of Law & Governance, LGSS Law Ltd.**
Electoral division(s):	**All**
Key decision:	**No**
Purpose:	**A report to set out the rationale and outline business case for the establishment of a company or companies owned by Cambridgeshire County Council for the purpose of identifying and developing potential sites for residential and commercial use.**
Recommendation:	**It is recommended that the Committee:**

i) Approve the principle of and business case for a wholly owned company or companies to be established and operated by Cambridgeshire County Council for the purpose of identifying, developing and managing residential and commercial property developments within the UK with a view to generating capital and revenue income for Cambridgeshire County Council.

ii) Request the Director of Law & Governance to incorporate a company or companies, limited by shares, to be wholly owned by Cambridgeshire County Council for the above purposes.

iii) Authorise the Director Law & Governance, in consultation with the Chairman/woman and Vice Chairman/woman to

a. Agree the final form of the company Articles.

b. Agree the arrangements for the exercise of the shareholder functions.

c. Agree and appoint the initial directors of the company.

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1. BACKGROUND

1.1 Cambridgeshire County Council (CCC) is facing unprecedented financial pressures, with reducing funding from central government, and increasing demands on its services. CCC is looking to alternative means of supporting the delivery of frontline services from rationalising and commercialising its own resources, including the use of its property assets.

1.2 CCC is in the fortunate position of continuing to be a major land owner in Cambridgeshire. This provides an asset capable of generating both revenue, and capital returns. The latter affords opportunities, over time, to promote land for new housing development and to realise significant enhancements in capital land value.

1.3 Until the current financial crisis, the traditional approach for local authorities has been to realise capital receipts from the disposal of surplus or development land. However, the pressure on revenue budgets has driven a new way of thinking about development opportunities, and together with the general powers of competence under the Localism Act 2011, many local authorities are increasingly looking for innovative methods to generate additional sources of income.

1.4 In view of CCC's land holdings, and the currently extremely buoyant economic conditions for housing development, there is an opportunity for CCC to develop its own land rather than sell it. Simply selling sites for others to develop, and profit from, is no longer an option for CCC. The scale of the financial challenges facing CCC requires that it has to review every opportunity available to it in order to create an on-going revenue stream that can mitigate the reduction in the services that it otherwise would have to make.

1.5 The vision is to transform CCC from being a seller of sites to being a developer of sites. CCC is therefore developing, and delivering, a series of principally residential development projects from its property portfolio across Cambridgeshire, planned over an initial 10-year timescale.

1.6 In addition to the financial benefits that will be derived from being a developer it also affords CCC additional influence and wider social and economic benefits. Being in control of a development will help CCC provide stimulus for employment, meet service needs in existing and new communities, mitigate long term potential service demand issues through housing design, and be able to influence both sides of housing infrastructure in a more coordinated manner.

1.7 The 'Property Portfolio Development' Programme (PPDP) has been established to deliver CCC's housing aspirations, and plans to do so by:

- Co-ordinating project delivery, bringing individual project plans together in an overall programme plan that captures timescales, residential units and financial returns.
- Effectively planning and managing project resourcing (inc. staff).
- Co-ordinating capital investment/returns between projects to ensure appropriate cash flow and financial resourcing.
- Delivering a co-ordinated reporting process to all relevant stakeholders.

- Supporting the appropriate procurement and delivery options for projects.
- Overseeing the establishment and transition to a Housing Development Vehicle
- Overseeing the development of marketing and post-construction management arrangements.

1.8 In order to deliver the PPDP effectively, an appropriate delivery mechanism needs to be established. In this instance the delivery mechanism will be a separate company established specifically to deliver the housing planned by CCC. This company is referred to as a Housing Development Vehicle (HDV) and is discussed in detail in section 4 (below).

1.9 HDVs can purchase or develop housing for market sale and/or letting on assured shorthold tenancies. A number of HDVs have been set up across the country over the last few years, as local authorities see them as a useful tool to generate additional income and much needed housing both for rent and sale. Local examples include Suffolk County Council, who have recently established a joint HDV with Forest Heath and St Edmundsbury District Councils. South Cambridgeshire District Council established a Housing Company almost two years ago with a focus on purchasing and renting property in order to deliver income and provide much needed affordable rented housing.

2. FINANCIAL BENEFITS

2.1 In the past CCC has sold surplus land that could be used for housing to developers. This has meant that those developers have had the opportunity to make the development profits associated with the housing. The intention for CCC to act as its own developer in future will provide the opportunity for it to realise the development profit in addition to the base value of the land. With the ability to generate a ‘reward’ from this approach the Committee need to be aware that CCC will face an equivalent amount of ‘risk’. Whilst these risks can be mitigated through appropriate governance and resourcing, they cannot be avoided completely.

2.2 Developing its own housing through the HDV will also allow CCC to realise benefits to revenue funding rather than just the capital receipt from the sale of land. Projections of future funding suggest that a revenue stream is likely to be more helpful to CCC than a one-off capital receipt.

2.3 The nature of housing developments is that there is a significant time lag from the point at which sites are identified until the point that a revenue stream is created. One way of ensuring that revenue is received by CCC much earlier in this cycle is for CCC to establish a market loan to the HDV. The HDV needs to borrow at market rates in order to avoid state aid regulations but CCC can borrow at far more competitive rates from the Public Works Loan Board and take the margin on the loan in to CCC’s revenue account. CCC will therefore gain approximately 3.0 to 3.5% on everything it lends to the HDV from the point at which the loan is made, not when sales or rents start to be received by the HDV. This will mean that the HDV will be making substantial losses for many years. This is not of concern as this will be within the financial model and long term business plan of the HDV.

2.4 An indicative example of the returns that would be expected from loaning funds to the HDV in this way is a development in East Cambridgeshire currently looking to provide 350 units. The loan finance required for the site would depend on the mixture between housing for sale and housing for rent, but would be likely to be a minimum of £25m based on building housing for sale. The interest cost of this to the HDV would be around £9m, of which around £6m would be received by CCC as the margin over its own borrowing costs. Significantly higher interest figures would result from building housing for rent. Table 1 (below) illustrates the financial inputs and outcomes of the proposed approach for the example development. This approach will be taken for each site before a decision to proceed is taken.

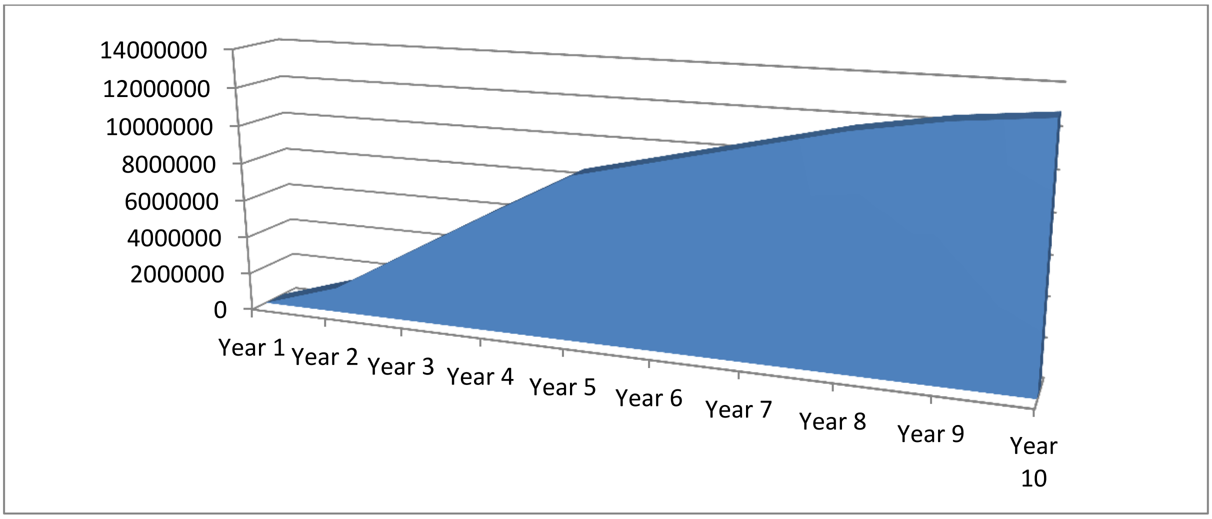
Table 1: Financial modelling for example site

Date Quarter Year		31-Mar-20 15 4	31-Mar-30 55 14	31-Mar-40 95 24	31-Mar-50 135 34	30-Jun-56 160 40
Inflation Factor Market Rental		*1.126x*	*1.513x*	*2.033x*	*2.732x*	*3.262x*
Inflation Factor Affordable Rental		*0.961x*	*1.291x*	*1.735x*	*2.332x*	*2.784x*
Inflation Factor Rental Overall Average		*1.043x*	*1.402x*	*1.884x*	*2.532x*	*3.023x*
Inflation Factor House Sales		*1.104x*	*1.413x*	*1.809x*	*2.315x*	*2.685x*
Inflation Factor Build Cost		*1.104x*	*1.413x*	*1.809x*	*2.315x*	*2.685x*
Inflation Factor Operating Cost		*1.104x*	*1.413x*	*1.809x*	*2.315x*	*2.685x*
Development Costs						
Land and Planning Costs						
Total Land and Planning Costs	**15,325,000**	**6,736**	**-**	**-**	**-**	**-**
Construction Costs						
Total Construction Costs	**50,741,486**	**2,395,999**	**-**	**-**	**-**	**-**
Infrastructure costs						
Total Infrastructure Costs	**15,536,025**	**882,916**	**-**	**-**	**-**	**-**
Internal Project Development Costs	**224,568**	**5,519**	**-**	**-**	**-**	**-**
Grand Total Development Costs	**81,827,079**	**3,291,170**	**-**	**-**	**-**	**-**
Sale receipts						
Equity Sale of Shared Ownership						
Net Equity Sales	**(11,869,923)**	**(66,521)**	**-**	**-**	**-**	**-**
Sale of Self-Build Plots						
Net Self-Build Sales	**(3,739,530)**	**(110,030)**	**-**	**-**	**-**	**-**
Sale of Market Units						
Net Unit Sales	**(74,931,844)**	**(3,627,078)**	**-**	**-**	**-**	**-**
Total Net Sales	**(90,541,297)**	**(3,803,628)**	**-**	**-**	**-**	**-**
Ongoing Operations						
Rental income						
Total Rental Income	**(35,985,516)**	**(44,354)**	**(198,476)**	**(248,614)**	**(334,116)**	**(398,953)**
Operating Costs						
Total Operating Costs	**9,813,596**	**13,424**	**57,218**	**68,267**	**87,388**	**101,343**
Net Operating Income	**(26,171,920)**	**(30,930)**	**(141,258)**	**(180,347)**	**(246,728)**	**(297,609)**
Funding - Overdraft Basis						
Loan Debt						
Closing		20,456,586	-	-	-	-
Funding - Investment Debt Basis						
Development Debt						
Closing		20,456,586				
Investment Debt						
Opening		-	4,450,797	2,695,780	940,762	(156,125)
Drawdown	5,240,556	-	-	-	-	-
Interest	3,940,434	-	55,635	33,697	11,760	(1,952)
Redemption fee	200,000					200,000
Repayment	(5,440,556)		(43,875)	(43,875)	(43,875)	(43,875)
Closing		-	4,406,922	2,651,904	896,886	(0)
Returns						
Net Cash Flow (nominal)	(25,900,348)	-	(141,258)	(180,347)	(246,728)	(297,609)
Cumulative Cash Flow		-	(601,450)	(10,497,972)	(19,038,136)	(25,900,348)
Net Present Value	**(6,616,083)**					

Note that the above is before company overheads (i.e. costs not directly project related) and Corporation tax.

2.5 Chart 1 (below) demonstrates the potential indicative returns to CCC over a 10-year period from commencement of the HDV, based upon the margin on loans to the HDV as set out in 2.3. The profile of potential returns is purely indicative at this stage. This chart assumes that all properties developed will be for rental purposes and therefore no capital is repaid. In reality this will not be the case and each development will include the property mix that is most appropriate for that location taking into consideration the market forces for that area. The profile of the actual revenue stream will also be affected by the planning and procurement processes for each scheme but the model does use the returns that have been modelled in detail for one site extrapolated over the whole pipeline. The detailed financial returns and the profile of these will be developed over the coming months as the pipeline of opportunities gains greater clarity. However with the aforementioned caveats the potential net income margin to the Council from the current pipeline could reach in excess of £12m over the next ten years.

Chart 1: Potential returns to CCC from the HDV.



3. NON-FINANCIAL BENEFITS

3.1 There would also be non-financial benefits associated with CCC developing housing. In particular these could help support the development of community resilience, which is a key objective for CCC.

3.2 Non-financial benefits include:

- Boosting housing supply to support economic growth.
- Quicker provision of affordable homes.
- Increasing competition in the market for developers and providing an example of good development practice.
- The ability to create key worker housing.
- The ability to design housing supply that could reduce the long term demand for CCC services.
- Addressing gaps in Cambridgeshire’s existing provision for specialist housing.

4. HDV KEY CONSIDERATIONS

4.1 There are a number of issues that have been worked through in considering how an HDV can be formed and this section 4 sets out a number of key issues as part of the process of setting up an HDV.

4.2 Having reviewed relevant legislation it is well established that local authorities have the power to set up, own, and operate stand-alone vehicles pursuant to the general power of competence under section.1 Localism Act 2011 coupled with its investment functions under section.12 Local Government Act 2003. However, if the local authority is utilising this power for “commercial purposes”, then it must do so via a company (section.4 Localism Act 2011). In relying on its investment powers, the local authority must ensure that the investment would be:

(a) consistent with its Treasury Management Strategy; and

(b) in accordance with the relevant provisions of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003.

4.3 Careful thought and consideration needs to be, and has been given, as to the most appropriate form for the HDV. Only two forms of corporate vehicle have been considered to be appropriate, those being: -

(1) a company limited by guarantee (CLG) and;

(2) a company limited by shares (CLS).

The CLS is the favoured option because:

(a) it can be utilised for general commercial activities;

(b) it offers greater flexibility than the CLG if CCC wished to sell or change the nature of its investment in the future;

(c) it is the most frequently used corporate vehicle for profit generating entities; and

(d) it is the form of corporate entity being used by other local authorities pursuing similar schemes (and is therefore tried and tested).

(e) it is a form that is better suited to the generation of inward investment.

4.3.1 When setting up the HDV as a CLS various issues are being considered, some of which are listed below:

(a) there will need to be a well-defined governance relationship between the owner/shareholder of the HDV (CCC), and the company itself i.e. one that clearly sets out the extent of control that CCC will be able to exercise over the HDV;

(b) the balance to be struck between ensuring adequate control over the HDV (in the interests of transparency and safeguarding public funds) whilst allowing the HDV to pursue operational activity with an appropriate level of autonomy for a commercial company.

4.3.2 Having reviewed the existing Local Authority Companies and with a view to keeping the structures simple and transparent and avoiding the potential for conflicts of interest to arise, it is recommended that Council Should exercise its control as owner through the medium of the Assets and Investment Committee which would in effect form a Shareholder Board. The Shareholder Board would exercise oversight over the company and all significant decisions such as:-

i) issuing shares,
ii) undertaking loans
iii) approving new development projects
iv) appointing and removing Directors

4.3.3 The day to day operational management of the company would rest with a small board of directors consisting of the Chief Finance Officer, Director of Law and up to three other directors selected for their relevant experience. This board would be held accountable by the A&I Committee to which it would make regular reports for monitoring purposes.

4.4 CCC intends to transfer existing development land to the HDV. Any such land transfer may trigger procurement obligations and the approach to be used will need to be determined on a case by case basis. There are exemptions to the procurement rules applying to land transactions and thought should be given to identifying the appropriate provisions.

4.5 Some local authorities have set up two HDV's, one to purchase and develop housing and a second to manage rented properties. This has the advantage of making risks easier to control, though will incur greater costs. A separate company to manage rented properties does not need to be set up now and the potential need for this will be kept under review.

4.6 The main risk of state aid applying in respect of an HDV wholly owned by CCC would be via the payment of any financial support/working capital from CCC to the HDV. In order to avoid any suggestion that unlawful state aid has occurred, any financial support such as start-up capital should be provided on terms that are roughly equivalent to that which would have been available to the HDV in the open market.

4.7 Given that the HDV will be a separate legal entity it will be able to employ its own workforce However, in the start-up phase consideration may also be given to secondment of staff in order to ensure that the launch of the HDV isn't unduly delayed by recruitment timescales.

4.8 The HDV will also need to have back office services such as HR, Finance, Legal etc. and in the start-up phases these may be provided by LGSS . There are specific exemptions in the procurement regulations that may allow CCC to provide services to the HDV without the need for a formal procurement exercise.

4.9 Expert advice will need to be sought regarding the most tax efficient way to structure the ongoing business operations for the HDV and ensure that CCC is fully tax-compliant.

4.10 Indicative timeline for establishment of the HDV

Activity - Date	**2016**									**2017**	
	April	**May**	**June**	**July**	**Aug**	**Sept**	**Oct**	**Nov**	**Dec**	**Jan**	**Feb**
Prepare Establishment of a Company as a HDV for Property Development Report and submit to A&I Committee for approval Inputs required from Finance, Legal, Assets, HR.	xx	xx									
Incorporate HDV and amend articles to requirements.	xx	xx	xx								
Obtain advice on tax implications and maximising tax efficiency.	xx	xx									
Appoint Director(s) to Board of HDV		xx	xx								
Design and agree governance arrangements for the HDV i.e. its relationship with CCC and the level of control/autonomy. Make any necessary constitutional changes to accommodate.	xx	xx	xx	xx							
Set up bank accounts and other necessary financial systems such as HMRC/VAT registrations.		xx	xx								
Agree SLA's for the provision of back office services to the HDV		xx	xx								
Agree initial capitalisation and terms of any loan facility – transfer funds.		xx	xx								
Design initial staffing structure and commence recruitment and/or agree secondment arrangements for key staff.		xx	xx	xx	xx						
Design Communications Plan for launch				xx	xx						
Identify and obtain sign off for individual projects to form pipeline (e.g. Burwell). NB Query whether land to be transferred to HDV at this point or whether the HDV acts as developer and land held by CCC.				xx	xx	xx	xx	xx	xx		
Procure external support for specialist skills in connection with the identified development projects, e.g. Project Management, Design, Financial, Planning Consultancy, and Construction Technical Support. These could be by way of framework agreements.			xx	xx	xx	xx	xx	xx	xx	xx	

5. ALIGNMENT WITH CORPORATE PRIORITIES

5.1 Developing the local economy for the benefit of all

The following bullet points set out details of implications identified by officers:

- The HDV will enable CCC to effectively use property resources in a way that will benefit individuals, communities and the county as a whole.
- As the owner/shareholder of the HDV, CCC will able to provide a mechanism to enable regeneration, housing growth (both affordable and market), community infrastructure and economic growth through construction and development.
- HDV developments can support investment in Cambridgeshire's future workforce through apprenticeship and training opportunities in the construction industry.

5.2 Helping people live healthy and independent lives

The following bullet points set out details of implications identified by officers:

- The investment in community infrastructure provided through many of the proposed development schemes will support communities that are growing to access essential services.
- CCC has the ability as the owner/shareholder of the HDV to (subject to financial viability) create housing that will support residents living healthy and independent lives, such as through the provision of lifetime homes.

5.3 Supporting and protecting vulnerable people

The following bullet points set out details of implications identified by officers:

- CCC has the ability as the owner/shareholder of the HDV to (subject to financial viability) create housing that will support and protect vulnerable people, such as through the provision of extra care facilities, residential homes, supported housing schemes etc.

6. SIGNIFICANT IMPLICATIONS

6.1 Resource Implications

The following bullet points set out details of significant implications identified by officers:

- The PPDP will need to be effectively resourced and supported to ensure that it delivers its objectives to time, quality and cost criteria.
- Appropriate resourcing to identify suitable sites to provide an ongoing pipeline of development opportunities for the HDV will be required
- The report above sets out details of significant resource implications for the HDV in paragraphs 4.7 and 4.8.

6.2 Statutory, Risk and Legal Implications

The report above sets out details of significant implications in paragraphs 4.2 to 4.9.

6.3 Equality and Diversity Implications

There are no significant implications within this category.

6.4 Engagement and Consultation Implications

The following bullet points set out details of significant implications identified by officers:

- Local communities, parish and town councils and other stakeholders will be engaged through pre-application discussions, statutory public consultations and planning application processes.

6.5 Localism and Local Member Involvement

The following bullet points set out details of significant implications identified by officers:

- The Assets and Investment Committee will act as the Client Committee for the HDV.
- The general and specific development conditions for each site transferred to the HDV will be set out by the Assets and Investment Committee.
- Local Members will be engaged through pre-application discussions, statutory public consultations and planning application processes.

6.6 Public Health Implications

The following bullet points set out details of significant implications identified by officers:

- Depending on the locations developed through the HDV, there are opportunities to improve the health of the worst off through new community facilities, better housing stock (such as supported living, extra care facilities, lifetime homes) and co-location of complementary services.

Source Documents	**Location**
Paper Re: Potential Legal Issues/Corporate Entities/Tax Issues To Enable The Deliverance of the Cambridgeshire County Council Development Plan Investment Review Group Briefing Paper: The Establishment of Appropriate Corporate Vehicles to Undertake Housing Development and Management Functions on Behalf of Cambridgeshire County Council.	Room 320, Shire Hall, Cambridge.