

CABINET

DATE OF MEETING: 3 NOVEMBER 2016

TITLE OF REPORT: UPDATE ON THE CREATION OF HART TRADING COMPANY

Report of: Head of Housing Services

Cabinet Member: Councillor Stephen Gorys, Housing

1. PURPOSE OF REPORT

1.1 To update Cabinet on progress with the model and obtain comments about the developing proposal for Hart District Council to set up a local trading company.

2. OFFICER RECOMMENDATION

2.1 To approve the ongoing development of a trading company model that will invest through both capital and borrowing initially to deliver more housing.

2.2 To determine the governance approach which in principle includes an approach that compromises a mixture of Officers and Members as directors on the Company Board.

2.3 To express its preference that Member membership of the Company Board be drawn from:

2.3.1 Any Member of the Council; and/or

2.3.2 Cabinet Members only; or

2.3.3 Identified by Cabinet Portfolios only

2.4 To note there will be a reduction in the Council's capacity to pursue new initiatives in light of the financial commitment associated with this proposal.

2.5 To approve working towards clarity in exit strategies including approaches to ensuring the Council's debts are repaid. This will enable Cabinet to review the pros and cons of different financial models.

3. BACKGROUND

3.1 In October 2015, Cabinet approved the principle of the creation of a trading company, wholly owned by the Council and limited by shares. Cabinet agreed to set aside a sum of £50k from reserves to cover costs associated with setting up the company, project management, as well as the legal and financial advice required to establish a sound Business Plan.

4. THE PROCESS OF SETTING UP A TRADING COMPANY

- 4.1 It is important that in setting up a trading operation, the Council must satisfy itself that it has considered all the risks of such an undertaking. This includes developing a full business case which covers projected financial performance and risks. Any final decision to proceed with a trading company should be accompanied by a full business plan covering how the company will operate.
- 4.2 The council must decide the company governance structure including the composition of the board and how the council will be represented – usually through a mixture of councillors and officers.
- 4.3 Trading companies can and do get into financial difficulties. Therefore it is important to ensure that there is an exit strategy written into the company's constitution covering what will happen if the company becomes insolvent. Most company structures will involve limiting the liability of the company directors.
- 4.4 Councils may be under no obligation to meet the company's debts and liabilities should it get into trouble, but political and service delivery considerations may mean they choose to.

5. PROGRESS SO FAR

- 5.1 Following Cabinet approval and ongoing discussions with Cabinet members, work has been undertaken to develop "Hart Investments Limited", including researching similar models in other areas, preparing the background to register the company in a basic form with Companies House, engaging preliminary legal advice, and developing the detail of a proposed model for Hart (confidential Appendix 1).
- 5.2 To develop the Company further, expert advice has been sought from consultants – Savills in partnership with Trowers & Hamblins. This partnership has been involved in supporting a number of other Councils to develop similar models successfully. This arrangement will provide additional support in the implementation phase of the project.
- 5.3 An initial business plan has been drafted (confidential Appendix 2) and officers and the Cabinet Members for Finance and for Housing have been working together to provide comments and challenge assumptions within the financial modelling. Trowers & Hamblins have also built on earlier advice received from the Shared Legal Service and Eversheds (confidential Appendix 3), providing an additional report (confidential Appendix 4) and a briefing on potential conflicts of interest associated with models of governance (confidential Appendix 5).
- 5.4 Initially it is expected that the Company would concentrate on delivering local housing with expansion to other commercial activities at a later date. The current proposal involves an investment of approx. circa £33m, with £29m being borrowed by the Council to support financing the company and a £4m capital investment using the majority of the Council's Housing Capital Fund. It is anticipated that this investment will achieve a property portfolio of 125 units over a period of 5 years.

5.5 The Head of Corporate Services has engaged Capita's Treasury Management Services to undertake due diligence with regard to the Business Plan. This will provide additional checks and balances to ensure we are developing a financial model that is robust and mitigates as much risk as it is possible to do in a market driven environment. The costs of Capita's support will be covered within the Cabinet approved budget.

6. CONSIDERATIONS

6.1 The development process will be iterative as we continue to hone the model. There is a challenging project plan (Appendix 6), however this should not take priority over ensuring we are collectively clear about any risks associated with pursuing the model.

6.2 The current timescales fit with the Council's decision making processes and have been designed with the intention that Council can consider the delivery of the Trading Company in alignment with the budget cycle.

6.3 Heavily investing in a market driven environment carries with it inherent risks. Officers are working to understand those risks and will ensure members are clear about the level of risk the Council may be taking should it proceed with this model. While there are risks, there are also clear benefits to pursuing the approach including the opportunity to generate income, invest in the local property market, and contribute initially to meeting local housing need in a way that the Council can directly influence through its shareholding.

6.4 Cabinet will need to determine members' role in the governance of the company. If the model will include member directors, Cabinet will also need to determine how they should be represented on the board. The choice is to allow Board membership to be drawn from any Member of the Council; to limit it to Cabinet Members only; or perhaps simply identify Board membership through Cabinet roles. Initial governance structures for the company have included relevant members on the company Board of Directors. Trowers & Hamlins have provided a note concerning potential conflicts of interest for members and officers and this is included at confidential Appendix 5.

7. OVERVIEW AND SCRUTINY COMMITTEE

7.1 Overview and Scrutiny Committee considered progress to date when it met on 18 October 2016. The Committee was overall supportive of the approach and endorsed the ongoing development of the trading company model. The Committee has recommended to Cabinet the continuation of the current approach to hone the business model and governance.

7.2 Cabinet may wish to note the following areas of key risks identified in the discussions between members at Overview and Scrutiny Committee. These are summarised below:

- Future reports regarding the trading company should reference that legal advice will be sought in the advent of a devolution deal to understand what that may mean in the context of the Council owned company.

- Financial risks associated with borrowing, lending practices, housing market changes, government interventions including budgets and legislative changes, and the impacts of Brexit all formed part of the committee’s discussions.
- There were concerns about ensuring the right level of staff resources are available to make the company a viable success, and concerns about impacts on existing services if the company diverts staff resources.
- There are reputational risks for the Council associated with the company, for example, if the company takes action to regain possession of units within its portfolio.
- Ensuring the activities of the trading company do not distort the local housing market or compound difficulties facing first time buyers in accessing owner occupation locally.

8. POLICY IMPLICATIONS

- 8.1 The proposed trading company represents a departure from the way the Council has traditionally operated, although it remains in scope of the Corporate Plan and Housing Strategy. It does adopt similar principles to previous Existing Satisfactory Purchase programmes that have been grant funded in the past.
- 8.2 The delivery of a trading company, and the experience of setting one up and trading, may provide further opportunities to consider commercial avenues that could be pursued in the interests of Hart residents.
- 8.3 Whilst there may be a range of opportunities associated with this proposal, there are also risks and sensitivities. These will be reviewed and worked through with assistance from Savills and Trowers & Hamlins, and with due diligence from Capita Treasury Management Services. Identified risks, to date, are highlighted in both confidential Appendices 1 and 2 and in Section 6 of this report below, and in the summary of Overview and Scrutiny discussions set out above in 4.6.
- 8.4 The governance structure is discussed within confidential Appendix 1, and in confidential Appendices 3, 4 and 5. The preferred options for the composition of the Board are sought from Cabinet as part of this paper.
- 8.5 In light of the level of investment and the amount of borrowing that the Council will need to undertake in order to finance the company, there are “opportunity costs” that members should be aware of. Essentially, pursuing this model may limit the Council’s capacity to develop other initiatives in future.

9. FINANCIAL IMPLICATIONS

- 9.1 £50k budget has already been approved to cover costs of specialist advice.
- 9.2 While the Council can invest in the company through £4m within the Housing Capital Fund, it will also need to lend money to the company to support it to trade. The Head of Community Services will work with the Head of Corporate Services and relevant Cabinet Members to establish the best options for Hart. At face value, the model that has been presented in the initial draft from Savills (confidential Appendix 2) does not include provision to repay the debt, which would mean the

Council maintains a level of debt circa £29m over the longer term. This could expose the Council to risks associated with this level of borrowing and to changes in lending practices over time. Officers and relevant Cabinet Members are challenging this assumption and looking at debt repayment options as part of the next iteration of the Business Plan.

- 9.3 Confidential Appendix 2 suggests some options in section 5.4 “Exit Strategies”, but these do not include ways in which the company could contribute to clearing the Council’s debt over a set period e.g. 25 years. Modelling alternative debt repayment strategies may require the business plan to consider refinancing options every 5 years. There will be risks associated with this approach.
- 9.4 There is also an identifiable lack of sensitivity testing of some of the broader assumptions within the model, such as the future of the housing market both in terms of property values and rental yields moving forward. These issues also need further investigation to ensure we are developing a model that affords healthy margins for unanticipated changes to the market environment.
- 9.5 The next steps will be to understand these financial implications in more detail as part of drafting a detailed business plan and governance structure for Cabinet to consider in January.

10. ACTION

- 10.1 It is requested that Cabinet approves the Officer recommendations set out in section 2 above.

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Appendix 1 (Confidential): Initial Draft Proposed Business Plan

Appendix 2 (Confidential): Housing Company Financial Business Plan

Appendix 3 (Confidential): Eversheds Legal Advice & Shared Legal Service Advice

Appendix 4 (Confidential): Trowers & Hamlins Report

Appendix 5 (Confidential): Trowers & Hamlins Briefing on Governance Matters

Appendix 6: Project Plan Milestone Dates

Appendix 6: Project Plan for Key Work Milestones

- 21/07/16:** Project Brief (ITT) document drafted & sent to prospective companies
COMPLETE
- 02/08/16:** Evaluate proposals/quotes received COMPLETE
- 03/08/16:** Establish approval COMPLETE
- 04/08/16:** Procure external support COMPLETE
- 09/08/16:** Inception meeting COMPLETE
- 31/08/16:** Initial report received COMPLETE
- 01/09/16:** Update report to Cabinet COMPLETE
- 07/09/16:** Initial Savills/Trowers report reviewed and comments/requests set out
COMPLETE
- 16/09/16:** Meeting to look at approach COMPLETE
- 26/09/16:** Revised report received COMPLETE
- 30/09/16:** Further comments returned to Savills/Trowers COMPLETE
- 18/10/16:** Report to O&S COMPLETE
- 03/11/16:** Report to Cabinet setting out format and proposed financial model -
Recommendation from Cabinet to Full Council for approval on signatory
- 08/11/16:** Feedback to Savills/Trowers following Cabinet
- 15/11/16:** Revised business plan received
- w/c 21/11/16:** Meeting with Savills/Trowers and Head of Corporate Services to review,
including determining potential implementation support that may be required
and associated costs.
- 24/11/16:** Full Council approval on signatory
- 05/12/16:** Revised business plan
- w/c 12/12/16:** Further meetings/revisions as may be required
- w/c 19/12/16:** Further meetings/revisions as may be required
- 05/01/17:** Final Business Plan to Cabinet. Recommendation from Cabinet to Report to
Full Council
- 26/01/17:** Full Council to approve final Business Plan
- w/c 27/02/17:** Implementation commences