

Lancaster City Council | Report Cover Sheet

Meeting	Cabinet	Date	27 October 2020
Title	Options to Set up the Housing LATCo		
Report of	Director for Communities and the Environment, Director for Economic Growth and Regeneration		
Purpose of Report			
To update members on the findings of the specialist legal and finance advice sought on options to set up the Housing LATCo (Local Authority Trading Company) and to recommend to Cabinet that they approve the establishment of the Housing LATCo.			
Key Decision (Y/N)	Y	Date of Notice	28.09.2020
Exempt (Y/N)		Exempt (Y/N)	N
Report Summary			
In July 2020, Cabinet approved a report which set out the strategic housing priorities identified in the draft Homes Strategy 2020-25, and authorised officers to obtain specialist legal and financial advice (establishing an initial budget of £40K) to advise the council on options to create a housing delivery vehicle. This report makes recommendations to allow the council to proceed with setting up the Housing LATCo and sets out a framework of suggested actions and delegations to allow timely progress.			
Recommendations of Councillors			
<p>(1) That Cabinet approve the establishment of a wholly owned company (Housing LATCo) limited by shares and delegate authority to the Chief Executive in consultation with the Section 151 Officer to take all necessary steps to incorporate the company, and enter into all necessary documents to facilitate the company's operation including the Articles of Association, Shareholder Agreement, Loan Agreement, Services Agreement and Secondment Agreement.</p> <p>(2) Cabinet delegate authority to the Chief Executive in consultation with the Leader and Portfolio Holder for Housing to agree the composition of the Board of Directors and the arrangements for the council to discharge its role as Shareholder of the Housing LATCo.</p> <p>(3) That a further budget of £50K is approved to re-appoint Trowers & Hamlins LLP to provide the necessary legal advice and prepare the documentation.</p>			

Relationship to Policy Framework
<p>Council Priorities – Happy and Healthy Communities, a Sustainable District, an Inclusive and Prosperous Local Economy</p> <p>Local Plan – contributes towards the provision of housing to meet a locally identified need and opportunities to increase the choice and supply of affordable housing.</p>

Housing Strategy – provides the necessary framework to deliver the strategic housing priorities identified.

Conclusion of Impact Assessment(s) where applicable

Climate	Wellbeing & Social Value
Digital	Health & Safety
Equality	Community Safety

The proposals set out in the report should not have any adverse impacts and should have some positive impacts particularly on climate change, equality and wellbeing/social value.

Details of Consultation

Specialist legal and financial advice has been provided by Trowers & Hamlin LLP and Savills Housing Finance Consultancy – the specialist reports are appended. Informal engagement has also taken place with the Directors of the Blackpool Regeneration Company to gain an insight into the company structure, rationale and successes achieved to date.

Legal Implications

The legal implications are set out in the reports of Trowers & Hamlin LLP.

Financial Implications

Following the approval by Cabinet to utilise £50K from the general fund Corporate Priorities Reserve for initial specialist legal and financial advice, the officer preferred option of Option 1 requires a further £50K be approved. This can be funded by re-purposing part of the remaining £67K of the £107K approved as part of the 2020/21 budget process, to continue with the formation of the Housing LATCo, rather than the purchase of a housing stock condition module.

Any further financial implications arising from individual scheme proposals will be reported back to Cabinet as appropriate prior to subsequent commencement.

Other Resource or Risk Implications

Detailed proposals for all strategic housing projects will be subject to full Business Case analysis by Capital Strategy Group and Cabinet which will set out the risks identified. It is inevitable however, that there will be running costs associated with the operation of the proposed Housing LATCo which will be set out within the report and during the initial period, the LATCo will run at a loss until it achieves a sufficient scale of income generation, and must have the necessary level of resources provided to ensure the level of pace and scale required can be achieved.

Section 151 Officer's Comments

Establishing a Local Authority Trading Company (LATCo) will provide the Council with a suitable overarching vehicle and the strategic freedoms needed to facilitate new housing and regeneration programmes through the General Fund. Work will continue with the support of external advisors to ensure that the LATCo is correctly constituted and appropriate governance structures are established.

As the strategic housing priorities outlined in the report continue to be developed detailed review and challenge of the supporting business cases will be undertaken to ensure they are robust, well considered and estimates and assumptions are based on the best available information. In line with regulatory requirements any associated prudential borrowing must be considered Prudent, Sustainable and Affordable across the entire Council and not in isolation. The outcomes of these reviews and the financial implications will be provided to Cabinet for consideration.

The use of virements to realign or refocus existing funds from one expenditure head to another is permitted subject to the limits set out in the Council's Medium-Term Financial Strategy. The value requested does not require full cabinet approval under the Council's existing virement policy. However, for transparency approval by Cabinet is sought for both expenditure and funding reallocation.

Monitoring Officer's Comments

The Monitoring Officer has been consulted when drafting this report.

Contact Officer	Kathy Beaton
Tel	Tel: 01524 582724
Email	KBeaton@lancaster.gov.uk

Links to Background Papers

1.0 Introduction

- 1.1 In July 2020, Cabinet approved a report which set out the strategic housing priorities identified in the draft Homes Strategy 2020-25, and authorised officers to obtain specialist legal and financial advice (establishing an initial budget of £40K) to advise the council on options to create a housing delivery vehicle (LATCo) as a means of maximising opportunities to utilise prudential borrowing opportunities to create the necessary development finance to bring schemes into fruition. Four strategic housing schemes have been identified which require a blend of prudential borrowing.
- 1.2 As a stock retaining local authority, Lancaster City Council already has the opportunity to borrow within the Housing Revenue Account (HRA). This was set out in the July 2020 report which confirmed that through previous analysis of the HRA by Savills, the council could comfortably borrow £25-£30M with

further borrowing potential depending upon future rent setting policy. Restrictions within the HRA only allows the provision of social housing controlled through housing legislation.

- 1.3 Prudential borrowing through the General Fund provides additional freedoms and benefits that cannot be achieved through the HRA. In order to create this opportunity, the council would need to create an arms-length vehicle which provides a clear degree of separation from properties held within the HRA and from the council's other duties as a body governed by public law. This would allow the council to take forward new housing and regeneration programmes that are not limited to social housing, provide opportunities to create surpluses or cross subsidise the provision of affordable housing free of the restrictions imposed by housing legislation. Ultimately the council borrows from the Public Works Loan Board (PWLB) and on-lends to the Housing LATCo. A loan agreement would be in place detailing the terms of the loan and the interest rate that will apply.
- 1.4 The four main strategic housing priorities identified were previously set out in the July 2020 report, and will require a blend of prudential borrowing detailed in Table 1 below:-

Table 1 – Borrowing Assumptions

Scheme	Expected Tenure	Expected costs	Borrowing Source
Canal Quarter	Mixed tenure	Still to be determined	General Fund borrowing via LATCo & HRA
Morecambe Property Acquisitions	Affordable	£3M initially	General Fund borrowing via LATCo
Mainway	Affordable	£20-30M depending upon scale and type of development undertaken	HRA
Extra Care Housing	Affordable	£10-12M	HRA

- 1.5 The Canal Quarter scheme is expected to deliver mixed tenures with some affordable provision expected through an element of cross subsidy. A scheme delivering mixed tenure can only be brought forward through prudential borrowing by the council through on-lending to the Housing LATCo. Scope also exists to borrow within the HRA to create an element of social housing within the development as deemed appropriate.
- 1.6 The Morecambe Property Acquisitions scheme also relies on borrowing through the Housing LATCo. Whilst it is expected that the tenure will primarily be rented accommodation, the rent levels will need to be set at a rate higher than social housing rents as no grant/subsidy is envisaged, but with the ultimate goal of being capped at Local Housing Allowance rates (Housing

Benefit Cap) and properties would not be subject to the Right To Buy which provides more certainty in relation to the financial modelling. The properties will serve the needs of the intermediate affordable market – those who are unlikely to qualify for social housing, but who are unable to afford conventional market housing but seeking a longer term stake which can more readily be provided by the council than some private sector landlords.

- 1.7 Cabinet should note that individual reports will be brought back to members which will provide more detailed information on each scheme proposal for consideration and to obtain the necessary approvals.

2.0 Options to set up the Housing LATCo – Legal elements/Group structure

- 2.1 Following July 2020 Cabinet, Trowers & Hamlins LLP and Savills Housing Finance Consultants were instructed to prepare specialist reports to examine the main legal and financial considerations that the council should consider in order to set up the Housing LATCo. These reports can be found at Appendix 1 and 2. A presentation was also arranged for the 23rd September 2020 jointly provided by Steve Partridge and Simon Smith from Savills and Scott Dorling from Trowers. The aim of the presentation was to provide an overview of the rationale, benefits and implications in setting up the Housing LATCo and to allow Cabinet and other elected members to ask questions.
- 2.2 The report provided by Trowers sets out the key drivers for the council in setting up the LATCo setting out the pros and cons, the type of group structure recommended reflecting the broad aims and objectives set by the council, the different types of corporate entities, the key documentation that will be required and entered into between the council and the LATCo and the governance arrangements including the formulation of the Shareholder Agreement and selection of Board members.
- 2.3 Trowers recommend that the council should create group structure which provides a **HoldCo** with potential to set up separate subsidiaries. A Hold Co would allow for a streamlined governance model. The subsidiary companies (which at this point are envisaged to be a **DevCo** (Development Company) and **Investment Co** but the model proposed would allow other subsidiaries to be created in the future. The key benefit of this arrangement is the ring fencing of risk.
- 2.4 DevCo – a Development Company would be required for the Canal Quarter scheme because it is the council's intention to bring forward a mixed tenure development which will include outright sale units. The DevCo is not intended to hold assets but creates the necessary degree of separation that allows the council to act as a commercial operator and generate profits. There are a range of tax and public procurement issues to consider, however.
- 2.5 Investment Co – an Investment Company would be required to hold the completed residential assets as landlord. The proposed Morecambe Property Acquisitions would therefore sit within the Investment Co with the primary aim of keeping the rents below market rent levels. If in the future, the council was

to acquire or build properties to let at market rent levels, a separate subsidiary would need to be created for this as the lending rates applied by the council would differ due to current public procurement/state aid regulations.

- 2.6 The recommended company type is a company limited by shares which is deemed the most suitable where the company seeks to distribute dividends and act as a revenue stream for the council and also allows Stamp Duty Land Tax group relief on land transfers from the council to the Group structure.

3.0 Procurement/Teckal Exemptions

- 3.1 The report from Trowers draws attention to the group structure and whether the subsidiaries are structured as a body governed by public law. If not, the subsidiary is free to award contracts outside of public procurement procedures. This has been considered within the report because it is proposed that the housing management functions will be undertaken by Council Housing Services as an extension of their existing landlord function. Trowers recommend that both the DevCo and Investment Co are set up as Teckal subsidiaries that would provide the necessary mechanisms and freedoms around the award of contracts outside of normal procurement requirements.

4.0 Key documents

- 4.1 A suite of documentation will need to be prepared by Trowers and which would be entered into between the council and the LATCo, with details and expected costs set out below:-

Table 2 Breakdown of Trowers Proposed Fees

Document	Indicative fee quote (excl VAT and disbursements)	Detail / assumptions
Memorandum and Articles of Association	£2,500 (per company – assumed 3 (for HoldCo, DevCo and InvestCo) including incorporation.	This will be based on the Model Articles but will incorporate the housing company's governance structure. This will include the production of the Articles
Governance documents, including 1. terms of reference for any shareholder committee, 2. conflicts of interest protocol, 3. board member service agreement	£2,000 (per document – we have assumed 4)	Trowers would produce templates for each of these documents but bespoke drafting relevant to LCC's particular governance structure (particularly in relation to the terms of reference) would need to be subject to a detailed quote once the structural issues have been determined
Business plan(s)	£1,000	LCC would produce this document and we can review it for suitability/compatibility with the

		Shareholder's Agreement – it is usually helpful for the Business Plan to include certain information that is referenced in the Shareholder's Agreement
Shareholder's Agreement	£3,500	This will deal with the relationship between the company and the shareholder (e.g. shareholder consent, role of the shareholder committee, etc). Depending on the complexity of the structure that is decided upon we would quote for this, specifically on instruction.
Development Funding Agreement	£6,500	A "heads of terms" document will be issued before drafting to help elicit key terms from the Council's finance team. This quote assumes a simple bilateral loan and no detailed negotiations
Working Capital Loan	£3,500-£5,000	This will be a loan to fund the initial ongoing revenue costs of the company.
Debenture	£2,500	Optional depending on the nature of funding to be provided
Equity Subscription Agreement	£2,500	Optional depending on the nature of funding to be provided.
Form of Assured Tenancy Agreement	£750	Often authorities like to ensure that the tenancies the Group companies are entering in to are agreed with the Council – and will be different in a number of respects to those usually entered by the Council. Assumes no detailed negotiation and a single draft with comments for review.
Framework Service Level Agreement	£1,500	Depending on how the Council will document/structure its resourcing for the Group companies (i.e. Trowers understand that the Council will be using Council staff to carry out Group activities, e.g. accounting, HR, audit) there will need to be some sort of documentation for the "recharge" to happen. We can provide a template agreement which may be populated with the relevant service description, fees etc.
Company director Training	£1,500	Training for any directors and associated legal team/senior leaders involved in the Group

Ad Hoc queries	£7,500	Trowers would suggest for budgeting purposes the Council includes a contingency for ad-hoc queries and further meetings with officers and members to discuss issue and concerns around governance arrangement and the like. These may relate to issues that arise as officers are working through the process and reflecting on the Council's internal processes or when things are being signed off.
TOTAL	£47,750	

5.0 Governance Arrangements

- 5.1 A key consideration for Cabinet will be the governance arrangements for the proposed HoldCo and the degree of control the council will be able to exercise over activities and its decision making. The HoldCo would then act as the single source of control over the group subsidiaries.
- 5.2 The Articles of Association and the Shareholder Agreement will set out the relationship between the council (as owner and sole shareholder of the HoldCo). Whilst the Board is the main decision making body and must act in the best interests of the company, typically the Shareholder Agreement will limit certain activities or decisions that must be obtained from the council (i.e. controls over borrowing) although a balance will need to be struck around the degree and types of control mechanisms which might otherwise impact on the effectiveness and agility of the company. The council will need to ensure that there is appropriate performance monitoring in place, and to this end, the council may wish to set up a Shareholder Committee to perform this role.
- 5.3 The structure and membership of the Board will also need to be carefully considered to ensure the Directors have the required skill sets, knowledge and financial skills. During the presentation, Scott Dorling of Trowers outlined some instances where Boards have been made up exclusively by elected members and issues have arisen due the conflicts of interests which can arise between the role of a Board member and an elected member of the council which need to be avoided ¹.

6.0 Grant funding through Homes England

- 6.1 Clarification has been sought from Trowers on whether there is scope to draw down grant funding through Homes England to improve the development viability of schemes. In all instances, Homes England require that rented

accommodation must be owned and managed by Registered Providers. As a stock retaining landlord, Lancaster City Council's landlord function fulfils this requirement, so new build schemes funded through the HRA such as the proposed extra care scheme should be eligible for grant. Officers have explored whether a mechanism exists for the LATCo to grant a long lease to Council Housing Services who would subsequently let and manage the properties as a mechanism to draw down grant funding without the risk of creating secure tenancies. To avoid this, the lease term would need to be less than 21 years for a house and 50 years for a flat (to satisfy an exemption to the Right to Buy scheme where the landlord has an insufficient interest). The Homes England Capital Funding Guide stipulates that where lease arrangements are in place, the lease period must be for a minimum of 60 years.

- 6.2 The council may wish to consider creating a subsidiary which could seek to acquire RP status as a means of drawing down grant funding for schemes outside of the HRA but this will require separate governance arrangements, the lead in time to acquire RP status is 6-9 months and the RP subsidiary would be bound by different regulatory requirements imposed by Homes England than currently apply to social housing stock held within the HRA.

7.0 Savills report: Business Case

- 7.1 The Savills report principally supports the setting up of the LATCo and highlights that Local Authority trading and housing delivery companies are now a well-established route to achieve housing investment and delivery, primarily driven by caps on HRA borrowing (which have since been removed) and research suggests that LATCo's have facilitated tenure diversification with new housing supply comprising 43% affordable rent, 23% social rent, 10% intermediate (sub-market), 16% outright sale and 8% market rent. Furthermore, the Savills report ratifies the benefits already identified in the July 2020 report in terms of the key drivers for the council, such as facilitating the increased supply of new housing, increasing tenure diversification, increasing the quality and standards of housing, acting as an exemplar landlord, and provides scope to deliver financial returns to the council.
- 7.2 The Savills report then focusses on the first project which has been identified by the council to kick start investment into the LATCo which is the Morecambe Acquisitions Project, primarily because a programme of acquisitions does not require the same lead-in time as a conventional new build scheme (which in terms of design, pre-development and planning permission would typically take at least two years). The Canal Quarter scheme is expected to be significantly larger in scale, be comprised of mixed tenure and could change the outputs considerably. Whilst it is useful to highlight some of the expected operational costs associated with the LATCo, members are asked only to note the financial modelling undertaken by Savills for the proposed Morecambe Property Acquisitions Scheme at this time and further analysis will take place and be reported back to Cabinet in a future report.

8.0 Staff resources and capacity

8.1 The Savills report takes no account of costs associated with increasing the council's existing staff resources. At this initial set up stage, it is not envisaged that the LATCo itself will directly employ staff and that the management and maintenance elements will be undertaken by Council Housing Services/Repairs and Maintenance Teams (with scope for recharges). However, it is important to acknowledge that the council has not undertaken any direct development of housing projects for some years, and the establishment currently lacks some of the skills and expertise which would need to be considered as part of the LATCo growth. It is crucial to the success of the LATCo that this is sufficiently addressed, and to provide development support to other identified housing projects coming through HRA borrowing, retrofitting schemes, the creation of local wealth building through training programmes, submitting bids for Homes England funding, potentially acquiring RP status for the LATCo and ultimately to fulfil the task of Managing Director which is paramount to the success of the proposed vehicle so that it becomes self-sustaining at the earliest opportunity and that support staff are sufficiently competent, have the right tools and are experienced in undertaking a full range of development appraisals that can be implemented with confidence and assurance.

9.0 Options and Options Analysis (including risk assessment)

Option 1: Approve the establishment of the proposed Housing LATCo

Advantages: Will allow a blend of prudential borrowing through the General Fund and HRA to deliver the strategic housing projects identified. Offers potential to create mixed tenure schemes, cross subsidises affordable housing and can create surpluses which could address the future years budget deficit. Diversifies the council's existing housing portfolio. The council is more able to meet a growing local housing need.

Disadvantages: Set up and operational running costs will be required. There will be capacity issues within the existing workforce in terms of support services with new skill sets needed.

Risks: New area of business for the council with different forms of tenure being provided. Demand for housing products although demand data suggests this would be low risk. Different governance arrangements in place. It could be some time before the LATCo is able to create surpluses. Property values can go down as well as up. The costs associated with producing zero carbon homes could mean schemes are marginal/unviable.

Option 2: Do not approve the establishment of the proposed Housing LATCo

Advantages: No direct financial risk or exposure to the council. Some outputs could still be achieved through partnerships/the council acting in an enabling capacity.

Disadvantages: The council is not delivering its key housing and regeneration priorities, growing and diversifying its housing portfolio to meet a wide range of housing need or proactively contributing to climate change through the provision of its own zero carbon homes. Surpluses could only be created through other forms of commercial investments which do not generate the same social value.

Risks: The HRA would be the only source of borrowing with limited headroom. There would be limited scope to provide holistic solutions to regeneration priorities. In areas like the West End, other costs associated with ASB/fly tipping, health inequalities and fuel poverty are likely to increase.

10.0 Officer Preferred Option (and comments)

10.1 The officer preferred option is Option 1. This is the only mechanism that will allow the council to bring all of their key strategic housing projects into fruition. Investment into housing development cannot be seen as risk free, and house prices and values can fluctuate but as this is a vehicle which will assume a longer term investment plan, the Savills report clearly demonstrates the successes achieved through housing investment vehicles, and that a scheme of acquisitions in Morecambe can be delivered viably if a longer borrowing period is assumed.

11.0 Conclusion

11.1 Cabinet approval is required to set up the new Housing LATCo taking account of the specialist legal and financial advice obtained, committing a further £50K to appoint Trowers to undertake the necessary actions and preparation of legal documentation, and to delegate authority to the Chief Executive in consultation with the Leader and Portfolio Holder for Housing to agree the composition of the Board of Directors and the arrangements for the council to discharge its role as Shareholder of the Housing LATCo and report back to Cabinet for consideration and approval.