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<b>Subject:</b>	<b>ESTABLISHMENT OF A PROPERTY COMPANY</b>
<b>Meeting and Date:</b>	<b>Cabinet – 5 November 2018</b>
<b>Report of:</b>	<b>Mike Davis, Director of Finance, Housing and Community</b>
<b>Portfolio Holder:</b>	<b>Councillor Michael Conolly, Portfolio Holder for Corporate Resources and Performance</b>
<b>Decision Type:</b>	<b>Key</b>
<b>Classification:</b>	<b>Unrestricted</b>

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**Purpose of the report:** To establish a local property company to provide the Council with a vehicle to invest in both private residential and commercial properties.

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**Recommendation:**

- (a) To approve the creation of a property company to develop, acquire and manage property investments at arm's length from the Council to provide a vehicle to invest in both private residential and commercial properties and deliver investment returns.
- (b) To approve the business case as attached at Appendix 1.
- (c) To approve the recommended company name 'Honeywood Property Services Ltd.'

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## 1. Summary

- 1.1 The Property Investment Strategy, which was approved by Council in November 2016, identified the need for the creation of one or more residential and commercial property companies to manage property investment at arm's length from the Council in order to compete with other trading companies and deliver investment returns.
- 1.2 Further advice has been received to the effect that both residential and commercial activities could be undertaken by one arm's length company which will be solely owned by the Council. Additional subsidiaries can be created if specialist boards are required for elements of the Company's operations or if joint venture options are to be explored.
- 1.3 The attached business case explains how the company will be established including the financial forecast and business arrangements required to operate the company on a daily basis. For the purposes of this report this company will be referred to as the Dover Local Property Company (DLPC).
- 1.4 There is a statutory requirement for the Council to approve the business case, Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009/2393. This report fulfils that requirement. The business case has been developed in accordance with the Secretary of State's guidance.

## 2. Introduction and Background

- 2.1 The Council's property investment work has been active since the approval of the strategy, mainly focusing on commercial opportunities, there is now a need to establish an arm's length company to manage the construction or purchase of residential properties which will be sold or rented in the private market. This activity

cannot be performed by the Council as where it is doing something for a commercial purpose; the Localism Act 2011 requires that this is done through a company. Once established the company may also be used for commercial investments within or outside the district if appropriate.

- 2.2 The establishment of the company will enable the Council to investigate and implement opportunities for developments within the district that it is currently unable to undertake due to restrictions on the Council's powers.
- 2.3 Members will be aware that the Government is in the process of setting higher housing targets for Local Planning Authorities with a greater emphasis on delivery. This has important implications for the Council as housing delivery rates are not at a level that was envisaged in the Adopted Core Strategy. It is considered that this proposal will see the Council proactively involved in delivery of market housing within the district, complimenting existing plans to provide new affordable housing funded through the Housing Revenue Account
- 2.4 It is important that the Company has enough flexibility to buy considered opportunities and work on a commercial basis. This may include joint ventures, special purpose vehicles and possibly development management agreements. The company could enter into and have subsidiary companies to be able to trade effectively in the property market place e.g. special purpose vehicles for particular projects.
- 2.5 The DLPC will be set up and incorporated as soon as practically possible as a private company limited by shares. Any profits made by the Company will either be reinvested into the operation or paid to the Council by way of dividend as sole shareholder.

### 3. **Identification of Options**

- 3.1 Full details of the operating procedures between the company and the Council are contained in the business case. The key points are as follows:
  - (a) The Council will be the sole shareholder and will initially invest £100 in share capital in the company;
  - (b) The Council will grant an initial loan at a commercial rate to the company of £100k to provide a level of working capital to undertake set up and other work as required;
  - (c) The Council will grant further loans to the company at a commercial rate of interest. These loans will be used to finance the purchase and construction of private residential properties or commercial investments;
  - (d) To avoid any conflict of interest, it is advisable for members and statutory officers not to be officials of the property company and therefore the directors and company secretary are proposed as:
    - (i) Directors:  
Head of Finance – Helen Lamb  
Head of Assets & Building Control – Martin Leggatt  
Corporate Projects Manager – Jayne Miles
    - (ii) Company Secretary:  
Commercial Solicitor – Beverley Dempster
  - (e) Unless the Leader directs otherwise the Council's powers and duties as member and shareholder of the company can be discharged by the Council's

chief executive under the existing scheme of officer delegation by virtue of section 323 (1) &(2) Companies Act 2006.

- (f) Support services will be provided by DDC officers and will be charged to the property company at the prevailing market rate;
- (g) Taxation is a key issue where the implications of Corporation Tax, Stamp Duty Land Tax and VAT will need careful consideration;
- (h) A separate website, email address, stationery and financial system will need to be established as part of the initial set up phase; and
- (i) The recommended name for the property company is Honeywood Property Services Ltd.

3.2 It is anticipated that the tasks required to establish the company will be completed by 31 December 2018

#### 4. **Evaluation of Options**

4.1 Option A - Create the Company: The Council will be able to invest in the construction or purchase of residential properties for sale or rent, plus commercial properties outside the district.

4.2 Option B - Don't create the company: The Council will not be able to invest in the construction or purchase of residential properties for a commercial purpose and may not be able to invest in commercial properties outside the district.

#### 5. **Resource Implications**

5.1 The company will be established with an initial share capital value of £100. This will be supported, at an appropriate time, with a loan of £100k to provide a level of working capital for the company. Future loans will be made available to the company based on individual business cases for investment opportunities.

5.2 Loans made to the company will be charged at market rates, above the level at which the Council can borrow from PWLB or other sources, resulting in an income stream for the General Fund. The General Fund will also benefit from any profits generated by the company.

5.3 The forecasts included in the business case are estimates based on investing £2m per year for the first five years of the company's operation. As is common with new companies the financial forecast shows a loss for the first couple of years due to initial set up costs and the timescales between initiating a project and when it is completed and generating a revenue stream. This modelling has been undertaken to illustrate a potential scenario, however, in practice, each proposal will be assessed in its own right and therefore the business case forecasts are expected to change significantly as projects are approved.

5.4 Creation and operation of the property company will be undertaken using existing in-house staff resources and external legal advice. The Legal advice will be funded from the Property Investment Strategy revenue budget approved by Council on 30<sup>th</sup> November 2016.

5.5 Minimal staff time will be required for creation of the company, and it can remain inactive/dormant, with virtually no costs, until there are opportunities to engage / invest.

5.6 By having the company established now, we are ensuring that we are in a position to act promptly should an opportunity arise, and should such investment be best

undertaken by a property company. This will reduce the risk of delays in potential investments while we set up the company.

## 6. **Legal Implications**

- 6.1 Legal advice on the set up of the company has been provided and will continue to be provided by Blake Morgan solicitors. Legal advice has been sought on the type of company that is required, the Council's powers to form the company, the governance arrangements and the contracting status of the company.

### Powers

- 6.2 The council is able to use its general power of competence set out in section 1 of the Localism Act 2011 (the 2011 Act). In exercising this power, a local authority is still subject to its general duties (such as the fiduciary duties it owes to its rate and local tax payers) and to the public law requirements to exercise the general power of competence for a proper purpose.
- 6.3 Section 4 of the Localism Act 2011 in particular extends the existing trading scheme under the Local Government Act 2003 so that in so far as the general power permits the Council to carry out a particular activity, then s.4 empowers it to do so for a commercial purpose. As the Council is not seeking to charge an individual for something it is required to provide by statute and is proposing to trade through a company limited by shares, then subject to proper exercise in accordance with the Wednesbury principles of reasonableness, the Council is permitted to undertake this activity.

### Ministerial Statement

- 6.4 The Council is not currently at risk of contravening a Ministerial Statement, issued on 20 March 2015, which reviewed the progress made by Councils in increasing house-building and provided a warning that house-building by Councils should not be pursued in a way such as to undermine the Government's commitment to right-to-buy. The purpose of establishing the proposed company is to undertake commercial activity in the private and commercial housing sector and not to provide social housing outside the Housing Revenue Account.

### Governance Arrangements

- 6.5 The company will be set up and governed as a wholly owned company of the Council. The company's day to day governance will be managed by a board of directors and the initial board consists of council officers.

### Controlled Regulated Companies

- 6.6 The Local Government and Housing Act 1989 deals with companies: (a) under the control of local authorities; and (b) subject to local authority influence. The LAPC is likely to fall within one of these categories and will, therefore, be required to comply with the relevant provisions of the Local Authority (Companies) Order 1995.

### Contracting Status and Procurement

- 6.7 The impact of the procurement regime needs to be considered from two angles:
- (a) the Council's relationship with the company; and

- (b) whether the company is itself subject to the procurement rules.

#### The Council's relationship with the company

- 6.8 There is an exception under the procurement rules which allows "parent" bodies (such as the Council) to trade with their "controlled" bodies (bodies over which they exercise a similar degree of control as they would over an in-house department), without having to go out to tender. This is known as the "Teckal" exception after the case which first established it.
- 6.9 To be a "Teckal" company, the requisite degree of control has to be shown (which is satisfied in this case) but the company must also fulfil a "function test"; i.e. the main part of its activity (80% or more assessed on annual turnover) must be carried out for the parent body; i.e. the Council.
- 6.10 The company is not considered to be a Teckal company as the main function for it, and the majority of its turnover, will be through trading on the commercial market with third parties, and not to provide services for the Council.
- 6.11 Therefore any contracts that the Council wants to enter into with the company for the supply/receipt of services, and which are above the relevant thresholds (currently £181,302 for goods and services, and £4,551,413 for works), will have to be tendered if over EU thresholds (unless any other exceptions apply). Contracts which are below threshold or in respect of which specific exceptions may apply, do not have to be tendered but the Council may still need to demonstrate value for money.

#### Whether the company is subject to procurement rules

- 6.12 As the company is likely to have an "industrial or commercial character", it is likely that it would not be regarded as a body subject to public law, and therefore not a contracting authority for purposes of the EU procurement regime. Therefore, it is likely that the company would not have to follow the procurement rules and could contract for goods, services and works in the same way as a private entity.
- 6.13 However, due to the ownership/control that the Council will have in the company, it is likely that it will need to appear in the Council's accounts and therefore there will be a need to demonstrate to the Council and its auditors that the company is receiving value for money. This could be done by some form of fair and open tendering appropriate to the value of the contract, but need not comply with the more stringent public procurement rules.

#### Contracting Services from the Council

- 6.14 Any arrangement between the DLPC and the Council will need to be on commercial terms, so as not to contravene the rules on state aid, and to ensure that, in its interests, the company is not paying more for such services than it would have to pay on the open market.

#### Shareholder Agreement

- 6.15 A shareholder agreement usually regulates the relationship of shareholders with each other. In the case of the DLPC the shareholder agreement will be between the Council and the DLPC and will, amongst other things, identify those matters in respect of which the Council wishes to reserve decision-making and right of action to itself. The shareholder agreement is yet to be drafted.

## Articles

- 6.16 A company's Articles of Association will be drafted, which will comprise the company's constitution. The DLPC's articles will be based on the model set of Articles, for companies limited by shares, tailored to suit the DLPC. They will set out, amongst other things, the internal management structure of the DLPC, the procedures for appointing and removing directors and the conduct of meetings.

## 7. **Corporate Implications**

- 7.1 Comment from the Section 151 Officer: Finance have led on the production of the report and have no further comments to add. (HL)
- 7.2 Comment from the Solicitor to the Council: The Council's Commercial Solicitor has been consulted throughout the report and has no further comment to make. (BD)
- 7.3 Comment from the Equalities Officer: This report does not specifically highlight any equality implications, however in discharging their duties members are required to comply with the public sector equality duty as set out in section 149 of the Equality Act 2010 <http://www.legislation.gov.uk/ukpga/2010/15>.

## 8. **Appendices**

Appendix 1 – Business Case

## 9. **Background Papers**

Property Investment Strategy – Council November 2016

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