

## ***Report to the Cabinet***

***Report reference: C-084-2009/10***

***Date of meeting: 1 February 2010***



**Epping Forest  
District Council**

**Portfolio:** Housing.

**Subject:** Formation of Local Housing Company and Associated Arrangements.

**Responsible Officer:** Alan Hall (01992 564004).

**Democratic Services:** Gary Woodhall (01992 564470).

---

### **Recommendations/Decisions Required:**

- (1) That a report be submitted to the Council recommending as follows:**
  - (a) To agree in principle to the establishment of a Local Housing Company (LHC) to which the Authority would provide mortgages to enable the company to purchase properties on the open market and to let them with assured tenancies at market rents to Council Housing Register nominees through "HomeOptions" (the Council's Choice-Based Lettings Scheme);**
  - (b) To agree the recommendation of the Cabinet that a LHC Cabinet Committee appointed by the Leader of the Council is the preferred forum for considering the establishment and operation of the LHC and for bringing forward proposals for consideration by the Cabinet and the Council;**
  - (c) To approve the Terms of Reference and Work Plan for the LHC Cabinet Committee as set out in Appendix 2; and**
  - (d) To note that the final decision on the following matters will be reserved for decision by the Council:**
    - (i) The proposed Articles of Association for the LHC;**
    - (ii) The total and/or maximum amount of mortgages to be made available to the LHC and how these should be funded by the Authority;**
    - (iii) How the Council will monitor and scrutinise the performance and finances of the LHC, in consultation with the Overview & Scrutiny Committee; and**
    - (iv) The initial appointment of the LHC's Directors at the appropriate time;**
- (2) That the appointment of Trowers and Hamlin (Solicitors) be extended to include the provision of legal advice on matters relating to the proposed formation and operation of the LHC, including the drafting of the company's Articles of Association; and**

**(3) That, pursuant to Recommendation (2) above, and to meet the cost of registering the LHC, DDF funding for this purpose be increased by £5,000 to £11,000 for 2010/11.**

**Reasons for Proposed Decision:**

The expected interest payments that would be received by the Council from proposed mortgages to the Local Housing Company are likely to be greater than the interest received from the Council's normal investments. The Council is unable to provide assured shorthold tenancies at market rents to housing applicants itself, hence the need to form a Local Housing Company.

Legal advice has been received on the proposed formation of the Local Housing Company (LHC). Recommendations on agreeing to the principle of the proposal and the mechanism to establish the company and to agree how the LHC would operate need to be agreed by the Council, on the recommendations of the Cabinet. It is felt that the formation of a Local Housing Company Cabinet Committee to consider the numerous issues relating to the LHC's formation and operation would be the most effective and expeditious approach. The Cabinet Committee would make recommendations to the Cabinet as appropriate. Some decisions would need to be made by the full Council on the recommendation of the Cabinet.

**Other Options for Action:**

- Not to form a Local Housing Company;
- Not to set up a Cabinet Committee, and agree that a different body should consider the issues and make recommendations to the Cabinet – e.g. an existing Cabinet Committee, a Portfolio Holder, a Portfolio Holder Advisory Group, an ad-hoc committee or the Overview and Scrutiny Committee;
- Not to set up a Cabinet Committee and have all issues considered by the Cabinet itself;
- To agree different Terms of Reference and/or Work Plan for the proposed Cabinet Committee or alternate body;
- To allow the proposed Cabinet Committee (or alternate body) to make some decisions without reference to the Cabinet; or
- To reserve a different list of decisions to be made by the full Council, or to not reserve any decisions.

**Report:**

Introduction

1. At its meeting in September 2009, the Cabinet considered a proposal from the Leader, Deputy Leader and Housing Portfolio Holder to investigate the formation of a Local Housing Company (LHC) to which the Council could provide mortgages, to enable the LHC to purchase properties from the open market and to then let them with assured shorthold tenancies at market rents to Council nominees. It was explained to the Cabinet that, in the current economic climate of low interest rates, it is possible that interest payments received from such mortgages to the Local Housing Company could be greater than the interest received from the Council's normal investments. Any surplus rental income (after the deduction of the loan interest and other costs such as legal, management and corporation tax) could also be returned to the Council through a legal agreement.

2. The report to the Cabinet in September 2009 suggested that a loan/mortgage to the LHC by the Council could, for every 10 properties purchased by the LHC, receive income from the loan (currently) of around £57,000 per annum more than the income received from the Council's normal investments. This would be in addition to any additional income the Council would receive from the LHC in relation to any surpluses it makes. The Council would also receive capital receipts when the LHC's properties are subsequently sold, amounting to any increases in the property's value (less the LHC's sale costs).

3. The other benefit would be a social one, since the LHC would let the properties to Council nominees from the Housing Register, which would include applicants in receipt of the local housing allowance (housing benefit), who would otherwise experience difficulty in accessing the private rented sector. The LHC could also agree to receive rent in arrears, instead of the usual rent advance.

4. It was also noted that the Council is unable to provide assured shorthold tenancies at market rents to housing applicants itself, hence the need to form a Local Housing Company. However, it was agreed that, since such an arrangement would be fairly unique, specialist legal advice should be obtained on a range of issues, to assist the Cabinet and the full Council to determine whether or not to proceed. It was also acknowledged that it would be necessary to undertake a more detailed financial appraisal of the potential costs and income, and whether the initiative would be financially viable.

5. A legal firm that specialises in this area, Trowers and Hamlin, were therefore appointed to investigate and report on the relevant issues, for a fee of £1,500 plus disbursements. A budget of £6,000 was also agreed to cover all professional fees of the required advice. It was agreed that a further report be considered by the Cabinet in due course, setting out the legal, financial and other issues and whether the initiative should be considered further.

#### Legal Advice from Trowers and Hamlin

6. Draft legal advice was received from Trowers and Hamlin in December 2009. Following discussions between the Director of Housing, Asst. Director of Corporate Support Services (Legal) and the Asst. Director of Finance and ICT (Accountancy), a list of queries in relation to the advice were raised, on which Trowers & Hamlin were asked to expand and clarify. The final version of the legal advice received from Trowers and Hamlin is attached as Appendix 1, which all members are encouraged to read and understand.

7. The following summarises the key points of the legal advice:

(a) The Council is legally able to form a company (referred to in this instance as a "Local Housing Company (LHC)"), which is relatively easy. The most appropriate form would be a company limited by shares, with the Council being the sole shareholder.

(b) The consent of the Department of Communities and Local Government (CLG) would be required.

(c) The directors of the LHC, who would all be Members of the Council, would have a number of important legal duties, responsibilities and liabilities, although they would not have personal responsibility for debts of the LHC, provided that they

comply with the law. Directors' Liability Insurance can be obtained. The directors would also have to act in the best interests of the LHC.

- (d) The directors of the LHC can be appointed and removed by the Council
- (e) Directors of LHCs are not normally remunerated or paid for their work. Indeed, if Council members who are directors of the LHC are paid, it would probably disqualify them for continuing to be a Member of the Council, because they would effectively be employed, indirectly, by the Council.
- (f) There could be a conflict of interests for members. This is discussed later in this report.
- (g) The LHC would need to have Articles of Association, setting out how the LHC will operate. Annual returns would have to be filed with Companies House and the LHC's accounts would have to be grouped with the Council's own accounts.
- (h) The LHC would not be able to recover VAT for repairs that it undertakes. It would also be liable for Corporation Tax on any surpluses it makes each year and capital gains tax on any surpluses from any future sale of properties.
- (i) The mortgages provided to the LHC would need to be carefully drafted, to ensure that they do not fall foul of any state aid rules, and would be secured on the properties purchased by the LHC.
- (j) There would be various agreements between the LHC and the Council, including the Loan Agreement and Charges, a Nomination Agreement and a Services Agreement.
- (k) The Services Agreement would set out the services that the Council would provide to the LHC, for an agreed price.
- (l) The Council, as sole shareholder, would be entitled to any surpluses made by the LHC;
- (m) The key risks identified by Trowers and Hamlin are:
  - (i) The purchased properties could reduce in value;
  - (ii) The purchased properties may not be able to be let, incurring void costs, or the tenants could accrue rent arrears;
  - (iii) The Local Housing Allowance (similar to housing benefit) is payable to tenants direct, which could lead to increased rent arrears;
  - (iv) There could be expensive structural problems with the purchased properties;
  - (v) The Council may not have adequate security for its mortgages, if the properties' values reduce;
  - (vi) If the LHC becomes insolvent, the Council could be one of a number of creditors and may not be able to recover its loans – although the Council should be the first in the line of creditors; and

- (vii) The Council could be considered as a “shadow director” and an aggrieved creditor could try to assert that that LHC’s directors had been doing “what the Council had told them to do” – however, there should be no liability for the Council, provided that the directors never trade whilst knowingly insolvent.
- (n) Although Trowers and Hamlin are aware of two London Boroughs that are also considering the establishment of LHCs, to receive and let void Council properties, they appear to differ from the Council’s proposal in two ways. Firstly, it appears that neither intend to let properties at market rents (one certainly intends to let the properties at “intermediate” rents – around 80% of market rents). Secondly, neither council intends its LHC to purchase properties off the open market. For these two reasons alone, this Council’s proposal appears to be unique in local government.

### Overall Financial Appraisal of Proposal

8. The initial report to the Cabinet on this proposal set out some general financial information from the Asst. Director of Finance & ICT (Accountancy), which suggested that the proposal to set up an LHC should be viable. However, before the Council proceeds with such a proposal, the Cabinet needs to consider a more detailed financial appraisal to satisfy itself that the financial returns to the Council would be much greater than if it simply obtained its usual investment interest from its deposits. The Cabinet also needs to satisfy itself that it is worth the time and cost to establish and run the LHC.

9. As members will appreciate, the Finance and ICT Directorate are currently focussing their efforts on the budget process. It has therefore not been possible to attach the financial analyses with this report. However, the Asst. Director of Finance & ICT (Accountancy) will either circulate in advance of the Cabinet meeting, or table at the meeting, financial analyses to show:

- (a) A summary of the options for providing capital funding to the LHC (which previously showed that the provision of an interest-only loan would be the most appropriate);
- (b) An indicative business plan for the LHC (showing expenditure Vs income), to demonstrate that the LHC would be viable – with a sensitivity analysis showing the effect of variables, particularly interest rates; and
- (c) A detailed financial appraisal on the financial benefits for the Council of providing interest-only mortgages secured on the properties, compared to the income that could be received from its usual investment sources - again, with sensitivity analysis showing the effect of variables, particularly interest rates.

### Proposed Way Forward

10. In view of the legal advice from Trowers and Hamlin, and assuming that the financial appraisals confirm the viability of the proposed approach, it is suggested that recommendations be made to the full Council that:

- (a) A policy decision be taken to agree, in principle, to undertake the initiative and to set up an LHC, subject to further detailed consideration and the actual decision to form a company (and to agree its Articles of Association) being made at a later date by the full Council; and

(b) The mechanism to establish the company and how the LHC would operate be agreed.

### Establishing the Local Housing Company

11. If agreement in principle is approved by the full Council, there will be numerous detailed issues to be considered and a number of important decisions to be made in relation to the LHC and the Council. There are a number of options available to consider and decide the issues. However, whichever option is chosen, it is recommended that all documents produced by the member body that considers the detailed issues are approved by the Cabinet and, where appropriate, the full Council.

12. The options for considering the detailed issues are as follows:

**Option:**

**Comment:**

(a) Allocate the role to an existing Cabinet Committee

The three Cabinet Committees in existence at present are for Finance and Performance Management, North Weald Strategy and the LDF.

There is currently a proposal to extend the terms of reference of the North Weald Strategy Cabinet Committee to cover a review of the Council's property portfolio. Further extension of the work of that Committee is not thought a practical proposition in the circumstances. The other Cabinet Committee also have continuing and substantial work programmes.

(b) All the issues are considered by either the Leader, Housing Portfolio Holder, Finance Portfolio Holder or another Portfolio Holder

It is felt that, in view of the number of detailed issues involved and their importance – and that the issues cut across the three portfolios referred to – it would be inappropriate for one portfolio holder to be given responsibility to consider and recommend on all of the issues.

(c) Establish a Portfolio Advisory Group

Portfolio Holder Advisory Groups may be established to assist individual portfolio holders with the carrying out of Cabinet functions. They are appointed and chaired by the Cabinet member concerned. Any political group on the Council may appoint one member to such a group. Decision making, or agreeing recommendations to the Cabinet, remain limited to the Portfolio Holder. However, the Cabinet member has discretion on whether councillors who are not part of a political group should be members.

A portfolio holder advisory group was tried in the initial stages of the LDF/G&T DPD process, but was eventually replaced by the Cabinet Committee mentioned above.

(d) Establish an ad-hoc Council Committee

As the major decisions on the LHC will be made by the Council (albeit on the recommendation of the Cabinet), there is an option for the Council to establish an ad-hoc

committee. This would have to be appointed by the Council (including the Chairman and Vice Chairman) and would be subject to pro-rata rules.

As it would be an advisory committee, it may not be necessary to apply the 2<sup>nd</sup> aggregate pro-rata calculation. Membership of such a Committee could include Cabinet members, and the majority group would be entitled to a majority of committee seats. There is a link with the responsibilities of the Cabinet in regard to housing, which would need to be addressed in the members appointed.

(e) Establish a new Local Housing Company Cabinet Committee

Cabinet Committees have formal agenda and minutes and are open to any member to attend. They are by law only to comprise Cabinet members. Their terms of reference are agreed, and appointments made, by the Leader of Council.

13. It is felt that the most efficient and expeditious way to consider and recommend most of the issues for the LHC and Council would be for the Leader of Council to establish a Local Housing Company (LHC) Cabinet Committee, under the powers given to her by the Local Government and Public Involvement in Health Act 2007. The Cabinet Committee would make recommendations to the Cabinet as appropriate, although some of the more important decisions would need to be made by the full Council on the recommendation of the Cabinet. The Leader would decide the membership and whether or not any other members should be co-opted, although it should be noted that, under local government legislation, it would not be possible for them to have a vote.

#### Terms of Reference of the Proposed LHC Cabinet Committee

14. The proposed Terms of Reference for the LHC Cabinet Committee are set out at Appendix 2. Appended to the Terms of Reference is a proposed Work Plan for the Cabinet Committee.

#### Constitutional issues around the formation of the LHC Cabinet Committee

15. The Assistant to the Chief Executive has advised that, if the Council subsequently appoints members of the LHC Cabinet Committee to become directors of the LHC, from the point that they become directors, those members would have to declare an interest and not take part in any Council discussions about the LHC. However, he has further advised that they can take part in all discussions and decisions up to that point. It is for this reason that it is suggested that the actual legal incorporation of the LHC, and the appointment of the first directors, should take place after all decisions in principle on this issue have been made.

16. The Council has adopted a protocol to advise members who also serve on independent bodies, whether as appointed representatives or separately from their role as Councillor. The LHC will fall under the protocol. The protocol cautions councillors that conflicts of interest between the role of Director of the LHC and the role of Councillor may well be significant and that they should determine how they are to deal with that conflict at the outset. Prejudicial interests might be created in this situation and would be reinforced if the Directorships held by Councillors were remunerated positions. A Directorship would also have to be registered on

Councillors' public declaration of interests. Further advice to appointed members would be available to avoid any difficulties.

17. Also, on the question of remuneration, if the role of Director of the LHC is to be remunerated by means of Special Responsibility Allowance (SRA), the Council is required to seek a report from the Remuneration Panel before such payments can be made. Further legal advice would also be needed on whether such an SRA is a legal option.

#### Further Legal Advice

18. Trowers & Hamlin have advised that, subject to certain assumptions, their fees for establishing an LHC would be between £5,000 - £7,000. It is therefore suggested that Trowers & Hamlin's appointment is extended to include the provision of further legal advice to the Cabinet Committee on matters relating to the proposed formation and operation of the LHC, including the drafting of the LHC's Articles of Association.

19. In order to fund additional professional advice and the registration of the LHC, it is suggested that the existing £6,000 budget provision for professional advice on the LHC be increased by £5,000 to £11,000 through the District Development Fund (DDF) in 2010/11.

#### Appointment of Directors to the Company

20. The full Council would need, at the appropriate time, to appoint the first directors of the Local Housing Company, in the same way as Council appointments to other external bodies.

#### The Next Steps

21. Subject to the Cabinet agreeing this report's recommendations, the next stage will be for the full Council to consider and agree the main recommendations at its meeting on 16 February 2010. If these are agreed, the Leader would then form the proposed Cabinet Committee and decide on the number of members and the membership. Officers will then draft reports on the issues set out in the proposed Work Plan for consideration by the Cabinet Committee (taking advice from Trowers and Hamlin where necessary). Trowers and Hamlin would also be asked to attend meetings of the Cabinet Committee as appropriate, and to draft the LHC's proposed Articles of Association for consideration by the full Council.

#### **Resource Implications:**

At this stage, the recommendations would only commit the Council to a maximum of £11,000 expenditure in professional fees. However, if the proposal goes ahead as planned, the Council's commitment, in terms of loan provision to the LHC, would be significant. This would be subject to a further report to the Cabinet.

#### **Legal and Governance Implications:**

These are set out in the advice from Trowers and Hamlin, attached at Appendix 1.

#### **Safer, Cleaner and Greener Implications:**

There is none.



### **Consultation Undertaken:**

The Local Government Association (LGA) has been consulted on the principles and has expressed an interest in being kept informed.

### **Background Papers:**

None.

### **Impact Assessments:**

#### Risk Management

The risks identified by Trowers and Hamlin are set out in Appendix 1, and are summarised in the report above.

However, there are a number of other risks, which the proposed LHC Cabinet Committee will be asked to identify, monitor and mitigate.

#### Equality and Diversity:

*Did the initial assessment of the proposals contained in this report for relevance to the Council's general equality duties, reveal any potentially adverse equality implications?* No

*Where equality implications were identified through the initial assessment process, has a formal Equality Impact Assessment been undertaken?* N/A

*What equality implications were identified through the Equality Impact Assessment process?*  
N/A.

*How have the equality implications identified through the Equality Impact Assessment been addressed in this report in order to avoid discrimination against any particular group?*  
N/A.