Shepway District Council

Regeneration and Housing Company

Business Case

FINAL Report

1st July 2014

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Executive Summary

Background and rationale

This document presents the business case for establishing a new arm’s length Regeneration and Housing Company of Shepway District Council (SDC). Establishing the Company is identified as a priority action in SDC’s Corporate Plan for 2013-2018, and in December 2013 SDC’s Cabinet approved for officers to work up full proposals.

The activities of the Company will be directed towards achieving three of Shepway’s strategic objectives set out in the Corporate Plan:

1. The need for more homes in the district – to help increase overall housing supply and the target of 400 new homes per annum; delivering more new affordable family housing; occupying empty properties, and encouraging private sector activity;

2. Boosting the local economy and job opportunities – by unlocking and redeveloping key employment sites; and

3. Delivering value for money – by developing new models of publicly owned housing, reducing housing costs and being able to trade on a full commercial basis.

Company objectives

The objectives of the company can be summarised as:

- To lead regeneration and development activity;
- To acquire housing for rent and sale;
- To lead site development activity;
- To facilitate development;
- To develop housing for market rent or sale;
- To hold and develop employment sites;
- To deliver enabling development infrastructure; and
- To provide a vehicle for agreed trading activities.

Company structure, governance and operation

The business case reviews the four options first presented to the December 2013 Cabinet on a number of alternatives that have been considered by local authorities elsewhere around the country (wholly owned company, Community Interest Company, Joint Venture options, Private Finance Initiative). The analysis concludes that the one which best fits SDC’s objectives is to establish
a controlled company, wholly owned by SDC, operating at arm’s length from the Council.

The Company will be led by a Board of Directors, responsible for setting the annual Business Plan – the key document which will guide the specific activities of the Company, and which will require annual Cabinet approval. Initially all Directors will be elected members, with a quorum of the Board established by a minimum of two Senior Directors (councillors from the majority party) and one other Senior or Junior Director (from the opposition party). Management staff will be provided on a part-time basis from SDC. Ultimate control and oversight of the Company will rest with the Leader and the Cabinet of the Council through controls that have been put in place.

The full legal and operational framework is set out in three ‘Key Corporate Control Documents’ - the Articles of Association; the Shareholder’s Agreement; and the Service Level Agreement.

**Funding and financial principles**

The proposal is that the initial focus of the Company during the first 18 months of operation will be a Housing Acquisitions, refurbishment and rental programme of up to 15 properties, and the use of the Company as a vehicle through which the Council’s Grounds Maintenance function can start to invoice for grounds maintenance activity for a variety of private and public sector clients.

Initial projections are that the Company will require capital investment of £2.2875m for the 15 properties. Operating costs are estimated at around £90,000 a year, and therefore the business case proposes the principle of a working capital loan of up to £300,000 to fund the business start-up phase and first two full years of operation.

The business case considers the pros and cons of three options for funding the Company’s capital investment needs:

**Option 1:** 100% shareholder equity, provided from SDC’s capital reserves;

**Option 2:** 100% loan finance (either from SDC’s capital reserves or SDC prudential borrowing from the Public Works Loan Board); and

**Option 3:** A mix of loan and shareholder equity finance.

Advice has been sought from public sector legal specialists, Bevan Brittan, and the conclusion reached that option 3, a mix of loan and shareholder equity (90:10 proportions) drawn in the first instance from SDC reserves is the preferred approach for the initial programme. This provides for the best return to the Council while allowing flexibility on draw-down timing; flexibility on interest rate and capital repayment charges, with State aid compliance managed within the de minimis rules. The Council acknowledges that external accountancy advice has highlighted that not all the interest paid (on a 90:10 loan:equity split, potentially 20%) is likely to be considered tax deductible under
the UK’s Transfer pricing legislation. This can however be reflected in the preparation of the Company’s accounts, or adjusted if challenged by the HMRC.

The business case also addresses a range of other financial issues – for example, start-up costs; financial delegation limits; the remuneration of Directors; recharging for Council provided services; taxation; UK Transfer pricing legislation, State aid; accounting and auditing, and how the Council will take security over the Company’s assets acquired with the benefit of the Council’s loan.

In terms of financial returns to the Council, the council will benefit from a finance facility for properties to be rented at Local Housing Allowance rate of 4% p.a. return; market rental housing at 4.88% p.a. return and 1% above base for a working capital facility.

**Risk assessment and management**

The business case also considers a full risk analysis, from both the Council’s and the Company’s perspective. Particular risks highlighted for the Council to consider are the level of control held by the Council versus responsibility handed to the Board; the potential for a State aid challenge; any possible adverse effect on the General Fund; and Company failure leading to reputational damage to the Council.

Risks to the company which will require close monitoring are: the level of rental income received; whether the estimate of £150,000 per property for acquisition refurbishment and letting is sufficient; the balance of workload of seconded staff; and potential conflicts of interest of members acting as Company Directors.

**Next steps**

Subject to Cabinet views of the Business Case, the next steps will include appointing Directors, incorporation, convening a board meeting, and developing, scrutinising and approving the first Business Plan.
1 Introduction

1.1 Purpose of this Document

This document presents the Business Case for establishing a new arm’s length trading company of Shepway District Council (SDC) to deliver regeneration and housing activities across the district and to be able to trade for profit.

This initiative responds directly to the Council’s Corporate Plan, approved in February 2014, which set out the Council’s intention to establish a new regeneration and housing company with the objective of helping contribute directly to the Council’s commitment for more homes, more investment and more jobs.

SDC’s powers to establish the trading company are contained within the Localism Act 2011 which requires that where activities are carried out for a profit they must be done through a company.

1.2 An Outline of the Proposal for a new Regeneration and Housing Company

Shepway District Council’s Cabinet first considered the principle of establishing a new Local Regeneration and Housing Company (’the Company’) at its meeting on the 31st July 2013, authorising officers to explore the potential for a new Company and to investigate similar models established by other local authorities elsewhere around the country. The experience of Ashford Borough Council (ABC) has been particularly useful to Shepway, given that over the last eighteen months, ABC has been developing its proposals to establish two local trading companies (a housing company and a building consultancy company).

SDC and ABC have been collaborating on a number of issues and this has helped deepen the relationship between the two councils.

In principle, SDC is looking for the Company to provide an important delivery vehicle for the Council to assist with:

1. Promoting new employment and housing investment across Shepway; to bring forward new development sites and encourage private sector investment either simply by stimulating activity and confidence in the market; or by entering into joint venture agreements which will help unlock private sector investment;

2. Leading a dedicated ‘Housing Acquisitions & Rental’ programme - an acquisition and conversion/refurbishment programme to provide residential properties in Shepway to let to families at rental levels with the flexibility to be either at or just below market rates (an arm’s length company would be able to charge rents at either 100% of Shepway’s Local Housing Allowance rate or above compared to the Council’s restriction a maximum of 80% of the LHA rate, and therefore would be better equipped to bring forward viable units); and
3. To introduce the ability for the Council to deliver new income streams, with an initial focus on Grounds Maintenance services, but with the intention that this might expand to bring in other services over time.

The proposal for the Company is intended to complement separately approved investment by the Council for a direct £30m Housing Revenue Account programme investment by the Council to bring forward 300 new council homes over the next 10 year period.

1.3 Cabinet Approval for Establishing the Company

Through the latter part of 2013, officers worked up a more fully developed proposition for establishing the Company, and this was considered and approved at the Council’s 18th December 2013 Cabinet meeting. The outcome of the meeting was an instruction to the Council’s officers to work up detailed proposals including financial modelling, governance and an assessment of risks, and then to report back to Cabinet with:

- Advice on the potential options for the trading company;
- Detailed proposals for governance;
- Detailed business planning of the company’s potential activities;
- Evaluation of the funding and accounting arrangements;
- Consideration of the risks to the Company and the Council and any mitigation needed; and
- Development of a communication strategy.

This business case represents the outcome of that instruction, and supports a report to Cabinet dated 16th July 2014 which recommends the incorporation of a wholly owned trading company, and the delegation of signatory authority to the Leader of the Council to approve company documents.

The rationale for this recommendation is that:

1. A wholly owned company will deliver against Council determined objectives and priorities for regeneration;
2. Core outcomes will be the delivery of more homes; a wider range of housing tenures and rental levels than currently delivered by the Council; more inward investment; and more job opportunities in Shepway;
3. The Company will provide a delivery vehicle for profitable traded services;
4. The Company will supplement existing Council activity in: (a) delivering affordable homes, increasing the provision of affordable family rental units; (b) bringing more empty homes back into use; and (c) providing affordable and appropriate employment / incubation space;
5. The Company will generate new sources of income for the Council in the long term, which may include the New Homes Bonus, increased Business Rates and Council Tax income, along with the prospect of attracting more inward investment into the District, and capital growth through its investments; and

6. The Company will provide a vehicle for delivering projects directly utilising additional public sector funding secured from sources such as Local Growth Funding or Growing Places funding or EU investment funds via the South East LEP once the Strategic Economic Plan and Growth Deal is approved by Government, expected during summer 2014.

1.4 Developing the Business Case and Business Plan

Officers set up a Development Project Board in December to bring together key officers from across Economic Regeneration, Property, Communities, Finance and Legal to oversee a range of strategic development matters, including the development of the Regeneration & Housing Company. The Board is chaired by the Corporate Director, Economic Regeneration, and Members are briefed on a monthly basis.

Officers also appointed GENECON Ltd to assist with the development of the Business Case and business planning work relating to the Regeneration & Housing Company and reached agreement with Ashford Borough Council for assistance from their in-house legal adviser to help prepare the set of ‘Key Documents’ setting out the Governance principles that will determine how the Company is incorporated; how its Board of Directors will be constituted; and how the balance between Board responsibility for driving the activities of the Company and control retained by the Council will be exercised.

Broadly, the development work has followed two strands of activity, covering:

- **Work Strand 1: Development of the Business Case, covering:**
  - The rationale and justification for setting up the Company;
  - Potential options for the Company;
  - Governance proposals;
  - Key principles for the financial operation of the Company.
  - Financing & accounting options; and
  - Key risks from both the Council’s and Company’s perspective.

- **Work Strand 2: Development of the Business Plan, covering:**
  - Activities and operational matters;
  - Financial modelling; and
  - Risk assessment.
1.5 **Structure of this Business Case Document**

The rest of this document focusses on the detailed content of Work Strand 1. The content for Work Strand 2 is set out within a separate but related Business Plan document.
2 Rationale for Establishing the Regeneration and Housing Company

2.1 Priority Action in Shepway District Council Corporate Plan 2013-2018

Establishing the Regeneration and Housing Company is identified as a priority action in Shepway District Council’s Corporate Plan for 2013-2018.

Establishing an arm’s length company will strengthen the ability of the Council to engage in the development of the district by:

- Generating income for reinvestment against Council determined objectives;
- Actively addressing market failures and barriers to economic development and regeneration; and,
- Acting more commercially in the pursuit of its strategic objectives for the area and establishing an entity which can engage with the market and deliver projects in partnership with the private sector.

Specifically, the proposed activities of the Company will be directed towards the achievement of three of Shepway’s strategic objectives as outlined in the Corporate Plan:

1. The need for more homes;
2. Boosting the local economy and increasing job opportunities; and
3. Delivering value for money.

2.2 The Need for More Homes

2.2.1 Corporate Plan actions and outcome targets

As indicated, the establishment of the Regeneration and Housing Company is seen as a key action for the Council under its objective for more homes. Of specific relevance to this Business Case, the Corporate Plan sets the following targets for more homes within and across Shepway district:

- By 2018 – an average of 350-400 new homes being built each year;
- By 2031 – between 2,000 and 2,500 new affordable homes;
- Land identified suitable for housing development;
- 300 new high quality Council owned homes to be developed over a 10 year period (the HRA programme) – to be significantly under way by 2018;
- By 2018, 100 new affordable homes being built each year (32 of which will be low cost home ownership); and
By 2018, the Council will be bringing 35 long term empty private sector homes back into use each year and securing the improvement of 100 private sector homes each year with Council intervention.

How the company makes a contribution and plays a role in delivering against these activities will be determined on a case by case basis, with investment proposals captured within future business plans.

2.2.2 Increasing Overall Housing Supply

Housing is in demand across Shepway district, and this is forecast to continue to grow across all tenures. The Core Strategy (2013) establishes a minimum housing delivery target of 350 new homes per annum until 2031 (8,000 new dwellings by the end of 2025/26), in order to meet existing and future demand. The Corporate Plan sets the ambition to exceed this target by building on average up to 400 new dwellings each year.

Achieving these targets will require quite a significant increase on current housing completion rates. The table below lists the annual housing completion rates for the district, taken from the annually prepared Shepway Authority Monitoring Reports. Although the completion numbers in the table suggests that overall Shepway has averaged 345 new homes each year since 2000, this rate of development has not been achieved in the most recent years and therefore the district needs to achieve a doubling of current rates if it is to raise the average rate to around 400 completions per annum. In summary, the table shows the following:

- Since 2000, a total of 4,489 completions, averaging 345 homes per year;
- Between 2000 and 2005 (6 years), 2,662 homes completed, averaged 444 homes per year;
- Between 2005 and 2013 (7 years), 1,827 homes competed, averaged 261 homes per year.
- Between 2009 and 2013 (4 years), 725 homes completed, averaged 181 homes per year.

<table>
<thead>
<tr>
<th>Year</th>
<th>New Housing completions</th>
<th>Year</th>
<th>New Housing completions</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000/01</td>
<td>354</td>
<td>2006/07</td>
<td>146</td>
</tr>
<tr>
<td>2001/02</td>
<td>410</td>
<td>2007/08</td>
<td>394</td>
</tr>
<tr>
<td>2002/03</td>
<td>400</td>
<td>2008/09</td>
<td>562</td>
</tr>
<tr>
<td>2003/04</td>
<td>369</td>
<td>2009/10</td>
<td>180</td>
</tr>
<tr>
<td>2004/05</td>
<td>376</td>
<td>2010/11</td>
<td>132</td>
</tr>
<tr>
<td>2005/06</td>
<td>753</td>
<td>2011/12</td>
<td>207</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2012/13</td>
<td>206</td>
</tr>
<tr>
<td>Total 2000-2005/06</td>
<td>2,662 homes</td>
<td>Total 2005-2012/13</td>
<td>1,827 homes</td>
</tr>
</tbody>
</table>

Data source: Shepway Authority Monitoring Reports
Looking forward, the Company will need to work closely with the Council. An option will be for the Company to be closely involved in helping identify and agree the strategic interventions that will be needed for the Council to achieve, and even exceed the completion rate target of 400 homes per annum. The Company’s annual business plans can then set out the Company’s contribution to the delivery of these interventions.

The Council has recently established a programme of building 300 new publicly owned homes over the next ten years, funded through the Housing Revenue Account (HRA). The establishment of the Regeneration and Housing Company will allow the Council to complement the HRA programme with more commercially focused activities aimed at significantly boosting overall housing supply – initially engaging in a housing acquisitions and conversions programme within the district, but longer term, getting actively involved in land acquisition and assembly, working in partnership with private sector developers to bring forward sites and perhaps even building housing for private market rent and sale. Certainly the intention is that the Company’s governance architecture will be sufficiently flexible to allow the range of this activity.

Anecdotal evidence suggests that housing delivery is beginning to pick up, with construction on a number of sites well underway. It will be important for the Company to be closely involved in monitoring and reporting the levels of activity being achieved.

### 2.2.3 Delivering More Affordable Housing

The district has a considerable undersupply of affordable housing. The 2011 Housing Strategy identifies the need for 750 new affordable homes each year over ten years to address existing and future need. The market and registered providers have consistently been unable to provide anywhere near this figure in recent years, and as an illustration of this, over the decade to 2013, the average annual number of completed affordable homes was just 55\(^1\). The shortfall is particularly acute in the supply of affordable three-bedroomed family housing, where supply only meets 12% of need\(^2\). The aspiration in the Corporate Plan is to significantly increase supply by delivering between 2,000 and 2,500 new affordable homes by 2031.

In the three years following the 2008 recession Shepway’s housing waiting list increased from 2,095 households (2009) to 3,375 households (2012)\(^3\). Over the year to October 2013 there were on average forty-one households in temporary accommodation and sixteen homeless households in the district\(^4\).

Establishing the Regeneration and Housing Company will allow the Council to enter the market to purchase properties and potentially offer a variety of

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1. DCLG Housing Live Table 1008, GENECON analysis
3. DCLG Housing Live Table 600
4. DCLG P1e returns, via Shelter Housing DataBank
housing products pitched at a level that will range from above traditional local authority affordable housing to market rent housing.

### 2.2.4 Occupying Empty Properties & Improving Housing Conditions

In 2011 there were 450 long-term empty homes in Shepway\(^5\). The Corporate Plan identifies a reduction in the number of long-term empty homes as a priority action, and establishes the target of 35 properties to be brought back into use each year by 2018.

The Council is also committed to improving housing conditions across Shepway – another Corporate Plan priority action. The 2011 Housing Strategy highlights that the worst housing conditions in the district are in the private sector, with 32% of properties failing to meet the Decent Homes Standard on thermal comfort criteria alone. The Council’s target is to improve 100 private sector homes each year until 2018\(^6\).

The establishment of the Regeneration and Housing Company will provide the Council with a vehicle to proactively enter the property market in order to acquire, refurbish and return empty or sub-standard homes to the overall occupied housing stock.

### 2.3 Boosting the Local Economy & Increasing Job Opportunities

#### 2.3.1 Unlocking and Redeveloping Key Employment Sites

Shepway has a large supply of employment land, but has historically not attracted the level of new investment and employment growth that the Council would desire. The ambition set out in the Corporate Plan, and the adopted Shepway Core Strategy Local Plan, is to deliver new office, incubation and industrial premises on approximately 20 hectares of land by 2031. Future growth is likely to be characterised by a continuing shift away from manufacturing activities into the service sector. Major developments, such as the recent introduction of high speed rail, bringing the journey time from London St Pancras down to less than an hour, have the potential to stimulate further growth of inward investment into a number of employment sites and sectors.

The 2011 Shepway Employment Land Review identified the need for the Council to take a more aspirational approach to attracting new businesses into the district economy by providing higher quality, more deliverable, quality employment sites\(^7\). Various identified sites have significant development constraints which could be eased through intervention from the Council.

The Regeneration and Housing Company will allow the Council to act as a facilitator in land assembly, and in the development and promotion of new employment premises.

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\(^7\) Nathaniel Lichfield and Partners (2011). Shepway Employment Land Review.
Within the context of the ‘approximately 20ha’, the opportunity for additional employment land has been further analysed as:

- up to 5 ha more land for industrial development on a well located, readily available site in Folkestone if the existing industrial allocations there appear unlikely to come forward and particularly if the Park Farm industrial area continues to experience losses to retail warehouse uses;
- the potential for a broad mix of office and industrial B1 space at Nickolls Quarry, of which 2-3 ha could be office space to serve the wider Hythe area;
- reflecting planned housing growth in the Hythe area, approximately 2-3 ha more land for industrial development at Nickolls Quarry or a similar amount of new land within Hythe if Nickolls Quarry does not provide such space;
- to make provision for between 5,000 – 8,000 sqm of office space in and around Folkestone town centre, potentially including some space within the Harbour redevelopment and/or other town centre or edge of centre development sites;
- further small incubation premises for business start-ups across the district to encourage indigenous business formation and to widen employment; and
- market-led opportunities - 3,000 to 5,000 sqm of flexible employment space could be aimed for by 2026.

The Council has also recently commissioned a property market review and the preparation of a Town Centres Study (Peter Brett Associates appointed) that will, alongside the 2011 Shepway Employment Land Review, provide a robust evidence base that will help with the identification of the future interventions required by both the Council and the Company to secure an appropriate mix of new employment generating developments in town centres and across the District more broadly.

In addition, the development of Shepway Places and Policies Local Plan, scheduled to take place over the next 12-18 months, will include a review of the appropriateness of current employment land allocations and the potential identification of new allocations, a process that also has the potential to identify new areas of activity for the Company.

2.3.2 Increasing the Supply of Business Incubation Units / Small Business Space

It is important that new businesses have a choice of appropriate affordable accommodation in order to support and facilitate the growth in the local economy. A further conclusion of the Employment Land Review (2011) was that Shepway needs to develop additional business start-up premises to encourage indigenous business formation and to widen employment opportunities.
In the Corporate Plan the Council has committed to the target of providing an additional 2,000 square metres of small-business space by 2018, with the aim of supporting 48 new businesses and 140 new jobs.

The Regeneration and Housing Company will allow the Council to prioritise the development of new business incubation units, by acting as a developer either alone through direct development activity or in partnership with other private sector developers.

2.4 Delivering Value for Money

2.4.1 New Models of Publicly Owned Housing Delivery

The Council is committed to directly providing new affordable housing in the District through its HRA programme to build 300 new homes. The maximum rent charged for these homes will be 80% of the Local Housing Allowance (LHA) – the figure used to determine how much housing benefit residents can receive. This formula also applies to new homes built by (or on behalf of) housing associations. In 2013/14 Shepway’s LHA rate was just under £500 a month for a two bedroom property, so the maximum rent would be approximately £400.

The affordable rent model is a crucial element of housing provision within the district. However, it does reduce the financial viability of some new housing developments. This means that the development potential of more difficult or marginal sites may be lost, with negative consequences for overall housing supply.

The Regeneration and Housing Company will allow the Council to explore and develop new models of publicly owned housing which are more commercially viable – including building and renting homes at the full LHA rate; introducing a rental product above traditional affordable housing; and even potentially part of the portfolio at full market rental if it is considered that this will accelerate the achievement of the Council’s objectives. The ability to be flexible to respond to market conditions and opportunities is a key principle and strength of the Company.

2.4.2 Reduced Costs from Temporary and Emergency Accommodation

The Council has a statutory duty to provide emergency accommodation to homeless residents assessed as being in priority need. It also provides temporary accommodation for around 400 households per year – where these people are at risk of homelessness and cannot be housed in council or housing association properties.

The costs of this provision is considerable. The Council pays for bed and breakfast accommodation, private rental deposits and rent-in-advance – which are ultimately not fully recovered through housing benefit. The net cost to the Council of bed and breakfast accommodation, after the recovery of housing
benefit subsidy, is around £150,000 per year. Around 25% of all rental deposits and rent-in-advance are written off as unrecoverable – a loss of over £28,000 in 2012/13.

Significant work is in-hand to develop a Social Lettings Agency with ABC to help address this issue, however, the Regeneration and Housing Company will provide a vehicle through which the Council could purchase and manage its own stock of temporary accommodation, thereby reducing costs and increasing the rate of cost recovery.

2.4.3 Ability to Trade for Profit

The Corporate Strategy identifies securing future income streams to support corporate initiatives as a priority action. The Council currently delivers a number of services which operate in commercial markets, in which its expertise and experience make it highly competitive. Currently however, these services can only be offered to private customers on a cost recovery basis.

The Regeneration and Housing Company will provide a commercial vehicle through which the Council can trade for profit. Surpluses can then be either reinvested by the Company against Council objectives, or returned to the Council as dividends to be reinvested directly by the Council.
3 Review of the Council’s Options for Establishing the Company

3.1 Objectives

The objectives set out in the Corporate Plan can be used to help guide the decision-making around consideration of options for establishing the Company. These can be listed as follows:

1. To increase the supply of homes across the district;
2. To help address the demand for more affordable homes;
3. To help unlock key employment sites and to bring forward employment space to help create jobs;
4. To increase the supply of business incubation units / small business space;
5. To create a trading vehicle through which the Council could use any profits generated for re-investment in Corporate Plan;

And to these, could be added:

6. Be implemented reasonably quickly and affordably.
7. To provide a more flexible delivery mechanism to focus resources and effort, which remains accountable to the Council.

The potential options for the Council have been evaluated using these objectives as a guide.

3.2 Overview of the Options Considered

The report presented to the December Cabinet considered a number of potential alternative approaches being used or considered by local authorities elsewhere around the country. A tabulated summary of the advantages and disadvantages of each was also presented and this is included below.

The four options discussed are:

Option 1: Wholly owned company;
Option 2: Community Interest Company
Option 3: Joint Venture, including Local Asset Backed Vehicles (LABVs);
Option 4: Private Finance Initiative (PFI)

3.3 Options Review – Advantages & Disadvantages

The following options have been considered as part of the preparation of this Business Case, and are summarised in table 3.1.
3.3.1 **Option 1: Wholly Owned Company**

**Option scope:**
Wholly owned company of SDC, subject to the controlled companies’ legislation and able to undertake trading activities for profit. This would include housing and employment projects, providing a delivery vehicle for direct delivery of SDC Corporate Plan objectives in respect of housing and employment space. It could pay dividends to the Council as sole shareholder and would have the power to transfer assets back to the Council. With Council or Cabinet approval, the Company would be able to enter into joint venture arrangements on a project by project basis if beneficial. The company would also provide a mechanism through which some Council services could be operated for profit.

**Probable outcome:**
- Controlled company of SDC with focussed Board and delivery team working towards delivery of agreed business plan;
- Controls to be put in place through the terms of the Articles of Association; the Shareholder’s Agreement and a Service Level Agreement.

3.3.2 **Option 2: Community Interest Company (CIC)**

**Option scope:**
The CIC structure is a relatively new company form, introduced by the UK Government in 2005. CICs are regulated by the Office of the Regulator of Community Interest Companies, part of the Department of Business Innovation and Skills (BIS). CICs are a type of limited company designed specifically for those wishing to operate for the benefit of the community rather than for the benefit of the owners of the company.

CICs can be limited by shares, or by guarantee. The statutory “asset lock” ensures that assets and profits are retained within the CIC for community purposes, and also prevents transfer to any other body other than another CIC or charity. Share issue can be used as a mechanism to raise money from the local community which could provide an option for helping to finance activities.

A CIC cannot be formed to support political activities which might curtail some of the objectives set for the Company in terms of the delivery of SDC’s Corporate Plan objectives. Any assets acquired with funding provided to it by SDC would become the assets of the Company, and although the Company would still be liable to re-pay loan funding to the Council, any assets of the Company could not be transferred back to the Council.

**Probable outcome:**
- Much more limited Council control / influence over the Company’s activities.
3.3.3 **Option 3: Joint Ventures**

**Option scope:**
Joint ventures can take different shapes and forms. Typically in the public/private sector development arena, a joint venture is project based, sometimes delivered through a formal JV partnership special purpose vehicle or sometimes through a simple development agreement. Typically however, these are based upon the public sector contributing land with the private sector investing development capital.

**Probable outcome:**
Joint ventures could provide a mechanism for delivering housing and employment outcomes, however, the focus will not be there to the same extent either in terms of Board or team focus to deliver outcomes against an agreed business plan. More likely this will be activity that the existing corporate structure of the Council will lead on, on a project by project basis as opportunities arise.

3.3.4 **Option 4: Private Finance Initiative**

**Option scope:**
The PFI is a formalised joint venture approach, with a sharing of risks and benefits. PFI has typically been used for the provision of homes, schools and hospitals, with the private sector providing the skills normally on a design, build, finance and operate basis with the public sector committing to long term revenue contracts from central Government, which enables the private sector to secure the necessary finance.

**Probable outcome:**
Approval would be subject to central government approval for the PFI credits, which is likely to be expensive and protracted to secure, taking the approval decision away from SDC and therefore unlikely to provide a suitable delivery mechanism for the Council. It may be suitable for the housing projects, but is unlikely to be suitable to help bring forward employment premises.

<table>
<thead>
<tr>
<th>Table 3.1: Summary of the Council’s options</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Potential Options</strong></td>
</tr>
<tr>
<td>-------------------------------</td>
</tr>
<tr>
<td>1. Wholly owned company</td>
</tr>
</tbody>
</table>


<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>the council. A wholly owned company could enter into joint venture arrangements on a project by project basis if beneficial.</td>
<td>private sector borrowing. Activities would not be limited, provided funding is sustainable and supported by robust business planning.</td>
</tr>
<tr>
<td></td>
<td>A CIC could undertake trading activities, including housing and employment projects. However surpluses and assets would be ring-fenced to the community purpose set out in the company’s articles and subject to the Statutory ‘asset lock’ contained within CIC legislation.</td>
<td>Activities could be broad and would be necessarily focused on community benefits.</td>
</tr>
<tr>
<td>2.</td>
<td>Community Interest Company (CIC)</td>
<td>Activities would be restricted to the CIC’s community purposes. Surpluses would be ring fenced to the CIC’s activities and any assets could only be transferred to another CIC. It would not be able to transfer surpluses back to the council.</td>
</tr>
<tr>
<td></td>
<td>Joint ventures could deliver housing and employment outcomes. They generally involve a public sector and private sector partner, sharing the investment, risks and benefits. Typically these are based upon the public sector contributing land with other investing development capital.</td>
<td>The council would not be in complete control of the joint venture activities. Typically benefits would return to the council in the form of assets at the end of any agreements, although there may be some capacity, depending upon the project for an earlier revenue stream.</td>
</tr>
<tr>
<td>3.</td>
<td>Joint Ventures</td>
<td>Joint ventures would provide the opportunity to share investment, risks and benefits with the private sector. A joint venture could be beneficial in attracting the necessary investment to deliver a specific scheme, for example on council owned land.</td>
</tr>
<tr>
<td></td>
<td>PFI arrangements are limited by the value of PFI credits available to support the project. They are also project specific, such as the Kent extra care PFI ‘Better Homes, active Lives’ which included new homes in Shepway.</td>
<td>Extremely complex legal and contractual structures with significant set up costs. Can prove to be expensive over the lifetime of projects as private sector partners will seek to cover long term risk factors through the contract pricing mechanism. PFI credits may not be available.</td>
</tr>
<tr>
<td>4.</td>
<td>Private Finance Initiative (PFI)</td>
<td>Potential to attract additional central government resources. PFI arrangements would not return any revenue funding to the council, although assets, such as land could be returned to the council at the end of the contract period. Unlikely to be suitable for bringing forward employment</td>
</tr>
</tbody>
</table>
3.4 Options Assessment

3.4.1 Review against Strategic Objectives

The options outlined above have been considered against the objectives set for establishing the Company. Only Option 1 meets all the objectives set.

<table>
<thead>
<tr>
<th></th>
<th>OPTION 1</th>
<th>OPTION 2</th>
<th>OPTION 3</th>
<th>OPTION 4</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>To increase the supply of homes across the district</strong></td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td><strong>To help address the need for more affordable homes</strong></td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td><strong>To help unlock key employment sites and bring forward for employment space to help create jobs</strong></td>
<td>✓</td>
<td>✗</td>
<td>✓</td>
<td>✗</td>
</tr>
<tr>
<td><strong>To increase the supply of business incubation units / small business space</strong></td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✗</td>
</tr>
<tr>
<td><strong>To create a trading vehicle through which the Council could use any profits generated for re-investment in Corporate Plan</strong></td>
<td>✓</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
</tr>
<tr>
<td><strong>Be implemented reasonably quickly and affordably</strong></td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✗</td>
</tr>
<tr>
<td><strong>To provide a delivery mechanism to focus resources and effort, which remains accountable to the Council</strong></td>
<td>✓</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
</tr>
</tbody>
</table>

X = does not meet objective; ✓ = does meet objective

The recommended approach is a wholly owned company. The next section looks in detail at the controls that would be put in place to govern the operation of the Company.
4 Governance and Operation of the Company

4.1 Proposed Legal Company Structure

The proposal is to set up an arm’s length trading company of the Council, incorporated as a company limited by shares under the Companies Act 2006, and accountable to its single shareholder, Shepway District Council. The Council will be the only organisation allowed to hold shares.

The Company will be required to produce annual reports and a register of Directors’ interests and activities. The Council’s liability is limited to the value of its shareholding - initially £1.

The Company will be a ‘controlled company’, as defined in the Local Government and Housing Act 1989. A controlled company is defined under the Act as either:

1. a subsidiary company of a local authority;
2. a company where a local authority has the ability to control a majority of the votes at a shareholders’ meeting;
3. a company where a local authority can appoint or remove a majority of the directors; or
4. a company that is under the control of another controlled company.

The trading company will fall within category (1) above and as a result is subject to The Local Authorities (Companies) Order 1995. This Order sets out regulations that are specific to controlled companies and start from the basis that the public should be aware that the company they are dealing with is controlled by the local authority. As such all relevant corporate documentation will need to state that the company is controlled by the local authority.

4.2 Corporate Control Documents

There are three documents which form the legal and operational framework of the Company (the ‘Key Documents’). These are as follows:

1. The Articles of Association (the ‘Articles’) – this document establishes the legal constitution of the Company including its legal structure, the role and powers of Directors, the decision-making processes and the status and holding of shares;

2. The Shareholder’s Agreement – this document places limits and qualifications on the operation of the Company. It ensures that the Council can have confidence and legal reassurance that the Company will not act in a way which places the Council at risk. It covers some of the same issues as the Articles, but also sets out mechanisms for Council control and oversight; and
3. The Service Level Agreement – this document forms the legal contract for services provided by the Council to the Company to assist its day-to-day operation, which will include accountancy and auditing, legal services, office space, procurement, IT services and the secondment of staff to resource its operations.

Other important documents which will also determine the operation of the Company will be:

1. Code of Conduct for the Company’s Directors;
2. Scheme of delegations in the Shareholder’s Agreement – controlling levels of expenditure and approval decisions; and
3. Loan agreement between the Council and the Company relating to loan capital (whether from Council borrowing or reserves) provided by the Council to the Company.

Taken together the Key Documents set out how the Company will be established, governed and managed on a day-to-day basis.

4.3 The Company’s Objectives

The objectives of the Company are set out in Schedule 4 of the Shareholder’s Agreement. These objectives formalise the scope of the Company’s intended activities, and are stated as follows:

- To lead the co-ordination and brokerage of regeneration, economic and development activity;
- To acquire housing and property to make available housing for rent and sale on a range of tenures including (but not limited to) shared ownership, shared equity, market sale and rent, affordable rent;
- To lead site development activity including securing private investment interest where appropriate;
- Facilitating partnership development arrangements to bring forward housing and employment site opportunities across the district of Shepway, including where appropriate joint ventures with other organisations;
- To develop residential housing either for market rent or private sale or in partnership with a registered provider of social housing;
- To develop or hold commercial employment or industrial uses of land and buildings;
- To develop or carry out such infrastructure works as are required to deliver any development or project;
• To commission conversion, improvement works and any other professional services relating to the Business;

• To carry out such trading activities as are identified in the Business Plan, initially relating to grounds and parks maintenance; and

• To carry out such trading activities as the Council and the Company may agree from time to time.

4.4 Operating Geography

The primary focus of the Company’s activities will be the development of residential housing and commercial employment / industrial uses (B1/B2/B8 use classes). Residential acquisitions and uses will be focused in the district. Other opportunities if they emerge, for example town centre retail or leisure uses, might also be acceptable if the business case can be made.

In terms of operating geography, the target area for the Company’s activities has been set quite wide covering the local authorities of Kent and the Medway and neighbouring authorities, clearly with a focus on Shepway district for the housing acquisitions and development sites programmes.

4.5 Operational Structure & Staffing

4.5.1 Board of Directors

The Company will be led by a Board of Directors, and they will be responsible for the management of the Company’s business and for setting the overall direction and strategy of the Company – within the stated objectives; for preparing, reviewing and maintaining the company’s business plan and for reporting to the Council.

The Articles require that there must be a minimum of four Directors appointed to the Board, but the total number is not limited. Directors are to be appointed by the shareholder, Shepway District Council, which also reserves the right to remove any Director.

Directors can be appointed to three different categories:

1. Senior Director – must be an elected councilor from the ruling party, or the majority party in the event of a no-overall control Council;

2. Junior Director – either an elected councilor or an officer of the Council;

3. External Director – a Director from outside the Council appointed on the basis of their expertise from the private or community sectors. There cannot be more External Directors than the total number of Senior and Junior Directors.

In the first instance it is intended that all the Directors will be elected members.
4.5.2 Staffing & Resources

Initially the Company will be resourced by employees of Shepway District Council, operating on a part-time basis. Support has been offered from Ashford Borough Council’s legal team to assist with property conveyancing matters, and external procurement of services will also be considered if a value for money case is made.

Based upon the initial programme proposed for the Company, three roles will be required for the Housing Acquisition & Rental Programme: a Property Buyer / Negotiator; a Building Surveyor to oversee works completed; and on-going management of the portfolio. There are options regarding the procurement of this which include: East Kent Housing, SDC staff resource, or an external contract. Detailed work is in-hand to establish the most cost effective method of delivery.

Grounds Maintenance activities will be resourced from the existing team.

The day-to-day executive role will be headed by a senior officer of the Council with administrative support, with both roles provided on a part-time basis by the Council.

The Council will charge the Company for staff time and for the overheads for the Company’s accommodation within the Council’s office space. These costs will be invoiced to the Company on a quarterly basis.

Other central resource services such as HR, IT and telephony, monthly management accounting, legal, and procurement will also be provided by the Council as chargeable services. The conditions and details of the provision and charging of services from the Council to the Company will be detailed in the Service Level Agreement.

It is also anticipated that some services such as accounts auditing and some legal services will be commissioned externally by the Council or by the Company directly.

The Company will not have a dedicated Company Secretary, however the Company Secretary’s role, in terms of maintaining statutory registers and filing of accounts, will be undertaken by the Council’s Principal Solicitor.

4.6 Operational Procedures

4.6.1 The Business Plan

Full details of the role of the Business Plan are given in Section 6 of the Shareholder’s Agreement. The Agreement provides for the Company always to have a current Business Plan.

The Business Plan is the key guide to the specific activities of the Company. The Shareholder’s Agreement provides for the Company to maintain an up-to-
date Business Plan for each financial year, setting out what the Company aims to achieve and how it will do it.

The intention is that the Plan will detail the projects for the forthcoming year, funding sources, resource allocations, and projected capital and expenditure budgets. The Business Plan will be prepared, reviewed, and up-dated by the Board of the Company and will be approved by the Cabinet of the Council.

If planned expenditure is set out within the Business Plan, and approved by both the Company and the Council, then it is not envisaged that the Company will need to come back to the Council to approve individual items of expenditure. A scheme of financial delegation contained within the Shareholder’s Agreement will guide this.

The Plan will provide the key document against which the Company will report progress, and the Board will be required to submit its up-dated Business Plan three months before the end of the current Business Plan period to align with Council processes. The Business Plan will be subject to normal scrutiny processes of the Council through quarterly reporting to Cabinet.

4.6.2 Operation & Decision-making of the Board

Full details of the operation and decision-making processes of the Board are outlined in the Articles.

Most decisions about the operation of the Company will be made by the Board of Directors, all of whom will be Council Members in the first instance. Board meetings will be held at least quarterly, but during the early establishment period, likely to be monthly or as deemed appropriate by the Directors.

The quorum for Board meetings – the minimum number of participants to make binding decisions – will be a minimum of two Senior Directors and at least one other Senior or Junior Director. An External Director does not count towards a quorum. Decisions must be approved by a majority of the Directors in attendance. The Chair of the Board of Directors is appointed by the Council from the Senior Directors and will hold the casting vote.

The Council will be represented at Board meetings by a Shareholder Representative. The lead officer will also attend Board meetings to report on progress and take instructions from the Board.

4.6.3 Decision-making at a General Meeting of the Company

The Key Documents and the law reserve for the requirement for some decisions only to be taken at a general meeting of the Company by the Council as shareholder. These are changes to the Articles, changing the name of the Company, issuing any additional shares or carrying out any new trading activity. The Leader, or someone appointed by the Leader, will attend general meetings as the Council’s Representative where necessary.
4.7 Operating principles – balancing Council oversight and control and Company decision-making

The Key Documents set out a number of principles which aim to define the boundaries between Company decision-making and Council oversight, control and accountability.

The intention is that the Cabinet will set the strategic direction for the Company, and approve its business plan. Any proposals to enter into joint venture agreements or subsidiary ventures will be considered as Material Matters and will have to go back to Cabinet for approval. The Company Board will be responsible for delivering against the Business Plan.

4.7.1 Arm’s Length Operation within the Framework of the Business Plan

Full details of the management of the company are outlined in Section 8 of the Shareholder’s Agreement. The Business Plan must be approved by the Cabinet of the Council. This will ensure that there will be accountability for the Company’s operating framework, and that it is the Council that sets the strategic direction of the Company. Following approval of the Business Plan, the Board and Company staff can take all operational decisions on projects contained in the Plan. Legally, the Company can conduct its business at arm’s length from the Council as long as it stays within the terms of the Key Documents and its activities are in line with the stated Objectives, and within the terms of a set of Material Matters set out within the Shareholder’s Agreement.

4.7.2 Council Oversight of Decisions on Material Matters

The Shareholder’s Agreement includes a check on the authority of the Company to do anything contained within the Business Plan, but subject to a set of ‘material matters’ requiring Council approval.

The full list of these ‘Material Matters’ is outlined in Schedule 3 of the Shareholder Agreement, and includes:

- Making any amendments or variations to the Key Documents;
- The appointment, removal and remuneration of Directors;
- The appointment or removal of auditors;
- Decisions relating to financial borrowing, loans and grant funding agreements;
- Before making an appeal against a local planning authority;
- Before forming a subsidiary or acquiring any interest in another company or partnership;
• Before changing Company registrations, accounting and auditing arrangements;
• The issue of any shares in the Company; and
• Before taking any step which may result in the winding up of the Company.

Decisions on the approval of Material Matters must be confirmed either in writing by the Leader of the Council or by resolution of the Cabinet. These will also be subject to normal Council scrutiny processes.

4.7.3 Council Oversight of Operational Decisions Outside the Business Plan

If the Company wants to undertake a large project which is in line with the stated Objectives, but is not in the current Business Plan, then it will need to seek approval from the Council. The Key Documents require that for all projects like this, with a cumulative annual value of more than £25,000, the Company will need to submit a business case for assessment and decision by the Cabinet.

4.7.4 Monitoring & Reporting

The Key Documents set out the responsibilities of the Company to keep the Council informed of its operations, project activities and progress towards its Objectives.

The intention is that the Company will prepare a quarterly report to the Cabinet of the Council to update on progress against the Business Plan. The Cabinet can also require a Director to attend any meeting of the Cabinet to provide an update.

The Company will also report annually to Full Council. Reporting will be subject to the normal Council scrutiny processes.

4.8 Operating Principles – Financial & Statutory

4.8.1 Capital Raising Powers

**Loan capital** - it is intended that Shepway District Council will provide financing to the Company in the form of loan and equity either from the Council’s reserves or raised by the Council through prudential borrowing, in order to finance its programmes of activity. Loan capital will be made available to finance both operational activities and costs but also project capital as and when needed to finance the Company’s programmes of activity;

It is intended that loan capital will be made available to the Company on commercial terms in accordance with State aid compliance principles;

**Grant capital** – although it is not anticipated that in the first instance the Company will borrow from external sources, the Company would be able to
receive grant funding for example from Regional Growth Fund; Local Growth Funding; and possibly from Europe to resource its programmes of activity; and

**Share issue** – the Company can issue different types of share for purchase by the Council, for example as an alternative to loans as a means of raising finance. This will however require Council approval as a Material Matter.

### 4.8.2 Dividends

The Council, as the sole shareholder of the Company, retains the option of declaring dividends.

### 4.8.3 Statutory Obligations

The Company is subject to the provisions of the Freedom of Information Act and the Environmental Information Regulations. The Council may be obliged – and has the right – to disclose information about the Company under its statutory obligations, without consulting the Board.

Both the Council and the Company are subject to the provisions of the Data Protection Act and have a mutual responsibility to fulfil any data protection obligations which arise as a result of the agreement between the two.

The Company is a ‘Controlled Company’ for the purposes of the Local Government and Housing Act 1989 and must comply with the regulations that accompany that Act.

The Company will also be subject to EU procurement rules and processes.

### 4.8.4 Disclosure

The Company will be required to publish the minutes of any general (i.e. shareholders) meeting for 4 years from the date of the meeting. There is no current obligation to make the board meetings public, or any publication requirements for expenditure. Matters relating to disclosure will be kept under review and the Company will respond as necessary.
5 Key Financial Operating Principles

5.1 Options for the company's operational and investment funding

5.1.1 Mechanism for drawing down funding from SDC

There are different sources available to SDC for providing both investment and operational funding to the Company. These are:

1. **Internal borrowing from SDC’s operational cashflow surpluses.** The Council’s current financial capacity indicates that up to £2m could be provided to the Company via this mechanism;

2. **Draw-down funding from SDC’s financial reserves.** Capital reserves of £2m are ring-fenced for economic development purposes, and up to £290,000 from business rates reserves; and

3. **Use of ring fenced capital receipts for regeneration and affordable housing options in East Folkestone.** The HRA has ring fenced capital receipts which are currently unallocated of £320,000. This funding can be used for regeneration and affordable housing options in East Folkestone and could be used for the LHA element of housing acquisition programme; and

4. **Prudential borrowing from the Public Works Loan Board (PWLB).** Subject to approvals being secured from Cabinet at the start of each year, the Council can organise draw-downs for the Company via a decision of the Council’s Chief Financial Officer. Key advantages are as follows:

   - Draw-downs can be organised to match closely the cashflow requirements of the Company;
   - Usually very quick turnarounds are possible from request to receipt of funds (within 2 days), enabling draw-down to be matched accurately to the Company’s capital needs.
   - SDC’s internal process would involve preparation of a revised Council Treasury Management Strategy to accommodate the Company. In order to meet the CIPFA Prudential Code for Capital and Code of Practice on Treasury Management, the Council is required to have regard to the following matters when arriving at its decisions:
     i. affordability – e.g. implications for Council Tax and housing rents,
     ii. prudence and sustainability – e.g. implications for external borrowing,
     iii. value for money – e.g. options appraisal,
     iv. stewardship of assets – e.g. asset management planning
     v. service objectives, and
     vi. practicality – e.g. achievability of the medium term financial plan
If a decision is made to use borrowing then this would need to be reflected in the Treasury Management Strategy of the Council.

5.1.2 **Ability to Receive Funds from External Sources**

A key advantage of the Company is that it will have the ability to apply for, receive, and administer funds (either grant or loan) from other public sector sources for delivery of the Company’s objectives.

Key funding sources for example might include EKDSC, Single Local Growth Fund or Growing Places funding or European funding from the South East Local Enterprise Partnership or further rounds of Regional Growth Fund direct from Government.

5.1.3 **Minimum Revenue Provision (MRP) Considerations**

MRP is a statutory minimum annual charge made to the General Fund (GF) for Non-HRA capital expenditure financed from prudential borrowing. The purpose of the MRP charge is to ensure that the GF and, ultimately, the local taxpayer meet the full cost of financing the borrowing incurred. Ordinarily, this would be achieved through the depreciation charge, however in local authority accounts, regulations require GF depreciation to be reversed out so that it is not a charge to local taxpayers.

MRP is a key consideration for determining if borrowing to finance capital expenditure is prudent, sustainable and affordable.

The value of the MRP is based on the asset life of the capital expenditure incurred and financed from borrowing. So, for instance, if SDC used borrowing to finance a new car park costing £1m with an estimated asset life of 20 years the MRP charge would be:

- £1m / 20 years = £50,000 pa

Where the council uses external borrowing to finance a loan to a third party for qualifying capital expenditure purposes, the recommended approach by CIPFA for the MRP calculation is to use the annuity method (the same basis as a traditional mortgage). The annuity period used will be based on the length of the loan made by the council to the third party. This means the MRP charge to the GF will increase each year over the life of the loan (the same as the principal element of a mortgage).

Current regulations allow for voluntary additional MRP sums to be charged to the GF if it is seen in the best interests of the council to do so.

MRP is only of relevance with regards to prudential borrowing. Therefore any loan finance provided to the Company from the Council’s Reserves will not need to incur the MRP charge.
5.2 Company start-up and operating costs – key principles

5.2.1 Start-up Costs

As with the incorporation of any company, there will be a series of start-up costs, around which the Council will need to decide whether it re-charges to the Company or is borne by the Council. These, for example, include business case and business planning consultancy support; legal support provided by Ashford Borough Council; senior officer time, and the costs of incorporation.

Assuming that the costs associated with preparation of the Business Case and legal governance, and senior officer time is borne by the Council as part of its economic development function, the start-up costs themselves for the Company are considered to be relatively minor, and have been assessed as follows:

<table>
<thead>
<tr>
<th>NEWCO START-UP COSTS</th>
<th>Yr 1</th>
<th>Yr 2</th>
<th>Yr 3</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>START UP COSTS</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Incorporation costs</td>
<td>1,200</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Branding, stationery</td>
<td>600</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounting system purchase</td>
<td>900</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounting system initial training</td>
<td>1,800</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ongoing Accounting Systems</td>
<td>480</td>
<td>480</td>
<td>480</td>
</tr>
<tr>
<td><strong>Sub-Total Start-up costs</strong></td>
<td><strong>£4,980</strong></td>
<td><strong>£480</strong></td>
<td><strong>£480</strong></td>
</tr>
</tbody>
</table>

Please note figures above are inclusive of VAT.

5.2.2 Recharging for Overheads & Staff Resourcing

The Service Level Agreement between the Council and the Company provides for the Council to assist the day-to-day operation of the Company by making available:

- Staff resources – the assignment of Council appointed staff to resource the Company’s programmes of activities, senior management time and any administrative support provided;
- Accounting, legal, procurement and internal audit services;
- Communications / PR / Media relations;
- Accommodation and premises;
- ICT systems and telephony; and
- Appropriate insurances, including public liability insurance and indemnity insurance for the Company directors.
The Council will invoice the Company quarterly for these services on a 100% cost recovery basis. Consideration will be given to deferred payment to allow the company to get established.

### 5.2.3 Working capital requirement

See also section 5.4.

The Council will need to give its approval to the principle that the Council will make available funds for covering the operating costs of the Company. The financial modelling undertaken to date suggests that resourcing and facilities costs will run at c. £76,000 - £90,000 p.a (depending on how staff resourcing costs for Activity 1 – property buyer and building surveyor) are accounted for. The table below includes an analysis of the initial assessment of operating costs which will be kept under review by the Board (excluding Activity 1 and 4 as note).

#### NEWCO OPERATING COSTS

<table>
<thead>
<tr>
<th></th>
<th>Yr 1 2014/15 6 months</th>
<th>Yr 2 2015/16</th>
<th>Yr 3 2016/17</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chairman's remuneration</td>
<td>1,978</td>
<td>4,055</td>
<td>4,156</td>
</tr>
<tr>
<td>Other Director's remuneration</td>
<td>2,082</td>
<td>4,268</td>
<td>4,375</td>
</tr>
<tr>
<td>Insurance</td>
<td>1,000</td>
<td>2,050</td>
<td>2,101</td>
</tr>
<tr>
<td>SDC Lead Officer time recharge</td>
<td>14,400</td>
<td>29,520</td>
<td>30,258</td>
</tr>
<tr>
<td>Activity 1: Professional Support East Kent Housing</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Activity 4: Grounds Maintenance</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Admin Staffing - including Board admin (time recharge)</td>
<td>936</td>
<td>1,919</td>
<td>1,967</td>
</tr>
<tr>
<td>Facilities Costs (premises, IT access, telephone)</td>
<td>600</td>
<td>1,230</td>
<td>1,261</td>
</tr>
<tr>
<td>Provision of ICT Support (SLA with SDC)</td>
<td>1,080</td>
<td>2,214</td>
<td>2,269</td>
</tr>
<tr>
<td>Accounting Support (SLA with SDC)</td>
<td>3,750</td>
<td>7,688</td>
<td>7,880</td>
</tr>
<tr>
<td>Legal Support (possibly external)</td>
<td>2,100</td>
<td>4,305</td>
<td>4,413</td>
</tr>
<tr>
<td>Internal Audit</td>
<td>4,200</td>
<td>2,153</td>
<td>2,206</td>
</tr>
<tr>
<td>Board expenses</td>
<td>900</td>
<td>1,845</td>
<td>1,891</td>
</tr>
<tr>
<td>External Audit</td>
<td>-</td>
<td>2,460</td>
<td>2,522</td>
</tr>
<tr>
<td>Annual accounts - property stock valuation</td>
<td>-</td>
<td>615</td>
<td>1,261</td>
</tr>
<tr>
<td>General contingency</td>
<td>6,000</td>
<td>12,300</td>
<td>12,608</td>
</tr>
<tr>
<td><strong>Sub-Total Newco Operating costs</strong></td>
<td><strong>£39,026</strong></td>
<td><strong>£76,621</strong></td>
<td><strong>£79,167</strong></td>
</tr>
</tbody>
</table>

Note: Costs for Activities 1 and 4 allowed for elsewhere within activity financial modelling. Activity 1: Year 1 £12,000, Year 2 £24,600

Note: Year 3 included as approval sought for working capital to support the first 30 months of the Company’s operation. This will be reviewed in line with business plan needs.

Assuming that approval is given to set up the Company, the proposal is that:

- Internal borrowing is used to provide a loan of up to £300,000 to support the Company’s first 30 months of operation; reserves, capital receipts and income to the council from the company can be utilised to provide the initial
funding for the Housing Acquisitions & Rental Programme, drawn down as is needed.

Section 6 explores the financing options for the Company in more detail, illustrating the impact of utilising different combinations of equity and borrowing for the Housing Acquisitions & Rental Programme.

5.3 Council Security over the Company's Assets

Given that the Company's investment funding will be provided by the Council in either the form of loan or equity finance, the Council will take security over the assets acquired. This could take the form of a first charge over each and every property acquired or a debenture over all the Company’s assets.

5.4 Demonstrating Solvency

In order for the company to be considered as a going concern and to be able to operate and pay suppliers, it needs to ensure that it can demonstrate solvency. The company business model has a substantial front loading of expenditure in the period when the company is establishing itself and the early years.

Based on the current level of activity of buying 15 units and managing them for 50 years, the company will not be able to support the suggested level of overheads. The company will be highly leveraged with loan funding levels of 90% or 100% and will require working capital funding of between £72,000 and £101,000 from the Council from year 3. It is recommended that going forward the company consider increasing the number of rental properties which should reduce the working capital required and increase the probability of the company breaking even. It is acknowledged that the company will need to carry out additional activity in the medium and longer term and that the 15 units is initial activity whilst the company establishes itself.

In order for the company to be able to demonstrate solvency going forward, the council will need to provide a formal commitment or guarantee to fund any cash shortfall in the Company each year, by way of a working capital facility. It is proposed that the Council make this available but with an annual review as part of the annual approval of the financial business plan and for an initial 5 year period. There will be a funding agreement in place and the company will pay the council at a rate of 1% above Bank of England base rate to ensure the council complies with state aid requirements.

5.5 Taxation issues

5.5.1 Non-recoverable VAT

The Company will incur VAT on the cost of any services procured from third parties (including the Council) and based on the initial housing acquisition activity of the company, the VAT will be non-recoverable. The provision of rental housing is an exempt supply.
If the company in the future builds new housing for outright sale including shared ownership properties, any VAT on costs related to such sales should be recoverable in full as the sale of new housing is zero rated.

If the company generates a mixture of taxable and exempt income, the company will be partially exempt and will have to carry out a partial exemption calculation to determine the recoverable percentage of overhead VAT.

5.5.2 Corporation Tax

External advice has been commissioned to conduct a high level corporate tax review for the proposed subsidiary company. The final business plan will cover the corporation tax issues in more detail.

The council is not liable to corporation tax however a subsidiary company outside the council is liable to corporation tax. The income from the property rental business and grounds maintenance will be taxed under corporation tax and certain deductions will be allowable. Corporation tax will also be due on any profits/gains on future sales of housing units.

The Company is likely to be liable to corporation tax at a rate of 21% on tax adjusted profits.

If the Council is to invest through equity distributions made by the company, this would not be deductible for corporation tax purposes however funding through loans would allow the company to deduct interest payments from their profits. If loans are below market rates, this may be subject to transfer pricing rules and further advice would need to be sought on this.

Equity distribution or interest paid to the council would not be taxable income to the council as the council is exempt from corporation tax.

If the company is to look to purchase, develop and sell properties or enter into joint venture structures in the future, further tax advice would need to be sought.

5.5.3 Transfer Pricing

The Council commissioned external advice on high level transfer pricing issues considerations for the company. The UK’s Transfer Pricing legislation applies to ensure that transactions between connected entities are carried out on commercial terms and on the same terms as would be available to a third party. This is based on the OECD (The Organisation for Economic Co-Operation and Development) guidelines and the arm’s length principle. HMRC will enforce these regulations based on whether a group exceeds the small and medium enterprise thresholds. Although the Company may not exceed these thresholds currently it is likely to in the future. The transfer pricing is strongly supportive of the State aid position. From a State aid perspective it is important to consider transfer pricing from a very early stage of the work.
The Council has modelled financing the company with between 90% and 100% debt finance. Few if any commercial businesses would be 100% debt financed and if a business is deemed to be financed by excessive debt from related parties then HMRC are likely to treat some of the debt as equity for tax purposes. This means that not all of the interest paid by the company would be tax deductible. From a transfer pricing perspective, a mix of debt and equity is preferred and the external advice recommends a loan to cost ratio of up to 70%.

The Council’s preferred approach however is to finance the Company with 90% debt finance in line with the Bevan Brittan advice on State aid and use of equity and to minimise the Council’s risk exposure. The implication for the Company is that the interest deduction on the difference between 70% and 90%, i.e. 20% of the debt finance is likely to be disallowed as a tax deductible expense by HMRC. The Company will be highly leveraged at 90% loan funding and obtaining finance in the future from a bank or private institution might be very expensive or difficult. The Council and the company will consider this when looking at future activity for the Company and consider how best it is financed.

There is also a commercial view that property companies are usually funded with debt finance separated into 2 loans, senior debt and subordinated debt on a ratio of 3:1. The market rate for subordinate debt is usually a higher rate than the senior debt to take into account risk. The Council’s preferred approach for the initial activity of acquiring up to 15 properties is to provide 90% debt finance at 4% for properties rented at Local Housing Allowance rent levels and 4.88% for properties rented at market rent levels. It is recognised that as activity increases the Council will need to consider whether it funds the company with separate loans for senior debt and subordinated debt.

It is essential that to maintain flexibility in the future for both the Council and the Company, the terms of the development funding between the Council and the Company should end after the initial development stage of 15 properties. A review of the appropriate funding package will be made in light of subsequent planned activities.

5.5.4 **Stamp duty land tax**

Stamp duty land tax is charged on all purchases of houses, flats and other land and buildings in the UK. The rate charged depends on the value of the purchase and whether it is a residential property or non-residential and mixed use properties. A residential property purchased below £125,000 is 0%, and a residential property between £125,000 and £250,000 is 1%.

5.6 **Directors’ Remuneration**

As a controlled company, the Company will need to comply with the following regulations:
• Not to pay to a Director any remuneration in excess of the maximum amount that could be paid for carrying out a comparable duty on behalf of the authority, less any amount already paid by the authority to that director.

• It is therefore proposed that the Company’s Directors will be remunerated at a level comparable to SDC’s Special Responsibility Allowance with the position of Chairman for example, carrying responsibilities equivalent to the position of Chair of a major committee (at £3,956), with other Directors carrying responsibilities equivalent to the position of Chair of a Minor Committee (at £1,388);

• If any of the Directors act as chairman on a major or minor committee, only one Special Responsibility Allowance will be paid;

• In terms of expenses, the Company must not pay more to a Director than would be payable by the Council;

• The Company will be required to provide any information that the local authority’s auditors require in relation to the accounts and affairs of the Company; and

• The Company will be obligated to provide information about the affairs of the Company to any Member of the local authority as they shall reasonably require for the proper discharge of their duty as a Member.

Board Directors will be remunerated directly by the Company.

5.7 State Aid Compliance

SDC has commissioned state aid advice for the setting up of the Company and its financing from Bevan Brittan. Bevan Brittan highlight that care is needed as any benefit granted by SDC to the Company - whether direct grant funding, discounted or free use of assets or equipment, advantageous loan terms or even indirect benefits, may potentially be caught as State Aid.

They flag however the four areas in which what may appear to be aid will actually fall outside the definition of aid – these being: 1) the Market investor principle; 2) No impact on competition; 3) No impact on trade between member states or within the de minimis rules; and 4) Payment for services. They also highlight the approved exemptions from aid: 1) the de minimis regulations; 2) the General Block Exemption Rules (GBER); 3) the Services of General Economic Interest Package (SGEI).

The easiest way for the Company to comply with the State Aid rules will be the market investor principle – benchmarking the aid against a private investor – i.e. if a loan is provided, by demonstrating that it has been provided at a market rate in terms of anticipated return on capital, charges for use of land or property. If staff or use of equipment or assets are provided by SDC, then these should be charged for at a market rate.
Bevan Brittan also highlight that the exemption relating to the public service obligations of General Economic Interest, and in this case, provision by the Company of Social Housing. However, more detail on the definition of Social Housing and analysis is needed to ensure that SDC’s objectives for the Company stay within the terms of the exemption. As the Company’s activities are wider than Social Housing, the Council would need to ensure that the benefit to the Company of any SGEI aid is ring-fenced for the social housing purpose only, and it must not cross-subsidise wider commercial activities.

Bevan Brittan’s advice is that for loan funding provided for commercial activities, then SDC should rely on the market investor principle. SDC can make use of the Commission’s Reference rate methodology, currently 0.88% for the UK, and adding a loan margin for the level of security and the financial strength of the company. Bevan Brittan highlight that the guidance rate for new companies is a 4% margin, suggesting an overall loan rate of 4.88%. This can be benchmarked against actual comparator data available in the market at the time. However this interest level is considered too onerous considering the Company is a wholly owned local authority controlled company. Further financial modelling is being undertaken.

Bevan Brittan’s advice is a debenture over all assets is appropriate security cover for the loan.

**Equity**

With regards to possible equity investment in the Company, Bevan Brittan’s advice is that this could also be done on the basis of the market investor principle, although they highlight that the likely rate of return on the equity may be more difficult to judge. They do highlight however that the return on this basis need not necessarily be immediate, and they recommend independent advice on the market equivalence of any equity investment as a sensible step for the Council to demonstrate that it has considered this.

**De Minimis**

The de minimis rules should also be considered as a potential mechanism, depending upon the level of loan or equity provided to the company. The aid will be on the financial benefit of any foregone interest not borne by the company. Therefore, for example, if SDC lent the Company £1m at 2.88%, arguably there would be State aid on the 2% forgone below the 4.88%. On a £1m loan this would be equivalent to aid of £20,000, over 3 years, £60,000.

Arguably therefore, SDC could lend the Company up to £2.5m at a preferential rate of 2.88% and the aid would still fall within the terms of the de minimis regulations (200,000 euros over three years).

Overall, Bevan Brittan’s advice is that there are a number of options available to SDC to demonstrate that finance provided to the Company is State Aid compliant. They also highlight that a number of approaches can be demonstrated and compliance does not necessarily have to rely on a single approach.
External accountancy advice\(^8\) has considered the rates of 2.88% and 4.8% and concluded that it is unlikely that a UK tax advantage exists that could be challenged by HMRC.

As noted at section 5.6.3, the Council has considered its position and concluded that from the Council’s perspective loan finance will be provided at 4% to fund properties acquired and let at affordable Local Housing Allowance rates, and 4.88% to fund properties to be let at market rental levels.

### 5.8 Management Accounting

The Board of the Company will in effect have the choice on whether the Council’s finance team provides a management accounting service for the Company via Service Level Agreement or whether this is externally sourced.

For the purpose of the Business Case, the assumption is made that this service will be internally provided and if so, there will be a segregation of duties issue, i.e. two posts will be needed – the first assigned and owing a duty of care to the company; the second post, acting on behalf of the Council monitoring the Council’s financial interest in the Company’s activities.

SDC’s finance team have confirmed that they will be able to make available the Council’s E-Financials management accounting system to the Company, enabling the Company’s accounting records to be kept totally separate from the Council. The company may however choose to procure its own system in due course such as Sage.

### 5.9 Internal & External Auditing

In principle, the Business Case assumes that the Company Board will appoint its own external auditor for preparation of the Company’s annual accounts and to report on the financial protocols and operation of the Company. This auditor will need to be different from the Council’s auditor (Grant Thornton).

As a controlled company, the Company will need to obtain the consent of the Audit Commission to the appointment of their auditors.

Also recommended within the first year of operation the company should consider the use of the Council’s internal auditors to monitor the Company’s systems and to check that internal structures, processes and procurement arrangements are correct and complying with agreed approval levels.

### 5.10 Scheme of Delegation & Financial Thresholds

Board decisions will need to be taken in a timely manner to pursue property purchases. The financial delegation thresholds are included as per the Shareholder’s Agreement with financial delegations for works, supplies and services aligned with existing SDC thresholds:

---

\(^8\) KPMG, 2014
Works, Services & Supplies:

<table>
<thead>
<tr>
<th>Total Value</th>
<th>Type of Contract</th>
<th>Procedure</th>
</tr>
</thead>
<tbody>
<tr>
<td>£1,000 to £9,999</td>
<td>Works, supplies and services</td>
<td>At least one quote to be obtained in advance</td>
</tr>
<tr>
<td>£10,000 to £74,999</td>
<td>Works, supplies and services</td>
<td>At least three quotes to be obtained in advance</td>
</tr>
<tr>
<td>£75,000 to relevant EU published threshold</td>
<td>Works, supplies and services</td>
<td>At least three written tenders in advance following advertisement by public notice. All contracts of £75,000 or more are considered to be strategic procurement and legal advice must be sought in advance of any procurement process beginning.</td>
</tr>
<tr>
<td>Exceeding the relevant EU published threshold</td>
<td>Works, supplies and services</td>
<td>EU rules apply.</td>
</tr>
</tbody>
</table>

Property Acquisitions:

<table>
<thead>
<tr>
<th>Total Value</th>
<th>Type of Contract</th>
<th>Procedure</th>
</tr>
</thead>
<tbody>
<tr>
<td>£0 to £150,000</td>
<td>Purchase of property</td>
<td>Officer decision in consultation with a senior director, subsequent notification of the purchase to the Board</td>
</tr>
<tr>
<td>£150,001 to £250,000</td>
<td>Purchase of property</td>
<td>Officer recommendation with sign-off by two senior directors, subsequent notification of the purchase to the Board</td>
</tr>
<tr>
<td>£250,000 and over</td>
<td>Purchase of property</td>
<td>Board decision.</td>
</tr>
</tbody>
</table>

Note: ‘Officer’ of the Council is seconded to work for the company via the SLA, they then effectively have the powers and delegations given to them through the company’s governing documents, including the Shareholder’s Agreement. This should then be sufficient to enable an officer acting on behalf of the Company to agree to purchase a property in accordance with the above table.
6 Financing Options & Proposals

6.1 Focus for the Indicative Business Plan
An indicative Business Plan is appended, focusing on the first 18 months activity through to the end of March 2016.

The focus will be on an initial programme of housing acquisition and rental, with the target of up to 15 properties to be identified, acquired, converted and let during this period. The Business Plan will set out the detailed financial projections for this initial phase of activity. Financial modelling has drawn upon the well tested model and robust assumptions developed and already familiar to the Council through its HRA programme.

This period will also provide the Board with the opportunity to shape the development of its own medium term strategy and corresponding business plan to take the company through the next 2-3 year phase of its development, setting targets for the expansion of its housing acquisition programme, and the widening of the Company’s activities to explore new build residential partnership opportunities with the private sector and an initial programme of commercial direct development.

6.2 Capital Requirement for an Initial Programme
At an assumed capital cost of £150,000 per property for acquisition and conversion works, total investment capital for this initial 18 month period covering 15 properties is estimated at £2.2875m.

6.3 Financing Options
The business case has considered three options, and a number of variations around them for financing the Company’s capital investment needs for the proposed first eighteen months of the Housing Acquisitions & Rental programme. External accountancy advice to the Council is noted where appropriate.

These three principal options are as follows:

- **Option 1: 100% shareholder equity**, provided from SDC’s capital reserves.
  
  - The external advice is that although from a transfer pricing perspective this option would not raise any issues, they do note that it is unusual for commercial property companies to be funded with 100% shareholder equity.

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9 KPMG, 2014
Option 2: 100% loan finance, two sub-options have been considered:

- Option 2a: SDC loan to the Company, provided from SDC’s capital reserves;
- Option 2b: SDC loan to the Company, with capital provided via SDC prudential borrowing.
- The external advice is that although some businesses may be highly leveraged few, if any, commercial businesses would be 100% debt financed, as lenders would typically expect a business to have some equity capital to provide a cushion for unexpected risks. They go further and outline that if a business is considered to be excessively financed from debt, HMRC is likely to re-characterise some of the debt as equity for tax purposes meaning that not all of the interest would be tax deductible.

Option 3: Mix of loan and shareholder equity finance from SDC capital reserves

- Option 3a: 90:10 loan : equity
- The external advice is that a mix of debt and equity is the preferred option from a transfer pricing perspective and the most consistent with the arm’s length principle.
- This advice also includes a recommendation that 70:30 debt equity split is likely to be considered appropriate from an HMRC perspective. The Council has considered this, but its preference now is for a 90:10 loan: equity as this is advantageous from the Council’s perspective, and the Company will simply need to make an adjustment within its accounts accepting that 20% of the interest paid to the Council will not be tax deductible.

Tabulated pros and cons analysis for each of the options, prepared from both the perspective of the Council and the Company are provided as follows:
### 6.3.1 Option 1: 100% shareholder equity

**Option 1 – 100% equity**
SDC purchases a share in the Company for £2.5m.

<table>
<thead>
<tr>
<th><strong>Pros for the Council</strong></th>
<th><strong>Cons for the Council</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>If the Council funds the loan from its own reserves then no MRP provision needs to be made.</td>
<td>Return on investment may be deferred if Company is unable to pay a dividend on the share.</td>
</tr>
<tr>
<td></td>
<td>The Council will only be paid dividends on the investment to the extent there are distributable reserves.</td>
</tr>
<tr>
<td></td>
<td>Tax inefficiencies as to get a return out of the Company it would be paid as a dividend which is taxed at source.</td>
</tr>
<tr>
<td></td>
<td>No security/mortgages over the properties. The Council would need to sell the company or wind up the Company to recover any of its investment and on a winding up, would only recover the full amount of the investment if there was sufficient funds remaining in the Company after all other creditors had been paid.</td>
</tr>
<tr>
<td></td>
<td>Potential issue if Council wanted a third party to invest in the Company as the Company would already have £2.5m of issued shares.</td>
</tr>
<tr>
<td></td>
<td>Market testing will be needed to ensure this investment is the best value for money</td>
</tr>
<tr>
<td></td>
<td>If the company has solvency issues then the shareholders have very little negotiating power with creditors and on an insolvency the shareholders only receive their investment once all other creditors and costs have been paid.</td>
</tr>
<tr>
<td></td>
<td>More complex valuation issues for state aid</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Pros for the Company</strong></th>
<th><strong>Cons for the Company</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial investment with less onerous repayment terms.</td>
<td>It will take longer to build up a payment history than if take on borrowing.</td>
</tr>
<tr>
<td>Improves the Loan to Value (LTV) ratio of the Company, which means the Company could get better rates on external funding (although the benefits of this may be limited as external funders may not take it into account).</td>
<td></td>
</tr>
<tr>
<td>Can defer dividend payments so would retain cash in the Company.</td>
<td></td>
</tr>
<tr>
<td>Flexibility – not tied into long term loan.</td>
<td></td>
</tr>
<tr>
<td>Not exposed to refinancing risk.</td>
<td></td>
</tr>
</tbody>
</table>
### 6.3.2 Option 2: 100% loan finance

**Option 2 – 100% loan**

SDC lends up to £2.5m to the Company to be secured on the properties that the Company then purchases.

SDC can fund that £2.5m either from reserves or from its own borrowings or a combination of the two.

<table>
<thead>
<tr>
<th>Pros for the Council</th>
<th>Cons for the Council</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan agreement would set out terms of repayment.</td>
<td>If the loan is funded by the Council borrowing money from a third party (eg PWLB) it may need to make a MRP provision (but loan repayment could match MRP).</td>
</tr>
<tr>
<td>Regular repayments made by the Company with a set interest rate means a regular income for the Council.</td>
<td>Market testing will need to be done to ensure that the interest rate that is charged to the Company on the loan is commercial and state aid compliant.</td>
</tr>
<tr>
<td>If the Council funds the loan from its own reserves, then no MRP provision and all of the repayments from the Company are income (this could be more than the reserves are earning in interest).</td>
<td></td>
</tr>
<tr>
<td>If the Company was unable to make the repayments, the Council could exercise its rights as mortgagee of the properties and sell them to recover its investment.</td>
<td></td>
</tr>
<tr>
<td>Tax efficient as interest payments and MRP are not subject to corporation tax.</td>
<td></td>
</tr>
<tr>
<td>If at a later stage a third party provides finance to the company, the new funder may want the council security and payments subordinated but as a lender it is likely that an intercreditor deed will be needed that will give the council some rights to agree on a course of action in the event that the new funder wants to enforce its security. Such rights would not exist if the council put in all their money by way of equity.</td>
<td></td>
</tr>
<tr>
<td>Simpler valuation issues for state aid purposes</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Pros for the Company</th>
<th>Cons for the Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regular repayments makes business planning easier.</td>
<td>The interest rate charged on the loan cannot be favourable compared to what is available in the market.</td>
</tr>
<tr>
<td>Loan is secured on the assets so if the Company gets into difficulty it can sell an asset to make the repayments. However, there may be timing issues if assets are not easily realisable.</td>
<td>High LTV ratio which would increase the cost of external funding in the future.</td>
</tr>
<tr>
<td></td>
<td>Transfer pricing regulations likely to mean that a proportion of the interest paid (on 100% loan finance, potentially as much as 30%) likely not to be accepted by HMRC as tax deductible, and therefore this will need to be acknowledged in</td>
</tr>
</tbody>
</table>
6.3.3 **Option 3: combination of loan and equity**

| **Option 3 – Combination of loan and equity** |  
| SDC could decide to invest some cash in the Company by way of a share purchase and loan the Company the balance. All of the Pros and Cons listed for Options 1 and 2 above will apply to the equity and loan elements of a combination funding arrangement. |  
| **Pros for the Council** | **Cons for the Council** |  
| Spreads the risk. | Still have to decide how to fund the loan element and what interest rate would be charged. |  
| | Some money would still be tied up in the Company without a clear method of releasing it. |  
| **Pros for the Company** | **Cons for the Company** |  
| LTV is balanced. | LTV would be higher than if the Company was fully funded by equity. |  
| Lower debt costs. | Adjustment likely to be needed within the Company’s accounts for a proportion (between 20%-30%) of the interest paid to the Council being non-tax deductible due to UK Transfer pricing legislation, depending upon the final mix of debt and equity agreed. |  

6.4 **Preferred financing approach**

The company will need both investment finance for the housing acquisitions programme and initial working capital to cover operational costs.

Having considered the above pros and cons, the proposal being recommended for financing the initial 18 month programme is option 3, a combination of loan and equity from the Council’s reserves. Having also taken legal advice from Bevan Brittan, the proposal is that no more than 10% would be provided as shareholder equity, and the remainder as loan finance to the Company, although the Council acknowledges that external accountancy advice has highlighted that not all the interest paid (on a 90:10 loan:equity split, potentially 20%) is likely to be considered tax deductible under the UK’s Transfer pricing legislation. This can however simply be reflected in the preparation of the Company’s accounts, or adjusted if challenged by the HMRC.

The recommendation for this initial financing from SDC’s capital reserves rather than prudential borrowing, is made on the basis that this will provide greater flexibility for the Council to control draw-down, repayment requirements and interest rate charged during the initial start-up phase. This would for example,
enable the Council to consider perhaps an interest only loan at a favourable interest rate (staying within State aid de minimis limits) which would enable the Company to build a reserve from which either capital repayments could be made or agreement reached to use this to fund additional prudential borrowing by the Council to continue to expand the portfolio of properties held.

The addendum indicative business plan models a series of scenarios, with and without capital repayment provision, illustrating the financial projections for the initial 18 months of the Company’s activities.

6.5 Potential for financial returns back to the Council

The Indicative Business Plan attached to the Business Case includes an assessment of the estimated financial impact on the Council of the preferred financing approach. It also considers a range of six financing scenarios testing a mix of loan and equity and rentals at full market or Local Housing Allowance levels and considers NPV and IRR positions for each of the options.

As noted at section 5.8, agreement has been reached that a finance facility for Local Housing Allowance properties will be made available by the Council at 4% p.a return; market rental housing at 4.88% p.a return and 1% above base for a working capital facility.
7 Financial regulations

7.1 Financial Policy

The Company will maintain full and proper accounting records at all times. The accounting records will be subject to inspection at all times by the Directors, the appointed auditors, and others as approved by the Board or Shareholder. Accounting records will follow the published Standard Accounting Practices. Company funds will only be used in accordance with the approved Business Plan, through processes followed in the Shareholder’s Agreement.

A full set of audited accounts will be produced for approval by the Board at the end of each financial year. The financial year will end on 31st March.

The Company will appoint a properly qualified firm of Accountants to audit the annual accounts and to provide technical accounting, tax and VAT advice as required.

All financial commitments for contracts and payments of £10,000 and above will be considered by a Senior Director of the Board before legal undertaking.

7.2 Taxation and VAT

The company will register with the Inland Revenue for PAYE and Corporation Tax, as required.

The company will register with Customs and Excise for VAT.

The Company will make all the necessary returns when required and within the legal timescales.

7.3 Investment

During its lifetime, the Company is likely to hold varying levels of funding within its accounts. At certain times these could be substantial, whilst during other periods it will hold only minimal or nil funds. The Company’s investment management approach will be reviewed periodically, as determined by the Board, to ensure the best use of funds are proposed within its Business Plan.

7.4 Financial Systems

A computerised accounts system will be established to enable the issue and recording of transactions, the minimum being:

- Income
- Expenditure
- Debtors
Creditors
Inventory of Asset
Purchases Orders
Sales Invoices (including credit notes)
Vat Returns
Corporation and PAYE Tax (as needed)
Payroll
Cost Centres
Reporting

Accounting support will be provided by SDC staff and recharged to the company. The arrangement will be kept under review and if needed an external service contract with a local accountant may be procured.

All financial transactions will be supported with original documentation, securely filed and retained.

7.5 Financial Information

A set of Financial Reports will be provided for the Board showing summaries of income and expenditure and cash. These accounts will be provided as and when required and in a format approved by the Board.

At the end of the financial year, a full Income and Expenditure Account, Balance Sheet, Cash Statement and accompanying written notes, will be produced in readiness for audit.

7.6 End of Year Audit

The Company annual accounts will be audited in accordance with best practice and statutory regulations. This will be completed within five months following the financial year end on 31st March, or as deemed appropriate by the Shareholder. Unaudited accounts will need to be submitted to Shepway District Council by 31st May.

After approval by the Board, the Annual Accounts and Report will be registered with Companies House.

7.7 Statutory procedures and regulations

There are a number of statutory documents which will be filed at Companies House, HM Customs and Excise and the Inland Revenue at required stages
during the financial year – on a monthly, quarterly and annual basis. These will be made accurately and on time.

7.8 Management Systems and Procedures
Management systems and procedures will be followed as demanded by the activities contained within the approved Business Plan. They will use SDC processes and systems as far as possible to reduce duplication for Officers and ensure efficiency in operations. They will include:

- Purchase Order System - a Purchase Order system will be established for the ordering of goods and services.
- Purchase Invoice System – a system for registering invoices requiring payment together with a relevant approval process will be established.
- Income System - income from sales, donations, grants and other sources will all be documented and recorded.
- External Funding & Grant Conditions – a system for the monitoring of external funding and grant related issues will be established which will allow the Company to respond to any conditions and controls.
- Project Information – a system for the orderly recording and filing of detailed financial and technical information will be established.
- The business of the Board meetings will be minuted, approved by the Board and signed by the Chairman.
- Appointments – a structure and approval process for appointing resources to support the company (e.g. consultants, contractors and suppliers) will be established and approved by the Board and in line with processes contained within the Shareholder’s Agreement. Staff roles and job descriptions will be established for direct employees and / or secondees as needed and in line with the Shareholder’s Agreement.

7.9 Compliance
A system will be established to ensure all procedures carried out on behalf of the Company comply with best practice, its policy and with the requirements contained in legal documents.

7.10 Relevant Regulatory Frameworks
All regulations relating to the Company being a Local Authority Owned Company will be complied with, including the Data Protection Act, Freedom of Information Act, and Environmental Regulations Act. The Board will receive reports on these matters as appropriate.
7.11 Delegations / Authorised Signatories

Delegation levels will be established for key Company staff (and SDC Officers delegated to support the Company) and Board members and included in the Shareholder’s Agreement.

Proposals are that signing authorities will be:

- Cheques and other bank payments up to £10,000 - SDC Officer with delegated authority;
- Cheques and other bank payments £10,000 and over - Senior Director, or SDC Officer with delegated authority;
- All external contracts – Chairman or Senior Director;
- Approval of Purchase Orders - SDC Officer with delegated authority;
- Approval of Purchase Invoices up to £10,000 - SDC Officer with delegated authority;
- Approval of Purchase Invoices £10,000 and above – Senior Director, or SDC Officer with delegated authority;
- Loan Agreements – Chairman or Senior Director; and
- Funding Agreements – Chairman or Senior Director.

7.12 Approval and Amendments

These Financial Regulations and as subsequently amended will only be valid following Board approval and with the Shareholder’s Agreement.
8 Risk Issues & Assessment

8.1 Risk Analysis

The risk analysis has been prepared considering the key risk issues between those impacting on the Council and those impacting the Company. Risk have been identified under similar category areas around Legal, Finance, Operational and Other.

8.1.1 Council risks identified

Table 7.2 below identifies the main areas of risk and uncertainty for the Council in setting up the Company, setting out a description of the risk area, probability and level of impact and mitigation proposals. Table 7.1 below presents a matrix style assessment providing a judgement on the combination of probability/likelihood of occurrence and severity of impact on the Council. This highlights that particular consideration should be given to risks E and D.

Table 7.1: Council risks - Assessment summary

| Likelihood | A | B | C | D | E | F | G | H | I | J | K | L | M | N | O | P | Q | R | S | T | U | V | W | X | Y | Z |
| Probability | 4 | 3 | 2 | 1 | | | | | | | | | | | | | | | | | | | | | | | |

Key:
A = high likelihood of occurrence
1 = High severity of impact for the Council

Table 7.2: Council risks - detailed assessment

<table>
<thead>
<tr>
<th>Council Risk</th>
<th>Probability</th>
<th>Impact</th>
<th>Risk Management Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Low</td>
<td>Medium</td>
<td>Legal advice has been commissioned in-house and from Ashford Borough Council and Bevan Brittan to ensure the company is set up correctly and guidance is followed. Appropriate governance arrangements to be put in place in accordance with key Company documents.</td>
</tr>
<tr>
<td>B</td>
<td>Low</td>
<td>Medium</td>
<td>Legal advice, both in-house and made available by Ashford Borough Council (with experience of setting up ABC’s two trading companies) has ensured that the Company has sufficient powers within its Articles of Association to enable it to trade effectively without exceeding its authority and powers.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>C</td>
<td>TUPE implications</td>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td>D</td>
<td>The balance between Council control and the Company’s ability to deliver against its business plan results in the Council ceding too much control.</td>
<td>Low / Medium</td>
<td>High</td>
</tr>
<tr>
<td>E</td>
<td>Breach of EU state aid rules – Council receives a challenge from the private sector</td>
<td>Low / Medium</td>
<td>High</td>
</tr>
<tr>
<td>F</td>
<td>Proposed investment decision impacting upon the Council’s prudential borrowing capacity</td>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td>G</td>
<td>Adverse impact on General Fund and taxpayer</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>H</td>
<td>The Company fails to adhere to loan repayment obligations</td>
<td>Low</td>
<td>Medium</td>
</tr>
<tr>
<td></td>
<td>Company defaults on its financial obligations to the Council</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>J</td>
<td>The balance between the financial imperative to keep operational costs to a minimum whilst adequately resourcing the Company is not managed effectively</td>
<td>Low</td>
<td>Medium</td>
</tr>
<tr>
<td>K</td>
<td>The Company fails and any losses made fall back to the Council</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>L</td>
<td>The valuation of the properties reduce to below the value of the Council’s loan to the Company resulting in an impairment cost which could fall to the Council’s revenue account.</td>
<td>Low / Medium</td>
<td>Medium</td>
</tr>
</tbody>
</table>

**OPERATIONAL**

<table>
<thead>
<tr>
<th></th>
<th>Conflict of interest over workload priorities of Council and Company</th>
<th>Low</th>
<th>Medium</th>
<th>The Council will retain control over the staffing of the Company. Council resources will be invoiced to the Company.</th>
</tr>
</thead>
<tbody>
<tr>
<td>N</td>
<td>Lack of capacity to manage the Company’s workload</td>
<td>Low</td>
<td>Medium</td>
<td>Staff resources carefully managed and staffing needs will be regularly reviewed, with flexibility retained to provide additional capacity as required.</td>
</tr>
</tbody>
</table>

**OTHER**

<table>
<thead>
<tr>
<th></th>
<th>Negative publicity potentially associated with challenges from private sector landlords</th>
<th>Low</th>
<th>Medium</th>
<th>SDC’s marketing team will manage carefully press releases and news stories around the launch of the Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>P</td>
<td>Conflict of interest for members acting as Directors of the Company</td>
<td>Low</td>
<td>Medium</td>
<td>Directors Code of Conduct to be issued. Significant interests and DPI to be declared. Dispensation to be received through application to Standards Committee to participate in debates but not vote on Council decisions relating to the Company.</td>
</tr>
<tr>
<td>Q</td>
<td>The Council reputation and public perception suffering in the event of the Company’s failure</td>
<td>Low</td>
<td>High</td>
<td>Risk assessment regularly reviewed. Communications plan will be developed and maintained to ensure the Company contributes towards a positive view of the Council’s services.</td>
</tr>
<tr>
<td>R</td>
<td>The setting up of the Company is new territory for the Council</td>
<td>High</td>
<td>Low</td>
<td>GENECON commissioned to assist in the preparation of the business case and business plan. Legal advice provided by Ashford Borough Council, drawing on their experiences setting up an arms-length local authority company. Legal advice commissioned from Bevan Brittan LLP.</td>
</tr>
</tbody>
</table>
Central Government introduce new guidelines following increase in arms’ length companies for local authorities. Central Government advice will be closely monitored and where flexibility is retained within the Company’s key corporate documents, the Company will make every effort to adhere to emerging guidelines.

### 8.1.2 Company Risks Identified

A similar exercise has been completed for an analysis of the main risk areas facing the Company.

Table 7.3 below presents a matrix style assessment providing a judgement on the combination of probability/likelihood of occurrence and severity of impact on the Company. This highlights that particular consideration should be given to risks Q, and M, noting also F, L, U, B, R and V although their likelihood of occurrence is considered lower.

#### Key:
- **A** = high likelihood of occurrence
- **1** = High severity of impact for the Company

<table>
<thead>
<tr>
<th>Likelihood</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
<th>E</th>
<th>F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Severity</td>
<td>4</td>
<td>3</td>
<td>2</td>
<td>1</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### Table 7.4: Company risks - detailed assessment

<table>
<thead>
<tr>
<th>Company Risk</th>
<th>Probability</th>
<th>Impact</th>
<th>Risk Management Action</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>LEGAL</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A Contractual Disputes</td>
<td>Low</td>
<td>Medium</td>
<td>Governance structures in place to ensure that contracts which require Council approval are considered appropriately. The Company will take appropriate legal advice before entering into contracts.</td>
</tr>
<tr>
<td>B The balance between Council control and the Company’s ability to deliver against its business plan results in the Company’s inability to operate effectively</td>
<td>Low</td>
<td>High</td>
<td>Detailed definitions contained within the key corporate governance documents mitigate against this risk. Board to be given adequate decision-making powers and independence.</td>
</tr>
</tbody>
</table>

**LEGAL / FINANCE**
C  Breach of EU state aid rules  Low  Medium  Legal advice commissioned from Bevan Brittan LLP. Council’s Finance Team is considering options for level of direct capital contribution. State Aid block exemptions for social housing being explored further. Possibility of debenture on company assets and a leasehold alternative are also being explored.

FINANCE

D  The Company fails to adhere to loan repayment obligations  Low  Medium  Repayment schedule set out within the Company’s business plan, which will return annually to Council for approval.

Again need to mention refinancing risk and early redemption charge.

E  Failure of housing to be competitive and/or attractive to tenants  Low  Low  The Company’s acquisition programme will be pitched at gaps in provision

F  Rental income returns fall short of projections included in the business plan  Low  Medium

G  Failure to arrange adequate insurance cover for the Company’s liabilities and assets  Low  Medium  The Council’s Finance Team is considering how to best address these issues. The Shareholders Agreement enables the Company to purchase and maintain adequate insurance against all risks comparable to that insured by companies carrying out similar business

H  Failure to arrange adequate insurance cover for the Company’s Directors  Low  Medium  The Company may purchase and maintain insurance for its Directors against any liability which may be incurred in relation to their role as Company Director

I  Challenge from auditors (Council or external)  Low  Low  The Company will appoint its own external auditors and accountant, subject to the approval of the Council.

J  Failure to comply with taxation laws (Corporation Tax and VAT)  Low  Low  The company needs to take independent tax advice.

K  Properties decrease in value resulting in an impairment  Low / Medium  High  The Company Board will need to look at options such as changing the mix of portfolio, refinancing or sale of properties.

L  Movement in interest rates  Medium  Medium  The Company business plan will need to take into account the likelihood of medium to long term increases in interest rates and the impact this will have on viability of future activities.

FINANCE / OPERATIONAL

M  Assumption of £150,000 per property for acquisition and refurbishment costs proves to be inadequate  Medium  Medium  Need to regular review business plan to ensure that up to date market conditions are included and that the activity is managed within the overall budget envelope.

OPERATIONAL

N  Mechanism for drawing down funding proves to be too slow to facilitate delivery of acquisitions programme  Low  Medium  Facility to be agreed drawing from Council draw down process
<table>
<thead>
<tr>
<th></th>
<th>Description</th>
<th>Risk</th>
<th>Impact</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>O</td>
<td>Higher level of voids than projected</td>
<td>Low</td>
<td>Medium</td>
<td>A void rate of 5% has been included in the business plan and will be regularly reviewed.</td>
</tr>
<tr>
<td>P</td>
<td>Allowances for maintenance and repairs in the business plan prove to be inadequate</td>
<td>Low</td>
<td>Low</td>
<td>This has been allowed for in the business plan and will be regularly reviewed.</td>
</tr>
<tr>
<td>Q</td>
<td>Conflict of interest over workload priorities of Council and Company</td>
<td>Low</td>
<td>Medium</td>
<td>Council will retain control over the staffing of the Company. Council resources will be invoiced to the Company.</td>
</tr>
<tr>
<td>R</td>
<td>Lack of capacity to manage the Company’s workload</td>
<td>Low</td>
<td>Medium</td>
<td>Staff resources carefully managed and balance of staffing needs regularly reviewed, with flexibility retained to provide additional capacity as required.</td>
</tr>
<tr>
<td>S</td>
<td>The Company is inadequately resourced in terms of management, accounting, legal and admin</td>
<td>Low</td>
<td>Medium</td>
<td>As above.</td>
</tr>
</tbody>
</table>

**PROCUREMENT**

| T | Failure to adhere to EU procurement rules                                   | Low  | Low    | Procurement rules transferred to the Company from the Council including the use of approved procurement frameworks. |

**OTHER**

| U | Conflict of interest for members acting as Directors of the Company         | Low  | Medium | Directors Code of Conduct to be issued. Significant interests and DPI to be declared. Dispensation to be received through application to Standards Committee to participate in debates but not vote on Council decisions relating to the Company. |
| V | Company strays beyond its objectives                                       | Low  | High   | Objectives clearly defined within governance documents and protected by annual Council approval of the Company’s rolling business plan. |
| W | Inaccuracy in stock condition information on the properties prior to acquisition | Low  | Low    | Detailed stock condition information acquired prior to acquisition.                                     |
| X | Inclusion of trading activities (Grounds Maintenance in the first instance) weakens the Company’s strategic focus | Low  | Medium | As proposed, the Company will provide mechanism for invoicing private work and will not detract from the strategic objectives of the Company’s programme of activities. |
9 Communications Strategy & Next Steps

9.1 Managing the PR around the Company’s launch
SDC’s Marketing Department will take responsibility for managing the publicity around the launch of the Company, for press releases and for day-to-day responses to news stories as they arise.

As a key action for the first Board meeting of the Company, the Marketing Department will bring forward its recommendations for management of the PR issues around the Company’s launch for the Board to endorse and include in its Business Plan. This will be reviewed as the Company is established and reviews its activities and, as a matter of courtesy, Ward Councillors will be advised of acquisitions made in their localities.

9.2 Positive news story for the Council, but care needed in the management
This is a positive news story for the Council, however the recommended approach is that there should be a soft launch unlike the major PR campaigns that there have been in other areas like Thurrock and Southwark. This should help with the launch of the Company through its early set-up stages, rather than building expectation too early on. Care will also be needed given that the first actions for the Company will be to move forward with its acquisitions programme, and the Company will not want to inflate expectations within the local market.

9.3 Next Steps
Subject to Cabinet views of the Business Case, the next steps will be to:

a. Appoint Directors, and allocate responsibilities of the Company Secretary to the Council’s Principal Solicitor.

b. Incorporate the Company.

c. Complete all the necessary documentation and enter into the Shareholder’s Agreement.

d. Call the inaugural meeting of the Company Board to develop and agree their first Business Plan for submission to Cabinet.

e. Consult scrutiny committees on the proposed Business Plan.

f. Submit the Business Plan to Cabinet for approval.

g. Take the recommendations from Cabinet to Council.