

This Report will be made
public 20 February 2018

Folkestone

Hythe & Romney Marsh
Shepway District Council



Report **C/17/81**

To: Cabinet
Date: 28 February 2018
Status: Key Decision
Director: Susan Priest, Corporate Director, Strategic Development
Cabinet Member: Leader of the Council, Councillor David Monk

SUBJECT: FUTURE STRATEGY - OPORTUNITAS LIMITED

SUMMARY: This report recommends a future direction for the Council's Regeneration & Housing Company, Oportunitas. It positions the future of the company in the context of the Council's Corporate Plan and Investment Strategy, and draws heavily on the outcomes of a financial remodelling exercise undertaken by the Council as the sole Shareholder, to identify the required level of investment and the appropriate debt to equity funding structure, to ensure that income returns to the Council are optimised while also allowing Oportunitas to become financially sustainable.

REASONS FOR RECOMMENDATIONS:

Cabinet is asked to agree the recommendations set out below on the basis that:

1. Oportunitas continues to deliver outcomes that directly address Corporate Plan priorities;
2. Oportunitas provides a revenue income stream to the Council and has secured capital growth in assets;
3. The initiative is tried and tested, controls and processes are established with a high degree of assurance; and
4. There is a wealth of opportunities to pursue in continuing to address the regeneration and housing needs of the district.

RECOMMENDATIONS:

Cabinet is asked to approve the following recommendations:

- 1) To receive and note the contents of report C/17/81.
- 2) To approve the outcomes from the strategic review of the company;
- 3) To approve that a further investment of £6,900,000 is required to be made in Oportunitas Limited for it become financially sustainable in the long term;
- 4) To approve the change in the overall debt to equity ratio for the council's total investment in Oportunitas Limited to 58% debt and 42% equity;

- 5) To seek Council's approval to a further equity investment of £4,430,000 in Oportunitas Limited to support expansion of its property acquisitions activity to be met from prudential borrowing, the release of the funds being subject to Cabinet approval of a Business Plan from Oportunitas Limited for 2018-19;
- 6) To seek Council's approval to provide a further investment loan of up to £2,470,000 to Oportunitas Limited to support expansion of its property acquisitions activity to be met from prudential borrowing, the release of the funds being subject to Cabinet approval of a Business Plan from Oportunitas Limited for 2018-19;
- 7) To authorise the Head of Democratic Services and Law in conjunction with the Corporate Directors for Strategic Development and Organisational Change to determine the arrangements and enter into the legal agreements for the proposed additional equity and debt investment by the council in to Oportunitas Limited; and
- 8) To authorise the Corporate Director for Organisational Change in conjunction with the Head of Democratic Services and Law to determine the requirement for the liquidity loan facility of £300,000.

1. BACKGROUND

- 1.1 Oportunitas was established as a result of SDC's Cabinet asking officers in December 2013 to work up full proposals to establish a Regeneration & Housing Company as a priority action within SDC's Corporate Plan 2013-2018.
- 1.2 The activities of the Company were directed towards achieving three of Shepway's strategic objectives:
 1. **The need for more homes in the district** – to help increase overall housing supply; 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.
- 1.3 The current Corporate Plan 2017-2020 includes three directly relevant strategic objectives which Oportunitas continues to support the Council in addressing:
 1. **More Homes** – to provide and enable the right amount, type and range of housing;
 2. **More Jobs** – to work with business to provide jobs in a vibrant local economy; and
 3. **Achieving Stability** – achieving financial stability through a commercial and collaborative approach.
- 1.4 Formal approval of the company's Business Case was given by Cabinet on 16th July 2014, with Cabinet approving the company's first Business Plan on 30th July 2014, and Council approving investment at their meeting on 6th August 2014. Oportunitas was incorporated on 14 May 2014 and a suite of three key documents underpin the legal and operating structure of the company:
 - i. **Articles of Association** – the legal constitution of the company, its legal structure, the role and powers of Directors, the decision-making processes and the status and holding of shares;
 - ii. **Shareholder's Agreement** – this sets out the limits and qualifications on what Oportunitas is expected and able to do. The Agreement contains the detailed day-to-day control mechanisms that the Council has over Oportunitas; and
 - iii. **Service Level Agreement** – this allows Oportunitas to request the services of any officers or area of the Council which is then charged back to Oportunitas for the resources used. External resources can also be procured in line with a scheme of delegation as part of the financial controls of Oportunitas.

Company Objectives

- 1.5 The Objectives of the company are captured in the Shareholder's Agreement and are intentionally wide in order to give the shareholder plenty of opportunity to consider how best to use its wholly owned vehicle over time. They 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;
 - To provide a vehicle for agreed trading activities.
- 1.6 The initial focus of Oportunitas was a Housing Acquisitions, Refurbishment and Rental Programme, and Grounds Maintenance trading for a variety of private and public sector clients outside of the Council's core role.
- 1.7 There was a clear intention to start modestly and review operations over time, drawing on initial lessons and considered ways of working. Three years on, there have been lessons learned and methods tested that provide the shareholder with a high degree of reassurance that appropriate controls are in place, revenue income streams have been established and capital growth of assets secured.

Direction & Management

- 1.8 Oportunitas is led by a Board of Directors, responsible for setting the annual Business Plan – the key document which guides its specific activities, and which requires annual Cabinet approval and regular monitoring. All Directors are 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). The Directors are: Cllr Jeffrey (Chair), Cllr Martin, Cllr Wilkins, and Cllr Lawes. Management staff is provided on a part-time basis recharged from SDC. Ultimate control and oversight of the Company rests with the Leader and the Cabinet of the Council.

Initial Funding & Financial Principles

- 1.9 The Business Case considered the pros and cons of three options for the initial investment in to Oportunitas:
- 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.
- 1.10 Advice in 2014 from public sector legal specialists, Bevan Brittan, concluded that option 3 a mix of loan and shareholder equity, drawn in the first instance from SDC reserves, was the preferred approach for the initial programme, allowing flexibility on draw-down timing, flexibility on interest rate and capital repayment charges, with State Aid compliance managed within the de minimis rules. Cabinet approval (decision C/14/21) and Council support (decision A/14/16) was given with full knowledge that the initial debt to equity ratio (90:10) would not be sustainable in the long term due to the initial modest investment approach along with set up and ongoing costs, and a strategic review was therefore programmed to be undertaken; a

summary of the results are reported below with more detailed on the financial aspects included in the appendices to this report.

2. STRATEGIC REVIEW

2.1 At the point of preparing this report, Oportunitas holds 30 residential properties and 1 commercial) and a further 4 residential units are at an advanced stage of being acquired. All, bar 8 units which are in Dover, are in Central Folkestone where the best rental yields have been found. The annual return to the shareholder has been in the order of £220,000 in 2017/18, and capital growth of assets are averaging 6% per annum.

2.2 Experience and reflections to date highlight that:

- i. Purchasing multiple units offer better deals as there are fewer potential investors that are seeking to acquire this type of property stock;
- ii. Fixed price off plan purchases give better values as early negotiations reduces the sales risk for developers;
- iii. Acquisitions have been made which have brought long term empties back into effective use, thereby supporting the regeneration of the town centre;
- iv. Property has been bought from local small development construction firms, thereby supporting local supply chains and local jobs;
- v. The current business plan target of securing rental yields at 5% and above has been achieved, although deals have been slow at times which has led to opportunities being explored beyond the district;
- vi. Grounds maintenance work for private clients has been slower than expected but Oportunitas is a trusted supplier to its local client base and there are opportunities to expand to take on larger external contracts;
- vii. Processes and ways of working have been established, relevant control mechanisms have been audited and offer a high degree of assurance;
- viii. A revenue income stream to the Council has been established which can be used to support broader objectives and activities of the Council;
- ix. Capital growth of assets has been secured which can be realized at the request of the Council; and
- x. A wide range of investment opportunities are available to be explored for example, through direct involvement in shareholder-led proposals at Biggins Wood, Princes Parade, Ship Street and Otterpool Park, etc., as well as through further private sector market-led opportunities.

2.3 In terms of the strategic future of the company, three options were considered:

Do nothing – this is increasingly challenging as the company is not yet operating at a sufficient scale to absorb the set up and overhead costs incurred under the current financial arrangement with the shareholder. This option is not recommended.

Close Oportunitas – there are two routes that could be used to wind up the company; voluntary strike off (Companies Act 2006) or voluntary liquidation (Insolvency Act 1986). While voluntary strike off would be the most efficient and quickest route, Oportunitas would have to realise its assets and repay creditors before dissolution and there would be processes to follow and activities which would incur additional costs, potential void periods resulting in loss of rental income, and overall budget considerations. This option is not recommended.

Refinancing & Scaling Up – the company becomes sustainable with additional investment of £6.9m while adopting a more prudent debt to equity ratio in the order of

58:42. Once funds are fully invested this would give a modest return to the shareholder of some 2.6%-3.1% equivalent to £300,000 - £360,000 per annum. Once capital appreciation has been considered, a more reasonable return to the shareholder is given which is in the order of 6%. This is the recommended option and more detail of the financial review is given in appendix 1.

3. BUSINESS PLANNING 2018/19

3.1 Subject to Cabinet's views on the strategic future of Oportunitas and approval for funds to be made available as outlined in section 2 of this report and detailed in the appendices, a Business Plan for 2018/19 from the Board will come forward for Cabinet's approval in March 2018.

3.2 Should Cabinet approval be given, the next steps will be to secure the appropriate capital borrowing along with the associated legal and financial agreements being put in place and then to pursue investment and trading opportunities as outlined in the Plan. Regular update reports will be given to Cabinet in line with requirements contained within the Shareholder's Agreement.

4. RISK MANAGEMENT ISSUES

4.1 A review of risks is included in the table below. These will be monitored through the year as activity against the Business Plan is reviewed and reported as appropriate to the Directors, to Corporate Management Team and to Cabinet.

| Perceived Risk | Likelihood | Seriousness | Preventative Action |
|--|------------|-------------|--|
| Financial – the expected returns to the Shareholder are not forthcoming. | Low | Medium | Close monitoring of the investment approach will be undertaken to ensure assumptions contained within the financial model are tested against activities and reviewed. |
| Financial - Company defaults on its financial obligations to the Council | Low | High | Security to be taken on the shareholder equity or loan provided by the Council to the Company by a first charge on each property acquired |
| Financial – the Company fails and any losses made fall back to the Council | Medium | High | The Council will see and approve the Company's annual business plan and will take early action if failure of the company was likely. The legal agreement will ensure that the council has the ability to enforce disposal of properties. |
| Financial – the valuation of the properties reduce to below the value of the Council's loan to | Low | Medium | The properties are valued annually as part of the year end |

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|---|-----|--------|--|
| the Company resulting in an impairment cost which could fall to the Council's revenue account. | | | accounting process and trends in property prices are closely monitored. This risk could also be mitigated by the Company selling properties. |
| Communications – failure to communicate the role and benefits clearly from Oportunitas undermine the excellent work being undertaken. | Low | Medium | Modest website enhancement is being progressed to ensure that clear messages, approved by the shareholder, are provided. All communications seeks to clarify the role of the company, distinct from the Council. |
| Other - The Council reputation and public perception suffering in the event of the Company's failure | Low | High | 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. |

5. LEGAL / FINANCIAL AND OTHER CONTROLS / POLICY MATTERS

Legal Officer's Comments: (Amandeep Khroud) The power for councils to trade their services for cost recovery only has been in force for many years. The power for councils to establish companies to trade for profit is set out more recently in the Localism Act 2011. The company model provides the only mechanism for local councils to operate more commercially and generate profit.

Officers have taken specialist legal advice from Bevan Brittan and will continue to work with these external legal advisers as and when the need arises.

- Finance Officer's Comments: (Charlotte Spendley) The financial review covered in the appendix to this report has been prepared by Financial Services and the financial implications to the council as shareholder are contained within it. The key financial risks regarding the council's investment in the company are shown in the risk management matrix in the main body of the report.
- Diversities & Equalities Implications: (Susan Priest). There are no diversities and equalities implications arising from this report.

APPENDICES

CONTACT OFFICERS & BACKGROUND REPORTS

Councillors with any queries arising from this report should contact the following officers prior to the meeting:

Susan Priest, Corporate Director, Strategic Development
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The following background documents have been relied upon in the preparation of this report:

- A. Oportunitas Business Case
- B. Oportunitas – Articles of Association
- C. Oportunitas – Shareholder’s Agreement
- D. Oportunitas – Service Level Agreement