



REPORT OF:	Head of Property Services and Head of Legal Services
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TO	EXECUTIVE
DATE:	30 June 2016
EXECUTIVE MEMBER:	Councillor Natalie Bramhall

KEY DECISION REQUIRED:	Yes
WARD (S) AFFECTED:	All

SUBJECT:	AUTHORISE THE CREATION OF A LOCAL AUTHORITY PROPERTY INVESTMENT AND DEVELOPMENT COMPANY AND LOAN FACILITIES
RECOMMENDATIONS:	
<ol style="list-style-type: none"> 1. The Head of Legal Services be authorised to incorporate (a wholly owned) Local Authority Trading Company in accordance with the arrangements described in this report. 2. The Shareholder function of the Council be delegated to an Executive Sub-Committee to be known as the Property Sub-Committee. 3. The remit and terms of reference of the Property Sub-Committee to be agreed as set out at Annex 1. 4. The Property Sub-Committee in consultation with the Head of Legal Services and Head of Property be authorised to finalise and document the following arrangements between the Council and the Company: <ol style="list-style-type: none"> a. The Articles of Association for the Company; b. Shareholder Agreement between the Company and the Council including the first Business Plan; c. Appointment of a Company Secretary and Auditor; d. Resourcing Agreement for the Company to use Council staff and facilities in furtherance of its business; e. Loan and draw down facilities to the Company. Loan and Draw Down agreements to be subject to the financial caps set out in the exempt information at Part 2 of this Agenda. These can be amended or increased as agreed by the Property Sub-Committee. f. Transfer of agreed Council assets into the property company set out in the exempt information at Part 2 of the report, together with further assets as 	

directed by the Property Sub-Committee.

5. To note the agreed terms of reference for the Executive Sub-Committee will be updated in the Constitution by the Monitoring Officer as an administrative update.

REASONS FOR RECOMMENDATIONS:

Setting up a property investment and development company will enable the Council to undertake property trading activities in order to enhance the economic wellbeing within the Borough to enable the Council to meet the funding challenges set down by Central Government as set out in this report.

EXECUTIVE SUMMARY:

In December 2014 the Executive considered and approved the Councils approach to property investment, development, borrowing and its approach to Joint Ventures and the potential to start a property company. The report also set out the political oversight, and those arrangements have now been working since that report. This report builds on that direction of travel and now sets out the business case to create a property trading investment and development company which will be wholly owned by the Council. The vision is ambitious, with the aim of the company promoting development of a number of Council owned assets as well as purchasing other assets for investment and development purposes both inside and outside the Borough. Some existing Council assets would be transferred to the Company to allow that to happen.

The Council has faced a 45% reduction in Government Grant since 2010, and the Council will receive no Revenue Support Grant from Central Government by 2017/18. The Council has managed the financial challenges to date from Central Government with no service reductions.

However the opportunities for further service efficiencies without an effect on Council services has become less because of the efficiency measures already taken by the Council over the last six years. The setting up of the Company is in response to the challenge the Council faces to substitute the removal of the revenue support grant by 2017/18. A property and investment strategy delivered by a commercial trading company will enable the Council to bring forward its own sites quickly and will also enable the Council to operate in a fast paced competitive market place and in areas where the Council cannot currently act. For example, the Council is not allowed under the Housing Act to grant shorthold assured tenancy agreements which means it would not be able to invest in and keep residential property. Therefore where residential property is involved, the Company would be in place to provide the appropriate delivery mechanism for that service. In addition, the Council is constrained to act within its own borders, whereas a commercial company would be able to access opportunities in other boroughs without restriction.

Every investment or development opportunity will be considered on its own merits as to whether it will be purchased and brought forward in the property vehicle or by the Council. The tax position is explained in greater detail later in this report.

The Local Authority Trading Company set out in this report will be a company limited by shares with the Council retaining 100% shareholding.

The Business Plan for the Company will set out the direction of travel to include investment and development work both inside and outside the Borough through Council

direct investment, special purpose vehicles, joint ventures, licences and development management agreements.

The Company will be managed by a small board of senior officers (Board of Directors) to allow for maximum speed of response and flexibility. The board will work within established structures for member / officer liaison on property matters. In addition an Executive Sub-Committee will exercise the Shareholder function of the Council to hold the Directors to account for the performance of the Company.

Executive has authority to approve the recommendations 1-5 above.

STATUTORY POWERS

1. A local Authority is able to establish a Local Authority Trading Company ('LATC') through the powers in section 95 of the Local Government Act 2003. A Local Authority is permitted to trade in anything that it is authorised to do under its ordinary functions.
2. Under section 1 of the Localism Act 2011 local authorities now have a general power that enables them to do anything that a private individual is entitled to do, as long as it is not expressly prohibited by other legislation. Section 4 of the same Act directs that anything which is done for a purely commercial purpose should be done through a company.
3. The Company would be a controlled company as defined in the Local Government and Housing Act 1989 as it is a subsidiary company of a local authority and as such the shareholder (the Council) has ultimate control over the activities and operational matters of the Company.

ISSUES

Background

4. Central Government funding for Local Authorities has reduced and is expected to reduce further. To enable the Council to continue to deliver and maintain the level of services our residents currently enjoy, it is essential alternative sources of income are found. The forming of a LATC forms part of the Council's management response to the reductions in Government grant.
5. This report follows on from the direction of travel set out in the 5 Year Plan 2015-20 for the Council to be financially self-sufficient. The 5 Year Plan describes how the Council will invest in property investment and development opportunities both inside and outside the Borough to meet this overriding ambition.
6. The Council has already established a strong record in property acquisition and development for example: the acquisition of the M&S long leasehold interest in Reigate, the long leasehold interest at Pittwod Industrial Estate, the long leasehold interest at Marketfield Way Redhill, the provision of two new leisure centres with associated sale of residential land, the development of Newman House in Horley and the establishment of a Joint Venture LLP in Horley.

7. However there are opportunities set out in this report that mean some property investment acquisitions and developments need to be undertaken in a separate trading company.
8. Typically property investment and development acquisitions within the scope of the proposed company are expected to be in the region of £1m to £5m and will include a diverse range of use types including residential, offices, industrial and retail. The property vehicle will target a minimum return of 6% with funding from Council's reserves, Public Works Loan Board or commercial sources. The aim would be to maximise the opportunities within the existing portfolio and bring in new opportunities to increase the mixed and balanced portfolio the Council already owns.
9. It is important that the Company has enough flexibility to buy considered opportunities and work on a commercial basis. This may include joint ventures, special purpose vehicles and possibly development management agreements. A LATC could enter into and have subsidiary companies to be able to trade effectively in the property market place e.g. special purpose vehicles for particular projects.

Considerations

Company Structure and Governance

10. The purpose of the Company is to concentrate on property investment and development work both inside the Borough and outside which is needed to provide a valuable income stream to the Council. Its focus will be on responding more quickly and effectively to market opportunities where the Council is more disadvantaged by the regulations on decision making which affect speed of response.
11. As a company wholly owned by the Council it is imperative that an appropriate governance structure is put in place to ensure the sound and robust management of the company alongside protection of the Council's financial and reputational investment in the company.

Shareholder Function

12. The Company shareholder has ultimate control over the Company. It controls the company in a variety of ways; the appointment of directors, provision of funding and the Articles of Association but operational matters can also be included in a Shareholder's Agreement as described below.
13. It is proposed that the Shareholder function of the Council is primarily executed through a dedicated Sub-Committee of the Executive comprising members appointed by the Leader (expected to be the Leader, Deputy Leader, Executive Members for Finance and Property with a minimum being three Members. If further appointments are required these will be made by the Leader).
14. The Shareholder will (through a Shareholder Agreement) set out the performance levels required for the company and the tolerances (e.g. financial and decision making) within which the Company may operate.
15. The Council as Shareholder can change the make-up of the Board of Directors and can change the Company Secretary in the same way.

16. The Articles of Association can make provision for the Shareholder to appoint Directors by serving notice in writing to the Company and to appoint any other person to be a Director in place of a Director who leaves office by whatever means. This can take immediate effect on service to the Company Secretary.
17. The company will be a 'controlled company' as defined by the Local Authority Government and Housing Act 1989 and as a result will be subject to the Local Authorities (Companies) Order 1995. The 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. The Council must 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 the Member's responsibilities, they must also provide information required by the Council's auditors.

Board of Directors

18. The Board of Directors will be responsible for delivery of the expected outcomes within the Business Plan. They will have oversight of the performance, financial and operational management of the Company within the parameters agreed with the Shareholder.
19. It is proposed that the Board would comprise three senior officers; the Chief Executive and the Head of Property as Joint Managing Directors and the Head of Finance. The Monitoring Officer would act as Company Secretary but would not be a Director. In addition once operational it may be that the Shareholder may wish to appoint additional independent non-executive directors to add further commercial experience to the board - this will be covered by the Shareholder Agreement.
20. The typical areas for the Directors to consider and approve include:
 - a. Specific investment transactions – acquisitions, sales, letting, agreement for leases, surrenders, borrowing and other key transactions.
 - b. Appointment of service providers – accountants, solicitors, agents, valuers, architects, property managers, and other professionals as deemed appropriate.
 - c. Reporting – reporting arrangements to the Executive Sub-Committee and Overview and Scrutiny Committee.
21. Whilst the Council's Chief Finance (section 151) Officer and Monitoring Officer will be part of the board this is with a clear understanding of the separation of functions between all officers on the Board of Directors and officers providing advice to the Shareholder on behalf of the Council. At the present it is not envisaged that conflicts will emerge but this will be kept under review and arrangements modified to accommodate any change in circumstances.
22. The statutory duties for directors of a company are set out in sections 171 – 177 of the Companies Act 2006. The statutory duties are in summary:
 - a. The duty to act within powers
 - b. The duty to promote the success of the company
 - c. The duty to exercise independent judgement

- d. The duty to exercise reasonable skill and care
 - e. The duty to avoid conflicts of interest
 - f. The duty not to accept benefits from third parties
 - g. The duty to declare an interest in a proposed transaction or arrangement with the company
23. Directors will also be subject to other duties set out elsewhere in law, including a large number of very important legal obligations around making investments, disposing of land, health and safety requirements, and employment laws, to name but a few. In particular, there are very important responsibilities on directors in the event that an insolvency situation seems likely. There are serious consequences for directors (including personal liability) in situations which fall within the statutory definitions of wrongful trading or fraudulent trading.
24. Consideration has been given to ensuring that key expertise (such as financial and legal advice) are available to advise both the Council as shareholder and the company. From time to time it may be necessary to buy in specialist corporate, property, marketing, legal and financial advice on a normal commercial basis to supplement the experience on the Board. .

Company Resources

25. It is anticipated that many of the support services which will be required by the company will be contracted out to the Council e.g. legal services for property acquisition and accounting services provided by local authority staff (and re-charged to the company). The Head of Property will be charged to the Company with an additional payment to be agreed by the Chief Executive to recognise the additional responsibility he is expected to undertake. As the property portfolio grows then additional staffing may be required and this will be agreed by the Chief Executive in the normal way. The Chief Executive, Head of Legal Services and the Head of Finance will not receive any additional remuneration for the work they undertake for the Property Company.

Documentation required to establish the company

26. The following documentation is required to complete the establishment of the LATC and associated governance arrangements.
- a. Articles of Association – the Company constitution setting out the rules governing the running of the company
 - b. Shareholder Agreement – this will be a key document as it will capture how the Council Shareholder will exercise its control over the Company and the expectations for performance delivery.
 - c. Loan Agreements – these set out the details of the funding arrangements between the Council and the Company.
 - d. Director Appointments – the terms upon which council officers who will be appointed as directors to the Company will need to be agreed.
 - e. Appointment of Company Secretary and an Auditor.
 - f. Business Plan – the business plan will be developed to cover a rolling 5-year period of investment activity (to coincide with the Council's five year

plan) and will outline the Company's planned operations. The Business Plan will be reviewed and agreed annually and will cover the following:

- i. Company objectives (as established in the Shareholder Agreement) but these are expected to develop over time.
- ii. Governance arrangements - sufficiency of the arrangements and any planned changes to the Board.
- iii. Operational plans.
- iv. Financial model and assumptions.
- v. Investment strategy.
- vi. Rents, sales and development assumptions.
- vii. Distribution Policy – is all trading profit to be returned to the shareholder or is any retained for future investment and/or running capital.
- viii. Fees, on-costs and tax.
- ix. Funding profile and sensitivity analysis.

Articles of Association

27. The Articles of Association are to be finally agreed by the Executive Sub-Committee but are anticipated to comprise the following:

- The articles are for a company limited by shares
- There will be one shareholder being Reigate and Banstead Borough Council
- The liability of the Council is limited to the nominal value of its share
- If a Director ceases to be employed by the Council then he will ordinarily cease to be a Director of the Company and a replacement sought
- Quorum for a meeting of the Directors and to be able to vote on the decisions of the Company.
- Some decisions can only be taken at a general meeting by the Council as Shareholder. e.g. to allocate extra shares, to reappoint the directors, to declare a dividend, to change the articles of association, etc.
- Requirements to sign documents on behalf of the Company
- The Company is obliged to comply with all the requirements that form part of it being a wholly owned subsidiary of a Local Authority.
- The Company needs to make arrangements to have the accounts audited.

Objects

28. Since 2009 most companies do not have objects clauses relying on the fact that the objects of the Company are generally unrestricted. The Company can then reflect the wide powers granted to the Council under the Localism Act 2011 to use a company to do anything commercially that individuals may generally do.

Shareholder Agreement

29. A Shareholder Agreement would operate in addition to the Articles of Association. The Shareholder Agreement will regulate the actions of the Company and give rights to the Council that would not be appropriate to be included in the Articles. It represents a finer level of detail and control:

- The setting of investment targets each year and the associated budget
- Approving and / or removing auditors
- Agreement of any borrowing arrangement and giving security in respect of borrowing
- Considerations before making a planning application or lodging an appeal
- Any matter that the Council shall advise the Company of in writing

Tax liability

30. The Company will be liable to corporation tax in the normal manner on profits, and will need to charge VAT.
31. Every property opportunity would be looked at on its own merits to decide whether to purchase through the Council or the Company dependent upon the taxation and legal implications of the opportunity concerned.

Risks

32. Members will be concerned to ensure that all risks of operating in a new way have been thoroughly considered.
33. Each acquisition will be considered in the light of investment and development appraisals, the overriding economic conditions prevailing, occupational and investment demand as well as the associated due diligence. These appraisals will be provided to members of the Property Sub-Committee. Each acquisition will be subject to these assessments as well as the normal legal and survey due diligence needed. Therefore each acquisition will be considered in light of this information.
34. The proposal in this report contains a number of checks and balances to ensure that the company operates within agreed parameters and can assure members that there is no greater financial risk to the Council than at present:
 - a. The Articles of Association will set out the powers available to Directors.
 - b. The Shareholder Agreement will set out further controls around dealings with properties.
 - c. The Property Sub-Committee will hold the directors accountable for delivery of the business plan. This is no different to the current arrangement whereby officers are held to account by members.
 - d. Funding provided by the Council and properties to be subject to development by the Council will have to be agreed by the Property Sub-Committee. Funding from the capital programme and/ or funding from prudential borrowing has to be agreed by Council.
 - e. Any asset transferred to the company by the Council will be subject to the usual requirements of best value and section 123 of the Local Government Act 1972. The Council will have up to date valuation advice before any transaction proceeds.
 - f. Assets transferred to the company by the Council can also be subject of charge by way of legal mortgage to protect the Council's interests should the company face financial difficulties.

- g. There will be ongoing liaison (as exists at present) between officers and councillors to ensure there are clear channels of communication and that councillors remain comfortable at all times with proposed deals.
 - h. The Property Sub-Committee is an Executive Sub-Committee and as such can be scrutinised by the Overview and Scrutiny Committee in the same way as any other Executive function.
 - i. Any project which poses more of a commercial risk, for instance an out of borough joint venture, can be contained in a subsidiary company (if appropriate) so as not to risk the company. This is a normal way of containing risk in property transactions and it applies here as it would in the general property market.
 - j. The company will have its own auditors and will be subject to the requirements of company law and filing at Companies House.
35. The Council needs to make substantial savings in the coming years to meet the revenue cuts from central government. Making these savings without the necessity of service cuts will be more difficult to achieve.

Staffing Implications

36. It is proposed the Head of Property will transfer in part or in whole across to the new vehicle. Other members of staff will initially be seconded across to the Property vehicle, and will be invoiced by the Council in the normal manner at normal commercial rates.

State Aid

37. EU regulations ensure that the Company cannot be subsidised by the Council. This means the Council must recover the costs of any accommodation, goods, services, employees or any other support it supplies to the Company. State Aid will also include loans to the Company and the rate of interest that loans to the Company will need to be charged. This will be reviewed on an ongoing basis. Specialist advice would need to be sought when making acquisitions or receiving loans from the Council in order to ensure that State Aid regulations are complied with.

Company Loan Facilities

38. As set out above the Company will seek loans from the Council that comply with State Aid requirements. Loans would include draw down provisions that meet the need of the business case. Where property acquisitions are made by the Company, loans from the Council would be secured against the property by way of a legal charge (or mortgage) in favour of the Council.
39. The loans will be sourced from the Council's capital reserves - where the Council would loan some equity - and the remaining finance will be sourced from the banking sector or through Public Works Loan Board. Details of the initial loan facility are set out in the exempt information at Part 2 of this Agenda.

Legal Implications

40. Section 1 of the Localism Act 2011 provides local authorities with the power to do anything an individual may do, subject to a number of limitations. This is referred to as the 'general power of competence'. A local authority may exercise the

general power of competence for its own purpose, for a commercial purpose and/or for the benefit of others i.e. this includes the setting up of a property company as described in this report. In exercising this power, a local authority is still subject to its general duties (such as the fiduciary duties it owes to its rate and local tax payers) and to the public law requirements to exercise the general power of competence for a proper purpose.

Powers to fund the Company

41. The property company will need significant funding to purchase property in the open market. Therefore, as well as the Council having the powers to form the property company it must also be able to provide it with the necessary loan and equity funding.
42. The Council has the power to borrow under the Local Government Act 2003 for the purposes of the prudent management of their financial affairs, or in connection with any of their functions. The borrowing must be prudent and comply with the Prudential Code.
43. As outlined, the Council intends to borrow monies and in turn support the property company through the provision of loans and subscription to share capital. This is permitted by virtue of the Localism Act 2011. In addition the Council has a power to provide financial assistance to a company providing privately let accommodation under section 24 of the Local Government Act 1988 (the 1988 Act).
44. Where is appropriate for the Company to develop Council owned land, the Council is entitled to dispose of land to the Company provided it complies with Section 123 of the Local Government Act 1972 which is the duty to obtain best value for property disposals.

Asset Transfers

45. It is proposed to transfer a number assets across to the vehicle. An initial list of these sites are set out in the exempt information at Part 2 of the report and are expected to be brought forward for mixed use or residential development. Other sites are likely to follow, this will be with the approval of the shareholder Board and will be to take advantage of the trading benefits of the property Company.

Procurement

46. The Council is establishing the company for a commercial purpose. It will be funded from a variety of sources, including Council money, other public money and private funding. It is intended that the company will have a commercial character so as not to count as "a body governed by public law" for the purposes of the Public Contract Regulations. This means that the requirements of the Regulations would not apply to the company. This position will be kept under review. The Company would intend to tender significant developments to ensure that value for money can be proven.

Other considerations

47. The decisions recommended are not considered to have an impact under the Equality Act (Equality Impact Assessment).
48. The decisions recommended are not considered to give rise to any impact under the Data Protection Act (Privacy Impact Assessment).

OPTIONS

49. Option 1 – Proceed with the setting up of a Local Authority Trading Company based on the transfer of assets across to the vehicle (as set out in the exempt information at Part 2 of this Agenda) to maximise the development options for the Council. This is the recommended option
50. Option 2 – Not to proceed with the forming the Local Authority Trading Company. This is not the recommended option.

FINANCIAL IMPLICATIONS

51. Full financial information set out in the exempt information at Part 2 of this Agenda.
52. The recommended option complies with the Council's financial priority to optimise its finances as set out in our Medium Term Financial Plan and 5 Year Plan 2015-20.
53. The financial objectives of the Property Investment strategy is to achieve a minimum 6% income return, which will be used to support Council services in other areas.

CONSULTATION

54. The Leader, Deputy Leader and Executive Members for Finance and Property and Regeneration have been consulted on the proposals.
55. The Monitoring Officer and Chief Finance Officer have been consulted on the contents of this report

Background Papers: Report to the Executive "Property Approach" December 2014

Executive (Property) Sub Committee

Background

The Council has established an Executive (Property) Sub-Committee which a Sub-Committee of Executive established specifically to discharge the functions of the Council as regards its corporate shareholding in the Property Company. The Sub-Committee will meet once a year to receive an annual report and annual accounts from the Company, but otherwise meetings will be called on an “as and when required” basis to deal with company business.

Membership

To be determined by the Leader of the Council from time to time. Only members of the Executive may sit and vote on the Committee. A minimum number of three Executive Members will be needed to undertake the shareholder function. Substitutes may be permitted at the discretion of the Leader.

Purpose

To exercise the function of the Council as a shareholder in relation to the Council's property trading company.

Remit

To undertake all functions of the Council as a shareholder under the Company Act 2006 in relation to the Council's property company, which may include without limitation:

- To determine the Shareholder Agreement between the Council and the company including Business Plan
- To appoint and dismiss directors of the company (where power is reserved to the shareholder)
- To agree any Directors Service Agreements (if required)
- Appointment and removal of a Company Secretary and Auditor
- To agree any Resourcing Agreement between the Council and company for the use of Council staff and facilities and reimbursement for the same
- To agree any loan agreements or draw-down of Council financing (subject to funds being made available by Council)
- To agree any reserved matter required by the Articles of Association or Shareholder Agreement
- To agree the Articles of Association or any amendment thereof