

6th February 2018

Policy, Projects and Resources Committee

Wholly Owned Company and Joint Venture

Report of: *Chris Leslie – Commercial Manager*

Wards Affected: *All*

This report is: *This Report is Public but refers to a schedule (Appendix A) that is Exempt due to legal professional privilege*

1. Executive Summary

- 1.1 This report sets out the business case to create a company that will be wholly owned by the Council. It also provides an update on the progress of acquiring a partner to assisting in the development of the Council's sites to realise regeneration and financial objectives.
- 1.2 As part of the Council's asset development programme a private company is required to engage in commercial activity and to facilitate future opportunities.

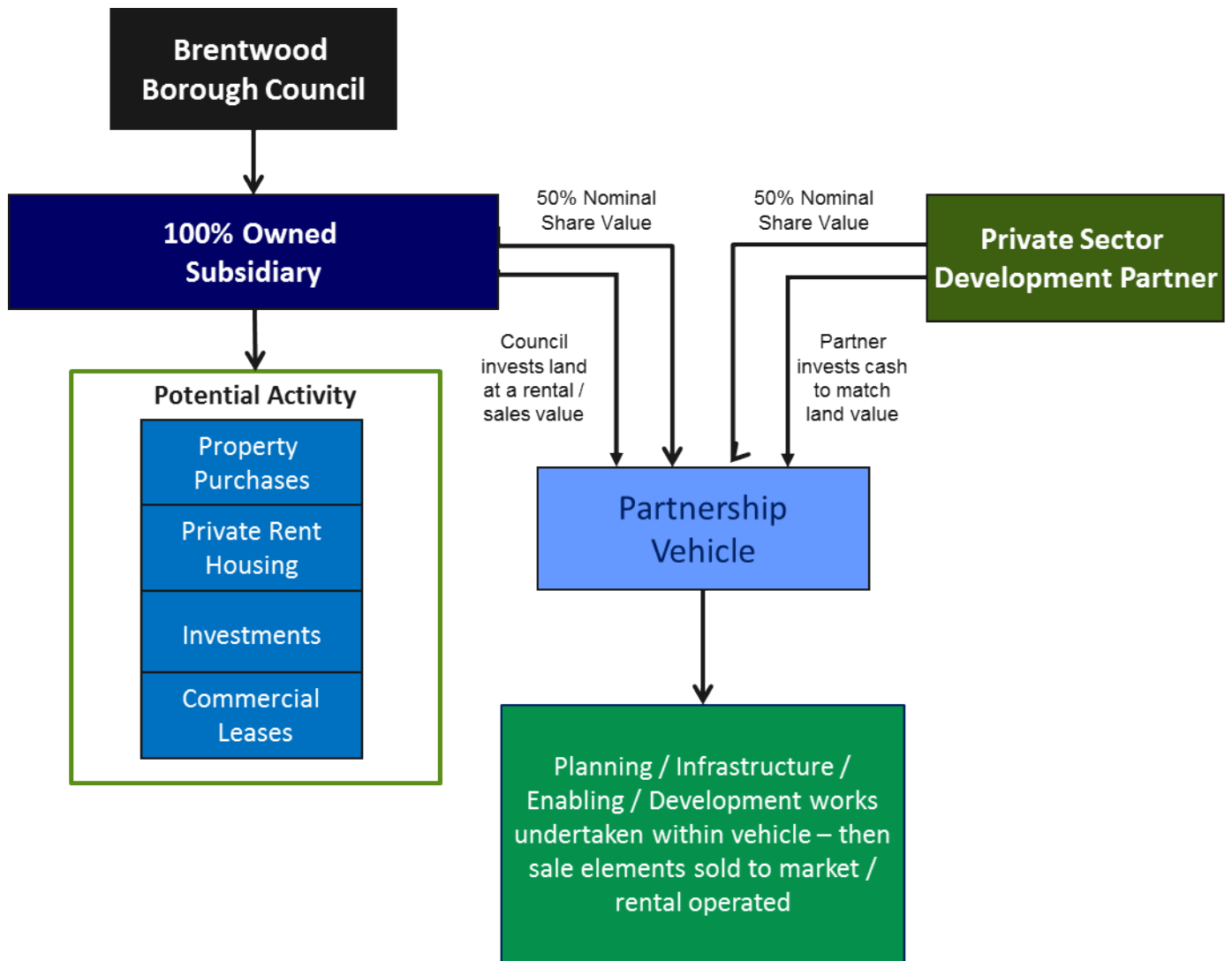
2. Recommendation(s)

- 2.1 That a report recommending the creation of a wholly owned company, (WOC) be brought to the next PPR Committee following finalisation of the governance arrangements.**
- 2.2 That the work on the procurement of an asset development partner continues and a decision to formally tender be brought back to the Committee.**

3. Introduction and Background

- 3.2 On 19 September 2017 the Policy, Projects and Resources Committee approved a hybrid approach for delivering the asset development programme. The Committee also approved the investigation of appropriate investment vehicles.
- 3.3 The hybrid approach involves the self-development of simple sites by the Council, while more complex sites would be undertaken jointly between the Council and a procured joint venture partner.

- 3.4 To maintain a revenue stream for the Council the self-developed sites will be leased out on a commercial basis. The Localism Act 2011 allows local authorities to do anything an individual can do. However, section 4 of the act requires that any commercial activity must be undertaken through a company.
- 3.5 Therefore, to comply with the requirements of the Localism Act 2011 the Council needs to establish a company. This will be wholly owned by the Council. It should be noted that certain local authority activities that could be considered commercial, such as leisure and car parks, are covered under separate legislation and do not need to be undertaken through a company.
- 3.6 The wholly owned company will seek to engage in a variety of commercial activities that will be asset based initially, and subject to appropriate business cases and financial sustainability could be extended into other areas such as service provision. Through a combination of equity from the sale of those Council assets, which are approved for sale through the asset challenge process and borrowing the Council would provide the company with a loan to acquire investment properties to generate a sustainable revenue stream.
- 3.7 Sites developed with a partner will also require the establishment of a separate company to comply with legislative requirements and to formalise the partnership. This will likely be in the form of a limited liability partnership (LLP) with ownership split 50:50. The best arrangement will be assessed through the procurement process.
- 3.8 The following diagram provides an illustration of the potential relationship between the wholly owned company and the joint venture vehicle.



4. Issue, Options and Analysis of Options

- 4.1 To act on a commercial basis the Council must do so through a company. Legal advice is that a limited company by shares is the best model. The overview of the legal advice from Sharpe Pritchard is at Appendix A.
- 4.2 Tax advice has also been sought from financial experts. The advisors are in place and will have significant involvement during investment activity as this is when tax liability will occur.
- 4.3 The Council has a number of assets that could be used more effectively to produce a better revenue stream. An example of this is the Town Hall that is undergoing development and once completed will require a company to manage the commercial and residential aspects. Conversely there are other assets with limited revenue generating potential that could

be sold, and the proceeds invested for a greater return for the Borough through the company.

- 4.4 Combining disposal proceeds with borrowing would enable the Council to provide sufficient funding to the company. With this investment the company would have the necessary funding to acquire properties that produce strong returns. The financing would be provided to the company by the Council in the form of a loan that the company would be expected to pay interest against. As a wholly owned company the Council would benefit from all surpluses generated.
- 4.5 Due to state aid rules the company would have to be charged interest at market rate for the loan. As the Council would borrow from the Public Works Loan Board (PWLB) below market rate, the Council would benefit from the difference in interest rates.
- 4.6 Initially the company would not employ anyone, and Council officers would provide the required services. The cost of officers' time would be charged to the company.
- 4.7 There will be two company Directors, the Head of Paid Service and the Chief Operating Officer. It is anticipated the company would be established in April 2018 and undertake activity in the first half of 2018/19. Policy, Projects and Resources Committee will receive reports in the Council's capacity as sole shareholder, from the company board, detailing their activity and performance.
- 4.8 In regard to finding a development partner, the Council has engaged the services of the East of England Local Government Association (EELGA) 31ten Consulting and J C Gill and Co Limited to assist on the asset development programme. So far, they have assisted with:
 - Refining asset information
 - Producing a provisional development programme
 - Considering options for delivery (hybrid option selected)
 - Undertaking soft market testing (completed in December 2017)
- 4.9 Following a very positive response from the soft market testing the intention is to continue market engagement with the objective of procuring a development partner and establishing a joint venture entity. As the procurement progresses options for development and company structures will be developed and reported to this Committee.

5. Investment Strategy (Wholly Owned Company)

5.1 Before undertaking an investment, advice will be taken from consultants who specialise in the investment class. Their advice will ensure that risk is minimised and returns maximised. Tax advice will also be sought on investments to minimise liability.

5.2 Investment Objectives:

Requirement	Reason for requirement	Investment approach to inform and impact on performance
Minimise risk	Risk needs to be carefully managed to ensure the company is sustainable.	Risk is a key consideration and low risk investments will be targeted. Over time an increased level of risk may be appropriate depending on the existing portfolio.
Focus on revenue returns	To meet revenue funding gap	Consideration for investing in existing property funds Acquire to hold, rather than to dispose Re-invest surpluses
Short term revenue generation	Meet short term funding gaps	Seek to invest initially in current revenue generating assets or funds. In the medium term, identify opportunities for greater return on investment (ROI) by taking a longer term approach e.g. acquisition of vacant properties or development to realise a revenue stream.
Long term revenue generation and capital growth	Balanced fund	Seek to invest initially in current revenue generating assets or funds in the short term. In the medium term, identify opportunities for greater return on investment (ROI) by taking a longer term approach e.g. acquisition of vacant properties or development to realise a revenue stream.

Requirement	Reason for requirement	Investment approach to inform and impact on performance
Ability to make quick decisions	Commercial opportunities can require the ability to react quickly to ensure they are not missed.	The Investment Company will need to be able to react quickly to investment opportunities.
Stakeholder buy-in	Stakeholder support is vital for the success of the company.	Regular reports and review of Company Performance.
Governance and Transparency	Meets the Councils audit and scrutiny requirements. Demonstrates basis of investment decisions and value for money.	Investment decisions evidenced based. Regular reporting and review of fund performance.
Commercial and political sensitivity	Set up and operation of the company may create conflicts of interest. As a public body there are reputational risks that may impact upon the nature and type of investments.	Appropriate governance structure to mitigate conflicts of interest. Consider reputational risks within all investment opportunities and subsequent investment management decisions.

5.3 Investment Criteria:

Requirement	Reason for requirement	Statements
The Council will invest in a balanced portfolio of assets	Manage risk	Specialist investment advice will be obtained
Portfolio development	Development to fit timing of revenue returns	Specialist investment advice will be obtained
Geographic focus	From a governance, legal and reputational perspective	National but initially an emphasis on opportunities in the Borough.
Target yield	Balance Risk and Reward	Investments will aim to achieve a net initial yield of 6%.
Leveraging the Investment Company/Assets	Maximising investment returns	Specialist investment advice will be obtained

5.4 Risks:

- In the long term, property investment tends to produce a strong return. However, in the short term there is greater risk of prices falling below the original investment.
- Investment in property and the carrying out of development activities carries risks at both macro and micro levels. Property rentals, values and occupancy rates typically fluctuate broadly in line with the regional, national and increasingly, the global economy.
- The timing of acquisitions and sales can thus have a significant impact on the rate of return as can complementary investment in lower risk or countercyclical investments such as Private Rental Residential property.
- Individual investments will be the subject of pre-acquisition due diligence and risk assessments and regular updates to the Council.

6. Financial Considerations

- 6.1 Based on the investment criteria the company would acquire property that aims to return an initial yield of 6%. This would allow the company to cover its operating costs and produce a surplus that it could reinvest. In addition to the rental income it is anticipated that over time capital appreciation in some of the properties would also occur.
- 6.2 Operating costs would also include time of Council officers who undertake work for the company.
- 6.3 The Council would benefit from the loan interest it receives, charges for officers' time and any surpluses made by the company.

7. Reasons for Recommendation

- 7.1 To create a wholly owned company Committee recommendation to Council and subsequent Council approval is required.

8. References to Corporate Plan

- 8.1 This fits with the Council's Transformation Vision, to explore new income generating ideas and opportunities.

9. Implications

Financial Implications

Name & Title: Phoebe Barnes, Principle Revenue Accountant

Tel & Email: 01277 312 839 phoebe.barnes@brentwood.gov.uk

- 9.1 There are considerable financial benefits to the Council's General Fund from the creation of a company.
- 9.2 However, investments carry a degree of risk and the company will need to be sustainable in the long term.

Legal Implications

Name & Title: Daniel Toohey, Monitoring Officer

Tel & Email: 01277 312 860 daniel.toohey@brentwood.gov.uk

- 9.3 This report sets out the business case to create a wholly owned company the legal basis on which the Council can set up a wholly owned company are contained in the Legal Advice as set out in Appendix A.
- 9.4 Insofar as the procurement of the development partner is concerned this must be undertaken in accordance with the Council's standing orders relating to contracts, and the requirements of the procurement regulations and related legislation. Legal Services, acting with specialist external solicitors, is available to advise and assist as the project goes forward.

10. Appendices to this report

- Appendix A – Legal Advice (Exempt)

Report Author Contact Details:

Name: Chris Leslie – Commercial Manager

Telephone: 01277 312500

E-mail: christopher.leslie@brentwood.gov.uk