

21st March 2018

Extraordinary Council

Wholly Owned Company

Report of: *Chris Leslie – Commercial Manager*

Wards Affected: *All*

This report is: *Public*

1. Executive Summary

- 1.1 This report sets out the business case and seeks approval to create a company that will be wholly owned by the Council. As part of the Council's asset development programme a private company is required to engage in commercial activity and also to facilitate future opportunities.

2. Recommendation(s)

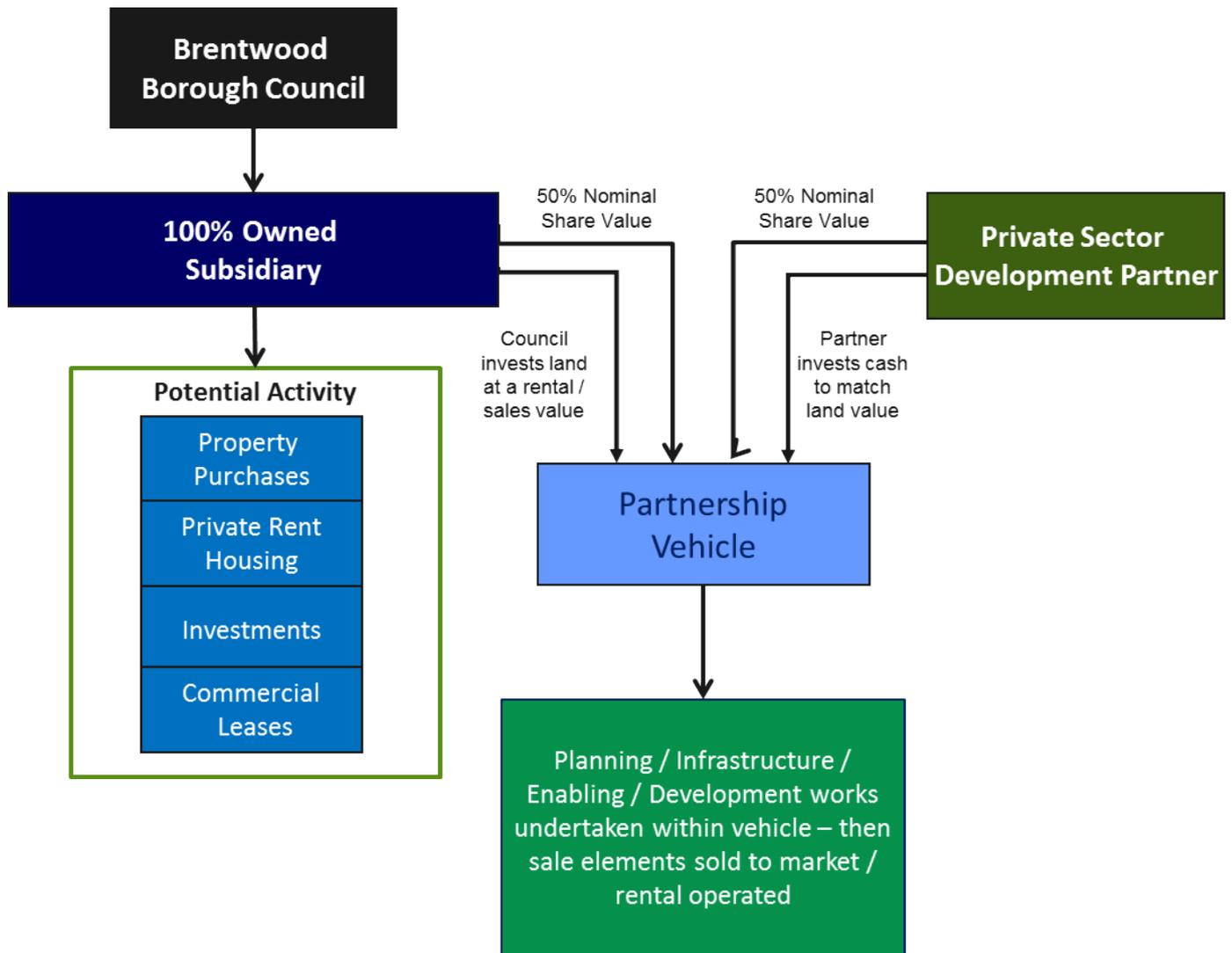
- 2.1 **That the creation of a wholly owned company be approved.**
- 2.2 **That authority be delegated to the Policy, Projects and Resources Committee to exercise the Council's decision making powers under the shareholder's agreement.**

3. Introduction and Background

- 3.1 The Corporate Plan for the Borough of Brentwood 2016-2019 includes a commitment to explore new income generating ideas and opportunities. At its meeting on 6th February 2018 the Policy, Projects and Resources Committee agreed that a report recommending the establishment of a wholly owned company would be brought to the next meeting.
- 3.2 On 19 September 2017 the Policy, Projects and Resources Committee approved a hybrid approach for delivering the asset development programme. 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.
- 3.3 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.

- 3.4 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.
- 3.5 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.
- 3.6 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, but the wholly owned company might have a role in that structure (depending on tax and governance advantages) as shown in the following diagram.



4. Issue, Options and Analysis of Options

- 4.1 There will be two company Directors, the Chief Executive and the Chief Operating Officer. 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.
- 4.2 Certain key decisions will be reserved for the PP&R Committee to approve. These are outlined in the reserve matters section of the shareholders agreement at Appendix A. They include the following areas:
- Entering into contracts outside the normal course of business
 - Loans and financing arrangements
 - Altering or ceasing business
 - Guarantees and indemnities
 - Shareholdings

- Appointment and remuneration of executive directors
- Business plan
- Corporate matters

4.3 The Directors of the company will take decisions relating to matters such as:

- Committing expenditure in accordance with the business plan
- Commissioning services
- Acquisitions in accordance with the business plan
- Monitoring and directing the work of the company

4.4 Each year the Policy, Projects and Resources Committee will be required to approve the company's business plan. This provides the scope that the company must operate within. Any variations to the business plan must be approved by the Committee.

4.5 Initially working capital will be provided to the company by the Council in the form of a loan. Subsequent loans will require Committee approval. Due to State Aid requirements the company will have to pay interest on the loan at market rate.

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

Requirement	Reason for requirement	Investment approach to inform and impact on performance
		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.
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 Council's 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	Appropriate governance structure to mitigate conflicts of interest. Consider reputational risks

Requirement	Reason for requirement	Investment approach to inform and impact on performance
	reputational risks that may impact upon the nature and type of investments.	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 minimum 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. Economic and Financial Considerations

- 6.1 Based on the investment criteria the company would acquire property that aims to return an initial yield of at least 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 Market data shows that a 6% target is in line with the average income return for 2017.

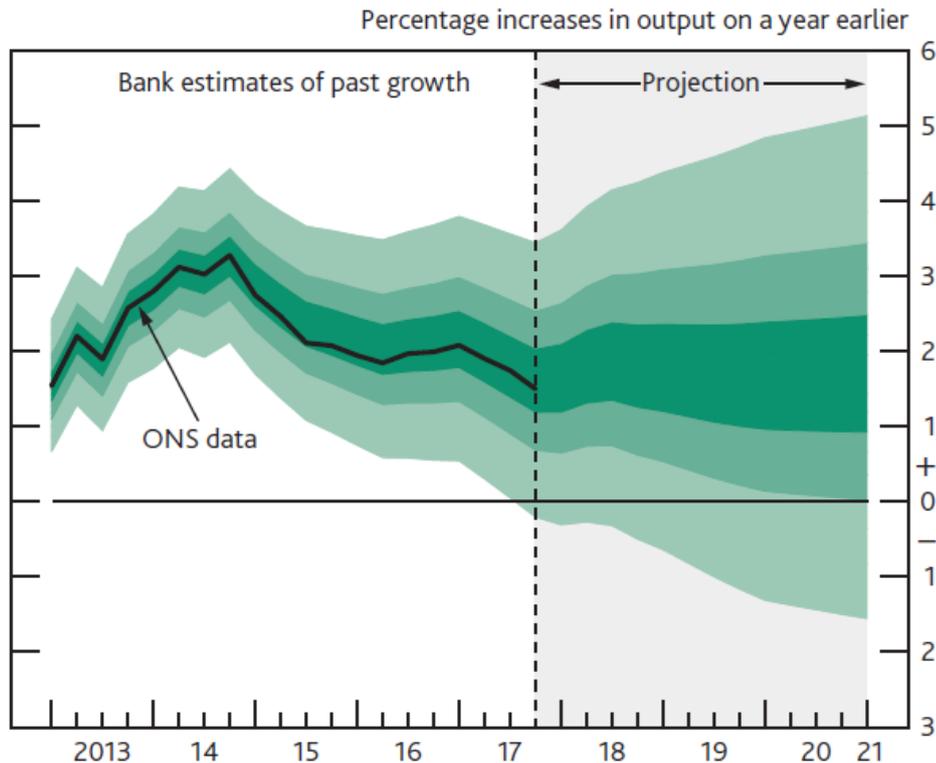


Source: MSCI

- 6.3 The Bank of England reported in their February 2018 Inflation Report that global GDP has been strong over the past year, with global growth estimated to have remained at 0.8% in 2017 Q4. That pace of growth is expected to persist in the near term. Productivity growth is expected to recover across advanced economies over coming years, but to remain below pre-crisis rates.

- 6.4 UK growth is expected to remain stable over the coming years at around 1.7%, with UK growth expected to be supported by the continued strength in global economic activity. However, there remain economic risks, such as Brexit, that may affect these predictions.

Bank of England GDP projection based on market interest rate expectations, other policy measures as announced (Feb 2018)



- 6.5 CBRE's UK Real Estate Market Outlook for 2018 highlighted that the property market had rebounding strongly from the uncertainty in the immediate aftermath of the EU referendum and that the UK property investment market has seen a surprise surge in transaction volumes, particularly from overseas investors. Investment volumes are likely to remain robust at around £60bn for 2018 as a whole.
- 6.6 Their sectoral picks included industrial and logistics property, especially in urban areas and the so-called 'beds sectors' (residential, student accommodation, hotels and healthcare). These sectors either exhibit non-cyclical characteristics, have very significant demand and supply mismatches, or (in the case of hotels) will benefit disproportionately from the weaker pound.
- 6.7 Funding for the investments would be provided to the company in the form of a loan. State Aid requirements mean that interest would have to be

charged at market rate (circa 4%). Therefore, investment returns would need to cover the interest costs and other operating costs, which include the use of specialist investment advisors.

- 6.8 Additionally, charges for Council officer time for work undertaken on behalf of the company will also be charged. Conversely, this will be income to the Council.

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: Jacqueline Vanmellaerts, Financial Services Manager

Tel & Email: 01277 312829

jacqueline.vanmellaerts@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, which it is legally entitled to do using The General Power of Competence under the Localism Act 2011. Legal Services, working with external legal advisers and specialists, will be providing advice and assistance going forward.

10. Appendices to this report

- Appendix A – Shareholders Agreement

Report Author Contact Details:

Name: Chris Leslie – Commercial Manager

Telephone: 01277 312500

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