

A report to Waverley Borough Council on the options for setting up a local delivery vehicle



Sceptre Court
40 Tower Hill
London
EC3N 4DX
t +44 (0)20 7423 8000
f +44 (0)20 7423 8001
www.trowers.com

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1 Background

1.1 We understand that Waverley Borough Council (the **Council**) are looking at the possibility of setting up a local delivery vehicle (an **LDV**), which could be used to achieve one or more of the following purposes:

- new house building,
- receiving vacant properties through a trickle transfer,
- estate remodelling,

and could include generating receipts for the Council to use towards its Decent Homes programme.

1.2 We have set out below a description of the different corporate forms which the LDV could take and provided examples of the types of legal structures which involve these different corporate forms taking into account the above purposes for which the Council may wish to use the LDV. If required the LDV could be set up with wider objectives than just housing (for example, to provide community facilities such as leisure centres) and its objects could include land acquisition, although more detailed consideration of such wider objectives is beyond the scope of this paper.

1.3 There are various options for the form of the LDV. It could be set up as a company, either limited by shares or by guarantee, an industrial and provident society or possibly as a limited liability partnership. The key decision making factors on choice of legal vehicle are likely to be whether the LDV is trading for profit or not, whether it is to be charitable or not, and whether there is a need now or in the future to be able to offer a partner or partners equity in the company. It is understood that at present the Council wishes the LDV to initially be set up as a non-charitable, not for profit vehicle with no equity partners.

1.4 In the final section of this paper we have described the basic formation requirements for setting up an LDV.

2 Companies Limited by Guarantee and Industrial and Provident Societies

If there is a possibility that the LDV is not going to be used to trade for profit, as is currently anticipated, the most suitable options are to set it up either as a company limited by guarantee (a **CLG**) or an industrial and provident society (an **IPS**). Both CLGs and IPSs can be charitable or non-charitable. There may be little to choose between using a CLG or an IPS for the LDV – it may simply come down to which model a local authority is most familiar with.

We have set out below a description of the main features of a CLG and an IPS followed by an example of a legal structure involving a CLG or IPS which has been considered by some authorities to raise finances to refurbish dilapidated void properties whilst also raising funding to invest in its Decent Homes programme for its retained HRA stock.

2.1 **Industrial and Provident Societies**

Industrial and provident societies have evolved out of mutual societies and they are registered with the Financial Services Authority. An IPS can be charitable or non-charitable but must be not for profit and exist for community benefit.

An IPS has shareholders, although the shares carry no financial benefit. The Council could never be the sole shareholder as there have to be at least three shareholders, but subsidiary status can be achieved if wanted by giving the Council a share and the right to appoint the board.

If the LDV were to be set up as a charity, a current advantage of an IPS over a company limited by guarantee is that charitable IPSs are exempt from registration with, and regulation by, the Charity Commission. However, it should be noted that at some point in 2009 charitable IPSs which are not registered social landlords will need to register with the Charity Commission also. IPSs may also have an advantage in terms of presentation as they are not perceived as being linked with profit-making in the same way that companies can be, although it should be noted that companies limited by guarantee are increasingly perceived as distinct from profit-making vehicles since many are charitable.

The IPS model used to be more restrictive than the CLG model because until recently it was not possible to register an IPS with 'class' voting rights. Class voting allows each class of an organisation's members potentially to have parity of votes, rather than each individual member having one vote. However, the Financial Services Authority have now been persuaded to accept registrations with class voting rights and it would be hoped that applications of a similar nature would be accepted in the future.

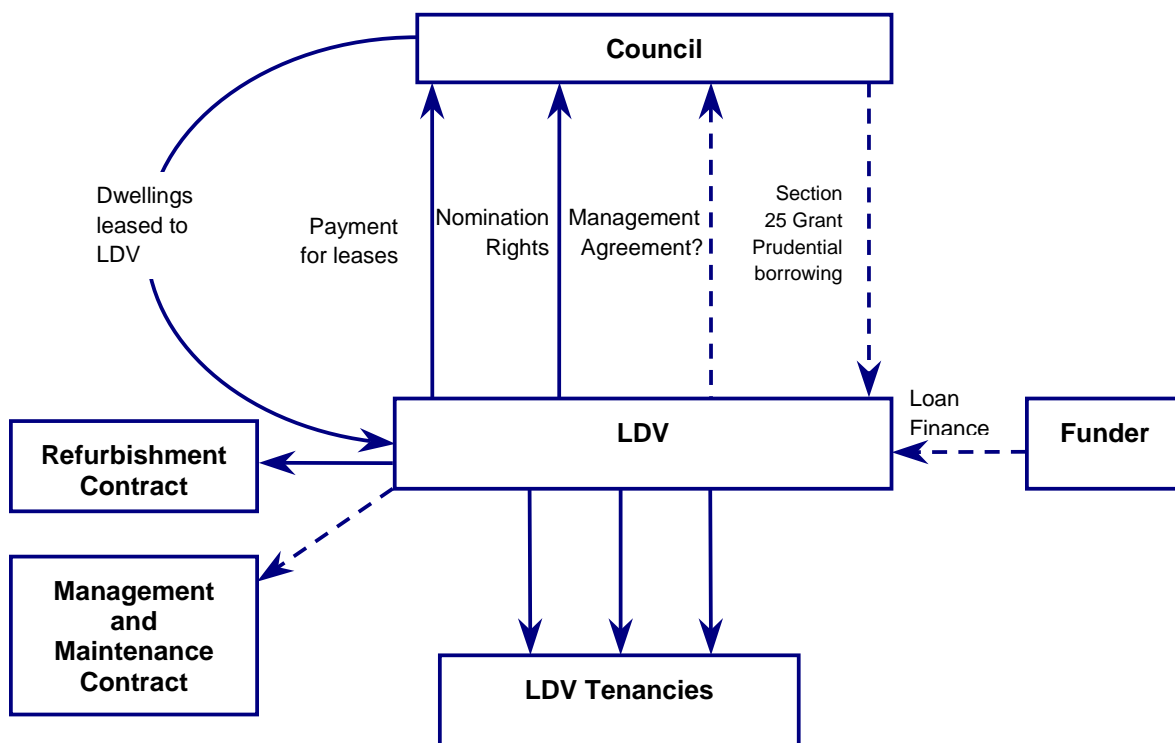
2.2 **Companies limited by guarantee**

A CLG is a company where the general members do not hold shares – but instead each member undertakes to pay a nominal figure (usually £1) in the event of any insolvency on the part of the company. It is possible to regulate the various interests of the members by creating different classes of members with different voting rights.

In addition CLGs are frequently used for social housing activities as they are not associated with profit-making in the same way companies limited by shares are.

If the LDV is to be a wholly-owned subsidiary, the Council could initially be the sole member. But a company limited by guarantee can have many members and different categories of members with different voting rights. Changing from a single member company to one with many is also simple.

2.3 **A structured example of an LDV receiving vacant properties and raising HRA funding**



As stated above, this model has been considered by some authorities to raise finance to refurbish some dilapidated void properties which are pepper-potted around its stock and also to raise funding to invest in its Decent Homes programme for its retained HRA stock. It would include the following features:

- The council creates an LDV as a company limited by guarantee or an industrial and provident society.
- The council grants a 125-year lease of up to 499 void properties to the subsidiary over a 4 or 5-year period at full value (taking into account any obligations contained in the transfer agreement). The cap of 499 properties prevents the lease of the properties being classified as a 'large scale disposal'. The lease could contain a break clause entitling the council to end the lease in certain circumstances or at certain times, although any outstanding loans would need to be repaid to the funder at the point that the break clause is exercised. .
- The LDV would procure a contractor to refurbish the properties within the first 6 months of the lease.
- The funding to pay for the leases and the refurbishment works would come from either private finance and/or possibly from prudential borrowing by the council.

- The LDV then lets the properties on a mix of tenures, including social rented accommodation (possibly including some temporary accommodation to homeless households or to other clients for whom the council has a duty to provide housing) and potentially some intermediate rentals.
- The lease payments to the council by the LDV could be used by the council to carry out improvements to its housing stock under its Decent Homes programme.
- The LDV would contract back to the council for management services (subject to the applicability of the EU procurement rules).
- The council would have nomination rights to the LDV's social rented accommodation.

3 **Companies limited by shares and limited liability partnerships**

It may well be that the Council decides that it does not wish to involve equity partners in the LDV but it may still be useful to rehearse the potential for a joint venture LDV here. As an alternative to the CLG and IPS models, if the Council wished to enter into a joint venture then an LDV set up as a company limited by shares (a **CLS**) or a limited liability partnership (an **LLP**) would be most suitable. These types of vehicles are used where the LDV either now or in the future is likely to want to trade for profit.

Set out below is a description of the main features of a CLS and an LLP followed by an example of a legal structure involving a CLS or LLP which has been considered by some authorities to remodel estates.

3.1 **Companies limited by shares**

The company limited by shares is generally viewed as the most appropriate legal form for the majority of joint ventures where an on-going business is to be run, due to the fact that the corporate structure is tried and tested and is underpinned by an established body of law and practice. However, there are potential tax disadvantages in the partners conducting the project through the medium of a limited company, which can be avoided by opting to form an LLP.

A company limited by shares is the type of company with which most people tend to be familiar. If the LDV is to be a joint venture company, the Council and its partner would each agree to subscribe for shares in the LDV and the rights and obligations of the partners with regard to the venture would be set out in a shareholders agreement.

In terms of overall control and financial and tax planning, the structure of a limited company provides considerable flexibility through the creation of different types of share and loan capital. A company can also create a floating charge over its assets, which is often a requirement of external finance. Companies can only distribute profits as dividends if profits have been made because of rules relating to maintenance of capital.

3.2 **Limited liability partnerships**

The Limited Liability Partnerships Act 2000 allows the incorporation of LLPs. The LLP is a novel business entity and combines limited liability for members with the relaxed internal

regulation of a traditional partnership. It is also a body corporate which is a legal entity separate from its members.

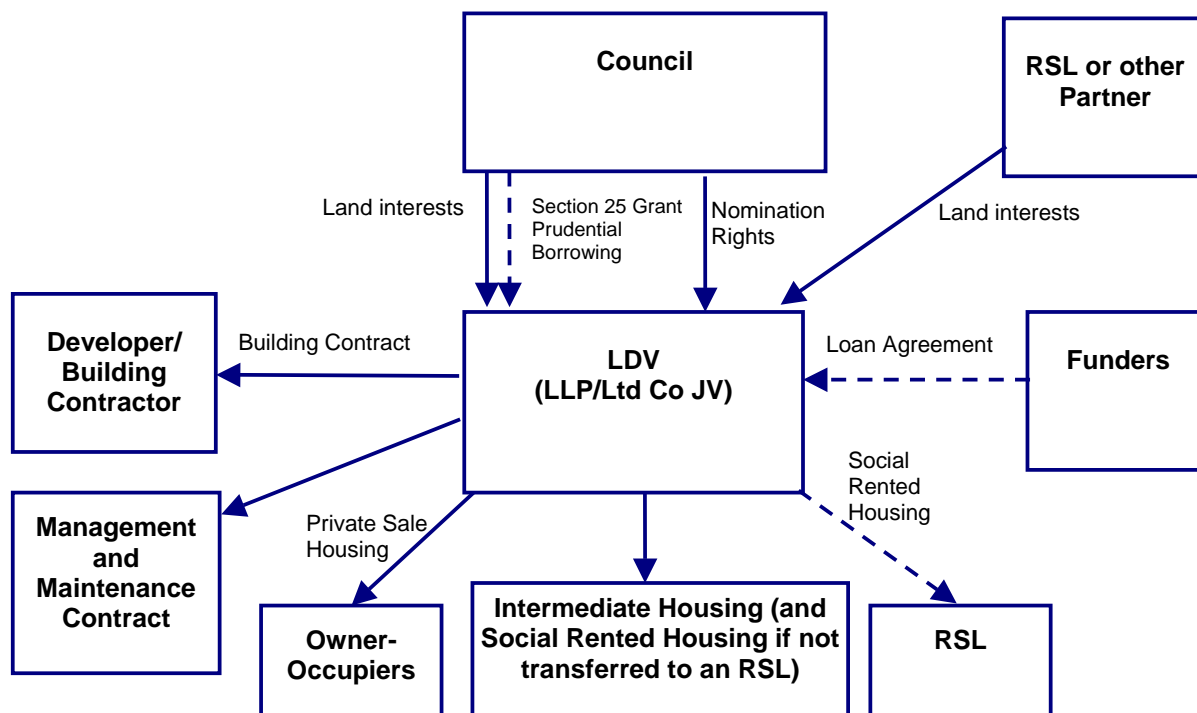
In a joint venture LDV set up as an LLP, the Council and its partner would be members of the LLP and the relationship between them would be governed by the terms of a members agreement. Any further parties wishing to join would need to execute a deed of accession to the members agreement, agreeing to be bound by its terms.

Members do not appoint a board to run the LLP on their behalf. There are at least two formally appointed designated members who are merely compliance officers. The running of the LLP rests with the members as they agree it. This internal freedom resembles a partnership. In practice, a body similar to a board is then established as the decision-making forum for most decisions.

The members are free to agree how to share profits and are also free to agree management roles and responsibilities. An LLP has no share capital so capital can therefore be reduced or increased at the will of the members. As the LLP is a body corporate with unlimited capacity it can create floating charges like a traditional limited company.

However, the principal advantage of using an LLP over a company limited by shares is the way in which it is treated from a tax perspective. The LLP is treated for tax purposes as a traditional partnership, and members are treated as traditional partners. Therefore, unlike a limited company, it is tax transparent and any trade, profession or business carried on by an LLP with a view to profit will be treated like a traditional partnership. Since the tax status of the partners determines how much tax is paid, the Council's share of any profits should be corporation tax free. The vires for a local authority to participate in an LLP is not free from argument and specific legal advice on the Council's power to participate in an LLP would need to be sought if this was the Council's preferred model.

3.3 A structured example of a joint venture LDV to remodel/regenerate an estate



This would be a joint venture vehicle set up with an RSL or other partner. This model has been considered by local authorities interested in remodelling/regenerating estates and, in so doing, offering the opportunity of generating receipts which the authority could use either towards other affordable housing or regeneration projects (including subsidy of its Housing Revenue Account) or otherwise towards support of its General Fund.

The model would include the following features:

- The model assumes the transfer of land to the LDV with vacant possession. The council would be responsible for decanting its tenants and rehusing them in other nearby council accommodation and, if necessary, promoting a compulsory purchase order within the project area in order that it could then transfer its land with vacant possession to the LDV for full value (taking into account any obligations contained in the transfer agreement).
- If appropriate the RSL/partner would transfer its land within the project area to the LDV. Further, the RSL/partner may be required to offer accommodation from its stock to any leaseholders within the project area who have exercised their right to buy, either acquiring at a discounted purchase price or under shared ownership arrangements (ie as an 'inducement' to enable the council to transfer land with vacant possession).

- Following transfer of the vacant properties and land, the LDV would enter into a building contract with a developer or building contractor to demolish (or refurbish if appropriate) the existing buildings and redevelop the land. The funding would come from either private finance or possibly from prudential borrowing by the council.
- The regenerated estate would include a mix of tenures through the provision of some housing for private sale and some intermediate housing (such as shared ownership schemes) with the aim of maintaining the original amount of social rented accommodation. Obviously this could only be achieved if it is possible to increase the overall number of units on the estate through efficient use of space.
- On practical completion of the new properties the LDV could transfer the social rented housing to an RSL and/or enter into a management and maintenance agreement with a third party (which could include the council (subject to the applicability of the EU procurement rules)) to manage and maintain its affordable housing stock (i.e. the social rented and intermediate housing).
- On practical completion the LDV may also enter into a nominations agreement with the council for the affordable housing.
- The completed affordable housing properties (if not transferred to an RSL) would be let by the LDV, either as assured or assured shorthold tenancies or on shared ownership (or other forms of intermediate housing) terms. The income from the properties would be used to pay any management and maintenance fees and any loan repayments. Any profits could be shared between the partners in the joint venture, including the council.

4 **Setting up an LDV – formation requirements**

- 4.1 Registration of a company limited by shares or by guarantee requires the initial subscribers (there need be only one subscriber) to sign the memorandum and articles and to submit these together with various forms signed by the proposed board members and secretary to Companies House together with the registration fee of £20 (or £50 for the same day service). Registration is usually completed within one week to ten days of the application.
- 4.2 Registration of an IPS requires three founder members to sign the rules and to submit these together with two forms relating to the IPS's proposed activities together with the registration fee of around £1,000. Registration is usually completed within about three weeks.
- 4.3 Registration of an LLP requires at least two subscribers to submit an incorporation document setting out the name, registered office and details of the proposed members of the LLP (which must be signed by all of the proposed members) to Companies House together with a registration fee of £20 (or £50 for the same day service). Registration is usually completed within one week to ten days of the application.
- 4.4 If the Council wished to set up the LDV as a shelf company in order to protect the name, Trowers & Hamlins could apply to register a company with the chosen name or, alternatively, the Council's legal officers could set up the company instead. If the LDV is to remain dormant for a period we would recommend setting it up as a CLG or CLS rather

than an IPS or an LLP. To set up an IPS there must be a reason as to why it is being set up as a community benefit society rather than a company, which is more difficult to demonstrate if it is to be dormant and the specific purpose to which the LDV will later be used has not been identified. If the Council later decided that it wanted an IPS, it may be possible to convert the LDV from a company into an IPS subject to Financial Service Authority clearance. The difficulty with setting up an LLP which is to be dormant for a period is that an LLP must be set up with a view to making a profit. Therefore the LDV could be set up as an LLP if a future use is identified and the LDV would definitely be used with a view to making a profit but an LLP could not be set up simply to save a name. Thus it would be simpler to incorporate the LDV as a company and at a later date, if the Council wished to use an LLP, an LLP could be set up and the company's name could be swapped with that of the LLP.

- 4.5 With regard to the fees incurred following the incorporation of a vehicle, even if it is to be dormant, whichever form of vehicle is chosen there will be an annual fee. The annual fee for a company limited by shares, a company limited by guarantee or an LLP is £30 and the annual fee for an IPS ranges from £50 to £395 based on a sliding scale depending upon the vehicle's total assets.

Trowers & Hamblins
August 2008