

**Creation of a Property Company – Information provided to Investment
Advisory Board May 2017**

1. As previously advised by its external legal advisors, under section 120 of the Local Government Act 1972 the Council may acquire by agreement any land inside or outside its area for the purpose of (a) any of its statutory functions or (b) the benefit, improvement or development of its area.
2. The Council has a number of statutory functions in relation to its financial affairs. For example, sections 25 to 29 of the Local Government Act 2003 impose a statutory responsibility on the Council to set and arrange its affairs to remain within prudential limits for borrowing and capital investment. These provisions also require the Council to make prudent allowance for the risk and uncertainties in its budget and regularly monitor its finances during the year, leaving it to the Council's discretion as to the allowances to be made and action to be taken. In particular, section 28 of the LGA 2003 requires the Council, upon reviewing its budget, to take any action it considers necessary to deal with any deterioration in its financial position.
3. The objective of the Council's Investment Strategy is to offset the budget deficit that has been identified by the Council. To the extent that the purpose of acquiring any property is to deal with the deterioration in the Council's financial position by way of income generation, the Council could rely on section 120 LGA 1972 on the basis that the acquisition is for the purpose of fulfilling its statutory functions. This will need to be documented and it should be explained how an acquisition will specifically help remedy that deterioration.
4. Similarly, when justifying any property investment within its area on the basis of "the benefit, improvement or development of its area", the Council will need to clearly document the specific benefits (economic or otherwise) that the Council area will benefit from as a result of purchasing property.
5. External advice has also confirmed that it is likely the acquisition of the property in order to generate income will constitute an activity for a commercial purpose. The Council will therefore be unable to rely on the general power of competence under s.1 of the Localism Act 2011 in acquiring the property, unless it forms a company for the purposes of property investment. The Council may be able to rely on the section 1 Local Government Act 2003 power to borrow. However, the Council should be mindful that borrowing purely to invest at a profit is likely to be considered unlawful. In order to rely on this power the Council will need to clearly document how the acquisition is for the purpose of the prudent management of its financial affairs, explaining how it forms part of a range of financial management measures and why the acquisition of the Centre is necessary for that purpose. Borrowing under section 1 of the 2003 Act may also be possible

on the basis that the acquisition is for the purpose of dealing with the deterioration of the Council's financial position. Again, this will need to be clearly documented with reasons. When assessing the suitability of the Centre and the acquisition in more detail, the Council should consider whether the acquisition would meet any other statutory functions (for example, development or regeneration duties).

6. The position therefore is that a company is not required in order to invest in property outside of the Borough, provided that the Council can justify the investment as falling within one of the Council's statutory powers, and the most appropriate of these would be the preservation of the Council's financial position.
7. Having said that, should the Council wish to set up a company in order to invest in property, then the Council 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.
8. Such a company would likely be a controlled company as defined in the Local Government and Housing Act 1989 as it would be a subsidiary company of a local authority and as such the shareholder (the Council) would have ultimate control over the activities and operational matters of the company.
9. Typically, property investment and development acquisitions within the scope of the proposed company are expected to be high, and will include a diverse range of use types. The property vehicle would normally target a specified minimum return 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.
10. 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.

Company Structure and Governance

11. The purpose of the company would be to concentrate on property investment and development work both inside and outside of the Borough which is needed to provide a valuable income stream to the Council. Its focus would be on responding more quickly and effectively to market opportunities where the Council is more disadvantaged by the regulations on decision making which affect speeds of response.

12. As a company wholly-owned by the Council, it would be imperative for an appropriate governance structure to be 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

13. The company shareholder would have ultimate control over the company and would control the company in a variety of ways, including the appointment of directors, provision of funding and the Articles of Association, but operational matters could also be included in a Shareholder's Agreement as described below.
14. The most appropriate avenue would be for the Shareholder function of the Council to primarily be executed through a dedicated Sub-Committee of the Executive comprising members appointed by the Leader, with a minimum of three Members. If further appointments were required these will be made by the Leader.
15. 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.
16. The Council as Shareholder can change the make-up of the Board of Directors and can change the Company Secretary in the same way.
17. 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.
18. As stated above, the company would be a 'controlled company' as defined by the Local Authority Government and Housing Act 1989 and as a result would 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, and they must also provide information required by the Council's auditors.

Board of Directors

19. The Board of Directors would be responsible for delivery of the expected outcomes within the Business Plan. They would have oversight of the performance, financial and operational management of the company within the parameters agreed with the Shareholder.

20. The Board would usually be comprised of senior Council officers, and whether any Councillors would also be appointed as Directors would be for the Council to decide. Both Officers and Councillors would be unpaid. Some local authorities appoint Councillors onto the Board, but this is not a requirement and there are no hard rules governing this. The Articles of Association would need to be drafted in such a way as to ensure that a Councillor's appointment would terminate should they be disqualified or fail to be returned at an election.
21. Some local authorities have appointed an independent non-executive director to each company, with that director being chairman of the Board. The non-executive director would be remunerated, and would be recruited following an advertisement and interview. This would also bring commercial experience to the Board.
22. A Company Secretary would be appointed but would not be a Director. Many local authorities have appointed their senior legal officer or monitoring officer to this position.
23. The typical areas for the Directors to consider and approve include:
- Specific investment transactions – acquisitions, sales, letting, agreement for leases, surrenders, borrowing and other key transactions.
 - Appointment of service providers – accountants, solicitors, agents, valuers, architects, property managers, and other professionals as deemed appropriate.
 - Reporting – reporting arrangements to an Executive Sub-Committee (annexe 1) and the appropriate Overview and Scrutiny Committee.
24. In making appointments to the Board, the Council would need to be extremely mindful of, and put in place measures to eliminate, any conflicts that could arise between the duties of the statutory Council officers, such as the Section 151 Officer and the Monitoring Officer, in providing their advice to the Council as the Shareholder, and the duties of the Directors to the company.
25. The statutory duties for directors of a company are set out in sections 171 – 177 of the Companies Act 2006. Those duties are, in summary:
- The duty to act within powers
 - The duty to promote the success of the company
 - The duty to exercise independent judgement
26. The Council would need to consider how the support services which will be required by the company will be contracted out to the company. This would include legal services for property acquisition and accounting services provided by local authority staff (and re-charged to the company).

Documentation required to establish a company

27. The following documentation is required to complete the establishment of a LATC and associated governance arrangements.

- Articles of Association – the company constitution setting out the rules governing the running of the company
- Shareholder Agreement – this will be a key document as it will capture how the Council as Shareholder will exercise its control over the Company and the expectations for performance delivery.
- Loan Agreements – these set out the details of the funding arrangements between the Council and the company.
- Director Appointments – the terms upon which Council officers who will be appointed as directors to the Company will need to be agreed.
- Appointment of Company Secretary and an Auditor.
- Business Plan – the business plan would be developed to cover a rolling 20 year period of investment activity and would outline the company's planned operations. The Business Plan would be reviewed and agreed annually and would cover the following:
 - Company objectives (as established in the Shareholder Agreement) but these are expected to develop over time.
 - Governance arrangements - sufficiency of the arrangements and any planned changes to the Board.
 - Operational plans.
 - Financial model and assumptions.
 - Investment strategy.
 - Rents, sales and development assumptions.
 - Distribution Policy – is all trading profit to be returned to the shareholder or is any retained for future investment and/or running capital.
 - Fees, on-costs and tax.
 - Funding profile and sensitivity analysis.

Articles of Association

28. The Articles of Association would be agreed by the Executive Sub-Committee but would likely comprise the following:

- The articles are for a company limited by shares
- There will be one shareholder – the 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. For example, 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

29. 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

30. A Shareholder Agreement would operate in addition to the Articles of Association. The Shareholder Agreement would 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

31. The Company would be liable to corporation tax in the normal manner on profits, and would need to charge VAT.

32. 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

33. Councillors will be concerned to ensure that all risks of operating in a new way have been thoroughly considered.

34. Each acquisition would 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 would be provided to members of the Executive Sub-Committee. Each acquisition would be subject to these assessments as well as the normal legal and survey due diligence required. Therefore each acquisition would be considered in light of this information.

35. Certain checks and balances are built into the above structure so as to ensure that the company operates within agreed parameters and can assure Councillors that there is no greater financial risk to the Council than at present:

- The Articles of Association would set out the powers available to Directors.
- The Shareholder Agreement would set out further controls around dealings with properties.
- The Executive Sub-Committee would 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 Councillors.
- Funding provided by the Council and properties to be subject to development by the Council would need to be agreed by the Executive Sub-Committee. Funding from the capital programme and/ or funding from prudential borrowing would need to be agreed by Council.
- Any asset transferred to the company by the Council would be subject to the usual requirements of best value and section 123 of the Local Government Act 1972. The Council would need to obtain up-to-date valuation advice before any transaction were to proceed.
- Assets transferred to the company by the Council would also be subject of charge by way of legal mortgage to protect the Council's interests should the company face financial difficulties.
- 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.
- The Executive Sub-Committee would be scrutinised by the appropriate Overview and Scrutiny Committee in the same way as any other Executive function.
- 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
- The company will have its own auditors and will be subject to the requirements of company law and filing at Companies House

State Aid

36. EU regulations ensure that the company could not 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 would also include loans to the company and the rate of interest that loans to the company would need to be charged. This would 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

37. As set out above the company would 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.
38. Loans could be sourced from the Council's capital reserves - where the Council would loan some equity – and/or from the banking sector or through Public Works Loan Board.

Powers to fund the Company

39. The company would need significant funding to purchase property in the open market. Therefore, as well as the Council having the powers to form the company it would also need to be able to provide it with the necessary loan and equity funding.
40. 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 would need to be prudent and comply with the Prudential Code.
41. The Council could borrow monies and in turn support the company through the provision of loans and subscription to share capital. This would be 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.
42. Where it were appropriate for the company to develop Council-owned land, the Council would be entitled to dispose of land to the Company provided it complied with Section 123 of the Local Government Act 1972, which is the duty to obtain best value for property disposals.

Procurement

43. In the above circumstances the Council would be establishing the company for a commercial purpose. It would be funded from a variety of sources, including Council money, other public money and private funding. It would be intended that the company would 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 would mean that the requirements of the Regulations would not apply to the company.

Executive Sub-Committee

Background

The Council would establish an Executive Sub-Committee specifically to discharge the functions of the Council as regards its corporate shareholding in the company. The Sub-Committee would meet once a year to receive an annual report and annual accounts from the company, but otherwise meetings would 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 would be able to sit and vote on the Committee. A minimum number of three Executive Members would be needed to undertake the shareholder function. Substitutes would 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 company.

Remit

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

- To determine the Shareholder Agreement between the Council and the company including the 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.