Housing Company Proposals

1. Summary of the Proposal

East Herts Council's Corporate Strategic Plan 2016/17 – 2019/20 includes 'undertaking feasibility work on setting up a company to build new homes' as a means of furthering the Council's priority to 'enhance the quality of people's lives'. The Medium Term Financial Plan includes income targets for a housing company from 2017/18 onwards.

It is proposed to conduct a detailed feasibility study into the establishment of a company, wholly-owned by East Herts Council, to:

- purchase existing homes in the open market, and/or
- buy properties off-plan, and/or
- receive properties currently held by East Herts Council.

This would essentially be an investment vehicle, herein termed Invest Co.

The establishment of a housing *development* company, herein termed Dev Co, to build properties would be a more complex undertaking. It is proposed, therefore, to commence feasibility work on this once the viability of Invest Co has been established.

2. Initial approach

A number of local authorities have now set up companies or are in the process of doing so, principally for:

- financial purposes, including getting the best return on council-owned assets, creating an ongoing revenue income stream and benefitting from the uplift in the value of assets acquired or built, and/or
- housing purposes, including providing additional private rented, affordable and market housing, and/or specialist housing, for example older persons' accommodation.

These two drivers are not mutually exclusive. Providing much needed housing in whatever tenure can also give the Council a financial return.

It is proposed that the first piece of work will be to establish a company, wholly-owned by East Herts Council, to:

- purchase existing homes in the open market, and/or
- buy properties off-plan, and/or
- receive properties currently held by East Herts Council.

These properties would then be let at market rents. The initial geographic focus would be East Herts, stretching to neighbouring districts and beyond if and when a business case suggested this would give a good return on capital.

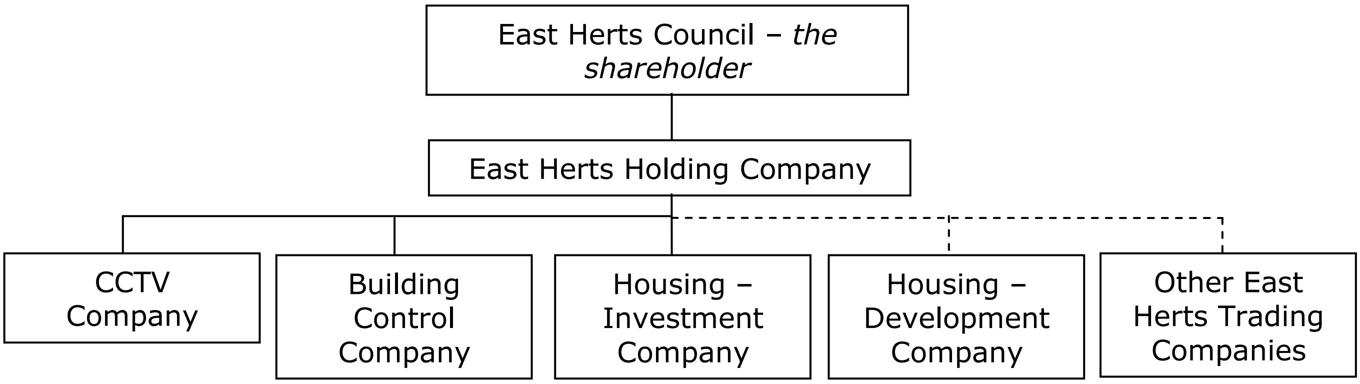
It is perhaps helpful to think of this as a housing investment company as the main aim at this stage will be to generate financial returns – the proposed company is thus referred to as Invest Co herein. This differentiates the proposed company from a housing *development* company which would *build* new homes. Housing development is markedly more complex than investing in existing properties, so it is proposed to focus first on the establishment of Invest Co, while at the same time working up proposals for a housing development company.

3. Potential structure

The Council has the power to acquire homes directly, however, the homes would then technically be counted as council housing. This would limit the type of tenancies that could be granted and would, in most cases, give tenants the right-to-buy. If more than 50 homes were acquired, the Council would need to reopen its Housing Revenue Account.

In addition, where a council is using its general power of competence to commercially trade, the Local Government Act 2003 requires that this be done through a company, rather than directly by the Council, and the Localism Act 2011 outlines the acceptable forms of company that can be used. The typical structure is a company limited by shares as this gives the maximum freedom over distribution of dividends to the shareholder, in this case, East Herts Council.

At the same time as setting up the proposed Invest Co, the Council may wish to establish a legal structure to accommodate all its current and potential future companies. In its simplest form, a structure would be as follows:

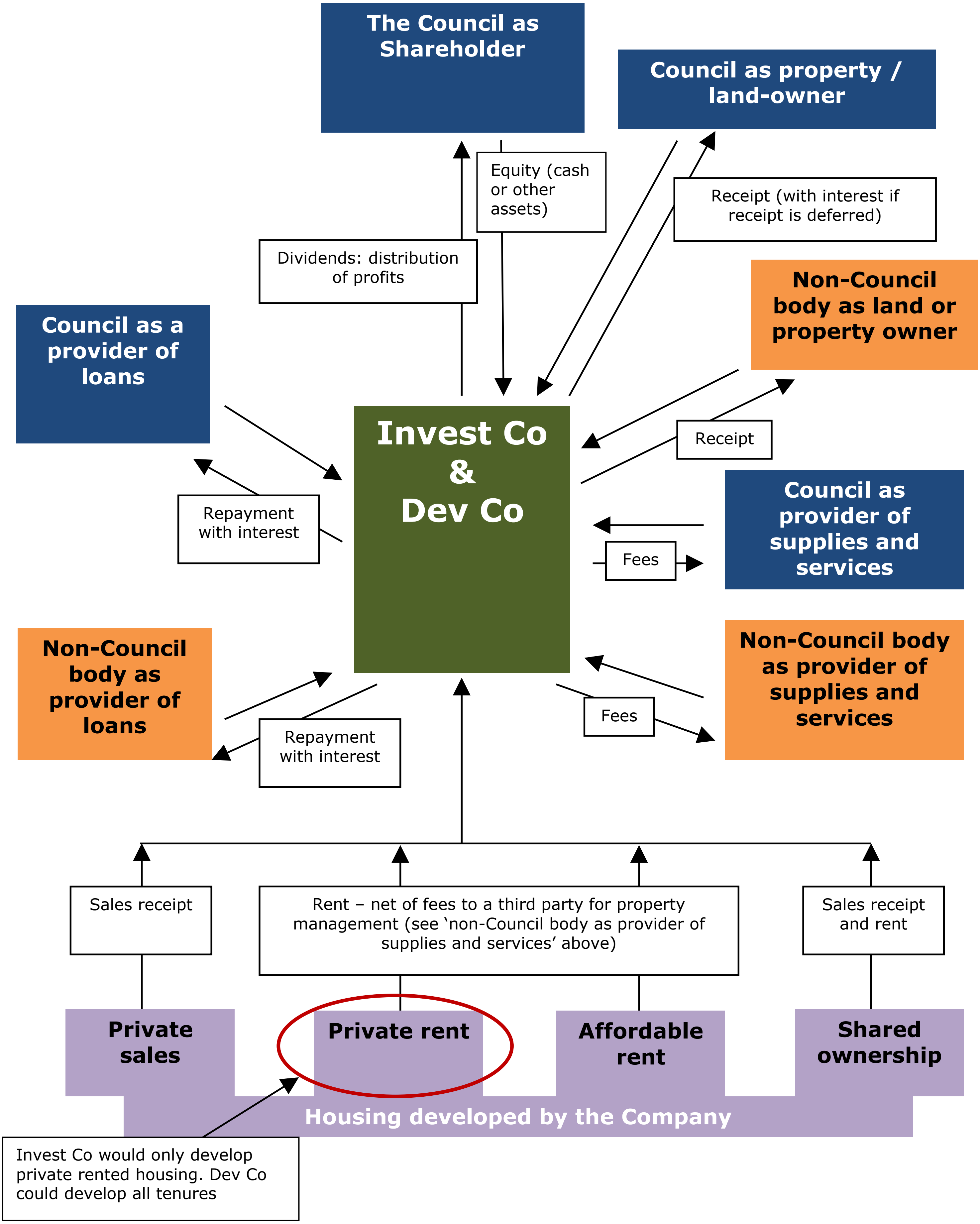


4. Generating financial returns from a housing investment company

The Council would be able to generate a financial return from an investment company in the following ways:

- lending money to the company at a higher interest rate than it either costs the Council to borrow or the Council is receiving on cash held on deposit
- recharging the company for the cost of Council officer time spent on the company
- annual dividends, that is, the profits net of tax made by the company from rental income and uplifts in the value of any assets sold by the company.

The diagram below shows the possible financial flows between the Company and the Council. In addition, it shows the Company's potential interactions with other organisations. Other non-Council bodies would include the third parties managing, maintaining or building the Company's properties and any owners of private land or properties which the Company acquires. This could also include other sources of loan funding available in the future.


The Council as Shareholder
Council as property / land-owner
Equity (cash or other assets)
Receipt (with interest if receipt is deferred)
Dividends: distribution of profits
Non-Council body as land or property owner
Council as a provider of loans
Invest Co & Dev Co
Receipt
Repayment with interest
Council as provider of supplies and services
Fees
Non-Council body as provider of supplies and services
Non-Council body as provider of loans
Fees
Repayment with interest
Sales receipt
Rent – net of fees to a third party for property management (see 'non-Council body as provider of supplies and services' above)
Sales receipt and rent
Private sales
Private rent
Affordable rent
Shared ownership
Housing developed by the Company
Invest Co would only develop private rented housing. Dev Co could develop all tenures

5. Outputs from initial business planning

An initial 30 year business plan has been produced in-house. The initial business plan indicates the following:

Portfolio acquired

- acquisition of 25 units over five years at £275,000 per property (two bedroom flat in the district, lowest quartile price at July 2016. Source: rightmove.co.uk). NOTE: these 25 properties could include transferring in East Herts' properties at Old River Lane, caretakers' properties and those acquired through Compulsory Purchase Orders. Transfer would be at open market value as part of the Council's equity stake

Equity and lending at 'industry standard' 35% equity/65% debt ratio

- equity investment by the Council of £2.5m
- lending to the Company by the Council of £4.75m on a 30 year term
- loan repaid at year 30 from sale of seven of the properties held. Alternatively, the debt could be refinanced

Income for Council

- average of c£98k a year in the first ten years of the 30 year business plan
- c£188k a year in years 11-20
- c£293k a year in years 21-30

Illustrative yields

- rental yield accruing to Invest Co at year 10 of 4.0% (annual rent as a percentage of value of the property portfolio at year 10)
- the yield would build up over time. For illustrative purposes, by year 10 the return on capital accruing to East Herts Council is estimated to be 4.5% (annual income to the Council as a percentage of the Council's equity stake). NOTE: the returns to the Council would be higher if the Council lent its own cash to Invest Co rather than borrowing monies to then lend on as assumed in the current business plan.