## Essential Reference Paper B: Answers to key questions raised about the proposals

| Question | Answer |
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| Have any other Councils set up such a company? | Yes.<br>While there is no central record of the number of such companies, a recent article by Trowers and Hamlins law practice, which has advised a number of councils on setting up housing companies (including East Herts Council) suggests around 40-50 companies have been set up (investment and development companies) with some 20-30 already having provided properties. |
| How would the council generate revenue income by setting up a property investment company? | There is now an established model for how councils generate income from property companies. Income would come from three sources:<br>• interest on money lent by the council to the company – this is the primary source of income<br>• recharges to the company for time spent by council staff on company business – essentially, the council would sell its services to the company<br>• dividends from the company to the council from the profits made by the company. |

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| How many properties would the company need to acquire to make it viable? | The company provides a revenue income to the council of around £10,000 per year per property owned, with potential capital growth on the value of the assets.<br>The model is scalable starting with the transfer of the five properties currently held by the council.<br>A larger portfolio would enable greater opportunities for economies of scale in terms of costs and thus higher revenue income to the council per property held by the company.<br>Through the shareholder’s (council’s) approval of the company’s business plan each year, the number of properties to be acquired in the coming year(s) would be set. |
| What is the modelled return? | The 30 year business plan is based on realistic figures for property acquisition and maintenance costs, rental income, costs of management, inflation and so on.<br>A portfolio of 25 properties acquired over five year could give an implied annual rate of return to the council of 5.86%. |
| How does the modelled rate of return compare with other investments? | Cash held in the bank currently earns 0.7% interest a year.<br>Property bonds held by the council received a rate of return of 7% gross in the last 18 months. This is a variable rate of return and is not guaranteed, furthermore this excludes the 1% cost of bond acquisition and 2% cost of disposal. Note: the figures quoted for the proposed investment company are net of the costs of entry to and exit from the bond market. |

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| What if the costs to company rise more sharply than expected without income rising to same degree? Would the company still be viable? | Various pessimistic scenarios of higher than anticipated cost inflation and lower than expected income inflation have been modelled. In these circumstances the council is still able to generate revenue income, largely because the primary income stream – interest on the loan(s) to company – remains unchanged. The level of income is, of course, reduced to a degree by adverse inflationary movement but the company remains viable.<br>Residual property is a relatively liquid asset when compared with, say, commercial property holdings, and so if financially expedient the shareholder could require the company to dispose of some/all of its assets. |
| Would there be any wider community benefits to setting up a property investment company? | Yes.<br>While the primary aim of the proposed company is to provide revenue income for the council, investing in the property market, particularly the residential property market, has community benefits, notably:<br>• providing income to protect existing council services and/or fund emerging priorities<br>• acting as a good private sector landlord, putting increasing pressure on poorer landlords to improve<br>• providing a potential 'last resort' action to tackle poor standards in the private sector and/or remedy empty properties where both informal advice and enforcement have failed<br>• increasing the availability of good quality private rented accommodation for those on short-term placements with local employers. |

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| Would tenants of the company have the right-to-buy? | No.<br>The tenants would have a tenancy agreement with a private landlord. Private tenants do not have the right-to-buy, nor are officers aware of any consideration being given nationally to extending the right-to-buy to tenants of private landlords.<br>The right-to-buy is a ‘condition’ of secure tenancies offered by councils – that is, the default tenancy for council housing. In addition, more recently, housing associations are able on a voluntary basis to offer the right-to-buy to their tenants. In this latter case, the government has agreed to compensate the associations for the impact of the right-to-buy discount offered. |
| Would it be better for the company to buy properties in lower value areas, rather than East Herts? | Should the shareholder (the council) wish, it could agree to the company purchasing properties outside of East Herts. Modelling indicates that slightly higher returns could be achieved by acquiring residential properties in nearby towns. |

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| Could the council simply provide a loan covering 100% of the company's needs rather than investing money without any interest accruing? | The council would be obliged under Market Economy Investor (and Lender) Principle and State Aid regulations to make loans to a company to which it is connected (that is, a company it owns) in a way a third party lender would. It is extremely unlikely that a new company without any financial equity or track record could access a loan covering 100% of its needs. Advice suggests a 65% loan would be advisable, although this could be slightly higher if the company could meet the repayment costs.<br><br>Other councils have reported making 100% loans to their companies. In fact, this '100% loan' consists of a loan with 0% interest coupled with a loan at commercial interest rate. The overall interest rate is then a combination of the 0% rate and the commercial rate, that is, the council receives a below market rate on its overall commitment.<br><br>In terms of interest payable by the company to the council, this approach is identical to East Herts proposed approach of more clearly differentiating equity and debt. East Herts' proposed approach has the added benefit of avoiding the problem of the company's finances being based on thin capitalisation (that is, too much debt) which would compromise its tax position. Furthermore, more detailed tax advice would be sought to ensure the most advantageous tax arrangements are put in place. |
| Could the council invest in other ventures and vehicles? | So long as the investment is not prohibited by CIPFA's Prudential Code, the council could invest in other ventures and vehicles and indeed it is anticipated that in coming years other opportunities will be brought to members' attention.<br><br>All options will need to be closely scrutinised in terms of liquidity, security and yield along with their compatibility and compliance with the council's Treasury Management and Investment Strategies. |

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| If the proposal is primarily a lending business, what is our scope for lending to other bodies and what sort of yield could we achieve? | A council does have the ability to lend to other bodies. The council must be satisfied that appropriate legal advice has been obtained for several reasons.<br>The council must ensure that State Aid obligations are not being breached. The council must act in line with the Market Economy Investor Principle. The Council would need to assess the yield on each loan on its own merits to demonstrate that the loan is a prudent use of the council's resources and such that any other lender (e.g. banks) would have a provided a loan on similar terms.<br>The council must act within the scope of its investment strategy which determines acceptable credit ratings for investments/lending.<br>There may be a need to register with the Financial Conduct Authority if there is not an exemption under the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.<br>In addition to these considerations the council must also ensure that it has acceptable security against any loan to provide mitigation in the event of default on the loan. |
| Could the company invest in commercial property? | Yes, the articles of association could allow this. |
| Would it be better to just sell the five residential properties the council owns? | While possible, arguably this approach has its disadvantages given the location of the properties – two are within parks – and the loss of control over the future use of the properties.<br>In addition, disposal would only give a one-off capital receipt; rental through a property investment company would provide a revenue income stream to the council of around £10,000 a year. |

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| What is the expected performance review period? | It is proposed that the company would be required to produce an annual business plan which would require the shareholder’s (council’s) approval. In this way, the shareholder can legitimately guide the activities of the company.<br>In addition, performance would be reviewed quarterly by members on the proposed Shareholder Advisory Group. |