

WELWYN HATFIELD BOROUGH COUNCIL
CABINET 5 SEPTEMBER 2017
REPORT OF THE EXECUTIVE DIRECTOR (RESOURCES, ENVIRONMENT AND
CULTURAL SERVICES)

PROPERTY COMPANY

1 Executive Summary

- 1.1 The Council is facing significant financial challenges over the coming years. In particular, reductions in Government grant, pressures to sustain and improve frontline services, along with restrictions on increases in Council Tax are all contributing factors which mean many councils are looking to operate more commercially in order to improve the financial resilience of the council in the longer term.
- 1.2 The Council has historically acquired properties to provide for future service requirements or to contribute to the regeneration of a particular area (e.g. Hatfield Town Centre). It should be noted that investments undertaken purely for income return could only be made through a company in order to comply with the requirements of the Localism Act 2011.
- 1.3 In January 2017, Cabinet approved the outline business case to set up a commercial property company (the Company) as an income generating investment vehicle with the aim to make significant annual contributions to the Council's General Fund in the face of funding shortfalls, and by doing so, put services on a more sustainable footing to support local people. In addition, the Council is constrained to act within its own borders, whereas a commercial company would be able to access opportunities in other boroughs
- 1.4 The purpose of this report is to set out the operational and governance structure of the property company; it is envisaged that the Company will go live during quarter 3 this year.

2 Recommendations

- 2.1 That Cabinet agrees to:
 - 2.1.1 The establishment of a commercial property company (the Company), which would be a company limited by shares and owned wholly by the Council;
 - 2.1.2 To appoint the Chief Executive and Executive Director (Resources, Environment and Cultural Services) as directors to the Company's Board of Directors;
 - 2.1.3 Note that Cabinet will perform the shareholder function on behalf of the Council.
 - 2.1.4 Note that Cabinet has an overriding power to take decisions relating to the Company. In addition, the authority of the Company's board of directors is

limited insofar as they must refer certain types of decision back to Cabinet for approval. These decision types will be detailed in the Memorandum of Understanding between the Company and the Council. Some of these decisions that will require Cabinet approval are listed in Appendix 1;

2.1.5 Delegate authority to the Executive Director (Resources, Environment and Cultural Services) in consultation with the Monitoring Officer, Executive Member for Resources and Executive Member (Governance, Community Safety, Police and Crime Commissioner and Corporate Property) to approve, finalise and document the following arrangements between the Council and the Company:

- The name of the Company;
- The Articles of Association for the Company;
- Memorandum of Understanding between the Company and the Council ;
- Appointment of a Company Secretary and Auditor;
- Loan and draw down facilities to the Company;
- Appointment of Non-Executive Director(s), if required;
- Any associated legal process and documentation necessary for the operational set up on the Company;
- An appropriate mechanism to monitor the performance of the company and
- A Service Level Agreement between the Council and the Company setting out the basis on which the Council will provide certain services to the Company.

3 Explanation

3.1 The Council is facing significant grant reduction from Central Government and the Council will receive no Revenue Support Grant from 2019/20. The setting up of the Company is in response to the financial challenge the Council is facing and to increase our financial self-sufficiency.

3.2 The council currently owns and manages a wide range of assets in its estate portfolio, for example, neighbourhood shopping parades, industrial units, garages, residential flats and retail space in Hatfield Town Centre. These are partially held for a mixture of social and urban town centre regeneration purposes and is bringing a combined income to the Council in excess of £4.5m per annum. These assets are in the main directly managed by the Council's existing Corporate Property team who have built up considerable expertise and skills in this area.

3.3 As part of the Capital programme budget setting process, £5 million per annum has already been set aside in 2017/18 and 2018/19 as a loan to the Company, and that income of £250k has been assumed to be received by the Council in 2018/19 rising to £500k per annum from 2019/20 onwards. The income to the Council will include interest income generated from loan to the Company as well as recharges income as the Council will be providing most of the services for the company.

3.4 Typically, property investment and development acquisitions within the scope of the proposed company are expected to be in the region of £1 million to £5 million and will include a diverse range of use types including residential, offices, industrial and retail. The property company is likely to target a return of around 8% (details to be finalised in the business plan). The aim would be to bring in new opportunities to increase the mixed and balanced portfolio.

- 3.5 It is proposed that the Company will be managed by a board of senior officers comprising of officers listed in the “Board of Directors” section below to allow for maximum speed of response and flexibility.
- 3.6 It is also proposed that the Cabinet will be the body that exercises the Shareholder function on behalf of the Council, in order to hold the Directors to account for the performance of the Company and to take certain strategic decisions which fall outwith the authority of the Directors.
- 3.7 It is important that the Company has enough flexibility to buy considered opportunities and work on a commercial basis. The purpose of the Company is to concentrate on property investment, which is needed to provide a valuable income stream to the Council. Its focus will be on responding more quickly and effectively to market opportunities where the Council is more disadvantaged by the regulations on decision making which affect speed of response.

Shareholder Function

- 3.8 The Company shareholder has ultimate control over the Company. It controls the company in a variety of ways; the appointment of directors, provision of funding and the mechanisms contained in the Company’s governance documentation (being a Memorandum of Understanding between the Council and the Company, as well as its Articles of Association).
- 3.9 The Board of Directors of the Company has authority to take decisions within parameters set out in the Company’s governance documentation. Decisions falling outside these parameters will be referred to Cabinet.
- 3.10 The Company’s governance documentation allows 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.
- 3.11 In addition:
- There will be one shareholder being Welwyn Hatfield Borough Council
 - The liability of the Council is limited to the value of its share holding
 - If a Director ceases to be employed by the Council then he/she will cease to be a Director of the Company
 - There will be a quorum requirement for a meeting of the Directors and to be able to vote on the decisions 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.
- 3.12 A Memorandum of Understanding would operate in addition to the Articles of Association. The Memorandum of Understanding will 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.

Board of Directors

- 3.13 The Board of Directors will be responsible for delivery of the expected outcomes within the Business Plan, which itself will be approved by the Council as shareholder. They will have oversight of the performance, financial and operational management of the Company within the parameters agreed with the Shareholder.
- 3.14 It is proposed that the Board would comprise two of the most senior officers employed by the Council, namely; the Chief Executive and the Executive Director (Resources, Environment and Cultural Services) acting as Directors of the Company. It should be noted that the Council's Corporate Property Manager and Capital Projects Manager will be available to provide advice to the Board of Directors. The Company Secretary is likely to be sourced by someone currently working for the Council, with the final appointment to be confirmed per the recommendation of this report. In addition, it may be that additional independent non-executive director(s) could be appointed to add further commercial experience to the board and the appointment and remuneration of which must be approved by Executive Board.
- 3.15 The typical areas for the Board of Directors to consider and approve include:
- a. Specific investment transactions – acquisitions, sales, letting, agreement for leases, surrenders, borrowing and other key transactions.
 - b. Appointment of service providers – accountants, solicitors, agents, valuers, property managers, and other professionals as deemed appropriate.
 - c. Reporting – reporting arrangements to the Shareholder
- 3.16 Whilst the Council's Chief Executive and Chief Finance (Section 151) Officer will be part of the Board of Directors, this is with a clear understanding of the separation of functions between all officers on the Board of Directors and officers providing advice to the Shareholder on behalf of the Council. A protocol on dealing with potential conflicts of interest will be drawn up in consultation with External Auditor and Pinsent Masons, if required. This will be kept under review and arrangements modified to accommodate any change in circumstances.
- 3.17 The statutory duties for directors of a company are set out in sections 171 – 177 of the Companies Act 2006. The statutory duties are in summary:
- a. The duty to act within powers
 - b. The duty to promote the success of the company
 - c. The duty to exercise independent judgement
 - d. The duty to exercise reasonable skill and care
 - e. The duty to avoid conflicts of interest
 - f. The duty not to accept benefits from third parties

g. The duty to declare an interest in a proposed transaction or arrangement with the company

3.18 Directors will also be subject to other duties set out elsewhere in law, including a large number of very important legal obligations around making investments, disposing of land, health and safety requirements, and employment laws, etc. In particular, there are very important responsibilities on directors in the event that an insolvency situation seems likely. There are serious consequences for directors (including personal liability) in situations which fall within the statutory definitions of wrongful trading or fraudulent trading.

3.19 Consideration has been given to ensuring that key expertise (such as financial and legal advice) are available to advise both the Council as shareholder and the company. From time to time it may be necessary to buy in specialist corporate, property, marketing, legal and financial advice on a normal commercial basis to supplement the experience on the Board.

Support Services for the Company

3.20 It is anticipated that many of the support services which will be required by the company will be contracted out to the Council e.g. sourcing of property deals provided by Corporate Property, accounting services provided by finance team (and re-charged to the company). The set up and the day to day operation of the Company will add to the workload of a number of Council's teams, but most noticeably Corporate Property team, who are also leading a number of key regeneration projects for the Council. As the property portfolio grows, additional resource may be required and this will be reviewed on a regular basis.

Company's business plan

3.21 Officers are currently working with consultants from East of England Local Government Association (EELGA) on the Company's first business plan. This document sets out the objectives of the company, financial assumptions and model, as well as the investment strategy for the company. It is envisaged that the business plan will be reviewed and updated annually going forward.

Operational Risks

3.22 Each acquisition will be considered in the light of investment appraisals as well as the associated due diligence. Each acquisition will be subject to these assessments as well as the normal legal and survey due diligence needed. Therefore each acquisition will be considered by the Board of Directors in light of this information.

3.23 A number of checks and balances are being put in place to ensure that the company operates within agreed parameters and can assure members that there is no greater financial risk to the Council than at present:

- a. The Articles of Association will set out the powers available to Board of Directors.
- b. The Memorandum of Understanding will set out further controls around dealings with properties.

- c. The Cabinet will hold the directors accountable for delivery of the business plan.
- d. Funding in excess of the approved capital programme has to be agreed by Council.
- e. 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 about the sustainability of the Company's business plan
- f. The company will have its own auditors and will be subject to the requirements of company law and filing at Companies House.

State Aid

- 3.24 European Union regulations ensure that the Company cannot 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 at market values. State Aid will also include loans to the Company and the rate of interest that loans to the Company will need to be charged. This will 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.

Procurement

- 3.25 The Council is establishing the company for a commercial purpose. It will be funded from a variety of sources, including Council money. It is intended that the company will have a commercial character and it may consequently be possible for it to not count as "a body governed by public law" for the purposes of the Public Contracts Regulations 2015 (the Regulations). This means that the requirements of the Regulations may not apply to the company. This position will be kept under review.

Implications

4 Legal Implication(s)

- 4.1 The Council has commissioned legal advice from Pinsent Masons LLP on the Company set up and governance arrangements and legal powers of the Council to enter into these proposals.
- 4.2 They have advised that the Council has power to establish a property company under the "general power of competence" introduced by Section 1 of the Localism Act 2011, which indicates that a local authority can do anything that a private individual is entitled to do, subject to certain statutory limitations. However, it should be noted that if a local authority wishes to do something for a commercial purpose, it must be done through a company under Section 4 of the same Act.

5 Financial Implication(s)

- 5.1 The capital programme for 2017/18 and 2018/19 includes the provision of a loan of £5 million per annum from the council to the property company.

5.2 The Medium Term Financial Plan assumes £250k of net revenue income will be returned to the council from the property company to support the General Fund in 2018/19 and that this will increase to £500k per annum from 2019/20 onwards.

6 Risk Management Implications

6.1 Failure to set up trading arrangement in strict compliance with legislation – Likelihood Low, Impact Medium. It should be noted that officers have engaged with specialists from EELGA and Pinsent Masons LLP who have worked with a number of local authorities to establish a property company.

6.2 Delays in setting up the property company due to lack of capacity to manage additional work – Likelihood Low, Impact Medium.

6.3 Insufficient Council expertise in managing commercial investments – Likelihood Low, Impact High.

6.4 Income generated by the Council through the Property Company not reaching the targets set out in the Medium Term Financial Plan – Likelihood Medium, Impact Medium

7 Security & Terrorism Implication(s)

7.1 There are no known security and terrorism implications associated with this recommendation.

8 Procurement Implication(s)

8.1 There are no procurement implications arising directly from the recommendation.

9 Climate Change Implication(s)

9.1 There are no known climate change implications associated with this recommendation.

10 Link to Corporate Priorities

10.1 The subject of this report is linked to the following Council's Corporate Priorities:

- Engage with our Communities and Provide Value for Money.

11 Equality and Diversity

11.1 There are no Equalities implications arising from this report.

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Background papers to be listed

24 January 2017 Special Cabinet – Property Company – outlined business case.

Appendix 1 – Examples of decisions that will require approval by Cabinet

Activity	Cabinet
Permitting the registration of any person as a shareholder of Property Company	Approval
Appointment of directors of Property Company	Approval
Increasing the amount of Property Company's issued share capital	Approval
Passing any resolution for Property Company's winding up or presenting any petition for its administration	Approval
BUSINESS PLAN	
First Business Plan	Approval
Amending the Business Plan of Property Company after it's been established	Approval
Forming any subsidiary	Approval
Acquiring shares in any other company or participating in any partnership or joint venture (incorporated or not).	Approval
Amalgamating or merging with any other company or business undertaking	Approval
OPERATIONAL	
Giving a guarantee, suretyship or indemnity to secure the liabilities of any person or assume the obligations of any person	Approval
Purchasing an asset or making an investment outside of the Business Plan	Approval
PROTOCOLS	
The approval of relevant protocols to include dealing with conflicts of interest	–