SUBJECT:	**Proposed Development Company – Initial Appraisal**
MEETING:	**County Council**
DATE:	**April 2019**
DIVISION/WARDS AFFECTED: All	

1. PURPOSE:

To consider the outcome of an initial appraisal into the feasibility and need the Council to set up its own trading company to undertake residential and commercial developments.

2. RECOMMENDATIONS:

2.1 To approve the findings of the initial appraisal and agree to the undertaking of a detailed business case to establish the proposed trading structure, financial viability and social outcomes.

3. BACKGROUND:

3.1 Full Council instructed officers to undertake an initial appraisal of the feasibility of the creation of a residential development company to tackle a concern around the lack of market and rental affordable housing. In the intervening period, officers have undertaken research on and met senior officers and advisors with comparable trading entities to establish the lessons learnt, legal frameworks, financial considerations and assess evidence of demand.

4 KEY ISSUES

4.1 The Local Housing Market Assessment in September 2018 highlighted the growing disparity in affordability of housing. The average house price in Monmouthshire stood at £307,600, the highest in Wales. The impact of this is for those that live and work in Monmouthshire earning a gross average of £25,360, owning their own home is unaffordable with earnings to value ratio of 12:1. For those that out commute the gross average earnings are £32,416 producing a 9:1 ratio and the same level of unaffordability. Private rental levels produced similar results. A sample of 249 marketed private rented houses were considered for the period June 2016 to June 2017. Of these only 7 properties fell within the Local Housing Allowance (used to determine housing benefit levels) and the majority would be unaffordable for households earning the average income. The escalation in house prices is being distorted in the south east of the County following the announcement of the removal of the Severn Bridge Tolls. Whilst Monmouthshire has seen an average rise in prices of 28% between January 2010 and May 2018, Bristol has seen a comparative increase of 37%, which has increased the attractiveness of the M4 corridor and resulting inward migration. This is particularly evident in Severnside who experienced a house price increase of 18.6% between June 2017 and June 2018 and this trajectory is expected to continue in the short term.

4.2 Conversely the development of new builds on allocated sites has been slow, resulting in a projected shortfall of 504 properties by the conclusion of the current Local Development Plan in 2021. The Local Planning Authority has implemented measures to supplement new house building through the introduction of windfall sites that meet their prescribed eligibility criteria, which includes 35% affordable housing. It is acknowledged that development in Monmouthshire is constrained by a need to protect and conserve historic landscapes and views, ecology, infrastructure capacity limitations and land values. Combined these limit the supply of new housing and at a time of increasing demand serve to increase house process as demand continues to outstrip supply.

4.3 The lack of affordability and supply is not unique to Monmouthshire and is a problem that many authorities have chosen to tackle through an interventionist approach with the creation of their own wholly owned Housing Development Companies (HDC).Local examples include Bristol City Council’s recently launched trading company, Goram homes with the intent of building 2,000 new homes. Similarly, Carmarthenshire County Council established Cartreficroeso, to unlock stalled or undeveloped housing sites and build out both market and HRA housing. Underpinning all of the models is the ambition to intervene in the supply chain by accelerating development and retaining financial value within the public purse. Clearly, this would be essential element of any company established by Monmouthshire, but in alignment with our Corporate Plan and Social Justice Policy, we would also want to maximise social value from any developments. At this initial stage we would expect these to consider carbon positivity through the implementation of renewable technologies as standard and where feasible turning properties into micro generating stations. We would also wish to consider electric vehicles, broadband infrastructure and explore varied methods of construction that would support the growth of local supply chains and upskilling of local communities. Clearly social outcomes will come at a financial cost; however, the retention of developers profit through the trading company will enable these decisions to be both possible and affordable.

4.4 The structure of a possible trading company will need to be determined through the development of the business case and the support of professional advisors with a proven track record in creating similar successful ventures. At this stage, however it is clear that the company will need to be wholly commercial to enable it to compete with the private sector on an equal footing. The Articles of Association, which embodies the values and the outcomes driving the company, are critical in determining the success of both the financial and social critical metrics and sufficient regard will need to be given to these in the next stage of the process. Typical models are companies limited by shares with the Council the only shareholder and therefore able to exert indirect control through the appointment of Directors as well as ensuring that any profits are pass ported back to support revenue and capital accounts.

4.5 The remit of the proposed DC will also need to be established. In the residential sector, this will be defining whether it intends to focus on private housing for both sale and rental or indeed, if it wants to compete in the same space as our existing Registered Social Landlords, (RSLs). Given that, a number of well-established RSLs serves Monmouthshire we would propose that no intervention in this sector is necessary and that we focus on the private and intermediate markets only. In the commercial setting, we would expect to explore opportunities as they are presented and progress only those with guaranteed occupiers that align to the Councils LDP and the outcomes of the Future Economies work.

4.6 Initial work has been undertaken to establish both the potential opportunities and risks and these are outlined in sections 2 and 3 of the supporting initial appraisal. These will need to be further defined as the parameters and outcomes are defined and the proposed legal structures are determined. In order however to maximise opportunities it is evident that the preferred structure needs to be flexible, potentially a holding company model which will enable the company to create subsidiary companies to act as single purpose vehicles or joint ventures as the need arises and viability is proven.

4.7 Powers to establish a trading company are granted via s95 of the 2003 Local Government Act. This however does not diminish the requirement for an authority to have regard to its fiduciary duties particularly when relying on its well-being powers as set out in Regulation 2 of the Local Government (Best Value Authorities) (Power to Trade) (Wales) 2006. The issue of state aid will need to be foremost in any relationship between the Council and its wholly owned company. To ensure compliance any lending from the Council to the company will need to be on commercial terms and from research to date a usual approach appears to be on lending at 2% above PWLB loan rates. This will also provide a revenue return to the authority, which ensuring statutory compliance.

4.8 The Council has a number of options when considering how to intervene in the housing market;

Do nothing – In essence, this would be to continue the existing practice of selling development land with no positive obligations to ensure compliance with procurement legislation. This would preserve the status quo and would not allow the Council to realise any financial or social value.

Sell the land with development obligations – This would enable the Council to specify compliance with affordable housing requirements and define specific outcomes, however in order to procure the development partner a formal OJEU compliant procurement process would need to be undertaken that could potentially further delay the delivery of sites.

Set up a Joint Venture – If there are positive obligations on the company, procurement legislation would similarly apply and an OJEU compliant procurement process would need to be undertaken. If there are, no positive obligations and the company will be managed and controlled, through the appointed directors, the Market Economy Operator Principle would apply and no procurement process will be required. However, control will be ceded to the company and the Council will need to rely on the Articles of Association to deliver its specified outcomes.

Establish a wholly owned trading company – In common with many other authorities this would appear to be the preferred method of delivery as the company will be wholly owned by the Council and the Articles of Association could be prescribed to ensure that it delivers its financial and social outcomes. It also ensures that the Council as the owner retains all financial value. Conversely, it also means that the Council will retain 100% responsibility for risks arising from lack of profitability, downturn in the market, lack of pipeline etc.

4.9 In common with any fledgling company, in the initial years the Company will not be able to return a profit and will rely on a cash flow funded by the Council. This will place a revenue burden on the Council, which will need to be factored into the business case when considering the viability of this proposition.

4.10 The supply pipeline will be key in the successful establishment of the proposed company and will rely on the Council transferring its development sites at market value into this company, rather than realising a capital receipt through the traditional disposal mechanisms. To maintain a robust supply pipeline the company will need to acquire additional sites, which will involve recycling profit or additional borrowing to fund these acquisitions.

4.11 Given that the motivation behind the creation of this company is to improve and sustain the wellbeing of our communities by intervening in the local housing market, it is intended that the company will trade within its geographical boundaries for the first 10 years of its operation.

4. REASONS

4.1 The Council is now developing a proven track record in its commercial activities through the recent acquisitions of Castlegate and Newport Leisure Park. The creation of a wholly owned Development Company would enable the Council to further develop its commercial activity through the lens of a social investor. Specifically we could determine our accepted minimum financial return below that of a commercial developer. This would enable us to make clear decisions on carbon neutrality, fuel poverty, energy and utilities infrastructure and future proofing properties so that the product generates savings for the occupier, aligns with our well-being agenda and provides decent, quality and affordable housing for our local communities. The company will have a long-term investment in the communities created through the development of apprentiships, supply chains and through the wider provision of services undertaken by the Council

4.2 The current market mechanisms are failing to meet demand and indigenous populations are increasingly being forced to re-locate as housing prices and rental levels become more and more unaffordable. This is particularly acute for young people and reflected in the outward migration of our younger demographic. This proposal would enable the Council to undertake development activities designed to speed up supply and meet design parameters that reflect the wider social justice agenda.

4.2 Whilst the initial appraisal supports the creation of the wholly owned company, the complexities of the proposal are yet to be defined which will require specialist advisors with a proven track record to support the next phase of work. It is anticipated that this work can be completed and reported back to Full Council by the end of the calendar year.

5. RESOURCE IMPLICATIONS:

5.1 The procurement of specialist advisors, to support the development of the business case and provide a proposed legal structure for the development company, will incur revenue expenditure. These costs will be managed within existing departmental budgets. To the extent that this is not possible Cabinet will be requested to approve retrospective earmarked reserve funding.

5.2 The proposed development company will be a revenue burden to the Council for the first years of trading given the need to acquire sites, the cash flow required to construct the properties and the time lag in deriving a return through sales or rentals. This will be quantified in the detailed business case and reported back in the report subsequently brought back to Council.

6. WELLBEING OF FUTURE GENERATIONS IMPLICATIONS (INCORPORATING EQUALITIES, SUSTAINABILITY, SAFEGUARDING AND CORPORATE PARENTING):

6.1 The proposal has considered the impact of the wellbeing agenda and is aligned to the principles of sustainable development.

6.2 This report is not anticipated to have any direct safeguarding or corporate parenting implications.

7. CONSULTEES:

SLT
Cabinet
Head of Legal Services
Head of Finance

8. BACKGROUND PAPERS:

Development Company – Initial Appraisal

9. AUTHOR: Debra Hill-Howells Head of Commercial & Landlord Services

10. CONTACT DETAILS:

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