



Report To: Cabinet
Lead Officer: Director of Housing

12 November 2015

BUSINESS CASE FOR ERMINE STREET HOUSING

Purpose

1. To report back to Council on the performance of the housing company pilot and to seek a decision on the future of the company.
2. This is a key decision because:
 - a) it is likely to result in the Council incurring expenditure which is, or the making of savings which are, significant having regard to the Council's budget for the service or function to which the decision relates, and
 - b) it is likely to be significant in terms of its effects on communities living or working in an area of the District comprising two or more wards.

and it was first published in the October 2013 Forward Plan.

Recommendations

3. It is recommended that Cabinet recommends to Council:
 - a) Option C, the expansion of the housing company portfolio over a five year period 2016/17 to 2020/21.
 - b) If Option C is approved it is recommended that the Cabinet recommends to Council:
 - The adoption of the of the five year business plan set out in Appendix B
 - Establishment of 3 new fixed term posts to deliver this business plan
 - Establishment of a Board to oversee the work of the company as set out in paragraph 29-31.
 - c) That the Executive Director be instructed to report in November 2015 to Council the necessary amendments to the Council's Treasury Strategy.

Reasons for Recommendations

4. The expansion of the portfolio as outlined in Option C and detailed in **Appendix A**, the Business Case and **Appendix B**, the Business Plan demonstrates that a return can be made for the Council, in the form of interest income, during the initial five year period, with the potential for even greater returns in subsequent years.

Background

5. Council agreed to a housing company pilot project at its meeting on 28 November 2013 and agreed to advance up to £7m funding to secure a market rented portfolio of homes. The pilot scheme went live in May 2014.
6. It was agreed that a detailed business case be brought back to full Council in the autumn of 2015 to provide an opportunity to approve the future activity of the company.

Considerations

7. Cabinet, at the meeting on 19 November 2013, approved a series of objectives for the housing company to:
 - Generate a revenue stream that will enable the Council to continue to deliver its services at a time of reducing Government grant.
 - Assist economic development in the district by helping to provide good quality, flexible rental housing for the many local businesses that have workforces with a high turnover of staff.
 - Explore innovative solutions to assist meeting housing need and gaps in the housing market, particularly those people that are unlikely to be granted an affordable housing tenancy or who do not wish to join the housing register but are finding it difficult to buy a house or finding it difficult to rent in the private rented sector.
 - Provide place leadership - supporting community development by investing in the local district and working alongside other private and public sector bodies.
8. The housing company is registered at Companies House as South Cambs Limited but during the pilot phase has begun trading as Ermine Street Housing. The name was adopted following consultation with Members and staff.
9. The loan portfolio in respect of assets held at the time of writing this report is £6,837,970, and results in the company owning 34 homes (plus 2 acquisitions in progress) with all of those intended for letting, now occupied. In addition the company has secured long term management deals with the Defence Infrastructure Organisation (DIO) and has a further 42 properties under management for five years, with more in the pipeline.
10. The pilot has been successful and has generated an income stream for the Council and also provided the opportunity for learning in a new area of business. A number of ideas have been tested during the pilot phase and a lot of work on the back office requirements has been worked through and set up.
11. During the course of the pilot project, Council has received interest payments from the company providing returns in excess of £100,000. In addition officer time spent in running the business has been recharged to the company by the Council.
12. The pilot spanned the first year of operation for the company, and as a result, included significant set up costs, which resulted in the company making a trading loss in year 1, which was as expected.

13. As part of the pilot, extensive market research was undertaken in preparation for the purchase of the initial property portfolio. The findings from the exercise are detailed in **Appendix A**, the Business Case.
14. Ermine Street has operated as an ethical commercial landlord and over the course of the pilot it has provided additional support to local people such as housing people with local connections and other challenging housing issues.
15. Discussion is underway with local employers and the Local Economic Partnership about how Ermine Street Housing may be able to help meet the needs of key workers in the district.

Options

16. The Business Case (**Appendix A**) sets out the three main options for the Council to consider. In summary these are:

A. Bring the project to an end and agree an exit strategy.

This would take around five years to achieve as there are leases with the DIO. This option carries the risk that the value realised on the sale of the property portfolio, including market appreciation, will not be sufficient to meet both the outstanding loan portfolio in respect of the original acquisitions and any short-term cash flow borrowing which the company holds as part of the company set up period.

B. Retain the current portfolio but do not expand any further

This option is financially sustainable for the company, but relies upon continuation and anticipated expansion of the management arrangements for the DIO to carry the fixed overheads for the company. Simply retaining the acquired stock as it stands in isolation, would not be considered a viable option, as approximately 30 properties would still incur a considerable sum of fixed operating overhead, and would be sensitive to void and bad debt levels.

C. Expand the portfolio over a five year business plan period, investing approximately £100,000,000, with the aim of owning and managing 500 properties by the end of that period.

With the assumptions made as part of the financial viability modelling, this option indicates that the company would be financially sustainable and able to return a steady revenue stream back to the Council. A portfolio of this size is also big enough to become a tradeable asset and therefore provide the Council with a stronger exit strategy in the future should it be needed. There are of course risks associated with the business expansion model, and these are outlined in Appendices A and B from the perspective of the Council and the company.

17. The Business Plan at **Appendix B** is the document supporting Option C to expand the portfolio.

Implications

18. In the writing of this report, taking into account financial, legal, staffing, risk management, equality and diversity, climate change, community safety and any other key issues, the following implications have been considered.

Financial

19. The financial implications for the expansion of Ermine Street Housing are incorporated into the Business Plan 2015/16 to 2024/25, which is included at **Appendix B** to this report.
20. South Cambridgeshire District Council will benefit from both the interest uplift in respect of lending to the company, and the ability to recharge staff employed by the Council to the company where they are working on behalf of Ermine Street Housing, therefore delivering an efficiency saving to the Council.
21. Based upon the current assumptions in the Business Plan, with the company taking out finance for 100% of the asset value, it is projected that the Council could be earning in excess of £600,000 per annum by the end of year two of the business expansion model. The projections for the Council in future years increase as the property portfolio grows, as detailed in **Appendix A**, the Business Case.
22. An alternative model, where the Council acquires an equity share, charges a lower interest rate for short-term borrowing, and increases the interest rate once the company has acquired its property portfolio, with lending on a longer term basis from this point on, has been explored and is a viable alternative funding option. If a debt (loan) / share equity split approach is taken in respect of the financing of the acquisition, the Council would generate a smaller return on the interest uplift, but would have the potential to benefit from an appreciating asset and increased share dividends in future years, or when assets are sold.
23. The Business Plan is predicated on the assumption that initial borrowing and on-lending will be short-term, and that the loan portfolio will be re-financed at the end of the initial 5 year period, if the Business Plan performs as projected.
24. There is also an assumption in respect of the financial impact for the Council, that the authority will not be required to make MRP (Minimum Revenue Provision), which would require the authority to set aside money annually.
25. Where the Council borrows and on-lends to a wholly owned subsidiary, the on-lending in respect of each asset acquisition would be recognised as capital expenditure, with the assumption that this would be subject to MRP by the General Fund.
26. It is, however, considered a necessity for the Council to register a fixed and floating charge over the company's asset to secure its investment. With a charge over, or alternatively an equity share interest in, an asset with value, the need to make MRP can be minimised or negated in totality.

Legal

27. Under both the Local Government Act 2003 and Localism Act 2011, the power to trade must be exercised through a company in order to generate a source of income. The legislation (the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009) permits councils to trade or "to do for a commercial purpose", anything which they are authorised to do for the purpose of carrying on their ordinary functions (which includes the well-being power and the power of general competence). This means councils can trade with the private sector for a profit and these profits may then go back to the council through dividends or service charges.
28. The 2009 Order requires that a detailed business case is considered and approved by Cabinet before trading can commence. The business case must be a "comprehensive statement" which includes details about:
- The objectives of the business.
 - The investment and other resources required to achieve those objectives.
 - Any risks the business might face and how significant these risks.
 - The expected financial results of the business, together with any other relevant outcomes that the business is expected to achieve.

Governance

29. It is proposed that from April 2016, if the Council approve the expansion of the company that a new board be set up to manage the governance.
30. It is proposed that the board consist of six voting members to include two elected members nominated by the Council, two executive officers (the Company Director and the Company Secretary) and two independent member selected for their skill sets. The lead manager for the company would attend as a non voting member.
31. The Council would retain overall ownership of the company and would be required to approve a five year business plan as well as annual updates. This would include the Annual Report.

Staffing

32. During the pilot phase the staffing needs have been covered by existing staff including two full time seconded officers and a temporary member of staff. The proposal set out in the Business Plan is for three full time posts to be created, still employed by the Council but working full time for the company. These posts include a lead manager, an acquisitions manager and a lettings manager. Other resources will be bought in by the company from either the Council or other suppliers as and when required, and the staffing will be expanded as the portfolio increases in line with the Business Plan assumptions. There may be financial advantages for the staff team to be directly employed by the company in the future, and this will be explored if the expansion model is approved.

Risk Management

33. There is a risk log for Ermine Street Housing and a separate risk log for the Council. These have been used during the pilot phase to manage the risks during the set up period. The latest versions of these are incorporated as part of **Appendix A**, from the Council's perspective and **Appendix B** from the company's perspective.

Equality and Diversity

34. Whatever option is agreed there will still be a degree of activity which will require a full Equality Impact Assessment but it a low priority, because although the number of people being affected is relatively high, there is a minimal relevance to equality duties, a low likelihood of differential impact and a low risk of discrimination.

Consultation responses (including from the Youth Council)

35. The development of the pilot phase has benefited from the input of a number of elected Members who have attended the Housing Portfolio Holder Advisory Group sessions.

Effect on Strategic Aims

Aim 1 - Engagement

- (1) Develop the property company pilot scheme into full business plans to deliver a mix of high quality housing and generate income

Background Papers

Cabinet reports:

- New Build Strategy-8 November 2012
- Future Housing Investment Plans- 19 November 2013
- South Cambs Update-13 February 2014
- South Cambs Ltd: appointment of Director and conflicts of interest-8th May 2014
- South Cambs Ltd-Business Case Update-11 September 2014

Council reports:

- Future Housing Investment Plans- 28 November 2013
- South Cambs Ltd: appointment of Director and conflicts of interest-5 May 2014

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NOTE – Appendices A and B have not been circulated to the press and public in accordance with the provisions of Section 100(A)(4) of the Local Government Act 1972 (exempt information as defined in Paragraph 3 of Schedule 12A of the Act), as they contain information relating to the financial or business affairs of any particular person (including the authority holding that information) and the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

Appendix A Ermine Street Housing Business Case (Confidential)
Appendix B Ermine Street Housing Business Plan (Confidential)