

<b>SUBJECT:</b>	<i>Establishment of a Local Authority Trading Company</i>
<b>REPORT OF:</b>	<i>Resources – Cllr Egleton</i>
<b>RESPONSIBLE OFFICER</b>	<i>Director of Resources – Jim Burness, Interim Director of Services - Anita Cacchioli</i>
<b>REPORT AUTHOR</b>	<i>Sue Markham, Principal Solicitor – 01895 837326 – sue.markham@southbucks.gov.uk</i>
<b>WARD/S AFFECTED</b>	<i>All</i>

## 1. Purpose of Report

The PAG is requested to review and comment upon this report, which will be considered by Cabinet on 8 February 2017. The report seeks to authorise in principle the creation of a local authority trading vehicle to facilitate opportunities for income generation.

## RECOMMENDATIONS TO CABINET

1. That the establishment of a local authority trading vehicle to allow the Council to exercise the power to trade contained in the Local Government Act 2003 and the Localism Act 2011 to facilitate income generation be approved in principle;
2. That the Interim Director of Services and Head of Legal and Democratic Services be authorised to engage suitable external experts to advise on the detail of the governance and funding arrangements of the proposed company and to assist in the preparation of a business case as referred to in the report;
3. That budgetary provision be made to commission the work referred to in Recommendation 2 above, to be funded from general reserves;
4. That a further report on the business case and recommended governance and funding arrangements be brought back to the Cabinet at the first available opportunity.

## 2. Executive Summary

The purpose of this report is to set out the range of matters that the Council will need to consider and determine in order to progress the establishment of a local authority trading company. The report addresses the various areas that require further investigation, leading to detailed recommendations for decision at a future meeting:

- Company requirements
- Governance arrangements
- Accounting and banking arrangements
- Staffing implications
- State aid
- Corporate implications

## 3. Reasons for Recommendations

To allow the Council to undertake trading activities in order to generate additional income.

## 4. Background

- 4.1. Following recent consideration of the Council's likely financial position over the next few years, it is clear that the Council will need to maximise income generating opportunities in order to counter the reductions in government grant.

- 4.2. Property experts, Savills, have been engaged to review the Council's property portfolio and advise on the opportunities for deriving income through pro-active management and development of the portfolio.
- 4.3. If the Council should decide to invest in residential property, to do so through a wholly owned company would mean that the company would be able to grant shorthold tenancies, which are commonly used in private sector rentals. The Council could not grant such tenancies itself.
- 4.4. There may be other types of property investment which the Council could undertake in house. Every investment would be looked at on its own merits to decide whether to invest via the Council or the company, depending on the taxation, legal and investment implications of what is proposed.
- 4.5. There are specific powers contained in the Local Government Act 2003 which allow a local authority to undertake trading activities. In addition, under the "general power of competence" introduced by Section 1 of the Localism Act 2011 local authorities now have a general power that enables them to do anything that a private individual is entitled to do, subject to certain statutory limitations. However, it should be noted that things done for a commercial purpose even under the Localism Act 2011 must be done through a company.
- 4.6. The company can, with good business planning, generate a surplus which can be returned to the Council by way of dividends, it being the single shareholder.
- 4.7. The Regulations made under the 2003 Act require a business to be prepared to support the use of the trading powers and the Council must approve the said business case.

## 5. Content of Report

- 5.1. This report proposes that the Council ("SBDC") establishes a trading company, wholly owned by the Council, to enable the Council to take advantage of the powers to trade for profit introduced under the Local Government Act 2003 and the Localism Act 2011, where opportunities to do so arise and it is appropriate to use the company as a vehicle for the trading activity proposed.
- 5.2. Company Structure - There are a number of different types of corporate vehicle available:
  - 5.2.1. Company limited by shares;
  - 5.2.2. Company limited by guarantee;
  - 5.2.3. Industrial and provident society.
- 5.3. Another potential vehicle, which will be considered in the business case is the Local Asset Backed Vehicle model. This is usually a medium to long term joint venture equity partnership between a Local Authority and a private sector investment partner. The Council would contribute land/assets, while the investment partner would contribute capacity to deliver skills, experience and funds to develop projects. A procurement exercise would be required to select a partner with whom costs and investment returns would be shared.
- 5.4. There are some other vehicles, such as a community interest company, a limited liability partnership or a joint venture company. However, for the purposes of general trading it is unlikely that such vehicles would be considered to be appropriate.
- 5.5. In practice a Company Limited by Shares tends to be used for those operations which have a commercial character and a Company Limited by Guarantee or Industrial & Provident Society for those which are set up to deliver community purposes or are set up for charitable purposes.
- 5.6. **Company Requirements** - In setting up the trading company, the following issues need to be addressed:
  - 5.6.1. Company Name

- 5.6.2. Purpose of the Company
- 5.6.3. Aims of the Company
- 5.6.4. Governance
- 5.6.5. Funding arrangements
- 5.6.6. Set up Requirements and Costs
- 5.7. There will be a number of other detailed matters to be considered and it is suggested that an appropriate delegation be granted to enable these to be investigated as set out in the recommendation.
- 5.8. **Governance Arrangements** - The Company must legally appoint Directors. The Directors of the company must ensure that the company does everything it is obliged to do by law and that any decisions they make are in the best interests of the company. There are a number of options for the make-up of the board, but it is essential that the Directors between them have the following skills:
  - 5.8.1. Financial
  - 5.8.2. Property
  - 5.8.3. Legal
  - 5.8.4. Investment
  - 5.8.5. Governance – other board experience
  - 5.8.6. Private sector
- 5.9. The Memorandum of Association will need to be completed. This will set out the company's objects which could be as wide as 'to carry on business as a general commercial company'. It also shows details of the company's share capital.
- 5.10. The Articles of Association will also need to be completed. These set out the regulations governing the running of the company's affairs.
- 5.11. An off the shelf company could be purchased with wide trading powers including property investment.
- 5.12. A major Governance issue is the relationship between SBDC (the Shareholder) and the Company's internal processes. It is important that the Company is able to act quickly in order to generate and sustain business but on the other hand the Council needs to be able to determine whether it is appropriate for the Company to make a particular investment.
- 5.13. This relationship would be set out in a suitably drafted Shareholder Agreement which would specify the roles and responsibilities of the board and the Council as shareholder and would spell out the rules and procedures for making decisions.
- 5.14. It is envisaged that the Cabinet will be responsible for overseeing the Company's overall trading activities, acting on behalf of Council who will be the Shareholders. It will be critical to minimise and manage any potential conflicts of interest by keeping roles separate wherever possible.
- 5.15. **Accounting and Banking Arrangements** - The Company will have to comply with all the regulatory requirements of the Companies Acts and additionally with the regulatory regime for local authority companies under the Local Government and Housing Act 1989.
- 5.16. The company may need to charge VAT and will be liable for corporation tax on its profits. However, the company's tax liability could be minimised by setting off allowable costs.
- 5.17. Balances held by the Company will be calculated on an annual basis. The Company will be responsible for providing its accounts and tax returns in the appropriate format within set deadlines. The accounting structure will have to ensure that all income, expenditure and VAT can be allocated to the Company by use of appropriate budget codes. The Company will use its own stationery for purchase orders and invoices and will facilitate the submission of the Company's VAT returns.

- 5.18.** The Company will be responsible for the engagement of an external auditor.
- 5.19.** As the Company will be controlled by the local authority a number of requirements may undoubtedly need to be met such as:
- 5.19.1.** The company must state on company stationery that the company is controlled by a local authority, giving the name of the relevant authority.
  - 5.19.2.** The company must limit the remuneration and allowances paid to directors who may be officers or members of the local authority to the amounts payable for comparable local authority duties, or as travelling and subsistence allowances.
  - 5.19.3.** The company must not publish party political material.
  - 5.19.4.** The company must provide information to the local authority's auditors.
  - 5.19.5.** The company must provide information to members of the local authority.
- 5.20. Business Case** - Initially the main thrust of the trading company will be to invest in land and buildings that can increase SBDC's income.
- 5.21.** The business case will examine the options for transferring land to the Company at market value in return for shares in the company or the alternative of providing loans to the Company to enable it to purchase the land.
- 5.22.** The trading company will enable the Council to operate property investment on a commercial basis. The Business Case in relation to the Council's investment strategy will be developed for consideration at a future Cabinet meeting and will cover aspects such as:
- 5.22.1.** The objectives of the property trading activities;
  - 5.22.2.** The investment and other resources required to achieve those objectives;
  - 5.22.3.** Any risks the business might face and how significant those risks are; and
  - 5.22.4.** The expected financial results of the business, together with any relevant outcomes the business is expected to achieve.
- 5.23.** The precise funding mechanism for the property side of the Company will be considered as part of the development of the full business case. However, such a mechanism could include a loan or series of loans by the Council to the Company to allow it to invest in accordance with the Strategy and Business Case. Under such circumstances, borrowing costs would be met by the Company. Loans would be made available to the Company on a basis which is compliant with the terms of funding which are similar to those which would be achievable by a private funder given the importance of competition law and State Aid rules. Specialist advice will be sought as part of the development of the business case.
- 5.24. Staffing Implications** – It is envisaged that, once established, the company will directly employ its own staff and engage professional support as required. However, it is most likely that the company will initially be operated on the basis of part-time secondments from the Council and as a result TUPE will not apply to transfer staff to the company. Whilst expertise in developing property is expected to be bought in by the company at director/development manager level, the company will need to access support functions such as finance, legal, HR and ICT, at least initially. Any Council resource will need to be recharged and the Business Case will need to assess the initial impact of staffing/accommodation/support needs. Later on the company's staffing needs will be reviewed as developments progress.
- 5.25. State Aid** - In order to ensure transparency and competitiveness with the private sector and not to breach the rules in relation to State Aid the company must not be subsidised by the authority. This means that the authority must recover the costs of any accommodation, goods, services, employees or any other support it supplies to the company. It will be necessary to set up suitable systems and financial controls to ensure this is the case and to demonstrate independence of the company from the authority.

## 6. Consultation

The Resources PAG has been consulted on the proposals and any comments will be reported to Cabinet.

## 7. Options

**7.1.** It is not a statutory requirement to operate a trading company so Cabinet could decide not to proceed. The potential income generation would be unlikely to be realised using other powers available.

**7.2.** Cabinet is recommended to proceed as set out in the report.

## 8. Corporate Implications

### 8.1. Financial

**8.1.1.** The budget for set up costs will need to be approved.

**8.1.2.** There will be a need to set up separate financial systems and accounting arrangements (including VAT). Future running costs may be offset to a degree against future income streams.

**8.1.3.** It is anticipated that the trading company will, in the first instance, use part time seconded staff, use council accommodation, equipment and services on the basis of recovering the full cost, and as a result start up costs should be minimised but would include matters such as insurance and auditors fees.

**8.1.4.** Financial advice will be required in relation to prudential borrowing requirements especially in relation to the ability to borrow to invest in property.

**8.1.5.** It is envisaged that some legal advice will also be required.

**8.1.6.** There are financial risks arising from the use of the Councils' trading powers. These would need to be analysed in detail as part of any individual business case put forward for the use of the trading powers. Although a trading company would be a separate legal entity with the benefit of limited liability any liabilities of the company to creditors in the event of significant trading losses occurring would have to be addressed as a potential risk for the Council.

**8.1.7.** As the Council will have effective control of the company, oversight of its on going operations would allow for early detection of any developing financial problems and the opportunity to take preventative action.

### 8.2. Legal

**8.2.1.** A local authority is able to establish a Local Authority Trading Company ("LATC") through powers in section 95 of the Local Government Act 2003. A local authority is permitted to trade in anything that it is authorised to do under its ordinary functions.

**8.2.2.** Under section 1 of the Localism Act 2011 Local Authorities now have a general power that enables them to do anything that a private individual is entitled to do, as long as it is not expressly prohibited by other legislation.

### 8.3. Risk Assessment

An initial risk assessment has been carried out, with the key risks and possible controls detailed in **Appendix 1**. The Business Case will examine these and any other commercial risks in more detail.

## 9. Links to Council Policy Objectives

### 9.1. Corporate Aims and Objectives:

Delivering cost effective, customer focused services, particularly by

- Optimising the effectiveness of our resources and assets

- Making the very best use of all our assets

### **9.2. Chiltern and South Bucks Joint Sustainable Community Strategy**

The Vision includes "A wide range of high quality housing, including a good supply of affordable homes to help meet community needs and maintain our services and communities."

### **10. Next Step**

Engage external experts to analyse the governance and funding options available, produce the required business case for consideration by the Cabinet and make recommendations to Cabinet at the first available opportunity.

<b>Background Papers:</b>	It is a legal requirement that we make available any background papers relied on to prepare the report and should be listed at the end of the report (copies of Part 1 background papers for executive decisions must be provided to Democratic Services )
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