Appendix A

Business Case

Property Company

Prepared by : Kevin Kendall

Sponsor : Pete Moore, Executive Director Finance & Public Protection

4th January 2019 final draft

Introduction

This is a business case for setting up a Property Co (PropCo) underneath the LCC Holding Company (Lincolnshire Future Ltd).

A business case must analyse the appropriate business model for a given initiative, which may or may not be through a company. Where a local authority is relying on section 95 Local Government Act 2003 (and arguably this reflects a wider fiduciary duty even where that power is not being relied upon), it must prepare and approve a business case pursuant to the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009. This requires the local authority to consider and approve a suitable business case for establishing a trading company, which must include details about:

a. the objectives of the business
b. the investment and other resources required to achieve those objectives
c. any risks the business might face and how significant these risks are
d. the expected financial results of the business, together with any relevant outcomes that the business is expected to achieve

It is expected that a variety of property and development opportunities will be presented for the PropCo to take forward, with each opportunity needing a separate business case to be approved by the Executive before commencing. The risks associated with specific developments and the expected financial results are only going to be known as and when opportunities are brought forward to the Executive, those subsequent business cases will need to cover points a-d above.

DRAFT

1. Overview

One of the opportunities for the PropCo is the development housing which as well as being a commercial opportunity for the Council would contribute to the need to increase housing delivery in the County. Another key opportunity is the development of specialist housing for adult care. In this context local authorities are looking at various ways to develop including those listed below. These options are also applicable for all types of development and not just housing:

1. ***Single wholly-owned vehicle for ownership***, where the council moves homes/properties into the vehicle with the function of being a "landlord" but no development plans.

2. ***Single wholly-owned vehicle for development***, where the company plays a role in new home/property delivery but only to the extent that the council may require all or some units built to be transferred into the company.

3. ***Wholly-owned company with subsidiaries***, where the company operates via site (or tenure) specific subsidiaries. This may be advantageous to ring fence risk in development activity or to unbundle differing types of housing/tenure. As an alternative to subsidiaries (the vertical model) underneath the company, the council could set up a number of companies (a horizontal model), each having a different focus or role. Equally, this approach can involve an overarching "holding company" not necessarily confined to housing activity. The degree of complexity depends on, and should be driven by, the objectives.

4. ***Joint venture vehicle***, where the council would engage with a range of developers to pursue either a bundle of projects or single projects (where of sufficient size/value to justify the transaction and set-up costs). This type of approach has been used by other councils where they wish to bring in the resources and expertise (and money) of a developer partner, but without ceding control via the traditional development agreement.

5. ***Virtual development company***, where the council ramps up its delivery capacity in-house. To do this, it recruits either fixed-term or permanent staff with the right mix of development management skills.

The Council has assessed that the most appropriate route would be a combination of 1 and 2 above. Option 3 is effectively the structure of the County Council's anticipated corporate group, given the LCC Holding Company has already been incorporated. JVs under option 4, where appropriate, may still be pursued. A company limited by shares has been chosen as the most appropriate vehicle for the PropCo. A summary of the key advantages and disadvantages of this model are set out below:

Advantages	Disadvantages
"Tried and tested" – a flexible and familiar structure which is still the most popular form of corporate vehicle.	Annual and event driven reporting to Companies House means a reasonably high degree of publicity regarding the company.
Simple mechanism for introduction of new equity/transfers of existing equity, although transfers of shares subject to potential 0.5% stamp duty charge. The share capital structure means the shareholder(s) can hold different numbers of shares (or different classes) and therefore, if there is more than one shareholder in the future, hold varying levels of influence.	Directors subject to statutory and common law duties, which will be of particular concern (to those directors) if the company is insolvent or is nearing possible insolvency.
Nature of shares as an investment gives	Company treated as a separate taxable entity

DRAFT

possibility of future "exit" as well as income return for shareholders, subject to there being sufficient profits available for the purpose of distribution.	from its shareholders.
Company can be established with a sole shareholder, so capable of being owned outright by the Council.	Potential issues surrounding valuation of shares on exit.

2. Objectives

It is recommended that the PropCo's objectives are established on a broad basis, so as not to exclude any particular opportunity. Accordingly, it is proposed that the PropCo's objectives will, broad terms, be:

- To acquire, lease, invest in, finance, develop, hold, manage and/or dispose of property including housing of various tenures and classes
- To stimulate and accelerate property development in Greater Lincolnshire and wider
- To undertake any and all activity which from time to time may be considered necessary, connected with or ancillary, or in any way conducive to attaining the above objectives

The principles above would be developed in more detail in each of PropCo's business cases.

3. Corporate structure

At present, the PropCo will be a dormant "shell" with no assets or business plans/cases to deliver. It will nevertheless "bolt into" the existing framework being established by the County Council underneath the LCC Holding Company, Lincolnshire Future Ltd.

The corporate and resourcing relationships between the Council, the Holding Company and the PropCo would be governed at a high level by four principal documents:

- A ***Shareholder Agreement*** setting out the more "commercial" elements of the corporate relationship between the Council, the LCC Holding Company and the PropCo, including how decisions are made, the matters reserved to the Council as ultimate owner of the group, how profits are treated, funding, information rights and other Council controls, and termination. The PropCo would undertake to adhere to its terms, thereby creating a more unified governance structure across the corporate group.

- ***Articles of Association*** for the PropCo are a requirement from a corporate law perspective and set out more "administrative" provisions. The Articles dovetail with the Shareholder Agreement.

- A ***Resourcing Contract*** setting out how the PropCo would "call down" support from the Council or other members of the corporate group when required. As with the Shareholder Agreement, the PropCo would undertake to adhere to its terms, thereby aligning the way in which the Council enables each subsidiary (including the PropCo) to operate. The nature of the resourcing (for example, physical assets, property, IPR, personnel) needs to be priced in a way which complies with state aid principles.

- A ***Funding Agreement*** setting out how the Council would fund the PropCo, to the extent the Council is not investing by way of equity subscription and/or third party debt is not sought. In any case, the funding arrangements would be agreed through the PropCo business plan (the adoption of which is a Council reserved matter).

The PropCo would be managed by a board of directors (albeit the board would operate in adherence to the documents listed above and therefore certain decisions would be reserved to the Council as ultimate owner of the group). For incorporation purposes, it is proposed that an LCC Executive Director is appointed as director. Upon approval of the first business case of the PropCo, it is proposed that further directors of the Board be nominated by the appointed Executive Director in consultation with the Leader of the Council Executive Councillor for Resources and Communications.

In addition to approving the appointments to the PropCo Board, the County Council retains a significant level of control through the reserved matters set out in the Shareholder Agreement.

The PropCo will be influenced by the Holding Company in terms of overarching policies, Data Protection, Health and Safety and Insurance. PropCo will establish a separate set of accounts, auditing and banking facilities coupled with governance requirements.

There are no immediate staffing requirements for the PropCo. Staffing requirements will be identified from individual business cases. There will be a need for the PropCo to administer its own internal administration and compliance with company requirements. It is envisaged that this will be managed in the first instance at least through secondment or the provision of services by the Council to the PropCo.

As the PropCo, would be 100% owned by the County Council it would be a local authority controlled company for the purposes of the Local Authority (Companies) Order 1995. This places a number of administrative, disclosure and financial obligations on controlled companies:

- Any financial support for the PropCo, or possible liability for the Council associated with the PropCo, will have to be included in any assessment of the Council's finances under the prudential framework for capital investment by local government.
- All "relevant documents" must state that the PropCo is controlled by the Council and name the Council.
- There are limits on the allowances payable to directors of the PropCo.
- PropCo would be bound by the restrictions on publication of information imposed by section 2 of the Local Government Act 1986. This means that it would be prohibited from publishing party political material.
- Directors of the PropCo must be removed if they become disqualified for membership of a local authority.
- The PropCo must obtain the Audit's Commission's consent to the appointment of its auditor.
- Requirements are imposed relating to the provision of information to the local authority's auditor and members and of financial information to the local authority.
- If the PropCo is not an arm's length company, then it must allow for public inspection of the minutes of any general meeting for four years after the meeting, unless disclosure would be in breach of any statutory requirement or obligation owed to any individual.

4. Company names

The following company names are put forward for consideration, at the time of writing this report all of the names are available at Companies House:

- Lincolnshire County Property Ltd
- Newland Gate Ltd.
- Newland Gate Developments Ltd
- Development Lincolnshire

5. Investment and other resources required to achieve those objectives

The investment and other resources required to establish the PropCo are low. The form of Shareholder Agreement and Articles of Association are near finalised and the PropCo will need to undertake various formalities to approve and adhere to them.

DRAFT

As an opportunity arises, it will be subject to:

- Commercial, financial and legal due diligence
- External commercial advice where that is considered appropriate
- A separate business case
- Executive approval

At this stage, it is anticipated that the PropCo would require finance and external support on:

- business planning and financial modelling
- market research
- legal matters
- Tax advice to ensure the most tax efficient structure is pursued

The borrowing requirements of the PropCo will be identified in the detailed business cases when opportunities are identified. The State aid implications of this will also be considered on a case by case basis.

Taxation will likewise be looked at in each PropCo business case. This will allow proper consideration of individual areas to include capital allowances, stamp duty, corporation tax, options to elect to tax for VAT purposes and lease arrangements. In principle, due to the establishment of the LCC Holding Company and subsidiary approach, this should enable the Council to take advantage of more tax efficient group company arrangements in appropriate circumstances.

The investment required would therefore be approved on a per-opportunity basis rather than upfront through this business case.

6. Risks

A register will be developed as more thought and investigation is undertaken into the management, operation and development activities proposed for the Company and as opportunities arise.

Common risks and their possible mitigation might include:

Risks	Mitigation
Insufficient through-put of business to justify separate PropCo	PropCo to be actively considered as owner/ developer of appropriate property, with suitability, viability to be established on a case by case basis. Underlying administration cost of PropCo low with lean resourcing model, so overheads kept to a minimum unless potentially viable cases are brought forward. At least initially, the costs of early stage business case development will be borne by the County Council rather than PropCo, with costs of approved business cases being on-charged to PropCo as part of the financial model.
Dependencies (resourcing, staffing, etc.) still located within the Council – this is the downside of a "lean" model.	PropCo to enter into Group-wide Resourcing Contract as above, to regulate drawdown of resources as needed.
Directors' duties owed by those on the Board of PropCo	Clarity of governance structure under Shareholder Agreement and Articles. Ensuring directors are those with the

	appropriate mix of skills and experience (i.e. they know what they are doing and why they need to make decisions). Regular review to ensure governance processes are working efficiently and properly. Training for potential Board members (one session already provided by Bevan Brittan).
Administrative burden increases with additional corporate structures such as PropCo	See above regarding administration costs.

Opportunity-specific risks, as well as the wider risks, are to be considered on a case by case basis with the Executive approving any opportunities and the relevant business cases going forward.

7. **Expected financial results of the business**

These are to be assessed as opportunities arise. At present, the PropCo will be a dormant "shell" with no assets or business plans/cases to deliver.

DRAFT

This page is intentionally left blank