CHESHIRE EAST COUNCIL

Cabinet

Date of Meeting:	7th May 2013
Report of:	Director of Economic Growth and Prosperity
Subject/Title:	Development Company
Portfolio Holder:	Cllr Jamie Macrae, Prosperity and Economic Regeneration

1.0 Report Summary

1.1 This report sets out the benefits, implications and proposed approach to the creation of a new delivery vehicle, to drive forward the development of the Council's land assets so as to promote housing and jobs growth. It summarises the work of Deloitte LLP (business and financial advisors) and Bevan Brittan LLP (legal advisors), appointed to evaluate options and report back on a preferred model to provide the best opportunity to realise the ambitions of the Council, and to create the infrastructure necessary to ensure greater prosperity for all our residents.

1.2 The report seeks Members' agreement to set up a wholly Council-owned and controlled, arms-length Development Company, limited by shares, where the Council retains the assets.

2.0 Decision Requested

2.1 It is recommended that Cabinet:

2.1.1 Recommend to Council the setting up of a Development Company – East Cheshire, Engine of the North, wholly owned and controlled by the Council, in the form described in this report, to drive forward the development of the Council's land assets, as a key element for the Council's wider plans for housing and economic growth.

2.1.2 Recommend to Council to appoint initially to the Board of the Company the following non-executive Directors: Cllr A Thwaite (Chairman), Cllr D Druce (Vice Chair), Cllr D Newton (Vice Chair), Cllr P Groves, the Director of Economic Growth and Prosperity (Caroline Simpson), the newly-appointed Head of Development (Darran Lawless) and agree that the Borough Solicitor, (Mike Rowan) take on the role as Company Secretary.

2.1.3 Recommend to Council that a Shareholder Committee is established comprising of the Leader, Deputy Leader, Portfolio Holder for Prosperity, Portfolio Holder for Resources and the Chief Executive.

2.1.4 Give delegated authority to the Interim Chief Executive and Interim Monitoring Officer to take forward the actions required to implement the recommendation and set up the Development Company, reporting back to Cabinet in October 2013 on progress. Specific actions to take forward are:

Set up the Company as operational (separate legal entity) and establish its Memorandum and Articles of Association by **end May 2013.**

Finalise initial staffing arrangements and related HR considerations; insurance arrangements; and other operating procedures to ensure that the Council's budget envelopes and capital plans in relation to the activities of the Company are clearly understood by **end May 2013.**

Develop a 3-Year Business Plan for the Company, to establish the portfolio of assets it is required to act upon; any provision of resources to facilitate land acquisitions; and set objectives against which its performance will be measured. Also draw up Company Objects and, if relevant, an Agency Agreement by **end October 2013**

3.0 Reasons for Recommendations

3.1 Following the Council's recent options appraisal on the most effective approach, and having received expert external advice and assistance from both Deloitte and Bevan Brittan LLP, the preferred option is delivery of the Council's objectives through a wholly-owned and controlled arm's length company, where the Council retains ownership of the physical assets.

3.2 It is considered that the principal advantage of this option, over all others, is that it allows the Council to focus its delivery through the separate arm's length company, without distracting the company's management and staff with the Council's other day-to-day operational requirements. The Company can also better promote the Council's land and property assets for development through the Local Plan and planning process.

3.3 In addition, the Company can be used flexibly by the Council as its agent, without tying the Council down to a single delivery model (as would a "local asset backed vehicle" (LABV) or transfer of assets). It is believed that this vehicle, also is likely to be regarded as more attractive by the Cheshire and Warrington LEP and possibly other public sector bodies, as a delivery vehicle for their purposes, than direct contract with an in-house Council team or a non-wholly controlled Council company/ joint venture.

4.0 Wards Affected

4.1 All

5.0 Local Ward Members

5.1 All

6.0 Policy Implications

6.1 The recommendation supports the Council’s priority of promoting and investing in local economic growth and the outcomes set out in the Three Year Plan, particularly in relation to ensuring Cheshire East has the infrastructure necessary for a strong, diverse and resilient local economy, and that the area is a good place to live and work.

7.0 Financial Implications

7.1 In February this year Cabinet approved spending of up to £100,000, from an existing Economic Development earmarked reserve, on independent legal and financial advice on the best way to take forward this initiative. Spending to date has been contained well within that envelope; the remainder of the reserve can be used to cover further Company set-up costs (e.g. marketing).

7.2 The Council’s Budget for 2013/14 provides for an enhanced Economic Growth function, in terms of both Revenue and Capital budgets, and the operational activities of the proposed new Development Company would be financed from within those approved resources. In future, it is envisaged that the Council’s Capital Programme would benefit from the work of the company e.g. through the realisation of capital receipts, from the sale of assets or from attracting additional inward investment.

7.3 Along with evaluation of options and matters of governance, the brief to Deloitte included a requirement for advice on related finance and accounting issues, particularly the relevant tax considerations. This report and its recommendations reflect the advice received.

7.4 As noted in section 14 below, the Company would be a provider of professional services; the Council would pay for the services of the Company as for any other external provider of consultancy services, on an appropriate value-for-money basis.

8.0 Legal Implications

8.1 It is proposed that the new delivery vehicle be a company limited by shares, due to the limited profit available and given the legal considerations highlighted in Bevan Brittan LLP's Advice Note. Section 6 of this Advice Note sets out various mitigation strategies in relation to the risks identified with the preferred option.

8.2 It is important for the Council to:

- Identify the scope of the agency role and its’ arrangements with the company;
- Consider who will be Board Directors and how such a role is to be reconciled with any role within the Council, taking into account actual and perceived conflicts of interest and bias, particularly with regard to planning matters, where in effect the Council is both the promoter of a development and the planning authority deciding on it;

- Consider the necessary constitutional and administrative processes which the Council has and make any necessary amendments to these, to ensure that the Company can be used effectively and efficiently to improve delivery timescales
- Consider the effective drafting of the Memorandum and Articles of Association of the Company, to give the Council the necessary degree of control (e.g. the Council would approve any Business Plan (i.e. the overarching "envelope" of the Company's activities), scrutinise the Company's performance and Board activities (directing the Board where necessary to act or not act in a certain way) and exercise a veto at Board level on all or key, strategic decisions affecting the Company), without hampering the day-to-day operations of the Company or discretion of it's Board so it retains agility and flexibility;
- Consider a clearly defined funding model for the Company; and
- Consider the clearly defined staffing arrangements for the Company

9.0 Risk Management

9.1 The potential risks associated with creating and operating a new delivery vehicle of this type, as recommended in this report are summarised in Appendix F, along with related impacts and how those risks may be mitigated or eliminated.

10.0 Background

10.1 In February Cabinet considered a report setting out the strategic case for creating a new delivery vehicle, to drive forward the development of the Council's land and property assets, to promote housing and jobs growth. Cheshire East has ambitious growth plans - with expected targets of at least 20,000 additional jobs and 27,000 new homes by 2030. We are aiming for at least 7,000 new homes in the next five years.

10.2 It is important that the Council is seen to drive forward its economic growth agenda through accelerated development of its assets, both strategic sites identified in the Development Strategy and smaller sites which can deliver investment and growth and contribute to housing supply. A new focused delivery vehicle will galvanise efforts to speed up the development of our own assets to bring about essential investment in new infrastructure and new housing, economic growth and capital receipts.

10.3 The earlier report to Cabinet in February recommended the engagement of legal and business/ financial experts, to evaluate options and report back on a preferred model to provide the best opportunity to realise the ambitions of the Council, in this regard. Following an appropriate procurement exercise, Deloitte LLP were appointed as financial advisors and Bevan Brittan LLP as legal advisors to the Council for this project.

10.4 The comprehensive project brief given to the consultants included the following elements: Consideration of options; Governance and scope; Financing of the vehicle; Financial, accounting and taxation matters; and Risk management.

10.5 Deloitte have prepared a report for the Council and Bevan Brittan LLP have complemented this with an advice note on legal matters; their Executive Summaries are shown as Appendices A and B respectively. This report summarises their work, makes clear recommendations on the preferred approach, and describes the next steps to implementation.

11.0 Consideration of Options

11.1 Following an initial review of the options for creating a delivery vehicle the expert advisors summarised the potential models for consideration as follows:

1. **Status quo** – continuing with the current team, without changes to its capacity and capability;
2. **Self-delivery** – strengthening the current team and making alterations to internal working practices;
3. **Wholly owned and controlled** arms length **company**
    a. *Where the **Council transfers the assets***
    b. *Where the **Council retains the assets;***
4. **Wholly owned, *not* controlled**, but influenced arms length **company**
    a. *Where the **Council transfers the assets***
    b. *Where the **Council retains the assets;***
5. Public/ private **joint venture.**

11.2 Clearly, the preferred delivery vehicle must be fit for purpose and capable of realising most or all of the Council’s objectives. The criteria against which options have been evaluated reflect the Council’s ambitions for speedy, large-scale housing and business growth, and for the new Company. They are shown in Appendix C; and they include the following objectives:

- to accelerate growth in terms of housing completion and jobs investment, using Council-owned land and property assets;

- to maximise development and minimise risk to the Council, by providing dedicated delivery arrangements and relevant and up to date property and commercial expertise;

- to secure additional private sector, Government and European Funding investment into the Borough, through creating a stronger focus on delivery; and providing a mechanism with the potential to deliver larger scale development schemes locally for the Cheshire & Warrington LEP;

- to create profitable and transparent relationships with developers and investors which deliver financial and regeneration benefits; and

- to capture the financial benefits and tax efficiencies of a dedicated delivery vehicle, which is Council-controlled, but can benefit from agile operating arrangements that can be developed at a later date when it is fully established.

11.3 Following evaluation and moderation of the options, by officers from the Council's Regeneration, Legal and Finance teams, the preferred delivery model is **Option 3b: Wholly owned and controlled arms length company, w*here the Council retains the assets***. Against the objective-based criteria described in Appendix C, this is considered to provide the best opportunity to realise the development ambitions of the Council; (a Summary of Evaluation Scores is shown as Appendix D).

11.4 This approach will allow the Council to focus its delivery through the separate arm's length company, without distracting the Company's management and staff with the Council's other day-to-day operational requirements. In addition, the Company can be used flexibly as an agent, without tying the Council down to a single delivery model (as would be the case,say, with an asset-backed Joint Venture company).

11.5 Furthermore, by creating a new identity and brand in this way– with a high profile and an "open for business" attitude – Cheshire East is likely to be seen as more attractive by developers and other external investment bodies and partners, than through a direct contract with the Council, or a non wholly-controlled Council company/ joint venture.

11.6 In addition, in keeping the structure/ scope of the vehicle simple in this way the Council would avoid the potential for "tax leakage" (i.e. unnecessary exposure to Stamp Duty Land Tax, Corporation Tax, etc.), that would otherwise be the case if the Council's assets were transferred to the Company (or asset acquisitions were made by the Company rather than by the Council).

11.7 In effect, the Development Company would in future provide professional services for the Council, acting on its behalf in the promotion of its assets for disposal and development, proactively creating productive relationships with developers and investors, negotiating agreements for sale, lease, or acquisition of sites for housing and business growth. In terms of the best legal form of such a corporate entity, the experts would recommend a "Company Limited by Shares".

11.8 This is because a company limited by shares is a "tried and tested" corporate vehicle used widely within the public and private sectors, with a separation of risks between the shareholder (in this case the Council) and the company and with a clear decision-making forum for the formulation of business strategy (the Board of the Company). Whilst both a company limited by shares and a company limited by guarantee are able to distribute any profits made (with a share-based company being marginally easier), a company limited by shares is more readily capable of being transferred to another party if required in the future. This means that if the Company had value (i.e. another party was willing to pay to own the Company in place of the Council), the Council's shares could easily be transferred to that other party.

11.9 Whilst there are some tax benefits to the use of a limited liability partnership over a company limited by shares or guarantee, given that profit generation and distribution will be limited, an LLP structure is not critical (see the Deloitte Report for details). In addition to this, there is a legal consideration for discounting the LLP model. Under section 4(2) of the Localism Act 2011, if a local authority does anything for a commercial purpose in the exercise of its general power of competence, it must do so through a company. Exercising the power for a "commercial purpose" is not defined in the 2011 Act, but the definition of "company" does not include LLPs. Where the development vehicle is generating profits from outside the Council's area and/ or those profits are not then recycled towards wider Council aims (for example, regeneration, housing, public realm works), it is more likely that the development vehicle's purpose is seen as commercial in nature. Using a company structure rather than an LLP structure avoids any later issues under section 4(2) of the Localism Act 2011.

12.0 Governance and Scope

12.1 Whilst it is for the Council to determine its preferred approach, the Deloitte report recommends that the Board of the Company should be constituted with a relatively small number of individuals in order to be the most effective.

12.2 Based on their experience, Deloitte have suggested that six directors (comprising a mix of Members and senior officers of the Council) would provide the appropriate balance of focus and resource to lead the strategic direction of the Company. Deloitte and Bevan Brittan LLP have each provided advice regarding the best means of ensuring conflicts of interest are avoided, in relation to membership of the Board:

- It is easier to manage the potential conflicts for an "officer director", as the Council can agree to the officer continuing to act in their substantive role despite potential conflicts; can agree not to take action against him where he is required to act contrary to the interests of the Council due to his role as a director; and can agree to his remuneration as a director if applicable. The selection and involvement of senior officers acting as directors to the company will require careful consideration by the Council for these reasons.

- Where a "councillor director" is concerned the Council, (as owner of the company and ‘ controller’ of the Board of Directors) can agree to him or her acting as a director, but under the provisions of the Localism Act 2011, the councillor would need a dispensation to enable him to act as a councillor where a conflict of interest arises or is particularly likely to do so, for example, where a Company Director is also a Cabinet Member. Dispensations may be able to be granted as the provisions of the Localism Act are fairly wide and, for example, a dispensation can be granted if the authority, "considers that granting the dispensation is in the interests of persons living in the authority's area", or "considers that it is otherwise appropriate to grant a dispensation". The member must apply for the dispensation in writing and it does not avoid the requirement for registration of interest or of disclosure whenever a matter of Council business affecting the company is being discussed.

- It is also important to remember, that despite all of the above being in place it can be very difficult to avoid the perception of bias, which, if proven, can invalidate the decisions of the Council and give rise to a public perception of wrongdoing which can be very difficult to resolve. For this reason, care needs to be taken over the selection of those elected Members who will serve on the Board of the Company.

12.3 With the above advice in mind, it is suggested that the Council agrees to appoint initially the following non-executive Directors: Cllr A Thwaite (Chairman), Cllr D Druce, Cllr D Newton, Cllr P Groves, the Director of Economic Growth and Prosperity (Caroline Simpson), the newly-appointed Head of Development (Darran Lawless) and agree that the Borough Solicitor, (Mike Rowan) take on the role as Company Secretary. It is recommended that the core role of the Chair and the Board of the Company is to ensure the work programme of the Company fits within the Council’s corporate objectives; to develop the strategic work programme; and importantly to monitor and drive forward delivery through robust performance management.

12.4 Bevan Brittan have advised that Directors' remuneration with the wholly-owned company will be governed by the provisions of the Local Authority Order 2005, which restricts the amount of remuneration that an elected Member may receive. In effect, this means that they cannot receive any additional remuneration from the Company for acting as a director, which is beyond the special responsibility allowance they would have received had the activities of the Company been discharged by the Council. Any remuneration they receive will be deducted from the SRA that they receive within the Council and they may only claim mileage and subsistence at the rates that apply to councillors.

12.5 Clearly, in order to implement this initiative, the Council will need to review and revise its decision-making structures. This will include defining the operating parameters of the Company – e.g. which assets are available for disposal or development; and giving the delegated authority required to negotiate agreements for sale or lease to developers, investors or end users or development agreements with developers; etc. – in such a way as to provide assurance to the Council regarding the proper management of its property assets.

12.6 The Council would exercise control of this new vehicle also by agreeing a 3-Year Business Plan for the Company, which establishes the portfolio of assets it is required to act upon as a priority; any provision of resources to facilitate land acquisitions; and set objectives against which its performance will be measured. This Business Plan will be specific to the Development Company but fit within the overall Council's reporting arrangements.

12.7 With regard to the accountability of the Company, the Council needs to determine reporting arrangements for the scrutiny of the Company's performance. As a provider of services helping to deliver the Council's economic growth agenda, the Company's activities would fall within the remit of the Portfolio Holder for Prosperity & Economic Regeneration and would be subject to the normal scrutiny arrangements of the Council. This would involve regular quarterly performance reports to Cabinet and Corporate Scrutiny Committee.

12.8 It is proposed that a Shareholder Committee is established comprising of Members from Cabinet and the Chief Executive to oversee the operations of the Company. It is recommended that the Shareholders Committee is comprised of the Leader, Deputy Leader, Portfolio Holder for Prosperity, Portfolio Holder for Resources and the Chief Executive. The proposed governance model is outlined in Appendix G.

12.9 As noted above, a key objective of this initiative is also to create the potential for the vehicle to operate outside the Council's geographic boundaries and provide advisory services for the Cheshire and Warrington LEP (and possibly other public sector bodies). Deloitte have noted that the Company would need to develop its service offer and commercial arrangements with the other authorities; and also have regard to associated resourcing requirements as well as to consider any impact on its tax position. Similar considerations would apply if the Council wished over time the Company to expand the scope of its functions beyond its original purpose.

13.0 Management Structure and Initial Work Programme

13.1 The management of the Company would complement the new organisational arrangements being developed in the Council, with the most senior role (Managing Director) working under the direction of the Company Board and with a reporting line to the Council's Director of

Economic Growth & Prosperity, relating to the work of a wider Council team and benefitting from other initiatives being taken forward to improve and streamline working practices in this context.

13.2 Regarding the staffing of the Company, it is envisaged that there would be a small “core” team of Managing Director; a Development Programme Manager; up to three Development Surveyors; a Legal Advisor; and a Finance Advisor, with ability to flex resource inputs relative to the needs of the work programme and associated funding as set out in the 3-Year Business Plan.

13.3 It is recommended that initially staff employed by the Council seconded to the Company, as required, with appropriate charges made to the Company’s account for their time, along with associated overhead and support costs. This approach would be simpler than TUPE transfer of staff to the Company, and particularly would avoid additional pension-related costs for both the Company and the Council. The Company may purchase external consultancy services directly though, relating to the requirements of the work programme and within the budget envelope and scope of its 3-Year Business Plan.

13.4 An initial work programme for the Development Company is being prepared for consideration. The Council’s substantial asset portfolio includes a range of land and property holdings, with the potential for significant residential and/ or business-led development. Subject to planning consent and the economic conditions prevailing at the time of marketing of sites, it is understood that capital receipts in excess of £100m may be achievable over the next 10 years. The Development Programme will evolve further as part of implementation, and will form the first 3-Year Business Plan for the Company.

14.0 Financing of the Vehicle

14.1 As the Company would be a provider of professional services, the Council would pay for the services of the Company, as it would for any other external provider of consultancy services. For the Council, such expenditure would be treated under the usual capital/ revenue rules, and with spending on services relating to the disposal of its assets chargeable against its associated capital receipts (subject to the statutory limit of 4% of each receipt).

14.2 As indicated in section 7, the financing of the operational costs of the Company (e.g. staffing, marketing, other services and support expenses) would continue to be provided for in the Council’s medium term financial plans – i.e. reflected in Capital project and disposals programmes, as they develop, with any costs not chargeable to capital being met from existing Revenue budgets for the Development Team and its associated support services.

15.0 Financial, Tax and Accounting Matters

15.1 The Deloitte report contains analysis and commentary on tax considerations, in respect of Corporation Tax, Stamp Duty Land Tax and VAT. It recognises that the position of Councils, in relation to tax, is particularly favourable (e.g. with no liability for Corporation Tax and particular rules in relation to VAT).

15.2 Consequently, in general terms when considering alternative delivery vehicles, there must be a focus on minimising "tax leakage". A high level summary of the tax implications of each of the options for new delivery vehicles is shown in Appendix E.

15.3 As noted in paragraph 11.3, the recommended option is for a wholly Council-owned and controlled company, providing professional services. Under this model - *with the Council retaining ownership of its property assets, until actual disposal to a developer, investor or end user (or indeed the Council acquiring assets, in relation to acquisitions negotiated by the Company on its behalf)* – the Council avoids over-exposure to Stamp Duty and Corporate Capital Gains Tax. Furthermore, simple reimbursement of operating costs of the Company would avoid Corporation Tax leakage, in material terms.

15.4 The external experts have provided information on company accounting, financial reporting and State Aid. As requested in the brief, they have also given advice on the financial aspects in respect of the staffing of the company, which we will need to give consideration to (e.g. as noted above, whether staff employed by the Council should be simply seconded to the Company; or formally transferred under TUPE, with the associated complexities and costs of pension transfers; and insurance/ indemnity matters relating to both officers and Members).

16.0 Risk Management

16.1 The potential risks associated with creating and operating a new delivery vehicle as recommended in this report are summarised in Appendix F, along with related impacts and how those risks may be mitigated or eliminated. A detailed Risk Management Plan will be developed and put in place as part of the actions needed to establish the new company.

17.0 Access to Information

The background papers relating to this report can be inspected by contacting the report writer:

Name: Caroline Simpson
Designation: Director of Economic Growth & Prosperity
Tel No: (01270) 686640
Email: caroline.simpson@cheshireeast.gov.uk