Deloitte - Executive Summary

APPENDIX A (1)

- **Background:** Cheshire East Council ("the Council") has ambitious growth plans with the Local Plan setting out the delivery of major new infrastructure, at least 20,000 jobs and 27,000 new homes by 2030. In response to the growth agenda, the Council is seeking to accelerate the development of Council owned assets and to boost the delivery of developer-led strategic sites and is considering the creation of a new dedicated Development Vehicle for this purpose. In March 2013, the Council commissioned Deloitte to support the financial aspects of a high level appraisal on a range of options for the Development Vehicle and to provide some specific advice and commentary on the proposed preferred option. The purpose of this report is to document the findings of our high level review. The Council has significantly shortened the timetable for this high level review. This report therefore comments on the work to date and further work and clarification is required to address a number of points raised in this report.

- **Option appraisal and preferred option:** The Council in conjunction with its legal advisers (Bevan Brittan) and Deloitte have development a shortlist of potential delivery options. A qualitative options appraisal has been scored by a project team consisting of Council officers, Deloitte and Bevan Brittan has identified the preferred option to be Option 3b*: Delivery through wholly-owned and controlled arms' length company where the Council retains ownership of the assets* ("the Company"). Under Option 3b, the proposed scope of the Company is to:

- To accelerate growth in terms of housing completion and jobs investment on Council owned assets;
- To provide dedicated delivery arrangements and property and commercial expertise;
- To secure additional private and Government investment into the Borough through increased focus on delivery;
- To potentially provide a mechanism to deliver schemes to the Cheshire & Warrington LEP as well as the Council;
- To create profitable and transparent relationships with developers and investors to deliver financial and regeneration benefits;
- To capture any financial benefits and tax efficiencies of a dedicated delivery vehicle which is Council controlled.

- **Council Assets** the proposed preferred option does not envisage the transfer of Council assets to the Company. The ownership and management of the Council assets will be retained by the Council and the financial transactions associated with the financing, maintaining and disposing of capital assets are expected to follow existing arrangements. The Council and Company will need to consider how the current arrangements regarding the management of the Council assets are impacted as a result of the newly formed Company in order to provide the management arrangements for the proper control, management and stewardship of Council assets.

- **Capital financing**: the Council has envisaged some form of "revolving fund" to facilitate asset acquisition. Given capital financing transactions will be retained in the Council, it may be that the benefits of the revolving fund could be achieved through the use of an "earmarked reserve" rather than a separate fund, subject to the impact on the Council's corporate financial management and capital financing plans and clarification of governance arrangements.

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- **Governance arrangements**: The Council preferred option is the delivery through wholly-owned and controlled arms' length company where the Council retains ownership of the asset. We understand the Council has given some early consideration to the governance arrangements for the Company although at this point in time proposed governance arrangements are still being considered by the Council and arrangements are not yet finalised.
- **Board representation and managing conflicts**: the Board should be constituted with a relatively small number of individuals to provide the appropriate balance of focus, skills and resource to lead the strategic direction of the Company. Larger numbers of individuals may result in reduced focus and strategic direction. The Council needs to manage potential conflicts (real and perceived) and consider the appropriateness of Councillors and lead officers acting within the Council on any matter which has a significant impact on the Company.
- **Decision making structures**: The Council will need to agree the parameters of the Company's decision making and how the management of the Company and key decisions will interface with existing Council decision making and approval structures. For example, will certain decisions require Cabinet approval, delegated approval from the relevant portfolio holder, approval from the relevant chief officer?
- **Company accountability and scrutiny**: we are informed by the Council that the activities of the Company 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. The Council needs to finalise these reporting lines to ensure appropriate arrangements are in place to manage the performance of the Company.
- **Accounting / reporting:** Company directors will be responsible for operation and management of the Company and for accounting records which are sufficient to show and explain the company's transactions and to enable them to ensure that any accounts required be prepared to comply with the requirements of the Companies Act (386 of the Companies Act 2006). Option 3b may qualify as a small company exemption although this will require further analysis and confirmation.
- **Employment model**: We understand from the Council that the estimated staffing and operating costs would be in the region of £0.5 million per annum and that most of the staff are likely to be Council employees. The Council is considering a secondment model (ie seconding of Council staff to the Company) at least in the first instance. In finalising the employment model the Council will need to be mindful of TUPE Regulations and these have been considered in the Bevan Brittan's Advice Note.
- **Financial skills**: the Company will require access to appropriate financial skills. Dependent on the finally agreed scope of the Company, it is likely that certain skills (eg accounts preparation) could be available on a call off arrangement from the Council. It may that expertise in commercial and financial structuring could be provided by the newly appointed Development Executives, through advisory support or through external recruitment.

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- **Corporate Tax**: under Option 3b, assuming the vehicle is established for EU procurement reasons as a ‘not-for-profit’ cost-sharing vehicle, the risk of corporation tax leakage should be minimised on the basis either (i) that the vehicle is not carrying on a commercial trading business for tax purposes so does not generate taxable surpluses or (ii) that it is a mutual trader (broadly, a service provider controlled by its members and funded by members’ contributions). Option 3b should also avoid any additional SDLT risk as no property transfers between CEC and the delivery vehicle would be contemplated. If the delivery vehicle were to undertake property transactions directly (as under Option 3a or Option 5), or (under Option 3b) provide commercial services with a view to a profit, the use of a “tax transparent” limited liability partnership (LLP) structure may be beneficial from a corporation tax perspective as it would enable the Council to benefit from corporation tax exemption on its share of profits accruing within the LLP. Use of an LLP would, however, be subject to the Council obtaining legal advice that the particular commercial activities are capable under the Localism Act of being undertaken using a partnership rather than a limited company. An LLP would also not generally be a suitable vehicle for a cost-sharing activity which is not undertaken on a commercial basis, as its presupposes that the LLP is carrying some form of business.

- **VAT**: the Council enjoys a beneficial VAT partial exemption regime allowing it to recover input VAT on its costs in full, provided the VAT incurred on costs relating to exempt supplies (which would include certain sales of land and property) is less than 5% of the total VAT incurred by the Council. We have not reviewed the Council’s partial exemption status as part of this exercise, but the possible impact of future property transactions on the Council’s VAT partial exemption position generally should be kept under review in case there is any risk of the 5% threshold being breached. Under Option 3b, the delivery vehicle is likely to be required to register for VAT and account for VAT on supplies made to the Council. For partial exemption reasons, we would recommend that it is separately VAT registered and is not included within a VAT group registration with the Council. As the vehicle would not itself be entering into property transactions, it should be fully taxable for VAT purposes enabling it to recover input VAT incurred on its costs, so the overall VAT position should be neutral.

- **Future scope expansion**: Going forward, we understand that the Council may wish to consider broadening the scope of the Company to operate outside of the Council’s geographic boundaries and also to potentially widen the scope of the Company to provide additional trading activities to other sectors. In exploring either or both of these scenarios, the Council would need to undertake the appropriate market sounding to provide a level of assurance on the demand for services; consider any potential tax issues; and develop the commercial and pricing mechanisms for such arrangements.