



ANNEX F

draft 2 dated 24 May 2016

The Royal Borough of Windsor and Maidenhead

Report on legal issues

in relation to the use of RBWM Property Limited as a housing company

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1 Introduction

- 1.1 We have been asked by the Royal Borough of Windsor and Maidenhead (the **Council**) to advise on the legal issues surrounding the use of their current subsidiary company RBWM Property Limited (currently registered as RBWM Property Limited) (the **Company**) as a housing company to encompass housing development and ownership.
- 1.2 It is understood that the Council would like to transfer between 6 – 10 properties currently owned by the Council to the Company. It is also envisioned by the Council that if a new development is built, pending the agreement of the developer to provide a number of units for affordable housing purposes, these could be owned by the Company. The Council would also like to fund the Company with between £2,500,000 and £3,000,000 worth of Section 106 contribution monies. It is also understood that the Council would also like to fund the Company by providing £200,000 from other Council funds.
- 1.3 We understand that the rationale for using the Company as a property development and management Company is the following:
- 1.3.1 To make a profit by delivering housing for market rent or market sale with a view to providing a revenue return to the Council as owner of the Company; and
- 1.3.2 Provide affordable accommodation for keyworkers.
- 1.4 This report covers the legal issues surrounding the powers of the Council to allow the Company to work as a property ownership development and management Company. It will also cover the powers of the Council to transfer properties and provide funding to the Company including in relation to vires (powers), state aid and governance.

2 General Power of Competence

- 2.1 Local Authorities have the power to do anything that an individual may do in accordance with Section 1 of the Localism Act 2011 (the **2011 Act**). This is referred to as the general power of competence, and a local authority may use this power for its own purpose, a commercial purposes or/and for the benefit of others. This power is however subject to a number of limitations, including pre-commencement limitations; which confirms that any legal restrictions, prohibitions or limitations that existed prior to 18 February 2012 (when the 2011 Act came into force) will remain in force.
- 2.2 Section 2 of the 2011 Act limits the general power of competence where it 'overlaps' with a power which predates it. This means that where the Council relies on the general power of competence and there is the same power which pre-dates it and is subject to restrictions, then the general power of competence will be subject to these restrictions. An example of this is Section 95 Local Government Act 2003, which gives the Council the power to trade, but is subject to restrictions contained within Regulation 2 of the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009 which requires a business case to be prepared and approved by the Council before the Company starts trading. Additionally, in accordance with section 4 (2) Localism Act 2011, a local authority wants to do anything for a commercial purpose, they must only use the general power contained in section 1 Localism Act 2011 through a Company.
- 2.3 The Council has already set up the Company, and therefore has satisfied itself as to the power to establish the Company. However, it is important to recognise that to the extent

that the Council wish to rely on the general power of competence to undertake market rent activities, then that is likely to constitute a commercial purpose, so a company must be used to do so. The Company will be subject to restrictions contained within Company law and its Articles of Association (the **Articles**).

3 Powers of the Company

3.1 The Company will have Articles which will contain the Company's specific objects, and the Company must act in accordance with the object and its powers as granted by the Articles. We have undertaken a review of the Company's Articles and note that the articles are fit for purpose for use as a housing company.

3.2 Additionally we would recommend that a Shareholders Agreement is required to ensure that the extent of the Company's authority and powers are properly documented once they received the proposed property transfer and funding. Below is a decision making matrix, which provides an example of the decisions that can be made at board level or at shareholder level within a housing company:

Issue	Officers of RBWM Property	Board of RBWM Property	Council (acting as shareholder of RBWM Property) (decisions taken via shareholder committee)
Customer issues	✓		
make any amendments to any Lettings Policy and Sales Policy;		✓	
implement the Rent Policy;	✓		
implement the Debt Recovery Policy;	✓		
Business issues	✓	✓	
Approve any business other than as contemplated by the Business Plan;			✓
Engage in business contemplated by the Business Plan (including acquisition of property that fits with an agreed Financial Model);	✓	✓	
Approve any contract with a value in excess of £500,000];			✓
Approve any arrangement, contract or transaction outside the normal course of its business or otherwise than on arm's length terms.			✓

Issue	Officers of RBWM Property	Board of RBWM Property	Council (acting as shareholder of RBWM Property) (decisions taken via shareholder committee)
Close down any business operation, or dispose of any material asset unless in each case such closure or disposal is expressly contemplated by the Business Plan;		✓	✓
Acquire any land with a value in excess of £500,000;			✓
Approve acquisition of any land or property outside of the Council's administrative area			✓
Make any amendments to the Financial Model;			✓
Adopt or amend RBWM Property's Remuneration Policy;			✓
Adopt or amend RBWM Property's annual Business Plan.		✓	✓

4 **Should the Company be a Registered Provider registered with the HCA?**

On balance, our recommendation is not to register the Company as a Registered Provider with the HCA (particularly because of recent government policy changes relating to the Right to Buy and the rent reduction regime), unless the potential availability of HCA grant is a key consideration for the Company, or if (for new developments of sufficient scale) local planning policies require an RP to take the affordable elements of a new scheme

5 **Council's power to provide funding to the Company**

5.1 Section 24 of the Local Government Act 1988 (**the 1988 Act**) provides the Council as housing authority the power to provide any person with financial assistance for the purposes of, or in connection with, the acquisition, construction, conversion, rehabilitation, improvement, maintenance or management (whether by that person or by another) of any property which is or intended to be privately let as housing accommodation. To 'make a grant or loan' is caught by this provision and land transfers and the provision of funding is would fall within this definition.

5.2 Section 25 of the Act provides that the power in Section 24 of the 1988 Act may only be exercised in accordance with consent of the Secretary of State. The Secretary of State has issued general consent under Section 25 of the 1988 Act – General Consent C - the general consent under section 25 of the 1988 Act for financial assistance to any person 2010 (**the 2010 Consent**). The consent provided states that a local authority may provide

any person with any financial assistance (other than the disposal of an interest in land or property) for the purposes of or in connection with the matters in section 24 of the 1988 Act. Accordingly there is a clear power for the Council to invest monies in the Company whether by way of loan of (additional) share equity. The Council could not rely on General Consent C as blanket consent for the transfer of land at an under-value. Additionally there is a risk to the Council that providing grant to the Council or on-lending at a preferential rate could be deemed to be State Aid (see below) if the land/monies were not applied to the provisions of affordable housing.

- 5.3 An additional consideration for the Council is that funds which have been received from Section 106 Town and Country Planning Act 1990 contributions will be ring-fenced. The Council must be satisfied that the funds being transferred to the Company are being used for the purposes that the funds were obtained. The Council may wish to develop properties and sell these at a lower value as affordable housing to key workers. This may be possible, but the concept will be subject to the terms of the relevant s106 agreements and the Council's planning policy. A review of the relevant s106 agreements will be undertaken to ensure that funds are able to be utilised by the Company.
- 5.4 Note that the provisions of s24 and 25 of the 1988 Act only apply in relation to the provision of rented accommodation by the Council and alternative powers would need to be used to fund the Company for any development for sale (most likely to be the utilisation of the General Power of Competence under Section 1 of the Localism Act 2011) discussed in paragraph 2 above.
- 5.5 **Council's Power to transfer land to the Company**
- 5.6 Section 123 Local Government Act 1972 (the **1972 Act**) provides the Council with the power to dispose of land held by them in any manner than they wish; the restriction on this being that, except with consent from the Secretary of State, a Council shall not dispose of land (otherwise than by way of a short tenancy), for consideration less than the best that can reasonably be obtained.
- 5.7 It has been recognised that there may be circumstances where local authorities consider it appropriate to dispose of land or property at an under-value and general consent has been granted Local Government Act 1972; General Disposal Consent 2003 (the **2003 Consent**). The general consent applies where the disposal of any interest in land is considered by the local authority to help secure the promotion or improvement of the economic, social or environmental well-being of its area. Where applicable, local authorities should have regard to their community strategy, and in all cases the under-value of the disposal cannot exceed £2,000,000.
- 5.8 The £2,000,000 limit is per individual disposal and is assessed on an unrestricted value basis - so a valuation cannot be artificially reduced by the imposition of voluntary conditions of sale (so for example a restriction on the Company use a property for affordable housing purposes would need to be disregarded for valuation purposes). Therefore a disposal of a property that is market valued at £1,999,999 and transferred or disposed of for a premium of £1 or nil value, would fall within the provisions of the 2003 Consent. Therefore the Council may transfer or dispose of land for a value that it feels fit, as long as it fits the criteria in point 4.7 above, and subject to the other considerations contained within this report.

- 5.9 Therefore if the properties are being transferred for the best value that can reasonably be obtained, or fall within the requirements of the 2003 consent, then the Council can transfer the properties to the Company.
- 5.10 The Council must be mindful however that if the transfer is for the purposes of rented accommodation then Section 24 of the 1988 Act will also apply. As stated previously, whilst the powers provided by Section 24 of the 1988 Act are available to disposals of land, the 2010 Consent does not extend to land disposals.
- 5.11 If the Council were to dispose of the properties at an under-value then because of the 1988 Act they would require consent from the Secretary of State via DCLG.
- 5.12 Finally, there is a risk that transferring land/property to the Company at a below market rate could be deemed to be State Aid (see below).
- 5.13 To avoid the complications of Section 24 of the 1988 Act and Section 123 of the 1972 Act, and to avoid the State Aid provisions, we would advise that it is generally easier to provide sufficient funding to the Company so that the land can be acquired for market value, but that where State Aid provisions are not an issue (broadly where the property is to be used for affordable housing) then it (subject to obtaining consent under section 24 of the 1988 Act and the disposal falling within the 2003 Consent) then the land/property can be sold at and undervalue .

6 **Fiduciary duties**

- 6.1 The Council's has fiduciary duties which can be summarised as acting as a trustee of tax and public sector income on behalf of its rates and tax payers. The Council in effect hold money but do not own it, and spend that money on behalf of its business rate and Council tax payers.
- 6.2 In making decisions concerning any investment and loans the Council makes to the Company they must, on each occasion, act efficiently and undertake funding (and related decisions) after proper consideration of the risks and rewards of them doing so. The Council will want to ensure that it achieves an appropriate return for any risk they take and that it has minimised the risks and potential costs to it if the Company becomes insolvent and/or defaults on any loans following the transition to a property management and development Company. The Council must also ensure that the transaction is proportionate and properly balanced against the anticipated benefit and the wider interests of its local tax payers, considering whether any monies they intend to invest/lend to the Company could be better used by the Council for the wider interest of its local tax payers. The Council must ensure that the decision to use the section 106 and other monies, and to transfer the land has been assessed with a proper consideration of the risks and that the transaction is proportionate. One way of assessing this test is to consider how else the the section 106 and other monies could be used and how such uses could benefit the Council (e.g. grant funding local RPs to acquire or develop housing).

7 **Tax**

- 7.1 The Council would need to obtain specific tax advice in relation to the Company and we are not instructed at present to provide this advice. In general however the Company will be subject to corporation tax on its profits and can only declare dividends out of its net-of-tax profits.

7.2 It may be possible to extract some of the profits to the participating Councils tax-free, for example by arm's length interest payments on loans or management charges but there will still be at least some tax liability in the Company.

7.3 In relation to carrying out letting via the Company, the Company will be subject to normal VAT recovery and residential rents and sales of houses are exempt from VAT. As such, irrecoverable VAT costs will need to be incorporated into the Company's business plan in relation to services purchased by it.

8 **Stamp Duty Land Tax (SDLT) on land transfers**

8.1 It would be possible to obtain "Group" relief on land/property transferred from the Council which would mean that any transfers of property from the Council to the Company would not incur SDLT.

8.2 For any other acquisition of land or property by the Company (as is the case with the Council) SDLT will be payable by the Company and SDLT liability will therefore need to be factored into the Company's business plan. Unfortunately, the Company would be liable to the additional 3% "surcharge" introduced on 1 April 2016 following the spring Budget in respect of investment properties.

This means that the rate of SDLT payable on "external" acquisitions would be as follows

	Purchase price	rate
	up to £125,000	3%
£250,000	over £125,000 and up to	5%
£925,000	over £250,000 and up to	8%
£1.5 million	over £925,000 and up to	13%
	over £1.5 million	15%

If more than 6 or more dwellings are purchased from a single purchaser then the Company could elect to treat the SDLT position as per a commercial property transaction, which may achieve a modest SDLT saving depending on the value of the property acquired.

9 **State Aid**

9.1 If the Council provides financial assistance to the Company by way of providing below market rate funding or transferring land at an under-value, then this may constitute State Aid.

9.2 The legal requirements of State Aid and what will constitute as State Aid is set out in the Treaty of the Functioning of the European Union (TFEU). Article 107 (1) TFEU confirms that the following aspects must be present for State Aid to exist:

9.2.1 amount to a grant of public money or a transfer of public resources;

- 9.2.2 favour certain undertakings (selective element);
- 9.2.3 which distort or threaten to distort competition in the European Union; and
- 9.2.4 affect trade between the Member States of the European Union.
- 9.3 Both financial payments to the Company and the transfer of property to the Company can be caught by the State Aid provisions and therefore funding arrangements between the Council and the Company must be correctly structured so that State Aid, as defined above, does not arise. The structure of any financial arrangement between the Council and the Company will be required to be in a manner which is permitted under the TFEU and European Directives, European Commission communications and decisions from the European Court of Justice.- either as a service of a general economic interest (in which case an exemption applies -see para 8.4 or via a market economy investor principle (para 8.5)
- 9.4 There is an exemption to State Aid for service of a general economic interest and therefore if the properties are developed or acquired for letting as social/affordable or intermediate housing then this exemption would be able to be applied. Provided that the accommodation is let at a rent which is demonstrably below market (as a rule of thumb 80% of market rate would seem a sensible starting point) , then this exemption would apply.
- 9.5 With regard to funding outside of this exemption, there are also provisions for which the funding could fall outside of the State Aid definition where the Council is acting in a way that a private lender and/or investor would in similar circumstances in a market economy – this is known as the Market Economy Investor Principle (**MEIP**).
- 9.6 The terms of a MEIP compliant loan must be commercial in nature and contain provisions which a private lender would require (clauses on regular payment, default, security over assets and similar terms); have a commercial interest rate which properly reflects the risk and security, and other factors which a private/commercial lender would take into account in calculating an appropriate interest rate.
- 9.7 We have been instructed by the Council that the loan of £200,000, which is being provided out of other Council funds, is being charged interest at a rate which a private lender would require. The Council must also ensure that the non-financial element of the loan complies with terms and conditions which a private lender would require to be compliant with MEIP. We recommend that if the Council decides to provide any further loans to the Company, an independent report which analyses the relevant risk in relation to the loan is obtained to confirm the above provisions apply to ensure compliance with the MEIP.
- 9.8 The Council also has the option to invest money into the Housing Company as equity (i.e subscription to share capital) either instead of providing it with a loan and/or as mixed equity/debt funding and the evidence which the Council would require in connection with any equity investment mirrors that which is required for a loan.
- 10 **Third party reliance**
- 10.1 This note has been prepared for the sole use of the Royal Borough of Windsor and Maidenhead. We do not accept or assume any liability or duty of care to any other body or

person to whom this note is shown, or into whose hands it may come, save or expressly agreed by our prior consent in writing.

Trowers & Hamlins LLP
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