

**Subject: Property Rental Company**

**Report to: Full Council – 11 July 2019**

**Report by: Neil Shaw, Strategic Director**

## **RECOMMENDATIONS**

- 1. Members consider and approve the scope and strategic objectives of the Property Rental Company contained in this report and that these be incorporated within the Equinox Enterprises business plan.**
- 2. a) Members consider and approve that a ‘sister’ company to Equinox Enterprises be established to hold rental properties.**  
**b) Members approve the appointment of the existing Directors of Equinox Enterprises as the Directors of the new Property Rental Company.**
- 3. Delegate authority to the council’s Strategic Director who, in conjunction with the Monitoring Officer, will establish the new company and engage a letting partner to undertake tenancy management for the rental properties.**

## **1. INTRODUCTION**

- 1.1. The Housing & Neighbourhoods Committee on 6 December 2018 agreed that work be undertaken seeking to establish a property management company to enable the council to hold rental properties. The Policy & Resources Committee meeting on 19 March 2019 agreed that the council progresses a HMO and Guesthouse purchase and repair scheme. This included agreeing an initial £2m capital budget to be used to deliver the scheme.
- 1.2. Legal advice has been sought from nplaw and Trowers Hamblins and the council has also examined the approaches taken by other local authorities who have set up such a company. This report outlines the process for establishing the company. The report was considered by members at the Housing & Neighbourhoods Committee on 20 June 2019 and this report has been referred onto Full Council for consideration and approval.

## **2. BACKGROUND**

- 2.1. The council is keen to establish a vehicle to enable it to hold properties which it can then rent to meet a wider range of strategic objectives and to deliver a revenue stream. The council is currently able to hold rental property as part of its housing stock and this is held within the Housing Revenue Account. The council is seeking to widen its role as part of the ‘Housing Deal for Great Yarmouth’ approved by the

committee in July 2018 to hold properties which it can then offer at market rent. The Deal sets the strategic context for how the council is seeking to use housing, alongside other levers, as a force for positive place-making in the borough.

- 2.2. On 6 December 2018 the committee approved the Empty Homes policy, that the council progresses two approaches – a loan scheme and an ‘invest and lease’ scheme. The loan scheme is being progressed but to deliver the ‘invest and lease’ option and to be able to purchase, repair and then retain properties for market rental (whether these are existing empty properties or not) a Property Rental Company is required.
- 2.3. The Policy & Resources Committee on 19 March 2019 agreed both an updated Acquisition & Disposal Policy and that the council progresses a HMO and Guesthouse purchase and repair scheme. This included agreeing an initial £2m capital budget to be used to deliver the scheme.
- 2.4. Properties to be offered at market rent require the council to establish a company to hold the rental properties. Equinox Enterprises is currently set up as a development company but, in its current form, cannot yet hold the rentals. It is therefore proposed that a new Property Rental Company within Equinox Enterprises is established.

### **3. SCOPE AND OBJECTIVES OF THE PROPERTY RENTAL COMPANY**

- 3.1. The company can be established to achieve a wide range of objectives. The council is seeking to establish the company to provide a degree of flexibility to meet current and possible future objectives it may wish to achieve. The council wishes to achieve the following objectives by establishing the property rental company:
  - To hold and manage market rent properties:
    - to provide a more sustainable mix of local communities, particularly in the town centre
    - to provide a commercial revenue return for the council’s General Fund
    - to set a high standard for the quality of and management of private rented homes
  - To manage properties and offer assured shorthold tenancies at intermediate rent:
    - to provide a wider range of rental properties available to local people struggling to access the local rental market
    - to offer targeted local people access to rental properties at below market rent levels

The council intends to focus on the first of these objectives immediately. The second objective provides the council flexibility to undertake this activity if it the business case for a property is financially viable. This is explored later in this report. It is intended that the Property Rental Company will only seek to acquire homes within the Great Yarmouth borough initially, although the company will have the power to obtain properties in a wider geographical location if this is desired in the future.

- 3.2. The council is seeking to avoid setting up a completely new company and governance structure so proposes that the new structure to hold the rental properties be held under the Equinox umbrella as a ‘sister’ company and incorporate a separate

company for the property rental business. The company functions will be subsumed within Equinox - one company with two 'arms': a development arm and a property rental arm. The development arm will be able to sell completed homes to the property arm. In addition, the property arm will be able to acquire homes more widely on the open market.

- 3.3. The council is seeking to hold the properties and engage a letting partner to undertake tenancy management and manage the lets. This approach may change over time when the second objective of the company is delivered or when the company has sufficient homes to undertake the management of the homes and letting process within the council if this becomes more cost efficient than a letting partner or the council wishes to exert more control over the lets.
- 3.4. It is not proposed that the company will acquire any affordable/social homes as such homes which would exclusively be for those households on the council's allocation list. These are more appropriately held within the Housing Revenue Account or owned by a Housing Association.
- 3.5. The company will also be able to hold properties at sub-market rental (generally defined as 'intermediate rent') accommodation. Although the primary focus of the company will be on providing a more sustainable mix of local communities and a commercial income stream for the General Fund, at some point in the future the council may wish to have the ability to hold a small proportion of properties which it can decide to let at sub-market levels.
- 3.6. Intermediate rent means lower cost accommodation which is provided on an assured shorthold tenancy to a tenant who is not a person nominated by the council under section 159(2)(c) of the Housing Act (1996) i.e. someone who is ineligible or low priority for local authority housing. Such properties cannot be held in the Housing Revenue Account. The council may wish to be able to provide intermediate rental properties to:
  - local people struggling to access the local rental market,
  - to offer targeted local people access to rental properties or
  - seek to support key workers
  - meet a particular sub set of private rental demand which is not being met whilst still meeting the commercial purpose of the company
- 3.7. Overall, the company would have the ability to link in with empty homes and HMO/guesthouse work including property acquisition with a view to holding rental properties.
- 3.8. The key issues to clarify to establish the 'sister' company are:
  - Examining existing local authority powers for these functions
  - Governance structure
  - Finance (including tax liability)
  - Legal issues (including the relevance of the Teckal exemption and state aid)

#### **4. LOCAL AUTHORITY POWERS**

- 4.1. Whilst council companies have existed for many years, with trading powers set out in Section 93 of the Local Government Act (2003), more recent diversification of new companies has been enabled by the General Power of Competence introduced in the Localism Act (2011). Whereas previously councils could only trade their existing activities, this legislation in essence allows a local council to undertake any commercial activity that an individual or private company can lawfully undertake, provided this activity is not explicitly ruled out or constrained for councils by another piece of legislation. This opens up purely commercial trading in services not provided by councils before, such as building homes for open market sale and full private market rent.
- 4.2. In terms of powers the council is therefore permitted to establish a local authority wholly owned company to develop, deliver, own and manage property as well as new development providing loan funding sourced from either Public Works Loan Board (PWLB) funding or external financing. The renting of housing at market rents would be pursuing a "commercial purpose" even if the council's ultimate purpose was to create mixed, economically active communities. The council's intention to seek a commercial return from its participation in the company, for example through dividend distribution, is likely to be deemed a commercial purpose and will be a fundamental requirement of the Property Rental Company.
- 4.3. Under Section 4 Localism Act (2011) the council can exercise its general power of competence for a commercial purpose but it must do so through a company. Therefore the "commercial" nature of the enterprise would justify the council's establishment of the company. All land and property transactions between the council and the company must comply with Section 123 of the Local Government Act (1972):
- "Except with the consent of the Secretary of State, a council shall not dispose of land under this section, otherwise than by way of a short tenancy, for a consideration less than the best that can reasonably be obtained."*
- 4.4. The council will be using the general power of competence in Section 1 of the Localism Act (2011) to establish the Property Rental Company. Legally, the use of the powers under the Act can be justified as a reasonable use of that power.

#### **5. GOVERNANCE ARRANGEMENTS FOR THE PROPERTY RENTAL COMPANY**

- 5.1. The council is keen to streamline the overall governance arrangements of Equinox and the new Property Rental Company so to avoid unnecessary duplication and ensure that both companies have agile and responsive decision-making processes. To ensure effective governance but minimise unnecessary additional bureaucracy, the current governance arrangements of Equinox will be replicated for the Property Rental Company. This means that the current Board members of Equinox will be appointed as Board members of the new Property Rental Company. This will necessitate holding separate board meetings which can be on the same day and probably increasing the frequency of meetings of the Property Rental Company's Board so it can consider proposals for acquiring a rental property and enable the company to move quickly if required. The Board would then report into the Policy & Resources Committee as Equinox does currently.

- 5.2. The Policy & Resources Committee on 19 March 2019 agreed that the Acquisition & Disposal Policy. This included clear parameters of delegated authority for Strategic Directors in consultation with the Section 151 Officer to approve the acquisition of property purchases from the open market (and the disposal of properties) in line with agreed budget and strategy. The Policy also outlined the financial considerations which will be undertaken when a rental property for potential acquisition is identified.
- 5.3. Where homes are transferred from Equinox (as developer) to the Property Rental Company they will be classed as intragroup transfers (Equinox and the Property Rental Company would have the council as a common parent). Legal advice has confirmed that this should not cause any conflict of interest, even if both entities have the same Board members.
- 5.4. In summary, as part of the arrangements to establish the new company this report is seeking approval to agree the appointment of the existing Directors of Equinox Enterprises as the Directors of the new Property Rental Company.

## **6. FINANCE**

- 6.1. The new company will be funded in the same way as Equinox currently is. This will be a mix of 50% share capital (equity) and 50% loans (debt). The Policy & Resources Committee on 19 March 2019 agreed an initial £2m capital budget to be used to deliver the HMO/guesthouse scheme and this will be used as the initial loan and capital for the company.
- 6.2. Section 1 of the Local Government Act (2003) gives the council power to borrow capital to fund the company if it so wishes in the future. It is unlawful for the council to borrow to on-lend to a Property Rental Company to fund revenue expenditure. Regulation 25 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (SI 2003/3146) stipulates the circumstances in which a loan made by a local authority to a third party (such as the Property Rental Company) is treated as capital expenditure. In effect, Regulation 25 ensures that the capital funding will be used for the same purpose as the Property Rental Company would under the loan. When providing a loan the council is required to act as a market lender and lend at a commercial rate (as is the case with the loans the council currently provides to Equinox).

## **7. LEGAL**

### Teckal exemption

- 7.1. In addition to the relevant local authority powers explored in Section 4 of this report, as with Equinox Enterprises, the Property Rental Company will operate under Regulation 12 (the "Teckal exemption") of the Public Contracts Regulations (2015). The company meets the "control and function tests" under the Teckal exemption as the council will exercise control which is similar to that which it exercises over its own services and there is no direct private capital participation in the company. More than 80% of the activities of the company will be carried out in the performance of

tasks entrusted to it by the controlling contracting authority (the council) or by other legal persons controlled by that contracting authority.

#### State aid

- 7.2. Loans to the Property Rental Company which are to be used for a commercial purpose, must be on the terms (including financing terms) which a market lender would require. Provision of the loans from the council to the company on commercial terms avoids any claim the council is providing state aid.
- 7.3. Any loans given by the council to the company for intermediate housing do not necessarily have to be on market terms as the state aid exemption is available for the provision of affordable/sub-market housing.

#### Tax

- 7.4. Efficient tax management is important in establishing the most appropriate structure for the new company. If Equinox Enterprises operates the property rental business from the properties it develops (or through further acquisitions) under the existing company structure, the corporation tax treatment of Equinox is likely to be less advantageous. For example, any acquisitions of property from trading stock (as a developer) to investment (for long term rental purposes) may incur a tax charge for Equinox (as Equinox will not have realised any cash from the deemed disposal on appropriation to fund the tax liability).
- 7.5. A separate investment holding company for the rental investment properties may also be more attractive to any future buyer of the rental property portfolio who could save stamp duty by purchasing shares in the Property Rental Company. The buyer would be liable to 0.5% of stamp duty on the value of the shares rather than stamp duty (with a potential top rate of 15%), on the value of the portfolio.
- 7.6. As such, incorporating the Property Rental Company as a separate business company is preferable and more tax efficient. The Property Rental Company will pay stamp duty when purchasing from third parties i.e. on the open market but should be able to claim stamp duty group relief on any property purchases from the council and Equinox.
- 7.7. The Property Rental Company will pay corporation tax on its rental profits and any chargeable gains.
- 7.8. Short-term renting of residential property is exempt from VAT. Therefore, the Property Rental Company will not have to account for VAT in respect of the rents it receives (whether sub-market or full market rent). As VAT is only generally recoverable to the extent it relates to VATable supplies the Property Rental Company will not be able to recover any VAT it incurs in relation to its letting activities. The company will incur VAT on legal fees, letting fees, repair and maintenance costs and also management fees charged by the council. The refurbishment of existing dwellings is generally standard-rated (a rate of 20%) although in some cases the

work may be reduced-rated (a rate of 5%). The purchase of completed dwellings is either zero-rated or exempt from VAT.

## **8. CONCLUSIONS**

- 8.7. The council is keen to establish a company which can hold residential properties which it can let. Equinox Enterprises is not currently established to undertake this function and the council is seeking to establish a 'sister' company to Equinox Enterprises. This will enable Equinox Enterprises (wholly owned by the council) to hold rental properties and it will then seek to engage a letting agent to undertake the day-to-day tenancy management .
- 8.8. The Policy & Resources Committee has already agreed a mechanism through which the council will purchase the properties. This is set out in the Acquisitions & Disposals policy agreed at Committee in March 2019. This same meeting also agreeing an initial £2m capital budget which will be used to provide an initial tranche of funding for the new company to purchase the properties.
- 8.9. The council has sought independent legal advice from both nplaw and Trowers Hamlins who have considerable experience advising local authorities setting up their own property rental companies. Establishing the new company as a 'sister' company to Equinox ensures it is legally compliant and the more tax efficient vehicle to hold the properties.
- 8.10. This report was considered and supported by members at the Housing & Neighbourhoods Committee on 20 June 2019. This report is seeking member approval to now proceed and establish the new company.

## **9. RECOMMENDATIONS**

- 9.1. **Members consider and approve the scope and strategic objectives of the Property Rental Company contained in this report and that these be incorporated within the Equinox Enterprises business plan.**
- 9.2. **a) Members consider and approve that a 'sister' company to Equinox Enterprises be established to hold rental properties.**
- b) Members approve the appointment of the existing Directors of Equinox Enterprises as the Directors of the new Property Rental Company.**
- 9.3. **Delegate authority to the council's Strategic Director who, in conjunction with the Monitoring Officer, will establish the new company and engage a letting partner to undertake tenancy management for the rental properties.**

<b>Area for consideration</b>	<b>Comment</b>
Monitoring Officer Consultation:	Yes
Section 151 Officer Consultation:	Yes
Existing Council Policies:	Acquisitions & Disposals Policy
Financial Implications:	Yes
Legal Implications (including human rights):	Yes
Risk Implications:	Yes
Equality Issues/EQIA assessment:	No
Crime & Disorder:	No
Every Child Matters:	No