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Maidstone Borough Council

**Report on potential approaches in relation to the
development of affordable housing**

Trowers & Hamlins LLP
3 Bunhill Row
London
EC1Y 8YZ
t +44 (0)20 7423 8000
f +44 (0)20 7423 8001
www.trowers.com

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1 Introduction

- 1.1 We are instructed by Maidstone Borough Council (the **Council**) in relation to a proposal to establish a new delivery structure for the acquisition of new affordable housing being developed within the Council's administrative area.
- 1.2 The initial proposal outlined in this paper contemplates involves the creation of a corporate vehicle (most likely a limited liability partnership (**LLP**) given its advantageous taxation status), owned jointly between the Council and a Registered Provider of social housing (an **RP**). The vehicle (a Housing Delivery Partnership or **HDP**) would operate at a strategic level with a view to sourcing affordable housing brought forward as part of planning obligations on developers in the Borough and the adoption of a new local plan.
- 1.3 In the alternative, the Council could establish a wholly owned company (**WOC**) with the same aim of sourcing affordable housing brought forward as part of planning obligations on developers in the Borough.
- 1.4 The model should be capable of facilitating the discharge of affordable housing obligations by developers in the Borough as well as generating a revenue return for the Council (and its RP partner).
- 1.5 This is a summary paper providing headline advice on the legal viability of the proposal highlighting key areas that will require further advice and discussion between the Council and an RP partner if the joint venture proposal is developed further.
- 1.6 Based on our review and as set out below, we do not think there is any legal reason that the Council cannot implement the project as anticipated. The Council will, however, need to take taxation and accountancy advice in due course as the model evolves.

2 Summary of advice on structuring

- 2.1 There are broadly two variations for the Council to consider in relation to pursuing the proposal.
- 2.2 Firstly, to pursue a HDP with co-investment and joint ownership with an existing registered provider.
- 2.3 It would seem to us that the key advantages of this route would be:
- 2.3.1 the ability to take advantage of the partner RP's own development pipe stream and its development expertise in terms of acquiring affordable housing from housebuilders;
 - 2.3.2 a reduced funding requirement from the Council (in the assumption that there would be financial investment put forward by the partner RP);
 - 2.3.3 the "self-selection", of an appropriate housing manager (ie the partner RP would undertake housing management - on the assumption that the Council would not wish to undertake direct day-to-day housing management of any stock which HDP acquired);
 - 2.3.4 the ability for housing management to be provided to the HDP in a VAT efficient manner (by VAT grouping the partner RP and the HDP); and

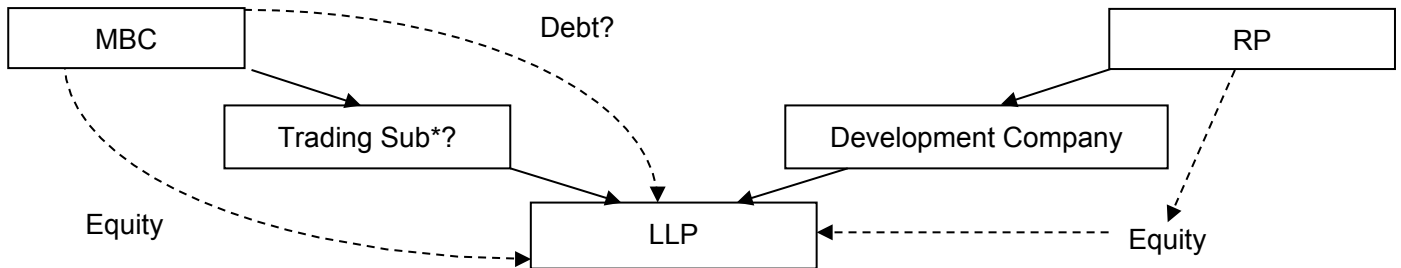
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- 2.3.5 finally, and less tangible, a joint venture with an existing Registered Provider should make that provider more committed to its activities within the Borough and should act as a catalyst for additional development by that provider within the Borough.
- 2.4 The alternative model would be for the Council to establish a WOC to acquire affordable housing brought forward under planning obligations by developers and without a joint venture arrangement with a registered provider.
- 2.5 It would seem to us that the key challenges with this approach would be as follows:
- 2.5.1 the model puts a materially greater funding requirement on the Council;
- 2.5.2 the interaction between the wholly owned company and the Council's existing planning policies would need to be carefully considered - in other words from a matter of planning policy, would the Council be comfortable with affordable housing being held by an entity which was not a registered provider (or else, consideration would need to be given to the registration of the housing company as a registered provider) (acknowledging of course that a HDP would not itself be a registered provider);
- 2.5.3 a solution would still need to be arrived in relation to housing management for the stock held by the wholly owned subsidiary - and in all probability that would need to be an existing registered provider - that being the case the housing company would incur irrecoverable VAT in relation to the housing management fee;
- 2.5.4 the Council getting comfortable with the vires issues outlined at paragraph 7; and
- 2.6 Set against these issues, of course, the setup and ongoing administration costs for a WOC would be lower than in relation to a HDV and - by definition - the council would retain complete control over the activities of the WOC - so, for example, in relation to any future decision about the long-term custody of the assets (for example a sale to a third party to realise a capital receipt) and/or in relation to day-to-day management decisions (for example in relation to rent setting). Whilst mechanisms can be drawn up in a joint venture agreement to map a way through those decisions with an RP partner, it is clearly more straightforward in a scenario where the company was wholly owned by the council.
- 3 **Business case**
- 3.1 The Council has committed to the delivery of new housing in the Borough. In this context affordable housing will be required as a planning obligation as developments come forward. The affordable housing supply provides an opportunity to the Council to generate an ongoing revenue stream, while encouraging a single owner of affordable housing on all new sites brought forward under the local plan has clear housing management advantages.
- 3.2 Under the HDV model, the Council establishes an LLP as a jointly owned vehicle with the purpose of acquiring affordable housing brought forward under the local plan and in turn generating profits/revenue returns for each party. The parties will need to commit resources to make a success of the venture. From the outset, each party needs a clear

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understanding of its obligations to the LLP and the outcomes to be achieved by the partnership and that there is a shared vision. The key principles are set out here for further consideration.

The model is shown in diagrammatic form below.



*Dependant on final analysis of Council powers

3.3 Principles

3.3.1 To combine the financial and organisational resources of the Council and an RP partner to create and capitalise a new joint venture vehicle with a specific focus on delivering affordable housing which meets local needs.

3.3.2 The LLP's core purpose would be to seem to us to be to:

- (a) acquire (ideally all) affordable housing brought forward under the new local plan; and
- (b) generate profits/revenue returns for the Council and its RP partner.

3.4 Future development programme and ongoing viability

3.4.1 Beyond its initial affordable housing remit, the LLP could subsequently evolve and develop a mixed portfolio of sites including those for outright sale or market rent. This would be dependent on the views of your RP partner.

3.4.2 The form of financial return from the LLP will, subject to sufficient profits being made for distribution, depend upon the extraction method that the parties agree upon across the various projects and will not, necessarily be the same, across those projects. For example, if the role of the LLP in a particular project is to operate as a developer and subsequent landlord, then this is likely to support a return by way of long term revenue stream. By contrast, if the purpose of the LLP on a project was to be one of market sale developer then a reasonably short to medium capital return might be more relevant. These are matters which would need to be determined by reference to the business plan(s) agreed by the Council and the RP partner.

3.4.3 For current purposes given the likely short/medium term focus an affordable housing brought forward by the local plan, a financial return structured as a long term revenue stream seem the more likely outcome.

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3.5 Leadership, operations and housing management

3.5.1 Consideration will need to be given to the resourcing of the day to day operation of the LLP (finance, HR, IT, admin, office space) and accounting to the Board for delivery. A project team made up of officers from the Council and the RP would be responsible for overseeing development of the business plan and subsequent delivery phase.

3.5.2 It is anticipated that the RP partner will procure development works on behalf of the LLP and will take on housing management responsibility for the completed properties.

3.6 Funding

3.6.1 In order to determine the likely funding requirement for the project, an outline business plan should be considered for the development of the agreed number of homes over an agreed period. It is envisaged that the Council and the RP partner will provide equity funding through a combination of investment of funds drawn from the PWLB and the RPs finances respectively.

3.6.2 In due course, or as part of the initial set up, the LLP could also acquire debt finance, either from the Council (via on-lent PWLB monies) or from 3rd party lenders.

3.7 A Wholly Owned Company

Under the WOC variant on the model exactly the same principles apply, save that the Council (as the sole investor in the WOC) takes all of the risks and rewards associated with the operation of the project.

4 Planning

4.1 Consideration will need to be given to the extent to which the Council can mandate that new affordable housing is directed to the LLP or a WOC and whether- as a matter the Council's planning policies- affordable housing brought forward in the Borough is required to be owned by an RP.

4.2 There is little – if any – precedent for a local planning authority mandating through its section 106 agreements that affordable housing be transferred to a specified entity/RP; clearly it is relatively common practice for local planning authorities to have a list of preferred RP partners but in our experience this has not been extended to a requirement to transfer to a particular entity.

4.3 Under Regulation 122, planning obligations imposed by a local planning authority must be "necessary to make the development acceptable in planning terms" and "fairly unreasonably related in scale and kinder to the development" and any obligation to transfer affordable housing to the LLP or a WOC would need to comply with Regulation 122.

4.4 We believe that there are justifications for such an approach that the Council could consider to be reasonable – but as we have discussed with the Counsel this is unlikely to

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be justifiable in the context of the Council's current local plan but could be in future iterations of it.

- 4.5 In any event, the Council would need to ensure that developers are not financially prejudiced from an obligation and here we would envisage a mechanism in the planning obligations for the developers to receive a "fair" price from the LLP for the affordable housing (perhaps which is in turn linked back to a viability approach for each individual scheme) and the ability for the developer to sell to a third party affordable housing provider if purchase terms are not agreed with the LLP/WOC within a reasonable timescale (with appropriate dispute resolution mechanisms).
- 4.6 There would, of course, be no difficulty if instead of the Council mandating a transfer of affordable housing to an LLP/WOC to LLP/WOC the LLP/WOC simply negotiated the acquisition of affordable housing from developers on a scheme by scheme basis, (i.e. completing against other RPs in much the same way as RPs compete between themselves for s106 schemes in the ordinary course of business).
- 4.7 Careful consideration will need to be given to the Council's affordable housing policy; as you will be aware, as a matter of law nor in the National Planning Policy Framework is there anything which obliges a local planning authority to require that affordable housing delivered under a planning obligation to be owned by a registered provider. That said, it is fully accepted that the vast majority of local planning authorities do in fact require ownership of completed affordable units to be held by an RP and as such, this point needs careful consideration by the Council. Clearly if an "exception" to your policies were to be made for the LLP/WOC, establishment of a precedent and the risk arises that other developers in the Borough seek to keep affordable housing out of the ownership of the RP sector.
- 4.8 If, after consideration, ownership of affordable units by an RP is mandated by the Council in its capacity as local planning authority then consideration would need to be given to amending the basic model outlined in paragraph 2.
- 4.9 One immediate thought would include the holding of the freehold interest in the affordable housing by the LLP and then an operating lease being let to the Council's RP partner (so that the tenants of the affordable housing were in fact tenants of the RP rather than of the LLP). That lease could be structured on a turnover rent/material ground rent basis so that economic value flowed back to the LLP. The alternative would be to structure the LLP (or a subsidiary of the LLP) in such a way that it was eligible itself to become an RP, this is arguably the less attractive route insofar as the deregulation measures issued by the government under section 93 Housing and Planning Act 2016 prohibit a local authority in holding a shareholding (or similar) interest in a registered provider - so the RP vehicle would need to be structured in such a way that it was legally independent from the Council. We would suggest that further thought is given to the structuring of the model once the Council's position in relation to its affordable housing policy is clarified.

5 **Attractions to the RP partner**

We believe that the HDP model outlined in this paper should be capable of forming a compelling proposition to an RP partner. In particular

- 5.1 It should provide access to new affordable housing schemes in the Borough that it may not be able to access alone;

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- 5.2 If structured properly, the debt held by the LLP should not be caught on the RPs own balance sheet, and so the LLP provides an “off balance sheet” opportunity for growth;
- 5.3 The opportunity to bring additional dwellings under the RP’s management;
- 5.4 The opportunity to forge a new strategic relationship with the Council.

6 **What is an LLP?**

6.1 It is suggested that the LLP be a 50:50 joint venture owned between the Council and your RP partner. The parties will need to consider in what capacity and through which vehicles they will participate in the LLP. A charitable RP partner, for example, is likely to wish to participate via a subsidiary company in order to make its participation as tax efficient as possible.

6.2 **Key features**

The key features of an LLP are as follows:

- 6.2.1 a LLP is a body corporate, a separate legal person from its members. The assets and liabilities belong to it and not the members;
- 6.2.2 LLP members, like company shareholders, have limited liability. When the LLP enters into a contract with a third party, the LLP is the party to the contract, not the members;
- 6.2.3 a LLP has no share capital. Capital can therefore be reduced or increased at the will of the members and there will be no rigid distinctions between capital and reserves;
- 6.2.4 when the LLP commits a tort, such as an act of negligence, the LLP is liable in much the same way as a limited company. Unlike partners in a conventional partnership, therefore, the members are not jointly liable for contracts entered into by the LLP nor are they jointly and severally liable for torts;
- 6.2.5 however, if members take on a personal duty of care, they may be liable for their own negligence and other torts if they have acted in breach of that duty. This is an important point to note, but is likely to be rare outside a professional partnership context;
- 6.2.6 there are at least two formally appointed designated members who are compliance officers with a role similar to that of a company secretary. There are no directors and the running of the LLP rests with the members as they agree it in a members agreement (see below);
- 6.2.7 as the LLP is a body corporate with unlimited capacity, it can create floating charges like a traditional limited company;
- 6.2.8 existing limited company insolvency rules generally apply to LLPs. This includes fraudulent trading and wrongful trading and most of the insolvency and winding up procedures for companies;

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6.2.9 a "clawback" rule potentially exposes LLP members more than shareholders of a limited company. This rule provides that any amounts withdrawn by members in the two years before the commencement of winding up (whether as capital, as repayment of a loan or interest on a loan, or as the distribution of profits) can be clawed back if the person making the withdrawal knew or ought to have concluded that, after the withdrawal and any withdrawals in contemplation at the time, there was no reasonable prospect that the LLP would avoid an insolvent liquidation. In light of this risk, members making a withdrawal from an LLP should consider up-to-date and accurate financial information before so doing.

6.3 **Members agreement**

6.3.1 The running of the LLP rests with the members as they agree it and it is usual for the members to enter into a "members agreement" to document how they intend to operate the business of the LLP.

6.3.2 An important issue to address will be decision-making – i.e. how the members intend that the LLP will make decisions. The members agreement will usually provide for each member to appoint representatives and for those members to meet on a regular basis. Within that, it may be necessary to agree delegations to certain individuals, if for example the LLP is considering the appointment of one of the parties as Development Manager. We imagine within that appointment, there will be a level of delegation to the relevant party to manage the development on a day to day basis.

6.3.3 In addition, it is common for important decisions to require a more formal written sign-off on behalf of each member. These are usually referred to as "reserved matters".

6.3.4 Given that the parties are likely to agree a voting structure in which it is possible for their votes to be deadlocked, the Council and the RP partner will need to consider how deadlock between them should be resolved, unless it is intended for the parties to have an absolute veto. Possible options are:

- (a) reference to chairmen/chief executives of parties for a negotiated resolution;
- (b) reference to expert or panel of arbitrators; and
- (c) use of a mediation or other alternative dispute resolution (ADR) procedure.

If the deadlock cannot be resolved after following some or all of the above (usually non-binding) procedures, the parties may agree a right to serve notice to trigger a "shoot out" formula (i.e. the notice will require the other party either to buy the first party's interest in the LLP or sell its own at a nominated price) or alternatively the non-consenting party might be required either to consent to the issue which gave rise to the deadlock or to sell its interest in the LLP at a fair value formula. We can advise in further detail if you do not have any fixed ideas as to how issues should be resolved.

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- 6.3.5 The members agreement will need to document the parties' funding obligations, noting (if applicable) the intention to take PWLB funding, and the parties' profit share entitlements, and would also typically address the following issues:
- (a) what restrictions (if any) should there be on the joint venture partners competing with the business of the LLP (e.g. what areas of business and/or what geographical area)?
 - (b) will the parties be obliged to refer any new business opportunities to the LLP?
 - (c) who will deal with the provision of company secretarial functions and the keeping of statutory books and accounting records? Will a separate fee be charged for this?
 - (d) are there any circumstances in which the parties should be able to transfer their respective interests in the LLP (important in the context of exit strategies for the Council- eg you may wish to sell your interest to an institutional investor or a REIT)?
 - (e) should either party have the right to exit or require the LLP to sell its assets and be wound up? Will either party have a break clause giving them the ability to give notice of termination (leading to liquidation of the LLP unless otherwise agreed) at any stage?
 - (f) will an "innocent" party have the right to call for a forced sale of an interest in the LLP upon material breach by a "defaulting" party?

6.4 Governance

- 6.4.1 The governance structure for the joint venture will be framed by each party's role and rights as a member of the LLP, even if this is indirectly through a company. There would also be a board charged with management of the LLP.
- 6.4.2 The members of the joint venture will retain strategic control over the operation of the vehicle through the right to approve a business plan and the requirement that certain listed decisions, referred to as "reserved matters", must be referred back to the owners rather than being within the discretion of the board. The principle is that the joint venture partners approve the business plan and the board then have the remit and discretion to implement it subject to the reserved matters. The level of discretion given to the board depends on the framing of the business case – i.e. how prescriptive or flexible it is – and what the reserved matters are.
- 6.4.3 The board of the LLP would be given a role equivalent to role of a board of directors on a company. Although a board member of an LLP is not the same as the director of a company, it is common in the governance documents to treat the position as the same meaning the individual will have duties to act in the best commercial interests of the LLP for the benefit of both parties.
- 6.4.4 It would be possible for members or officers of the Council to be board members. On a joint venture of this nature focused on delivery of operational

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matters, an officer board would typically be recommended with strategic and significant control retained to members via the shareholder or LLP member rights.

6.5 Taxation of an LLP

- 6.5.1 We recommend that a full tax review of the proposed structure is undertaken both by the Council and its RP partner in due course but the following represents an overview of the tax treatment of the LLP.
- 6.5.2 The LLP is treated for most tax purposes as a traditional partnership, and the members are treated as traditional partners. Therefore, unlike a limited company, it is tax transparent and any trade, profession or business carried on by the LLP with a view to profit will be treated like a traditional partnership.
- 6.5.3 Profits arising from the LLP will be trading income. There is no exemption for charities from corporation tax in respect of trading income other than for a trade that is exercised in the course of actually carrying out the primary purpose of a charity (for example some shared ownership leases granted by registered providers) or which is carried out for the beneficiaries of the charity.
- 6.5.4 If the new organisation is to be a LLP, the members of that LLP would pay tax on their respective share of profits. This means that those profits in the hands of a charitable RP partner would be taxed as non-charitable trading activity. By contrast, if the charitable RP participates through a wholly owned non-charitable subsidiary so that the subsidiary rather than the RP was a partner in the LLP, the subsidiary would be in receipt of taxable income, but should be able to make Gift Aid payments to the RP to reduce or remove any taxation liability arising.
- 6.5.5 The LLP structure is a means of mitigating tax liability rather than eradicating it. There may be circumstances in which tax liabilities can arise. For example, the LLP may not have the working capital to allow it to distribute profit to its partners and a Gift Aid payment cannot be made if the intended payer does not have the money to make the payment. Given that the profits of the LLP are taxable whether or not they are in fact distributed, this would potentially result in a tax liability in the LLP.

As discussed in paragraph 4.2, the position of returns to the Council will depend on the structure adopted and will require further discussion between the parties.

7 The Council's vires to participate in and deal with the LLP

- 7.1.1 In our view, the Council has a range of powers permitting it, in principle, to enter into the JV as an LLP and to lend (or on-lend PWLB funds) to it. The Council's relevant powers are summarised in Appendix 1.
- 7.1.2 The nature of the power utilised may influence the structure of the Council's participation in the LLP and the taxation treatment of the Council's returns. For the reasons discussed below, this will require further analysis as discussion between the parties over the precise activities of the LLP firm up.

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- 7.1.3 If the Council relies upon the General Power of Competence established under section 1(1) of the Localism Act 2011, which broadly speaking allows it to "do anything individuals may generally do", then consideration needs to be given to the Council's purpose in entering into the LLP. If its purpose is "commercial" (i.e. one directed towards the making of profit), then the legislation requires that it must use a subsidiary company (see diagram at page 2 which shows how a Council company would "fit"). The use of a company would bring with it a potential charge to tax. In order to generate a return to the Council, it is anticipated that the company would send its profit share to the Council. Whilst an RP subsidiary is currently permitted to gift aid its profit share to its RP parent (as a charity) without any loss to Corporation Tax, that option is not available to the company as the Council does not have charitable status. Accordingly, the company's distributions to the Council will be net of Corporation Tax liabilities. It should be noted that the taxation position would be the same for the Council if the joint venture vehicle was itself a company as opposed to an LLP.
- 7.1.4 The law on what is and is not "for a commercial purpose" is not clear cut and there is only one authority on the point, which is not free from doubt. Given that an LLP is a body which is, by definition, established "with a view to profit", then there is a risk that direct participation by the Council in the LLP (securing a more beneficial taxation treatment) could be held to be *ultra vires*.
- 7.1.5 By contrast, if the Council were seeking to rely upon its investment powers under section 12 of the Local Government Act 2003, there is no requirement to invest through a company. In our view, making a capital contribution to an LLP with a view to a potential return to the Council is a form of investment. The Council would, of course, need to have regard to relevant investment guidance¹ and be satisfied that the investment was prudent – that the LLP is likely to realise and distribute profits and that the level of profit/return justified the investment.

Vires issues connected with a WOC

- 7.2 The Council have powers under the General Power of Competence established under section 1(1) of the Localism Act 2011 to establish a WOC.
- 7.3 However, the Council will be required to justify that the WOC is being established for a proper purpose and it would, in our view, require careful consideration if the Council was establishing the WOC as a means to provide 'social rented' housing of the type that would ordinarily be held in a Council's HRA, and is doing so to avoid the RTB applying to any tenancies granted by the WOC. In other words the Council could not be seen to be establishing a WOC to avoid re-opening an HRA and/or to avoid the RTB.
- 7.4 Ensuring that the Council has a clear rationale for establishing the WOC is also important in the light of the concerns that were expressed in the Ministerial Statement issued in March 2015 by the then Housing Minister about the establishment of local housing companies in particular circumstances. The Ministerial Statement provided, amongst other things, that the Government would not support the establishment of local housing companies where such companies are established for the purposes of avoiding the RTB or avoiding the HRA borrowing restrictions imposed by Government.

¹ "Guidance on Local Government Investments" (revised version 2010)

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7.5 The Ministerial Statement reinforces the need for the Council to be clear as to its rationale for establishing the WOC at all times, ensuring that there is clear evidence of this throughout the decision making process.

7.6 The Housing White Paper, published on 7 February 2017, to some extent echoes the statements of the then Housing Minister stating:

"we want to see tenants that local authorities place in new affordable properties offered equivalent terms to those in council housing, including a right to buy."

7.7 This is arguably not a policy shift from the March 2015 Ministerial statement but the wording contained within the White Paper specifically references "a" right to buy as opposed to "the" Right to Buy and is stated to be a Government expectation only. The Government has confirmed that it will not be consulting on this point, nor is there any suggestion that it will be seeking to impose any legislative changes in this regard. Therefore, without a statutory requirement, and provided the establishment of the WOC cannot be struck down as an ultra vires act of the Council (of which we know no relevant precedent), the properties developed by the WOC would not be subject to the statutory RTB.

7.8 We would also note that the White Paper "welcomes" innovative models to provide more housing by local authorities and specifically references local housing companies and joint venture models. This is positive as it is a clear statement of support by the Government.

7.9 The Council will need to be mindful of the above considerations when justifying its use of powers as we have described above.

8 **Funding of the LLP**

8.1 **Equity**

8.1.1 The LLP will require capital in order to operate and deliver against an agreed Business Plan. Decisions will have to be made between the parties as to:

- (a) What the LLP's capital requirements will be;
- (b) What initial investment (in terms of capital or loans) will be made by each party;
- (c) Whether that investment can be made by means of payment in kind (e.g. assets or know how);
- (d) The timing of the funding contributions and whether any default or dilution provisions apply if either party breaches.

8.1.2 If capital is to be given in kind, consideration will need to be given to the respective values of each to ensure that the Council and the RP contributions are the same. If they are not then an additional cash equity payment may be required from one or other party.

8.2 **PWLB funding**

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8.2.1 As discussed in Appendix 1, we believe that powers exist to enable the Council to access PWLB funds and on-lend monies to the LLP should that be agreed as necessary under the LLP's business plan.

8.2.2 In order to do so, a loan agreement will need to be put in place between the Council and the LLP. The terms of that loan will need to be scrutinised for compliance with State Aid requirements; save that the LLP should be able to take advantage of the exemptions from the State Aid regime for affordable housing.

8.3 **Security for loans**

8.3.1 If debt is to be advanced by the Council (or a 3rd party) , then consideration will need to be given to the issue of security for that loan. Whilst it is possible for the LLP to create floating charges over its assets, we believe it more appropriate for the LLP to give a first fixed legal charge over developments to the Council (or a 3rd party) as funder. This would not be unusual and would be a similar arrangement to a developer having debt funding in place for the period of its development.

8.3.2 The parties will need to consider the extent to which the Council, in its capacity as funder only, requires a watching brief over the development as it progresses and all duties of care from professionals involved in the scheme, for example the employer's agent, and the contractor. Ideally the Council's security package should be agreed in advance of site selection so that any requirements can be built in to the supply chain.

8.4 **Funding a WOC**

From the Council's perspective the same funding issues apply to the funding of a WOC, save that necessarily the risk profile is higher because all of the funding requirements are coming from the Council.

9 **Procurement Issues**

9.1 **Selection of the JV partner**

The establishment of a joint venture between the Council and an RP will not in and of itself be caught by the public procurement rules as no contract for goods, works or services is involved.

9.2 **Will the LLP be subject to the public procurement rules?**

9.2.1 Until further detail is available as to the precise nature of the LLP's proposed activities, membership and financing it is not possible to give a definitive opinion on this question. We describe below the analysis which will need to be undertaken and which may influence the decisions that the Council and the RP will need to take in the creation of the joint venture.

9.2.2 To determine the classification of the LLP, it will be necessary to look at its nature and structure. The Public Contracts Regulations 2015 (the **2015**

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Regulations) set out the necessary test. If the LLP is determined to be a "contracting authority", it will be obliged to follow the procurement rules.

9.2.3 The 2015 Regulations categorise "contracting authorities" as:

"the State, regional or local authorities, bodies governed by public law or associations formed by one or more such authorities or one or more such bodies governed by public law, and includes central government authorities, but does not include Her Majesty in her private capacity."

9.2.4 Of the descriptions given above, the LLP is perhaps most likely to fall within the second category, namely a 'body governed by public law'.

9.2.5 The LLP can only be a 'body governed by public law' and, therefore, subject to the 2015 Regulations, if all of the following three limbs are met:

- (a) it is established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character; and
- (b) it has legal personality; and
- (c) it is either:
 - i financed for the most part by the State or regional or local authorities or other bodies governed by public law (**Financed**), or
 - ii subject to management supervision by those bodies (**Supervised**), or
 - iii having an administrative, managerial or supervisory board, more than half of whose members are appointed by the State, regional or local authorities, or other bodies governed by public law (**Controlled**)

9.2.6 Failure to meet any one of the above three limbs means the LLP will fall outside the 'body governed by public law' definition. Taking each in turn:

- (a) established for meeting needs in the general interest, not having industrial or commercial character

The concept of "needs in the general interest" is different from the question of whether a body has an industrial or commercial character. For example, a body's activities could constitute "needs in the general interest", but if the body also has an industrial or commercial character, it will fail this limb of the test and would not meet the definition of a body governed by public law). An analysis of this key element can only be undertaken when there is greater clarity over the precise nature of the LLP's business and activities.

- (b) Legal personality – an LLP would fulfil this limb of the test;

- (c) Financed, Supervised or Controlled:

- i *Financed* - this will involve analysing if the LLP is dependent (directly or indirectly) on any contracting authority for more than 50% of the

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financing its general activities. Not all financing from the authority has to be taken into account - only finance that 'has the effect of creating or reinforcing a relationship of dependency'. Contracts freely negotiated in consideration of the receipt of services or supplies may be disregarded.

Any contributions from the Council would count towards financing from a local authority. Whether that constitutes majority 'State' funding would depend on any financing from the RP partner and also confirmation of the procurement status of the RP's vehicle that is to be the member of the LLP (**DevCo**).

- ii *Supervised* - a power to intervene in the management decisions of a body is likely to constitute "management supervision", although this is not definitive. If a contracting authority with supervisory powers, is able directly to influence management decisions, has powers to wind up the LLP, suspend management or appoint an administrator, such factors will be sufficient to demonstrate 'supervision'. In this case, much will depend upon the DevCo's status and the terms of the LLP's Members Agreement as to whether this limb is satisfied.
- iii *Controlled* - If more than half of the members are appointed by a contracting authority, this element of the definition will be satisfied. Again, much will depend upon the DevCo's status and the terms of the LLP's Members Agreement as to whether this limb is satisfied.

9.3 Will the LLP be able to purchase services from the Council and the RP?

- 9.3.1 It is probable that the LLP will wish to purchase services from the Council and the RP or vice versa not least in relation to the development services and housing management.
- 9.3.2 Whilst further analysis is required, it is likely that the LLP will be treated as a jointly controlled "Teckal" subsidiary of both the Council and RP for the purposes of the 2015 Regulations. Pursuant to Regulation 12, any contract through which either the RP or the Council procure services, works or supplies from the LLP will not constitute a public contract subject to the Regulations. Accordingly, the Council and the RP would be likely to be able to award such contracts without first undertaking a regulated procurement exercise.
- 9.3.3 The position is less clear in relation to contracts under which the LLP wishes to purchase services from the Council and/or RP. Although the 2015 Regulations codify previous case law dealing with the intra-group arrangements, there is no express exemption for contracts let by a jointly controlled Teckal subsidiary in order to procure services from those parent entities. Although it is possible to argue that the principles which inform the relevant case law and Regulation 12 should also extend to any contract let by the LLP to its parent organisations, there is no express exemption to the usual procurement rules in those circumstances.
- 9.3.4 While the risk of success challenge to such contracts cannot be disregarded entirely, our view is that the risk is likely to be relatively low. First, any potential challenger in the market is likely to have limited visibility of the proposed

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arrangements between the Council/the RP and the LLP. In addition, any potential challenger would need to counter the argument that the principles previously established through case law under the 2006 procurement regulations are extinguished by the 2015 Regulations.

10 **Tax**

We have not included a detailed tax analysis within this report although we would be happy to do so once further detail of the proposal is agreed. We would recommend that the Council consider obtaining specific tax advice on SDLT, corporation tax, transfer pricing and VAT implications of these proposals as the structure develops.

11 **Saving Provision**

This Report is prepared solely for the use the Council in connection with the transaction. No liability is accepted for its use by any other person or body or for any other purpose.

Trowers & Hamlins LLP

draft date June 2018

Appendix 1

Council's powers

Available powers to participate in joint venture

Section 1 of the Localism Act 2011 ("General Power of Competence")

Section 1(1) of the Localism Act 2011 empowers the Council to do "anything that individuals generally may do" (the GPC).

Where the GPC is conferred on the Council to do something, it can do it in any way whatever, including for, or otherwise than for, the benefit of the Council, its area or persons resident or present in its area.

There are limitations on the GPC including:

- (a) an obligation to act through a company where the Council is exercising the GPC to do something for a "commercial purpose"; and
- (b) the GPC cannot supplement a power that pre-dates the GPC so as to remove a pre-commencement limitation. For these purposes, "pre-commencement limitation" is defined as a "prohibition, restriction or other limitation imposed by a statutory provision" in the 2011 Act or a previous Act. Whilst the existence of an overlapping existing power does not limit the generality of the GPC, if a pre-commencement power is subject to restrictions, those restrictions apply also to exercise of the GPC in so far as it is overlapped by the pre-commencement power.

"Commercial purpose" is not defined but is generally understood to include activities which are directed towards the making of profit/surpluses.

"Company" means a company formed and registered under the Companies Act 2006 or the Companies Act 1985 or a society registered or deemed to be registered under the Co-operative and Community Benefit Societies and Credit Unions Act 1965. It does not include a limited partnership, a limited liability partnership or a trust. This reflects the Government's intention that local authorities should not gain an unfair advantage, especially in fiscal matters, when they competed against the private sector in the market.

Section 12 of the Local Government Act 2003 (investment power)

Section 12 provides the Council with a stand-alone power to invest, for any purpose relevant to its functions under any enactment or for the purposes of the prudent management of its financial affairs.

In exercising its powers of investment, the Council must have regard to the statutory guidance issued by the Secretary of State and specified guidance published by CIPFA.

The Council would need to ensure that the exercise of this power is consistent with its Annual Investment Strategy or that the Strategy is amended to reflect the proposal.

Section 24 of the Local Government Act 1988 (financial assistance for privately let housing)

Section 24 provides that, subject to section 25, the Council as a local housing authority has 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

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(whether by that person or by another) of any property which is or is intended to be privately let as housing accommodation".

The Council will be providing financial assistance if it does or agrees to do any of the following:

- (a) make a grant or loan to that person;
- (b) guarantee or join in guaranteeing the performance of any obligation owed to or by that person;
- (c) indemnify or join in indemnifying that person in respect of any liabilities, loss or damage; or
- (d) acquires share or loan capital in that person if that person is a body corporate.

Property is treated as privately let as housing accommodation at any time when:

- (a) it is occupied as housing accommodation in pursuance of a lease or licence of any description or under a statutory tenancy; and
- (b) the immediate landlord of the occupier of the property is a person other than a local authority.

Before exercising the power under section 24 (or any other power to provide financial assistance or a gratuitous benefit), the Council must obtain the Secretary of State's consent under section 25 Local Government Act 1988. There are general consents issued in 2010.

Available powers to dispose of land

Section 123 of the Local Government Act 1972 (land disposal)

In relation to land not held for planning or housing purposes, subject to certain conditions, the Council has the power to dispose of its land in any manner it wishes and receive consideration for its land under Section 123 Local Government Act 1972. The Secretary of States consent is needed if PCC receives less than the "best consideration that can reasonably be obtained". A general consent is available for use in relation to certain "under value" transactions.

Available powers to borrow and on-lend

It is intended that the Council will on-lend funds borrowed from the PWLB to the LLP. Specific financial and accounting advice will require to be taken in relation to the detailed arrangements, but the following analysis suggests that from a vires point of view the proposition is actionable.

Section 1 of the Local Government Act 2003 (**the 2003 Act**) provides a local authority with the power to borrow money for any purpose relevant to its functions or for the purposes of the management of its financial affairs.

The control on the amount that the Council could borrow is governed by the prudential limit which it has determined for itself in accordance with its duty under Section 3 of the 2003 Act. As with any Council borrowing, the Council is also required to have regard to the Prudential Code for Capital Finance in local authorities (**the Prudential Code**) when carrying out its duties with regard to borrowing money. This includes a requirement to have regard to its financial commitments and obligations to any companies or other similar entities in which it has interests.

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Borrowing should normally be for capital expenditure as accounting requirements in existing legislation for authorities to balance their revenue budgets prevent the long-term financing of revenue expenditure by borrowing. However, the system confers limited capacity to borrow short-term for revenue needs in the interests of cash-flow management.

Government guidance clarifies that a Council is able to borrow to invest (under section 12 see above) but speculative borrowing purely in order to invest at a profit remains unlawful.

The Council, therefore, has power to borrow (with a view to on lending to the LLP) if the borrowing is relevant to its functions. We believe the Council will be able to satisfy itself that the purpose of the borrowing here is relevant to a number of different Council functions, including housing, economic regeneration and functions under section 1 of the Localism Act 2011.

In terms of the on-lending to the LLP, Section 24 of the Local Government Act 1988 provides the Council with the power to provide a wide range of financial assistance (including the making of loans) to any person in connection with the provision of privately let housing accommodation. This would cover the social/affordable/market rent and shared ownership units to be provided by the LLP. Where Section 24 is to be relied upon, the Council must first obtain the consent of the Secretary of State under Section 25 of that Act. General Consent C issued by the DCLG in December 2010 currently provides the relevant coverage.

To the extent that the lending is to cover other types accommodation (e.g. market sale units or retail space), then it is anticipated that the Council will seek to rely upon:

- (a) its general power of competence under Section 1 of the Localism Act 2011; and/or
- (b) the power under Section 111 of the Local Government Act 1972 which empowers local authorities to do anything whether or not involving the expenditure, borrowing or lending of money which is incidental, conducive or calculated to facilitate the exercise of any of their functions. This would include the exercise of functions in relation to housing, economic regeneration and under Section 1 of the Localism Act 2011.

Specific accounting advice will be required to be taken as to the treatment of on-lent sums if they are to be used to finance any of the LLP's revenue costs.