

SPECIAL AUDIT AND GOVERNANCE COMMITTEE

7 August 2017 at 9.30 am

Present: - Councillors Chapman (Chairman), Mrs Oakley (Vice-Chairman), Blampied, Brooks, Cates, Mrs Porter, Purchase and Wheal.

Councillor Haymes was also present during the meeting.

138. WELCOME

The Chairman welcomed Members and Officers of the Internal Audit & Finance teams and Paul King (Audit Director) from Ernst & Young to this Special Meeting of the Committee.

139. APOLOGIES FOR ABSENCE

Apologies for absence had been received from Councillors Edwards and Maconachie.

140. DECLARATIONS OF INTEREST

The Monitoring Officer has advised Members of interim arrangements to follow when making declarations of interest. They have been advised that for the reasons explained below, they should make their declarations on the same basis as the former Code of Conduct using the descriptions of Personal and Prejudicial Interests.

Reasons

- The Council has adopted the Government's example for a new local code of conduct, but new policies and procedures relating to the new local code are yet to be considered and adopted.
- Members have not yet been trained on the provisions on the new local code of conduct.
- The definition of Pecuniary Interests is narrower than the definition of Prejudicial Interests, so by declaring a matter as a Prejudicial Interest, that will cover the requirement to declare a Pecuniary Interest in the same matter.

Where a member declares a "Prejudicial Interest", this will, in the interests of clarity for the public, be recorded in the minutes as a Prejudicial and Pecuniary Interest.

The Director of Place declared a Personal Interest in Agenda Item 3 [Council Owned Property Company] as he was a Director of Trisanto. He stated that if he was called to speak he would do so in his role as Director of Place.

141. LOCAL PROPERTY COMPANY

The Chairman, in introducing this item, firstly referred Members to Appendix B of the agenda papers, as reported to Cabinet on 31 July 2017, relating to the Risk Register and the business case as prepared by the Housing Strategy & Delivery Manager (HS&DM).

The Chairman drew Members' attention to the second paragraph on page 122 relating to the Council's Risk Appetite Statement. This stated "the level of risk the Council is prepared to tolerate or accept in the pursuit of its strategic objectives". The Chairman outlined that the two specific elements of the Council's Risk Appetite Statement that needed to be considered in considering the establishment of a Local Property Company (LPC) were transformational change and development and regeneration.

The Chairman confirmed that these statements had been taken from the Council's Risk Management Policy Statement and Strategy; specifically they were contained in Appendix 3 to that document which had been agreed in September 2015 by the then Director of Resources and Deputy Chief Executive and the then Cabinet Member for Corporate Governance.

The Chairman reminded Members to note what was stated within this document which was the role of this Committee in regard to risk management. The Chairman then read out to Members the role of the Committee in this instance and in reviewing the risks associated with the next steps that needed to be completed by the Council before the Local Property Company could commence any trading activity. This was to:

- Provide an independent assurance of the adequacy of the risk management framework and the associated control environment so as to best protect the Council's reputation
- Provide independent scrutiny of the authority's financial and non-financial performance, to the extent that it affects the authority's exposure to risk and weakens that control environment
- Oversee the work of the internal and external audit and receive periodic reports from the authority's Governance and Risk Group
- Monitor the effective development and operation of risk management and corporate governance in the Council

In considering the business case for operating a LPC the Chairman suggested to the Committee that it should work through the risk register produced for this project discussing each of the risks identified – these being from Risk 1 through to Risk 27 with the Committee's debate and observations being recorded. This approach was agreed by the Committee.

The Chairman then circulated to the meeting an information document which related each of the risks back to the appropriate page in the business case for ease of reference and to assist effective discussion.

Before discussing each of the separate risks listed, the Chairman invited the HS&DM to introduce this item. He outlined that a list of potential risks had been produced as a comprehensive document which would be continually updated as the LPC developed its business operations. The register had been drafted with input and having been independently reviewed by the Council's advisors.

The discussion on each numbered Risk is summarised below:

- **Risk 1** – inexperience, lack of market knowledge and market trends.

**Statement from HS&DM** - This covered the risk that the Council would be taking in terms of the whole purpose and work of the LPC. There would be the need for the LPC to be careful in looking at how work would be addressed in terms of the LPC having the appropriate skills and market knowledge to address this new business environment and especially in ensuring the appointment of appropriate Directors and staff having the correct experience to address this type of business activity.

### **Questions from the Committee**

- Would business activity compete with what was contained within the HRA Business Plan? The HS&DM confirmed that there would be no competition as the HRA Business Plan was about a specific type of development. The LPC's remit and focus would be on other market interests covering housing for sale, rent and affordable housing for sale such as shared ownership and other types of starter homes or shared equity properties. The LPC would also look at private land acquisition and other public sector estates where the landowner did not have the funds or capability to resource or develop the land themselves.

- How would the LPC compete with larger companies such as Barratt and Persimmon Homes? It was outlined that the LPC would also purchase land and would build houses and so would be in competition with private development companies large and small as well as housing associations too inside and outside of the District if suitable opportunities arose.
- Could more explanation be provided in terms of the differences between how the HRA Business Plan would be progressed compared to the work of the LPC. Surely they would be competing for the same land. It was outlined that the work of the HRA would be in two areas – all within the District and on HRA development sites owned by the Council. The LPC would not touch this land. Looking at other sites, the approach would be to acquire affordable rented housing on private sites taken forward by developers. If there was a section 106 obligation to provide a proportion of affordable housing, the LPC would look to acquire this. The new development at Foxes Furlong in Barnham was cited as an example. It was also explained that there would potentially be new opportunities for the HRA to acquire new housing from the LPC which might not come about if the LPC was not in place. The Director of Place provided further detail on how this would work.
- Who would undertake the detailed market research that would be key to the LPC's success? What would be the cost of this and was this detailed in the Business Plan? It was confirmed that this work would be undertaken by the LPC. Some preliminary work had been undertaken looking at house prices; land prices; and build costs prices to see what levels of development would need to come forward and at what cost for marketing property for sale. The LPC would undertake the identification work of sites and the Council would critique whether a specific loan would be appropriate or not. This was background information supporting the business case.
- Although there were clear benefits in establishing the LPC in terms of providing the Council with additional revenue streams, there was concern expressed over the lack of instructional knowledge that members of the board would have – the HS&DM was asked what lessons had the Council learnt from other authorities to ensure that this project would be a success?

It was stated that the Council had attended various meetings that had been set up for local authorities (LA's) who were in a similar position to Arun. Those in attendance had been LA's who had operated LPC's for some time. There had been some key themes shared in respect of lessons learnt. One was expecting too much too soon. Another had been the ability to attract and recruit suitable staff with the appropriate development knowledge from the private sector to run the LPC.

- Concern was expressed that there appeared to be a conflict of interest in terms of the Director of Place's emerging role on the Board of Directors of the LPC and his continuing role within the Council. It was felt that this was an issue that the Council needed to look into. The Director of Place confirmed that if this became a growing concern then he would stand down from the LPC though Members needed to recognise the importance of having an Officer of the Council on its Board of Directors – this applied to many other LPC's. He also confirmed that there was nothing to prevent an officer of the Council also being a director of a LPC.

- **Risk 2** - Development Opportunities

### **Questions from the Committee**

- Concerns were expressed that development opportunities were limited, especially as Arun was an asset poor authority in terms of land holdings. It was explained that the LPC would intend to engage the services of experienced land buyers with good knowledge of the local market and that its Articles of Association would be unrestricted enabling it to operate outside of the District if suitable opportunities were identified.
- How would the LPC ensure that it would be able to source public assets not controlled by the Council as there had been examples where this has not happened with other LPC's. The same answer as above was provided.
- The Chairman asked if the wording contained in the Note on page 105 of the Cabinet papers "*Note – it is unlikely at present that HRA land will be available to the LPC for development purposes*" – was accurate in terms of the use of the word *unlikely*. The Director of Place explained that this note stated that this was an unlikely scenario and

would be a matter for the Council [with responsibility for HRA] to determine if land was surplus to requirements and should be disposed of to the LPC. Given the Council's target to deliver 250 homes over the next ten years – the Council would use its land first and so it was unlikely that such land would be presented to the LPC to bid for.

- Questions were then asked about the term 'market price' and how this would be used and that this should be best value to the Council. A discussion took place on the issue of State Aid, and how the Council's land assets would be valued. It was explained that the District Valuer would value any sites.
- **Risk 3** - This outlined the importance for the Council to have sufficiently detailed tools at its disposal to critique any investment required from the LPC. There may be the need to bring in external support and advice on such technical aspects.

**Statement from HS&DM** - This covered the risk that the Council would be taking in terms of the whole purpose and work of the LPC. It was almost inevitable that the Council would look to bring in external support and advice on this technical aspect. The Council currently used external advice on developer appraisals.

#### **Questions from the Committee**

- The Committee agreed that the Council should not make any decisions without the input of external advice.
- **Risk 4** - Government funding.

**Statement from HS&DM** - it was explained that the funds provided to housing associations and others for the development of affordable housing for rent and sale over the last few years and the levels of government grant for rented housing had fallen. The Director of Place provided some figures. This would not be an issue for the LPC unless it chose to register with Homes and Community Agency; presently there was no intention to do this.

#### **Questions from the Committee**

The Chairman outlined that he felt that this was an important issue for the Committee to note.

- **Risk 5** - Development pipeline

**Statement from HS&DM** - The importance of having a robust pipeline of potential schemes for the first 5 years and onwards was confirmed. This was the length of planned programme that most organisations had in place. As well as land purchase, the LPC could take out options on land not owned by the Council. The process for this and associated risks was explained to the Committee. It was stressed that securing these options was seen as critical.

**Questions from the Committee**

- When taking out an option – what level of deposit had to be paid and could this be lost – for example if a leaseholder defaulted on a property rented to them by the LPC who was responsible for the interest on the loan taken out to buy the property. The HS&DM explained how land options worked and that there were different clauses for different options. Options were also time related in terms of obtaining the required permissions to take development schemes forward. If these were not realised there was then potential that that option would be at risk and could be lost. There were many costs in the development cycle and an option agreement was just one of those that would present risks.
- In terms of a pipeline for development had any research been undertaken in terms of land available? From a Local authority perspective and as part of the work undertaken on the Local Plan, many documents had been produced confirming what land was available. Many private sector companies had land banks which Members felt would restrict local land available to the LPC and that additional competition could increase land prices. The HS&DM explained that from a local authority perspective, and in preparing for the Local Plan, many documents had been produced confirming the availability of sites.

- **Risk 6** - Experienced Board Members and staff

**Statement from HS&DM** - as well as the LPC needing to appoint skills and experienced staff it was equally important for the LPC to be able to attract and appoint the appropriate balance of skills consisting of experienced and appropriate commercially minded persons to sit on the Board. The LPC was looking at a small Board being made up of one Elected Member of the Council [excluding

Members of the Cabinet and Development Control Committee]; one Senior Officer; and a maximum of three independent non-executive directors. It would be the 3 independent non-executive directors that would be critical as they would be recruited to bring commercial housing development and finance experience to the Board. The LPC would be looking to put together job descriptions and person specifications. The independent non-executive director positions would be paid roles and this was common practice.

### **Questions from the Committee**

- How would the LPC compete with the private sector in attracting people to these posts? It was explained that the LPC would focus more on drive and motivation targeting those wanting to put something back into their local communities. The Director of Place provided some further information on the person specification for the non-executive director roles. The LPC would only consider those who had undertaken a similar type of role before and would focus on the skill set they could bring as a Director ie the right property and/or financial experience.

- **Risk 7** - Lack of experienced staff

The Chairman outlined that as this had already been discussed earlier.

- **Risk 8** - Members don't buy into the LPC proposals so it is not supported.

The Chairman outlined that this had already been discussed earlier.

- **Risk 9** – the Council is not prepared for the impact of national policy changes.

In relation to Risks 9 to 12, the Chairman commented that the changes in public and national policy (including those that may occur as a result of Brexit) were not known at this time. It was agreed that as the implications were not currently known that there would be no value in the Committee debating these risks at this time.



- **Risk 10** - Council is not prepared for the impact of regulatory changes.

In relation to Risks 9 to 12, the Chairman commented that the changes in public and national policy (including those that may occur as a result of Brexit) were not known at this time. It was agreed that as the implications were not currently known that there would be no value in the Committee debating these risks at this time.

- **Risk 11** - Brexit outcome leads to uncertainty in the markets

In relation to Risks 9 to 12, the Chairman commented that the changes in public and national policy (including those that may occur as a result of Brexit) were not known at this time. It was agreed that as the implications were not currently known that there would be no value in the Committee debating these risks at this time.

- **Risk 12** - Brexit affect – change in Government leadership

In relation to Risks 9 to 12, the Chairman commented that the changes in public and national policy (including those that may occur as a result of Brexit) were not known at this time. It was agreed that as the implications were not currently known that there would be no value in the Committee debating these risks at this time.

**Statement from the HS&DM** - it was outlined that the Shareholder Advisory Group would require the LPC to advise them of any operational and delivery issues (including those occurring as a result of Risks 9 to 12). The make-up of this Group was outlined and Members were reassured that this would include the Section 151 Officer.

- **Risk 13** - Insufficient Pipeline

**Questions from the Committee**

- The lack of available land was a concern. The Director of Place explained that the LPC would not be looking to acquire large scale developments. The main target would be for land with around 10-20 units to minimise risk.
- Would council tax payers who fund the Council be getting a fair deal? The HS&DM referred to the business case and the arrangements in place

- How would the LPC stand competitively in getting funds? The Director of Place explained how funding requests would be considered with the use of the Shareholder Advisory Group. The Shareholder Agreement would set out this detail. The Committee was reassured that the Council would ensure that any loans were on an appropriate level and the Council would receive a good return. On-lending fees were explained.
- It was expected that funds would initially be obtained by the Council via the Public Works Loan Board (PLWB). These funds might form the basis of loans to the LPC but at a higher rate paid by the Council to the PWLB.
- **Risk 14** - Unable to attract appropriately skilled and experienced directors – as this has been discussed earlier – no further discussion took place on this risk as matters had been covered under Risk 6.
- **Risk 15** - Reputational risk to the Council

**Statement from the HS&DM** -

The Business Case covered the need to have an exit strategy in place in the event that the LPC did not work as planned. This was to ensure that at least the investment costs would be recovered at the point of exit. This strategy would form part of the Business Plan yet to be agreed. It was explained that it was also important for the public to be able to distinguish between the Council and the arm's length company which would be making its own operational decisions.

The approach used by other LPCs such as South Norfolk was explained as they had created their own trading company.

**Questions from the Committee**

- The Chairman referred to the importance of the Shareholder Agreement still to be drafted as this would set out how the checks and balances in this agreement would be delivered.
- **Risk 16** – Shareholders and the operational running of the LPC

**Statement from the HS&DM**

The shareholder agreement would set out how the relationship between the Council and the LPC would operate.

### **Questions from the Committee**

- Could the HS&DM define what was meant by the Council – legally if the Council owned the LPC then surely every Elected Member would be a shareholder and would have liability. Would Members have the right to say that they did not wish to be a shareholder? This could affect how the Council might deal with prospective candidates at future elections.
  - What would happen for Members if the LPC did not succeed. It was believed that Members would not have a personal liability. However, there might be some circumstances of impropriety when a Director might have some personal liability.
  - The HS&DM agreed to confirm the position and advise Members.
- **Risk 17** - State Aid

### **Statement from the HS&DM**

The Business Case clearly set out the details that related to State Aid. The Council had taken a great deal of legal advice from its advisors Trowers and Hamblins in terms of structuring the business case in relation to this issue.

### **Questions/Comments from the Committee**

- The Council would need to be completely satisfied that any funding supplied to the LPC, as a third party organisation complied to the appropriate rules.
- The shareholder agreement had been mentioned on numerous occasions in the debate so far but this was not available for Members to refer to.
- Would a draft be available for Members to work through ahead of Full Council on 13 September 2017? Members were advised that a draft of the shareholder agreement was being worked on with legal advisors. It was difficult to confirm if this would be completed in time for 13 September 2017 as Officers were working through a series of other supporting documents such as a revised Articles of Association; Service Level Agreement; and Loan Agreement.

- The Committee was of the view that the shareholder agreement needed to be made available to Members before they could make any decision on whether to approve the Business Case for the LPC. In view of this, it was felt that the decision on the LPC at Full Council on 13 September 2017 should be deferred to a later date and until these documents could be reviewed.
  - Members were concerned over the issue of limited liability and the enormity of the decision in agreeing the business case of the LPC for the Council.
  - Members wanted to know how this decision affected Members sitting on the Development Control Committee and where there could be other conflicts of interest. Members asked to receive more clarity around the issue of prejudicial interests in relation to the LPC.
  - The Director of Place responded stating that he could provide additional information on the points raised in time for Full Council on 13 September 2017.
  - Following further discussion, Councillor Purchase proposed “that the decision to approve the business case and risk register for the LPC be deferred for decision at Full Council on 13 September 2017 until the outstanding documentation such as the shareholder agreement be made available to Members”. This was seconded by Councillor Blampied. On this proposal being put to the vote it was declared CARRIED.
  - The Group Head of Council Advice and Monitoring Officer provided input stating that this recommendation could not stop the recommendations from the Special Meeting of the Cabinet held on 31 July 2017 being put to Full Council for consideration on 13 September 2017. The proposal just agreed, would need to be made at Full Council as part of the deliberations on the recommendations. This was noted by the Committee.
- **Risk 18** - Failure to arrange adequate Insurance

**Questions/Comments from the Committee**

- How much insurance cover would be required and who would pay for this? The HS&DM confirmed that these were all issues for the LPC to resolve. Any stock that the LPC held would need to be insured and indemnity insurance would need to be provided for the Directors.

- **Risk 19** - Failure to comply with Company Law

**Statement from HS&DM** - this linked in with Risk 18. This was part of the scope for the shareholder agreement. All Directors of the Board would have to comply with company law defined under the 2006 Companies Act.

**Questions from the Committee**

- How would lax behaviour be dealt with? It was explained that this would be set out within the Shareholder Agreement. Any Director would have personal responsibility for the way that they conducted themselves and the way that they followed the law in terms of the 2006 Companies Act. The LPC currently did not have a Chairman or Company Secretary. Its Company Secretary was likely to be its Managing Director. This would be one of the first roles for the LPC as it was for it to decide who to appoint.
- **Risk 20** - consideration of employment law including TUPE. The Director of Place outlined that as Council staff were not being transferred to the LPC, this should not be an issue and so no discussion took place on this risk.
- **Risk 21** - Property Company failure

The Chairman stated that he wanted to receive assurance that the Council's Section 151 Officer would be part of the Shareholder Advisory Group with regular reporting on progress of the LPC being monitored and that the Shareholder Agreement be something that the Committee should be able to review.

- **Risk 22** - Insufficient financial controls in place

The Chairman stated that the business case made it clear on start-up expenses and in terms of how the initial capitalisation of £1 million could be spent, if approved. It was felt that there was a significant risk to the Council in terms of financing. The HS&DM outlined that again this would be the role of the Shareholder Advisory Group but that the £1m was for start-up costs rather than any initial build project.

### **Questions/Comments from the Committee**

- The importance of the Shareholder Advisory Group was outlined in ensuring that the Council would be best served and that the LPC was managing its affairs as it should.
  - It was outlined that the control levers needed to remain with the Council with the Council signing off the Business Plan that would accompany the business case as this would be a key financial/operating document.
  - Discussion returned to the proposal for the Council to approve the £1 m supplementary estimate where concern was expressed that the Council's general fund reserves should not fall below £4m. The Group Head of Corporate Support explained that the £1m working capital would be financed from revenue balances – this amount could not be borrowed. Any working capital should be a loan and this would come back to the Council at some stage with interest.
  - There was concern that no details on cash-flow forecast had been provided by the LPC – was this being worked on? The HS&DM outlined that this would be for the LPC to produce as part of its Business Plan which would set out its own arrangements for finance in the future. Each loan required by the LPC would be submitted to the Shareholder Advisory Group and this process would apply for each individual loan request. Recommendations would then be made to the Cabinet to approve. The involvement of the Section 151 Officer was again explained.
  - There was concern expressed over the Cabinet approving the loan requests with the feeling that all loan requests should come to Full Council to approve.
  - There was feeling that in the absence of the Shareholder Agreement or cash-flow forecast this risk could not properly be considered.
  - There was concern that the £1m working capital fund would be insufficient to set up the LPC.
- **Risk 24** - Challenge from the Council's external auditors

### **Statement from the HS&DM**

It was accepted that the LPC would need to follow the CIPFA code of practice in terms of any loan applications agreed from the LPC.

The Audit Director from Ernst & Young was invited to comment. He confirmed that as a wholly owned subsidiary of the Council he would expect the Council to apply the relevant accounting tests. The LPC would need to prepare its own accounts and consideration would be needed as to whether it would be appropriate for the Council to prepare group accounts. Under the Code of Audit Practice External Auditors would need to consider all implications and would need to be assured that the LPC would provide value under the Value for Money Conclusions part of its annual audit as this would be a new departure for the council. They would consider the arrangements that the Council put into place for the establishment of the company; the degree to which the council had engaged in this.

- **Risk 25** - Lack of capacity to manage additional workload

#### **Questions/Comments from the Committee**

- Reference was made to some of the concerns expressed by the Overview Select Committee on 25 July 2017 in terms of the recruitment by the LPC of external advisors. The Director of Place explained that it was for the LPC to make these decisions and that it would be likely that the LPC would need to buy in professional construction experience to enable the LPC to set up contracts with developers/contractors/sales agents etc.
- **Risk 26** - Poor investment acquisitions
  - The Committee agreed that this risk could not be discussed until a copy of the shareholder agreement had been received.
- **Risk 27** - Poor rate of return on property development deals

#### **Statement from the HS&DM**

It was outlined that the Business Plan, when complete, would be reported to Full Council for approval and that any subsequent revisions should also be submitted to Full Council for approval. Other sets of documents such as the Articles of Association and Service Level Agreement would not be reviewed unless any significant changes were made. In terms of the Shareholder Agreement it was felt that this document should be submitted to the Audit & Governance Committee for agreement and review as and when required to ensure that the appropriate levels of governance were in place.

Having completed a thorough review of the Risk Register the Chairman invited the Group Head of Council Advice and Monitoring Officer to outline how the deliberations of the Committee could be framed in terms of any further recommendations that the Committee might wish to submit to Full Council on 13 September 2017.

The Head of Council Advice and Monitoring Officer outlined that:

- The recommendations from the Overview Select Committee from its meeting held on 25 July 2017 has been referred to and agreed at the Special Meeting of Cabinet held on 31 July 2017;
- The recommendations from the Special Meeting of Cabinet on 31 July 2017 would be referred to Full Council on 13 September for discussion and decision;
- This Committee was entitled to either propose alternative recommendations such as a request to defer this decision, as agreed earlier in the meeting, or it could request amendments against the recommendations of Cabinet when debated at Full Council on 13 September 2017.

Looking at the recommendations from Cabinet on 31 July 2017, the Chairman outlined that with recommendation (i) approving the business case, because the shareholder agreement featured so largely in what the Committee had raised as concerns in terms of risk, he took Members' comments as implying they were not in a position to support it. This had been the reason for the Committee's earlier recommendation to defer the approval of the business case unless a copy of the shareholder agreement could be drafted and sent to Members in advance of Full Council.

The Group Head of Council Advice and Monitoring Officer stated that the Committee, based on the recommendation it had already made and agreed, needed to consider and ask if the shareholder agreement could be prepared in advance of 13 September Full Council and whether Members of the Committee would be prepared to receive a draft version or substantive draft version of this document. On putting this to the vote, the Committee agreed that a substantive draft would be acceptable. Other factors discussed were whether there should be a further Meeting of the Committee to consider the draft shareholder agreement ahead of Full Council.

The Chairman stated that the need for a further meeting would be considered when a substantive draft of the Shareholder Agreement had been produced and circulated to Committee Members.



Following further discussion, the Committee

RECOMMEND TO FULL COUNCIL – That

- (1) The risk register in respect of creating Tresanto [a Council owned property company] be noted [as per Recommendation (2) - Cabinet – 31 July 2017]; and
- (2) Approval of the business case (as per Recommendation 1 - Cabinet – 31 July 2017] be deferred until Members are able to receive a copy of the shareholder agreement.

The Chairman thanked Members and Officers for their input in considering this important issue for the Council.

(The meeting concluded at 12.24 pm)