

<b>Report of:</b>	Deputy Mayor and Executive Member for Children's Services Director of Regeneration
<b>Submitted to:</b>	Executive
<b>Date:</b>	24 January 2023
<b>Title:</b>	Middlesbrough Development Company
<b>Report for:</b>	Decision
<b>Status:</b>	Public
<b>Strategic priority:</b>	Town Centre
<b>Key decision:</b>	Yes
<b>Why:</b>	Decision(s) will have a significant impact in two or more wards, and involves a financial impact over £150,000.
<b>Urgent:</b>	No
<b>Why:</b>	Not Applicable

**Executive summary**

The Council set up a trading company in 2018 called MHomes, with the aim of taking forward housing schemes in areas that commercial housebuilders would not develop. Although there has been a subsequent change in name (to the Middlesbrough Development Company) and a shift in focus (to progressing urban living) the company has successfully progressed a number of schemes. Since its inception, and change in focus, a number of good practice guides for local authority trading companies have been published – most recently by the Chartered Institute of Public Finance and Accountancy. The company's governance arrangements have subsequently been reviewed and their 'fit' against the new guidelines assessed. Alongside this, a review has also considered whether the developments undertaken could be achieved in future without the need for a local authority trading company, to ascertain the long term need for the company. The review concluded that the work required to ensure the new guidelines are met by the company is significant, and that the outcomes pursued by the company could potentially be achieved in future through a range of different routes, without the mechanism of a separate company. As the company would not provide any benefit that could not be

delivered through the Council, it would only exist as an additional overhead that limits the Council's overall value for money. As a result, it is proposed that the company ceases trading upon completion of its existing portfolio of development projects in April 2023.

## **Purpose**

1. The purpose of this report is to determine the long term future of the Middlesbrough Development Company, given future delivery expectations, and the wider context of best practice guidance published by Local Partnerships (a joint venture between the Local Government Association, HM Treasury and the Welsh Government), and new guidelines recently issued by The Chartered Institute of Public Finance and Accountancy (CIPFA).

## **Background and relevant information**

### *History*

2. Middlesbrough Development Company was established in 2018 under its previous name of MHome. The role of the company was to intervene in the housing market on sites that commercial developers wouldn't progress. The role of the company has however evolved since 2019 as the Council focused its activities more on facilitating urban living developments and taking control of eyesore sites and properties.
3. Since its establishment, Middlesbrough Development Company has successfully progressed the following:
  - a. development of Boho Village, 45 apartments and 16 houses at Middlehaven in partnership with Bright Ideas (due for completion March 2023);
  - b. development of 24 homes and four retail units at Newbridge Court on the site of the former Tollesby Shops (due for completion April 2023);
  - c. purchased eyesore sites at Evesham Road and Penistone Road to enable future development; and,
  - d. funded the redevelopment of eight empty properties in North Ormesby and Gresham in partnership with the Ethical Housing Association.
4. The company was always intended to be a facilitator of development and therefore has operated with only one employee (a Managing Director), buying in further expertise when required on issues such as marketing, accounting or legal support. This has proven to be sufficient to enable the above developments to be progressed.

### *Funding*

5. The majority of funding for the company and its activities has been provided by Middlesbrough Council in the form of a loan, that was to be paid back upon the completion and sale of developments. To date the Council has provided funding of around £11.9 million and repayment of the loan element has only recently commenced as the first phase of the Boho Bright Ideas scheme has now been sold and occupied (a deal is in place to sell the remaining phases upon completion – ending the company's role in the development).

6. The funding provided for tackling eyesore sites and properties was provided to the company as a grant, and although some level of long term return is anticipated, it was intended to be reinvested in addressing further eyesore sites and properties.

#### *Role*

7. The activities pursued by the company have undoubtedly proven to be a success and have changed the landscape in both Middlehaven and at Tollesby. The way the schemes have ultimately been progressed, has however led to questions over whether these types of activities could in future be progressed directly by the Council, without the added risks and overheads inherent in operating a separate trading company.

#### *Guidance*

8. The company was originally set up against the context of other councils pursuing such activities, and a number of existing local authority housing companies were examined and used to guide the initial structure for the company. Since this time, local authority trading companies have come under greater scrutiny around the UK and in some instances have featured in investigations around financial impropriety. As a result, new guidance has been issued by CIPFA into the operation of local authority trading companies, which aligns them more to the controls in place within local government than the more flexible commercial world.

#### *Review*

9. As the existing set of projects undertaken by the Middlesbrough Development Company are coming to an end, it is an appropriate time to consider whether such a vehicle is required in the longer term. It is also an appropriate time to consider whether the publication of new guidance requires significant investment in the company to enable it to meet best practice.
10. A review has therefore been undertaken to ascertain:
  - a. do the future aspirations for the company require an external trading company structure, or could they be delivered in other ways?; and,
  - b. does the company meet the highest standards of good governance, and the expectations of the CIPFA guidelines?

*Do the future aspirations for the company require an external trading company structure, or could they be delivered in other ways?*

11. The role of the company has evolved over time and is focussed largely on two things – buying up eyesore properties for development by others and leading on developments that do not offer the commercial returns required by the market. The future direction of the company therefore reflects the current portfolio of projects.
12. Although the two capital projects undertaken by the company to date (Boho Village and Newbridge Court) have been successful in bringing forward the development of new homes, the methods used to do so have not been exclusively available to the private sector. They have both been undertaken through routes that the Council could have pursued, although the difference is the level of risk appetite inherent in any commercial development would have perhaps been viewed differently had they been presented as

purely Council led schemes. If the Council was prepared to directly undertake developments of this nature and accept the inherent commercial risks, then an external company structure would not be required to replicate them if a decision was made to pursue similar schemes in the future.

13. Although specific work on purchasing eyesore sites and properties has been undertaken by Middlesbrough Development Company in recent months, this supplements the ongoing work delivered within the Council to address such properties. If the type of work undertaken by Middlesbrough Development Company around eyesore sites and properties was to be pursued at any point in the future, it could be delivered through a number of different routes, including enhanced inhouse provision. A company structure would not however be essential to it being taken forward in future.
14. As the funding for development activity has all come through either loans direct from the Council, or through Homes England funding directly accessed by the Council, again it is difficult to conclude that a trading company structure is still a necessity to deliver the same types of activities in future, given the way the company's priorities have evolved since 2019.
15. The commercial experience and skills utilised through the Middlesbrough Development Company to stimulate projects, undertake negotiations and deliver activity has however clearly been beneficial. Local authority officers do not routinely carry this level of commercial expertise, but if required it would be available by procuring this on a case-by-case basis using commercial organisations to deliver specific projects.

*Does the company meet the highest standards of good governance, and the expectations of the CIPFA guidelines?*

16. As the activities of the company have turned from theoretical to actual, and the practicalities of taking and implementing board decisions have become more complex, a number of weaknesses have been identified in the board arrangements and the relationship with the Council that would need addressing. Veritau, the Council's internal auditors were asked to provide a view on the overall governance situation, and the improvements that would be required to meet the highest standards of good governance. Early conclusions from this work include:
  - a. the roles and responsibilities within the company are insufficiently defined for a local authority trading company, with potential conflicts of interest arising through lack of clarity and lack of separation. The role of the shareholder is particularly unclear; and,
  - b. some of the operational aspects of the company do not reflect local authority regulations, or frameworks – such as procurement, risk, performance management and project management.
17. The relationship with the company would also require further work from the Council's perspective, as there needs to be a suitable governance structure put in place within the Council structures to review performance, or provide the necessary oversight and accountability for it to function effectively. Specifically issues around Information Governance, Data Protection and other legal requirements are not governed by an appropriate agreement with the Council – which could cause unnecessary risks in the future. Additional work is also required to provide improved transparency around Value for Money and alignment of investments with Council priorities.

18. It is clear from the review that revising the arrangements to follow the higher standards of governance set out by Local Partnerships, and CIPFA in their recently published *Local Authority Owned Companies – A Good Practice Guide*, and to minimise any future risk to the Council would require a significant investment of time and money to achieve. The board of the company would need to be reshaped, the staffing structure bolstered, and the arrangements the Council employs to monitor and support it would need to change.
19. The key gaps identified in issues such as procurement and risk management would require additional staffing to be brought in to manage processes to the standard required by local authorities (and advocated by CIPFA), as would bolstering arrangements around performance management and project management. The current staffing/operation of the company is geared towards commercial expertise and would not therefore have the capacity or experience to adopt the policies and frameworks to align with the Council's approach. Recent examples of issues around Information Governance have highlighted this further, where the company needs to register with the Information Commissioner's Office independently from the Council.
20. It is therefore appropriate to consider whether making this investment to reshape the company arrangements represents value for money, and balances with the potential risk and reward.

#### *Overall Balance of Risk and Opportunity*

21. As the challenge of reshaping the company to meet recent guidelines is significant, and the risk of financial/reputational issues occurring in the interim is also significant, the benefits of retaining a trading company structure in the longer term would need to be significant to justify continuing in that direction. Given the ongoing aims of the company could potentially be achieved within the local authority if required, or through other contracting routes, it is recommended that the Council seeks to exit from the current arrangements.
22. If the trading company structure is not required in the longer term, then the appropriate steps should be taken to close down the company, exit from existing contractual commitments and ensure that any residual assets are placed into appropriate arrangements. The following actions are therefore proposed:
  - a. retain the company under current arrangements until the completion of the Boho Village and Newbridge Court schemes are completed (estimated to be March 2023). The remaining unsold assets within both schemes would either be sold off, or held directly by the Council to provide a capital or revenue return to pay back the original loan;
  - b. seek alternative arrangements for sites and properties already purchased through the eyesore sites/properties programme, to trigger investment and redevelopment;
  - c. cease trading through the company and dispose of any other minor assets (assumed to be negligible). This would also require ending the contract of the Managing Director, the company's only employee.

## *Winding up Middlesbrough Development Company*

23. As the company is wholly owned by Middlesbrough Council, the board of the company comprises staff and elected members. Any decision to close down the company would therefore need to be enacted by the directors of the company in line with its Articles of Association, and the laws governing company registrations.

### **What decision(s) are being recommended?**

24. That the Executive endorses the proposal to close down the Middlesbrough Development Company and put in place alternative arrangements within the Council to manage or dispose of any assets.

### **Rationale for the recommended decision(s)**

25. The limited benefits of continuing to operate a trading company structure do not justify the investment required to reshape the company and minimise the short and long term risks to the Council given a separate company is not required to enable the Council's goals in this area to be achieved.

### **Other potential decision(s) and why these have not been recommended**

26. Although the option to continue with the company does exist, it would require significant investment to meet the expectations of the recent guidance published by CIPFA which would impact financially on the ongoing business case for the company's viability. Adherence with the guidance would minimise the longer term risk to the Council, although some residual commercial risk would always remain.

27. The benefits of continuing with the company do not seem to justify the investment of time and money required to reshape and bolster the company, and it has therefore been concluded that the company will have run its natural course, once its current development portfolio is complete.

28. There is also an option to 'do nothing' and keep the company operating as it exists now. This would expose the Council to unnecessary risk in the longer term, which would be unacceptable given the conclusions of the above review, and the increased requirements of the recent CIPFA guidance.

### **Impact(s) of the recommended decision(s)**

#### ***Legal***

29. As the Middlesbrough Development Company has entered into numerous contracts for the developments at Middlehaven and Tollesby, it would be prudent for these to be reviewed by the Council's Legal Services Team to ensure the Council are not exposed to any ongoing liabilities. The contracts in place around recently purchased eyesore sites and properties would also need to be examined to ensure that the Council is complying with statutory requirements whilst alternative arrangements or disposal are sought. As the proposal seeks to wind the company up at the conclusion of its major projects, this assurance work whilst necessary, should be relatively straightforward.

30. The formal closure / winding up of the company will also need to be overseen by the Council to ensure that the directors of the company act in accordance with the agreed Articles of Association, and the relevant laws governing company registrations.

### ***Strategic priorities and risks***

31. Winding up the company would potentially impact a number of priorities set out in the Strategic Plan. Key priorities affected would include:

- a. establish the requirement for potential CPO of derelict buildings and problem sites;
- b. St Hilda's housing starts around Old Town Hall; and,
- c. commercial and residential development of west and south side Middlehaven sites.

32. As the Middlesbrough Development Company is only one of the routes by which the Council addresses these priorities, work towards them would still continue in the event of the recommendation being approved.

### ***Human Rights, Equality and Data Protection***

33. Winding up the company would mitigate the existing identified risks around governance issues such as data protection. The impact of the company ceasing to exist would not however have any impact on issues around equality or human rights.

### ***Financial***

34. As the company is funded by loans from the Council that are subject to interest payments, there is an opportunity cost to winding up the company of around £60,000 per annum. Some borrowing costs could however also be reduced, as assets are sold and capital sums returned to the Council early. Neither sum has been factored into the current Medium Term Financial Plan, so the Council's projected financial position is not compromised.

35. The company has made a combined operating loss of £340,000 since 2018 prior to the first returns on commercial deals arriving recently. If the company was wound up this would be included alongside other project costs in the overall reconciliation. This figure may increase to reflect any abortive fees on projects currently in partial development, but these would be assessed/negotiated as part of the winding up process. There may also be some limited exit payments with regard to the termination of the contract for the Managing Director.

36. This operating loss would however be mitigated (and exceeded) by the future income the Council would directly receive through rent at Newbridge Court (Tollesby). At capacity the net rental income would be in excess of £100,000 per annum, although this figure is exclusive of any fees that may need to be paid to a management company should the Council choose to outsource this responsibility.

37. Existing financial arrangements between the Middlesbrough Development Company and Ethical Housing Association would be considered for either novation or cessation. There are no other financial implications to consider.

## Actions to be taken to implement the recommended decision(s)

Action	Responsible Officer	Deadline
Agree contractual completion arrangements for existing Middlesbrough Development Company schemes	Director of Regeneration	End March 2023
Agree transition / cessation arrangements for assets and other contracts relating to Middlesbrough Development Company	Director of Regeneration	End March 2023
Wind up Middlesbrough Development Company	Director of Regeneration	End July 2023

## Appendices

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## Background papers

Body	Report title	Date
CIPFA	Local Authority Companies – A Good Practice Guide	31/05/22
Middlesbrough Council	Middlesbrough Development Company Business Plan Update	05/10/21
Local Partnerships	Local Authority Company Review Guidance	30/09/21
Middlesbrough Council	Middlesbrough Development Company – Empty Homes Partnership	07/09/21
Middlesbrough Council	Middlesbrough Development Company Finance	11/05/21
Middlesbrough Council	Middlesbrough Development Company Strategic Plan	01/09/20
Middlesbrough Council	Housing Delivery Vehicle New Direction	20/12/19
Middlesbrough Council	Housing Delivery Vehicle Preferred Delivery Model	18/12/18
Middlesbrough Council	Housing Delivery Vehicle	12/06/18