

## MUNICIPAL YEAR 2019/2020 REPORT NO. 49

### MEETING TITLE AND DATE:

Cabinet  
17<sup>th</sup> July 2019

### REPORT OF:

Commercial Director

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### Agenda – Part:1

### Item: 14

**Subject:** Business Plans of the Council's Trading Companies – HGL & EIL

**Wards:** All

**Key Decision:** 4928

**Cabinet Member consulted:** Cllr Maguire

## 1. EXECUTIVE SUMMARY

- 1.1 This cover report and the attached reports to the Shareholder Board summarise the content of the Business Plans put forward by two of the Council's trading companies, Housing Gateway Ltd (HGL) and Enfield Innovations Ltd (EIL).
- 1.2 Under the current Shareholder Board Terms of Reference, final approval of the company business plans is reserved to Cabinet for decision. The Shareholder Board has provided substantial feedback, strategic direction and input into the business planning process for a number of months and considered the business plans at its meeting on 25<sup>th</sup> June.
- 1.3 HGL provides affordable tenancies, let under a nominations agreement with Council Housing, and low-cost temporary accommodation within the borough. The company's business plan identifies a need to restructure the financial model of the current portfolio to provide financial stability, after which the company plans an expansion of 250 additional properties to the portfolio.
- 1.4 The expansion will be funded through lending from the Council. £51.1m of loans are currently available to the company to draw down as required, comprising £49.35m approved by Council in February 2019, and £1.75m carried over from 2018/19. A further facility of £51.4m is identified within the Council's Pipeline projects schedule; however, this sum would require approval from Council before it would be made available to the company.

- 1.5 The business plan for EIL focusses primarily on delivering the completion and sale of the properties within the Small Housing Sites 1 (SHS1) project.
- 1.6 This is contingent on realising sufficient value from sales by September 2019 to meet the company's immediate obligations on debt repayment to the Council. The business plan includes a sale for an element of 21 properties for which an offer has been received. This will address the immediate risk of insolvency.
- 1.7 This report presents options for the disposal of the company's portfolio in order to achieve value for the Council. The option assessed as the best overall commercial decision is a split strategy which retains 21 properties within the social sector via a housing association, disposes of two properties to the HRA, and disposes of the remaining 17 via individual market sales. This achieves an overall positive financial value.
- 1.8 Cabinet approved in July 2017 the sale of the 57 properties in which EIL maintained an interest. 17 of these properties have been sold to the HRA. Shareholder Board has approved the disposal strategy for the remaining 40 properties.

## **2. RECOMMENDATIONS**

- 2.1 To approve the presented business plans for HGL and EIL in line with the recommendations made by Shareholder Board, as detailed within paragraphs 2.1 – 2.4 of Appendix 1, and paragraphs 2.1 – 2.3 of Appendix 2.
- 2.2 To delegate to Shareholder Board the authority to approve as shareholder representative the final proposed financial structure for HGL, based on the presentation of a full options appraisal by the company, and within the remit of the Shareholder Board's Terms of Reference.
- 2.3 To delegate authority, as recommended by Shareholder Board, to the Council's Commercial Director to act as representative of the Council's shareholder function and make decisions on shareholder reserve matters relating to the delivery of the approved business and operating plans of the Council's wholly owned trading companies, where such decisions would not require Member approval if applied to a Council department under the Council's scheme of delegation.

### **3. BACKGROUND**

- 3.1 The Shareholder Board was created as a sub-committee of Cabinet in 2018, with the aim of acting as a point of single oversight and governance support to the Council's trading companies.
- 3.2 Under the Board's Terms of Reference, it provides guidance and input on company business plans prior to presentation of the business plans to Cabinet for final approval.
- 3.3 The Shareholder Board has engaged with officers and company directors in both February and April 2019 to provide guidance to the companies on its preferred strategic direction. The companies have developed their final business plan in accordance with the given direction, and now presents the plan for approval. The company has prepared the plan in accordance with the priorities identified by the shareholder, and in the required format. The plan covers the period April 2019 – March 2020 and will be updated on a rolling annual basis. Shareholder Board is due to consider the first such rolling update in February 2020, prior to the next financial year.
- 3.4 The plans presented represent two of the Council's trading companies, EIL and HGL. A third company, Energetik, has a 40-year business plan which was approved by Cabinet in 2017. It is currently undergoing review and update subject to live funding applications with external financing sources for the Council's Tranche 2 investment company. Following a confirmed outcome of current applications, a revised business plan will be presented to Cabinet for approval as part of the Council's Tranche 2 decision, currently scheduled for September 2019 and due to be presented to both Cabinet and Council.

#### **Key company objectives and risks**

##### HGL

- 3.4 HGL has identified three key strategic objectives, detailed on pages 3-4 of the Business Plan (Appendix Two). These are:
  - To expand the portfolio by 250 homes;
  - To deliver additional £1m per annum temporary accommodation cost avoidance to the Council; and
  - To consider how to either return post-tax profit to the Council or invest in further housing.

These are in line with the priorities identified by the Shareholder Board.

- 3.5 The immediate risk to achievement of objectives is the company's cash flow and its ability to meet loan repayments to the Council. The Business Plan identifies refinancing as a key dependency to achieving company objectives. However, the company business plan does not clearly indicate how refinancing compares to other options for addressing the key underlying risks; therefore, the company has been requested to return with a detailed report before approval of the forward financial model is approved. Risks and refinancing plans are detailed further within paragraphs 3.7 – 3.9 of this report, and paragraphs 3.11 – 3.19 of Appendix One.

### EIL

- 3.4. The central objective of EIL's the business plan is to complete the SHS1 project and realise a cumulative company profit through sale of the 40 completed properties. This will close off the project and allow the company to either return profits to the Council or invest in further business opportunities.
- 3.5 The main risk to this objective is company solvency. Due to delay of completion on the SHS1 project, the company has not been able to sell its properties at the originally envisioned time. While there was contingency for delay in the business plan, the company is approaching a critical stage; without sufficient sales by September 2019, the company is at risk of insolvency and being unable to fund its loan repayments to the Council. The preferred disposal strategy outlined within the business plan minimises the risk of this occurrence.
- 3.6 Progress against strategic objectives for all companies will be reported quarterly to Shareholder Board. In addition, Shareholder Board has requested monthly sales updates from EIL, to monitor the progress of the company's disposal strategy and ensure financial risks do not materialise.

## **Summary of strategic actions for the years 2019-22**

### HGL – refinancing

- 3.7 The Business Plan identifies a need for HGL to refinance its current portfolio. One option is an external refinancing package this would involve agreeing a package with an external fund lender, which would provide cash to repay the on-loans the company currently has from the Council, amounting to around £115m. The Council could then choose to repay its own loans

from the Public Works Loans Board (PWLB) early, or re-invest the funds received elsewhere. This would be a decision for the Council and would not involve the company.

- 3.8 An external option would likely require a Parent Company Guarantee from the Council to achieve terms which would be viable for the company. Any financial commitment on the part of the Council would not fall within the purview of the Shareholder Board. Therefore, any consideration of a Parent Company Guarantee would be progressed through a governance process as appropriate under the scheme of delegation.
- 3.9 The Council has also identified the option to restructure its existing loans to the company through reducing the amount of capital repayment currently required. This is a model which has been successfully implemented by other Local Authorities with similar companies to HGL. This is a recent development and as such, the option has not been fully appraised and compared to other available options for refinancing. To this end, the company is requested to provide a full report for future approval of the financial structure, in order to allow full consideration and comparison of all options to determine which option represents best value for the shareholder and company.
- 3.10 Further detail on refinancing can be found within paragraphs 3.11 – 3.19 of Appendix One.

#### HGL – Portfolio expansion

- 3.11 HGL has proposed a portfolio expansion of 250 properties to March 2022. This will enable the company to expand the benefit provided to the Council through discharge of homelessness duties and provision of lower cost temporary accommodation.
- 3.12 The company has total approved loan facilities of £51.1m from the Council, which it may draw down as required. A further £51.4m has been identified within the Council's future capital pipeline, however this has not been approved at the appropriate and therefore cannot be utilised by the company until such approval is granted.

#### EIL – SHS1 Disposal Strategy

- 3.13 Cabinet approved the sale of EIL's properties under the SHS1 project in July 2017.
- 3.14 The company has considered a number of options, including bulk private sale, sales to the HRA or HGL, and individual sales.

- 3.15 The preferred option originally presented within the Business Plan to the Shareholder Board consisted of a split strategy covering sale of 21 properties to a housing association.
- 3.16 The company continued to conduct negotiations following the filing of papers for Shareholder Board, and was able to achieve an improved position, whereby two properties will be purchased by the HRA, 21 will continue to be disposed to the housing association under a Rent to Buy scheme, and the remaining 17 will be sold individually through the market. The company has also achieved 100% nomination rights in perpetuity in relation to units disposed to the housing association, for as long as the properties remain rented and are not purchased by the association's tenants.
- 3.17 The above position in paragraph 3.16 was approved by the EIL Board on 24<sup>th</sup> June, and by the Shareholder Board on 25<sup>th</sup> June. The company's Business Plan has been amended to reflect the change.
- 3.16 The Shareholder Board has approved the disposal strategy and requested monthly updates on progress, in view of the critical timeline for disposal.

#### **4. ALTERNATIVE OPTIONS CONSIDERED**

- 4.1 No alternative reporting or planning was considered. The company requires a Business Plan to determine its operations for the year.
- 4.2 The alternative option for delegation to the Commercial Director is that all reserve matter decisions would require decision of the Shareholder Board or other committee as appropriate. This is not considered efficient or entrepreneurial and would potentially result in the trading companies requiring greater approval levels than a Council department. The recommendation made will bring the implementation of reserve matters in line with the Council's scheme of delegation and does not delegate any matters over which Members would normally exercise scrutiny and approval for a Council department.
- 4.3 The key alternative options for strategic decisions outlined above are identified within section four of both Appendix One (HGL) and Appendix Three (EIL).

#### **5. REASONS FOR RECOMMENDATIONS**

- 5.1 HGL's business plan provides a stable basis for the company to continue operating over the next three years and includes clear

and measurable proposed benefits to the Council. Refinancing of the company's existing portfolio will address the company's immediate cash flow risks. It will provide financial stability to the company and enable the Council to continue realising annual and long-term value returns from the company through temporary accommodation cost avoidance, company profit and portfolio appreciation. However, it is responsible use of public money for the Council to ensure that the developments proposed represent the best value options. Due to recent development of options not considered within the business planning process, it is important to ensure all available options are fully appraised to provide assurance that best value is being achieved.

- 5.2 The most significant risk to achievement of EIL's objectives is the immediate risk of insolvency in September 2019 should insufficient sales be realised. The recommendation made to Shareholder Board and further recommended to Cabinet is the option which best addresses this risk without causing further risks to other key Council services or trading companies.
- 5.2 The Council's companies have a number of reserve matters; these are matters for which the Directors of the company require shareholder approval. The recommended delegation brings the implementation of these approvals in line with the Council's scheme of delegation, ensuring that companies are able to act as responsively as possible while still maintaining oversight appropriate to the use of public funds.

## **6. COMMENTS FROM OTHER DEPARTMENTS**

### **6.1 Financial Implications**

- 6.1.1 The Company's outstanding debt as at 31.03.2019 was £113.9m. The Company currently repays both principal and interest on its loans. This may change depending on the outcome of the current refinancing work.
- 6.1.2 There is currently £51.1m in the Council's approved 4-year Capital programme, available for loan drawdown by the Company, subject to the relevant governance. This includes £1.75m carried forward from 2018/19.
- 6.1.3 A further £51.4m is included in the Council's 'Pipeline projects' schedule. All projects within this list are subject to the relevant Cabinet or Council approval, an assessment of affordability and a review of other Council priorities at the time.

6.1.4 EIL's outstanding loan as at 31.03.2019 was £12.2m. The repayment of this is subject to the disposal of the current remaining properties.

6.1.5 With the split sale option, which includes the forecast completion of individual sales by December 2019, the company will be able to pay off the outstanding loan by December 2019. Should there be any delays to the current sales forecast, the Council and company will need to agree refinancing options

#### HRA Implications (relating to EIL sales)

6.1.6 See part two report.

## **6.2 Legal Implications**

6.2.1 The Council has a general power of competence under s1(1) of the Localism Act 2011 to do anything that individuals may do, provided it is not prohibited by legislation, and subject to public law principles. Under sections 1(4) and 4 of such Act 2011, the Council can use this general power to do something for a commercial purpose or otherwise for a charge so long as it does this through a company. In approving the company's business plan, and the associated recommendations proposed in this Report, the Council is acting within its powers.

6.2.2 Under company law, a company is limited to acting with the objects set out in its Articles of Association. The Articles of Association for both HGL and EIL, state that the company's objects are unrestricted.

6.2.3 The Council is subject to fiduciary duties to act prudently with public money entrusted to it and a general duty to secure best value under the Local Government Act 1999. It should require its trading companies to follow the Council's own procurement rules when awarding contracts to demonstrate best value.

6.2.4 One of the options of 'doing nothing' in paragraph 4.4 of Appendix One, could result in the company becoming insolvent. If a company goes into an insolvent administration or liquidation (insolvent as determined by the balance sheet test, and at some point before then the director knew or ought to have realised that there was no reasonable prospect of avoiding the insolvency, he may be made liable to contribute to the assets of the company: the quantum of liability is at the court's discretion but is assessed by reference to the liabilities incurred and loss to



creditors caused by the director's actions (or inaction) after the point at which he knew or ought to have known that there was no reasonable prospect of avoiding the insolvency. This liability is called liability for wrongful trading and is dealt with in [sections 214](#) and [246ZB](#) of the IA 1986.

- 6.2.5 The court will not make an order for wrongful trading if, knowing there was no reasonable prospect that the company would avoid going into insolvent liquidation or insolvent administration, the director took every step with a view to minimising the potential loss to the company's creditors as he ought to have taken.
- 6.2.6 Under the current reserve matters, the Council as shareholder has a general power under the Articles to direct the directors to take or refrain from taking specified action. In addition, the Articles contain a comprehensive list of matters to be referred to the Council as shareholder. Reserve matters refer to and list various relevant measures on loans, winding up and administration.
- 6.2.7 The reserved matters referred to in paragraph 5.2, above, balance the need for the Council to retain strategic control with the importance of providing the company with the commercial freedom to maximise its chances of success.
- 6.2.8 When supporting its trading companies, the Council must be mindful of the rules with regard to state aid. 'Aid' in this context means any benefit conferred, not just payments of cash. This could include any services/resources provided by the Council to the company at less than market value.

### **6.3 Property Implications**

EIL and HGL are not subject to the Council's Constitution which includes the property procedure rules therefore, they are at liberty to dispose of assets in accordance with the company articles alone.

## **7 KEY RISKS**

- 7.1 Due to the company's close association with the Council, poor service provision by the company could have negative reputational effects on the Council. The business plan includes clearly stated operational KPIs which will be reported to the shareholder on a quarterly basis to monitor service provision.

- 7.2 The company has a key financial risk of insolvency. This is detailed above, and the restructuring of the company's financial model is considered the most effective long-term mitigation of this risk.
- 7.3 The business plan identifies a risk that the company and HRA could pursue the same type of properties for acquisition and could compete against each other, which would limit the potential gains to the Council overall. The company indicates that it will seek to work with the HRA to ensure this situation does not arise.
- 7.4 The Managing Director of HGL also holds a key Council post in relation to housing, the main client department for HGL. While there needs to be close working with Housing to ensure the company continues to meet the Council strategic housing needs, governance structures will also need to ensure that potential conflicts of interest between the client and MD roles of the Managing Director are managed and decision-making process have suitable independence and separation of duties.
- 7.5 Future loans to the company will need to continue the Council's history of good compliance and practice in regard State Aid. On-lending agreements will continue to be processed through legal services, with access through contracts to specialist State Aid advice to ensure compliance.
- 7.6 There is a reputational risk to the Council if EIL is unsuccessful or records a loss because of failure to realise value of SHS1 properties, as the project was initiated and developed by the Council. The business plan identifies actions for the company to liaise with the Council's press team to ensure they are prepared for any arising issues.
- 7.7 For EIL there is a significant risk of insolvency in September 2019 should insufficient sales be realised by this time. The main recommendation set out above addressed this risk through a successful sale, and additionally officers are working with EIL colleagues to identify State Aid compliant contingency plans in the event that unforeseen events render the recommended sale unsuccessful.
- 7.8 There is a risk that EIL properties are not completed on time for sale, as the project has been significantly delayed before. The completion date is currently expected in July. Officers are not aware of any reason to believe that further delays are likely, however there remains regular liaison with EIL colleagues to ensure any issues are raised promptly.

- 7.9 Individual sales of EIL properties may have some risks associated in terms of delays and value which are outlined above in paragraph 3.18. EIL has in its business plan supplied a clear timetable, including income targets, to achieve disposal of all properties, thereby providing the shareholder an effective way to monitor progress. Should the shareholder approve the sales plan, then the progress against that stated in the business plan will be regularly reported to the Board.

## **8 IMPACT ON COUNCIL PRIORITIES – CREATING A LIFETIME OF OPPORTUNITIES IN ENFIELD**

### **8.7 Good homes in well-connected neighbourhoods**

EIL has developed a number of properties to supply to different elements of the housing sector, to provide more supply of good quality housing in Enfield. HGL helps to alleviate housing pressures by reducing the pressure on the temporary accommodation budget as well as increasing the availability and affordability of good quality private housing.

### **8.8 Sustain strong and healthy communities**

EIL's new build houses are good quality and will enable residents to achieve a high quality of life and health in their homes and communities. The small-scale developments have regenerated formerly low-quality areas of land in communities. HGL aims to help improve physical and mental health by providing good quality housing for residents who otherwise may be located for longer periods in unstable temporary accommodation.

### **8.9 Build our local economy to create a thriving place**

The company aims with its sale to provide housing supply to a local housing association, creating affordable housing solutions within the local area to benefit the local economy. HGL aims to provide good quality homes that have a fair rent, thereby enabling tenants to spend more of their money in the local economy.

## **9 EQUALITIES IMPACT IMPLICATIONS**

There has been no equality Impact assessment completed.

## **10 PERFORMANCE AND DATA IMPLICATIONS**

The Shareholder Board will put in place a formal and robust reporting process between the companies and the Council to ensure they are supporting the Council's aims and objectives.

Regular reports will draw on the information provided in business plans to assess progress throughout the year.

## **11 PUBLIC HEALTH IMPLICATIONS**

There are no public health implications associated with this report.

### **Background Papers – None**

Appendix One – HGL Business Plan: part 1 report to Shareholder Board

Appendix Two – EIL Business Plan: part 1 report to Shareholder Board