

MUNICIPAL YEAR 2019/2020 COVER REPORT

MEETING TITLE AND DATE:

Shareholder Board
25th June 2019

REPORT OF:

Commercial Director

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Agenda – Part:1**Item:**

Subject: Enfield Innovations Ltd business plan 2019-20

Wards: All

Key Decision: 4928

Cabinet Member consulted: Cllr Maguire

1. EXECUTIVE SUMMARY

- 1.1 This cover report summarises the content business plan produced by Enfield Innovations Ltd (EIL), the Council's wholly owned regeneration company.
- 1.2 The business plan focusses primarily on delivering the completion and sale of the Small Housing Sites 1 (SHS1) project.
- 1.3 EIL forecasts a loss at year end, though the company remains in cumulative profit over the course of its life.
- 1.4 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.
- 1.5 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 and achieves an overall positive financial value. The split strategy covers bulk sale of 21 units to a housing association, and individual market sales of the remaining 19 properties.
- 1.6 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. The disposal strategy for the remaining 40 properties is set out within the Business Plan.

2. RECOMMENDATIONS

- 2.1 To recommend to Cabinet to approve the EIL Business Plan for 2019-20.
- 2.2 To request the company circulate a monthly sales update report to the Shareholder Board, reporting on the sales achieved each month against the targets stated within the Business Plan 2019-20.
- 2.2 To recommend to Cabinet delegation of authority 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 EIL Business Plan, 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 In its role as shareholder, the Board is required to review EIL's business plan. Authority to approve the Business Plan remains with Cabinet.
- 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 company has developed its 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.

Objectives and risks

- 3.4. The central objective of 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.
- 3.6 The disposal options outlined below identify challenges and ways to address this risk. Alongside this, officers are working closely with EIL colleagues to identify clear, agreed, State Aid compliant contingency plans to protect the Council's investment should the company be unable to realise sufficient value by September 2019. Agreed arrangements will be reported in full through the appropriate Council process as determined by the scheme of delegation.

Disposal Options

Bulk sale to the HRA or Housing Gateway (HGL)

- 3.7 As per the Shareholder Board's request during the planning process, company officers worked with Housing Finance to determine whether the HRA would be able to purchase the properties.
- 3.8 The outcome was that a bulk sale would not be viable under the HRA's criteria. The HRA has a maximum price cap to enable viable returns from properties and many of the SHS1 properties are above this limit. Appendix Two identifies that bulk sale option for the HRA has a negative net present value and would therefore be equivalent to a current loss to the HRA.
- 3.9 The same scenario exists for HGL, which also has staggered price caps for one, two and three bed homes respectively. The properties within the SHS1 development exceed these values; therefore, purchase of the properties by HGL could cause significant affordability risks for HGL.
- 3.10 This highlights a general risk on bulk sale, which is that SHS1, though packaged as one development project, consists of five separate developments and a wide range of property types and values. For example, some properties within the Forty Hill segment of the project are valued well above the viability criteria of both the HRA and HGL. The diversity of the portfolio for disposal is a challenge to finding a bulk buyer generally, as

many operators within the housing industry specialise in particular types and/or values of homes.

- 3.11 Bulk sale to the HRA or HGL would mitigate EIL's risk of failing to sell, would ensure prompt disposal of the full portfolio, and would increase the supply of social housing available through the Council. However, the prohibitive cost of the properties would create significant affordability issues for either the HRA or HGL and would therefore place the delivery of other key Council housing services under substantial risk. It is therefore not considered an effective overall commercial decision for the Council as shareholder.

Bulk sale to the private market

- 3.12 EIL has previously attempted to dispose of properties in bulk through the private market. The company conducted a sales exercise from September to December 2018, which resulted in two viable offers for the full portfolio. However, one offer was subsequently revised by the buyer to a lower amount which the company could not accept, as it would not have covered the company's liabilities, leaving it in a loss-making position.
- 3.13 The second offer was subsequently withdrawn in March 2019 due to an unexpected change in the buyer's investment criteria.
- 3.14 Finding a bulk buyer through the private market is challenging due to prevailing market conditions. Year-on-year house prices in London had decreased by 1.9% in March 2019 (figures from Office of National Statistics). This coupled with general uncertainty over Brexit implications for housing has rendered it difficult to find a buyer at a viable price, as is shown by the failure to conclude an offer through the previously undertaken process. While the benefits of this option are the potentially faster disposal of the full portfolio, this option is considered to have a significantly high risk of failure, and is highly unlikely to be achievable by September 2019, the critical moment for the company. This option is not therefore recommended to the Shareholder Board.

Individual Sales

- 3.15 The company has also considered individual sales of properties. This returns a positive net present value to the HRA, as well as expected profit to the company, thereby realising a net value benefit to the Council.
- 3.16 However, this carries some significant attached risk. The property market is currently poor for sales, and therefore expected values achieved may not be accurate. Additionally, the

company has a critical cash flow point approaching at September 2019, and there is no guarantee that sufficient properties will be sold by September to fund the company's loan repayment due at this point.

- 3.17 This is therefore considered to be a less effective overall commercial decision than the final option of split sales, which delivers a net benefit (though less than individual sales), but also mitigates the immediate cash flow risks for the company.

Split sale between housing association and subsequent individual sales

- 3.18 The company has received an offer for 21 properties from a housing association which it considers to be market value for those properties. Conclusion of this offer would enable EIL to dispose of just over half the portfolio of 40 properties on or shortly after practical completion and extend its solvency significantly beyond September 2019. The Council is negotiating with the association to obtain both primary and secondary nomination rights to these properties, to provide extended benefit to the shareholder.
- 3.19 The company intends then to dispose of the remaining properties to the market individually. The Business Plan includes monthly sales targets leading up to disposal of final properties in December 2019; as identified above, the conditions of the property market are not conducive for sales at the current time, and the timetable set by the company may be challenging to deliver. However, there may be some scope to review plans to sell properties individually, provided that the sale to the housing association is realised by September 2019.
- 3.20 While the split sale proposal does not retain properties within the Council or its companies, the current offer from the housing association does retain 21 properties within the social sector, helping to reduce the potential homelessness burden on the Council, particularly if nomination rights can be successfully agreed with the association. This is considered preferable to private sale. While it does not minimise disposal risk through sale of the full portfolio, a successful sale will remove the immediate risk of insolvency and realise market value for the 21 properties sold; the removal of immediate insolvency risk is an important benefit to the Council commercially.
- 3.21 It should be noted that the net present value of the split sale is also negative for the HRA. Therefore, it also represents an effective current loss to the HRA. However, it results in a corresponding increase in expected EIL profit, thereby offsetting loss in value to the HRA over both full bulk sale and full

individual sale, and retains some properties within the social sector, thereby achieving greater social value. It also does not incur direct risk for other Council services or companies. The sale to a housing association is therefore considered the best short-term commercial decision for the Council as shareholder.

3.22 It is important to note that the latter part of the proposal (individual sales) carries some risks. The property market is challenging and there is likely to be little margin for flexibility in achieving sufficient value to realise a profit on the development. The timetable which the company has set is also ambitious and may have a high chance of setback considering the condition of the property market. Though it is considered better to aim for an ambitious disposal timetable, it should be acknowledged that market conditions may lead to some sales passing beyond the planned end date. Private sales also may not contribute to the social housing sector and may therefore carry less social value for the borough than other disposal routes.

3.23 It is therefore recommended that Shareholder Board approve a split sale strategy with the initial sale of 21 properties to the housing association as per the current offer the company has received.

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.

4.3 The key alternative options for disposal are set out in paragraphs 3.7 to 3.17 above, and within Appendices two and three of the Business Plan.

5. REASONS FOR RECOMMENDATIONS

5.1 The most significant risk to achievement of the company's objectives is the immediate risk of insolvency in September 2019 should insufficient sales be realised. The recommendation made is the option which best addresses this risk without causing further risks to other key Council services or trading companies.

- 5.2 The company has 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 loan as at 31.03.2019 was £12.2m. The repayment of this is subject to the disposal of the current remaining properties.
- 6.1.2 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

- 6.1.3 The proposal to sell 21 properties to a housing association and the remaining 19 on the private market as individual sales, results in an estimated loss of income to the HRA of c. £430k. This change sees the NPV reduce from a positive £183k to a negative £260k. The original expected sales value was £18.2m (selling 40 properties on the private market individually) but this change shows a reduction in sales income to £17.8m. The shortfall of sales income will be funded from HRA reserves.
- 6.1.4 The individual sales are expected to complete in 2019-20, If there are delays in the sales this will need to be modelled into the HRA 30-year Business Plan.

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 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 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.
- 6.2.5 When supporting the company, 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

Enfield Innovations Ltd is 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 There is a reputational risk to the Council if the company 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.
- 7.2 For the company 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.

- 7.3 There is a risk that 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.
- 7.4 Individual sales 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

- 8.2 **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.
- 8.3 **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.
- 8.4 **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.

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 A – EIL Business Plan 2019-20 – appended to the part two report.