APPENDIX 1

MUNICIPAL YEAR 2019/2020 – REPORT NO. COVER REPORT

MEETING TITLE AND DATE:

Shareholder Board
25th June 2019

REPORT OF:
Commercial Director

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Agenda – Part:1	**Item:**
Subject: Housing Gateway ltd (HGL) - Business Plan 2019-22 **Wards:** All **Key Decision No:** 4928	
Cabinet Member consulted: Cllr Maguire	

1. EXECUTIVE SUMMARY

1.1 This cover note summarises the content of the HGL business plan for 2019-22.

1.2 The business plan identifies that HGL will return a cumulative profit over the course of the three-year plan, in the expected amount of circa £1m, though this will entail a loss within the first year of the plan due to refinancing needs.

1.3 This will run alongside a planned expansion of HGL's portfolio by 250 properties over three years, however this will encompass some adjustments of the company's financial model, specifically through refinancing to provide financial stability to the company's current portfolio.

1.4 Subject to receipt of further detail on the financial structure proposals, it is officers' opinion that the Business Plan represents a good return to the Council through a combination of profit, cost avoidance and social value. However, the planned expansion may be challenging and will require careful monitoring to ensure both success and continued alignment with shareholder priorities.

2. RECOMMENDATIONS

2.1 To recommend to Cabinet to approve the activities detailed in the HGL Business Plan for 2019-22, subject to presentation of a further report for approval of the forward financial structure based on a full options appraisal, and the submission of clear annual expansion targets.

2.2 To recommend to Cabinet to delegate authority to the Shareholder Board to approve the future reports detailed in recommendation 2.1.

2.3 To recommend to Cabinet to delegate to the Council's Commercial Director the authority to act as representative of the Council's shareholder function and make decisions on shareholder reserve matters relating to the delivery of the approved HGL Business Plan, where such decisions would not require Member approval if applied to a Council department under the Council's scheme of delegation.

2.4 To delegate to the Leader of the Council the authority to approve an appointment to the current vacant position on the HGL Board.

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 approve HGL's business plan.

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 2022 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.

Strategic Objectives and risks

3.4 HGL has identified three key strategic objectives, detailed on pages 3-4 of the Business Plan. 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. Risks and refinancing plans are detailed further within paragraphs 3.11 – 3.19 of this report.

3.6 Progress against strategic objectives will be reported quarterly to the Shareholder Board.

3.7 The company currently retains a directorial vacancy. Under the Articles of Association, the Council may nominate an appointment to this vacancy. Officers are liaising with the company Board and have requested an indication of the skills and knowledge the company feels would most benefit the effectiveness of its Board. A nomination will be made based on the company's response.

Financial Projections

3.8 The company projects that based on a refinanced model, it will prove to be net profitable over the three-year course of the business plan. Further details are included within the Part 2 section of this report.

3.9 The projection is based on refinancing, the full costs and terms of which were unknown at the time of calculation. The full options appraisal as suggested under recommendations will be expected take account of the indications received from the market.

3.10 The financial projections also do not take into account potential portfolio expansion, as this cannot be accurately modelled until timescales on refinancing options are clear. Therefore, it is expected that as part of a revised business plan the company will produce an updated version of financial projections taking account of all variables as far as is reasonably possible.

Refinancing package

3.11 The Business Plan identifies a need for HGL to refinance its current portfolio; 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.

3.12 The refinancing package will assist the company by providing financial stability over the current portfolio. Currently the company repays Council loans on interest plus capital terms (as necessitated in order to make loans viable for the Council). The company also provides rental on the basis of LHA rates which have been subject to central government pressures through limiting increases below inflation rates. Therefore, as the company's capital loans and repayments have increased to expand its portfolio, the growth of its cash income has been limited.

3.13 The company is therefore in a position where it has extreme challenges in raising sufficient cash income to finance its loans repayments. It is important to note that this is not an issue of profitability; due to the increasing value of its portfolio the company retains a healthy profit position. It is a cash flow issue of having sufficient liquid cash funds to finance repayments on a day-to-day basis.

3.14 The refinancing packages seek to address this risk through the potential for external funds to offer interest only repayment terms. The company has initiated negotiations with four possible fund providers, which has identified that interest only repayment can be achieved. Interest only payments, based on the broad indicative terms put forward by fund providers, will reduce the actual cash amount the company is required to make on regular repayments, thereby bringing the repayments within the company's cash financing ability.

3.15 This will allow HGL to financially stabilise its existing portfolio and continue to utilise that portfolio to provide annual cost avoidance to the Council of circa £1m per year over the course of the business plan. It will also permit the company to then pursue its expansion plans.

3.16 It is important to note that to achieve the best terms, and indeed viable terms, of refinancing, external fund providers have indicated they will require the Council to provide a Parent Company Guarantee over HGL's refinanced loans. This is not considered to increase risks to the Council. The Council's potential exposure would be at the same level as its current loans to the company. The company's portfolio is currently valued at around £126m, greater than the loan it will take on. This can reasonably be expected to increase further over the long-term, providing the ongoing alternative option of portfolio sale should circumstances change again and the company experience further issues.

3.17 It is also noted that a Parent Company Guarantee cannot be approved by the Shareholder Board. It is a Council decision and matter, and it is appropriate and important to separate this decision from decisions made as sole shareholder of HGL. A separate report will be developed when full terms and conditions relating to any Parent Company Guarantee have been identified, and the report will be progressed through the appropriate channels under the Council's scheme of delegation.

3.18 It is the view of officers however that all options, including the possibility of restructuring its existing loans with the Council, are not fully explored within the business plan. As such, it is not possible to state whether it represents better or worse value for the shareholder compared to restructuring existing loans.

3.19 It is recommended that the Shareholder Board instruct the company to return to Board within three months presenting the two potential options of external refinancing and loan restructuring.

Portfolio Expansion

3.20 HGL has identified a three-year target of 250 new homes, with the accompanying proposal to diversify the company's portfolio of products. The company estimates this will deliver £1m per annum in cost avoidance for temporary accommodation.

3.21 £49.3m of funding to be made available to the company to finance its expansion plans through on-loans from the Council has been approved at Council in February 2019. This will be available for the financial years 2019-21. A further planned £51m has been identified with the capital pipeline for 2022-23 but has not been approved. This would require further approval at Council level.

3.22 There is a key dependency for expansion of addressing the company's immediate liquidity risks. The portfolio cannot be expanded until these risks are addressed; therefore, a detailed breakdown of yearly expansion targets cannot be developed until the liquidity solution is in place. A detailed plan will be requested from the company once the financial situation has been resolved.

Overall conclusions

3.26 It is the recommendation of this report that the options presented in the business plan require further development. While there are no objections to company proposals in principle, in the extent that the company has been financed through substantial capital loans of public money, the Council as shareholder bears a responsibility to ensure that the company pursues the best value options for its development.

3.27 It is the view of officers that while the business plan presents an effective strategic case for the benefits of a revised finance structure, it does not demonstrate a full case that they represent the best value against all other options, nor the full details as to how potential benefits would be realised.

3.29 However, it is also recognised that the company requires a working business plan and endorsement of its overarching activities. It is therefore recommended that Shareholder Board recommend to Cabinet to approve the activities of the company as outlined in the business plan, subject to further development of its proposals and submission of annual expansion targets. It is recommended the company return to a future Shareholder Board with full reports outlining its plans for approval, delivering the assurances and appraisals required by the Council to approve the strategic development of the company.

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 refinancing are sale and leaseback, portfolio sale, a working capital loan, restructuring its loans from the Council or to do nothing.

4.4 Doing nothing will result in the company becoming insolvent. This would affect the income received from loan repayments and would require the appointment of an administrator, over whom the company, and therefore the Council as shareholder, would not be able to exercise control. This is not therefore recommended as there are other options which address the prevailing cash flow risk, preserve benefits of the company to the Council and retrain control and oversight of the Council's investment.

4.5 The Council could provide a working capital loan to the company, prolonging its solvency. However, this would not address structural issues causing the risk of insolvency and would increase the Council's total loan exposure without obtaining any discernible long-term benefit as the company would still be at risk of long-term insolvency. This is not therefore recommended as there are less costly options which better address risks to the company over the long-term.

4.6 Sale and leaseback, debt restructuring, and portfolio sale options will be developed and appraised in full prior to the presentation of a revised business plan within the next three months.

5. REASONS FOR RECOMMENDATIONS

5.1 The 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. However, it is responsible use of public money for the Council to ensure that the developments proposed represent the best value options.

5.2 The refinancing plan is considered an effective long-term option to 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, in officers' view the business plan does not fully demonstrated that it is the best value option.

5.3 Officers in particular consider that the company has not fully explored restructuring options in regard to its loan, and therefore it cannot be said at this time whether refinancing represents a better option than restructuring. Therefore, it is recommended that the company explore this with the Council and return to

Cabinet with a revised business plan within three months. Officers will support this with a working group in collaboration with the company.

5.4 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.

5.5 The company currently has a directorial vacancy for which the Council will nominate a director. The next Shareholder Board is several months away, and therefore to ensure the most effective operation of the company board, and the most effective mix of skills, it is recommended that authority be delegated to the Leader to approve the appointment on behalf of the Shareholder Board.

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.

6.2 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 Housing Gateway Limited (HGL), 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 above, 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 5.4, 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 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

Housing Gateway 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 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.

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

8.1 Good homes in well-connected neighbourhoods

The company 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.

8.2 Sustain strong and healthy communities

The company 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.

8.3 Build our local economy to create a thriving place

The company 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.

11 PUBLIC HEALTH IMPLICATIONS

There are no public health implications associated with this report

Background Papers - None

Appendix A – HGL Business Plan 2019-22 – attached to the part two report containing exempt information