London Borough of Enfield

Cabinet

11th November 2020

Subject: Trading Company Annual Accounts & Performance
Cabinet Member: Cllr Mary Maguire
Executive Director: Jeremy Chambers – Director of Law & Governance

Key Decision: 5197

Purpose of Report

1. The purpose of the report is to identify and communicate the results achieved by the Council's wholly owned trading companies and provide assurance that they continue to contribute effectively to the achievement of the Council's corporate objectives

Proposal(s)

2. Recommended that Cabinet:
    1. Note the results presented by the companies.
    2. Approve the wind-up of EIL, following the sales of the final two properties in which it holds an interest, and delegate authority to the Director of Law & Governance to enact the wind-up in consultation with the company's Directors.

Reason for Proposal(s)

3. The company accounts are approved by the Company Boards and are presented to Cabinet for transparency and to ensure companies' performance remains in accordance with the Council's strategic priorities.

4. EIL has no viable project to move on to following the sales of its final property interests. Given the company has not delivered value, coupled with the absence of immediate opportunities, it is assessed that there is no value in keeping the company structure in place.

Background

5. During the financial year ending March 2020, four companies wholly owned by the Council operated to deliver services to residents. These were:
    1. Housing Gateway ltd (HGL)
    2. Lee Valley Heat Network Operating Co ltd (trading as Energetik)
    3. Enfield Innovations ltd (EIL)
    4. Independence and Wellbeing Enfield ltd (IWE)

6. The companies operated for the year on the basis of business plans given final approval by Cabinet in July 2019, which included financial projections and KPI targets for companies to be measured against. These projections and targets form the basis for quarterly performance reports provided to the operational shareholder function. The final year-end results are presented in this report.

7. IWE has since been insourced as of 1st June 2020. The legal entity is currently in the process of being wound up, as per the Cabinet decision of 22nd January 2020.

Main Considerations for the Council

Housing Gateway

8. Housing Gateway's business plan projected a loss of (£400,000). Prior to Coronavirus restrictions, the company was on course to exceed this substantially, with an Operating Profit of £4.5m against £2.8m interest payments. In normal circumstances, this would give a projected net profit of £1.7m before tax, overachieving against the business plan. The company has also delivered an estimated £2m temporary accommodation cost avoidance to the Council across the year, which would have represented a very good year for the company.

9. However, following the imposition of lockdown restrictions and the consequent effect on property markets, the company's portfolio was down valued as part of external audit. The company values its assets on an annual basis in accordance with the Council's accounting requirements, as the Council is required to include the value of its subsidiary companies on its own balance sheet. The loss of value is adjudged to have occurred in March 2020, and therefore affects this presented set of accounts.

10. The total down valuation across the portfolio has amounted to £9.1m, as is identified by the line 'Other gains or losses' in the Profit and Loss statement, and the associated note.

11. The effect of this has been to impact the net profit and record a £6.8m loss. However, this is an accounting loss due to falling asset values, as opposed to an operating loss, an important distinction as it identifies that the business' activities are still fundamentally profitable, and the loss has occurred only due to the external shock suffered by the property market as a result of the Covid-19 pandemic.

12. The loss does not have an impact on the company's ability to function, nor the core profitability of its activities, nor the cost avoidance achieved by the Council through use of HGL's services. It also does not affect the cash flow of the business, as the value of the portfolio as a fixed asset is for accounting purposes, and the value of fixed assets has no impact on cash income. Indeed, as per paragraph 6, the company has outperformed expectations in regard to its operations.

13. The devaluation also affects the company's balance sheet, which identifies the extent to which the company's assets outweigh its liabilities. The devaluation of the company's portfolio has substantially reduced its buffer in this regard, although it still retains a positive ratio, its assets being worth £1.25m in excess of its liabilities. However, it is a positive sign for the Council's investment that the company has been able to sustain a substantial shock to its portfolio, but remain in positive equity; this offers reassurance to the Council as shareholder and lender that the company has purchased prudently, and the Council's investments in the company are safely protected by the value of the portfolio. The first round of financial monitoring for 2020-21 has also identified an initial improvement in the company's net asset position to £1.5m.

14. Housing Gateway has completed actions needed to implement its business plan for the year. It has met all performance targets with the exception of resident satisfaction; the company advises that this is largely due to dissatisfaction with repairs and maintenance contractors. A timeline for a new customer satisfaction exercise is currently being drawn up. The company used the same contractors as Council Housing for the period, which have now been replaced by an insourced service. This will continue to be monitored through the current financial year.

Energetik

15. Energetik has recorded a positive result, outperforming its business plan projection for the year by £430,000. It is the second successive year that the company has substantially outperformed its business plan, and it is now in a strong overall net positive position against its business plan since its inception. Due in part to the change in delivery strategy at Meridian Water, it has been able to postpone its capital expenditure required to deliver its major infrastructure, which has had reduced the company's borrowing requirements in early years.

16. The company is currently in a phase of high capital investment as it seeks to build out its network and assets, which has a significant effect on its bottom-line result. Looking in detail at the accounts, it can be seen that the company has delivered a gross profit on its activities for the first time, which represents good progress on a par with business plan expectations. Gross profit measures the profitability of the day-to-day business operations, before interest payments on its loans are accounted for. This indicates that the company's operations model is fundamentally profitable, with the next phase of the business plan being to expand its customer base to the point that the income base is large enough to also exceed interest payments and therefore record net profit.

17. The final net profit result then takes into account repayment of the company's loans, which leaves a final overall loss of £570,000; as highlighted above, this is a substantial improvement on the projected business plan position of a £1m loss.

18. The company has a net asset position of (£2.2m). This is also anticipated within the business plan and is the result of investment in design costs prior to asset construction. The construction of some energy centres is underway, which may help to redress the asset balance in future accounts. The company also has approved loan facilities available, which to date it has not utilised as quickly as previously envisioned, therefore there is not assessed to be a high cash flow risk.

19. Energetik has completed the key actions required by its operational plan for the year and has performed well on KPI targets. Where targets have been missed this has in part been due to the company's service contractor; Energetik's contract with its service contractor includes a penalty system for underperforming KPIs, and these have been enacted to recover contract fee for Energetik wherever applicable under the contract terms.

20. The completion of key actions enables the company to move forward with the build out of its network, as well as exploring potential opportunities for expansion.

Robin Hood Energy & Bristol Energy

21. Given the recent emergence of high-profile losses sustained by Robin Hood Energy ltd (RHE) and Bristol Energy (BE), wholly owned by Nottingham City Council and Bristol City Council respectively, this report represents an opportunity to provide assurance on Energetik's financial management, and the difference of its business model to those companies.

22. In terms of business model, RHE and BE were set up as licensed utility providers in the electricity and gas market; that is, the sale of electricity and gas to domestic and commercial customers in the same marketplace as large scale utility providers such as British Gas, Npower, Eon etc. As a result, they were in direct competition with large scale competitors to obtain and then retain its individual customer. These are highly regulated and competitive markets, relying on market forecasting, and competitive purchasing of gas and power, similar to market trading, which carries high level of risks.

23. Energetik does not operate in the gas and electricity market. Energetik builds heat networks as part of development projects; this enables Energetik to consider each business development proposal on its own merits and assess financial viability; Energetik will not connect to developments it does not consider to be viable, therefore it will not incur capital expenditure on projects it has not done substantial financial modelling on, and projected profit for.

24. In financial management terms, while posting a loss, Energetik has outperformed its business plan for successive years; its business plan projects a loss while capital is invested in building its network and other infrastructure assets, which becomes profitable once the network is built out and revenues from an increased customer base increase.

25. RHE posted losses which greatly exceeded business plan expectations; in some years it posted £5m plus losses when the business plan projected

profit. The fact that Energetik is outperforming expectations, and has recorded gross profit before loan repayments, provides comfort that the company is operating as expected and the projection of long-term profit is realistic and achievable.

26. The funding structure of Energetik also works to minimise risk to both Council and company. The company has approved loan facilities which it draws down against on a quarterly basis, taking only those drawdowns necessary for its business that quarter. This allows the company to manage its interest repayment effectively, and the Council can limit its financial exposure while monitoring progress and performance achieved by the company.

27. Further, Energetik does not compete for individual customers. Once a network is built and connected to a development, Energetik is the sole heat supplier able to access the development properties. In reciprocity to end consumers, Energetik benchmarks its heat prices against gas each year, which aims to offer a price equivalent to the 'Big Six' energy firms when replacement costs and breakdown insurance is included i.e. a like-for-like comparison.

EIL

28. EIL's business plan projected a loss of (£150,000) after the sale of all its property interests. After utilising property sale income to repay loans from the Council, it has recorded a final position of (£600,000), though it has not yet sold all properties.

29. This is, in part, due to the company's interest in properties built through the Small Housing Site phase 1 project not achieving sale within the timeframe initially envisioned, particularly in regard to the bulk sale of 21 properties to North London Muslim Housing Association, as identified within the performance report. This has entailed unforeseen expenditure on aspects such as property security, and higher legal fees due to conveyancing processes taking longer than expected, which has then impacted on the overall financial bottom line.

30. The sale of the final properties remaining at year end has then subsequently been affected by the Covid-19 pandemic, which has delayed the completion of sales. However, no buyers have withdrawn as a result of the pandemic, and the sole remaining property is now progressing towards completion.

31. It has resulted in a balance sheet net assets figure of (£115,000), meaning that the remaining property value at 31st March 2020 was assessed to be worth less than the remaining liabilities to the Council. As such, the surplus of debt over assets is currently estimated at around £160,000. The company remains able to fully service its loan repayments to the Council with value expected from final property sales, however a Parent Company Guarantee fee levied on the company by the Council cannot be met.

32. Originally the strategy was to let the properties through a leasehold interest. However, substantial delays to the development projects caused by the insolvency of a sub-contractor resulted in the rental model to becoming

unviable, due to the projected delay in receiving rental income against loan payback. Therefore, a mitigating scenario of property sale was pursued to limit the Council and company's financial exposure.

33. Appendix 4 further details the path of EIL's involvement in the Small Housing Sites project from the Council's perspective as shareholder, and identifies lessons learned which have been applied to subsequent proposals. The Housing Revenue Account (HRA) also held interest in the properties developed through the project, and the Financial Implications record the effects of sales on the HRA, which is at a net positive impact due to the value of sales achieved by EIL.

34. There are no other performance measures to report, as the sale of properties is the sole aspect of the company's approved business plan.

<u>Independence and Wellbeing Enfield</u>

35. Independence and Wellbeing Enfield has returned a zero result after tax, against a pre-tax profit of £31,500. This shows that the company making efficient use of the management fee paid for services by the Council. It retains a surplus of assets over liabilities of £400,000. This is assessed to be a good position given that the company is free of loan or long-term debt obligations, nor does it have fixed assets on which it relies for a positive position.

36. In January 2020 Cabinet approved the insourcing of the services provided by IWE, and the subsequent wind-up of the company. The services were insourced on June 1st 2020, and the wind up of the legal entity is underway. As such, the performance is not presented in this report, as it is not deemed to be of value in the prevailing circumstances.

Safeguarding Implications

37. There are no safeguarding implications to this report.

Public Health Implications

38. The specific proposal does not have any implications for public health. However, Energetik and HGL do contribute to public health through the low-cost heating and housing they respectively supply, and therefore it is important to monitor their performance to ensure such benefits continue.

Equalities Impact of the Proposal

39. The proposal has no equalities impact.

Environmental and Climate Change Considerations

40. The proposal does not have any direct climate change or environmental impacts, although Energetik's business plan works towards significant carbon

reduction in energy provision. Impacts of particular company proposals or business plans will be considered in the relevant reports.

Risks that may arise if the proposed decision and related work is not taken

41. If companies' performance is not monitored and reported, then the companies may fail to deliver against objectives, and may not contribute towards the Council's Corporate Plan, or provide a return on the Council's investment. Cabinet may be unable to fulfil its role as shareholder guardian in ensuring that companies continue to align strategically with the Council's objectives.

42. The key factors to monitor for HGL over the coming months will be arrears levels and portfolio value. It is, as yet, unclear how the end of the furlough scheme in October will affect levels of arrears, and reporting will be undertaken to promptly identify any negative effect. It will also be important to monitor the portfolio value and by extension the net balance sheet position to ensure continuing positive equity, which has already shown improvement over the figures within the 2019-20 accounts.

43. For Energetik, the key factors to monitor will be gross profit, to ensure the positive result in 2019-20 continues. Related to this, the level of staffing costs capitalised will be important, as efficient use of staff time on generating revenue (as opposed to developing network assets) will be part of continuing to achieve gross profit.

44. For EIL the shareholder function will continue to monitor sales until the final remaining sale is complete, and the proposals regarding wind-up can be enacted.

Risks that may arise if the proposed decision is taken and actions that will be taken to manage these risks

45. The proposal is to note progress, to provide assurance on company performance, and to provide an opportunity for oversight and challenge. There are therefore no specific risks arising from the proposal relating to the companies considered.

46. It should be noted that this report does not consider the Council's partially owned and/or dormant companies, therefore it cannot offer assurance on risks related to those companies. The purpose and value of these is currently under review, and recommendations regarding them will be presented in due course, with full consideration of related risks.

Financial Implications

47. HGL – as reported in paragraph 6 above there was a revaluation of the company's asset portfolio, reducing the underlying value of the company. arising mainly from the impact of the Covid19 pandemic. This equates to a 7% reduction in the company's investment portfolio as at 31st March 2020. A similar downward revaluation has been seen across other Council Housing

assets, followed by signs of a subsequent recovery post year end. It is anticipated that the asset values (and HGL's directly related valuation) will recover in future years, in-line with the wider housing market.

48. IWE – As at 31st March 2020 the company was free of debt or any long-term obligations. As such the windup of the company which is now underway will not have any adverse impact on the Council's finances. Cash balances of £600k have been transferred back to the Council as all obligations are believed to be fulfilled.

49. Energetik – The company made a loan drawdown of £2.7m during 2019/20, which facilitated the delivery of key activities as detailed in the company's business plan.

50. EIL – The company had 2 unsold properties at year end. The debt position will be finalised during the current financial year, once the last 2 properties are sold. As at 31st March 2020, the asset valuation appeared unlikely to cover the company's outstanding debt and a loss of circa £150k is anticipated.

51. The actual profit or loss position will be known when the last 2 properties are sold.

52. The EIL sales have seen an increase in value which has resulted in additional income to the HRA. The effect on the HRA of the Small Housing Sites project was most recently reported to Cabinet in January 2019. The position achieved has improved by £128,000. This is largely due to higher than anticipated total value achieved from EIL individual sales.

53. The following table provides a full updated position for the HRA from January 2019, based on the sales activity that has been undertaken by EIL in 2019-20 and subsequent months.

HRA SS1	**Original projection**	**Updated projection**	**Difference**
Expenditure			
Works Costs Phase 1	5,938,386	5,113,398	
Works Costs Phase 2	13,715,981	13,692,752	
Other Works	2,077,415	2,204,705	
Acquisitions/Demolitions	1,445,216	1,445,216	
Fees, staffing & project costs	1,292,547	2,001,873	
Total Expenses	**24,469,545**	**24,457,944**	**-11,601**
Income			
RTB receipts	-1,991,097	-1,991,097	
S106	-1,943,157	-1,943,157	
GLA grant	-690,000	-690,000	
Total Subsidy	**-4,624,254**	**-4,624,254**	**0**
Private sales (LBE 23%,	-6,412,945	-6,529,573	

EIL 77%)			
Shared equity receipt	-3,626,000	-3,626,000	
Total Debt	**9,806,346**	**9,678,117**	**-128,229**

54. The delays to EIL sales have not impacted on HRA borrowing.

Legal Implications

48. The Council has a general power of competence under Section 1(1) of the Localism Act 2011 to do anything which individuals generally may do provided it is not prohibited by legislation and subject to public law principles. In addition, in accordance with such Act, the Council can set up a company under the Companies Act 2006 to do, for a commercial purpose, that which it is empowered to do under the general power of competence.

49. When supporting the companies, particularly in its role as lender/funder, the Council must be continually mindful of the rules with regard to state aid. 'Aid' in this context means any benefit conferred, not just monetary payments. This could include any services/resources provided by the Council to the company at less than market value.

50. When taking any actions in its role as shareholder, the Council must also be continually mindful of the requirements of the Companies Act 2006, and the requirements contained in the Articles of Association of each company.

Workforce Implications

51. There are no workforce implications to this report.

Property Implications

52. There are no property implications to this report.

Other Implications

53. There are no other implications to this report.

Options Considered

54. The only alternative option is not to report or monitor progress, which as identified in paragraph 25 may result in a lack of cohesion between the Council's objectives and its use of companies.

55. The alternative to wind-up of EIL is to leave the company dormant. As there is no viable project for the company in the foreseeable future, there is not assessed to be any value in this option.

Conclusions

56. The progress of the companies should be noted, and monitoring continue throughout the current financial year.

57. Subject to completion of final sales, the Council should wind-up EIL as a company entity.

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11 November 2020

Appendices

Appendix 1a-c: Company letters presenting accounts
Part 2 – restricted:
Appendix 2a and b: Housing Gateway accounts and performance report
Appendix 3a and b: Enfield Innovations ltd accounts and performance report
Appendix 4a and b: EIL accounts and performance report
Appendix 4c: EIL Shareholder Timeline
Appendix 5: IWE accounts