London Borough of Enfield
Cabinet

3 March 2021

Subject: **Company Business**
Cabinet Member: **Cllr Mary Maguire, Cabinet Member for Finance and Procurement**
Executive Director: Jeremy Chambers, Director of Law and Governance

Key Decision: **5277**

Purpose of Report

1. This report seeks to consider and approve the business (or operating) plans for the Council's wholly owned trading companies, Housing Gateway ltd (HGL) and Lee Valley Heat Network Operating Company ltd (trading as Energetik). The business plans are reviewed annually for approval.

2. This report also seeks to provide strategic direction to the Directors of Energetik – the Council's wholly owned subsidiary energy company – to facilitate continued growth of the company through extending their networks to new customers. It proposes to commence a medium-term strategic review of Energetik, with the aim of supporting the business to consolidate and grow in the long term. This report will be supported by further reports on specific options and funding later in the year, which will approve the final form of any proposed expansions.

Proposal(s)

3. To approve the updated Business Plan of HGL for the period 2021-24.

4. To note and supports the updated Operating Plan of Energetik for the period 2020-23.

5. To note the ongoing discussions between Energetik and LB Haringey and LB Hackney to supply heat to residents of other north London boroughs, as included in the Energetik operating plan.

6. To note the potential in-borough expansions proposed by Energetik, which are currently under consideration by officers as part of a wider strategic review on the future direction of the company.

Reason for Proposal(s)

7. The Council as sole shareholder of HGL reviews and approves the business plan annually. The proposal for the company this year represents a continuation of business plans and models approved in previous years.

8. Energetik operates a two-tiered planning structure. The company works towards its 40-year business plan, the most recent update to which was approved by Cabinet in September 2019. This is supported by a rolling three-year Operating Plan, which sets out the key deliverables required over the next three years to achieve the overarching business plan.

9. Energetik's Operating Plan does not require the Council's approval as shareholder, however it is reported to Cabinet in the interests of transparency and good relationships between the shareholder and the company, and in order to enable Cabinet to effectively conduct its role of overseeing the forward strategic direction of the company.

Relevance to the Council Plan

10. Good Homes in Well Connected Neighbourhoods. Our ambition is to massively increase housing supply is an opportunity for us to develop homes and neighbourhoods for people on different incomes, which help people of all ages live healthier and more environmentally sustainable lives.

11. This decision is also important to our commitment to Climate Action, as once the Energetik network is connected to the Energy from Waste facility, it will lead to a measurable reduction in carbon emissions arising from heating and hot water in resident homes.

Background

12. In early 2019, the Council's trading companies refreshed their business plans. The companies produced plans covering the period 2019-22. The exception to this was Energetik, which operates a two-tier planning system, with an overarching 40-year business plan supported by a three-year operating plan. Energetik refreshed its business plan for the Tranche 2 funding decision in September 2019 and updates its operating plan to a three-year forward view each year.

13. The companies have now been requested to provide a rolling update on an annual basis. This will consist of updated financial projections and strategic action plans, updates if relevant to performance measures and other related analysis (e.g. market and customer analysis for HGL).

14. A full refresh of the business plan including market and other analysis will be conducted for approval at the end of the original period of the business plan, i.e. March 2022.

15. Energetik was incorporated as a private company in 2015 as a two-tier holding company and operating company. The holding company has now been wound up and the Council is now the sole shareholder of Lee Valley Heat Network Operating Company Ltd, with Energetik as the company's trading name.

16. The company's overarching business plan includes a presumption that the company will seek to expand over the long term.

17. As of 31 December 2020, Energetik has 587 connected properties and 472 customers, and is expected to have approximately 4900 customers by March 2027. Energetik has a positive track record of customer service, with on average 85% of calls answered within 20 seconds during the first half of 2020-21, and only 2.5 total hours of heating interruptions across all sites in the same time period.

18. The current number of connections is ahead of the business plan targets, which state that 363 connections to be achieved by 31st March 2021.

Main Considerations for the Council

Housing Gateway ltd

<u>Strategic Objectives</u>

19. HGL's proposed strategic objectives are stated as follows:

    a. Deliver demonstrably, good quality housing for residents through a variety of products suitable for residents on low to median income levels. Deliver increased housing supply to the Council with at least an additional 300 units by 2024.

    b. Deliver savings to the Council of £1.5m pa, contributing to the Council's financial pressures arising from the shortfall in the provision of temporary accommodation. Ensure a suitable financing structure for the company.

    c. Either return 50% of post-tax profits to the Shareholder each year in the form of a dividend providing the Council with an additional cash injection or invest in additional housing to meet housing needs.

    d. Develop the ethical estate agency, Enfield Let, providing an excellent service for tenants and landlords alike. In doing so providing significant cost savings to the Council and reduction in the use of temporary accommodation. Establishing a portfolio of 730 units by year 3.

20. These are assessed to be in line with previously approved business plans and decisions, and effectively aligned to the Council's corporate plan

objectives and will provide a good contribution towards and help to improve the overall housing offer for residents.

Key business targets

21. HGL's key strategic target for the core portfolio is to expand by 300 properties by March 2024. It should be noted that this is subsequent to a previous target to achieve 250 properties by March 2022, which is currently unlikely to be delivered. While the company believes the expansion target stated in the presented business plan is achievable, the lack of expansion achieved in light of previous targets indicates that there is a substantial risk of the target not being achieved. This would not affect the financial viability of the company; however, it would mean that less families would be assisted than envisioned.

22. Enfield Lets has a target of 490 properties by October 2020, which would represent the first year of operation. 400 of these are transfers from existing schemes over to Enfield Lets, and 90 would be new acquisitions from the private sector.

Finances

23. Revised projections have been produced for the forward plan based on progress within 2020-21, using year-end 2020-21 projections as at the end of December 2020.

24. The overall projections include Enfield Lets. However, for in-year monitoring purposes, Enfield Lets is treated as a distinct business unit with its own monitoring. This is to ensure that the business case for Enfield Lets as presented to Cabinet in June 2020 is achieved.

25. The figures indicate reduced profits compared to the previous year's update, though the figures are still an improved position on the 2019 business plan. While it is unlikely a dividend could be taken, the company will continue to provide temporary accommodation savings, and the projected profits provide assurance over the continuing financial viability of the company.

26. The company projects – at the time of preparing this report – to end 2020-21 with a pre-tax profit of £987,000. In future years, the company projects pre-tax profits over £1.3m, £2.4m and £2.98m. It should be noted that this will depend on the success of Enfield Lets, which will be individually monitored as per paragraph 34.

27. For further detailed financial data, please refer to confidential appendix A.

Energetik

Operating Plan key tasks

28. The operating plan notes that the construction of the Meridian Water energy centre, which will serve phase one of the Meridian Water development, has been delayed, now commencing in February 2021 as opposed to October 2020. This is due to ensuring the full discharge of planning conditions prior to construction.

29. Further key tasks for the year include continuing negotiations with North Middlesex Hospital and Haringey for potential supply; and pilot projects for retrofits, i.e. exploring the feasibility of connecting already built houses to the networks, as opposed to solely new developments. These are small level projects to identify the feasibility, challenges and costs of a potential wider rollout. It is important to note that the current overarching business plan does assume any level of retrofitting in order to be viable. The projects will also utilise a combination of external funding and previously earmarked monies, thereby not incurring any new or unplanned expenditure from loan funding.

<u>Finances</u>

30. At the time of preparing this report, Energetik projects a profit before tax of £68,000, with a final result of (£508,000) after interest payments are accounted for. This is an improvement over the year's budget of approximately £125,000. The budget for 2021-22 indicates a final result of £126,000 profit, due to the projected receipt of connection fees. If achieved this would provide For more detailed financial data and projections, please see confidential appendix Bii.

Expansion of Energetik's network

31. Potential expansion of Energetik' s network to more customers is referenced as a long-term consideration within the 40-year business plan. Expanding the company will reduce the borough's carbon impact and provide better – quicker and less risky – returns to the Council as shareholder. However, these benefits increase the council's total financial investment in Energetik and given the Council's fiscal policies, reduces the Council's ability to invest in other council priorities.

<u>Current Opportunities</u>

32. The company has proposed development customers which would entail extending the network from the Meridian Water development northwards and westwards across the borough. There are two proposed expansions:
    a. The 'green line' expansion – extending from Meridian Water north along the east corridor of the borough to Ponders and Southbury, connecting to significant proposed developments at Edmonton Green and Southbury, with the potential to extend west from Southbury to the Civic Centre. This line could be expected to bring around 3200-3500 further connections initially.
    b. The 'yellow line' expansion – This would extend across the south of the borough, from the proposed Joyce & Snells development to Arnos Grove Ladderswood development, and to Southgate Village. This proposal currently does not link to any major new proposed

developments, although it would provide future capacity. It is proposed by the company that it would be funded through a HNIP application for a £17m grant, and £8m low cost loans. However, should the HNIP application be unsuccessful, then it would be proposed that the yellow line not be taken forward.

33. The expansions would reduce the company's reliance on Meridian Water and Joyce and Snells to deliver net profits, thereby making it more likely that net profitability will be achieved.

34. The outline comparison of the expansions to the current business case are summarised in the table below:

Metric	Current business case	Scenario 1 – Green line extension	Scenario 2 – Green line + Yellow line
No. of connections	Ca. 15,000	Ca. 18,500 (+23.33%)	Ca. 18,500 (+23.33%)
Additional Funding Requirement above current approval	N/A	£25m	£26m plus £6m HNIP loan = £32m (plus £17 million grant from HNIP)
Retained earnings in Energetik	£39 million	£74 million (+ 89.74%)	£74 million (+ 89.74%)
Full LBE loan repayment	2055	2050	2049
Net profitable	2034	2027	2027
IRR	5.32%	5.53%	5.3%
Carbon savings – trees planted equivalent	522,337	694,640	758,540
Nitrous Oxide savings – cars off road equivalent	75,491	99,281	119,934
Additional Jobs	Small number	121	

Strategic Review

35. The company has performed well to date on its objectives. The current opportunity provides an effective moment to undertake a wider review of the Council's long-term strategy towards Energetik; the Council's situation having developed significantly since the previous investment decisions, it

is prudent for the Council to consider how to sustain this performance over the medium term to and return on the council's financial investment, and how best to maximise the environmental benefits of the heat network in the context of the changing nature of energy policy, the growing and more operational nature of the company, and the potential for further investment in the future. Further, CIPFA are currently consulting on changes to the the Prudential Code for Capital Finance in Local Authorities; due to be finalised towards the end of year for 2021/22 implementation. Local authorities are required to 'have regard' to the Prudential Code when developing their capital investment plans.

36. It is proposed to undertake a strategic review of ownership options for Energetik, considering the following.

- Government policy support for low carbon district energy networks.
- Technical skills and experience needed to sustain the company.
- Scenarios for growing Energetik' s customer base beyond the approved business plan.
- Options for enabling further financial investment to enable future growth. These could include but are not limited to: partnerships with other public or private organisations, debt refinancing, splitting the pipe and the customer businesses, or sale of the company.
- Timing of any change to Council governance or ownership.
- The Councils total risk exposure, and the combined financial and social return projected to be achieved.

37. The review will be led by senior officers, with input from Energetik Directors in a supporting role. Central government departments BEIS and DIT are currently engaged in encouraging investment into UK heat networks and have offered to work with the Council to identify options and to test the market for partners or other forms of investment specifically for the extension proposals. This will assist officers in identifying a wider range of options, in particular options which may not require the Council (or potentially the company) to borrow to fund future growth.

38. The Cabinet Member for Finance and Procurement will be informed of the review's progress and will bring the outcome to Cabinet for any decisions arising.

Safeguarding Implications

39. There are no safeguarding implications

Public Health Implications

40. Potential expansions to Energetik's network serve to improve air quality to the extent of approximately 14,500kg reduction in Nitrous Oxide over 40 years. This will assist in providing better public health for Enfield residents.

41. Housing Gateway properties enable the Council to provide stable housing to families in need, and to provide the best quality temporary

accommodation for homeless families, assisting both physical and mental health.

Equalities Impact of the Proposal

42. There are assessed to be no equalities impacts to the proposal.

Environmental and Climate Change Considerations

43. The proposed expansion to Energetik's network is projected to provide the following environmental benefits:

    a. 33% increase in Carbon emission savings (equivalent to 172,000 trees planted)
    b. 31% increase in Nitrous Oxide emissions (equivalent to 24,000 cars removed from road)

44. This is in addition to the delivery of the existing business plan, which would provide a baseline reduction of 261,169 tonnes of carbon dioxide and 52,000kg nitrous oxide.

45. There is also potential to expand this if retrofit pilots identify that retrofitting can be rolled out effectively at a larger level, or if negotiations with North Middlesex Hospital are successful.

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

46. If the business plans of subsidiary companies are not approved or challenged, then the companies may drift from the Council's strategic aims, resulting in the Council failing to achieve value from its significant investments in both HGL and Energetik. They may also overspend or spend on activities not approved by the Council, leading to the Council being placed at higher risk of financial loss through company failure. The Council's total exposure is currently circa £130m, therefore this would be a substantially high impact risk. Regular update and Cabinet consideration of business plans helps to reduce the likelihood of risk occurrence.

47. If a strategic review is not undertaken, the following risks will apply:

    - The Council will continue to see pressure from the company and its customers to support growth through financial investment and the incurring of borrowing – this will conflict with other priorities the Council has.
    - Without succession and resilience planning there is a risk the company will lose key staff and skills, with the impact that the Council will not be in a position to realise the financial and social returns as shareholder and may experience financial loss.
    - The company may drift from the Council's overall strategic goals and objectives, rendering the long-term benefits achieved (either financial or social) less valuable to the Council as shareholder.

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

48. An overriding general risk for all companies is that financial and performance targets may not be met, or key actions to deliver strategic objectives may not be delivered. This is managed through regular Shareholder reporting, which covers four elements of financial performance, return on investment, service performance and key actions for the year. These will be reported quarterly by all companies to the Council's Commercial Board for challenge and agreement of any remedial actions required.

49. There is a risk that in-year developments render HGL's business plan unviable or cause it to require revision. Under agreed reserved matters, the company has clear delegated authority and can make changes up to agreed financial levels or on agreed types of tasks. Any changes outside these limits would be brought back to Cabinet to ensure they remain in line with the Council's strategic objectives for the company.

50. HGL could find portfolio expansion difficult due to market conditions and the viability limits on potential purchases. This has been addressed in part in previous years, with a £5m equity input into the company by the Council, which has increased the number of viable properties as repayment will not need to be taken into account. As per the main considerations, the number of expanded properties is also not essential for the financial viability of the business, though failure to achieve it would limit the assistance that can be provided to residents of the borough in need of housing.

51. There is also a risk of a significant cash tax liability for HGL in the coming year. Due to coronavirus pandemic, a substantial amount of value was lost from the company's profit due to falling property values. Should that value return, as expected, then the reverse will occur; a substantial and unusually high profit will be recorded. This profit will be value, not cash, but it may cause a substantial corporation tax liability; this could be a risk due to the narrow cash flow margins under which the company operates. The shareholder function carries out regular monitoring exercises which should identify any issues, and will work with the company should a cash flow issue arise, to identify and implement a solution.

52. Delays or revisions to Meridian Water could affect the progress of Energetik. The company has commenced work on constructing its Energy Centre to serve Meridian Water in February 2021. Delays to the continuation of Meridian Water could affect connections and therefore profit over the next few years for Energetik. The proposed expansions would work to reduce the reliance on Meridian Water and spread risk over a wider range of developments. The key activities action plan for 2021-22 also includes action entries working to continue exploring opportunities to de-risk the development reliance, including the feasibility of retrofits.

Financial Implications

53. The amounts included in the Energetik and HGL Business Plans are included in the Council's 10 year Capital Programme 2021/22 to 2030/31.

54. HGL – The HGL Business Plan covers the 3 year period 2021/22 to 2024/25 period. The Council's Capital programme for the same period has a capital budget allocation of £93.8m (£56.8m new approval in addition to the existing £37.0m existing allocation but will exclude any 2020/21 unspent budgets rolled forward to 2021/22 onwards).

55. Energetik – The Energetik Business Plan identifies expansion opportunities for the company which could be part funded through grant and low cost loans from the Government's Heat Network Investment Project (HNIP).This is estimated at circa £49m. The Council's 10 year Programme has built in additional funding of £32m met by borrowing. This will need to be subject to a business plan review and a future Cabinet decision.

56. The continued growth of HGL is part of the Council's Housing Strategy to reduce reliance on temporary accommodation which will have a positive impact on the Council's overall revenue budget.

57. The Council lends to these Companies who repay this debt; the expected interest payments reduce the Council's overall interest charges to the General Fund, the forecast interest payments are set out below and included in the Ten Year Treasury Strategy:

	Forecast interest 2020-21 £m	Forecast interest 2021-22 £m	Forecast interest 2022-23 £m	Forecast interest 2023-24 £m
Companies	4,240	4,898	5,315	5,961

Legal Implications

58. 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.

59. The Council has various legal and fiduciary duties in relation to the budget. The Council is required by the Local Government Finance Act 1992 to make specific estimates of gross revenue expenditure and anticipated income leading to the setting of the overall budget. The Local Government Act 2003 entitles local authorities to borrow and invest as long as their capital spending plans are affordable, prudent and sustainable.

60. The 2003 Act requires the Chief Finance Officer to report to Council as part of the budget process on the robustness of the estimates of borrowing, investment and spending and the adequacy of the proposed financial reserves taking into account the affordability, prudency, sustainability, value for money, stewardship of assets, service objectives and practicality requirements as provided by the CIPFA's Prudential Code of Capital Finance in Local Authorities concerning borrowing and investment.

61. Members are obliged to take into account all relevant considerations and disregard all irrelevant considerations in seeking to ensure that the Council acts lawfully in adopting a budget. The Council must set and maintain a balanced budget and must take steps to deal with any projected overspends and identify savings or other measures to bring budget pressures under control. Members should note that where a service is provided pursuant to a statutory duty, the Council cannot fail to discharge its duty properly. Members have a fiduciary duty to the Council Taxpayer for whom they effectively act as trustee of the Council's resources and to ensure proper custodianship of the Council's resources.

62. In its dealings with the companies, the Council must be mindful of its different roles, and understand the parameters and responsibilities of each. In relation to both HGL and Energetik, the Council has the following roles: shareholder, strategic client, lender/funder and provider of services.

63. When supporting the companies, the Council must also be mindful of the rules with regard to state aid – and, as of 1 January, the new subsidy control regime applicable in the UK - and should seek legal and financial advice on a regular basis. The EU state aid rules continue to apply to any aid awarded by the Council to the companies before 1 January 2021, but the grant of any 'subsidy' after that date must be assessed against the new regime.

Workforce Implications

64. There are no workforce implications.

Property Implications

65. There are no property implications.

Other Implications

66. There are no other implications.

Options Considered

67. For HGL, the first alternative is to do nothing and allow the companies to continue with their existing business plans covering the period 2020-23. This would create a risk that the business plan would not take into account in-year developments (most notably the changes to the schedule for the lettings agency properties) which have a significant impact on the

business plan. Continuing to measure the company's performance based on the content of the existing business plan would not provide accurate or useful interpretation of the company's success or otherwise in meeting the objectives set for them by the shareholder, and therefore the shareholder would not be able to make effective strategic decisions on the company, of effectively challenge the company if required. For these reasons this option is not recommended.

68. Another alternative would be a complete refresh of the entire business plan. Such an exercise was carried out in early 2019, and there is no reason to consider that a further exercise would reveal any significant change in any of the background analyses that were conducted by the company to inform the previous business plan, and this is not therefore recommended as it is not assessed to be an effective use of resources. Generally, a full refresh would be undertaken every three to five years, meaning that a refresh would be due from March 2022.

69. A final alternative for HGL would be for Cabinet to reject the business plan and request a revision. This would be an appropriate option if the business plan did not reflect the Council's objectives for HGL, or if the Council wished on reflection to change its objectives for HGL.

70. In regard to Energetik's Operating Plan, the shareholder does not approve the Operating Plan being presented, therefore formally there is no alternative. However, it is essential for the success of the company that a collaborative relationship is maintained between the company and the shareholder. As such, should Cabinet have concerns on the content of the Operating Plan, officers would work with the company to address those concerns and provide further assurances to Cabinet that the Council's priorities were reflected in the company operating plan.

Conclusions

71. The company business plans presented are in general a continuation of existing approved activities, and it is therefore recommended they be approved.

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19 February 2021

Appendices
Appendix A – Draft HGL Business Plan 2021-24
Appendix Bi – Draft Energetik Operating Plan 2021-22
Appendix Bii – Draft Energetik budget 2021-22

Background Papers
The following documents have been relied on in the preparation of this report: