London Borough of Enfield

General Purposes Committee

22 April 2021

Subject: Local Authority Trading Company update
Cabinet Member: Cllr Maguire
Executive Director: Jeremy Chambers – Director of Law & Governance

Key Decision: N/A

Purpose of Report

1. To update the General Purposes Committee on the performance, governance and key risks of Enfield's subsidiary trading companies.

Proposal(s)

2. To note the progress in regard to governance and performance review of the Council's trading companies.

Reason for Proposal(s)

3. The Committee has received biennial updates on progress and this report continues that commitment. This update is for transparency and to ensure appropriate scrutiny of the Council's risks as a shareholder; there is no specific decision to be made.

Relevance to the Council Plan

4. The Council's trading companies deliver key priorities for the borough. Housing Gateway provides both temporary accommodation and stable affordable housing for residents and families in need of housing provision. Energetik provides low carbon heat through a district heat network and seeks to offer low prices to customers comparative to the market.

Background

5. The Council has three active trading companies: Energetik (trading name of Lee Valley Heat Network Operating Company ltd), Housing Gateway ltd, and Montagu LLP (full company name Montagu 406 Regeneration LLP).

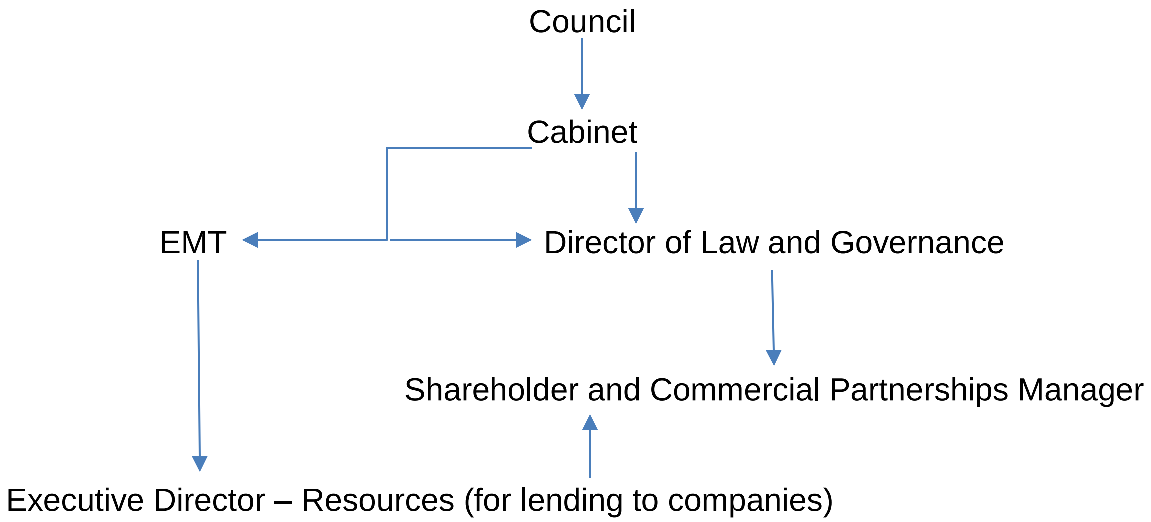
6. The following companies are inactive, and officers are in the process of winding the companies up or divesting the Council's interest: Independence and Wellbeing ltd (100% owned), Enfield Innovations ltd (100% owned), Enfotec (100% owned), and Enfield Norse (40% owned).

7. The following companies were dissolved in the year 2020-21: Red Lion Homes (25% owned), Lee Valley Heat Network ltd (100% owned – the former holding company for Energetik).

Main Considerations for the Council

<u>Governance of the Trading Companies</u>

8. The governance of the Council's trading companies has undergone significant change since the previous report to the former Audit and Risk Committee, via both officer initiative and a series of internal and external reviews of both general governance and specific companies. The general structure for governance is as follows:



9. Exercise of the Council's powers as shareholder of its companies is performed in accordance with the Council's scheme of delegation, with the Director of Law and Governance as the relevant Director. Decisions relating to lending or otherwise funding of companies fall within the remit of the Executive Director – Resources. Further, the Council maintains client relationships with companies in respect of services the companies provide to or affecting the Council, which are managed within the relevant service area.

10. A list of Reserved Matters is also maintained with wholly owned companies, within a Shareholder Agreement, which cover matters of company business which require shareholder approval before being enacted. While the Council does have a general power within company constitutions, allowing the Council to instruct Directors to take, or not take, any particular action, the Reserved Matters ensures that certain key strategic decisions must be referred to the Council for approval before being taken. This enables the Council to ensure that such decisions are in accordance with the Council's priorities and strategy, and that the companies remain in close strategic alignment with the Council.

11. In respect of exercising its general and Reserved powers, it is important the Council is mindful of the legal duties conferred on Directors by the Companies Act 2006.

12. The equivalent decisions within the Montagu joint venture are governed by a series of agreements with the Council's partner, Henry Boot developments, principally the Members Agreement, Development Agreement and Land Agreement. However, officers have identified scope to improve these arrangements by agreeing underlying agreed operating procedures with Henry Boot and will look to strengthen this area in the coming year.

13. Regular annual reporting is undertaken to Cabinet on both company business plans and accounts & performance. The business plan report is taken in March of each year, and includes refreshed financial and service projections, and key actions for the year. The full business plan, including all market and other analyses, is required to be updated every three years; the next full update is due in March 2022.

14. The annual accounts and performance are reported to Cabinet in September – November each year, depending on the completion of audits. This report links the financial and performance and delivery of key actions back to the business plan, and reports on the extent to which the business plan for the year was achieved. This is supported by quarterly in-year reporting to the officer Commercial Board.

15. The oversight and governance of the Council's loans to companies lies with Finance and Treasury services, with appropriate support from the Shareholder function as needed. Clear repayment schedules are in place and monitored on a regular basis. The draw down structure of loans enables the Council to manage its risk exposure on an ongoing basis, with regular approval required before each loan instalment is released by the Council. Part of the approval process covers ensuring the relevant company is up to date with repayments.

16. Companies are also subject to regular internal and external audit review, both on company operations, and from the perspective of the Council's governance of its companies. A strategic risk register from the Council's perspective as shareholder is maintained and reported to every other meeting of the officer Assurance Board.

Subsidy Control

17. Previously, the Council has been required to adhere to the State Aid regulations as determined by EU Directives when investing in its subsidiary companies. From 1st January 2021 these have ceased to apply as a result of Brexit.

18. The UK government has indicated its intention to replace State Aid regulation with a system known as Subsidy Control. A draft proposal for the system has recently finished consultation on 31st March 2021.

19. The draft proposals show that the UK government intends to follow a principles-based approach to allowing public bodies to invest in their subsidiary companies. This has the potential to allow the Council to be more flexible in its approach towards companies compared to the hard regulation of

State Aid, however it will be difficult to identify specific implications until Subsidy Control proposals are finalised and guidance published.

20. Officers intend to commission a full external review of all company operations and financing against the Subsidy Control regulations, once the final regulations and guidance are available.

Performance of the Trading Companies

21. Performance of the remaining companies has been promising since the previous report. Energetik continues to deliver improved financial and service results against its business plan from year to year. A first operating profit was delivered in 2019-20, and indicative accounting figures for 2020-21 show the company delivering a profit before interest and tax. The company further projects in its 2021-22 budget that it will deliver a first net profit; if achieved, this would be five years ahead of schedule within the business plan.

22. Energetik has also delivered ahead of schedule on connections with circa 600 connection achieved by 31st March 2021; this places the company one year ahead of schedule on its business plan connection projections.

23. Housing Gateway has delivered better than projected financial results every year of its business life, with one exception; due to the Covid-19 pandemic and its initial effects on the property market in March 2020, the company's 2019-20 accounts included a £9m down valuing of its portfolio, causing a substantial accounting loss (it is important to note that this was not a cash loss and did not affect the operations of the business). Had the pandemic not occurred and no down valuation been recorded, the company would have overperformed against its projections again. Officers expect the value to be added back to the portfolio over the next couple of years accounts.

24. Housing Gateway provides LHA rental rate housing and temporary accommodation through a Nominations Agreement with the Council. This provides additional housing supply and lower cost temporary accommodation to the Council, delivering a current in-year revenue saving of £2m. Over the course of the business life, the savings enabled by the company equate to an estimated financial return of 6-7%. In addition to this, over 700 families have been assisted with stable housing or better-quality temporary accommodation, which would not otherwise have been possible.

25. Montagu LLP is yet to undertake any substantive operational business, therefore there are no performance considerations to report at this time. It has filed dormant accounts for all previous years since inception as it has undertaken no transactions.

Strategic risks for the Council

26. The Council has a number of strategic risks in relation to companies, which are detailed below. This section of the report focuses on the key high risks likely to be relevant over the coming two to three years, or in some cases beyond.

Financial exposure

27. The Council's active companies operate in areas which require significant capital investment up front; heat networks, property lettings, and regeneration. This means that the in the event of a company failure, the Council would be substantially exposed. The Council currently has around £115m loans to Housing Gateway and £14m loans to Energetik, with further facilities approved for Energetik up to a total of £45m. In addition, the ten-year capital programme includes allocations of £43.5m to Montagu LLP and a further £32m for Energetik, though the expenditure of these allocations will be subject to further consideration and approval. There is also an allocation of £94m over the coming three years for HGL, although the use of this will depend on the extent of viable properties available in Enfield.

28. The key mitigation for the Council, therefore, is to minimise the likelihood of company failure. This is carried through regular monitoring, through cautious assumptions within business plans, and through extensive review of the financial aspects of projects proposed by the companies; this includes external due diligence, scenario planning and stress testing.

29. Specifically in regard to Energetik, the Council will review its long-term strategic plan for the company. In order to reach its full potential and deliver the maximum possible environmental benefits, the company will need to grow its network, which will require regular investment; this is unlikely to be within the Council's risk appetite to undertake and would carry substantive opportunity costs. Therefore, work will be undertaken in collaboration with external expertise in order to identify potential mechanisms to encourage external investment in the company in the future.

Enfield Lets

30. Enfield Lets is a new business unit of Housing Gateway, approved under the company's business plan submitted in June 2020. Enfield Lets sees Housing Gateway acting as a managing agent for lettings for the first time in its life.

31. While there is considerable potential financial upside to the project, it also rests on the assumption that the company can attract sufficient new interest from the private lettings sector to provide a profitable scale. Initial results are promising. In the first year to October 2021, the company requires 70 properties; at 23rd March 2021, 18 properties had completed transferral to Gateway's management and an average of 2 new properties signed up per week was being achieved. The company projects to have 130 properties acquired by October 2021.

32. While this indicates good progress, it will be important to continue monitoring these sign ups throughout and beyond the first year, as it is a critical success factor for the project.

Montagu LLP business plan assumptions

33. The business case financial projections for the regeneration project to be undertaken by Montagu LLP were last approved in January 2020. Given the substantial fluctuations in property markets and general significant developments since that time, it is possible that the assumptions made are no longer relevant. These will be reviewed in collaboration with Finance and Property over the coming year, and the business case will be updated for Cabinet approval, by the latest in March 2022.

Montagu day to day operations governance

34. While the strategic governance arrangements with the Council's partner in Montagu LLP, Henry Boot, have been in place for some time via the suite of agreements mentioned above, the day-to-day operating arrangements of the company have not been documented. Previously this has not been a risk as the company has primarily formed a vehicle for strategic discussion and has not actually undertaken any business. However, over the coming year it will commence delivery of actual tasks, and as such the operational procedures and decision-making structure will need to be agreed between the partners. This is a key task for the coming year, to mitigate the risk of ineffective operation of the company, or lack of adequate Council input and influence over decisions.

Safeguarding Implications

35. There are no safeguarding implications.

Public Health Implications

36. There are no direct implications, however Energetik in particular contributes to public health through the improvement of air quality, as its heat sources will result in substantially lower nitrous oxide emissions than traditional energy provision.

Equalities Impact of the Proposal

37. There is no decision and therefore no equalities impact.

Environmental and Climate Change Considerations

38. Energetik's current business plan projects emission savings for carbon dioxide (261,169 tonnes) and nitrous oxide (52,000kg), over the 40-year life of the business plan. This is equivalent to the planting of 522,337 trees (CO_2), and 75,491 cars removed from the road (NOx).

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

39. While there is no specific decision requiring approval within this report, if the system of governance and oversight of which this report forms a part is not adequately maintained, there is a risk that companies may fail, exposing the Council to substantial financial loss, or the companies may drift from the

Council's strategic vision, resulting in a failure to deliver defined and measurable benefit to the Council and residents of the borough.

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

40. There are no specific risks arising as a result of this report. The overarching strategic risks of the trading companies are detailed above.

Financial Implications

41. There are no specific financial implications as there is no decision. In regard to company financing generally, the Council currently has a total of approximately £129m invested in its companies, with a further £30m approved investment in Energetik. The ten-year capital programme also includes further allocations of £43.5m for Montagu LLP, £94m for HGL, and £32m for Energetik. HGL's provision of temporary accommodation and low-cost housing saves the Council circa £2m per year from the revenue budget.

Legal Implications

42. 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, under sections 1(4) and 4 of such Act, 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.

43. Further statutory powers exist to enable the Council to establish and invest in its companies, and Section 1 of the Local Government Act 2003 permits the Council to borrow and lend (subject to complying with the Prudential Code for Finance in Local Authorities).

44. In its dealings with the companies, the Council must be mindful of its different roles - shareholder, strategic client, lender/funder and provider of services - and understand the parameters and responsibilities of each. It must also take any decisions in relation to its companies with proper regard to its fiduciary duty to act prudently with public monies.

45. As flagged at paragraphs 17-20 above, there is a new Subsidy Control regime applicable in the UK and the Council should seek legal and financial advice to ensure continued compliance. 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.

46. When taking any actions in its role as shareholder, the Council must comply with the requirements of the Companies Act 2006, and the requirements contained in the Articles of Association of each company.

Workforce Implications

47. There are no workforce implications.

Property Implications

48. There are no property implications

Other Implications

49. There are no other implications.

Options Considered

50. There is no decision being made, therefore there are no other options to consider. The Committee could determine not to receive updates on trading company performance, governance and risk; however, to report updates is considered effective governance and important for oversight, scrutiny and transparency, therefore this would not be recommended.

Conclusions

51. Over the last two years since the previous update, officers have sought to improve the governance of trading companies, and review the benefits achieved from each company. As a result, three remain. Two wholly companies perform well year-to-year and provide substantial current or projected benefit to the Council. The joint venture covering the Montagu industrial site will undergo substantive review and oversight over the coming year as the project progresses towards the commencement of construction.

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Appendices

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