Subject: Equinox Enterprises Ltd – Financing

Report to: ELT – 6 July 2022

Policy and Resources Committee – 12 July 2022

Council – 21 July 2022

Report by: Finance Director and S151 Officer

Subject Matter/Recommendations:

This report asks Members to recommend financing to the wholly owned company trading as Equinox Enterprise Limited (EEL) and makes recommendations for a financing facility of up to £10m to be available for the company, to fulfil the new build housing development of Eastwood Phase 2, which is reported to Members separately on the agenda.

Recommendations:

That Committee:

(1) **Recommend to Council** approval of the financing for Equinox Enterprises Ltd of up to £10m (from a £7.5m revenue loan facility and £2.5m equity/share capital). The equity share capital £2.5m will need be added to the capital programme following this approval to be funded by borrowing.

(2) **Recommend to Council** that the Investment Strategy 2022/23 (updated July 2022) at Appendix A be approved (updated in line with the financing requirements approval for this report).

(3) Delegate the drawdown of the financing facility to the S151 Officer.

1. INTRODUCTION / BACKGROUND

1.1. Council approved the establishment of Equinox Enterprises Limited (EEL) in 2016 to enable the council to take a more commercial approach to developing new homes. EEL have completed Phase 1 Eastwood with a build of 50 market homes for private sale and 6 affordable rented homes purchased by Great Yarmouth borough Council.

1.2. The report included separately on the agenda provides details on Eastwood Phase 2. This report is recommending a medium-term loan facility (over 3 years) from the Council to enable EEL to deliver the development of Eastwood phase 2 (through a mixture of loan and equity in the company).

2. FINANCIAL IMPLICATIONS

2.1. As the shareholder for EEL, the Council has previously provided financing to the company in the form of debt (via a loan facility and equity at a debt-to-equity ratio of 75:25). EEL has identified a total funding requirement for Eastwood phase 2 of up to £10 million, which in the current proposed ratio of debt to equity would equate to loans to EEL of £7.5 million and equity/share capital of £2.5 million.

2.2. The report is therefore recommending the total financing of EEL be made up of £7.5 million loan facility and £2.5million equity/share capital, the timing of the drawdown of the loan and equity would be in consultation with the S151 Officer.

2.3. The Council do not need to account for the loan facility as a capital investment as it is only provided on a medium-term basis to finance the cashflow of the company. The equity/share capital in EEL is treated as a capital expenditure, The capital expenditure will be financed by borrowing.

2.4. Where local authorities finance capital expenditure by borrowing, they are required to make an annual charge to the revenue account for future repayment of the debt (minimum Revenue Provision). In 2021 the government consulted on changes to the application of MRP, following concern that local authorities have not been making prudent revenue provision specifically around the provision capital loans. The assumptions of the financial impact to the council of the provision of loans to EEL has taken a prudent approach and therefore does make an allowance for an MRP charge. Should there be any changes following the outcome of the consultation the impact will be considered as part of the wider capital programme planning.

2.5. The loan facility will be a medium-term facility and on a repayment of principal and interest basis for a period of up to 3 years. Over the lifetime of the loan the MRP charge within the Council's general fund will be mitigated by the interest received from EEL for the borrowing facility.

2.6. The investment strategy for 2022/23 approved by Council in February 2022 set approved limits for the Councils subsidiaries (EEL and Equinox Property Holdings, EPH) of loans of up to £5.5m and £4m for shares equity for both its subsidiaries. However, this is not sufficient to cover the increase in borrowing being requested as part of this report for EEL and following the approval of increased financing for EPH at Council on the 23rd June 2022. Therefore the 2022/23 investment strategy has been updated to account for the change in the financing requirements for EEL & EPH, including increasing the limits for 2022/23 to £10.5m for loans and £6m for share capital for the subsidiaries. The updated strategy for approval is provided at Appendix A of this report.

2.7. The Council, in providing this financing of the company, is setting EEL a target of at least 2% return on investment (RoI) from the delivery of the East Wood Phase 2 project in line with the EEL report provided as part of this committee agenda. The Council expects EEL to strive to achieve higher than the 2% RoI but is included to ensure that the overall performance of the company can be assessed on the project completion.

3. RISK IMPLICATIONS

3.1. Risk of non-payment of interest and loan repayments. This is mitigated by the Council's equity within EEL, 100% owned by the Council.

3.2. Impact of changes to the MRP requirements – the outcome of the consultation will be monitored and if changes are required to the Council's MRP policy these will be updated accordingly, in the meantime a prudent approach has been taken in respect of allowing for MRP.

3.3. The financial stability of the company will continue to be monitored including the ability to repay the loan and proactive action will be taken as required to mitigate the financial implications to the Council.

4. CONCLUSIONS

4.1. To enable EEL to complete Eastwood Phase 2 a loan financing facility and share purchase is required. Approval from Council is therefore being sought for a total of £10m to be invested with EEL (loan facility of £7.5m and shares to be purchased of £2.5m). The drawdown of these funds by the company will be delegated to the s151 officer to administer and control. Following this the approved limits within the Investment Strategy will need to be updated.

Area for consideration Comment	Comment
Monitoring Officer Consultation	
Section 151 Officer Consultation	
Existing Council Policies See background papers	
Financial Implications Within existing budgets	
Legal Implications (including human rights)	
Risk Implications	
Equality Issues/EQIA assessment	
Details contained in strategy	
Crime & Disorder	
Every Child Matters	

Investment Strategy Statement 2022/23

(Updated July 2022)

Author	**Finance**
Version No.	**2022/23**
Updated by	**Financial Services Manager**
Date of update	**July 2022**
Description of changes to this version	**Updated for impact of increased share & loan facilities for subsidiaries approved in June & July 2022**
Document Status	**To be approved**

INVESTMENT STRATEGY 2022/23

1. INTRODUCTION

1.1 The Authority invests its money for three broad purposes:

- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as treasury management investments),
- to support local public services by lending to or buying shares in other organisations (service investments), and
- to earn investment income (known as commercial investments where this is the main purpose).

1.2 This investment strategy meets the requirements of statutory guidance issued by the government and focuses on the second and third of the above categories.

2. TREASURY MANAGEMENT INVESTMENTS

2.1 The Authority typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local authorities and central government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy. The balance of treasury management investments is expected to fluctuate during 2022/23, with an average investment of £12m anticipated for the financial year.

2.2 **Contribution**: The contribution that these investments make to the objectives of the Authority is to support effective treasury management activities.

2.3 **Further details**: Full details of the Authority's policies and its plan for 2022/23 for treasury management investments are covered in a separate document, the treasury management strategy, available here: https://www.great-yarmouth.gov.uk/policies

3. SERVICE INVESTMENT LOANS

3.1 **Contribution**: The Council lends money to its subsidiaries (Equinox Enterprises Limited and also once it is operational Equinox Property Holdings), local charities, local businesses, and local residents (in the form of home improvement loans), to support local public services and stimulate local economic growth.

3.2 The loans made to Equinox Enterprises Limited and when established Equinox Property Holdings, as the subsidiaries of the Council, form part of investment in the company to provide an initial cash injection to enable the company to become established. The purpose of Equinox Enterprises Limited is to develop housing for sale (including affordable homes) and the purpose of Equinox Property Holdings is to provide quality rental housing in the borough. This supports the Councils objective within the Corporate Plan 2020-2025 to provide a mix of attractive good quality housing for all sectors of the workforce and community that is fit for purpose for all and meet both the borough's existing and future needs.

3.3 Discretionary loans are granted to local charities and businesses, this will be following a decision by the Policy and Resources Committee and /or Council as applicable. In line with the Corporate Plan 2020-2025 these loans are granted to support the local charities and businesses that assist in improving the communities and facilities in the borough. The rates for service loans will be set at appropriate rates that reflect counterparty risks and duration.

3.4 The Council has a responsibility to address private sector housing that is in poor condition or needs adaptations to meet the needs of those with disabilities. The Council also has an objective within the Corporate Plan 2020-2025 to provide help early, when people need public health and care, to prevent avoidable problems and to help more people to help themselves as well as tackling challenges within communities. Home improvement loans help residents to redress housing issues that impact on their health. The home improvement loans are made from a recycling pot following repayment of loans made as part of prior year capital programme allocations.

3.5 **Security**: The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the Authority, upper limits on the outstanding loans to each category of borrower have been set as follows:

Table 1: Loans for service purposes in £ millions

Category of borrower	31/3/21 Actuals			**2022/23**
	Balance owing	Loss allowance	Net figure in accounts	Approved Limit
Subsidiaries: Equinox Enterprises Limited and Equinox Property Holdings	0.00	0.00	0.00	10.50
Local Charities	0.69	0.0	0.69	1.00
Local Businesses	0.00	0.00	0.00	1.00
Local Residents (Home Improvement Loans)	2.29	0.02	2.27	3.00
TOTAL	**2.98**	**0.02**	**2.96**	**15.50**

*loans, except for those to local residents, granted in 2022/23 will be subject to Council/Committee approval during the year.

3.6 Accounting standards require the Authority to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Authority's statement of accounts are shown net of this loss allowance. However, the Authority makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments. It should be noted that both the loans to local charities and local residents are equity loan agreements, so the Council obtains a share of the equity of the borrower's property as collateral. This reduces the risk of the Council not recovering the loan amount from the borrower and occasionally generates a small surplus depending on the agreement type used. On occasions where a loan to a local business would clearly meet the service objectives of the council, loans would be given on market terms. These loans will be made with due attention to the risk to the council, and the rate of interest charged on the loan will be commensurate with the security provided, the duration of the loan and the risk of default (i.e., non-repayment).

3.7 **Risk assessment**: The Authority assesses the risk of loss before entering, and whilst holding service loans by undertaking due diligence proportionate to the level of the loan being granted to mitigate as far as possible any risks of non-recovery. This will also include taking external advice as applicable, such as discussion with NP Law as part of the loan agreement process.

4. SERVICE INVESTMENTS: SHARES

4.1 **Contribution**: The Council has shares in Equinox Enterprises Limited and will have shares in Equinox Property Holdings when it is established as its subsidiaries. The Council invests in its subsidiaries to enable them to develop affordable and quality housing within the borough and with the aim of them providing a return on the investment.

4.2 **Security**: One of the risks of investing in shares is that they fall in value meaning that the initial outlay may not be recovered. In order to limit this risk, upper limits on the sum invested in each category of shares have been set as follows:

Table 2: Shares held for service purposes in £ millions

	31/3/20	Actuals		2022/23
Category of company	**Amounts invested**	**Gains or losses**	**Value in accounts**	**Approved Limit**
Equinox Enterprises Limited (Subsidiary)	2.23	0.00	2.23	5.0
Equinox Property Holdings (Subsidiary)	0.00	0.00	0.00	1.0

4.3 **Risk assessment**: The Authority assesses the risk of loss before entering into and whilst holding shares by undertaking the appropriate due diligence. As further contracts and opportunities are considered, the company's performance will inform the risk assessment.

4.4 **Liquidity**: Any new investment proposal will be considered for approval via the appropriate decision-making route in line with the council's Constitution.

4.5 **Non-specified Investments**: Shares are the only investment type that the Authority has identified that meets the definition of a non-specified investment in the government guidance. The limits above on share investments are therefore also the Authority's upper limits on non-specified investments. The Authority has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition.

5. COMMERCIAL INVESTMENTS: PROPERTY

5.1 **Contribution**: The council owns a varied portfolio of commercial properties including seafront concessions, warehouses, workshops, offices and industrial units across the borough. These form a significant element of the council's asset management plan which is available here: https://www.great-yarmouth.gov.uk/article/3222/Plans-and-performance

Table 3: Property held for investment purposes in £ millions

Property	**31/3/21 Actual**		**31/3/22 Expected**	
	Gains or (losses)	**Value in accounts**	**Gains or (losses)**	**Value in accounts**
Offices	0.00	5.70	0.20	5.90
Corporate Estates	(0.69)	39.01	0.20	39.21
Seafront Concessions	0.06	4.68	0.00	4.68
Market	(0.15)	0.42	0.00	4.68
TOTAL	**(0.78)**	**49.81**	**0.40**	**50.21**

5.2 **Security**: In accordance with government guidance, the Authority considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

5.3 A fair value assessment of the Authority's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment. Should the 2021/22 year end accounts preparation and audit process value these properties below their purchase cost, then an updated investment strategy will be presented to full council detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom.

5.4 **Risk assessment**: The Council's internal Property and Asset Management team includes members of the Royal Institution of Chartered Surveyors (MRICS) and they assess the risk of continuing to hold the current property investments. They do this in a number of ways including engaging external advisors, agents and reference to quality financial/property press when required. In doing this they assess the market that the investment is competing in, the nature and level of competition, along with expectations on how the market/customer needs will evolve over time, barriers to exit, and any ongoing investment requirements. The strategic objectives are designed to mitigate risk by:

- The Council's fundamental aim of revenue income or a capital return;

- Having a portfolio approach to avoid concentration of risk in any one property, tenant or risk type.

The Council has not invested in commercial properties outside of the borough and does not intend to make any further investment in additional commercial property with the primary purpose of generating a yield. Changes within the prudential code have imposed restrictions on the Council's ability to borrow for capital expenditure on developing or purchasing investment properties (i.e. primarily for yield) which have influenced this decision.

5.5 **Liquidity**: Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice and can take a considerable period to sell in certain market conditions. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed, the Authority do not rely on capital receipts to finance the capital programme. Any capital receipts received will be used to reduce the borrowing requirement within the financial year they are received.

6. LOAN COMMITMENTS AND FINANCIAL GUARANTEES

6.1 Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the Authority and are included here for completeness.

6.2 The Authority has committed to make up to £1.5m of loans to its subsidiary, Equinox Property Holdings but further loans could be committed with in the year to the other subsidiary, Equinox Enterprises Limited if approval is granted by the Council. The Council does not have any financial guarantees, nor does it intend to make any.

7. PROPORTIONALITY

7.1 The Authority achieves a balanced revenue budget incorporating surpluses generated from investment activity. Table 4 below shows the extent to which the expenditure planned to meet the service delivery objectives and/or the level that the Authority is dependent on achieving the expected net profit from investments over the lifecycle of the Medium-Term Financial Plan. Should it fail to achieve the expected net profit, the Authority's contingency plans for continuing to provide these services would be to undertake further review of the delivery and potential savings or to use reserves in the short-term.

Table 4: Proportionality of Investments

	2020/21 Actual	2021/22 Forecast	2022/23 Budget	2023/24 Budget	2024/25 Budget
Gross service expenditure	65.81	70.40	71.02	71.50	71.50
Investment income	2.69	2.48	2.77	2.08	2.08
Proportion	4.1%	3.5%	3.9%	2.9%	2.9%

8. BORROWING IN ADVANCE OF NEED

8.1 Government guidance is that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. The Authority would not follow this guidance if it was financial advantageous and only after undertaking due diligence to consider risks involved. Currently the Council has not borrowed in advance of need.

9. CAPACITY, SKILLS AND CULTURE

9.1 **Elected members**: Elected members are provided with annual training by our external advisors, Arlingclose. The Treasury Management Strategy and the Mid-year Treasury Management Strategy are presented to members during the financial year and should any queries arise these would be responded to by officers or advisors as applicable.

9.2 **Statutory officers**: Regular meetings are held throughout the year with our external advisors, Arlingclose. Officers working on a daily basis with investment decisions attend courses offered by both Arlingclose and CIPFA throughout the year. Arlingclose provide daily updates of changes in the market as well as providing staff with a contact for queries that arise.

9.3 **Commercial decisions**: Future decisions on historic commercial investments, including potential disposals, will be made following consideration of robust business cases for approval in line with the current decision-making governance arrangements. Future spend on historic commercial investments will be capital expenditure and will therefore also be approved as part of the capital programme. Where applicable the Council would seek to engage external professional advisors, for example financial, property and legal advice.

9.4 **Corporate governance**: The Asset Working Group is made up of both finance and, property and asset management officers, who initially consider the future of current investment commercial properties, such as disposals or additional spend required. Regular progress reports on decisions taken are also reviewed by the group.

9.5 After initial consideration business cases are completed for the disposal or improvements to property investments, including undertaking due diligence and considering risks, and these form the basis for reports presented to the Policy and Resources Committee for approval.

9.6 Other investment decisions are based on the Treasury Management Strategy, with any changes reported for approval as required to Policy and Resources Committee.

10. INVESTMENT INDICATORS

10.1 The Authority has set the following quantitative indicators to allow elected members and the public to assess the Authority's total risk exposure as a result of its investment decisions.

10.2 Total risk exposure: The first indicator shows the Authority's total exposure to potential investment losses. This includes amounts the Authority is contractually committed to lend but have yet to be drawn down and guarantees the Authority has issued over third-party loans.

Table 5: Total investment exposure in £millions

Total investment exposure	**31.03.2021 Actual**	**31.03.2022 Forecast**	**31.03.2023 Forecast**
Treasury management investments	33.65	13.00	13.00
Service investments: Loans	2.96	2.90	10.00
Service investments: Shares	2.23	2.46	5.00
Commercial investments: Property*	49.81	50.21	51.00
TOTAL INVESTMENTS	**88.65**	**68.57**	**79.00**
Commitments to lend	0.00	0.00	0.00
TOTAL EXPOSURE	**88.65**	**68.57**	**79.00**

** Through its significant asset base, the Council has invested historically in commercial property for financial gain and to support regeneration.*

10.3 **How investments are funded**: Government guidance is that these indicators should include how investments are funded. Since the Authority does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However, the following investments could be described as being funded by borrowing. The remainder of the Authority's investments are funded by usable reserves and income received in advance of expenditure.

Table 6: Investments funded by borrowing in £millions

Investments funded by borrowing	**31.03.2021 Actual**	**31.03.2022 Forecast**	**31.03.2023 Forecast**
Treasury management investments	0.00	0.00	0.00
Service investments: Loans	0.00	0.06	4.00
Service investments: Shares	2.23	2.46	5.00
Commercial investments: Property *	18.87	18.72	18.53
TOTAL FUNDED BY BORROWING	21.10	21.24	27.53

** Commercial Investments – The portfolio of commercial investment properties are historic assets which the Council owns or has an interest in for which it is not possible to quantify the level of funding by borrowing. The figures quoted relate to the investments made since 2008/09.*

10.4 **Rate of return received:** This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

Table 7: Investment rate of return (net of all costs)

Investments net rate of return	**2020/21 Actual**	**2021/22 Forecast**	**2022/23 Forecast**
Treasury management investments	0.27%	0.35%	0.44%
Service investments: Loans	6.03%	0.6%	1.33%
Service investments: Shares	N/A	10.45%	N/A
Commercial investments: Property	4.08%	3.41%	4.39%
ALL INVESTMENTS	**10.38%**	**14.80%**	**6.16%**

10.5 The treasury management investments returns above reflect the current low interest rates that are expected to continue in the short to medium term. The fall seen in the loan return in the table reflects the repayment of the £6.2m loan to Equinox Enterprises Limited during 2020/21. Equinox Enterprises Limited are expected to pay the first dividend on the Authority's shares by the end of 2021/22.

Table 8: Other investment indicators

Indicator	**2020/21 Actual**	**2021/22 Forecast**	**2022/23 Forecast**
Debt to net service expenditure ratio	4.96%	8.36%	10.04%
Commercial income to net service expenditure ratio	35.53%	33.00%	31.81%