

## Interim Report on the Restructure of the Arms Length Development Companies

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City of Edinburgh Council

20 August 2009

### 1 Purpose of report

To inform the Council on further progress of the restructure of the arms length development companies: EDI, Promoting and Regenerating Craigmillar (PARC), Waterfront Edinburgh Limited (WEL) and Shawfair Developments Limited (SDL).

### 2 Summary

- 2.1 As part of the restructuring approved at the May Council meeting, a redundancy process has been initiated at EDI. Negotiations have begun with Lloyds TSB, the company's main creditor, on a loan repayment strategy. Depending on the outcome of these negotiations a cash injection from the Council may be required.
- 2.2 There has been a slow but steady increase in residential sales at PARC, albeit from a low base, but these are not yet at a level which would permit the financing of any new speculative development. A revised business plan for further development is therefore required and will require consultation with the Scottish Government.
- 2.3 The finances within WEL have now been stabilised. A renegotiation of the bank debt combined with prudential borrowing on the part of the Council, means that the rental income now covers both revenue outgoings and the cost of the loan in the current financial year.
- 2.4 The complexity of the restructuring process and the need to make decisions quickly requires an extension of the delegated authority which allows the Directors of City Development and Finance to manage the restructuring of the company until the end of March 2010.
- 2.5 SDL is also in a stable position and is currently dormant. A decision on the future of the company awaits a new strategy currently being developed on the future of Council led property development in the city.
- 2.6 The Council remains committed to regeneration in Edinburgh despite the significant challenges that recent property market conditions have created. In parallel with this review, our regeneration strategy is being refreshed and will be presented to the Economic Development Committee at its meeting in October.

### **3 Main report**

#### **Background**

- 3.1 At the direction of the Council, on 1 May 2008, City Development undertook a review of the Council's arms length property companies. The interim report of the review was submitted to the Council on 18 September 2008.
- 3.2 The review addressed the strategic role and purpose of the companies, their performance, financial controls, returns on investment, management structure and governance arrangements. The final report also made a number of recommendations aimed at improving their operational effectiveness and also predicted, as a result of wider economic circumstances, the need for additional Council investment. In addition, the appraisal recommended the rationalisation and restructuring of the companies to achieve greater cost effectiveness and a closer alignment with the Council's future needs. The final review was approved by Council on 18 December, 2008.
- 3.3 On 28 May, 2009 the Council approved the use of the prudential framework to acquire the investment property portfolios from EDI, Parc and WEL, while, in tandem, seeking to restructure the bank debt within those companies. Council also approved the restructuring of the arms length companies to achieve a sustainable cost base. It also delegated authority for these actions to the Directors of Finance and City Development in consultation with CEC Holdings.

- 3.4 The following is an update on each of the companies:

#### **EDI**

- 3.5 The former acting Chief Executive has now left the company and EDI has been put under interim management.
- 3.6 In order to put the company onto a firmer footing, a redundancy process has been initiated, with the aim of reducing staffing levels from 29 to 13 and thus halving the related staffing costs. The process should be complete by the end of August. Future staff resources will be devoted to three areas of activity: the running of the company itself, the management of assets and rent revenues and the continuation of the work of PARC at Craigmillar.
- 3.7 With assistance from the Council, negotiations have begun with EDI's main lender, Lloyds TSB, on proposals to repay existing loans. Lloyds is currently undertaking due diligence on the company which should be completed by the end of August. In order that a mutually agreeable settlement is reached with the bank as soon as possible, every effort is being made to co-operate with the bank's representatives on this exercise.
- 3.8 Until the loan position is resolved, the company's financial position will continue to deteriorate and short term financial support from the Council will probably be required. The new interim management is still reviewing the current cost structure and asset base and will report back on its conclusions by the end of September. The most appropriate way forward will be informed by the bank's own findings. The sale of the EDI portfolio to the Council is clearly also on hold while the loan position is resolved.

- 3.9 In the meantime, EDI is reviewing its own investment and property holdings to consider the option of selling certain assets in order to improve the overall cash flow position within the company.
- 3.10 While EDI's financial position has suffered, due in part to the general economic conditions, it is important that the new interim management are given sufficient time to assess the condition of the company in detail and to come back to the Council with its informed views on the way forward. It is also recognised that the Council requires clarity on any ongoing liabilities it might face, should a decision be made to provide continuing financial support to the company.

#### **PARC Craigmillar**

- 3.11 Through the company's "ParcLife" brand, there is slow but steady sale of new houses in two areas, Wauchope and Greendykes. A new housing phase in Wauchope will commence shortly funded fully by a Housing Association, providing 15 units for social, and 11 for mid-market rent. Despite this good news, the current rate of sales suggests that PARC is not generating sufficient income to take forward much of its planned activity and discussions will be required with lenders on the repayment of existing loans.
- 3.12 As a result of wider challenges in the general banking sector, the Dunfermline Building Society (DBS), PARC's main source of finance for residential development, is unable to invest in new residential developments. While DBS continues to meet existing obligations, discussions are taking place regarding loan repayments. The Council approved in May 2009 funding of £0.6m to enable the completion of residential developments at Greendykes Phase B and Wauchope Square Phase 7. As a consequence of market conditions, lower demand for new housing means that the replacement of Castlebrae Community High School is unlikely to be possible before 2018 at the earliest.
- 3.13 A revised implementation plan for PARC, reflecting the current property market, is being developed to coincide with a wider report on EDI operations. This is expected in the next few weeks. Proposed public infrastructure and facilities will inevitably be postponed. The Scottish Government, which has invested £26m in the project, are being kept informed of developments. Again, it is important to emphasise that the interim management should be given the time they require to fully assess and undertake the required restructuring. This is in view of the normal complexity of development finance which has been further exacerbated by the current market conditions.

#### **WEL**

- 3.14 In common with the other part of the city, the economic downturn has resulted in a lack of land sales at WEL over the past eighteen months and resulting in substantial write down in land values. The impact of this is that as of 31 March 2009, the company had net asset value of less than £1.0m, with assets of £12.7m and liabilities, including bank borrowings, of £11.7m. This jeopardised the company's future as a going concern.

- 3.15 The City of Edinburgh Council's decision to use prudential borrowings to acquire WEL's investment property portfolio for £7.5m and for WEL to offer the entire sum to the bank in full and final settlement of WEL's outstanding debt, was accepted on 29 May 2009. The legal agreements to transfer title of the properties have now been completed.
- 3.16 The rental income from the investment properties acquired by CEC, will service the prudential borrowing debt during the period of the loan and provide a surplus which can be utilised to meet WEL's ongoing revenue costs in the current financial year. It should be noted that WEL does not have sufficient funding to meet any essential capital costs such as site remediation works.
- 3.17 The core team at WEL has been reduced to 3.5 FTE with seven estate officers employed to manage the site. The Acting Chief Executive post has now been moved to a part time position. The permanent staff has been advised of the prospect of the transfer to CEC Holdings Limited and HR Consultants have been appointed to manage the process.

#### **Shawfair**

- 3.18 Shawfair Developments Limited was established as a joint venture between the Miller Group and the City of Edinburgh Council and Midlothian Council. The Miller Group managed legal, financial and administrative matters and provided funding for the project for the initial years. Due to the continuing downturn in the economy, the Miller Group withdrew their interest and both Local Authorities reimbursed the company for their financial investment.
- 3.19 The project is now dormant. A board meeting has been scheduled for 31 August 2009 to consider the next steps for the company.

#### **The Proposed Way Forward - Final Structure**

- 3.20 On 28 May 2009, it was reported at Council that the review had identified the need to rationalise company activity in order to reduce the existing cost base and provide a stronger alignment with the city's future regeneration and development needs. It was proposed that the remaining assets of both EDI and WEL would be transferred to CEC Holdings Limited, including TUPE transfer of all staff, with the companies then being wound up.
- 3.21 Further developments, as outlined in this report, have given rise for a need to reconsider the future respective roles required of both the Council and the arms length companies. A physical regeneration strategy for the city is being developed and will be submitted to the Economic Development Committee in October.
- 3.22 This strategy will detail proposals for Council led property development in Edinburgh. The plan will recognise the positive impact that property development should have on wider city regeneration including the creation of sustainable communities, employment opportunities and the environment in the city. These are all Council priorities which require the organisation's leadership. Perhaps, therefore, a more direct role in implementation is required. The future role of CEC Holdings will therefore need to be considered in this context.

## **4 Financial Implications**

- 4.1 The Council may need to consider further cash investments into EDI and PARC. The amount of funding required will only be clear in the next few weeks once the full due diligence which is currently underway is complete. The potential transfer of EDI assets to the Council remains under consideration but this transaction needs to be assessed against ongoing liabilities and the overall business case.
- 4.2 WEL and Shawfair have now been stabilised and no further financial assistance from the Council is required in the immediate future. A decision on their future awaits the full development and approval of a new physical development strategy.

## **5 Environmental Impact**

- 5.1 The environmental impact of the restructuring is seen as neutral. It is intended that the new physical regeneration strategy will take into account actions that have a positive environmental impact on the city.

## **6 Conclusions**

- 6.1 The Council is undertaking a major exercise in stabilising the arms length companies which have all been adversely affected by the current economic downturn. This has created a level of fragility in both EDI and PARC.
- 6.2 The Council remains committed to regeneration across the city. A refreshed regeneration strategy will be submitted to the Economic Development Committee in October.
- 6.2 Slow residential sales at PARC, in particular, mean that a revision of current plans is required. A further report will therefore be tabled on the future of EDI and PARC at the Council meeting in October. In the meantime, the interim management are being given the time to fully assess the condition of the companies and their related programmes.
- 6.3 At WEL, the rental income from the investment properties acquired by CEC will service the prudential borrowing debt during the period of the loan and provide funding to at least contribute to the ongoing revenue costs.
- 6.4 A Shawfair Board meeting has been scheduled for 31 August 2009. The company's future activity will depend partly on overall strategy of the Council with regard to arms length delivery in the future.

## **7 Recommendations**

- 7.1 To note the progress towards the restructuring of its arms length development companies.

7.2 To extend until 31 March 2010 the delegated authority allowing the Directors of City Development and Finance to manage restructuring activity as described in this report.



**Dave Anderson**  
Director of City Development

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Appendices	n/a
Contact/tel/Email	Greg Ward / 0131 529 4298 / greg.ward@edinburgh.gov.uk
Wards affected	Craigmillar, Leith, Granton, City Wide
Single Outcome Agreement	n/a
Background Papers	n/a