

# The City of Edinburgh Council

10.00am, Thursday, 31 May 2018

## The EDI Group Ltd - Transition Strategy

<b>Item number</b>	8.1
<b>Report number</b>	
<b>Executive/routine</b>	
<b>Wards</b>	All
<b>Council Commitments</b>	1, 2, 10, and 50

### Executive Summary

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This report provides an update on the progress made to date in closing down EDI Group Ltd and its subsidiary companies and bringing its development activities and land holdings into the Council.

It follows the approval of the EDI Transition Strategy by the Housing and Economy Committee on 2 November 2017 and seeks approval for financial elements of the strategy and the governance arrangements moving forward.

## The EDI Group Ltd - Transition Strategy

### 1. Recommendations

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- 1.1 Council is asked to:
  - 1.1.1 Note the EDI Transition Strategy as agreed by the Housing and Economy Committee and the progress made to date in its delivery;
  - 1.1.2 Agree the governance arrangements, as proposed, for the next stages of transition and instruct CEC Holdings Ltd Board to proceed on this basis.
  - 1.1.3 Agree the revisions to the Shareholder Agreement in respect of CEC Holdings and EDI Group Ltd.
  - 1.1.4 Agree to the pension liability being taken forward by the Council on an on-going basis rather making a cessation payment; and,
  - 1.1.5 Agree to the setting aside and potential use of up to £1m from the Council's City Strategic Investment Fund to cover any cash flow issues that may arise over the remainder of the transition period.
  - 1.1.6 Agree to the Parc Craigmillar Ltd Loan Book being transferred to the Council.

### 2. Background

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- 2.1 The Economy Committee and the Finance and Resources Committee considered reports on 7 February 2017 and 23 February 2017 respectively setting out the options available to the Council regarding the operating model for its property companies, including issues arising and proposed transitional arrangements. These reports were considered by members under a 'B' agenda at both meetings.
- 2.2 The outcome was an instruction to the Chief Executive and the Board of CEC Holdings, EDI, PARC Craigmillar, Waterfront Edinburgh and Shawfair Land Limited to commence consideration and where possible the implementation of Option 3 (In-House Model) as set out in those reports.
- 2.3 On the 2 November 2017 the Housing and Economy Committee approved the Transition Strategy for closing down EDI and moving projects in-house.

### 3. Main report

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### **Progress to Date**

- 3.1 Since the report on 2 November 2017 Council Officers have continued to work with EDI to implement the Transition Strategy.
- 3.2 EDI staff have prepared handover packages and have been working through these with Council officers. Good progress is being made in this regard and it is anticipated that this process will be complete by the end of May 2018. By this point in time, the majority of EDI projects will have been moved into the Council and will subsequently be moved forward under normal Council project management and approval processes.
- 3.3 There will also be work remaining within EDI although this will be significantly reduced and it is unlikely that this will be sufficient to justify the number of staff currently employed within EDI. This will be a matter for the EDI Board to consider.
- 3.4 Council officers have been identified as lead officers for each of the projects that are transferring into the Council and officers have also been identified to manage to the areas of work that will remain within the EDI Group Ltd and to provide support to the EDI Board in the running of the company as and when EDI staff are made redundant. The EDI Board has been advised that the Council is ready to provide the staff resource necessary to support the ongoing business of the company.
- 3.5 As part of the transition process the value of work undertaken by EDI on project development will be assessed by the Council based on the Council's intended development approach. Value will be attributed as appropriate with an element of the cost incurred being written off.

### **Governance**

- 3.6 The current governance arrangements are set out in Appendix 1 and are designed to facilitate joint working between Council officers and EDI staff, while also respecting the role of Council Committees and the EDI Board in decision making.
- 3.7 The governance arrangements that will be put in place once EDI staff have left the company, or transferred into the Council, are shown in Appendix 2. In the light of the decision to bring the work of EDI 'in-house' the following key changes are considered appropriate:-
  - The EDI Board should be made up of elected members only;
  - The Chief Executive of the Council (or delegated senior officer) will prepare the reports for the consideration of the EDI Board and take forward the resulting decisions; and,
  - The staff resource required to take forward the work of the company will be provided by Council staff.

3.8 In the absence of an Executive Director the EDI Board may wish to agree a scheme of delegation to allow day to day decision making to take place without recourse to the Board.

### **Shareholder Agreement**

3.9 The Shareholder Agreement between the Council, CEC Holdings and EDI Group Ltd, is provided in Appendix 3. It is appropriate to revise the agreement at this stage to reflect the strategy that the Council as Shareholder has asked the EDI Group Ltd to take forward and to reflect the changes in governance arrangements. The key changes proposed are as follows:-

- At Section 3 Business of the Company – text should be inserted to reflect that the business of the company will continue but that this will now be pursuant to the transition strategy and ultimately the closure of the company.
- At Section 4 Directors – this would be amended to remove the requirement for an Executive Director and non-elected Non-Executive Directors to be appointed to the Board leaving only Elected Members as Board Members.

3.10 These changes are intended to give clear direction to the Company directors regarding the wishes of the Council. Following approval of this report the final terms of the revised Shareholder Agreement will be agreed with the directors of CEC Holdings and EDI Group Ltd.

### **Pension Liability**

3.11 The approach being taken in managing the cash and assets within EDI during the closing down period, allows for the cost of the pension liability within the company to be met through a one off payment to buy out this liability and this remains the case.

3.12 Council officers have taken forward discussions with Lothian Pension Fund to assess whether it would be possible, and preferable, to take forward the liability on an on-going basis. The outcome of this exercise is that taking on the pension liability on an on-going basis is the preferred approach. The financial implications of this approach are set out in the Financial Impact section below.

### **City Strategic Investment Fund (CSIF)**

3.13 In agreeing the strategy for the transition of EDI activities into the Council, the Housing and Economy Committee agreed in principle the use of up to £1 million from the CSIF to ensure that any cash flow issues within EDI can be resolved should such an issue arise. Although this is not anticipated and there should not be any need for a cash injection from the Council, it is considered prudent to set aside money for this purpose to avoid unexpected pressure on Council budgets. The CSIF will only be used if necessary and any expenditure will be recovered from EDI in due course.

## **Shared Equity**

- 3.14 PARC Craigmillar Ltd owns shared equity in 19 properties in Craigmillar. During the close down period, the approach previously assumed was for Council staff to administer the loan book on behalf of PARC Craigmillar. However, as the Council also owns shared-equity in Craigmillar, it is proposed that the Council purchase the loan book and manage the loans alongside its portfolio. This would be less administratively cumbersome and provides a long-term solution for the affected property owners.
- 3.15 The cost of the loan book purchase can be met from writing down loan stock of an equivalent value and the price will be established through valuations obtained for the properties.

## **4. Measures of success**

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- 4.1 The measures of success are that the transition strategy is delivered:
- In accordance with the objectives set;
  - On time and within cost parameters; and,
  - That projects continue to be effectively delivered in line with the Council's housing and economic objectives.
- 4.2 Progress against these measures will be tracked in six monthly reports to Housing and Economy Committee.

## **5. Financial impact**

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- 5.1 In November 2017 it was reported to Housing and Environment Committee that the Council would receive a total of £21.657m from the wind down of EDI. This was to take the form of cash and land receipts resulting in the repayment of all outstanding loan stock and share capital, along with an estimated dividend of £4.4m. In addition, it was noted that the Council was expected to receive a further £7.5m in profit share from developments at Market Street and Brunstane.
- 5.2 The original modelling was carried out based on the balances sheets of August 2017 and reflecting the then estimates of land sales values. The modelling has been redone during February 2018 based on the latest December 2017 year-end balance sheets and revised estimates for land sales and pension liabilities. The latest modelling now shows the cash and land receipt increasing to £25.767m, resulting in repayment of all outstanding loan stock and share capital together with an estimated dividend of £8.5m. In addition, anticipated profit share from Market Street and Brunstane has increased to £9.158m.

- 5.3 As stated in paragraph 3.14, the purchase of PARC Craigmillar’s shared equity loan book can be met from the repayment of loan stock. These loans will in turn be repaid by current home owners in accordance with the legal agreements in place.
- 5.4 The financial implications of this process for the EDI Group Ltd have been modelled by EDI staff and checked by Council staff. In addition, the taxation implications of the strategy have been reviewed by EDI’s external tax advisers, to minimise the risk of any unintended adverse impact on either EDI or the Council. The audited accounts for EDI are available for public viewing and show a healthy financial position with sufficient funds and assets available to allow the transition strategy to proceed as intended. However, given the nature of property market in which EDI operates, these forecasts are likely to change. The financial modelling will therefore be rerun on a regular basis.
- 5.5 EDI will remain solvent throughout this transition process and the financial strategy is designed accordingly. Notwithstanding this, it is prudent to set aside £1m from the City Strategic Investment Fund (CSIF) to cover any cash flow issues that may arise. There are sufficient funds available to cover this potential expenditure and regular reports are provided to the Housing and Economy Committee on use of the CSIF. This money, if spent, will be repaid to the Council by EDI and as set out above there are sufficient proceeds from the closing down of EDI activity to cover this potential expenditure.
- 5.6 As stated in paragraph 3.11, EDI’s pension deficit on cessation of its activities has been calculated on an ongoing basis. It is expected that it will terminate its membership of Lothian Pension Fund on 31 October 2018, when the last staff member has been made redundant. A one-off cessation valuation will be calculated by the Fund’s Actuary on EDI’s exit. This will assess the net deficit of assets against liabilities, thus crystallising the pension debt as far as EDI is concerned. Since the Council is providing a guarantee encompassing the full scale and duration of EDI liabilities, the “ongoing” rather than the more prudent “gilts basis” is appropriate for the cessation valuation. In future actuarial valuations, assets and liabilities will be included with those of the Council.

## **6. Risk, policy, compliance and governance impact**

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- 6.1 Risk – As stated above the Council is the parent company of EDI. The proposed closedown of EDI is a managed process and while land and projects will transfer directly to the Council the financial and corporate elements of this process will remain within EDI. There is not considered to be any significant additional risk to the Council as a result of this strategy.
- 6.2 Reputational Risk – Some of the EDI companies have been in existence for over 20 years and there may be reputational issues with winding them up at this time. However, there has been significant change during this period with the Council in under unprecedented finance pressure. These reasons alone will mitigate against any reputational issues arising.

- 6.3 Policy - The risk around loss of momentum in key areas of regeneration such as Craigmillar, Granton and Fountainbridge is mitigated by the way in which this strategy is phased and planned. There are arrangements in place to ensure a smooth transition and the continued delivery of projects in line with Council policy objectives.
- 6.4 Compliance – The processes in place will ensure that financial, legal, and employment rules are observed throughout this process.
- 6.5 Governance – The governance (existing and proposed) and control measures in place, both within the Council and EDI, are considered to be appropriate.

## **7. Equalities impact**

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- 7.1 There are not considered to be any negative equalities impacts arising from this report.
- 7.2 Any equalities or rights issues arising in relation to development projects will continue to be assessed through existing arrangements within EDI and the Council.

## **8. Sustainability impact**

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- 8.1 The impact of this report in relation to the three elements of the Climate Change (Scotland) Act 2009 Public Bodies Duties have been considered, and the outcomes are summarised below.
- 8.2 There are not considered to be any sustainability impacts arising from this report.
- 8.3 Any sustainability impacts in relation to development projects will continue to be assessed through existing arrangements within EDI and the Council.

## **9. Consultation and engagement**

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- 9.1 The CEC Holdings and EDI Boards have been advised of the proposed governance arrangements and revisions to the Shareholder Agreement. Council officers will continue to consult with the Board members in finalising and implementing the new working arrangements.
- 9.2 Consultation in relation to EDI staff has been undertaken and will continue to be undertaken by the Executive Director of EDI supported by Council officers where appropriate.
- 9.2 Consultation and engagement with local communities and investment/development partners will continue to be taken forward in relation to individual projects, for example the Fountainbridge Sounding Board in relation to India Quay.

## 10. Background reading/external references

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- 10.1 Report to the City of Edinburgh Council on 13 December 2012 entitled [Council Companies](#);
- 10.2 Report to Finance and Budget Committee on 21 February 2013 on [4 to 8 Market Street: Proposed Disposal](#);
- 10.3 Report to Council on 27 June 2013 on [Rationalisation and Restructure of Council Arm's Length Companies – Progress Report](#);
- 10.4 Report to Council on 6 February 2014 on [Rationalisation and Restructure of Council Arm's Length Companies – Progress Report](#);
- 10.5 Report to Economy Committee on 22 May 2014 (B Agenda) on Fountainbridge: Disposal/Development Options;
- 10.6 Report to Finance and Resources Committee on 4 June 2015 (B Agenda) on Fountainbridge – Transfer of land to the EDI Group Limited
- 10.7 Report to Economy Committee on 7 February 2017 (B Agenda) on Council Property Companies – report by the Chief Executive
- 10.8 Report to Finance and Resources Committee on 23 February 2017 (B Agenda) on Council Property Companies – referral report from the Economy Committee
- 10.9 Report to Economy Committee on 2 November 2017 (B Agenda) on EDI Transition Strategy.
- 10.10 Link to EDI Website and Company Accounts - <http://www.edigroup.co.uk/information>
- 10.11 Shareholder Agreement – CEC Holdings and EDI Group Ltd

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## 11. Appendices

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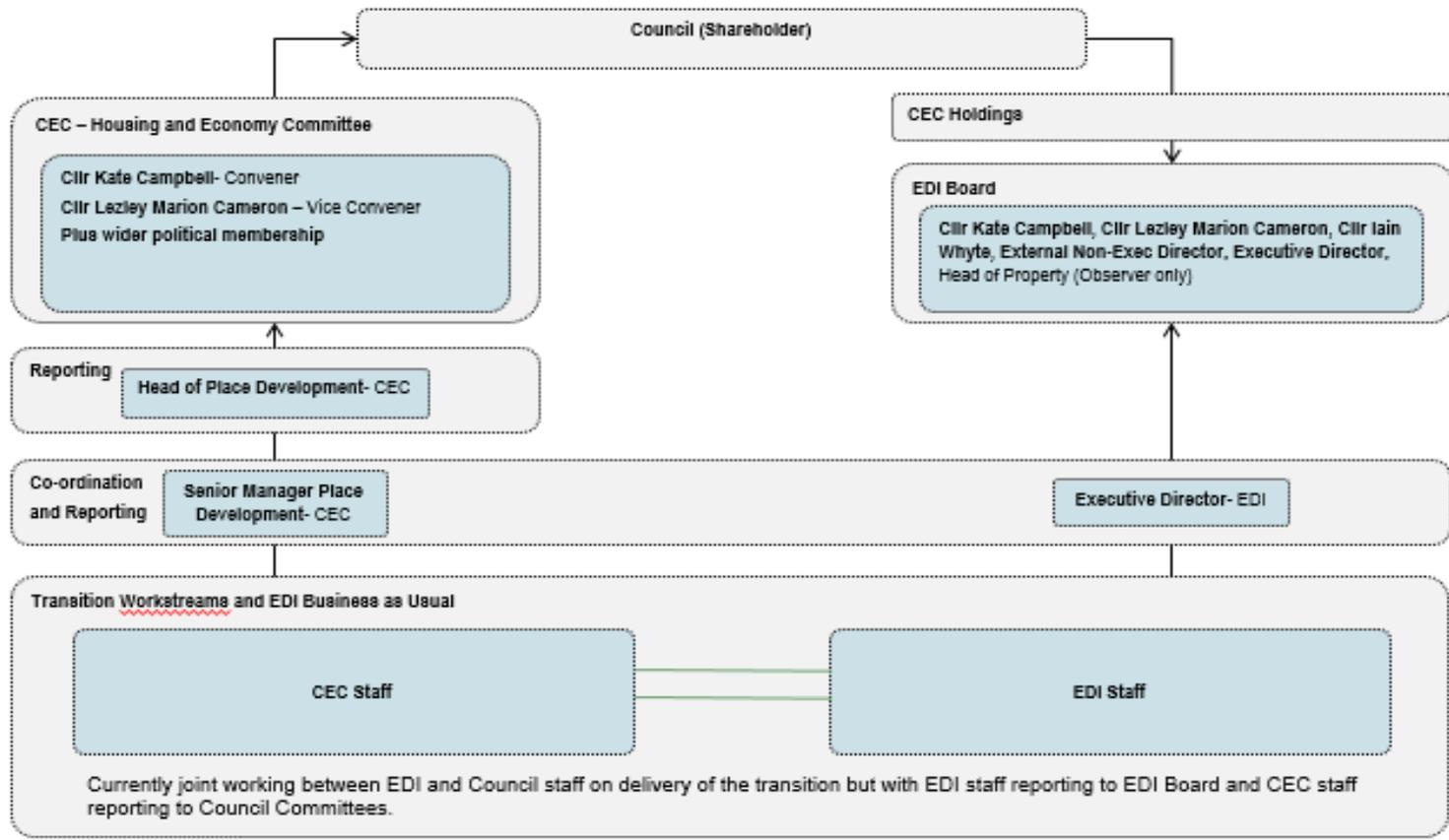
Appendix 1 – Current Governance Arrangements

Appendix 2 – Proposed Governance Arrangements

Appendix 3 – Financial Plan

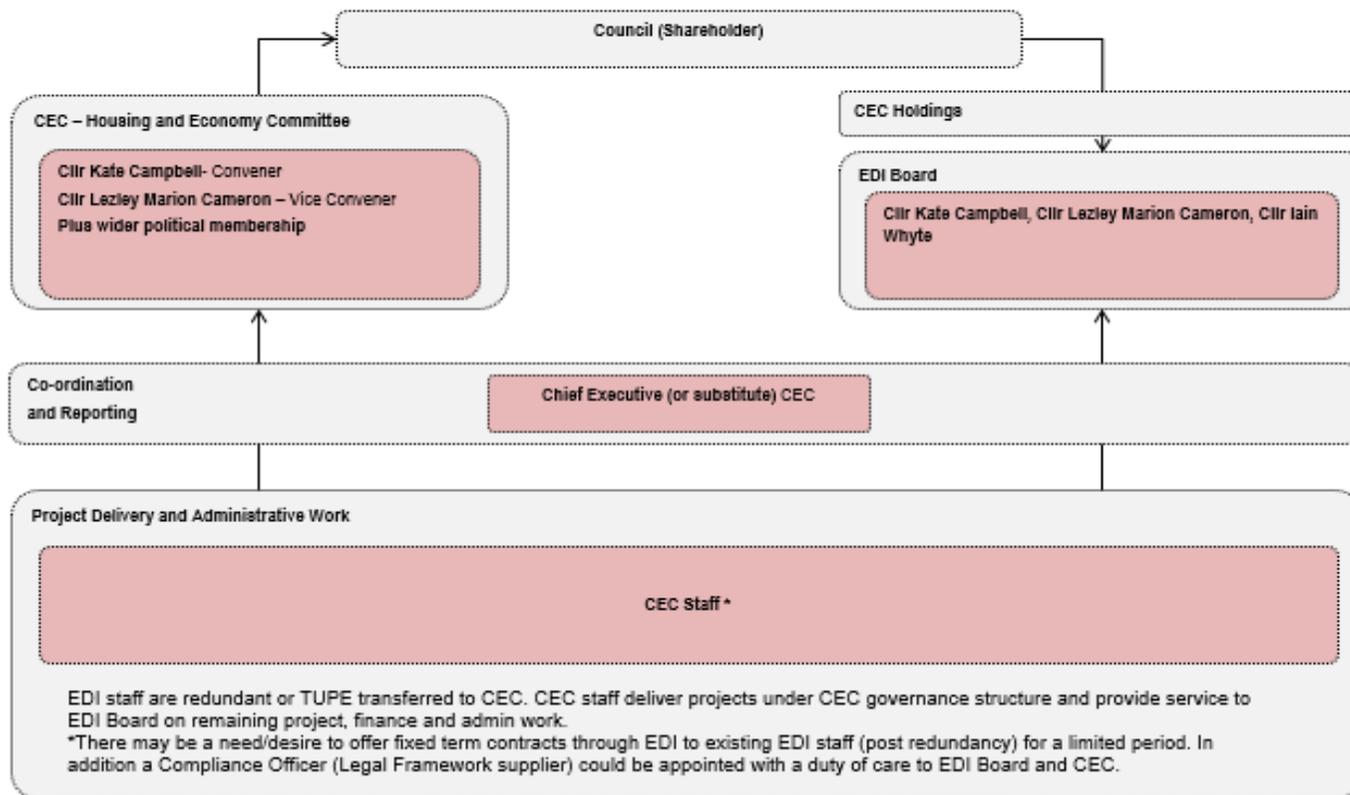
Appendix 1 – Current Governance Arrangements

# Project Governance – Current (April 2018)



Appendix 2 – Proposed Governance Arrangements

# Project Governance – Future (Post June 2018)



### Appendix 3 – Financial Plan

<b>Financial Plan</b>		
	<b>Cost</b>	<b>Receipt</b>
	<b>£'000s</b>	<b>£'000s</b>
<b>Received by Council</b>		
Land & buildings		3,895
Cash		21,872
<u>Total</u>		<u>25,767</u>
<b>Offset against</b>		
Intercompany Loans	1,229	
Loan Stock	7,538	
Share Capital	8,500	
<u>Total</u>	<u>17,267</u>	
<b>Net Financial Position</b>		
Net amount received from EDI		8,500
In addition the Council is contractually entitled to a profit share from Market Street and New Brunstane estimated at £9.158m spread over ten years.		