



Northumberland

County Council

SHAREHOLDER CABINET COMMITTEE

20 July 2023

Advance Northumberland Review of Company and Financial Structure

Report of Jan Willis, Executive Director of Transformation and Resources and S151 Officer

1. Purpose of the Report

- 1.1. To update the Committee on the progress of the review of Advance Northumberland company and financial structure and emerging options.

2. Recommendations

- 2.1. To consider the draft options appraisal attached as a confidential appendix to this report and authorise the Executive Director of Transformation and Resources to progress the detailed work outlined at 4.7 with a view to bringing a further report to the Committee in due course.

3. Link to the Corporate Plan

- 3.1. This report is consistent with the priorities in the Corporate Plan 2023-26 “Achieving Value for Money”.

4. Key Issues

- 4.1. As was noted in the strategic review of Advance Northumberland undertaken in 2022, the current company structure and financial model, both of which are a legacy of the Arch era, are not fit for purpose or sustainable for the long term.
- 4.2. The corporate structure groups together disparate activities (for example house building and project management) and does not lend itself to clarity about the operational performance of different parts of the business.
- 4.3. The funding structure, which is based on notional equity and 100% interest only loan funding from the Council, means that a very high proportion of operating income is paid out in interest, leaving little headroom for the investment necessary to sustain and grow the profitability of the group. Under transfer pricing rules introduced by HMRC in recent years some of these interest payments can no longer be offset against corporation tax liabilities. The highly leveraged financial model leaves the company vulnerable to the risk of negative equity because of reduced asset valuations and principal on loans can only be repaid from asset sales which restricts options for alternative funding vehicles such as joint ventures.

- 4.4. In January 2023 Grant Thornton were commissioned to undertake a strategic review of the corporate and financial structure of Advance Northumberland and its subsidiaries. Grant Thornton's overall conclusion is that without change to the current arrangements it will be difficult for the group to grow, given the lack of surplus to invest or service further investment.
- 4.5. In addition to a new corporate structure (detailed in the attached draft options appraisal report) which is better aligned to the activities undertaken by Advance Northumberland, Grant Thornton have recommended that the Council consider a debt for equity swap to free up cash for investment in the residential and commercial portfolios to increase the overall profitability of the group and allow Advance Northumberland to repay the remaining debt over a period of time on an annuity basis.
- 4.6. They have further proposed that the remaining debt is redistributed across the group in such a way as to ensure more consistent and sustainable loan to value ratios and reflect the different risk profile of different parts of the business and that a revolving loan facility is put in place to enable Advance Northumberland to draw down funding for land purchase costs as and when required.
- 4.7. The proposals put forward by Grant Thornton would have significant accounting and financial implications for the Council. Any reduction in the amount of company debt would impact on the Council's revenue budget due to lower interest receipts, although potentially, this could be offset by lower Minimum Revenue Provision. Existing loan agreements would need to be updated and loan terms and interest rates reassessed to reflect the new commercial terms and ensure they were subsidy compliant. Tax implications would need to be considered and the Council would have to assess any provision required for impairment of assets. Finally, there would likely be significant transaction costs which would have to be funded.
- 4.8. Further detailed exploration of all these issues informed by expert independent advice from the Council's treasury management and tax advisers and discussion with the external auditor on accounting treatment would be required before any definitive proposals could be put before the Committee for approval.

IMPLICATIONS ARISING OUT OF THE REPORT

Policy	None.
Finance and value for money	Ensuring that the corporate and financial structure of wholly owned Council companies is both fit for purpose and sustainable is integral to the Council's best value duty. As detailed in the report, any proposal to restructure the current debt arrangements would have significant financial and accounting implications which would need to be explored in detail before any recommendation could be put to the Committee.
Legal	
Procurement	None.
Human Resources	None.
Property	None.
Equalities	None.
Risk Assessment	None.
Crime & Disorder	None.
Customer Considerations	None.
Carbon Reduction	None.
Health & Wellbeing	
Wards	All.

Background Papers:

Report sign off:

	Name
Monitoring Officer/Legal	Stephen Gerrard
Executive Director of Transformation and Resources & S151 Officer	Jan Willis
Chief Executive	Helen Paterson
Portfolio Holder(s)	Wojciech Ploszaj

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