

Supporting small businesses through the Environmental Upgrade
Agreement legislation and model

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Purpose and background

1. On 21 July 2020, the Future Melbourne Committee requested management, *Investigate the Environmental Upgrade Agreement mechanism in the Local Government Act 1989 to assess whether it can potentially be broadened to apply to any type of building upgrade*. The resolution made particular reference to enabling small business such as hospitality, events, tourism and small retail, to obtain finance.
2. The *Local Government Act 1989 (Act)* permits a building owner, a lender and a council to enter into an Environmental Upgrade Agreement (EUA). Under a EUA, a loan is made by a lender to a building owner to pay for environmental upgrades (to increase the capital value of the land) with the loan repaid via council rates.
3. Any extension of the EUA model to provide funding for other building upgrades that improve the capital value of the land, would:
 - 3.1. Require amendment to the Act to broaden the type of improvements that can be undertaken (to enable upgrades beyond the delivery of environmental benefit).
 - 3.2. Only be available to an owner of the relevant land, and only where the value of the land exceeds current mortgages on the land, a fundamental requirement of the EUA model.
4. On 23 July 2020, the Federal Government announced the Coronavirus SME Guarantee Scheme. Under the Scheme, the Government will provide a guarantee of 50 per cent to small and medium enterprise (SME) lenders for new unsecured loans to be used for working capital.

Key issues

5. The COVID-19 pandemic has placed significant financial strain on small business within City of Melbourne. With pedestrian traffic down by up to 90 per cent, a drop in consumer demand is impacting the hospitality and retail sectors. Australian Bureau of Statistics (ABS) data indicates that inner Melbourne (along with inner Sydney) is the hardest hit region in the country.
6. Businesses report that their most significant challenge is lack of cash flow for operational expenses including staffing, rent and finance costs, for example leased coffee machines.
7. Through its COVID-19 Business Grants, the Council has supported small businesses to invest in minor capital upgrades to pivot their operations during the pandemic.
8. If building owners are unable to access commercial debt products due to financial stress, it is unlikely that EUA finance would reduce barriers to accessing finance. EUA loans are still subject to responsible lending criteria by the banks.
9. Under the Act, an EUA is established with the owner of the land, as they are liable to pay the rates for the land. Approximately 98 per cent of businesses in the City of Melbourne lease their premises and therefore do not have a direct financial interest in building upgrades.
10. Tenants can negotiate with building owners to overcome the split incentive issue, but this adds complexity to the EUA and typically relies on a financial saving flowing to the tenant as a result of the upgrade, for example through energy bill savings.
11. Modified EUA finance would not enable loans to small businesses for operational expenses such as staff salaries, rent, finance costs or even fit outs. EUA finance relies on improving the capital value of a building which excludes fit outs in a typical commercial lease.

12. Whilst the financial risk sits with the lender under the EUA and the loan is designed to be paid off through Council rate payments, there has been a significant increase in overdue rate balances and deferral/waiver applications received by Council recently. As at 1 July 2020, overdue rates balances were \$17.83 million compared to \$9.71 million at the same time last year.

Recommendation from management

13. That the Future Melbourne Committee:
 - 13.1. Notes that limitations on the model that enabled environmental upgrade agreements detailed in this report makes it an unsuitable model to assist small business such as hospitality, events, tourism and small retail with cash flow issues.
 - 13.2. Continues to work with State and Federal Governments to provide small businesses in the City of Melbourne with financial support and other resources to aid survival of Melbourne's small business community.

Attachment:

1. Supporting Attachment (Page 3 of 3)

Supporting Attachment

Legal

1. Legal advice has and will continue to be provided on the matters the subject of this report.

Finance

2. There are no financial implications of the report other than those highlighted in the report.

Conflict of interest

3. No member of Council staff, or other person engaged under a contract, involved in advising on or preparing this report has declared a direct or indirect interest in relation to the matter of the report.

Health and Safety

4. In developing this proposal, no Occupational Health and Safety issues or opportunities have been identified.

Stakeholder consultation

5. Management has engaged with small business throughout the COVID-19 pandemic to understand the financial impacts on business.
6. No additional stakeholder consultation has occurred to contribute to the development of this report.

Relation to Council policy

7. The recommendation is consistent with the following endorsed Council strategies and plans:
 - 7.1. General Financial Hardship Policy.
 - 7.2. Rates Financial Hardship Policy.
 - 7.3. Local Economic Support Package.

Environmental sustainability

8. Environmental sustainability opportunities will be considered through ongoing business support measures in response to the COVID-19 pandemic.