

## **East Herts Council**

**Date of Meeting: 29<sup>th</sup> January 2020**

**Report by: Joint Report by the Directors of Millstream Property Investments Ltd and the Executive Member for Financial Sustainability**

**Report title: Millstream 30 Year Business Plan: 2020/21 Onwards**

**Ward(s) affected: All**

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### **Summary**

- This report presents the Business Plan for the 30 year period commencing 2020/21 prepared by Millstream Property Investments Ltd (herein referred to as 'Millstream' or 'the company'). It updates the company's previous 30 year plan. In line with the Shareholder Agreement between Millstream and the council, the directors of the company are required to review the company's business plan and submit for the approval of its shareholder (the council) a revised plan each year, based on a rolling 30 year planning period.
- This report is presented by the directors of the company jointly with the council's Executive Member for Financial Sustainability because it is recognised that the income accruing to the council from Millstream's activities will be of paramount interest to members.

### **RECOMMENDATIONS FOR COUNCIL, that:**

- (a) Millstream Property Investment Ltd's 2020/21 30 Year Business Plan, including its programme of acquisitions and development, presented in the EXEMPT Appendix A, be approved**
- (b) £2.75m unused loan approvals granted to Millstream by full Council on 19<sup>th</sup> December 2018 in support of the previous business plan be reassigned to support the new priorities**

## **in the 2020/21 30 Year Business Plan**

### **(c) up to an additional:**

- **£3.70m be loaned to Millstream on commercial terms or as shareholder cash loans and**
- **£0.65m be made available as a shareholder asset-backed loan**

**to combine with the existing unused loan approvals covered in recommendation (b) to enable Millstream to deliver its acquisitions and development programme for 2020/21 as detailed in the business plan, including substituting schemes if necessary**

### **(d) authority be delegated to the Head of Strategic Finance and Property to determine (i) the balance of commercial and other loans relating the company's activity and (ii) the terms and conditions attached to the finance made available.**

## **1.0 Proposal(s)**

- 1.1 As required by the Shareholder Agreement, Millstream has revised and updated its business plan and now puts before Council its new 30 Year Business Plan commencing 2020/21.
- 1.2 In overall terms, the company is proposing to its shareholder, full Council, approval of its business plan which would:
  - increase the company's portfolio of residential properties from nine properties in the company's ownership at the end of 2019/20 to 36 available for letting by the beginning of 2022/23 at the latest
  - see Millstream offer the council two units of accommodation for use as much needed temporary accommodation for homeless households and in doing so assist the council reduce its use of bed and breakfast accommodation for homeless people

- meet the income targets set by the council for 2020/21 and 2021/22, notably by providing the council with an annual revenue income projected to be £166k in 2020/21 rising to over £300k a year within three years
- require additional loan capital to combine with the unspent loan approvals already agreed by Council
- affirm Millstream's willingness to work with the council to provide a wider range of affordable rented and private rented properties in the future.

## **2.0 Background**

- 2.1 At its meeting of 5<sup>th</sup> September 2017, the Executive approved the establishment of a property investment company wholly owned by East Herts Council, subsequently incorporated in February 2018 as Millstream Property Investments Ltd.
- 2.2 The council established the company as a commercial endeavour with the aim of generating an income stream to the council arising from:
  - interest on loans made by the council to the company
  - council officer time and services sold to the company
  - operating surpluses available as dividends, on the assumption that the company pro-actively manages surpluses so as to legitimately minimise losses to corporation tax.
- 2.3 The Shareholder Agreement between Millstream and the council requires the directors of the company to review the company's business plan on an annual basis and submit an updated plan for the approval of its shareholder (the council). Full Council has previously approved Millstream's business plans on an annual

basis at its meetings held on 18<sup>th</sup> October 2017 and 19<sup>th</sup> December 2018.

2.4 Millstream's directors have reviewed the company's business plan and produced a revised 30 year business plan, rebasing the forthcoming financial year as the first year of this 30 year period. Millstream has fully complied with the requirement in the Shareholder Agreement to have submitted its first draft 30 Year Business Plan to the council's Shareholder Representative (Richard Cassidy, the Chief Exec) and the members of the Shareholder Advisory Committee by 31<sup>st</sup> October in the preceding year. The views of the council's Lead Member for Financial Sustainability and Head of Strategic Finance and Property have also been sought. Thus, the company, having consulted these representatives of the council, is now presenting its final draft revised 30 Year Business Plan for the period commencing 2020/21.

2.5 As required by the Shareholder Agreement, the company's 30 year business plan includes:

- a schedule of properties and/or sites it proposes to acquire in the next financial year whether described by name or the number and/or value of specific types of property at least differentiating residential and commercial and existing built properties and sites
- a financial business plan covering not less than 30 years based on development and management and maintenance of existing assets and acquisition of planned new assets
- a procurement plan which shall include details of contracts coming to an end and contracts to be tendered

- an asset management plan including management, maintenance, disposals and acquisitions plans
- key performance indicators with previous performance and targets for the coming financial year; and
- estimates, assumptions regarding reinvestment of profits, distribution of dividends and capitalisation of profits for the coming financial year including the amounts it will be prudent to retain in order to meet operational costs in the coming financial year and the amounts available for distribution to the Shareholder.

### **3.0 Reason(s)**

- 3.1 Millstream's directors contend that the proposed business plan as presented in the EXEMPT Appendix A meets the requirements of the Shareholder Agreement and contributes to the council's income targets presented in the budget report elsewhere on this agenda. The business plan, which presents a programme of acquisitions and development, includes commercially sensitive information provided by a third party (that is, Millstream) and so is exempt from consideration in public. The directors of the company have incorporated amendments to the first draft plan suggested by the various council representatives consulted, as discussed in paragraph 2.4 above.
- 3.2 The revenue cashflows for both Millstream and the council are presented in the business plan attached in the EXEMPT Appendix A. The council's targets for income accruing from Millstream's activity are projected to be met in 2020/21 and 2021/22 from this latest proposed 30 Year Business Plan. The company's next business plan, commencing 2021/22, which will be presented to Council for approval in a year's time, will

include proposals to meet the council's targets in 2022/23 and 2023/24.

- 3.3 Due diligence by the company has revealed that the redevelopment of the Kingsmead site is no longer commercially viable and that progressing the scheme would require the council to provide a substantial level of non-recoverable subsidy which would not represent best value. Millstream can still meet its income targets set by the council for 2020/21 and 2021/22 and will bring forward proposals in future business plans to meet subsequent years' targets. Millstream has made suggestions to the council as to how grant monies already allocated to the company could instead be used by the council to contribute to the refurbishment of the existing community centre.
- 3.4 The company proposes to retain the current performance indicators (PIs) agreed by the shareholder – see the table below. Performance (to date) in 2019/20 and targets for 2020/21 are given in the business plan.

<b>Performance Indicator</b>	<b>Reason</b>
Gross yield per private rented property – annual rent as a % of property value	'Industry standard' means of gauging the value and performance of private rental stock
Average price per property acquired in the open market	A means by which the shareholder can monitor that the company is acting within the financial envelope approved by the shareholder
Company's projected end-of-year financial position as a % of modelled position at year start	A means by which the shareholder can monitor the overall financial performance of the company

## 4.0 Options

- 4.1 The specific proposals within the business plan have been subject to discussion with the Shareholder Representative and members of the Shareholder Advisory Group who have indicated that the council

would like Millstream to bring forward development proposals. This has been accommodated.

- 4.2 Other options considered but not recommended include the following.
- 4.3 Acquisition of only five individual properties in line with the purchasing programme in 2019/20 – NOT RECOMMENDED because this would mean Millstream could not meet the additional target set by the council to yield an additional £100k income stream for the council.
- 4.4 Acquisition of more individual properties than planned – NOT RECOMMENDED as Millstream would ideally wish to diversify its sources of income. That said, however, the company has established a track record of successful property purchases and would revert to acquisition of individual properties if any of its other acquisition or development proposals cannot proceed for whatever reason, having discussed such a move with the Shareholder Advisory Group.
- 4.5 Prioritisation of new build over acquisition of properties – NOT RECOMMENDED as the lead-in time for development, coupled with the greater risks as compared with property acquisition, means that over-emphasis on new build could put at risk the company's ability to meet the income targets set by the council.
- 4.6 Decision not to adopt the revised business plan – this option is open to Council although this approach is NOT RECOMMENDED as without the proposed programme of acquisitions and development the company would not be able to meet the council's income targets which would put significant pressure on the council's resources.

## **5.0 Risks**

- 5.1 Millstream's directors have identified a series of risks

and mitigations.

- 5.2 Risk 1: the company is unable to acquire the number and type of properties within the cost criteria in the business plan. To mitigate this, the company keeps the local market under close review and is confident of being able to acquire the necessary properties by, if necessary, amending the size, location and type of properties acquired, including amending the balance of acquisitions between houses and lower cost flats. The exact details of the portfolio of properties acquired by the company is not crucial, so long as the yield, that is the rental income expressed as a percentage of the purchase price, produced by the properties is maintained at the level discussed in the business plan as this will ensure the company can deliver the income targets set by the council. The Shareholder Advisory Group will be kept informed of the progress of Millstream's acquisition programme.
- 5.3 Risk 2: new build development cannot proceed due to, for example, cost increases or planning considerations. Development proposals by the company are based on prudent assumptions, however, it is recognised that it is impossible to be absolutely certain about costs at the outset of any capital project. Furthermore, development will always be subject to gaining planning permission. The company will engage suitable expertise to ensure costs are minimised and planning issues are addressed at the pre-application stage. Should development not be able to proceed, however, the company will seek alternative development opportunities or revert to property acquisition so as to ensure the council's income targets are met, having discussed such a move with the Shareholder Advisory Group.
- 5.4 Risk 3: there are adverse inflationary movements and other costs increases. The business plan includes a comprehensive 'downside sensitivity analysis' which has



sought to assess the combined impact of a number of adverse changes. The sensitivity analysis indicates that the company's profits over the lifetime of the business plan, and thus the availability of dividend payments to the council, would be eroded by the adverse factors applied over the 30 years of the business plan. Of note, however, is that the impact is not 'fatal' on the company's viability. Furthermore, the company believes it could, if / as necessary, mitigate the impact of inflation through, for example, revenue efficiencies, value engineering and procurement efficiencies. In addition, the downside sensitivity testing has a less marked impact on the income to the council as although dividend income would drop, this loss would in large part be offset by increased interest income from Millstream accruing from the imposition of higher interest rates.

## **6.0 Implications/Consultations**

- 6.1 Paragraph 2.4 above explains how the company has consulted the shareholder during the preparation of this revised business plan.
- 6.2 The 30 Year Business Plan includes full 30 year forecasts for the company's cashflows along with capital requirements to cover the acquisitions in 2020/21 and the developments commencing in 2020/21. The business plan has been subjected to sensitivity testing with the results included in the business plan.
- 6.3 Development or acquisitions commencing beyond 2020/21 will be the subject of consideration by Millstream in the coming year and the company will discuss emerging schemes with the council, notably the Shareholder Rep and members of the Shareholder Advisory Group. The company is open to working with the council to acquire, own and manage both affordable rented and private rented homes developed by the

council as part of the Northgate End and Old River Lane developments in Bishop's Stortford and will, in consultation with the shareholder, bring forward proposals in future years' business plans.

- 6.4 Annex B to the business plan includes revenue cashflows for the council. These cashflows enable the council to realise its targeted additional income in 2020/21 and 2021/22 arising from the company's activities. The company has noted the council's targets for 2022/23 and 2023/24 and will bring forward proposals in next year's business plan to deliver this income for the council.
- 6.5 The company will carefully manage its finances so as to ensure resources are available to manage and maintain its properties. Realistic assumptions have been made for void periods and bad debt based on benchmarking with other organisations. In addition, resources for day-to-day repairs and replacement of capital items such as kitchens and bathrooms over the lifetime of ownership have been included in the financial modelling. Again, the financial provisions for repairs and investment have been based on benchmarked data.
- 6.6 Detailed tax advice was sought during the inception of the company and, where the company or the shareholder feels it necessary, further advice will be sought to ensure that the company's finances are managed in the most tax efficient way.
- 6.7 The company relies on meeting its capital requirements from funding provided by the council. The proposals in the 2020/21 30 Year Business Plan foresee the council making resources available to the company in the form of:
  - loans made on commercial terms
  - shareholder cash loans

- shareholder asset-backed loans (the council providing an asset to the company in return for a charge on the company's assets to a commensurate value).
- 6.8 The capital requirements of the company over the period 2020/21 to 2021/22 arising from the proposals in the business plan under consideration are given in the Annex C to the business plan.
- 6.9 Specific advice has been sought from Cipfa regarding the handling of the commercial and shareholder loans to the company. This has confirmed the council's and company's existing understanding, that is, that the commercial loans should be made with interest charged at rates likely to be available to the company in the open market, with the council able to dictate its own rates for the monies it is lending in its capacity as a shareholder.
- 6.10 This report seeks Council approval of the funding required by the company.

### **Community Safety**

Yes/No

### **Data Protection**

Yes/No

### **Equalities**

Yes/No

### **Environmental Sustainability**

Yes/No

Millstream pays close attention the Energy Performance Certificate ratings of the properties it acquires. In addition, it prioritises works to its properties to increase energy efficiency, for example, in 2019/20 the company replaced the boiler in one of its properties with a new, high efficiency condensing boiler.

When building new homes, the company will meet the energy efficiency standards set out by the council in its District Plan and national building regulations.

### **Financial**

Yes/No

See the discussion of revenue and capital implications in section 6 above.

### **Health and Safety**

Yes/No

### **Human Resources**

Yes/No

### **Human Rights**

Yes/No

### **Legal**

Yes/No

### **Specific Wards**

Yes/No

Development or significant acquisitions in particular wards will be discussed with the relevant ward members should Council approved the business plan.

## **7.0 Background papers, appendices and other relevant material**

- 7.1 EXEMPT Appendix 1 – DRAFT Millstream 30 Year Business Plan 2020/21.

### **Contact Member**

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for Financial Sustainability

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