East Herts Council

Date of Meeting: 2nd March 2021

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: 2021/22 Onwards

Ward(s) affected: All

Summary

- This report presents the Business Plan for the 30 year period commencing 2021/22 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 2021/22 30 Year Business Plan, presented in the EXEMPT Appendix A, be approved

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 2021/22.

1.2 In overall terms, the company is proposing to its shareholder, full Council, approval of its business plan which would see the company retaining the portfolio of properties held at the end of 2020/21 for rental in the private market.

1.3 The company is not proposing any new acquisitions or developments in 2021/22.

2.0 Background

2.1 At its meeting of 5th 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 18th October 2017, 19th December 2018 and 29th January 2020.

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 for 2021/22 to the council's Shareholder Representative (Richard Cassidy, the Chief Exec) and the members of the Shareholder Advisory Committee by 30th October 2020. The views of the council's Lead Member for Financial Sustainability and Head of Strategic Finance and Property have also been sought.

2.5 Following submission of the first draft business plan, the Shareholder Rep informed the company of an HM Treasury change announced in November 2020 that relates to councils making investments primarily for yield. The change appears to have the effect of precluding the council from lending money to Millstream to acquire or develop properties. The council is seeking counsel's opinion on this and so until the implications are clearer, at the Shareholder's request, the company has submitted a business plan based on no property acquisitions in 2021/22 – see EXEMPT Appendix A.

2.6 The company's 30 year business plan therefore includes:

- confirmation that there is no schedule of properties and/or sites it proposes to acquire in the next financial year

- 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 adheres to the request by its Shareholder not propose any acquisition or developments in 2021/22.

3.2 The business plan as presented will contribute to the council's income targets presented in the budget report elsewhere on this agenda. It should be noted that the business plan includes commercially sensitive information provided by a third party (that is, Millstream) and so is exempt from consideration in public.

3.3 The company will work with the council on future options once counsel's opinion on the HM Treasury rule change has been received.

3.4 In addition to this rule change, there has been another, unrelated amendment to local authority accounting rules since Millstream was established which will have an impact on the company's ability to buy or build homes in the future.

3.5 This additional change means that if, as was anticipated when Millstream was formed, the council needs to borrow money to then lend to Millstream, the council will need to make annual provisions for the repayment of the money it has borrowed; this is known as a minimum revenue provision (MRP). This is akin to the principal repayments required as part of a repayment mortgage. Prior to the tightening of the MRP rules, when councils borrowed money to lend to their housing companies they did not have to make minimum revenue provisions if they did not wish to; they could instead rely on the property/properties being sold at any point to repay the council's borrowing. New Millstream activity will now require the council to make minimum revenue provisions, which will form extra pressures on the council's revenue budget.

3.6 To mitigate this extra revenue pressure, if Millstream buys or builds a property from 2021/22 onwards, the profits it pays over to the council as a dividend must at least cover the minimum revenue provisions. Also, as the council will have to pay interest on money it borrows, interest payable by Millstream to the council would probably have to increase too. Millstream's directors and the council's Head of Strategic Finance and Property have already opened discussions about potential new ways in which Millstream could operate within this new financial environment.

3.7 The company proposes to retain the current performance indicators (PIs) agreed by the shareholder – see the table below. Performance (to date) in 2020/21 and targets for 2021/22 are given in the business plan.

Performance Indicator	Reason
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
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

3.8 The revenue cashflows for both Millstream and the council are presented in the business plan attached in the EXEMPT Appendix A. The council's target for income accruing from Millstream's activity is projected to be met in 2021/22.

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 while wishing to support the company's growth have asked that a business plan based on no further acquisitions be brought forward and followed unless counsel's opinion indicates that lending to the company could continue without barring access to PWLB financing and an alternative financial model can be established. If this were to be the case, council officers and Millstream directors would investigate whether further acquisitions would be viable within the council's resulting financial position.

4.2 Alternative options considered but not recommended include the following.

4.3 Acquisition of further properties as in 2020/21 – NOT RECOMMENDED because until counsel's opinion provides greater clarity on the recent financial regulation changes, there is a risk that this could jeopardise the council's ability to borrow money to fund its existing capital programme in a financially prudent and viable way.

4.4 Prioritisation of new build over acquisition of properties – NOT RECOMMENDED because there would be the same risk as identified in paragraph 4.3. For avoidance of doubt, if Millstream does not develop the site in Watton-at-Stone as previously approved by Council this does not stop the council using / disposing of the site for another purpose so long as this is within the new financial regulations.

4.5 Decision not to adopt the revised business plan – NOT RECOMMENDED because it is considered important to clearly show that Millstream is not acquiring or developing properties while the council awaits clarification on the recent financial regulation changes.

5.0 Risks

5.1 Millstream's directors have identified a series of risks and mitigations.

5.2 Risk 1: 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, 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. 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 assumed in the 'downside sensitivity analysis'.

5.3 Risk 2: local rental market values drop as a result of adverse economic movement arising from Covid and/or Brexit. The company has not experienced any difficulties to date. That said, as the company operates at the lower value end of the rental market which is typically more resilient in times of economic turbulence, the company's directors consider that it has protected its position in the market as best it can.

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 and has been subjected to sensitivity testing with the results included in the business plan.

6.3 Millstream's directors will continue to talk with council officers about future opportunities for acquisition and/or develop in light of the various financial regulation changes. Should any opportunities arise in-year, the company will submit an amended business plan for consideration.

6.4 Annex B to the business plan provides illustrations of the revenue cashflows to the council. These cashflows enable the council to realise its targeted income accruing from the company's activity in 2021/22.

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 and the company's experience since first letting properties in September 2018. 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 during the audit of the 2019/20 accounts so as to ensure that the company's finances are managed in the most tax efficient way.

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 2020/21 the company replaced the boiler in one of its properties with a new, high efficiency condensing boiler and has upgraded internal insulation as part of the works to bring properties to a lettable standard.

Financial

Yes/~~No~~

See the discussion above.

Health and Safety

~~Yes~~/No

Human Resources

~~Yes~~/No

Human Rights

~~Yes~~/No

Legal

~~Yes~~/No

Specific Wards

~~Yes/~~No

7.0 Background papers, appendices and other relevant material

7.1 EXEMPT Appendix 1 – DRAFT Millstream 30 Year Business Plan 2021/22.

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