East Herts Council

Date of Meeting:	1 March 2022
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: 2022/23 Onwards
Ward(s) affected:	All

Summary

- This report presents the Business Plan for the 30 year period commencing 2022/23 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 council's shareholding, any asset value increases which could in time by returned to the council through dividends and any 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 2022/23 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 2022/23.

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 it currently holds for rental in the private market.

1.3 The company is not proposing any new acquisitions or developments in 2022/23.

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, 29th January 2020 and 2nd March 2021.

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 2022/23 to the council's Shareholder Representative (Richard Cassidy, the Chief Exec) and the members of the Shareholder Advisory Committee by 29th October 2021. The views of the council's Lead Member for Financial Sustainability and Head of Strategic Finance and Property have also been sought.

Changes to how the council would lend money to Millstream

2.5 Since the company's inception, a number of changes to the way the council can lend money to Millstream have arisen; some anticipated and some unexpected.

2.6 The company's directors and the council's Head of Strategic Finance and Property have reviewed the impact of these changes on any *further* borrowing to the company to fund *additional* property purchases or development. It should be noted that the changes do not affect the company's existing portfolio of properties. The cumulative outcome of the changes is discussed below.

Council's switch to external borrowing to fund its capital programme

2.7 To date, the council has lent its own capital resources to Millstream to fund the purchase of properties. It has been recognised from the earliest discussions with members about establishing a company that, at some point, the council could be in the position of having to to fund its capital programme by external borrowing. This is now the case.

2.8 Modelling, however, demonstrates the council's interest payments would be lower than the payments from Millstream resulting from the additional properties the company would buy with the new loans, meaning the council would still be able to receive an income from the company even if it simply on-lent money it borrowed.

HM Treasury rule introduced in November 2020 that bans a council from borrowing from the Public Works Loans Board (PWLB) if its capital programme includes 'investment for yield'

2.9 As discussed above, the council could still receive an income from Millstream even if it had to borrow from an external source to raise the money to lend to the company. A new rule introduced by HM Treasury in November 2020, however, suggested that if the council did this, it would not be able to access loans from the PWLB. The PWLB provides local authority with loans attracting the lowest interest rates available, so the council would not wish to cut itself off from this source of finance.

2.10 Subsequent counsel's opinion sought by the council and shared with Millstream has, in fact, confirmed that lending to Millstream would *not* be classed as 'investment for yield' under this rule and thus the rule is not of itself an impediment to the council lending to Millstream.

CIPFA guidance change regarding the need for a council to make a minimum revenue provision if it lends to a company to fund property acquisition

2.11 Minimum Revenue Provision (MRP) is essentially the amount the council must set aside from its revenue budget each year to cover the cost of repaying the principal amount of the money it borrows. The aim is to ensure that a council can repay the loan over the useful life of the capital asset it finances with the loan.

2.12 As raised last year when the company's previous business plan was put in front of Council, at the time of

Millstream's inception, councils had a degree of freedom over the determination of when an MRP was required and as residential property can be sold relatively quickly to repay any debt, many councils decided there was no need to make an MRP. Since then, however, CIPFA have amended their regulations such that council *must* now make an MRP in such circumstances.

2.13 This unforeseen CIPFA regulation change means that for new lending to Millstream to create a revenue income for the council, the income from the company to the council must be in excess of the council's borrowing costs *and* minimum revenue provision.

2.14 Business modelling by the company, reviewed in detail by the council's Head of Strategic Finance and Property, has revealed that the company cannot create sufficient income to cover the interest and MRP charges from any newly acquired properties and thus it is no longer viable for the council to lend money to the company for new property purchases.

2022/23 Business Plan

2.15 Given the context described above, the company has submitted a business plan based on no acquisition of additional property in 2022/23 – see EXEMPT Appendix A

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

- confirmation that there is no schedule of properties and/or sites the company proposes to acquire in the next financial year
- a financial business plan covering the coming 30 years based on management and maintenance of existing assets

- a procurement plan which includes details of contracts coming to an end and contracts to be tendered
- an asset management plan
- key performance indicators with previous performance and targets for the coming financial year; and
- as described in the Shareholder Agreement, 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 discussion of the company's operating model and context with the Shareholder Advisory Group held on 25th October 2021.

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 proposes to retain the current performance indicators agreed by the shareholder – see the table below. Performance (to date) in 2021/22 and targets for 2022/23 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

3.4 The revenue cashflow for Millstream and an illustration of the cashflow for 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 2022/23.

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. Members of the group, while wishing to support the company's growth, appreciate the financial rules and regulations relating to council borrowing and on-lending have changed in recent years and so are supportive of the proposed business plan which seeks to create a cashflow to the company's shareholder (the council) from the management of the company's existing property portfolio.

4.2 Alternative options considered but not recommended include the following.

4.3 Acquisition of further properties in 2022/23 funded by Millstream taking out a loan from a 'high street provider' – NOT RECOMMENDED. Research by the company directors and the council's Head of Strategic Finance and Property indicates that a high street bank loan for 69% loan to value (LTV), the average of the leading high street loans available to property investment companies, augmented with a loan from the council for the remaining 31% would see the company being unable to cover the council's interest and MRP before even providing any additional income to the council.

4.4 The council uses capital receipts as they arise to fund lending to Millstream – NOT RECOMMENDED. The council's Head of Strategic Finance and Property has pointed out to Millstream's directors that the council doesn't have many capital receipts and so, year-to-year, the council would have to determine if it has any new capital receipts and then lend them to Millstream. More importantly, receipts are already factored into the council's capital programme and so spending them on Millstream would simply mean the council would have to borrow more from the PWLB to fund its other capital liabilities. In overall terms, only £10k income would be available from Millstream to cover every £17k of borrowing costs and MRP incurred by the council.

4.5 Prioritisation of new build over acquisition of properties – NOT RECOMMENDED. The same pressures on the company to cover the council's interest and MRP liabilities and provide additional income as discussed earlier in this report would pertain. The company's directors have modelled a modest development of four houses on an existing parcel of council land; unfortunately, the annual revenue income to the council from Millstream was found to be £36k less than the council's interest and MRP costs and thus the option is not viable.

4.6 Decision not to adopt the revised business plan – NOT RECOMMENDED because it is considered important for the council, as the company's sole shareholder, to agree the direction for the company over the coming year.

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’ to 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. In addition, 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 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 2022/23.

6.4 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.

6.5 Detailed tax advice was sought during the inception of the company and during the audit of the 2020/21 accounts so as to ensure that the company's finances are managed in the most tax efficient way.

Community Safety

No

Data Protection

No

Equalities

No

Environmental Sustainability

Yes

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, to date in 2022/23 the company has replaced the boilers in two of its properties with new, high efficiency condensing boilers and has upgraded internal insulation as part of the works to bring properties to a lettable standard.

Financial

Yes

See the discussion above.

Health and Safety

No

Human Resources

No

Human Rights

No

Legal

No

Specific Wards

No

7.0 Background papers, appendices and other relevant material

7.1 EXEMPT Appendix 1 – DRAFT Millstream 30 Year Business Plan 2022/23.

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