

East Herts Council

Date of Meeting: 18 January 2023

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: 2023/24 Onwards

Ward(s) affected: All

Summary

- This report presents the Business Plan for the 30 year period commencing 2023/24 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 be 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 2023/24 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 2023/24.
- 1.2 In overall terms, the company is proposing to its shareholder, full Council, approval of its business plan which would see the company continuing to provide properties for rental in the private market.
- 1.3 The company is not proposing any new acquisitions or developments in 2023/24. The company anticipates, however, disposing of three properties for the reasons outlined in the 2023/24 Business Plan (see EXEMPT Appendix A). The company is also exploring whether it would be feasible at the time of disposal to take on ownership of a residential property it currently manages on behalf of the council.

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, 2nd March 2021 and 1st March 2022.

- 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 2023/24 to the council's Shareholder Representative (Richard Cassidy, the Chief Exec) and the members of the Shareholder Advisory Committee by 31st October 2022. The views of the council's Lead Member for Financial Sustainability and Head of Strategic Finance and Property have also been sought.

Millstream's property portfolio in 2023/24

- 2.5 As discussed in detail in the report to Council accompanying the 2022/23 Business Plan last year, 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 combined impact of these changes is that *with regard to new acquisitions*, it is no longer possible for Millstream to meet the interest costs that would be charged by the council and make a level of return to the shareholder (the council) as a dividend that would cover the council's minimum revenue provision attached to the money it would need to borrow to then lend to the company. In short, as highlighted in the 2022/23 Business Plan, it is not financially viable for Millstream to buy any new properties. Members are directed to the report to Council of 1st March 2022 concerning the company's previous business plan for a more detailed explanation of this.
- 2.7 Millstream's directors have assumed the disposal of three

properties in 2023/24. Members are directed to section 4 of the 2023/24 Business Plan in the EXEMPT Appendix A for a more detailed discussion of this commercially sensitive matter.

- 2.8 At the time of the company's inception, it was envisaged that any disposals could be replaced by new acquisitions. The company's directors and the council's Head of Strategic Finance and Property have modelled whether this is now possible. Given financial regulation changes since Millstream was formed – outlined in paragraph 2.6 above – it has been demonstrated that it will not be financially viable for Millstream to replace any of the properties by acquisition in the open market. Disposing of properties without replacement will have the unavoidable impact of reducing the annual cashflow to the council from Millstream's operations. Council officers have built this into the council's budget setting process for 2023/24 onwards. It is worth noting that the company is exploring the feasibility of taking on ownership of a property which it currently manages on the council's behalf. As Millstream already remits the income from this property to the council, taking on ownership, while bringing the property in line with the company's other properties, would not add to the cashflow to the council.
- 2.9 Ownership and management of Millstream's existing portfolio of properties does, however, remain viable because the loans made by the council to buy these properties were funded by the council's own resources rather than external borrowing.

2023/24 Business Plan

- 2.10 Given the context described above, the company has submitted a business plan based on disposal of three properties in 2023/24 and no acquisition of replacement or additional properties in 2023/24 – see EXEMPT Appendix A. It should be noted that the feasibility of taking on ownership of a property Millstream already manages on the council's behalf is being explored; this would not add to the cashflow to the council.
- 2.11 The company's 30 year business plan therefore includes:

- assumptions regarding the changes to the company's property portfolio in 2023/24
- 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 and 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 18th November 2022.
- 3.2 The business plan as presented will contribute to the council's income targets within its 2023/24 budget to be presented to Council in March 2023. 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 – albeit with a minor amendment such that the average gross yield across the whole portfolio rather than for individual properties is now used given the varying timescales for rent reviews across the portfolio. Performance (to date) in 2022/23 and targets for 2023/24 are given in the business plan.

Performance Indicator	Reason
Average gross yield across the property portfolio – annual rent across all properties as a % of properties' total 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 2023/24.

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, net of the anticipated disposal of three properties.
- 4.2 When preparing the previous business plan, the alternative

options of Millstream borrowing from a 'high street lender', the council earmarking any receipts it generates for making loans to Millstream and the company prioritising new build in place of the acquisition of existing properties were all considered. All these options were NOT RECOMMENDED because none of them were financially viable. Members are directed to the report to Council of 1st March 2022 for more details on these rejected options

- 4.3 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 'downside sensitivity analysis' which has sought to assess the combined impact of a number of adverse changes. Of note, the business plan already includes markedly increased inflation for 2023/24 and 2024/25 with the sensitivity analysis modelling the impact of heightened inflation persisting throughout the lifetime of the business plan. 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 income from Millstream accruing from the imposition of higher charges for staff rates to reflect higher inflation.

5.3 Risk 2: local rental market values drop as a result of adverse economic movement. The company has not experienced any difficulties to date. In addition, as the company operates at the lower value (though good quality) 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 2023/24.

6.4 The company will carefully manage its finances 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 2021/22 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

National evidence has found that those with a number of protected characteristics under the Equality Act 2010 are likely to experience lower incomes than others. Millstream provides good quality homes at the lower rental end of the private market and thus provides opportunities for those struggling to afford average private rents.

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, high efficiency condensing boilers and internal insulation.

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 2023/24.

Contact Member

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