

East Herts Council

Date of Meeting: 26th February 2025

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

Report title: Millstream 30 Year Business Plan: 2025/26 Onwards

Ward(s) affected: All

Summary

- East Herts Council established Millstream Property Investments Ltd in 2018 to provide a good rate of return on its capital within the range of options available at the time, however, much has changed since then.
- The council, Millstream's sole shareholder, having reviewed its options, now considers there are more financially advantageous ways to use the capital currently invested in Millstream.
- This report lays out the case Council to resolve that the company disposes of its assets, thus giving the council access to the money currently invested in the company.
- Potential alternative uses by the council of the receipts generated by property disposal are discussed in this report.

RECOMMENDATIONS FOR COUNCIL, that:

- (a) Millstream Property Investment Ltd's 2025/26 Business Plan, presented in the EXEMPT Appendix A, which includes property disposal as an option, be approved**
- (b) acting as Millstream's sole shareholder, Council agrees to use its reserved power, under the Shareholder Agreement with the company, to resolve that the company disposes of its properties.**

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 Business Plan commencing 2025/26.

- 1.2 In line with the Shareholder Agreement between East Herts Council and Millstream, officers of the council (the company's sole shareholder) and the directors of the company have discussed the council's need to review of its investment in the company. Much has changed since the company's incorporation in 2018 with regard to, notably:
- the council's move from internal borrowing to external borrowing, that is, the council now needs to fund its capital project from borrowing rather than use of its own resources (termed, internal borrowing)
 - interest rate rises since 2018 to which the council is now exposed given its need to borrow.
- 1.3 It is council officers' view that the council would now benefit from the company selling its properties and returning the capital receipts to the council. The council could then use the capital to avoid incurring further debt and/or meet one off revenue pressure through the flexible use of capital.
- 1.4 Therefore, this report recommends that Council, as Millstream's shareholder, uses the power reserved in the Shareholder Agreement to forward a resolution, via communication from the council's Shareholder Representative (the Chief Executive) to the company, that Millstream commences a programme of disposal of its properties. For clarity, the Shareholder Agreement enables *only the council* (as the shareholder) to approve disposal of properties, not Millstream's directors alone.

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
 - operating surpluses available as dividends, on the assumption that the company pro-actively manages

surpluses so as to legitimately minimise losses to corporation tax

- council officer time and services sold to the company at a 5% premium.

- 2.3 The Shareholder Agreement between Millstream and the council explicitly enables dialogue between the directors of the company and officers of the council so that the council can, among other things, '*protect its interests as a Shareholder*' (paragraph 5.4 of the Shareholder Agreement) and '*monitor its investment in the Company*' (paragraph 5.5). These clauses were included in the Shareholder Agreement as it was recognised that in future years, the council's financial and other interests may be better served by alternative use of its resources.
- 2.4 Furthermore, the Shareholder Agreement reserves for Council as the shareholder, rather than solely the company, decision-making over a series of important matters including, among others, '*the sale, transfer or **disposal** of the whole or a substantial part of the Business*' [emphasis here added] (paragraph 10.1.5), with the Shareholder Agreement explicitly defining that '*the Business of the Company shall be to acquire and develop Residential Property and Commercial Property and to **dispose** of, let and manage such property*' [emphasis here added] (paragraph 3.1).
- 2.5 This report lays out the case for the council now considering that its financial interests will be better served by Millstream selling its properties and returning the receipt to the council, given the significant changes to the internal and external financial environment in which the council is now operating.

3.0 Reason(s)

- 3.1 At its meeting of 5th September 2017, the Executive approved '*the strategic and financial business case for establishing a Property Investment Company, wholly owned by East Herts Council, for the purpose of **generating revenue and capital income***' [emphasis here added].
- 3.2 Council officers have reviewed the potential alternative used for the council's money currently invested in

Millstream. It is crucial to consider whether the council's capital investment in Millstream still represents the best way to generate revenue and capital income.

- 3.3 It is to be expected that, over time, both the council's internal financial environment and the external rules, regulations and pressures within which it needs to operate will change. Thus, it is imperative that the council should continue to keep under review whether its investment in Millstream represents the best use of its scarce resources. Three pertinent questions, which will be addressed in turn, are:
- how does the annual cost to the council of borrowing up to a level invested in Millstream compare with the income it derives from the company annually?
 - what would be the revenue impact to the council of liquidating its investment in Millstream and using the capital in another way?
 - should the council liquidate its investment now or seek to benefit from capital growth over the longer term?

How does the annual cost to the council of borrowing up to the level invested in Millstream compare with the income it derives from the company annually?

- 3.4 The council has not loaned Millstream any capital since 2020/21, the year in which the company made its last acquisition. During the years 2018/19 to 2020/21, the council invested £4.94m in Millstream through a mixture of loans at a commercial interest rate and share capital (converted over time from non-interest bearing shareholder loans extended by the council to the company).
- 3.5 All money lent to Millstream was funded through internal borrowing, that is, the use of the council's *own* resources. As the income from interest on council's money was very low at the time, the cashflow to the council from loans at 4.73% interest on a 60% loan-to-value ratio more than compensated the council for the loss of interest on its cash holdings. In other words, use of its resources to invest in Millstream at that time made very good sense.
- 3.6 Since that time, however, the size of the council's capital programme has grown such that the council now has to

rely on external borrowing. This means that although the council never borrowed to on-lend to the company, it is appropriate to now consider any detrimental impact to the council of the *unavailability* of its capital tied up in Millstream. Thus, when considering the Medium Term Financial Plan (MTFP) from 2025/26 onwards, the cashflow from Millstream needs to be compared with the cost of borrowing incurred by the council for the amount of money it has had to borrow because it can't access the capital invested in Millstream.

3.7 This dramatically affects the calculation of whether income from Millstream is sufficient for the council's needs. A comparison of the position in 2020/21 (once all the company's properties had been acquired) and 2025/26 is given in the table below.

<i>Negative figures represent a cost to the council in this table</i>	2020/21 £'000s	2025/26 £'000s
Interest payments made by Millstream to the council (full year costs)	141	141
Dividends	0	3
Premium at 5% paid on recharges to Millstream for council staff time*	1	1
Total cash inflow to the council from Millstream	142	145
Interest the council would receive from keeping the money in the bank (assumed 0.5% interest on money held on deposit in 2020/21)	25	0
Interest, at 5.2%, payable by the council on borrowing that it wouldn't incur if it used the money invested in Millstream for its own capital spend in 2025/26	0	-257
Total interest payment to (a negative figures) / from the council	25	-257
Cash inflow to the council minus cash outflow	117 net INCOME	-112 net LOSS

* Although typically included in the cashflow to council, the actual staff costs being paid by Millstream are not included here because it is now assumed that if staff time were not expended on Millstream, a commensurate saving would be made in the council's revenue budget given the extreme financial pressures on the council.

3.8 The table clearly shows that the council's decision to establish and invest in Millstream was financially sound and prudent at the time, as a healthy net income was produced. The switch to the council needing to borrow to fund its capital programme in the years since setting up

the company, coupled with interest rate rises over the same period, now means, however, that an annual net *income* to the council from investment in Millstream of £117,000 has been reversed into an annual net *loss* of £114,000. It is clear, therefore, that investment in Millstream no longer presents the council with a source of revenue.

- 3.9 It is worth noting that income from Millstream's management of the council's property at 6 Water Lane, Hertford is not included in the above table as the company simply passes over the rental income net of costs. The council remains in control of the future use or disposal of this asset.

What would be the revenue impact to the council of liquating its investment in Millstream and using the capital in another way?

- 3.10 The discussion above has shown that as the council's financial environment – both internal and external – has changed, the income from interest payments on loans to Millstream has been outstripped by the interest the council has had to pay on borrowing an amount commensurate to its investment in the company.
- 3.11 In addition, it is important to consider the opportunity cost of the council's investment in Millstream. Put simply, is the council incurring a cost from retaining its capital in Millstream because it can't use the money for something else?
- 3.12 The council's current and upcoming capital requirements are such that a minimum revenue provision (MRP) has to be made in the council's revenue account whenever money is borrowed. Essentially, this is the amount in the revenue budget that has to be retained year-on-year so that there are sufficient resources to repay the loan at the end of its term. It is akin to an individual with a mortgage paying off part of the capital borrowed from their earnings each year.
- 3.13 Of note, the council is required to pay for new waste collection vehicles as part of the new waste management contract. Assuming an eight year lifespan for the vehicles, the council would need to make provision to pay off the money borrowed to buy them over just eight years and thus would need to make an annual MRP of:

- capital outlay on waste collection vehicles divided by eight.
- 3.14 Millstream's 2023/24 accounts included a new surveyor's valuation of the company's 17 properties. If all the company's properties were sold, all the capital generated in the company (net of the cost of sales and any tax) would then be available to pay over to the council in two ways:
- firstly, as repayment of the loans made by the council to the company and
 - then, as a dividend to the council as the company's sole shareholder.
- 3.15 The business plan included at the EXEMPT Appendix A provides an analysis, at section 11, of the benefits to the council of using the proceeds of the sale of Millstream's properties to avoid new debt when buying the waste collection vehicles and/or contribute to other one-off revenue pressures, notably those associated with transformation. For example, if all the income to the council was put towards waste collection vehicle purchase, this could lead to avoidance of combined interest and MRP of around £1m annually in the revenue budget for eight years.

Should the council liquidate its investment now or seek to benefit from capital growth over the longer term?

- 3.16 While the value of property grows year-on-year, it is important to recognise that at the same time, over the long run, the spending power of a set amount of money drops because of inflation.
- 3.17 Over the last 20 years to 2024, Office of National Statistics (ONS) figures show average annual house price inflation of 3.1%, which is higher than average annual Consumer Prices Index (CPI) inflation 2.7%. If this pattern continues, the value of the Millstream's properties would grow in real terms.
- 3.18 A comparison of the income to the council of property retention by Millstream for 30 years with disposal in the coming few years is given in the table below. Note: expanded details are provided in Tables 18 and 19 in the

Millstream Business Plan at **EXEMPT Appendix A.**

Summary of comparative use of council's capital invested in Millstream	
Scenario #1: Millstream continues to operate for 30 years and properties sold at year 30	
Total ongoing cashflow to council (negative figure is a cost)	-2,123,463
Capital receipt at year 30 (discounted to 2025 value)	6,157,953
Scenario #1: Total benefit to council	
Scenario #2: Millstream disposes of properties (25% of properties in 2025/26, 50% in 2026/27 and 25% in 2027/28)	
Revenue saving from full use of receipt to avoid borrowing to acquire waste collection vehicles	7,120,706
Scenario #2: Total benefit to council	
Scenario #3: Millstream disposes of properties (25% of properties in 2025/26, 50% in 2026/27 and 25% in 2027/28)	
Revenue savings from using receipt to top up other receipts to avoid borrowing to acquire waste collection vehicles	3,888,690
Contribution to one-off revenue pressures, notably transformation costs	2,673,784
Scenario #3: Total benefit to council	
6,562,474	

3.19 The table shows that although the value of Millstream's properties is likely to outstrip general inflation, the advantages of liquating the council's investment and using the money to address immediate pressures are greater, whether the proceeds are used in full to avoid new debt for purchase of the waste management vehicles and used to contribute to both waste collection vehicles and other one-off revenue pressures, notably those arising from transformation.

Millstream's 30 Year Business Plan 2025/26

3.20 Millstream's directors contend that the proposed business plan as presented in the **EXEMPT Appendix A** meets the requirements of the Shareholder Agreement. It shows how the company itself can continue to operate as a going concern given its existing loans and liabilities. It also provides an illustration of the impact of the company's activities from the perspective of its shareholder, the

council. This supports the council's case for the company disposing of its portfolio as discussed above.

4.0 Options

- 4.1 Do not adopt the revised 30 Year Business Plan and retain the existing plan approved by Council on 28th February 2024. NOT RECOMMENDED because this plan, while continuing to provide an income to the council, does not recognise the negative cashflow to the council incurred by the continued operation in this way.
- 4.2 Preparation of an alternative plan that would see the council's loans and shares liquidated by means of the company refinancing its borrowing from a 'high street lender' and repaying its loans to the council and buying back (all but one) of the shares it has issued to the council. NOT RECOMMENDED because financing the company in this way has been investigated before – members are directed to the report to Council of 1st March 2022 for a more detailed discussion – and has been found to not be feasible. In short, even with an uplift in the value of the company's property portfolio, refinancing would require borrowing at a loan-to-value ratio of around 90% which would not be attractive to the market. Even if a loan on these terms were available, an interest and capital repayment loan would require payments of c£300k per year and an interest only loan would require payments of £220k per month. At present, the company would be able to only fund c£180k thus this option is not viable.
- 4.3 Disposal of the company portfolio over the coming three years (or sooner) as fixed term tenancies come to an end. RECOMMENDED for the reasons outlined in this report. Given the regular move on and reletting of properties, the company's directors anticipate that in most, if not all cases, properties would be sold whenever a tenant decides to end their tenancy. In other cases, the company would look to give a longer than statutory notice period to enable the tenant to find another home, while at the same time inviting offers from sitting tenants to buy the homes. If any household were to experience difficulty securing alternative accommodation at the end of the tenancy, they would be given information about approaching the council's Housing

Service for advice and support.

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. If the council decided that Millstream should continue to operate for 30 years, the directors contend that adverse inflationary pressures could be absorbed by efficiencies.
- 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 the company's position in the market and the shareholder's share value as best it can.
- 5.4 Risk 3: a slow property market could see the company having difficulty achieving the surveyor's valuations on disposal. This risk is being mitigated by the directors' decision to keep investing in the maintenance of the properties up until the point of any future disposal. The company would seek the expert advice of local estate agents as to whether there is a market to acquire some or all of the properties as a going concern and/or to add to an existing landlord's rental portfolio. At all times, the directors would act so as to maximise shareholder value, that is, by seeking to attain best consideration for the properties.

6.0 Implications/Consultations

- 6.1 The company has shared the revised business plan with members of the Shareholder Advisory Group and council officers.
- 6.2 Detailed tax advice continues to be 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 A – DRAFT Millstream Business Plan 2025/25.

Contact Member

Cllr Carl Brittain – Executive Member
for Financial Sustainability

carl.brittain@eastherts.gov.uk

Contact Officer and Report Author

Jonathan Geall – Director, Millstream Property
Investments Ltd

Contact Tel No 01992 531594

jonathan.geall@eastherts.gov.uk

and

Mathew Crosby – Interim Head of Strategic Finance

mathew.crosby@eastherts.gov.uk