ANNEX 2a

VALLEY HOUSING LTD (Registered Number: 10157625)

Updated Business Plan 2023/24 to 2025/26

1 Executive Summary

1.1 Valley Housing Ltd (VHL or the company) is a wholly owned subsidiary of Test Valley Borough Council (the Council) created for the purposes of managing and developing residential properties in the borough.

1.2 The properties managed will be held to generate income and meet identified unmet demand for housing within the borough.

1.3 The company is able to provide assured shorthold tenancies, allowing flexibility for tenants and better management for the Council that will meet local demand for privately let housing.

1.4 The company will manage and develop properties using one of two models:

- Leasing freehold properties owned by the Council and managing them in the local housing market.
- Developing or buying its own houses using loan finance provided by the Council at a commercial rate.

2 Introduction and Context

2.1 This Business Plan describes how the company will manage and operate its business.

2.2 The Business Plan will be reviewed throughout the year by the directors to ensure that its objectives remain relevant to prevailing conditions in the local property market.

2.3 It will be updated and reported to the Council twice per year. This is expected to be in February as part of the Council's budget setting process and in July alongside a directors' report of the previous financial year's performance. Due to the July Cabinet meeting being cancelled, this report will be presented to Cabinet in August 2023.

2.4 This Business Plan should be read in conjunction with the company's Articles of Association and the Operational and Loan Agreements entered into between the company and the Council.

2.5 The company will not have a maximum life but it will be entering into leases with the Council to take on the responsibility and management of properties for periods of at least 20 years.

3 The Company's Aims and Objectives

3.1 The company provides residential properties for market rental. The properties offered will be of a type that helps to meet known local demand.

3.2 The company has slowly built its portfolio of properties since being created in 2016. There are currently twenty-three houses in its portfolio. There is a clear plan to grow the portfolio at a moderate pace over the medium term. This is shown in the financial summary attached as an annex to this report.

3.3 The plan builds in an expected growth scenario of four additional properties per year. This remains the same moving forward but will be undertaken with due regard to market volatility, due diligence and financial prudence.

3.4 Given the tight control over the company that is exercised by the Council through the Operational Agreement, it will be necessary for the company's objectives and priorities to run alongside those of the Council. Most pertinent in this case is the Council's Corporate Plan 2023-2027 and the priority of "Inclusion and Prosperity".

3.5 The company expects to become responsible for the management and letting of some of the remaining domestic properties owned by the Council. Their transfer will be considered at the most appropriate time in relation to the existing leases in place. Approval for the company to manage these properties was given by the Council on 19 April 2017.

4 Governance

4.1 The company is a wholly owned subsidiary of Test Valley Borough Council. The company will carry on its business in accordance with the terms and conditions of the Operational Agreement into which it has entered with the Council. The corporate structure for the company is as set out in the Operational Agreement. This provides that:

- The Council's Cabinet will approve any director appointments. Directors will be unremunerated.
- The role and authority of the directors is to manage within a Business Plan agreed at least annually by the Council.
- The company may be supplied with services through agreement by Test Valley Borough Council at market rates.
- Reserved matters (i.e. significant decisions) must be approved by Test Valley Borough Council.
- A Cabinet Member may be appointed as the Council's shareholder representative (the Finance and Resources Portfolio Holder has been appointed to this role).

- No loan financing can be entered into without the written authority of the Council.

The directors will monitor advice / consultation papers issued by the government relating to the policies and practices of private landlords. Of particular note at the time of writing is the ongoing consideration by government to the principle of abolishing Section 21 notices that may affect the ground on which a landlord can seek to end a tenancy, where the tenant is not at fault. This consideration has been included in the government White Paper “A fairer private rented sector” which was published in June 2022. In addition to the potential abolition of ‘no fault’ Section 21 evictions, the White Paper also discusses potential to introduce a ‘Decent Homes Standard’ for private rented sector properties. Government consulted on the proposal to introduce a decent homes standard for the private rented sector in September 2022. At the time of writing the outcome of the consultation, which closed on 14 October 2022, has not been published.

In the meantime, VHL is aware of the recommendations arising in the coroner’s report into the tragic death of 2-year old Awaab Ishak, which supports more rigorous requirements, and enforcement, of housing standards associated with damp and mould, having determined that Awaab Ishak’s death had been caused by prolonged exposure to mould leading to respiratory arrest. The VHL directors have required for any reports on damp or mould to be brought to their attention by the company’s managing agents as part of regular inspections.

Funding

4.2 The company will operate under direct control of the Council. It is anticipated that the following two methods of financing will be used.

<u>The company leases dwellings from the Council.</u>

The company will enter into leases with the Council for the future management of a property. The company pays a lease rental to the Council and markets the property for rent in the local property market. The rental income received from the tenants will service the lease cost and other operational overheads.

<u>The company owns dwellings.</u>

In this scenario, the company would purchase dwellings using loan finance provided by the Council, with interest charged at a commercial rate. The company would earn an income from the tenants that it finds for each dwelling to service the interest cost and all other operational overheads.

4.3 The most appropriate scenario will be considered in each case, after taking into account the taxation and other relevant implications of the decision. In practice, it is expected that the most likely method of delivering houses in the coming years will be through an operational lease from the Council.

4.4 It is worth noting that, using the current acquisition model, it is necessary for both the Council's Property and Asset Management Service and the directors of VHL to agree that the purchase is a suitable investment for both parties before any new purchases can be pursued.

4.5 The continuation of this approach is dependent on the Council having sufficient capital reserves or borrowing capacity to purchase the number of properties required to grow VHL. It is assumed that the expected growth forecast will be achievable over the medium term based on the amounts currently approved in the Council's capital programme.

4.6 There will come a point in the medium-long term where the portfolio size is of a large enough scale that some external costs, such as those of managing agents, could be brought 'in-house' to reduce overheads and increase control. It is not expected that this point will be reached in the forecasts for growth presented with this report. All scenarios in the financial forecast are based on a continuation of the existing arrangements for managing the portfolio.

4.7 The company will incur a number of overheads including property maintenance; management and administrative support; and back-office systems that will be provided by the Council. Where the Council provides such a service, the costs will be recharged to the company at a commercial rate.

4.8 The formula for agreeing management and administrative service costs will be fixed at the end of the financial year, based on the estimation of time spent on company activities by Council officers. This is explained in more detail in section 6 below.

4.9 The Council has approved an operational debt threshold of £250,000, which the company can draw on during the early years of trading. Interest on this facility is charged to the company at a commercial rate. At the time of writing, £40,000 of this facility had been drawn down with the latest tranche occurring at the end of June 2020.

4.10 Similarly, the Council has approved a budget of £3M that can be made available to finance any capital investment made by the Company under the second option in paragraph 5.1 above. In order to gain approval for this, the company will have to submit a full business case to the Cabinet and receive its approval before being able to draw down any funds. The Operational Agreement prevents the company from seeking other external sources of funding without the Council's written consent.

5 Financial Forecasts

5.1 During the 2022/23 financial year, there was a considerable amount of volatility and turbulence in the housing market. This combined with a high level of competition for properties has meant that house prices remained buoyant and moved so quickly that no suitable properties were acquired. The directors have taken the view that house prices may continue to fall in the near term and will continue to monitor opportunities in the local market more generally. The directors will explore any suitable opportunities as they arise.

5.2 In the meantime, the directors have focused on developing the properties currently owned by the Council. Renovations to the Crosfield Hall Flat have now competed. With the properties at Fleming Avenue near completion it is expected that these three properties will be leased to VHL and let in the middle of 2023/24. In addition to this, plans are also in place to renovate the properties at 105-109 New Street, these properties are now expected to be transferred to VHL and let by in early 2024.

5.3 The Council owns the freehold of all the properties managed by VHL. The properties are leased to VHL for the company to manage.

5.4 The company has built in an expected growth of four further properties per year from 2024/25 onwards.

Overall position

5.5 The financial forecast for the next three years is appended to this report. It assumes two different scenarios:

- A continuation of the existing portfolio with no additional growth in the next three years, beyond what is already known.
- A continuation of the existing portfolio with an expected growth of 4 properties per year going forwards.

5.6 It is expected that VHL will remain profitable in the medium

5.7 In 2023/24, it is expected that the company will return a profit before tax of around £16,500 increasing to £26,500 in 2024/25 and £34,600 in 2025/26.

5.8 Corporation Tax payable is expected to be £3,100 in 2023/24, £5,000 in 2024/25, and £6,600 in 2025/26.

When calculating the estimated figures, the directors have assumed that maintenance costs will be around 11% of revenue. Agency costs are calculated in accordance to the charges levied by the agents that VHL use however an allowance for agents charges relating to changing tenants is also added on top of this.

Expected growth.

5.9 Turnover is expected to grow from £274,000 in 2023/24 to £384,700 in 2025/26. This reflects the anticipated growth from twenty-nine to thirty-seven properties.

Overheads and expenditure

5.10 The most significant cost to the company will continue to be the lease rentals payable to the Council for the properties it takes on. The Council has now amended the lease charges payable by VHL, which has increased gross margins for VHL. Despite receiving less income from the lease charges, the Council will still ultimately benefit from its share of the profits in the company as 100% shareholder.

5.11 Allowances have also been made for ongoing maintenance and for agents to manage the day-to-day relationships with tenants, including rent collection and out-of-hours response.

5.12 Overhead costs are slightly higher in the year that a new property is first added to the portfolio. This reflects the directors' and other officers time to bring in the new property (that is recharged by the Council) and that there will be higher agency fees for finding, assessing and moving the first tenants into a property.

5.13 After taking the above into account, the company expects the gross profit from managing its property portfolio to be in the region of 16% in 2023/24 onwards.

5.14 The majority of the Administrative and Management costs are relatively fixed, with insurance, audit fees and TVBC management recharges being the most significant. An increase in the number of properties managed by the company is not expected to cause these charges to increase significantly.

5.15 The TVBC management recharge is agreed annually and comprises three elements:

- A fixed charge for general running of the business to include director meetings, bookkeeping etc.
- A charge for the ongoing management of the existing portfolio. This allows time for arranging maintenance works and liaising with agents regarding tenancy matters.
- A charge for taking on new properties to the portfolio. This allows extra time for viewing new properties, liaising with agents for marketing the properties and agreeing lease terms with the Council.

5.16 This charge was last reviewed when the charge for 2022/23 was set. The Business Plan forecasts assume that the management charge will gradually increase as more properties are taken on.

5.17 The Business Plan allows for feasibility work and professional fees related to taking on new leases and developing opportunities that may arise in the local housing market. The level of this budget is determined by the amount of growth expected in the forecast.

6 Taxation

Value Added Tax (VAT)

6.1 The company's income source over the medium term is expected to be the letting of domestic property, which is exempt from VAT. As a result, the company will not be able to register for VAT and will not be able to reclaim any VAT on the costs it incurs.

Corporation Tax

6.2 The company will have to pay corporation tax on any profits / gains it makes. It is expected that VHL will incur a Corporation Tax liability in each year of the Business Plan.

Stamp Duty Land Tax

6.3 As a company limited by shares and wholly owned by the Council, the company will be able to benefit from Group relief for Stamp Duty Land Tax (SDLT) on the lease of the dwellings to the company, meaning that no SDLT would be due. This is on the proviso that the company and Council are not de-grouped within three years of the transfer.

6.4 The company and the Council will monitor the SDLT requirements and will act reasonably and adopt lawful but tax efficient mitigation strategies where available and appropriate.

7 Risk and Mitigation Strategies

7.1 Throughout the life of the company there will be risks that need to be managed to reduce the likelihood and impact of unwanted outcomes. The risk management strategy for the company will follow that of the Council and take account of the wider market context as well as the immediate risks associated with each individual property.

7.2 Risks will be considered and entered on to a risk register, together with risk owners and appropriate action plans.

7.3 There are a number of risk types that the company will face. These include:

- Strategic – e.g. Strategy unable to respond to change. Outcomes do not match identified need. Exit strategy not clearly defined.
- Economic – Market conditions adversely affect the company's financial performance.
- Political – e.g. Changes to the Council's requirements of the company.
- Reputational – Perception of the company or the Council as its parent.

7.4 The risk register is a standing item for consideration at every directors meeting. There are currently twelve amber risks identified. There were no red risks.

8 Exit Strategies and Termination

8.1 In determining potential exit strategies, the factors that need to be taken into account include:

- The protection of creditors and ensuring all known liabilities are met, including any loan finance provided by the Council
- The transfer or surrender of any leases that the company may have in place at any time
- Disposal of any properties owned by the company
- Maximising the net worth of the company for re-distribution to the shareholder
- Ensuring that any transactions taken in respect of termination or exit are carried out tax efficiently.