**APPENDIX 1**

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# New Forest Property Holdings Limited

## Business Plan 2018

## 1. EXECUTIVE SUMMARY

1.1 NFPH is the housing trading arm of New Forest District Council. The company and its subsidiaries have been set up by the Council, and the group wholly owned by New Forest District Council. The NFPH group of companies are separate legal entities, each managed by a Board of Directors.

1.2 This document sets out the NFPH group Business Plan for the immediately foreseeable future, with an emphasis on the next 5 years. It provides the overarching vision and broad strategic objectives, as well as the summary financial forecasts that sit behind the Business Plan.

1.3 The Business Plan has been produced on the basis of a £10m investment being made over a 4 year period to acquire and develop properties. It is anticipated that the group will retain ownership of around 40 properties by the end of this initial investment period. The financial forecasts should be taken as indicative if it is felt appropriate for the company to grown beyond this.

1.4 Broadly the Business Plan sets out;

- The group structure and background as to the purpose of each company
- The vision, broad strategic objectives, and culture
- The business environment that the companies will operate in, including a summary of the market and the competition
- The operational arrangements of the companies, including management arrangements and procurement of services
- The financial assumptions, requirements, capitalisation, projected income and expense account, viability assessment and sensitivity analysis
- An understanding of the risks, including financial, operating, supply/demand, independence and political influence.

1.5 The Business Plan demonstrates that over the initial period of investment, the company expects to be profitable by year 11 (loan interest payments will commence by year 2), building to annual profits before interest and tax in excess of £400k thereafter.

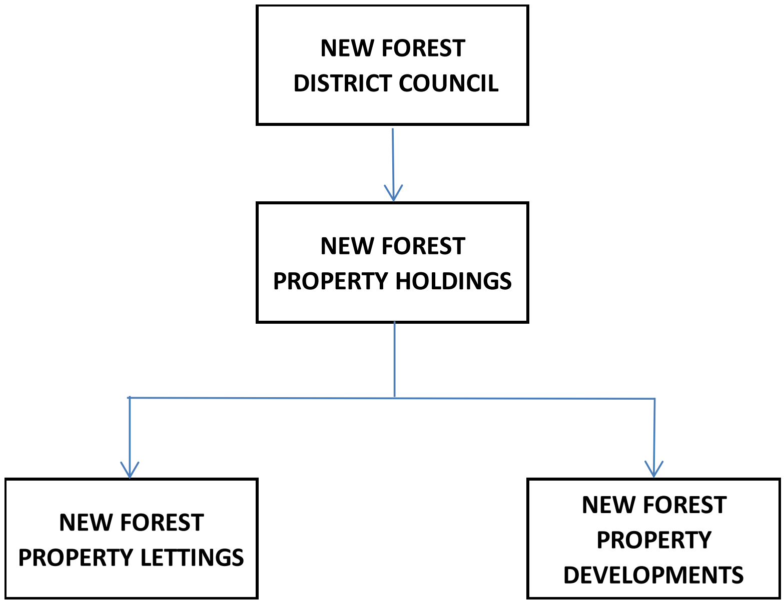
1.6 The anticipated shareholder equity return over the 50 year business plan is £41.806m, at an internal rate of return of 5.54% and a positive net present value of £2.45m. The initial losses in NFPH accrue to a peak of £205k in year 11 but then has sufficient profit available for dividend distribution by year 18. Whilst a business owned by shareholders expectant of dividends may struggle to make this appear viable, the shareholder in this instance is receiving an income in the form of loan interest payments from year 2, and the Group has a healthy balance sheet with gearing of 67%, and long term assets of £10m by the end of year 4.

1.7 Investment in property is not without risks, however identifying, understanding and keeping an up to date risk register with will minimise the possibility of these occurring.

## 2. GROUP STRUCTURE

2.1 The NFPH group has been established by NFDC to purchase privately owned properties, either as existing private sector rental income producing units or with vacant possession for letting to private sector tenants, and to develop acquired sites to build dwellings to deliver a more diverse range of housing and tenures.

2.2 NFPH is wholly owned by New Forest District Council. There are 2 subsidiaries sitting below NFPH; NFPL and NFPD.




**New Forest Property Holdings**

The BoD for the parent company will have overall responsibility for ensuring the subsidiaries fulfil the group aims and objectives. The performance of the subsidiaries will be consolidated into group accounts, and in turn, these consolidated with NFDC. The 2 subsidiaries have been established under the parent company in line with best practise as seen in the private sector.

**New Forest Property Lettings**

This company will own and manage properties suitable for letting in the residential sector and also mixed use residential and commercial properties, for example commercial unit below and residential accommodation above (covers mixed use as the Council can own 100% commercial premises directly). It will be responsible for the sourcing and procurement of suitable properties, and also the procurement of necessary tenancy management services.

**New Forest Property Development**

This company will develop out sites acquired for a variety of housing tenures and types either for sale or rent. Properties will be procured at arm's length by NFPL, or by other third parties (which could, for example include the Council's own HRA). A fully detailed and costed business case would be produced and evaluated for each potential development project, ensuring that the development in question meets the vision, objectives and culture expected by the NFPH group.

2.3 The Articles of Association are included at annex 1, and confirm in full the governance arrangements. In summary, each company will have its own board which will initially consistent of the same 4 Directors. The board makeup will consist of 2 senior Council Officers, with one acting as Company Secretary, and 2 members, with one acting as Chairman.

## 3. VISION, OBJECTIVES AND CULTURE

| | |
|---|---|
| **VISION** | • The absolute requirement to build a commercially sustainable business which will offer its shareholder a worthwhile return on funds invested<br>• NFPH will make a positive contribution to the District Councils corporate plan objectives and will generate a source of income to NFDC to protect the delivery of front line services<br>• It will be known for acquiring and developing quality properties and services which meet the needs of its customers<br>• NFPH will establish a strong reputation that stands for quality, integrity and good value for money<br>• NFPH will be landlord and partner of choice within the New Forest |
| **OBJECTIVES** | • To provide a range of high quality housing and commercial properties to the people of New Forest District, and beyond<br>• To ensure high quality landlord services are received by its tenants<br>• As a housing developer, increase the number of new homes being delivered in the District<br>• NFPH will maintain and manage its assets in such a way as to maximise their useful life expectancies and protect their capital values<br>• To grow beyond the initial £10m funding commitment from NFDC with a view to building the company's asset base, and so income return to the Council as shareholder |
| **CULTURE** | • NFPH will be a group that people wish to do repeat business with<br>• The board will adopt a can-do attitude, whilst still analysing risks and declining bad business<br>• All customers will be treated with the utmost respect and integrity and provided with high quality services<br>• NFPH is trusted by NFDC and is offered significant opportunities of partnership working and investment |

| | |
|---|---|
| | • NFPH will understand that mistakes can be made, but will learn and also acknowledge successes<br>• NFPH will establish and build close relationships with a variety of departments within NFDC in order that the group can achieve its objectives |

## 4. BUSINESS ENVIRONMENT, MARKET AND COMPETITION

4.1 New government targets on house building and Councils' local plans mean more opportunities for new housing exist across the Country. This does however mean there is likely to be strain on the trades required to build high quality new housing. NFPH will need to be careful who it decides to do business with.

4.2 NFPH will initially be operating within the New Forest District Boundary. The local housing market is strong and demand for good quality accommodation is high, and set to increase in the future. Mixed use property (i.e. commercial premises with residential property above) is also a suitable source of property acquisition for NFPL, and so will also be considered for ownership within the group.

4.3 The market for private rented residential property is likely to remain strong over the long term with increasing numbers of households living in the rental sector. NFPH will primarily seek 2 and 3 bedroom houses and flats in the district for rental or development to generate the necessary returns as anticipated by this business plan.

4.4 New taxation changes also mean for individuals, the private rented sector as a means of generating in income return is less attractive than it once was and which may also mean a movement by some private landlords out of the residential property market. However, this may generate opportunities to acquire residential property for let if private landlords exit the market and also offers the NFPH the opportunity to be an attractive landlord for tenants to deal with.

4.5 There are a number of Council policy developments to support the proposition that the market for private rented residential property in the District is likely to remain strong. The Council's recently adopted Economic Development Strategy 2018 - 2023 will seek to promote key strategies in the District to increase the skilled workforce, to increase growth and productivity and to facilitate vibrant towns and villages all of which are likely to promote the market for residential accommodation.

4.6 The Council's recently published draft Local Plan 2016 – 2036 seeks to provide around 10,500 additional homes within the plan area to help meet the needs of the District within the Southampton, Bournemouth and Salisbury housing market areas. The draft Local Plan also seeks to provide a range of good quality new homes by type, size, tenure and location to address local housing needs, in particular homes that are more affordable for younger households.

4.7 Over the long term, residential property prices have consistently risen in real terms. Whilst the level of historic house price rises cannot be guaranteed, there is likely to be an under supply of housing. It is estimated of a need for new housing in England in the region of 300,000 per annum, a level of building not reached since the late 1970's.

4.8 The demand for differing tenure types is changing, with shared ownership schemes becoming a more popular choice for people who want to own their own home, but cannot necessarily afford the high level of deposit required and ongoing mortgage repayments. NFPL will need to carefully consider the market it will operate within, and offer a range of tenure and ownership options, not limited purely to market rent. As the Company expands, it may also be in a position to offer landlord management services itself to small landlords.

## 5. OPERATIONAL ARRANGEMENTS

5.1 NFPH will not initially employee any staff directly. The BoD will be responsible for procuring the services it needs and will look to manage its property portfolio through a series of SLA's with the Council and will support the services provided to it by the Council with specialist services from third party suppliers, when needed. Charges levied between the Council and NFPH will be made at arm's length and on commercial terms, and will be reviewed by the BoD annually.

5.2 NFPH will ensure all necessary legal requirements and policies are in place prior to the commencement of trading, for example dealing with deposits, client account, data protection and GDPR.

5.3 NFPH will be wholly owned and under the control of the Council as sole shareholder. Although NFDC will be able to award contracts to the NFPH without being subject to the EU procurement regime, the NFPH will need to comply with Public Contract Regulations when awarding its own tenders, for example for housing development works.

5.4 The NFPH group board members have a legal duty to act in the best interests of the company. NFPH will report regularly to the Council. NFPH's constitution and agreements will detail the governance arrangements, manage potential conflicts of interest, set out dividend policy and other parameters for the board.

## 6. FINANCIAL ASSUMPTIONS

6.1 The Group will be financed through a series of loans and equity investments.

6.2 The Council has agreed to provide initial financing of up to £10m, on the basis of up to 33% equity. An initial drawdown of £2.0m is made available to the Company (£660k equity and £1.34m debt), with a further drawdown being made available subject to shareholder scrutiny of the initial tranche, and the company and Council objectives being met.

6.3 The loans will be on a drawdown facility basis and the intention is to use this facility when individual properties are acquired and/or developed. Loans will be secured against the net assets of the Group.

6.4 Loans will be issued on variable repayment basis at an interest rate compliant with meeting state aid requirements. It is expected this will be in the region of base rate + 4.75%. The repayment of the loans will be agreed by the Board of Directors and the Councils Head of Finance (in consultation with the Councils Portfolio Holder for Finance).

6.5 NFPH will need to provide security to the Council for its loans in the form normally expected by a commercial lender. These are likely to include a debenture over the assets and undertaking of the holding company (including a charge over shares in the subsidiaries), and a guarantee and a debenture from each of the subsidiaries, which would include fixed charges over all the property held by the development company. It is also expected there will be intragroup loan agreements between NFPH and its subsidiaries which deals with the money being on lent by NFPH onto the subsidiaries.

6.6 In the event the company has insufficient funds to meet a loan repayment after the 50 year period, the company has the option to sell assets to enable outstanding loans to be repaid should shareholder support not be forthcoming.

6.7 The actual incurrence of costs and collection of revenues due will differ for each property acquired. To inform the indicative financial model for NFPL, the assumptions as set out below have been used:

| **Item** | **Assumption** |
|---|---|
| Borrowing Rate | Base Rate + 4.75% |
| Repayment Method | Interest Only assumed |
| Equity Investment | 33% |
| Inflation - CPI | 2% |
| Rental Inflation | CPI |
| Expenditure Inflation | CPI |
| Ave. Monthly Rent | £670 (1 B Flat) - £1,050 (3 B Semi) |
| Ave. Purchase Price | £140k - £318k |
| Ave. Void PA | 60 days at start + 2% PA thereafter |
| Ave. Bad Debt | 2% PA |
| Management Fee / Unit | £800 PA |
| Insurance Cost / Unit | £400 PA |
| Ave. Annual Maintenance | 5% of income |
| Ave. Annual Marketing | 1% of income |

6.8 The shareholder recognises that the company will not be in a position to pay dividends on its investment for quite some time, however, taking into consideration the income to be received through loan interest and management fees, and of course the longer term capital growth expectations, the shareholder is comfortable with this position.

6.9 In order to inform the projected I&E account position, an indication of timings of acquisitions and the indicative equity / loan ratio based on 33/67 is as follows;

| **Fin. Year** | **Year 1** | **Year 2** | **Year 3** | **Year 4** |
|---|---|---|---|---|
| **Purchases** | 4 | 16 | 15 | 7 |
| **Loan** | £604,000 | £2,512,000 | £2,299,000 | £978,000 |
| **Equity** | £298,000 | £1,237,000 | £1,132,000 | £482,000 |
| **Total** | **£902,000** | **£3,749,000** | **£3,431,000** | **£1,460,000** |

6.10 The board will be responsible for making an assessment on each potential acquisition and/or development, to ensure the annual returns are sufficient to cover the annual direct costs, including; the loan interest and annual maintenance, insurance and management fees. Whilst NFPH propose to hold the properties for the long term it will review its holding on an annual basis to ensure they are performing adequately.

6.11 Based on the assumptions as included in section 6.7 and 6.9, the high level Income and Expense Account for NFPL would appear as follow:

| | **Yr1 £** | **Yr2 £** | **Yr3 £** | **Yr4 £** | **Yr5 £** | **Yr 6 - 15 £** |
|---|---|---|---|---|---|---|
| Total PRS Income (Net of Voids/Bad Debt) | 1,731 | 102,037 | 266,434 | 404,164 | 445,165 | 4,971,925 |
| Management Cost | (142) | (8,187) | (21,387) | (32,833) | (36,370) | (406,203) |
| Insurance Cost | (71) | (4,093) | (10,694) | (16,416) | (18,185) | (203,102) |
| Reactive Maintenance Cost | (45) | (2,657) | (6,938) | (10,525) | (11,593) | (129,477) |
| Planned Maintenance Cost | (45) | (2,657) | (6,938) | (10,525) | (11,593) | (129,477) |
| Marketing Cost Cost | (18) | (1,063) | (2,775) | (4,210) | (4,637) | (51,791) |
| Total Operating Costs Irrecoverable VAT | (64) | (3,731) | (9,747) | (14,902) | (16,476) | (184,011) |
| Total Operating Costs | (386) | (22,389) | (58,479) | (89,412) | (98,853) | (1,104,066) |
| **Net Operating Income** | **1,345** | **79,648** | **207,955** | **314,753** | **346,312** | **3,867,859** |
| Interest on Cash | - | 57 | 183 | 289 | (369) | (15,183) |
| NFDC Loan Interest | - | (92,120) | (238,568) | (355,813) | (383,230) | (3,832,299) |
| **Profit/(Loss) Before Tax** | **1,345** | **(12,415)** | **(30,430)** | **(40,771)** | **(37,287)** | **20,377** |
| Corporation Tax Charge | (256) | - | - | - | - | - |
| Profit/(Loss) After Tax | **1,089** | **(12,415)** | **(30,430)** | **(40,771)** | **(37,287)** | **20,377** |
| Dividends | - | - | - | - | - | - |
| Net Profit/(Loss) In Period | **1,089** | **(12,415)** | **(30,430)** | **(40,771)** | **(37,287)** | **20,377** |
| Cumulative Profit/(Loss) | 1,089 | (11,326) | (41,756) | (82,527) | (119,813) | (99,436) |

6.12 Year 5 best represents 'steady-state' with the rental income and operational expenses increasing annually from this point in line with CPI and the loan interest payment to the Council capping at £383,230 PA. Although at year 5 the company still shows an operating loss, by year 11 the company begins to turn a profit, at which point the retained losses carried forward begin to reduce until they are cleared by year 17. Whilst a business operating under commercial terms with shareholders expectant of dividends may struggle to make this business model appear viable, the Council is all the while making a return on its investment through the loan interest charges, and the Group has a healthy balance sheet with gearing of 67%, and long term assets on its Balance Sheet of £10m.

6.13 The anticipated shareholder return over the 50 year business plan is £41.806m, at an internal rate of return of 5.54% and a positive net present value of £2.45m. The initial losses in NFPH accrue to a peak of £205k in year 11 but then has sufficient profit available for dividend distribution by year 18.

6.14 The long term nature of the business makes it susceptible to a number of market and operational risks. It is anticipated that the company would be most sensitive to changes in the following areas;

- **Rate of Inflation** – This is the greatest risk, should rent increases be lesser, or remain static over the period. Conversely, it is also the area that most increases the viability of the company if rents increases were higher than projected.

- **Increase in Loan Interest** – Due to the tight rental yields and gearing at 67%, increases in the cost of debt will have a significant impact on the company's ability to generate a profit.

The following table summarises the impact of a series of changes in the assumptions that have been made (for avoidance of doubt, the base position on rent is +2% PA, so a sensitivity of -1%, equates to +1% PA):

| Shareholder Return: | Base Position | Rent Inflation | | | Borrowing Rate | | |
|---|---|---|---|---|---|---|---|
| | | +1% | -1% | -2% | +2% | +1% | -1% |
| Over 50 yrs (£'000) | £41,807 | £65,783 | £25,891 | £21,522 | £41,813 | £42,242 | £41,101 |
| Over first 5 yrs (£'000) | £1,199 | £1,199 | £1,199 | £1,199 | £1,624 | £1,409 | £1,031 |
| IRR over 50 yrs | 5.54% | 6.57% | 4.59% | 4.12% | 6.21% | 5.79% | 5.44% |
| NFPH Peak Operating Loss (£'000) | £205 | £94 | £794 | £8,578 | £3,514 | £1,297 | N/A |
| NFPH Peak Loss Yr | 11 | 7 | 29 | 50 | 32 | 22 | N/A |

6.15 The board will need to be prepared to consider renegotiating with the Council the group's gearing as a potential mitigation against the results of the sensitivity analysis. At present 67% is assumed in the financial modelling. Gearing of 60% is still reasonable, and is still likely to be considered feasible for the Council as shareholder.

## 7. RISKS

7.1 NFPH, whilst operating in an established market and using a similar model faces a series of risks. Property Markets are prone to unconnected financial shocks and are subject to political interference nationally.

7.2 The risks and their impacts on NFPH business plan are set out in summary below. All have actions which monitor and minimise the possibility of these risks occurring within the risk register.

- Development risk including a failure to secure planning permission for schemes, developing inappropriate dwellings, unforeseen costs such as ground conditions, construction cost overrun, defective design or construction, contractor insolvency etc.
- Capital values and rental values can fall as well as rise.
- Inability to find tenants and/or sell properties, leading to loss of income and delay in WOC repaying debt.
- Disputes with tenants and tenant default.
- Financial risks including that financing costs could rise.
- External factors. Property investment, whether direct or through pooled funds, is subject to factors the Council cannot control, e.g. failure of tenants, changes in perception of what is a good location, economic downturn etc.
- Changes in government policies which inhibit the delivery of the business plan
- Standards expected through SLA's or third party service providers not met
- Management, Insurance and Maintenance fees are higher than expected
- Rent margins are tighter than anticipated meaning the ability to cover expenses through income is restricted
- Skills and experience of the board fails to meet the necessary requirements
- The company through its directors and the Council will need to respect each other's boundaries and understand the differing responsibilities.
- Central government has the ability to affect the Company's ability to meet its objectives through changes in housing policies. Changes to SDLT rates are an example of how national policy will impact NFPH.