

Report to the Cabinet

Report reference: C-040-2021/22
Date of meeting: 7th February 2022



Portfolio: Finance, Qualis Client and Economic Development – Cllr J. Philip

Subject: Qualis Quarterly Monitoring Report – Q4 2020/21 and
Quarterly Monitoring Report – Q1 2021/22

Responsible Officer: Andrew Small (07548 145665).

Democratic Services: Adrian Hendry (01992 564246).

Recommendations/Decisions Required:

Discuss this report and agree any actions required before its consideration by Council.

1. Executive Summary

- 1.1. The Governance framework for Qualis, as agreed by Cabinet in February 2020, included the requirement that Qualis should report to Epping Forest District Council on its performance Quarterly.
- 1.2. This report presents the fourth Quarter's monitoring report for the Qualis trading year 2020/21 and covers the period from 1 October 2020 to 30 September 2021. The Quarter 1 position covering 1 October 2021 to 31 December 2021 is also provided as part of this reporting.
- 1.3. Attached as Appendix A is the Qualis Board monitoring report for Quarter 4. This will be presented to the Qualis Board at the end of January and thus is theoretically able to be changed. If the Board does require any changes, these will be verbally update to this meeting. **[Note:** The Audit of the Qualis accounts identified a small number of changes which are report in Section 4 of this report. The net effect being to increase the reported loss by £83,655 in the Audited Statements. Because the Board Report was produced before the completion of the Audit it does not reflect these corrections].
- 1.4. The report has taken longer to produce than the normal production timeframe as it is dependent on the Audit of Qualis Accounts by their Auditor.
- 1.5. As the Quarter 4 report has taken longer to produce the initial Quarter 1 report is now also available and so this is presented as Appendix B to this report to provide the latest position.
- 1.6. Because of the fall of meeting dates this report will be considered by Cabinet before Stronger Council Select Committee. If Stronger Council has any comments these will be relayed directly to the Portfolio Holder.

- 1.7. Performance is measured in the attached reports against the business plan targets for 2020/21 and 2021/22. The Board report highlights performance against these using the recognised Red, Amber, Green reporting system (RAG).
- 1.8. Although Qualis is reporting a loss in the second year of trading this is essentially a timing issue associated with the granting of Planning permission for the development of the Epping sites. This was granted shortly after the year end (September 2021) and enables costs associated with achieving Planning permission to be removed from the Profit and Loss account Reserve in the Quarter 1 report for 2021/22
- 1.9. **Noting the point raised in paragraph 1.8 above, once the impact of achieving Planning permission is allowed for, the underlying trading position is a small net profit for Year 2 (Quarter 4), broadly in keeping with the Business Plan assumptions. Whilst Quarter 1 of Year 3 also shows a loss, this is similarly associated with achieving Planning consent for Roundhills and once allowed the position would also show a small net profit broadly in line with the target.**

2. Introduction

- 2.1. The Qualis Shareholder agreement, as agreed by Cabinet on February 2020, includes the following paragraph,

‘The Company shall procure that quarterly management accounts and reports (including a balance sheet, profit and loss account and cash flow statement) containing such information as EFDC may reasonably require are provided to EFDC and EFDC’s Representative.’

- 2.2. The Cabinet resolution also requires that the Council’s S151, as the key conduit between Qualis and the Council, provides a commentary to the Council on the performance of Qualis at each Quarter review.
- 2.3. In compliance with this requirement Qualis has provided the Council with the Quarters’ Management Accounts for consideration. Qualis has also supplied the full set of Audited Accounts for each of the Qualis Group companies including the Auditors comments. No significant issues are identified but the Auditors have made some minor recommendations. It is understood that the Accounts will be signed by the Auditors with an unqualified opinion once agreed by the Qualis Board.

3. Commentary on the Trading Performance for Quarter 4, 2020/21 (Qualis Year 2)

- 3.1. The Qualis first year was financially dominated by outgoings associated with its creation and set-up. The second year, however, shows a balance of income and expenditure with a small forecast profit target within the single year Business Plan presented to Council in December 2020. It is recognised that as a developing company revenue earnings will gradually be built up over time.
- 3.2. The Qualis Board report attached at Appendix A meets the requirements placed upon Qualis within the Shareholder agreement. The Board report presents the Balance Sheets, P&Ls and a Cash Flow explanation. It also RAG rates key quarterly deliverables against the Business Plan. The Section 151 has been provided with the full detailed accounts and Auditor’s statement; these are summarised in this report but not reproduced.

- 3.3. **Cabinet should note that majority of the deliverables for Year 2 Quarter 4 for are flagged as Green with the exceptions highlighted below.**
- 3.4. **Income and Expenditure (Reduced to Amber)** – The Board report includes cumulative losses up to the end of the 4th quarter of £2,099,972 (analysed in paragraph 3.8 below) compared to a business plan expectation of a profit of £366,381. This is deterioration on the last quarter where the in-year losses stood at £1,106,614. However, the reason given is consistent with previous reports and is accepted. The reason for the accumulated loss is largely associated with accrued expenditure on development sites, which Qualis is unable to charge to its Balance Sheet as ‘Work in Progress’ until planning consent is given. Once Planning consent is awarded, this cost will be removed from the Profit and Loss account. Achievement of Planning consent took longer than originally anticipated but has now been achieved. Granting of Planning permission fell marginally beyond the Qualis year end and so the costs remain as a charge in the Profit and Loss Account at the year end. Granting of Planning Permission will be reflected in the Year 3 Quarter 1 report for Qualis, thereby reducing the carried forward losses on their Balance Sheet. Achievement of Planning permission is a major milestone and represents the removal of a significant risk in delivering the Qualis Business Plan targets. The delayed acquisition of the third commercial property also contributes to the combined loss and this is discussed further below. These two issues mask the continued improvement in Qualis Management revenues associated with the Housing Maintenance contract. **Note: This position has improved marginally following Audit as a capital loan repayment was identified as being misclassified as an interest payment in the draft accounts, the restatement of which improves the revenue position by £99,263.**
- 3.5. **Qualis Commercial (Flagged as Amber)** – due to it being unable to take the costs of achieving Planning permission to the Balance Sheet at the year end, as discussed in the previous point. It had been anticipated the Planning would be achieved prior to the year end and the forecast reflected this.
- 3.6. **Qualis Living (Flagged as Amber)** - The acquisition of the third asset was completed in Quarter 4, but the delay is finding and acquiring the right asset has impacted on the cash earned during the year. The forecast had assumed that all investment purchases would be secured by December 2020 and the under achievement reflects the delays in completing all acquisitions. **Note: Recorded income reduced following the Audit process – see section 4.**
- 3.7. The Board report (Appendix A, section 7.5) provides a useful analysis of how the £30 million provided to Qualis for commercial acquisitions has been utilised.
- 3.8. The table below sets out the actual net income and expenditure against that expected for each of the Qualis companies.

Qualis Company	Expected £	Actual £	Variance £	Last Report £
Group	41,866	56,339	14,472	41,002
Commercial	29,105	-1,877,001	-1,906,105	-1,127,364
Management	45,042	182,311	137,269	307,362
Living	250,268	-461,621	-711,889	-327,614
Total	366,281	-2,099,972	-2,466,253	-1,106,614

Note: Following Audit the Commercial loss has reduced to £1,777,738 and Living has increased to £644,539, increasing the total group loss to £2,183,627

- 3.9. The Balance Sheet position, showing Fixed Assets and accumulated net worth of Qualis, is set out in the table below. Fixed Assets are individually identified for members' information as the Council charges these for security purposes against the loans provided. The Net Worth position reflects the accumulation and carry forward of set-up costs to be offset by future planned profits.

Qualis Company	Fixed Assets £	Net Worth (Q4) £	Last Report £
Group	66,359	72,719	57,382
Commercial	-	-2,848,737	-2,099,101
Management	64,481	-170,642	-45,528
Living	30,271,382	-470,912	-510,530
Total	30,402,222	-3,417,572	-2,597,777

Note: Following Audit the Balance Sheet Position for Commercial has improved marginally to £2,748,737, reducing the total group negative equity to £3,317,572.

- 3.10. Delivery of the surplus contained in the single year Business Plan largely depended upon successfully obtaining planning consent for the Epping regeneration sites within the year. In practice this happened shortly after the year end, thereby distorting the reported position. In all other respects the Qualis Business Plan objectives are being met and showing good performance against the individual targets set out in the Qualis Board report including progress on bringing forward the redevelopment sites in the District.

4. Qualis Audit of Accounts and Opinion

- 4.1. Qualis provided a full set of accounts and the audit opinion for each of the Qualis group of companies.
- 4.2. Corrections were made to the accounts for two Qualis companies as a result of the Audit process which alter the position reported in the Quarter 4 Board report. These were;
- In Qualis Commercial - £100,000 of capital loan repayment were misreported as interest. The net effect of correcting this was to reduce the reported loss by £100,000;
 - In Qualis Living – the largest of which being income paid in advance from a commercial tenant had not been split correctly between 2020/21 and 2021/22, reducing recorded income and increasing the loss. Combined changes as a result of audit increased the reported loss by £183,000 from the numbers contained in the Board report for Qualis Living.
- 4.3. With the adjustments made the Auditor is satisfied with the accounts and intends to issue an unqualified opinion once the Qualis Board has approved these. No significant issues have been identified but the Auditor has made a small number of recommendations which Qualis has agreed to implement.
- 4.4. The recommendation made by the Auditors are that there should be more comprehensive documentation of the accounting system, its controls and the lines of responsibility for the system, and that Qualis retains a more comprehensive record of their professional advisors. Qualis has already put an action plan in place to address the issues identified.

5. Quarter 1 2021/22 (Qualis Year 3)

5.1. Qualis have also provided the first Quarter's monitoring report for their reporting year 2021/22 covering the period up to the 31st December 2021. At the time of writing this report has yet to be considered by the Qualis Board and as such it is provisional and may alter following Board consideration.

5.2. Qualis have also changed the report format to closer align to their management reporting and thereby making it easier to produce and understand. The report identifies that further development of the reporting format is underway, including a revised presentation of the Balance Sheet information and this will be presented in the Quarter 2 Board report.

5.3. The Profit and Loss position at the end of Quarter 1 is summarised in the table below;

Qualis Company	Expected £	Actual £	Variance £	Last Report £
Group	-35,925	45,689	81,614	0
Commercial	0	-457,432	-457,432	0
Management	-37,007	-9,748	27,259	0
Living	124,150	37,550	-86,599	0
Total	51,218	-383,941	-435,158	0

5.4. As referred to in the Quarter 4 outturn position reported in 3.4 above, Planning consent for the Epping sites was not given until after the 30th September 2021, (Qualis year-end). This was the primary reason for the reported overspend at year end as £1.7 million of cost incurred during 2020/21 in getting planning consent could not be treated as added value until consent was awarded. With consent being achieved in Quarter 1, this cost has been removed and taken to the Balance Sheet as Work in Progress. This has the effect of reducing the deficit balance on the Profit and Loss Reserve. In total £1.3 million has been removed but £450,000, related to Roundhills in Waltham Abbey, has been brought forward into 2021/22 as Planning consent for this site is being progressed separately. Similarly to the Epping Sites, this cost will be carried on the Profit and Loss account until Planning consent is gained.

5.5. There are two Key Financial performance indicator issues identified within the report, the first is the loss against the targeted profit for the first Quarter which is explained in the previous paragraph by the Planning position on Roundhills. The second is associated with the drawdown of the next tranche of Qualis loans. This was not completed prior to the end of December 2021 as had been targeted. It is now expected that this will be completed around the date of Cabinet's meeting, thereby resolving this issue.

6. Resource Implications

6.1. The Epping Forest District Council Budget and Medium-Term Financial Plans partly rely on interest paid by Qualis for the loans the Council has given. Delays in obtaining Planning consent, issues around title and delays in completing the loan agreements will mean that actual payments to the Council are lower than expected in 2021/22 and this is reported in the Epping Forest District Council Budgetary monitoring reports. The proposed budget for 2022/23 takes account of these factors.

6.2. Actual lending to Qualis at the year-end is follows;

Loan Purpose	Facility £ Millions	Term Years	Interest Rate %	Advanced at Quarter 4 £ Millions	Advanced at Quarter 1 £ Millions
Working Capital Loan	6.0	5	4.10	6.0	6.0
Asset Purchase	30.0	10	4.00	30.0	30.0
Construction Loan	68.0	30	6.00	6.0	6.0
EFDC Asset Purchase	16.8	30	4.94	0	16.8
Regeneration Loan	35.0	TBC	TBC	0	0
Net Receipts	155.8			42.0	60.8

6.3. At the Qualis year-end the amount loaned to it by the Council was £42 million against a Council commitment at that point of £120.8 million. This commitment was subsequently increased by the Council for a further £35 million to support regeneration activity within the district area.

6.4. It was initially expected that the Asset Purchase loan would complete by 1st April 2021, but in practice completed fractionally after the Qualis year end, due to delays associated with the legal documentation and title. These delays will reduce the lending margin earned by the Council in 2021/22, but it is expected that some of this will be recouped through earlier advances of the construction loan than the budget assumed.

7. Legal and Governance Implications

7.1. None contained within this report.

8. Safer, Cleaner and Greener Implications

8.1. None.

9. Consultation Undertaken

9.1. None

Background Papers

Group Company Governance Document – Cabinet 6 February 2020