

Report to Cabinet

Report reference: C-036-2022/23
Date of meeting: 6th February 2023



Portfolio: Finance – Cllr J. Philip
Subject: Quarterly Monitoring Report – Q4 2021/22
Responsible Officer: Andrew Small (07548 145665).
Democratic Services: Adrian Hendry (01992 564246).

Recommendations/Decisions Required:

To Discuss this report and agree any actions required.

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 2021/22 and covers the period from 1 July 2022 to 30 September 2022. This also effectively represents the Qualis 3rd trading year outturn report. Attached as Appendix A is the Qualis Board monitoring report for Quarter 4.
- 1.3. Performance is measured in the attached report against the business plan targets for 2021/22. The Board report highlights performance against these using the recognised Red, Amber, Green reporting system (RAG).
- 1.4. The management accounting figures are those agreed by the Qualis Board as at their year-end but were still subject to a final tax computation being carried out between Qualis' tax advisors and their Auditors. The final outturn has changed as a result of this work and final results from the audited accounts are also included in this report.
- 1.5. The unexpected and significant shift in economic factors occurring over the past 9 months has had a huge impact on the finances of the Council and this is also replicated on the plans of Qualis. Not all elements of the Qualis business model are impacted to the same extent, and probably the development arm is experiencing, (and likely to continue experiencing), the greatest impacts due to its dependency on borrowing, construction cost inflation and movement in housing prices. These issues are addressed in the single year Business Plan recently presented to the Council, covering the period 1st October 2022 to 30th September 2023.
- 1.6. Despite this, overall Qualis has only reported a small and greatly reduced loss on previous years. The loss is attributable to a downwards revaluation of investment property, which is linked to market turbulence, and the underlying position is that of a

profitable trading position. All Qualis companies have reported profits, with the exception of Qualis Living (the investment company that carries all development costs), which is impacted by historic planning delays and construction price inflation.

- 1.7. Recent changes to borrowing rules effectively prohibit the acquisition of commercial interests outside of the district, this together with the increasing challenge of finding suitable regenerations sites within the district that meet PWLB lending criteria, has meant that actual performance for Qualis Living has fallen considerably short (by £1.98 million) of the target set within last year's business plan. This is attributed to a combination of adverse legislative changes which restrict local authority borrowing freedom and rapidly deteriorating market conditions.
- 1.8. Market conditions for new developments are now less favourable and uncertain with the likelihood of fewer opportunities to bring forward highly profitable schemes. In the face of this, both profit and dividend expectation from Qualis will need to be reduced and delayed whilst the current economic uncertainty and volatility resolves itself over the short to medium term.

2. Introduction

- 2.1. The Qualis Shareholder agreement, as agreed by Cabinet in 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.

3. Commentary on the Trading Performance for Quarter 4, 2021/22 (Qualis Year 3)

- 3.1. 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 reports key financial performance indicators and key quarterly deliverables against the Business Plan.
- 3.2. **Cabinet should note that Qualis have flagged two key deliverables, and these are highlighted below.**
- 3.3. **Cash in Bank (Position Deteriorated)** – Below the target of £6 million by £5,010,00, (£2,733,218 below target in Quarter 3). The lower cash position is attributed to 'Failure to acquire additional investment properties that meet criteria, which is a result of new Public Works Loan Board restrictions and economic factors'. This is of lower concern as a debt funded organisation holding large sums of cash is inefficient and the objective of holding lower cash balances is a revised approach reflected in the 2022-2023 budget and business plan.

- 3.4. **Income and Expenditure (Reduced to Amber)** – The Board report includes cumulative losses up to the end of the 4th quarter of £44,362, (subsequently increased to £139,432 after audit), compared to a business plan expectation of a profit of £1,639,318. Whilst the cumulative loss has reduced slightly from the Quarter 3 position of £370,288 the variation from target has increased. However, the reason given is consistent with previous reports and is accepted. The reason for the accumulated loss is largely twofold and constant. Partly it is associated with accrued expenditure on the Roundhills development site, 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. The second issue is the delays in sourcing suitable regeneration sites within the district that provide a surplus income after servicing debt, until the property or site is ready for redevelopment
- 3.5. **Qualis Group, Qualis Commercial and Qualis Management** – All report profits ahead of target as at Q4.
- 3.6. **Qualis Living (Flagged as deteriorating)** – Qualis has experienced delays in finding and investing in suitable local properties using the regeneration loan of £35 million that the Council has made available to it. As this process is taking longer than had been assumed in the Business Plan, it is impacting upon the forecast higher rental income. At this stage in the Business Plan Qualis had assumed that it would have drawn £10 million from the Council whilst, for the reasons given above, this has not happened.
- 3.7. The table below sets out the actual net income or expenditure after tax as shown in the final accounts against that expected for each of the Qualis companies. The final accounts for Qualis Living also include disclosure of a deferred tax liability of £1.7m which is not included in the Actual figures below.

Qualis Company	Expected £	Actual £	Variance £	Last Report Q3 (2021/22) £
Group	32,262	131,936	99,674	91,913
Commercial	0	65,317	65,317	-489,112
Management	60,457	107,010	46,553	28,825
Living	1,546,599	-443,695	-1,990,294	-919,975
Total	1,639,318	-139,432	-1,778,750	-1,288,349

- 3.8. 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 and also includes the potential deferred tax liability which will not crystallise until those profits are realised.

Qualis Company	Fixed Assets £	Net Worth (Q4) £	Last Report Q3 (2021/22) £
Group	70,626	197,502	133,907
Commercial	0	-2,683,420	-2,962,171
Management	54,160	-63,632	-441,474
Living	44,474,521	-2,909,257	-1,061,246
Total	44,599,307	-5,458,807	-4,330,984

- 3.9. The reported deficit position now incorporates some capitalisation of Work in Progress on the Qualis development sites, thereby explaining the increase in the deficit carried forward. Qualis anticipates achieving a positive net worth position during their trading year 2024/25 – this coincides with the anticipated completion of their initial developments.

4. Resource Implications

- 4.1. 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 meant that actual payments to the Council were lower than expected in 2021/22 and this was reported in the Epping Forest District Council Budgetary monitoring reports. The Budget for 2022/23 makes some allowance for delays.

- 4.2. Actual lending to Qualis at the year-end is as follows:

Loan Purpose	Facility £ Millions	Term Years	Interest Rate %	Advanced at Quarter 3 £ Millions	Advanced at Quarter 4 £ 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	11.0	11.0
EFDC Asset Purchase	16.8	30	4.94	14.0	14.0
Regeneration Loan	35.0	TBC	TBC	0	0
Net Receipts	155.8			61.0	61.0

- 4.3. At the end of Q4 the Council had loaned Qualis £61 million against a Council commitment of £155.8 million.
- 4.4. The drawdown of loans is generally taking longer than originally anticipated in both the Qualis Business Plan and in the Council's Budget and this impacts on the delivery of financial planning target. Further delays will reduce the lending margin earned by the Council in 2022/23, but it is expected that some of this will be recouped through earlier advances of the construction loan than the budget assumed.

5. Legal and Governance Implications

- 5.1. None contained within this report.

6. Safer, Cleaner and Greener Implications

6.1. None.

7. Consultation Undertaken

7.1. None

Background Papers

Group Company Governance Document – Cabinet 6 February 2020