Governance Scrutiny Group

Tuesday, 23 July 2019

Capital and Investment Management Outturn 2018/19

Report of the Executive Manager – Finance and Corporate Services

1 Summary

1.1 The purpose of this report is to summarise the transactions undertaken during the 2018/19 financial year as part of the Capital and Investment Management function.

1.2 During the year the Corporate Governance Group received the half-yearly asset and investment management update report on 4 December 2018 and a training session from the Council's treasury advisors, Arlingclose, which was well received by Members across the Council.

1.3 The report also provides information on the Council's commercial investment activity as it embraces the new CIPFA Code ensuring there is both transparency and scrutiny in terms of both treasury and asset investment decision making.

2 Recommendations

2.1 It is recommended that the report is agreed by the Governance Scrutiny Group.

3 Reasons for Recommendation

3.1 This Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management activities and the actual prudential and treasury indicators for 2018/19. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Finance in Local Authorities (the Prudential Code).

4 Supporting Information

A) TREASURY MANAGEMENT

Prudential Indicators Summary

4.1 During 2018/19 the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year are as follows:

	2017/18 Actual £000	2018/19 Original	2018/19 Actual £000

Prudential and treasury indicators		Estimate £000	
Capital Expenditure	9,816	11,906	6,748
Capital Financing Requirement	9,300	14,653	8,300
Investments	(23,982)	(13,635)	(30,261)

4.2 The approved capital programme for 2018/19 was £11.906m, with £12.061m accelerated from 2017/18 and further adjustments of £804k during the year giving a total provision for the year of £24.771m. Actual expenditure against the approved programme was £6.748m (27%) giving rise to a variance of £18.023m. Carry forwards of £13.118mn were approved by Cabinet on 11 June 2019. There were savings totalling £167k, overspends of £79k; and £4.817m removed from the Programme. The increase in the Investments balance between years reflects slippage/removals from the Capital Programme.

Capital Expenditure and Financing

4.3 The Council undertakes capital expenditure on both its own long-term assets and on grants that can be capitalised under statute (capital payments to third parties). These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.) which has no resulting impact upon the Council's borrowing need; or
- If insufficient financing is available or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

4.4 The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed:

Prudential and Treasury Indicators	2017/18 Actual £000	2018/19 Original Estimate £000	2018/19 Actual £000
Capital Expenditure	**9,816**	**11,906**	**6,748**
Less Financed by:			
Capital Receipts	(6,455)	(5,995)	(4,754)
Capital Grants	(2,119)	(1,009)	(1,862)
Reserves	(505)	(370)	(132)
Increase in Borrowing Need	**737**	**4,532**	**0**

The Council's Overall Borrowing Need

4.5 The Council's underlying need to borrow for capital expenditure is called the Capital Financing Requirement (CFR). The CFR represents the net capital expenditure in 2018/19 and prior years that has not yet been paid for by revenue or other resources.

4.6 Part of the Council's treasury management activity is to organise the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be through utilising temporary cash resources within the Council (internal borrowing) or sourced through borrowing from external bodies, for example, the Public Works Loan Board (PWLB).

4.7 Where a positive CFR exists, the Council is required, by statute, to make an annual charge called the Minimum Revenue Provision (MRP) to reduce the CFR based on the life of the relevant assets. This provision effectively raises cash to either help repay loans or replenish internal borrowing.

4.8 The total CFR can be reduced by:

- The application of additional resources (such as unapplied capital receipts); or
- Charging more than the statutory revenue charge (MRP) each year through a voluntary revenue provision (VRP).

4.9 For 2017/18 and 2018/19 the Council decided to set the MRP at £1m mainly to recover internal borrowing for the Arena.

4.10 The Council's CFR for 2018/19 represents a key prudential indicator and is shown below. The table shows that no additional borrowing was needed in 2018/19 giving rise to a reduction in the CFR of £1m, after deducting the MRP of £1m in 2018/19.

Capital Financing Requirement (CFR)	**2017/18 Actual £000**	**2018/19 Actual £000**
Opening Balance	**9,563**	**9,300**
Add: unfinanced Capital Expenditure (per above)	737	0
Less: MRP/VRP	(1,000)	(1,000)
Closing Balance	**9,300**	**8,300**

Net Borrowing, CFR, Authorised Limit and Operational Boundary

4.11 The borrowing activity is normally constrained by prudential indicators for net borrowing, the CFR and by the Authorised Limit for external debt.

4.12 The authorised limit is the "affordable borrowing limit" required by section 3 (1) of the Local Government Act 2003 and represents the limit beyond which borrowing is prohibited and was set at £25m.

4.13 As the Council did not need to resort to external borrowing during 2018/19 these indicators are not applicable

4.14 Similarly, the Council is required to set an operational boundary, which is the expected borrowing position of the Council during the course of the year. The operational boundary is not a limit and actual borrowing can be either below or over the boundary subject to the authorised limit not being breached. The Operational Boundary was set at £0m to reflect the expected borrowing position. The Authorised limit of £25m gives room for any variations from this.

The Ratio of Financing Costs to Net Revenue Streams

4.15 This compares net financing costs (borrowing costs, including interest foregone from the use of cash balances less investment income) to net revenue income. This indicator shows how the proportion of net income used to pay for financing costs is changing over time and is negative as a result of investment yields exceeding borrowing costs.

	2017/18 Actual £000	2018/19 Estimate £000	2018/19 Actual £000
General Fund	-2.46%	-2.59%	-3.62%

Upper Limits for Fixed and Variable Rate Exposure

4.16 The purpose of these indicators is to allow the Council to manage the extent to which it is exposed to changes in interest rates:

	2018/19 Limit	2018/19 Actual
Fixed Upper Limit for Fixed Interest Rate Exposure	50%	20%
Variable Upper limit for Variable Interest Rate Exposure	100%	80%

Upper Limit for Total Principal Sums invested over 1 year

4.17 This limit is intended to contain the exposure to the possibility of any loss that may arise as a result of the Council having to seek early repayment of any investments made. If an investment had to be repaid before its natural maturity date due to cash flow requirements then, if market conditions were unfavourable, there would be an adverse impact on the Council.

	2018/19 Limit £000	2018/19 Actual £000
Upper Limit for Total Principal Sums Invested over 364 days	14,200	6,000

Treasury Position at 31 March 2019

4.18 The Council's debt and investment position is managed by the treasury team in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities in line with the approved treasury strategy. Procedures and controls to achieve these objectives are established through reports to Members via the Governance Group and reporting and through officer activity detailed in the Council's Treasury Management Practices. The following table details the

Counterparties that the Council had placed investments with at the end of 2018/19.

Institution	Length of Term	Amount £	Current Interest Rate
Aviva Liquidity Funds	Call	20,342	0.70%
Blackrock	Call	872,519	0.75%
Federated Investors (Uk)	Call	1,161,186	0.78%
Goldman Sachs Asset Management	Call	147,576	0.72%
HSBC Asset Management	Call	2,672,151	0.38%
Invesco Aim	Call	3,118,187	0.78%
Aberdeen Asset Management	Call	1,545,491	0.78%
Bank Of Scotland Plc	32 Days	106,930	0.57%
Barclays Bank Plc	32 Days	253,092	0.52%
Santander Uk Plc	35 Days	2,209,281	0.75%
Blackpool	I Year	5,000,000	0.70%
Broxtowe	I Year	1,000,000	0.75%
Conwy County Borough Council	6 Months	3,000,000	0.45%
Salford City Council	9 Months	5,000,000	0.45%
Royal London Cash Plus Fund	On-going	1,002,657	0.43%
Ccla Diversified Income Fund	On-going	994,926	0.43%
Ccla Property Fund	On-going	2,147,456	4.58%
Miscellaneous		9,319	Various
Total Investments/Average Interest Rate to Date		**30,261,113**	**1.16%**

The strategy for 2018/19

4.19 The expectation for interest rates within the strategy for 2018/19 anticipated that short term money market rates would increase slightly and that the Bank Rate would rise from 0.75% to 1.25%. The Council continued with the prudent investment of the treasury balances to achieve the objectives of security of capital and liquidity of its investments, whilst achieving the optimum return on investments. The continuing uncertainty of the market resulted in restrictions remaining on which counterparties investments could be placed with, which affected the level of interest that could be achieved from investments. Given the impact of 'Bail-in' legislation the Council continues to diversify its investment portfolio.

Investment Rates and Outturn Position in 2018/19

4.20 The Bank Rate increased from 0.50% to 0.75% on 2nd August 2018 and short term money market rates also rising slightly which continued to have a significant impact on investment income. Whilst the Council continues to ensure investments are secure the Council is proactively looking to maximise its rate of return. The overall rate of return on investments for the year was 1.16% which compares with the budgeted rate of 0.75%. This improved return together with underspend on the capital programme has resulted in an increased net return on investments of £403,167 against a budget of £259,500.

4.21 The Council's investment policy is governed by the annual Capital and Investment Strategy approved by Council on 8 March 2018 (and prior to this approved by the Corporate Governance Group in February 2018). This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, for example, rating outlooks and credit default swaps information. The investment activity during the year conformed to the approved strategy and the Council had no liquidity difficulties.

4.22 The Council's longer term cash balances comprise primarily of revenue and capital resources, although these will be influenced by cash flow considerations and the need for working balances and contingencies. The Council's core cash resources are detailed in the following table and confirm that whilst the Council has delivered a capital programme and has to operate with an increasingly constrained revenue budget, its reserves and balances remain in a healthy position given the on-going financial challenges going forward.

Balance Sheet Resources	**31 March 2018 £000**	**31 March 2019 £000**
General Fund Balance	2,604	2,604
Earmarked Reserves	10,532	11,818
Usable Capital Receipts	8,168	7,036
Capital Grants Unapplied	108	98
Total	**21,412**	**21,556**

Conclusion – Treasury Management

4.23 Overall the Council has successfully achieved its objectives of ensuring investments were held with relatively secure counterparties; ensuring there was sufficient liquidity to operate efficiently and enable the delivery of objectives; and achieve a yield on investment returns given the constraints placed upon the Council (in terms of both financial market risks and the need to retain liquidity and protect capital).

B) ASSET INVESTMENT STRATEGY

Overview

4.24 The Government and CIPFA have recently issued new guidance on Treasury Management activity, which particularly focuses on the role of longer term investments specifically held to make a commercial return. The Council's Asset Investment Strategy falls within this definition.

4.25 This section of the report reviews the current position and the issues that influenced the Asset Investment Group's future approach to investments.

Investments 2018/19

4.26 During 2018/19 the Asset Investment Group agreed to proceed with two new asset acquisitions and investments. An investment of £1.4m for the Co-op, Trent Boulevard was completed on 19 April 2018 and £0.805m for Boundary Court, Castle Donington on 27 February 2019. Further details are provided below:

Co-op, Trent Boulevard

4.27 Details of the investment appraisal are attached at Appendix A, and are summarised as follows:

- It gives a current rental of £69,000 and gives a yield of 4.75%;
- Refurbished in 2017;
- Strong covenant (credit score of 60, below average risk);
- 15 year lease, no breaks - unusual in the market;
- 5 year rent review in line with CPI (with a collar and cap of 1% and 3%);
- Good location & population catchment (26,000 people within 1 mile);
- Provides further diversification for the asset portfolio;
- after 40 years a positive net present value (for the central case) of around £0.325m and an internal rate of return (IRR) after financing costs of 4.34% (typically Government Green Book projects aim for 3.5% IRR);
- Food retail can be a fluctuating market, although not so much with the convenience store market;

Boundary Court, Castle Donington

4.28 Details of the investment appraisal are attached at Appendix B, and are summarised as follows:

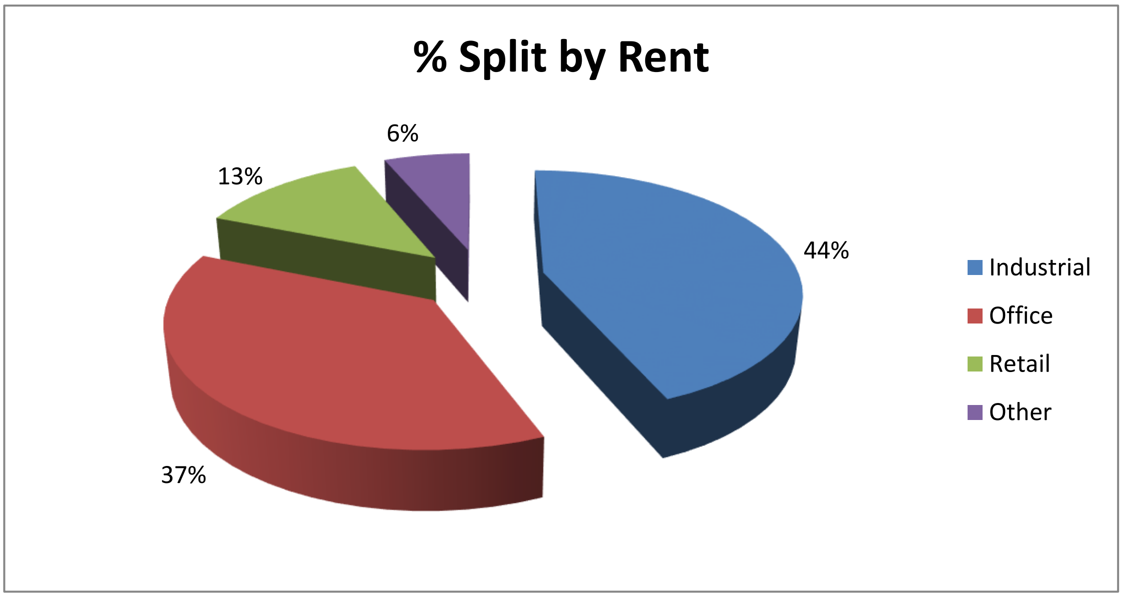
- after 40 years a positive net present value (for the central case) of around £0.293m and an internal rate of return after financing costs of 4,66% (typically Government Green Book projects aim for 3.5% IRR) are expected;
- The building is only 10 years old so few property repair issues are anticipated;
- Within the £0.83m upfront cost, £25k is to be appropriated to reserves for risks surrounding potential repairs to the sewer;
- One lessee has a good covenant strength, one is not so good. The financial model does assume a 3 year turnover with tenants and a 12 month void period to mitigate this risk;
- One lessee has a 5 year lease (ending 2023), and a break and rent review in 2021 and another a 10 year lease until 2027 with a break and rent review in 2020;
- It is for office accommodation so gives good balance to the Council’s property portfolio;
- It is a solid location an established business park with good transport links to the M1 and A50. Few voids at the location, with one void next door;
- It is a fully repairing and insurance lease;
- Geographically it is not too far away from the Borough boundary and within the confines of the Midlands Engine;
- The rail hub development should give a positive opportunity for future rental stream.

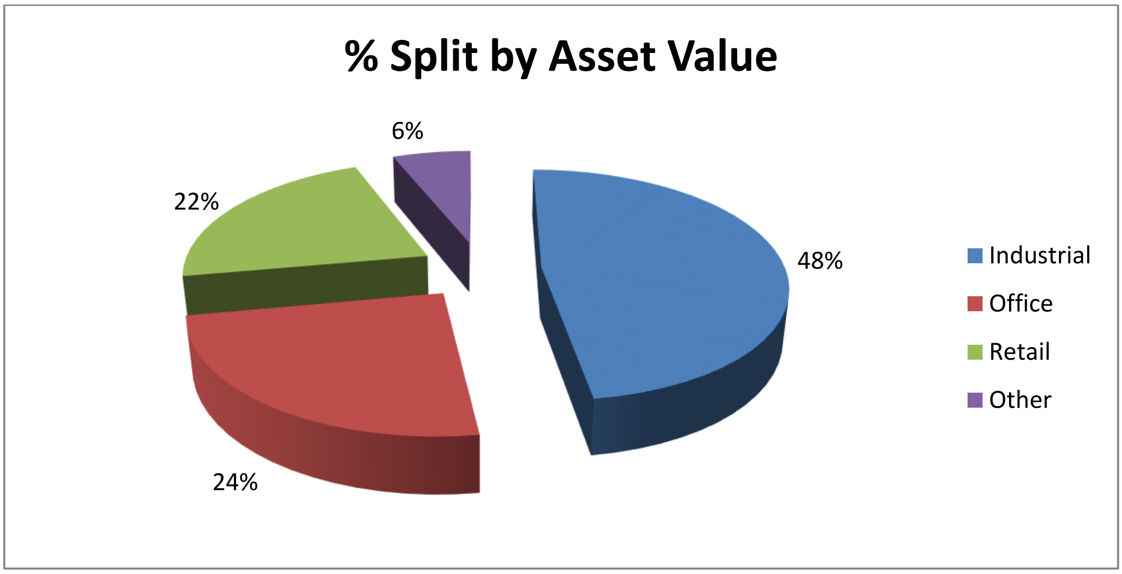
Current Position

4.29 In terms of the Asset Investment Strategy and the fund the table below exemplifies the current position and significant work undertaken primarily by the Property, Legal and Finance teams. Currently £4.761m remains outstanding from the original £20m allocation.

Total (incl. acquisition costs)	Gross Return	Investment	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
£2,700,000	4.31%	NCCC Loan (interest)	76,700	76,900	73,600	70,500	67,100	63,800
£1,477,500	4.67%	Trent Boulevard (Co-op)	69,000	69,000	69,000	69,000	69,000	69,000
£984,000	6.76%	Finch Close	66,500	66,500	66,500	66,500	66,500	66,500
£1,917,000	6.26%	Bardon	120,000	120,000	120,000	120,000	120,000	120,000
£2,500,000	5.88%	Cotgrave - New Offices	25,000	30,000	30,000	30,000	30,000	30,000
		Cotgrave- Ind Units	100,000	117,000	117,000	117,000	117,000	117,000
£1,750,000	5.71%	Ind Units Moorbridge				100,000	100,000	100,000
£860,000	6.98%	Castle Donnington		30,000	60,000	60,000	60,000	60,000
£1,150,000	5.22%	Fairham Pastures					60,000	60,000
£1,900,000	**5.26%**	Cotgrave Phase 2				100,000	100,000	100,000
£15,238,500	**5.50%**	**Totals**	**488,250**	**548,870**	**578,870**	**778,870**	**838,870**	**838,870**
£4,761,500	**5.50%**	**Outstanding balance**	**261,880**	**261,880**	**261,880**	**261,880**	**261,880**	**261,880**

4.30 If we look at the Council's overall property portfolio (this excludes the loan to NCCC) there is a good spread of risk (classifying by the rental earned or the asset value), as depicted below:





4.31 From the above there is more investment in the industrial sector given much of the property investment, in the past, has been about economic growth and regeneration within the Borough. More recent acquisitions have been in retail and office spreading the risk from income streams.

4.32 In terms of risk in relation to the Council's budget the following table demonstrates that whilst property income is important for the Council's budget; there is not an over emphasis upon property income and there are other income streams. This is in keeping with the Council's Treasury Management Strategy where the objective is that the ratio of investment income as a proportion of the council's income does not exceed 30%.

<u>Commercial Investment income and costs</u>

	2019/20 £'000	2020/21 £'000	2021/22 £'000	2022/23 £'000	2023/24 £'000
Commercial Property Income	(1,356)	(1,406)	(1,906)	(1,966)	(1,966)
Running Costs	532	512	513	514	514
Net Contribution to core functions	(824)	(894)	(1,393)	(1,452)	(1,452)
Interest from Commercial Loans	(85)	(80)	(76)	(71)	(67)
Total Contribution	(909)	(974)	(1,469)	(1,523)	(1,519)
Sensitivity:					
+/- 10% Commercial Property Income	136	141	191	197	197
Indicator:					
Investment Income as a % of total Council Income	18.9%	18.7%	23.3%	23.6%	23.5%

The Way Forward

4.33 The Council's original intention was to look at generating around £1m of additional property rental income to help bridge the anticipated budget deficit, and the majority of this (83.9%) will be achieved by 2023/24 (see table at paragraph 4.29). The analysis also excludes potential income from a Crematorium (assuming this goes ahead). Last year the AIG decided to rein in its commercial investment activity given risks within the property market and the amount of capital investment required locally (and this was supported by Council as part of the budget). Uncertainty over the crematorium particularly may mean a review of this strategic approach and acquiring more commercial assets.

4.34 Given the above the following was recently approved by Cabinet (11 June 2019):

a) The carry forward of £13.118m capital underspends into 2019/20; and
b) To carry forward the £4.761m on the Asset Investment Strategy into 2019/20 for commercial acquisitions.

Conclusion

4.35 The position on tall council investments, whether treasury or commercial investments, remains fluid. Clearly risks remain in the treasury markets, the property market and also with the Council's capital programme. Failure to deliver additional income streams will increase the requirement to identify further efficiencies or utilise reserves in the short to medium term. Such decisions will be considered and reported as part of the MTFS 2020/21 budget process and be reported in financial reports in 2019/20.

5 Alternative options considered and reasons for rejection

5.1 There are no other options.

6 Risk and Uncertainties

6.1 The report covers many treasury risks including counterparty and interest rate risk and also property risks both unique to individual properties and the wider strategic view of property. Commercial property investment risks are covered particularly in paragraphs 4.27 and 4.28 as well as how risk is mitigated in totality by diversification and not over reliance on property income (paragraphs 4.30-4.32).

7 Implications

7.1 Financial Implications

Financial implications are covered in the body of the report.

7.2 Legal Implications

Compliance with the Local Government Act 2003.

7.3 Equalities Implications

None

7.4 Section 17 of the Crime and Disorder Act 1998 Implications

None

7.5 Other Implications

None.

8 Link to Corporate Priorities

Efficient and effective treasury and property management enables the Council to achieve its corporate priorities.

9 Recommendations

It is RECOMMENDED that the report is agreed by the Governance Scrutiny Group

For more information contact:	Peter Linfield Executive Manager – Finance and Corporate Services 0115 914 8439 plinfield@rushcliffe.gov.uk
Background papers Available for Inspection:	Statement of Accounts 2018/19; Capital and Investment Strategy 2018/19; Capital and Investment Strategy – Mid-Year Report 2018/19
List of appendices (if any):	**Glossary of Terms** **Appendix A** – Investment Appraisal, Co-op, Trent Boulevard **Appendix B –** Investment Appraisal, Boundary Court, Castle Donington

Glossary of Terms

Money Market Funds – these funds are pooled investment vehicles consisting of money market deposits and similar instruments. They have the advantage of providing wide diversification of investment risks.

CCLA Property Fund - this a local authority property investment fund. The property fund is designed to achieve long term capital growth and a rising income from investments in the commercial property sector.

COMMERCIAL PROPERTY INVESTMENT STRATEGY ASSESSMENT MATRIX

Appendix A

PROPERTY	**111 Trent Boulevard, West Bridgford**
PROPERTY TYPE	**Food Retail**
TENANT	**Co-op**

ASSESSMENT CRITERIA	**Excellent / very good**	**Good**	**Satisfactory**	**Marginal**	**Uncertain**
Tenancy strength	Multiple tenants with strong financial covenant	Single tenant with strong financial covenant	Single or multiple tenants with good financial covenant	Tenants with average financial covenant	Tenants with poor financial covenant strength
Lease length and break (for main tenants/income)	>15 years	11 - 15 years	10 - 8 years	7 - 5 years	<5 years or vacant (unless reflected in price)
Rate of Return - % rent against capital	>8%	7%-8%	5%-7%	3%-5%	<3%
Portfolio mix (asset type is balanced in portfolio - no more than x% of portfolio)	<50%	50%-60%	>60%-70%	70%-80%	>80% of portfolio
Property Sector & Risk	Industrial (lower risk)	Office (lower-mid risk)	Warehouse Retail (med risk)	Retail, Leisure (higher risk)	Residential (not part of investment strategy)
Void (after Lease end including marketing, fit out and rent free)	0-9 months	9-12 months	12-18 months	18-24 months	>18 months
Location	Prime	Not prime but in established location	Secondary	Remote from other developments	Isolated, undeveloped area, limited infrastructure links
Tenure	Freehold	Lease >200 years	Lease 100 - 199 years	Lease 75 - 99 years	Lease <75 years
Repairing terms links to Building quality	Full repairing & insuring	Interal repairing 100% recoverable	Internal repairing partially recoverable	Internal repairing non recoverable	Landlord
Building Quality/Age	<10 years	10-20 years	21-30	31-35	>35
Rental Growth	within 1 year	within 2-5 years	within 5-7 years	within 7-10 years	>10 years
Purchase Price	<£2m	Between £2m and £3m	Between £3m and £4m	Between £4m and £7m	>£7m
Proximity to Borough	within Borough	within Nottinghamshire	within East Midlands	within the Midlands	National
Energy Rating (2018 legislation can't let with F/G assessment)	A/B	C	D	E	F/G

CONTEXTUAL INFORMATION

PROPERTY	
Address	111 Trent Boulevard
Location/Situation (ie what is nearby)	Residential area with some shops/business/services in adjacent and opposite: 2x hair salons, convenience store, newspaper shop, fish & chips and café
Description of Asset (ie age, layout, construction, services, car park)	A single storey former industrial unit recently extended and converted to a Co-op retail food
Size/site area	2,500 sq ft (232m2) sales 1,250sq ft (116m2)
Planning ie use/class	Food retail
Conditions of sale	

COSTS	Total Capital Purchase costs	Total Annual Revenue Costs	Total Annual Income
Purchase price	£1,400,000		
Purchase costs ie SDLT, legal, agents, survey fees	£91,000		
Refurbishment costs	£0		
Borrowing costs/Capital costs		£9,800	
Business Rates		£0	
Management costs & Sinking Fund		£3,450	In-house mgmt
Service charge apportionment		£0	
Rent/Income			£69,000
Total	£1,491,000	£13,250	£69,000
Net Annual Profit			£55,750

Life Costs ie current condition	Not inspected, but had recent refurb so should be in good condition - would need to check services
Yield	4.75%
Return on Investment (years)	27
IRR	
Rental growth	CPI uplift at year 5 (cap & collar 1-3%)
Opportunity to add value (ie lease/tenant mgmt, regearing, building changes)	No
Other costs	

LEASE TERMS	
Tenure ie Freehold/Leasehold	Freehold
Tenant/Tenant Mix	One tenant - Co-op
Tenant covenant strength	Strong
Lease term & breaks	Lease term 15 years, no breaks
Rent review & terms	Every 5 years, CPI increase, cap & collar (1-3%)
Key lease conditions ie alienation	
Cashflow risk ie to rents	Secure tenancy
Void ie current/expected	18 months
Lease type ie FRI (repairing obligation)	FRI

OTHER	
Economic Factors ie market commentary	Co-op food retail is a strong sector currently, good location with similar business services
Potential uses/alternative uses	Alternative use could be residential or other retail, business use
Benefits	Refurbished in 2017 Strong covenant (credit score of 60, below average risk) 15 year lease, no breaks - unusual in the market 5 year rent review CPI Good location & population catchment (26k people in 1 mile) Good mix for asset portfolio
Risks	Food retail can be a fluctuating market, although not so much with the convenience store market Return on investment is 24 years Not undertaken inspection, unclear how much of old building retained Limited information so far Awaiting EPC

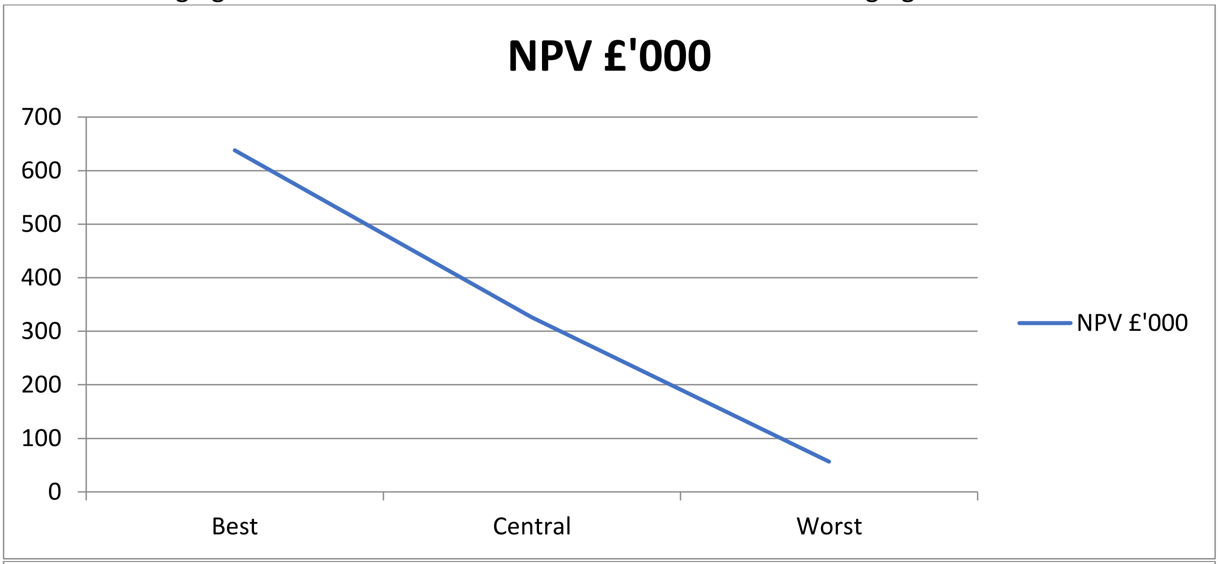
Summary	Solid investment opportunity in a good area with a strong covenant and lease term. However, due to low yield (indicating a 'safer' investment risk), the return is longer, which may impact on 'affordability' of asset in portfolio

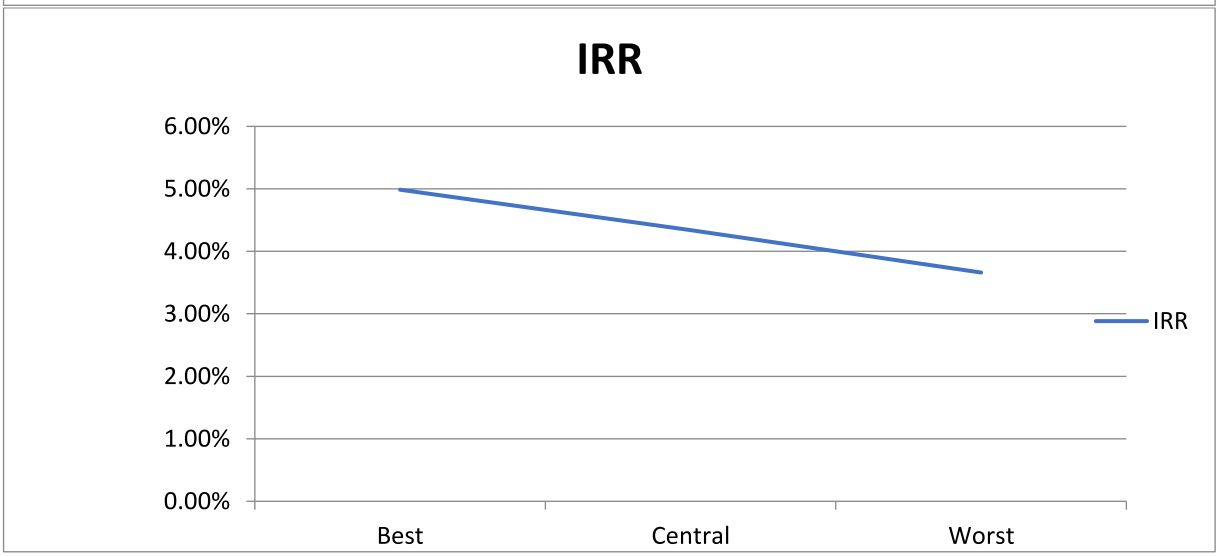
Sensitivity Analysis

1. The following assumptions have been made ranging from worst, central to best case scenarios:

Sensitivity	Best (pa)	Central (pa)	Worst (pa)	Rationale
Inflation for management costs and repairs	1.7%	2.0%	2.3%	Central case being Government inflation target
Inflation on rent and asset value; rent review 5 yearly	2.5%	2.0%	1.5%	Linked to inflation targets and more variable
Variable borrowing rates. Borrowing assumed over 40 years for 50% of financing	Current rate	+0.30%	+0.60%	Assume interest rate rises
Vacancy factor	Assume 18 months vacancy at year 16,21, 26 etc			

2. Using the above assumptions and assuming disposal in Year 40 gives a positive Net Present Value ranging from £637k to £56k and an internal rate of return ranging from 3.66% to 4.99%.





COMMERCIAL PROPERTY INVESTMENT STRATEGY ASSESSMENT MATRIX

Appendix B

PROPERTY	**6 Boundary Court, Willow Farm Business Park**
PROPERTY TYPE	**Office**

ASSESSMENT CRITERIA	**Excellent / very good**	**Good**	**Satisfactory**	**Marginal**	**Uncertain**
Tenancy strength	Multiple tenants with strong financial covenant	Single tenant with strong financial covenant	Single or multiple tenants with good financial covenant	Tenants with average financial covenant	Tenants with poor financial covenant strength
Lease length and break (for main tenants/income)	>15 years	11 - 15 years	10 - 8 years	7 - 5 years	<5 years or vacant (unless reflected in price)
Rate of Return - % rent against capital	>8%	7%-8%	5%-7%	3%-5%	<3%
Portfolio mix (asset type is balanced in portfolio - no more than x% of portfolio)	<50%	50%-60%	>60%-70%	70%-80%	>80% of portfolio
Property Sector & Risk	Industrial (lower risk)	Office (lower-mid risk)	Warehouse Retail (med risk)	Retail, Leisure (higher risk)	Residential (not part of investment strategy)
Void (after Lease end including marketing, fit out and rent free)	0-9 months	9-12 months	12-18 months	18-24 months	>24 months
Location	Prime	Not prime but in established location	Secondary	Remote from other developments	Isolated, undeveloped area, limited infrastructure links
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Repairing terms links to Building quality	Full repairing & insuring	Interal repairing 100% recoverable	Internal repairing partially recoverable	Internal repairing non recoverable	Landlord
Building Quality/Age	<10 years	10-20 years	21-30	31-35	>35
Rental Growth	within 1 year	within 2-5 years	within 6-7 years	within 8-10 years	>11 years
Purchase Price	<£2m	Between £2m and £3m	Between £3m and £4m	Between £4m and £7m	>£7m
Proximity to Borough	within Borough	within Nottinghamshire	within East Midlands	within the Midlands	National
Energy Rating (2018 legislation can't let with F/G assessment)	A/B	C	D	E	F/G

CONTEXTUAL INFORMATION

PROPERTY			
Address	6 Boundary Court, Willow Business Park, Castle Donington		
Location/Situation (ie what is nearby)	Located within an existing, established business park		
Description of Asset (ie age, layout, construction, services, car park)	Built in 2008, portal frame with brick to all elevations and some double height glazing to the front. Semi detatched with 22 car parking spaces Suspended ceilings with inset lighting Full height reception area with communal area (subject to service charge) Air conditioning Double glazing Self contained wc facilities within each office Additional admin for service charge of £18k, recharged to tenants (unless void)		
Size/site area	5304 sq ft (493m2)		
Planning ie use/class	B1 office		
Conditions of sale	Unknown		
COSTS	**Total Capital Purchase costs**	**Total Annual Revenue Costs**	**Total Annual Income**
Purchase price	£805,000		
Purchase costs ie SDLT, legal, agents, survey fees	£52,325		
Refurbishment costs	£0		
Borrowing costs/Capital costs		£3,220	
Business Rates		£0	
Management costs & Sinking Fund		£9,540	NB: any void period would be a loss of rent and an additional cost for Business
Service charge apportionment		£0	Rates (RV is £56k for whole) and service charge (£18k pa for whole)
Rent/Income			£63,600
Total	£857,325	£12,760	£63,600
Net Annual Profit			£50,840
Life Costs ie current condition	Building 10 years old, would expect to be in good condition with limited works required in next 5 years. Inspection needed.		
Yield	7.25%		
Return on Investment (years)	17		
IRR			
Rental growth	Limited within 5 years, perhaps small growth of £10k pa upon review. HOWEVER, likely to have a period of void due to poor credit rating of one tenant		
Opportunity to add value (ie lease/tenant mgmt, regearing, building changes)	Limited currently, but possiblity to increase rent upon review or with new tenant within 5 years		
Other costs	Void costs likely within 12 months - business rates, services charge, no rent		
LEASE TERMS			
Tenure ie Freehold/Leasehold	Freehold purchase		
Tenant/Tenant Mix	Two tenants paying equal rent		
Tenant covenant strength	One tenant good One tenant poor 'moderate/high risk of failure within 12 months'		
Cashflow risk ie to rents	One tenant 5 year lease (from Sept 2018) ends 2023 with break and rent review at 2021 Second tenant 10 year lease (Oct 2017) ends 2027 with break and rent review at 2020		
Rent review & terms	One tenant rent review at 2021 Second tenant rent review at 2020		
Key lease conditions ie alienation			
Cashflow risk ie to rents	Likely to have a void period - could be 6 month void with 6 month rent free		
Void ie current/expected	12 months void, within next 12 months		
Lease type ie FRI (repairing obligation)	Fully repairing and insuring, plus service charge for shared areas		

OTHER	
Economic Factors ie market commentary	Significant amount of economic uncertainty, which impacts on the property market. Retail is as a sector is failing and the risk is that this filters to other areas of the property market, not least due to the supply chain, but also for bigger econmic reasons ie Brexit. Property investment in this context should be carefully considered. The office and industrial markets are still strong and this is property is locating within an established business park with no apparent current voids.
Potential uses/alternative uses	None
Benefits	Established business location Building 10 years old Popular area with limited voids Good lot size and fit with existing portfolio Reasonable yield and return Good EPC rating - C Fully repairing and insuring
Risks	Estate Service Charge (cost unknown) Building Service Charge - requires estates management and cost to this Two tenants - one poor credit rating with moderate to high risk of failing within 12 months Risk of rent default by high risk tenant and ability to bring the lease to an end - could incur legal costs here Lease break in 2 & 3 years Void costs - includes loss of rent plus cost of business rates and service charge Economic and market uncertainty
Liquidity	Small lot size likely to have greater demand in the local market making the sale quicker
Local economic benefits	None
Local Search info	Unknown
Delivery Model ie set up a new company, JV, with another Council	N/A

Summary	*Good lot size in established business park location with good communitication links to A50 and j24/j24A M1. *Building only 10 years old, limited financial implications for structural repairs, although some internal fitout works will be required as part of good estates management. *Good EPC rating - C *Fully let, although one tenant has a poor credit rating with a risk of failure within 12 months - this could have void implications and legal costs if the tenant defaults on rent payments but remains insitu. The other tenant's lease expires in 3 years *The positive of this is that there could be some rental growth within 5 years, possibly an additional £10k pa if triggered by a rent review or new tenant *Fully repairing and insuring with a rechargeable service charge (when fully let) *Void allowance of 12 months to secure new tenant and provide rent free, during which time business rates and service charge will be payable *Overall, there are some risks with the quality of one tenant and a short lease for the second tenant, it could require some estates management costs in the short term. However, it's a small lot size, a reasonable yield and return, would sit comfortably within the existing portfolio and is worth consideration. The office and industrial markets are still strong and this property is located within an established business park with no apparent current voids, however the purchase of any property should be considered in the context of the current market and economic climate and the unknown impact of Brexit and the decline of retail. Given the likelihood of a void period in the near future, the financial cashflow is likely to have a significant bearing on whether to proceed.

Sensitivity Analysis

1. The following assumptions have been made ranging from worst, central to best case scenarios:

Sensitivity	Best (pa)	Central (pa)	Worst (pa)	Rationale
Inflation for management costs and repairs	1.7%	2.0%	2.3%	Central case being Government inflation target
Inflation on rent and asset value; rent review 5 yearly	3%	2.0%	1%	Linked to inflation targets and more variable
Vacancy factor	Assume 12 months vacancy every 3 years			One of the tenants has a poor credit rating

2. Using the above assumptions and assuming disposal in Year 40 gives a positive Net Present Value ranging from £22k to £681k and an internal rate of return ranging from 5.74% to 3.61%.