Governance Scrutiny Group

Tuesday, 24 November 2020

Capital and Investment Strategy – Mid-Year Report 2020/21

Report of the Executive Manager - Finance and Corporate Services

1. Purpose of Report

1.1. The purpose of this report is to summarise the capital and investment activities of the Council for the period 1 April to 30 September 2020. During this period, the Council acquired Unit 1 Edwalton Business Park closely followed by Unit 3 Edwalton Business Park in October.

1.2. The Capital and Investment Strategy for 2020/21, approved by Council on 5 March 2020 outlines the Council's capital and investment priorities as follows:

- Security of capital;
- Liquidity of investments; and
- Optimising yield earned on investments (cash and property).

1.3. The strategy includes indicators that help ensure that the Council's capital investment plans are affordable, prudent and sustainable. Setting an integrated Capital and Investment Strategy is a requirement of the CIPFA Code of Practice.

2. Recommendations

It is recommended that the Group notes the Capital and Investment Strategy up-date position at 30 September 2020.

3. Reasons for Recommendation

3.1 CIPFA's Code of Practice for Treasury Management (2017) recommends that Councillors should be informed of Treasury Management activities at least twice a year. This report, therefore, ensures this Council is embracing best practice for the scrutiny of capital and investment activity in accordance with the Code of Practice.

4. Supporting Information

Economic Background

4.1. The Coronavirus outbreak has caused huge economic damage to the UK and around the world. In the first six months of 2020/21:

- The fall in growth in the UK economy was revised from 28% to 23%, still one of the largest falls in output of any developed nation.
- The Bank of England base rate was cut on 19 March 2020 to 0.1%, just a week after being cut to 0.25%.

Economic Forecast

4.2. Economic growth fell by a record 20% in April 2020. The economy has since been recovering better than expected but medium-term projections are a less informative guide than usual. We are now in a second lockdown which could damage the economy further. Up until now the Government have been trying to deal with any spikes in virus infections with localised measures, in an attempt to limit the amount of economic damage done but unfortunately has now had to resort to another national lockdown set to last at least 28 days.

4.3. UK unemployment rate stood at 3.9% in the second quarter of 2020, unchanged over a three-month period and below market expectations of 4.2%. The Bank of England has warned that this figure could double to 7.5% by the end of the year, and only fall slowly in 2021. The full effects of the Covid19 outbreak have been significantly mitigated by the extensive take-up support from temporary government schemes. Uncertainty remains about the prospects for employment after furlough comes to an end.

4.4. The current Bank of England base rate is 0.1%. The Bank of England took emergency action in March to cut the Bank Rate to first 0.25% and then to 0.1%. It has remained unchanged, but some forecasters are suggesting that a cut into negative territory could happen. The Bank of England suggest such a move would do more damage than good. Link (the Council's Treasury Advisors) are forecasting no change within the forecast horizon ending on 31 March 2023.

4.5. Inflation, for July 2020, showed a bigger than expected rise to 1% from 0.6% in June. This trend is set to continue with inflation levels expected to be above 2% in 2023.

4.6. Overall, there was a strong pick-up in economic growth although more recently evidence suggests this has stunted. The furlough scheme was set to end October but has now been extended to the end of March 2021 due to the fear that its withdrawal will lead to many job losses. Consumers will also probably remain cautious in spending and this will dampen growth. Uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year is a significant risk. Economic recovery is expected to be only gradual and, therefore, prolonged. The trajectory will be dependent on factors such as the success of a Coronavirus vaccine.

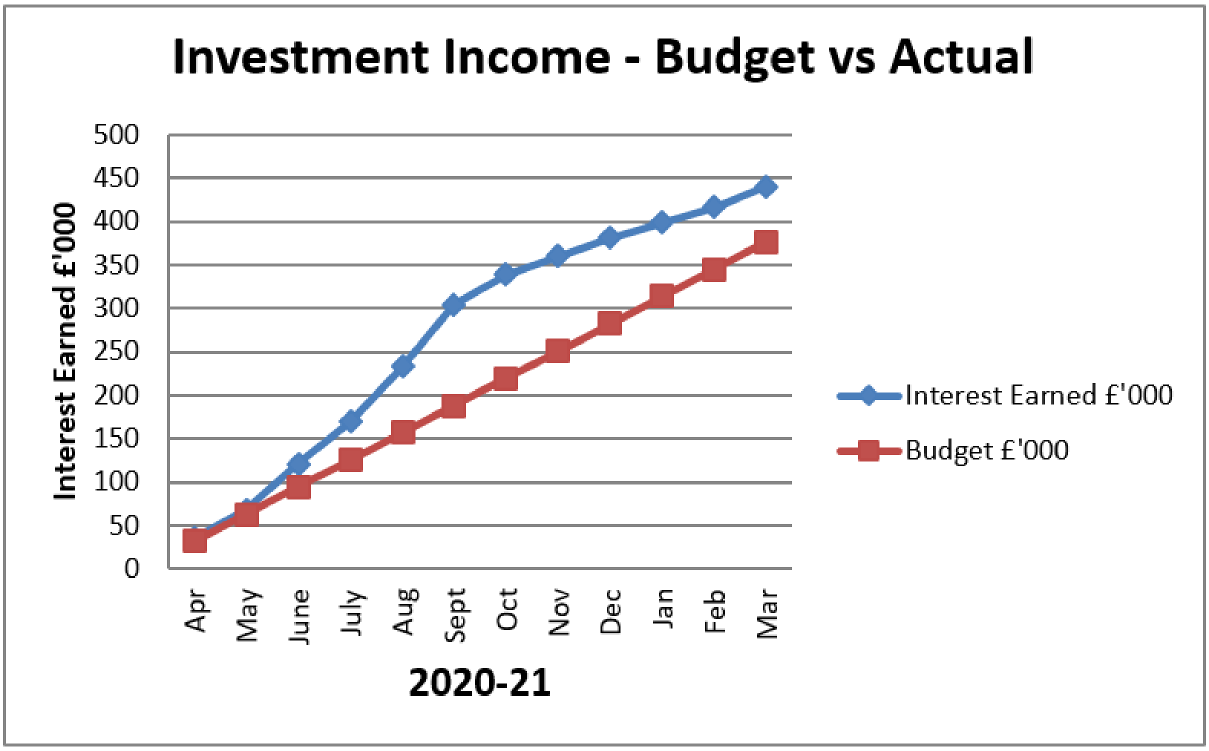
Investment Income

4.7. A combination of base rate forecasts, constraints on the lending list and the expenditure expected to be incurred on the Capital Programme meant the Council budgeted to receive £376,800 in investment income in 2020/21. Actual interest earned to 30 September 2020 totalled £297,610 with total receipts for the year expected to be £440,460. Interest receipts are higher than estimated due to investing in higher interest earning diversified funds coupled with delays in the capital programme. Going forward this could change; for example, if interest rates alter in light of the second wave of Covid19. All investments have been made in accordance with the Council's Capital and Investment Strategy.

4.8. In order to maintain returns and mitigate risks, the Council has continued to diversify its investments mix. As a result, the Council is currently placing deposits in Money Market Funds, Call Accounts, CCLA Property Fund, UK Local

Authorities and Diversified Funds with a maximum of £5 million being placed with any single institution.

4.9. The projected return on investments is highlighted in the following graph, which depicts the performance against the budget.



4.10. The average interest rates achieved so far this year on the Council's investments are compared to the London interbank bid rate (LIBID) rates. In addition, the Council has just over £12 million invested in diversified income and property accounts that are earning on average a rate of 4.3% in interest.

Benchmark	2020-21 LIBID	Council Performance
Instant Access	0.07%	0.10%
1 month	0.02%	0.08%
3 month	0.11%	-
6 month	0.21%	0.50%
12 month	0.35%	0.42%

4.11. The table below highlights the level of investment activity and the rates obtained at 30 September 2020. Investments were made in line with Link's approved counterparty list.

Financial Institution	Amount £	Length of Investment	Interest	Date
Rotherham Metropolitan Borough	5,000,000	184 days	1.00%	26 May 2020
Lancashire County Council	5,000,000	2 Years	1.20%	15 Oct 2019
Aviva Investors	339,161	Call	0.00%	N/A
Federated Investors (Uk)	4,707,920	Call	0.06%	N/A
Hsbc Asset Management	1,368,466	Call	0.01%	N/A
Invesco Aim	4,993,702	Call	0.04%	N/A
Aberdeen Asset Management	4,456,231	Call	0.08%	N/A
Barclays Bank Plc	263,955	32 Days	0.02%	N/A
Santander Uk Plc	1,805,000	Call	0.12%	N/A
Residual MMF/Call Account Balances	331,592	35 Days	0.47%	N/A
Royal London Cash Plus Fund	991,347	On-going	1.38%	N/A
Ccla Property Fund	2,070,647	On-going	4.58%	N/A
Ccla Diversified Income Fund	1,779,479	On-going	4.58%	N/A
Kames Diversified Income Fund	3,358,073	On-going	5.01%	N/A
Investec Diversified Income Fund	3,706,999	On-going	4.07%	N/A
Total Investments/Average Interest Rate	**40,172,572**		**0.74**	

4.12. As the table above indicates, investments at 30 September 2020 totalled £40.173 million with an average rate of interest of 0.74% (2019/20 1.87%). In light of the pandemic, it is no surprise that for the first half of 2020/21 interest rates achieved were lower than last year. These funds were available on a temporary basis, and the level of funds available were mainly dependant on the timing of precept payments, receipt of grants and progress on the capital programme. The rates achieved vary between different institutions, for different durations, dependant on when the investment was made.

4.13. We are currently carrying out a Money Market Fund (MMF) review with a view to maximising returns on the call accounts. Whilst the Council continues to ensure investments are secure and liquidity is achieved (in light of uncertain income streams), it is proactively looking to maximise its rate of return.

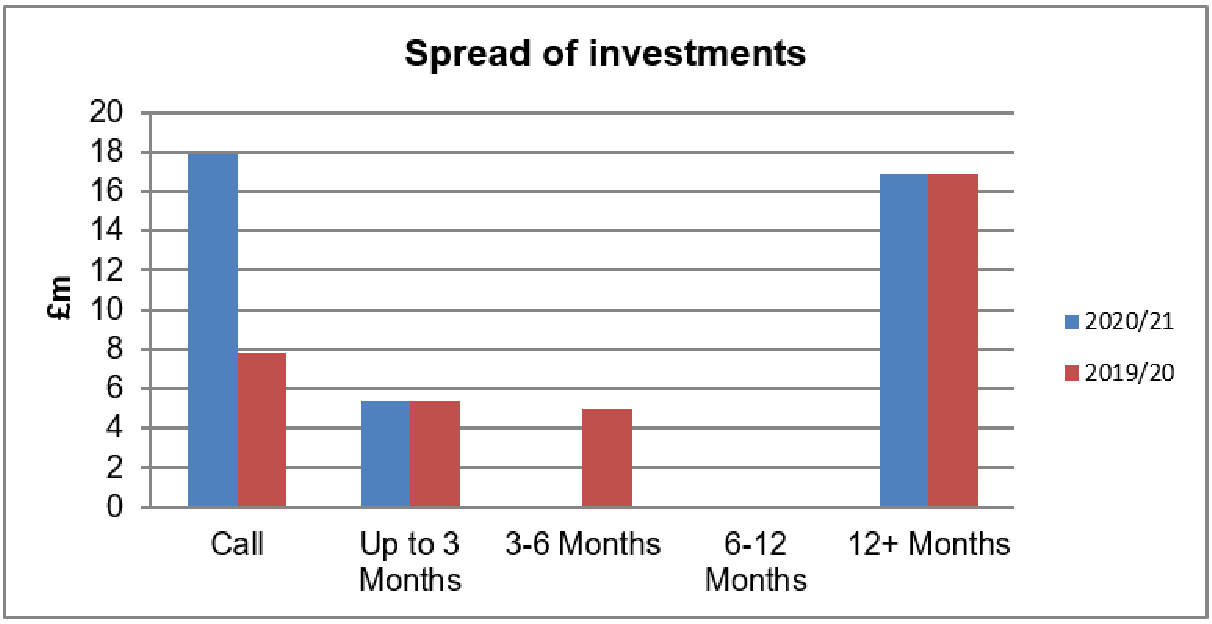
4.14. The fair value of the Council's diversified funds fell by £1.238m at 31.3.2020. The table below shows their recovery to date. These investments are held long term and it is anticipated that in the long term these values will recover. As at 31.09.2020 these funds had recovered by £573,991.

Fair Value	31.03.2020	30.09.2020
Kames	3,358,073	3,644,676
Investec	3,706,999	3,944,358
RLAM	991,347	1,005,134
CCLA Property	2,070,647	1,984,521
CCLA Divesified	1,779,479	1,901,846
	11,906,545	**12,480,536**

4.15. It should be noted that £17.3 million of the above investments relate to funds held in relation to Section 106 Agreements that are yet to be released by the Authority. As part of the agreement, interest has to be paid over once funds are released. This interest amounts to approximately £129,000.

4.16. The above details the counterparties that the Council had placed investments with at 30 September 2020. The graph below depicts our investment spread showing the range of investments and the different time periods; balancing both cash flow risk and counterparty risk and shows the movement from longer term to shorter term investments between 2019/20 and 2020/21. A consequence of Covid19, and ensuring liquidity, is that increasingly the Council is holding lower values of investments, over a shorter period of time, with a greater number of institutions. This is compliant with the Council's Capital and Investment Strategy and recommended action by the Council's Treasury advisors.

4.17. Council agreed, 24 September 2019, to consider its carbon footprint and aim to divest from fossil fuel investments. Currently 22% (24% in 2019) of our portfolio is invested in diversified funds which invest in equities and, therefore, carry a small risk of fossil fuel investments. Security, Liquidity and Yield are the Council's main priority (in accordance with the CIPFA Code for treasury investments).



Borrowing

4.18. In accordance with the Local Government Act 2003, the Council has a statutory duty to determine and keep under review how much it can afford to borrow. Therefore, the Council establishes 'Affordable Borrowing Limits' (or Authorised Limit) as part of the Prudential Indicators within the approved Capital and Investment Strategy Statement.

4.19. The 'authorised limit' and 'operational boundary' indicators govern the maximum level of external borrowing to fund the capital programme and short-term cash flow.

4.20. The need to externally borrow is now anticipated to be nil in 2020/21. The Operational Boundary set for the year is £20m (see **Appendix A**).

4.21. As part of the Capital and Investment Strategy, the Council established a range of Prudential Indicators (which also accords with professional practice) to monitor both Treasury and Capital as the two are intrinsically linked. Details of the performance against the Prudential Indicators can be found at **Appendix A**. Key comments to note are as follows:

(a) Capital Expenditure – The original budget for 2020/21 was £18.936m and revised largely due to carry forwards giving a current budget of £38.371m. The programme was reviewed in the light of Covid19 impact and re-phasing of £18.465m has been requested together with the removal of £3.828m, the unallocated balance of Asset Investment Strategy provision (this element will be referred to Council). These adjustments will give a revised Capital Programme of £16.078m for 2020-21. The projected outturn is £14.522m – resulting in an estimated underspend of £1.556m. This position is reported to both Cabinet and Corporate Overview Group.

(b) Financing costs to net revenue stream – improved position anticipated due to higher investment returns and projected underspends in net service expenditure.

(c) Expected investment position – linked to underspend on the capital programme- see (a) above.

(d) Capital Financing Requirement (CFR) – the closing position will be less than budgeted for as a result of capital programme re-phasing as mentioned at (a) above. The CFR projected end of year position is £11.527m.

Commercial Investments

4.22. The definition of investments in CIPFA's definition of treasury management activities above covers all financial assets of the organisation as well as other non-financial assets which the organisation holds primarily for financial returns, such as investment property portfolios. This may, therefore, include investments which are not managed as part of normal treasury management or under treasury management delegations. All investments require an appropriate investment management and risk management framework, which is outlined in the Capital and Investment Strategy.

4.23. The Council is committed to becoming self-sustainable as Central Government funding reduces. This includes ensuring that the Council maximises any income from existing assets and, where there is a business case, invests in assets where there is a commercial return. The Council is holding significant capital funding resources which do not require the authority to undertake borrowing at this stage. These are invested with various financial institutions as detailed above. However, there may be other investments that represent an opportunity to generate higher returns on these funds.

4.24. In recent years, the Council identified specific sums for its Asset Investment Strategy within the Capital Programme which has totalled £20m. This includes commercial investment in areas such as investment in property and subsidiaries, or loans that support service outcomes. Of the £8.382m balance at the start of the year, £4.554m was committed to two acquisitions of Business Units in West Bridgford (paragraph 4.25), the balance £3.828m will be referred to Council for removal from the Programme and will not require funding.

Investments 2020/21

4.25. The purchase of Unit 1 Edwalton Business Park was completed 9 July for £2.083m and Unit 3 Edwalton Business Park was completed 13 October for £2.449m. Further details are provided below.

Unit1, Edwalton Business Park

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

- The property is leased to Brown Shipley & Co Ltd;
- 10 year Fully Repairing and Insuring (FRI) lease with no break, year 5 rent review (upwards only review)
- It is a well-established location and within the Borough;
- The property is new, with low maintenance costs, and high-quality finishes
- Indications support strong demand for offices in the locality.
- There is a single tenant cash flow risk, albeit this is mitigated by the Council's overall investment property rental streams;
- Rated as grade A on the Energy Performance Certificate

Unit3, Edwalton Business Park

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

- The property is leased to Inspired Villages Group Ltd, guaranteed by Legal and General;
- 10 year FRI lease with no break, year 5 rent review (upwards only review)
- It is a well-established location and within the Borough;
- The property is new, with low maintenance costs, and high-quality finishes
- Indications support strong demand for offices in the locality
- There is a single tenant cash flow risk, albeit this is mitigated by the Council's overall investment property rental streams
- Rated as grade A on the Energy Performance Certificate

4.26. Individual commercial investment proposals included within the Asset Investment Strategy (AIS) are subject to specific business appraisals. The governance surrounding such decisions is included in the AIS. Details for the above acquisitions can be found at Appendices B and C.

4.27. The Government issued revised guidance on local government investments, effective from April 2018. This guidance introduces additional disclosure requirements some of which are specific to investments of a commercial nature. The Authority now has to disclose its dependence on commercial income and the contribution non-core investments make towards core functions. This covers items included in the Council's AIS, as well as pre-existing commercial investments.

4.28. The expected contributions from commercial investments included in the AIS are shown below. In order to manage the risk to the Council's budget, income from commercial investments should not be a significant proportion of the

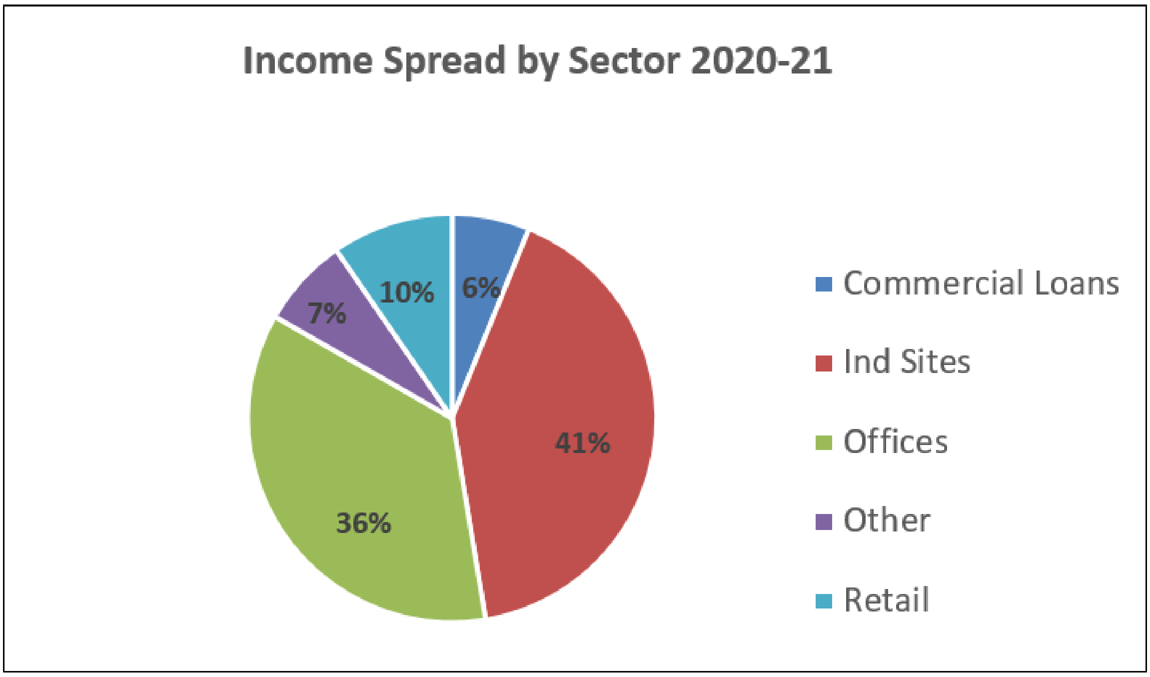
Council's income. As shown below, it is estimated to be around 20% in the current year. Our objective is that this ratio should not exceed 30% in future years, subject to annual review.

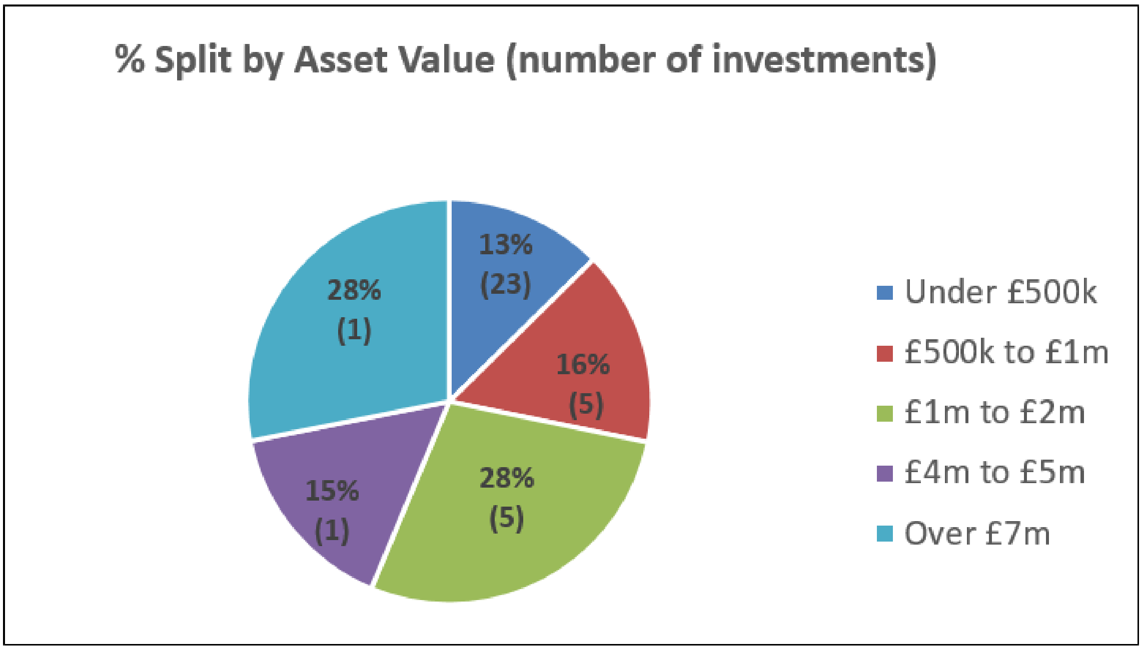
Commercial Investment income and costs

2020/21	Original £000	Current £000	Actual £000	Projected £000
Commercial Property Income	(1,557)	(1,557)	(752)	(1,461)
Running Costs	614	617	244	627
Net Contribution to core functions	(943)	(940)	(508)	(834)
Interest from Commercial Loans	(83)	(83)	(3)	(96)
Total Contribution	(1,026)	(1,023)	(511)	(930)
Sensitivity:				
+/- 10% Commercial Property Income	156	156	75	146
Indicator:				
Investment Income as a % of total Council Income	20.0%	20.0%	18.5%	21.3%
Total Income	8,209	8,209	4,071	7,316

Risk Exposure Indicators

4.29. The Council can minimise its exposure to risk by spreading investments across sectors and by avoiding single large-scale investments. Generally, there is a spread of investment across sectors. The Council's commitment to economic regeneration (not purely financial return) has meant that many of its investments have been in industrial units, which have been very successful. Covid has accelerated remote working which currently has reduced office occupation during lockdown. There is a risk that this may become a new way of working which could reduce demand for office accommodation although the long-term impact is unknown. This will be monitored and reported in future reports.





Security and Liquidity

4.30. Commercial investments are held for longer term asset appreciation as well as yield. Investments or sales decisions will normally be planned as part of the consideration of the 5-year capital strategy to maximise the potential return. Nevertheless, the local and national markets are monitored to ensure any gains are maximised or losses minimised.

4.31. To help ensure asset values are maintained the assets are given quarterly inspections, together with a condition survey every 3 years. Any works required to maintain the value of the property will then form part of Council's spending plans.

4.32. The liquidity of the assets is also dependent on the condition of the property, the strength of the tenants and the remaining lease lengths. The Council keeps these items under review with a view to maximising the potential liquidity and value of the property wherever possible.

4.33. The liquidity considerations for commercial investments are intrinsically linked to the level of cash and short-term investments, which help manage and mitigate the Council's liquidity risk.

Training and Development

4.34. The Council's Treasury Management Advisors, Link Asset Services held a presentation and training session to Councillors on 27 November 2019 and the next is scheduled for 9 December 2020.

5 Conclusion

5.1. Treasury Management continues to be fraught with difficulty. The UK economy is more uncertain whilst the terms of BREXIT are being negotiated and more so by the legacy impact of the worldwide Covid19 pandemic. Together with general international political uncertainty, the effects are expected to have a long-term impact on interest rates and the returns that can be achieved from investments. Officers will continue to be vigilant and report any significant issues to the Governance Scrutiny Group.

6 Risk and Uncertainties

6.1. The report covers both counterparty, interest rate and property related risks.

7 Implications

7.1. **Financial Implications**

Financial implications are covered in the body of the report.

7.2. **Legal Implications**

There are no specific legal implications identified in this report. The report demonstrates the Councils good practice in following CIPFA's Code of Practice for Treasury Management (2017) recommends by informing Councillors of Treasury Management activities at least twice a year. Adoption of the best practice, ensures scrutiny of capital and investment activity undertaken during the relevant period.

7.3. **Equalities Implications**

There are no equalities implications identified for this report

7.4. Section 17 of the Crime and Disorder Act 1998 Implications

There are no implications

8 Link to Corporate Priorities

Quality of Life	No direct impact
Efficient Services	Responsible income generation and maximising returns
Sustainable Growth	No direct impact
The Environment	Helping to protect the environment by consideration of carbon footprint and fossil-based investments as referred to in paragraph 4.17

9 Recommendations

It is recommended that the Group notes the Capital and Investment Strategy update position at 30 September 2020.

For more information contact:	Peter Linfield Executive Manager - Finance and Corporate Services 0115 914 8439 plinfield@rushcliffe.gov.uk
Background papers available for inspection	Treasury Management Strategy 2020/21
List of Appendices (if any):	Appendix A – Prudential and Treasury Indicators for 2020/21 position at 30 September 2020 Appendix B – Appraisal Documents Unit 1 Edwalton Business Park Appendix C – Appraisal Documents Unit 3 Edwalton Business Park

APPENDIX A

Prudential and Treasury Indicators for 2020/21
Position at 30 September 2020

	2020/21 £'000 Original Estimate	**2020/21 £'000 Current Projections**
Prudential Indicators		
Capital Expenditure	18,936	14,522
Proportion of financing costs to net revenue streams	6.01%	3.87%
Expected Investment Position (at 31 March 2021)	14,328	22,650
Capital Financing requirement as at 31 March 2021	21,849	11,527
Treasury Management Indicators		
Authorised Limit for external debt Borrowing and other long term liabilities	25,000	25,000
Operational Boundary for external debt Borrowing and other long-term liabilities	20,000	20,000
Upper limit for fixed interest rate exposure on investments up to 1 year	50%	50%
Upper limit for variable rate exposure (investments)	100%	100%
Upper limit for total principal sums invested over 1 year	7,200	11,300

APPENDIX B

ASSET INVESTMENT STRATEGY APPRAISAL MATRIX

Appendix B

PROPERTY	**Unit 1 Edwalton Business Park, Landmere Lane, West Bridgford, NG12 4DE**
PROPERTY TYPE	**Office**
TENANT	**Brown Shipley & Co Ltd**

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 - 14 years	10 - 8 years	7 - 5 years	<5 years or vacant (unless reflected in price)
Rate of Return - % rent against capital	>8%	6%-7%	5%	3%-4%	<3%
Portfolio mix (asset type is balanced in portfolio - no more than x% of portfolio)	<50%	50%-60%	>61%-70%	71%-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	10-12 months	13-18 months	19-24 months	>24 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 6-7 years	within 8-10 years	>11 years
Purchase Price	<£2m	Between £2m and £3m	Between £3.1m and £4m	Between £4.1m 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

PROPERTY	
Address	Unit 1 Edwalton Business Park
Location/Situation (ie what is nearby)	A popular location on Landmere Lane, off Melton Road close to the established and popular Wheatcroft Business Park. The property is located within Edwalton Business Park, providing easy access to West Bridgford and Nottingham, also the ring road giving access to the M1 via the A453 and Nottingham Parkway. The development will provide four detatched, two storey office buildings with parking
Description of Asset (ie age, layout, construction, services, car park)	Yet to be constructed, each of the four buildings is of high architectural merit, set within landscaped grounds with parking. Each office has raised floors, air conditioning, fibre broadband, mezzanine meeting rooms, vaulted first floor ceilings with sky lights, PV panels, LED lighting, one parking space per 225sq ft Service charge will be levied to cover the maintenance and upkeep of the common parts
Size/site area	5,826 sq ft GIA
Planning ie use/class	B1, office
Conditions of sale	

COSTS	Total Capital Purchase costs	Total Annual Revenue Costs	Total Annual Income	Comments
Purchase price	£1,970,000			
Purchase costs ie SDLT, legal, agents, survey fees	£128,050			
Refurbishment costs	£0			
Borrowing costs/Capital costs		£7,880		
Business Rates		£0		
Management costs & Sinking Fund		£11,000		In-house management
Service charge apportionment		£0		
Rent/Income			£110,000	
Total	£2,098,050	£18,880	£110,000	
Net Annual Profit			£91,120	

Life Costs ie current condition	Brand new, put 5% sinking fund in place for future building maintenance
Yield	5.25% (Gross Rent)
Return on Investment (years)	23
IRR	
Rental growth	Rent review at year 5
Opportunity to add value (ie lease/tenant mgmt, regearing, building changes)	No, brand new purpose built office
Other costs	

LEASE TERMS	
Tenure ie Freehold/Leasehold	999 year lease
Tenant/Tenant Mix	Single tenant
Tenant covenant strength	Please see attached credit check - further investigation required.
Lease term & breaks	10 year lease, no breaks
Rent review & terms	Rent review at year 5
Key lease conditions ie alienation	
Cashflow risk ie to rents	10 month rent free
Void ie current/expected	12-18 months void/rent free
Lease type ie FRI (repairing obligation)	To be confirmed - likely to be FRI

OTHER	
Economic Factors ie market commentary	Early indications demonstrate strong demand for new offices in this location. Four buildings, one owner occupied. RBC completed Agreement For Lease (999 years) for Unit 3. Strong rents at £20psf. Generally strong covenants
Potential uses/alternative uses	None
Benefits	New building - low initial planned maintenance costs Pre-let tenant with strong guarantor (Legal & General) 10 year lease no breaks Rent review at year 5 Good location High quality, architecturally led design Good demand and rent at £20psf

Risks	10 month rent free - will this be topped up? Single tenant cashflow risk due to value of rent within context of portfolio Construction delay Quality of construction Managing defects period Further details / checks required for Pre-let. 12-18 month void
Liquidity	
Local economic benefits	
Local Search info	
Delivery Model ie set up a new company, JV, with another Council	

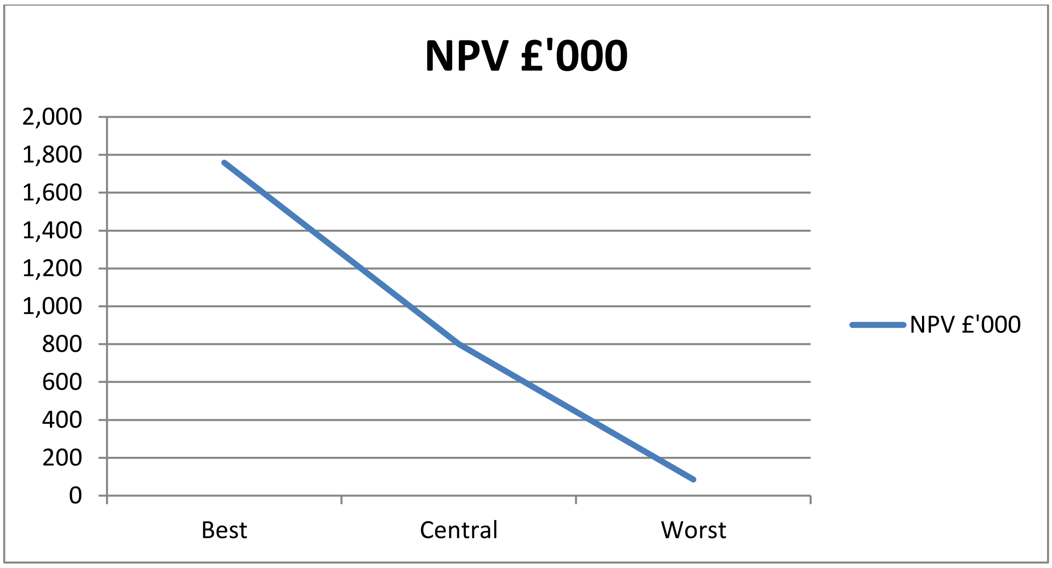
SUMMARY
Opportunity to acquire one further unit on the business estate, with a pre-let in place, in addition to the recent purchase of Unit 3. Demonstrated good demand so far with one owner occupier and two pre-lets. High quality design and internal space provides good competition against other offices. Strong rent at £20psf on 10 year lease with no breaks. Quality of tenant as per credit check (attached). Appears to be a good investment (subject to further checks on pre-let); some risk over cashflow with single tenant and rent of high value, so need to factor in 18 month void to cashflow to determine overall assessment.

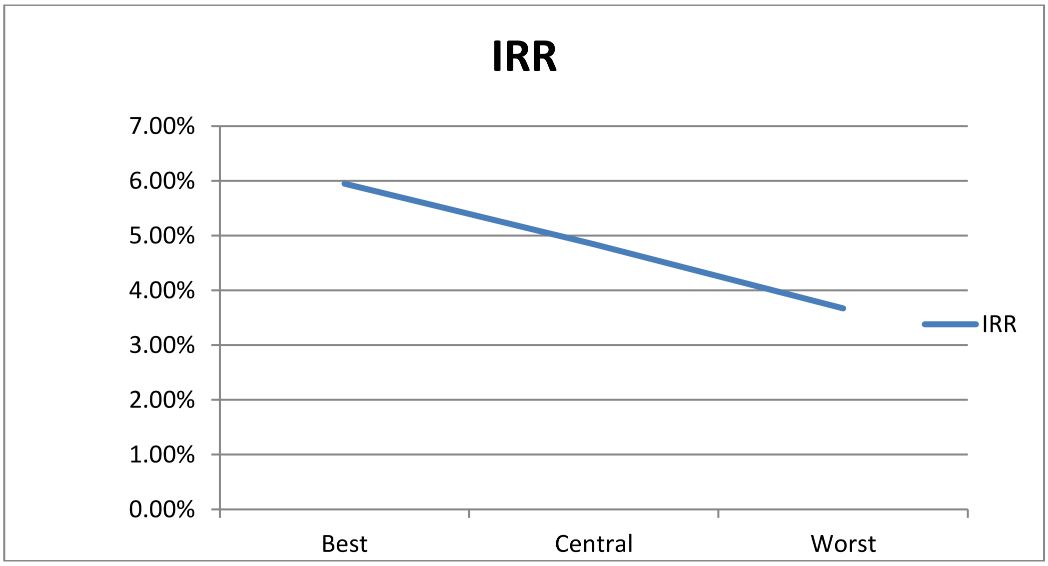
Sensitivity Analysis

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	3.0%	2.0%	1.0%	Linked to inflation targets and more variable
Vacancy factor	Assume 6 months vacancy at years, 5, 10 etc			

2. Using the above assumptions and assuming disposal in Year 40 gives a Net Present Value ranging from £1.759m to £0.085m and an internal rate of return ranging from 5.95% to 3.67%. The worse case scenario is unlikely given the length of tenures.





APPENDIX C

ASSET INVESTMENT STRATEGY APPRAISAL MATRIX

APPENDIX C

To complete, highlight the applicable box using RAL, 50% of answers should be Excellent, Good or Satisfactory - however, to be appraised alongside the contextual information in tab 2 for comprehensive review

PROPERTY	**Unit 3 Edwalton Business Park, Landmere Lane, West Bridgford, NG12 4DE**
PROPERTY TYPE	**Office**
TENANT	**Inspired Villages Group Ltd guaranteed by Legal and General**

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 - 14 years	10 - 8 years	7 - 5 years	<5 years or vacant (unless reflected in price)
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Portfolio mix (asset type is balanced in portfolio - no more than x% of portfolio)	<50%	50%-60%	>61%-70%	71%-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	10-12 months	13-18 months	19-24 months	>24 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 6-7 years	within 8-10 years	>11 years
Purchase Price	<£2m	Between £2m and £3m	Between £3.1m and £4m	Between £4.1m 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

PROPERTY	
Address	Unit 3 Edwalton Business Park
Location/Situation (ie what is nearby)	A popular location on Landmere Lane, off Melton Road close to the established and popular Wheatcroft Business Park. The property is located within Edwalton Business Park, providing easy access to West Bridgford and Nottingham, also the ring road giving access to the M1 via the A453 and Nottingham Parkway. The development will provide four detatched, two storey office buildings with parking
Description of Asset (ie age, layout, construction, services, car park)	Yet to be constructed, each of the four buildings is of high architectural merit, set within landscaped grounds with parking. Each office has raised floors, air conditioning, fibre broadband, mezzanine meeting rooms, vaulted first floor ceilings with sky lights, PV panels, LED lighting, one parking space per 225sq ft Service charge will be levied to cover the maintenance and upkeep of the common parts
Size/site area	6,842 sq ft
Planning ie use/class	B1, office
Conditions of sale	

COSTS	Total Capital Purchase costs	Total Annual Revenue Costs	Total Annual Income	Comments
Purchase price	£2,320,000			
Purchase costs ie SDLT, legal, agents, survey fees	£150,800			
Refurbishment costs	£0			
Borrowing costs/Capital costs		£18,530		
Business Rates		£0		
Management costs & Sinking Fund		£13,685		In-house management
Service charge apportionment		£0		
Rent/Income			£136,850	
Total	£2,470,800	£32,215	£136,850	
Net Annual Profit			£104,635	

Life Costs ie current condition	Brand new, put 5% sinking fund in place for future building maintenance
Yield - Simple	4.51%
Return on Investment (years)	24
IRR	
Rental growth	Rent review at year 5
Opportunity to add value (ie lease/tenant mgmt, regearing, building changes)	No, brand new purpose built office
Other costs	

LEASE TERMS	
Tenure ie Freehold/Leasehold	999 year lease
Tenant/Tenant Mix	Single tenant
Tenant covenant strength	Unknown - indications that strong covenant (ie guaranteed by Legal and General)
Lease term & breaks	10 year lease, no breaks
Rent review & terms	Rent review at year 5
Key lease conditions ie alienation	
Cashflow risk ie to rents	12 month rent free
Void ie current/expected	12-18 months void/rent free
Lease type ie FRI (repairing obligation)	Unknown

OTHER	
Economic Factors ie market commentary	Early indications demonstrate strong demand for new offices in this location. Four buildings, one owner occupied, two with pre-lets, one being marketed. Strong rents at £20psf Strong covenants
Potential uses/alternative uses	None
Benefits	New building - low initial planned maintenance costs Pre-let tenant with strong guarantor 10 year lease no breaks Rent review at year 5 Good location High quality, architectually led design Strong demand and rent at £20psf Asset value with tenant only £100k more than quoted construction costs

Risks	12 month rent free - will this be topped up? Single tenant cashflow risk due to value of rent within context of portfolio Construction delay Quality of construction Managing defects period Unknown tenant 12-18 month void
Liquidity	
Local economic benefits	
Local Search info	
Delivery Model ie set up a new company, JV, with another Council	

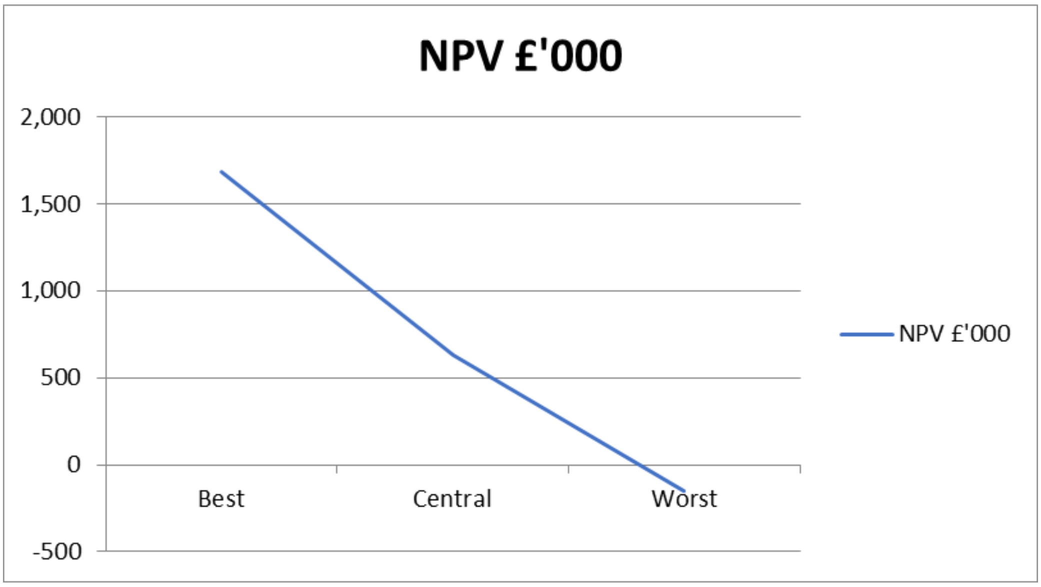
SUMMARY
Opportunity to acquire one unit with a pre-let in place, as detailed in this appraisal and one vacant unit (subject to a separate appraisal). Demonstrated strong demand so far with one owner occupier and two pre-lets. High quality design and internal space provides good competition against other offices. Strong rent at £20psf on 10 year lease with no breaks. Quality of tenant unknown. So far been provided two different prices for build cost, need to clear this up - from these figures, it appears the asset value with the tenant is only £100k more than the quoted construction costs. Appears to be a good investment; some risk over cashflow with single tenant and rent of high value, so need to factor in 18 month void to cashflow to determine overall assessment.

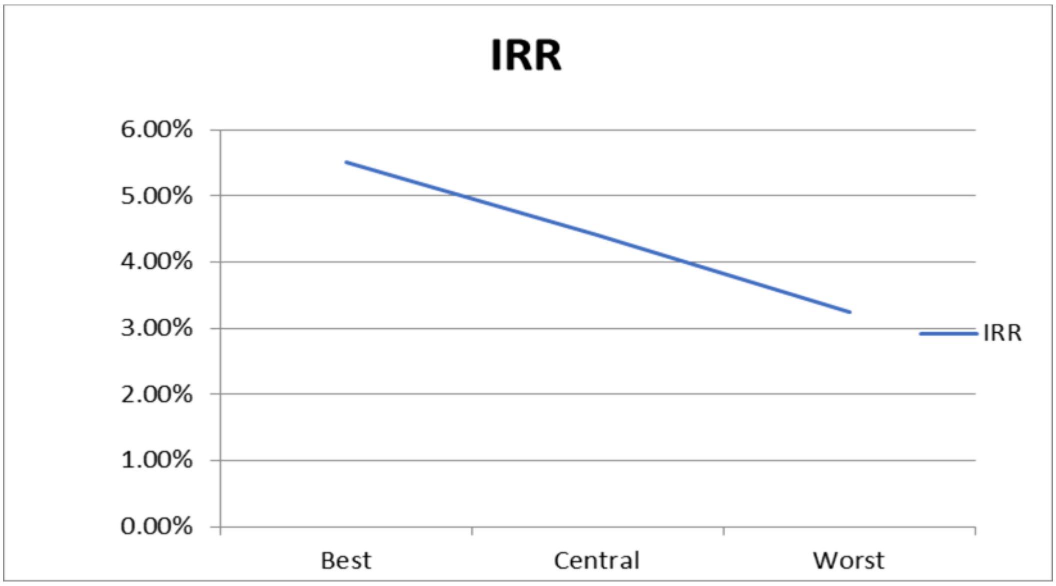
Sensitivity Analysis

3. 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	3.0%	2.0%	1.0%	Linked to inflation targets and more variable
Vacancy factor	Assume 12 months vacancy at year 1, 5, 10 etc			

4. Using the above assumptions and assuming disposal in Year 40 gives a Net Present Value ranging from £1.165m to a negative £0.152m and an internal rate of return ranging from 5.52% to 3.2%. The worst case scenario is unlikely given the length of tenures.





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.

Covered Bonds – these investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means they are exempt from bail-in.

Pooled Funds – shares in diversified investment vehicles consisting of different investment types including banks, equity shares and property, these funds have the advantage of providing wide diversification of investment risks

LIBID – London Inter Bank Bid Rate. The rate at which banks are willing to borrow from other banks