Appendix B – Indicative Financial Projections & Borrowing Costs

Based on information available at the time of writing (November 2017), below is a breakdown of how an acquisition fund of £75m plus acquisition costs can derive c£1m of revenue after costs to support the financial sustainability of the Council. The proceeds from the first tranche of £35m are also shown.

	Original 1st Tranche Investment	Updated 1st Tranche Investment	Entire Investment
Capital Investment	**25,000,000**	**35,000,000**	**75,000,000**
Acquisition fees @ 7%	1,750,000	2,450,000	5,250,000
Total Borrowing / Expenditure	**26,750,000**	**37,450,000**	**80,250,000**

Borrowing			
Term (Years)	50	50	50
Annuity PWLB Loan Interest Rate % @ 23/11/17	*2.66*	*2.66*	*2.66*
Interest Payments pa	**711,550**	**996,170**	**2,134,650**

Profit & Loss Example *(Income less Costs)*			
Target Portfolio Yield %	*5.85*	*5.85*	*5.85*
Rent Receivable *(Yield x Investment)* pa	**1,462,500**	**2,047,500**	**4,387,500**
Interest Payments pa	(711,550)	(996,170)	(2,134,650)
Management costs @ 3% of Rent Receivable	(43,875)	(61,425)	(131,625)
Sinking fund @ 5% of Rent Receivable	(73,125)	(102,375)	(219,375)
Surplus Generated (before MRP*) pa	**633,950**	**887,530**	**1,901,850**
Annuity Minimum Revenue Provision (MRP)	(261,995)	(366,793)	(785,985)
Surplus (After Annuity MRP*) pa	**371,955**	**520,737**	**1,115,865**

Sensitivity analysis in change in gross rental income

The business plan identifies a target gross rental yield of 5.85%, which if achieved would generate £1.9m per annum in income after costs, but before MRP. The table below shows the impact a change in the gross income yield could have on the annual income estimates:

Sensitivity Analysis	**£25m**	**£35m**	**£75m**
Change in income yield 0.5%	£ 125,000	£ 175,000	£ 375,000
Change in income yield 1.0%	£ 250,000	£ 350,000	£ 750,000
Change in income yield 1.5%	£ 375,000	£ 525,000	£ 1,125,000
Change in income yield 2.0%	£ 500,000	£ 700,000	£ 1,500,000
Change in income yield 2.5%	£ 625,000	£ 875,000	£ 1,875,000

For example, if the income yield were to increase from 5.85% to 6.85% (an increase of 1%), this would generate additional income of £350,000 per annum on a £35m portfolio. A reduction in yield would have the opposite effect.

Sensitivity Analysis on the Surplus Generated

A sensitivity scenario analysis is shown in the table below to illustrate the effect that the yield has on the return achievable from the portfolio – assuming an acquisition fund of the full £75m or the updated tranche 1 acquisition fund of £35m. This highlights that the portfolio needs active management and care in choosing the right acquisitions to ensure the minimum yield is achieved.

All of the figures below are based on the annuity MRP treatment shown above, providing either £785,985 (for the £75m acquisition fund) or £366,793 (for the £35m acquisition fund) of MRP in year one. The provision for the repayment of borrowing (level of MRP) would increase year on year.

Portolio Size	**25,000,000**	**35,000,000**	**75,000,000**
Projected Annual Surplus @ 5.85%	371,955	520,737	1,115,865
Projected Annual Surplus @ 4.00%	-90,545	-126,763	-271,635
Projected Annual Surplus @ 4.50%	34,455	48,237	103,365
Projected Annual Surplus @ 5.00%	159,455	223,237	478,365
Projected Annual Surplus @ 5.50%	284,455	398,237	**853,365**
Projected Annual Surplus @ 6.00%	409,455	573,237	**1,228,365**
Projected Annual Surplus @ 5.297%	233,705	327,187	**701,115**
Breakeven: Projected Annual Surplus @ 4.36%	205	287	615

Breakeven
A minimum yield of 4.363% is required in order for the £75m acquisition fund to breakeven in year one, i.e. cover the cost of loan repayments, the alternate Minimum Revenue Provision, the sinking fund for maintenance and the expected management / administration costs.

Indicative Borrowing Financial Implications
The Council will consider a number of factors when assessing how much the Council will borrow to finance the commercial property strategy. It is likely that the majority of the commercial property acquisition strategy will be funded via Public Works Loan Board (PWLB) borrowing.

When assessing affordability, the Council will consider the annual cost of financing the acquisitions, the income generated, the costs of running and maintaining the property and the factors that could potentially affect the net income to the Council (which is needed to repay the financing costs of the proposed property acquisitions of £35m or £75m).

Council officers who have responsibility for treasury management will, in consultation with the S151 officer, determine the most appropriate product(s) for the Council's borrowing requirements. There are a number of options available to them and they will be advised by the Council's treasury management advisors and guided by the Council's adopted treasury management strategy and CIPFA regulations.

Percentage Increase in Council Tax
It is clear that a significant reduction in rental income (a yield below 4.363%) would result in a revenue budget deficit being created. If the Council did not have the available budget surplus to cover this additional cost, it may be forced to cut expenditure or increase Council tax to cover the deficit. The table below shows the impact on Council Tax and the additional income that a % increase in Council Tax generates (using the existing Council Tax base).

Impact on Council Tax	£
Increase of 1.0%	£ 45,000
Increase of 2.0%	£ 90,000
Increase of 3.0%	£ 135,000
Increase of 4.0%	£ 180,000
Increase of 5.0%	£ 225,000
Increase of 6.0%	£ 270,000
Increase of 7.0%	£ 315,000
Increase of 8.0%	£ 360,000
Increase of 9.0%	£ 405,000

The business case for property acquisitions allows for reserves to be built up in a sinking fund to cover any shortfall in rent or maintenance cost for which the council would be liable. The strategy that is to be adopted by the Council addresses the risk that changes in rental income could affect overall portfolio profitability by virtue of being spread across asset types, classes and geographies.

Different tenant classes and lot sizes and indeed borrowing terms will mean that a loss on one asset could well be compensated by a profit on another asset. It also important to note that the strategy has excluded any profit or loss for a change in capital values.

Summary
If a portfolio yield of 5.85% is achieved, the above figures show that an acquisition fund of £80.25m could generate a surplus of £1.12m per annum. This is net of forecast administration and maintenance (sinking fund) costs. Using the same basis, a £35m acquisition fund could generate a surplus of £0.521m per annum.

As part of the Annual Treasury Management Strategy setting process, Members have the opportunity to set the Council's policy for providing for MRP (Minimum Revenue Provision). There are various methods which can be employed and members will be able to determine the most prudent method of provision. The annuity accounting method has been adopted, but this decision could be reviewed in the future for further borrowing. MRP accounting methods have a fundamental impact on the surplus that can be generated from this type of strategy.