Appendix 2

Financial Methodology

This financial analysis and the methodology applied enables a comparison of whether it is better to dispose of an income generating asset and realise the capital receipt now or continue to hold the asset and receive the income over the life of the building.

The analysis assumes the capital receipt will be used instead of borrowing to fund the capital programme. This enables a comparison to be made on whether, over the life of the building, the saving on borrowing is greater than the estimated rental income and residual value of the building. As the analysis is based on cashflows over, generally, 25 years, the methodology incorporates a net present value (NPV) analysis of the future income, and the residual value of the asset compared to the savings on borrowing. This analysis uses a discount factor to present the future cash flows as a value as at today.

The model includes the net position of the income received over a 25-year period plus the residual value of the asset, less potential savings on borrowing costs, along with any capital refurbishment costs (if they are expected to be required to the building within the period). Investment properties are generally let on a full repairing lease basis, so most repairs and maintenance costs are expected to be funded by the leaseholder.

The NPV analysis discounts future cash flows to the present value based on the premise that the value of the future cash flows decrease over time due to the time value of money. The discount rate used is based on the cost of borrowing of £80k per £1m which works out at around 6.2%.