



TPE 2023 – Case Study Part 2

Skene

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Case Study

It is two weeks since you completed your initial lending assessment on Skene. Robert Alloway is on holiday. Pep has some ideas which he is keen to share with the bank, so you have agreed to have a meeting with him in Robert's absence. The phone rings and it is Pep.

"Good afternoon, Fred. Thank you for agreeing to speak to me. Your report really got us thinking and we realised that we had to come up with some clear strategic plans for the club to continue its long and successful history." "You're welcome", you reply. "At Alba we are keen to be a modern, forward-thinking bank, looking to help its customers and be very much part of the community."

Pep begins, "I have various things to talk about and I've sent you an email with a file headed 'Options'. (Appendix 1)

Options

"Yesterday the board discussed two possible outline options for the club and I was authorised to show them to you today as we would be interested in whether the bank would be prepared to support us with each of the ventures. We think they are quite radical! As the bank is one of our trusted business advisers I would like to ask you to review each of the options and give me an idea as to which option would be the best for us to follow and whether the bank might be prepared to support us with further lending to carry out the option.

"Also, could you include some information regarding the risks with regard to tax in general, VAT in particular? As you are aware, the club has partial exemption status for VAT purposes. We are subject to VAT on catering and bar income and on 10% of subscription income. It would be helpful to get your thoughts on whether we will be able to reclaim VAT on any of the options? When we built the sporting facilities we didn't get back any VAT and some of the Board are a bit resentful of that. Is there anything we could do and is there a downside?

"Unfortunately, under either of the options we will have to close the tearoom. Could you also include some advice on the best way to exit from that business?"

"No problem," you reply. "I will have a look at each option, outlining the risks and rewards we see for you and what conditions we might place on any lending associated with each. I'll also include some information on exiting from the tearoom business. I'll pull it all together into a report for Tessa and draw some conclusions on any terms of lending. Once we have reviewed the position internally, Tessa will be in touch to discuss the situation further."

Pep advises that he has sent you another email headed 'Project A'. (Appendix 2)

"This might interest you; it is a little project which Robert Alloway and I have been working on, privately. I could cut you in at a special rate if you are willing to help us? I have heard from someone in the local rotary club that the property company which owns the office block across from the Town Hall is in trouble and is looking to sell the property quickly. There is one tenant in the office block, a blue-chip organisation on a long lease. Robert has already formed a property company of which I am the director and we are looking to arrange finance through the bank and purchase the offices. The rental from the tenant will more than cover the loan repayments. I think there are a few others interested in the same thing, but if you and Robert can arrange the finance, I can find out what they are offering and offer a better deal. I heard the other interested company is SACI Property Developments." You smile nervously realising that SACI Property Developments are a customer of the bank. You realise you will need to give Project A

some thought. “Anyway, let me leave that email with you”, Pep continues, “I have another appointment, with the solicitors.”

“Wait, as I am a customer of the bank there is one thing you could do for me before I go,” he says. “My elderly aunt who lived in Skipton in Yorkshire has recently passed away and, after taxes, she has bequeathed £300,000 in cash to me. My daughter, Maria, who is aged 18, has been awarded a place at a musical theatre school in Manchester and I’m thinking of using the £300,000 to purchase a flat for her to live in whilst in Manchester and selling it again once she graduates. I am looking at a good area and I am confident there will be a rise in house prices over the four years Maria will be living there. It will have two bedrooms so it is likely that we will rent the other room to another student at the college. My lawyer has suggested a deed of variation in order that the £300,000 could be bequeathed directly to Maria, allowing her to buy the flat. I’m not sure though about her having so much money so early in life. My wife and I have enough income to get by on. Although she doesn’t work and has no other income, Project A will secure our futures.

“Right, now, I’m late. Could you put your thoughts on the inheritance, and the implications of my lawyer’s suggestion, in an email to me? Thanks.” Pep hangs up the phone.

You pause for a moment and consider the work you must do this afternoon. Thinking about the guidance that you received at your induction course, you make a mental note to keep alert to any other matters you should report to Tessa or other authorities. “I’d better get started”, you say to yourself, and turn to your laptop to begin.

Required:

- Prepare the report for Tessa as requested;
- Draft the email to Pep regarding the inheritance; and
- Report on any other issues you consider to be relevant to this client.

APPENDIX 1

Options

Option 1

The club sells a piece of land to a national hotel chain which is planning to build a hotel for business travellers. The payment profile is as follows:

		Skene Receives
		£
Month 1	Contract is signed	10,000
Month 6	Planning application submitted	90,000
Month 12	Planning permission received	100,000

Due to the uncertainty of the planning process, the timescale for submission and approval of the application are the most likely estimate of the time involved.

The chain will require a new access route from the main road which will be across the site of the six existing five-a-side football pitches, meaning these will require to be moved to another area of the club grounds. The estimated cost for this is £100,000 (including VAT), spread evenly over the six months it will take to complete the work. The current VAT status of the pitches will continue and so any input VAT included will not be recoverable. The club plans to commence this work at the same time as signing the contract, so the new pitches would be built regardless of the outcome of the hotel chain's planning application.

The hotel chain has indicated that it will require to conduct preliminary ground works on the site of the existing five-a-side pitches as soon as the contract is signed. They can let us keep using three of the six pitches, at least until full works begin, if and when they get planning approval. At this point the remaining pitches would also be dug up.

If planning permission is not granted, Skene will be left with three old pitches in addition to the six on the new site, plus money in the bank from the hotel chain. I think each additional pitch can make us £750 a month, so it looks like a great scheme, don't you think?

Based on our past dealings, I would expect the arrangement fee to be £1,500 and the monthly interest rate to be 0.683%.

Option 2

We think that there is a good opportunity for us to move into the wedding hospitality market and we have two ideas as to how we could do this. Either we try and compete with the local hotels or we try to compete with the castle in the next village, which offers a more upmarket venue.

1. The club refurbishes the bar area (cost £25,000 excluding VAT), extends the clubhouse (cost £200,000 excluding VAT), creates a restaurant and targets the market for weddings. We could probably accommodate 150 guests. Estimates indicate we could host 40 weddings per year. Approximately two weddings each week (Friday and Saturday) during May to August (four months) and one wedding per week in March and September, with an average spend per guest of £50. Costs are estimated at £15 per guest. We would need to employ a head chef and extra catering staff amounting to £100,000 per year. Another refurbishment would be necessary after five years.
2. We compete with the local castle which offers a more traditional upmarket wedding experience. We would refurbish the bar area (cost £50,000 excluding VAT), extend the clubhouse (cost £500,000 excluding VAT) and create a restaurant. This option would only accommodate 120 guests. Estimates indicate we could still host 40 weddings per year. Approximately two weddings each week (Friday and Saturday) during May to August (four months) and one wedding per week in March and September, but the average spend per guest would be much higher, at around £100. Costs are estimated at £25 per guest. We would need to employ a head chef and extra catering staff amounting to £100,000 per year. Another refurbishment would be necessary after five years.

APPENDIX 2

Background information on Project A

The proposal is to ask the bank for borrowings of £940,000 to assist with the purchase of the commercial premises at 123 High Street which is currently leased to Large Blue-Chip plc ('LBC'). The premises will be purchased with the existing tenant continuing in place.

If we can agree a purchase price of £900,000, land and buildings transaction tax will be circa £67,000 and we are allowing £10,000 for legal fees. Therefore, we should request borrowings of £980,000 over 10 years on a capital and interest term loan.

The monthly repayments, calculated over a 10-year period and based on current rates, are around £9,350 (£112,200 per annum).

Our repayments will be met from the rental income from LBC. They pay rent of £175,000 per annum. The lease will expire in May Yr36.

Rental income is more than sufficient to cover the term loan payments.

The bank would normally require a contribution of around 30% from us, but I am sure you can find a way around that.

At the end of the lease, we will own a building which, if property prices rise by 5% per year, by then will be worth over £1,450,000. We will nearly be millionaires!