

BABRGH AND MID SUFFOLK DISTRICT COUNCIL

TO: JOINT OVERVIEW AND SCRUTINY COMMITTEE	REPORT NUMBER: JOS/19/31
FROM: Councillor David Busby - BDC Cabinet Member for Assets & Investments Councillor Peter Gould - MSDC Cabinet Member for Assets & Investments	DATE OF MEETING: 22 JUNE 2020
OFFICER: Emily Atack – Assistant Director Assets & Investments, Managing Director CIFCO	

CAPITAL INVESTMENT FUND COMPANY ('CIFCO CAPITAL LTD') BUSINESS TRADING AND PERFORMANCE REPORT 2019/20

1. PURPOSE OF REPORT

- 1.1 This report presents the trading activity for CIFCO Capital Ltd (CIFCO) for 2019/20. Appended to the report (Confidential Appendix A) is the draft business plan 2020/21 which subject to Council approval will form the basis of CIFCO trading in 2020/21. CIFCO's performance against each business plan is monitored quarterly by the Holding Companies. The board of CIFCO directors continually assess the market and appropriately apply and adapt the guidelines of the business plan throughout each trading year.

2. OPTIONS CONSIDERED

- 2.1 The options available are to approve the 2020/21 CIFCO business plan for its adoption by CIFCO or to recommend amendments to the business plan.
- 2.2 The business plan had been prepared by the Board of CIFCO in consultation with its fund managers Jones Lang LaSalle (JLL). The Business Plan has been approved by the Holding Companies.

3. RECOMMENDATIONS

- 3.1 The Council notes CIFCO Capital Ltd trading activity and performance for the year to 31st March 2020
- 3.2 The Council approves CIFCO Capital Ltd's 2020/21 business plan for adoption by CIFCO Capital Limited.

REASON FOR DECISION

3.3 To provide appropriate governance and performance monitoring for the operation of CIFCO Capital Ltd for the 2020/2021 period.
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4. KEY INFORMATION

- 4.1 CIFCO Capital Ltd has been trading since 2017, over the last 12 months CIFCO has commenced the second phase of investment which was approved by Council last year and now holds 14 diverse commercial assets largely across the Eastern region. Details of these assets can be found on the CIFCO website <https://cifcocapital.com/our-portfolio/>
- 4.2 During 2019/20, two assets were acquired by CIFCO, growing rental income to £3.39m showing a net initial yield of 5.78% to CIFCO and increasing the Councils' gross income from £2.33m to £2.49m. This has increased net income (after Councils' borrowing costs) to £929,000 for Babergh DC and £704,000 for Mid Suffolk DC (£1.633m in total). The differing net amounts reflect the Councils' different treasury management strategies. These figures are equivalent to 13.5% of income generated by Council Tax for the Councils. This income makes a significant contribution to the Councils' budgets being equivalent to 10% of the Councils' staff costs.
- 4.3 This year has not been without its challenges and the difficulties for the retail sector, particularly for shopping centres and the high street, have increased with the ever-growing demand for internet shopping. The strength of the warehouse sector has continued to grow as a corollary to this. It has also been a factor of the market that there were fewer opportunities available, partially as a result of the Brexit uncertainty, resulting in a reduction in the number and value of transactions, and increased competition for attractive assets. The decisive election result in December removed that uncertainty and December proved to be a very busy month for transactions. However, the arrival of COVID-19, and the subsequent lockdown, effectively put a stop to market transactions in March. The Board immediately revised its risk register and looked particularly at the income security of pending transactions. As a result, one acquisition was put on hold and one aborted. Moving forward, it is likely that the uncertainty and disruption in the market caused by the COVID-19 pandemic will open opportunities for investment at good value, but the Board will be assessing these very carefully before proceeding. In addition, through its advisers, the Board is working with its current tenants to ensure continued income flow, and to minimise the likelihood of any tenant failures. The Board continues to operate a strong risk management strategy and has in place an expert team of professional advisers to ensure that acquisitions meet the criteria required by our shareholders.
- 4.4 The 2020/21 business plan considers the strategy for further investment of the second tranche of investment approved last year, alongside the on-going management of the existing fund and the company.
- 4.5 The updated investment strategy for 2020/21 commissioned by the Board and developed by the Board's Fund Manager (JLL) is designed not only to give strong short-term results but medium and long-term income resilience. CIFCO

does not specifically target Capital growth and its projections are not based upon such growth, but a focus on income growth.

4.6 This medium to long term resilience is based upon:

- A current average WAULT (weighted average unexpired lease term) to expiry of 8 Years 5 months
- A strategy that balances the portfolio so that a significant number of the assets are 'Core' and liquid
- A strategy that balances other attributes such as geography, asset class and sector so that resistance to medium and longer-term market stresses in any individual attribute can be mitigated
- A company structure that allows flexibility in asset acquisition and disposal.

4.7 The 2020/21 Business Plan contains all the elements of the previous Business Plan approved by both Councils last year. The Plan includes:

- A review of performance over the last 12 months against key performance indicators together with strategy for the year ahead.
- A summary of the full market conditions assessment and revised investment strategy commissioned by the Company's Fund Manager, JLL.
- The JLL market assessment, upon which the business plan is based, looks at the individual attributes of each asset class.
- The risks of investment in individual asset classes specifically reflecting the increased challenges in the high street retail sector.
- The business plan is not the document to analyse the strengths and weaknesses of individual tenant covenant. This is a matter for the Board in its due diligence as those assets arise in the marketplace and for the quarterly portfolio covenant review by Board undertaken independently by fund manager JLL, however the business plan does review the proportion of the fund let to different strengths of covenant.
- The Business Plan incorporates high level financial cash flow back to the Council through loans. CIFCO borrows on a fixed rate so interest rate fluctuations are mitigated. Cashflow and operational finance is dealt with quarterly by the Board alongside quarterly risk analysis
- In addition, the Board's future revisions to its investment strategy are influenced by quarterly portfolio analysis report from JLL. This covers:
 - Investment Guidelines
 - JLL IPD (a UK benchmarking index) Forecasts
 - Tenant Covenant Log
 - Critical Dates Schedule
 - Individual Property Business Plans
 - Tenancy Schedule
 - Arrears

- EPC Schedule

4.8 The principal change to the previous year’s investment strategy relates to extending the period for full investment from 24 to 30 months from April 2019 thereby seeking full investment by October 2021. The Board continues to diversify the portfolio away from High Street retail through the acquisition of non-retail assets. The portfolio is currently over-weighted towards the office sector; however, the Board is comfortable with over investment in this area and this will be addressed in the next phase of investment. The chart below shows the current make-up of the portfolio versus the 2019 strategy:

Portfolio Sector Split 2020 versus 2019 Strategy

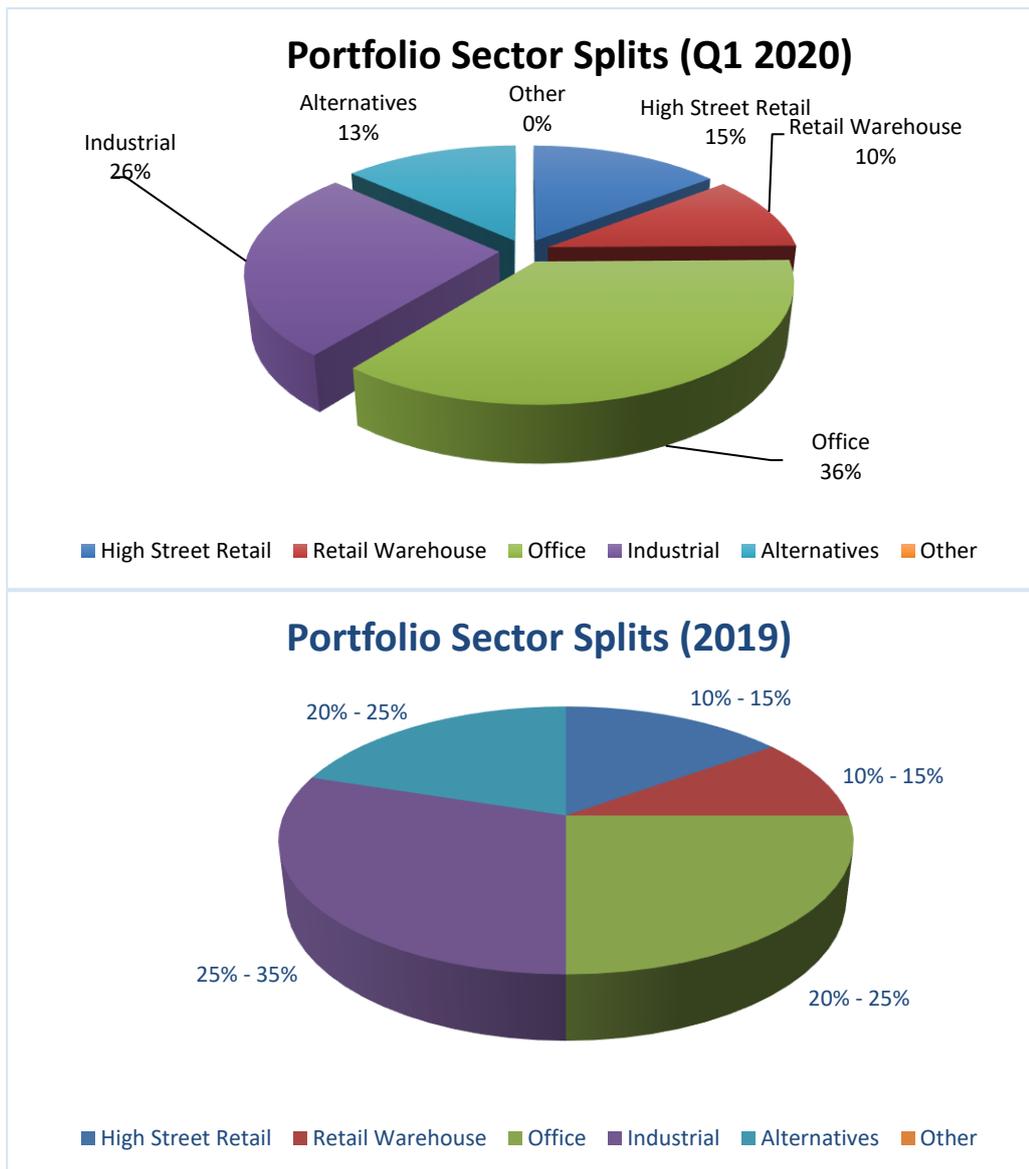


Figure 1

4.9 The Board also seeks to sub-categorise sectors to further diversify risk, for example the office sector of the fund will look to include single let and multi-let offices.

5. KEY PERFORMANCE INDICATORS (KPI)

5.1 The key performance indicators were set within the **2019/20** Business Plan, these are set out below together with performance against these targets: -

KPI	Description	Target	Actual
1	Net Initial Yield (NIY) Performance against target	5.75%	5.78%
2	Equivalent Yield (EY)	6%	6.41%
3	Progress against 24 Month full investment target to be achieved by April 2021	£100M	£60M
4	Quarterly Rent Arrears Measured by the amount of rent outstanding at the end of the quarter as a percentage of the total rent due that quarter.	<5%	Q1- 0.00% Q2- 1.71% Q3- 6.76% Q4- 28.29%

5.2 Rent arrears were below target for the first 2 quarters of the year, they increased in quarter three largely due to a tenant facing financial difficulties. A payment plan was put in place with this tenant and their business was starting to improve with increased payments due in March. This business has subsequently been affected by COVID 19 but is continuing to trade and make regular rent payments. The Board anticipates that KPI 4 will be difficult to meet in the short term due to COVID 19 but aspire to returning to meet this target longer term.

6. LINKS TO JOINT CORPORATE PLAN

- 6.1 A resilient and robust business plan for CIFCO Capital Ltd will contribute to the strong governance of the Company and its performance. The Business plan aligns with The Councils' Corporate Plan and Medium Term Financial Strategies to complete the investment of the second tranche of investment and deliver an important income stream into our districts to support the delivery of services and projects within our districts.
- 6.2 The income generated through CIFCO supports the investment in other key projects such as Gateway 14 Ltd, Babergh & Mid Suffolk Growth housing projects as well as other regeneration and development projects delivered directly by the Council. The diverse nature of these investments mitigates the Councils' overall exposure to risk with CIFCO providing immediate income return from capital investment whilst longer term development projects are delivered.
- 6.3 The investment in CIFCO is a long-term investment which will create a legacy for future generations.

7. COMPANY STRUCTURE AND IN-YEAR REPORTING

- 7.1 The Board of CIFCO Capital Ltd ('CIFCO') is responsible to its shareholders MSDC (Suffolk Holdings) Ltd and BDC (Suffolk Holdings) Ltd for the proper performance of the company against the business plan approved by the two parent Councils in July each year.
- 7.2 The Board meets monthly to review performance of the assets and fund, make new acquisition decisions, appoint corporate advisers, and put in place strategies and policies for company governance. A wide range of approvals have taken place throughout the year covering risk, performance management, governance, acquisitions, portfolio management, delegations and procurement. Since Lockdown in March the Board have been holding virtual Board meetings and have also held a virtual strategy day.
- 7.3 Each acquisition is recommended to the Board by Jones Lang La Salle, approved in the first instance by the CIFCO Board subject to satisfactory due diligence and then reported to each Holding Company Board for further consideration and approval before funds are released. No acquisition can be made without the approval of both Holding Company Boards.
- 7.4 Each quarter the Chairman of CIFCO reports progress at a simultaneous Holding Company Boards meeting. He presents his assessment of the market and company activity during the last quarter and performance data relating to that activity.

- 7.5 The CIFCO Board reviews its annual business plan and investment strategy continuously to ensure that it remains consistent with the marketplace and emerging risks and opportunities. Its investment strategy is developed with advice from Jones Lang LaSalle Ltd (JLL). The Business Plan is amended in full annually. The Business Plan is presented to both Holding Companies for consideration and approval before it progresses to both full Councils for final consideration.

8. BOARD DIRECTOR PROFILES

- 8.1 The Board of CIFCO comprises 3 non-executive directors, the managing director (who is also the Assistant Director for Assets & Investments) and two Councillor directors- one from each shareholder, Cllr Rick Meyer and Cllr Michael Holt who joined the Board in June 2019.
- 8.2 The Board provides Council shareholders perspective (through the appointment of two elected member Directors and the Managing Director) balanced with a strong commercial property industry expertise (through the appointment of three industry expert Directors not linked to the Council and the Managing Director who is Chartered Surveyor with experience in the property investment market). All Directors undergo a mandatory and externally validated skills assessment before appointment.

Directors' Profiles



Chris Haworth (Non-Executive Director and Chair) - BSc in Estate management from Reading University, fellow of the Royal Institution of Chartered Surveyors, and a member of the National landlords Association. Partner of Carter Jonas for 12 years, until August 2012, and Head of the National Commercial Division for 8 years.



Emily Atack (Managing Director and Assistant Director Assets 7 Investments) – Emily is a Member of the Royal Institution of Chartered Surveyors (RICS). She has approximately 20 years' experience in both private and public sector, primarily in dealing with commercial property transactions.



Henry Cooke (Non-Executive Director)- Investment banking professional with over 30 years' experience in roles across research, sales, trading, structuring, origination, syndication and asset management of US, UK, Australian and European mortgage backed, asset backed, whole-business and real estate financing



Mark Sargeantson (Non-Executive Director) – Fellow of the Royal Institution of Chartered Surveyors, partner of Cluttons, until early 1991. Acted for a wide range of property owners and investors mostly in portfolio and asset management in London and across the UK. Joined Fenn Wright, Ipswich in April 1991 and was a partner until 2008 and a consultant to the practice to the present day.



Michael Holt (BDC Councillor Director)

Michael has worked in the motor industry for over 38 years and has been a Company Director for the past 11 years. He has been a District Councillor since 2015 representing a Ward in the west of Babergh.



Richard Meyer (MSDC Councillor Director)

Retired security risk management professional with senior management experience in: the Armed Forces, RAF Regiment; the Private Sector, De Beers; and the Public Sector with the British Library. He was elected as a District Council in May 2019.

9. CORPORATE GOVERNANCE

- 9.1 CIFCO Capital continues to have robust corporate governance, reporting quarterly to the BDC (Suffolk Holdings) Ltd and MSDC (Suffolk Holdings) Ltd Boards. Quarterly updates are provided to full Council from the Cabinet Member for Assets and Investments. The Councils' internal audit team completed a review of the company's transaction and property management processes in 2019/20 and found that substantial assurances are in place, with no recommendations for improvement.

- 9.2 CIFCO Capital has complied fully with all Companies House registration and filing requirements. Ensors are the company's financial auditors. CIFCO Capital Ltd.'s financial year aligns with the shareholders financial year ending 31st March.
- 9.3 The Non-Executive Directors have signed service agreements laying out individual obligations. These agreements are aligned to the Company's adopted Articles.
- 9.4 Board Members undertook Director training focusing on Corporate Law and Director requirements this year and the Board has also adopted a new director guidance code which aligns with other companies within the group and clearly sets out the expectations, responsibilities and obligations for all directors.
- 9.5 A self – evaluation and an evaluation of the Chair is undertaken by the Board annually.

10. FINANCIAL PERFORMANCE AND ACQUISITION PROGRESS

10.1 The Councils have received total net income of circa £3m since CIFCO's incorporation in 2017, details are set out in the table below:

CIFCO (Babergh)					CIFCO (Mid Suffolk)				
£ 000					£ 000				
	2017-18	2018-19	2019-20	Cumulative		2017-18	2018-19	2019-20	Cumulative
Revenue Impact					Revenue Impact				
Interest Received	(86)	(782)	(1,245)	(2,113)	Interest Received	(86)	(782)	(1,245)	(2,113)
Interest Paid	11	119	316	446	Interest Paid	11	235	541	787
Net Interest	(75)	(663)	(929)	(1,667)	Net Interest	(75)	(547)	(704)	(1,326)
Dividends from CIFCO	-	-	-	-	Dividends from CIFCO	-	-	-	-
Total Revenue	(75)	(663)	(929)	(1,667)	Total Revenue	(75)	(547)	(704)	(1,326)
£ m					£ m				
	2017-18	2018-19	2019-20	Cumulative		2017-18	2018-19	2019-20	Cumulative
Capital Movement					Capital Movement				
Capital Borrowed	12.38	13.71	4.05	30.14	Capital Borrowed	12.38	13.71	4.05	30.14
Loans Repaid	-	-	-	-	Loans Repaid	-	-	-	-
Gross Borrowing	12.38	13.71	4.05	30.14	Gross Borrowing	12.38	13.71	4.05	30.14
Loans Made to CIFCO	11.15	12.34	3.64	27.13	Loans Made to CIFCO	11.15	12.34	3.64	27.13
Loans Repaid	-	(0.08)	(0.12)	(0.20)	Loans Repaid	-	(0.08)	(0.12)	(0.20)
Equity	1.23	1.37	0.41	3.01	Equity	1.23	1.37	0.41	3.01
Gross Investment	12.38	13.63	3.93	29.94	Gross Investment	12.38	13.63	3.93	29.94
Net Capital Movements	-	0.08	0.12	0.20	Net Capital Movements	-	0.08	0.12	0.20

10.2 The Councils have different treasury management approaches and as such whilst the gross amount receivable from CIFCO is the same, the net amounts differ depending upon their finance costs as set out in the table below.

BDC CIFCO Tranche 1 £26.097m	£m	MSDC CIFCO Tranche 1 £26.097m	£m
Interest Receivable (From CIFCO)	(1.171)	Interest Receivable (From CIFCO)	(1.171)
Interest Payable		Interest Payable	
£14.847m Short term loans 0.8%	0.055	£3.597m Short term loans 0.8%	0.036
£5m 10 Year loans @ 1.71%	0.082	£10m 10 Year loans @ 1.71%	0.164
£6.25m 50 Year loans @ 2.63%	0.163	£12.5m 50 Year loans @ 2.63%	0.326
Total Interest Payable	0.300	Total Interest Payable	0.526
<i>NB. £11.25 PWLB borrowing not yet taken</i>		<i>NB. All £22.5m PWLB borrowing taken</i>	

Net Return	0.871	Net Return	0.645
CIFCO Tranche 2 £3.916m		CIFCO Tranche 2 £3.916m	
Interest Receivable (From CIFCO)	(0.074)	Interest Receivable (From CIFCO)	(0.074)
Interest Payable		Interest Payable	
Short term loans 0.8%	0.015	Short term loans 0.8%	0.015
<i>NB.PWLB borrowing taken</i>		<i>NB.PWLB borrowing taken</i>	
Net Return	0.059	Net Return	0.059

- 10.3 The CIFCO accounts for the year ending 31st March 2020 show a loss of £3.5m after taxation. This loss includes the one-off costs of acquiring the 2 additional assets during 2019/20 (including stamp duty and fees of circa £0.5m) and an adjustment in portfolio valuation following the annual year-end revaluation. The portfolio was revalued as at 31st March 2020 by Knight Frank as independent valuers. The portfolio value reduced by 5.66% (£3.15m) overall. Whilst some of the assets values have remained stable, most have been adjusted downwards particularly in the retail sector, reflecting the structural change and malaise in the High Street which is being accentuated by COVID 19. This revaluation reflects the valuer's assumptions in light of COVID 19 and the uncertainty around business survival in these challenging times. The contracted rent and estimated rental value of the portfolio continues to increase, albeit in the short-term payment plans have been agreed with some tenants whilst they are unable to trade partially or fully. In most cases this will result in a deferment or monthly payments of rent rather than a failure to receive these payments.
- 10.4 CIFCO successfully collected over 70% of the March 2020 quarter rent due and consequently were able to make the full quarter debt repayment to the Councils despite the COVID 19 challenges faced by businesses. Whilst the June quarter is likely to be more challenging, the diversity of the portfolio in terms of tenant, location and sector is mitigating the impact of COVID 19 on the fund and helping to maintain an important income stream for the Councils. The Councils total interest repayments in respect of loans taken out to fund CIFCO equated to £0.856m in 2019/20 which is equivalent to approximately 25% of the contracted rent paid to CIFCO. Rental collection by CIFCO would need to fall considerably before it was insufficient to cover the Councils related debt.
- 10.5 The Board of CIFCO is aware of the current government consultation (closing 31st July) looking to prevent the future use of PWLB funds for yield return. The Board of CIFCO will support the Council in making representations in this regard. To date there is no timescale for these proposed changes to be implemented. Alternative funding sources will be investigated with the shareholders, should PWLB funds no longer be available for investment for yield purposes.
- 10.6 The administrative costs of operating CIFCO Capital Ltd for the financial year ending 31st March 2020 were circa £545,000. Administrative costs include professional fees, executive and non-executive resource costs. CIFCO Capital paid the Councils £70,000 for staff and premises overheads for this financial year.

10.7 The Board has considered the merits of acquiring 77 assets, rejected 64 as unsuitable, submitted offers on 13 and acquired 2 since the last year's business plan. The Board, with Holding Company approval, acquired two assets between 16th May 2019 and 31st May 2020 at a value of £5.390m.

10.8 From these 2 properties, the company receives £356,586 in rental income per annum, bringing the total annual rent to £3,393,112 against the previously anticipated rental income of circa £3.1 million per annum.

10.9 CIFCO acquired DW Fitness unit in Lincoln on 15th May 2019 as reported in last year's business plan. A summary of the assets acquired between 16th May 2019 and 31st May 2020 are set out below:

Johnsons Honda, Greyfriars, Milton Keynes (15th January 2020)



- Purpose built car showroom in a prominent position fronting a conglomerate of car dealerships including Mercedes-Benz, Volvo, VW and Skoda
- Fully let to Johnsons Cars Ltd

Renaissance House, Epsom (15th January 2020)



- Multi let town centre office fully let to several tenants in an established business location in Epsom

11. CORPORATE APPOINTMENTS

11.1 In 2020/2021, the Board will work with the following corporate partners to support its investment activity:

- JLL – Fund Manager and Acquisitions Adviser
- Birketts LLP - Legal Adviser
- Zurich UK – Corporate Insurer
- Axa - Portfolio Insurer
- Aquilla Insurance Brokers Ltd - Insurance Broker
- Lloyds Bank PLC – Corporate Banking
- Ensors – Accountancy and Audit
- Grant Thornton – Tax and Strategic Finance Advice
- Workman LLP – Property Management
- Knight Frank – Independent Portfolio Valuers

12. RISK MANAGEMENT

This report most closely links with the following Significant Risk:

Risk Description	Likelihood	Impact	Score	Mitigation Measures
10) If the Capital Investment Fund (CIFCO) does not generate forecast investment returns, we may be unable to meet the income projections for the Councils	2	4	8	CIFCO has now completed acquisitions for the first tranche of funding and commenced the second phase. The adoption of the proposed business plan will provide governance, accountability, and a framework for the second tranche of funding. CIFCO activity continues to be closely monitored, together with market conditions and any changes or prospective changes in government legislation.

12.1 The Board of CIFCO Capital Ltd actively manages risk and considers the fund risk register formally at the Board meetings each quarter. There is a comprehensive risk management strategy in place which requires the Managing Director to attend a group risk panel each quarter to report on risk to the Holding Company Chairs and shareholder senior risk officers.

12.2 The Board continues to review the risk register regularly as a consequence of COVID 19 to ensure that risks were appropriately recorded and mitigated.

13. REVISED BUSINESS PLAN CONSULTATIONS

13.1 The Board of Directors considered the 2020/21 business plan at a virtual strategy day in May with its adviser JLL. The Business Plan has subsequently been developed with the Board of CIFCO and approved by both BDC and MSDC Holding Companies who recommend its approval by the Council for adoption by CIFCO.

14. EQUALITY ANALYSIS

14.1 An Equality Impact Assessment was originally completed in September 2016. The outcome of the assessment was that the strategy itself will not impact residents, staff or any specific protected characteristics. Funding for the programme is independent of existing revenue streams and therefore it will not impact the delivery of any existing front-line services.

15. ENVIRONMENTAL IMPLICATIONS

15.1 There are no known negative environmental impacts resulting from the proposals within the CIFCO Capital Ltd Business Plan 2020/21. It should be noted however that The Board of CIFCO is aware that its shareholders have both declared a climate emergency and are keen to improve the sustainability of their investment portfolios. The CIFCO portfolio is let primarily on full repairing and insuring terms and as such the Board will work with tenants where possible to reduce carbon emissions through the use of its buildings and will, during the course of this financial year, develop a sustainability policy for adoption.

16. APPENDICES

Title	Location
(a) Investment Strategy	Attached
(b) DRAFT CIFCO CAPITAL LTD Business Plan 2020/21 (CONFIDENTIAL)	Attached