

BABERGH AND MID SUFFOLK DISTRICT COUNCILS

TO:	BDC Council MSDC Council	REPORT NUMBER: MC/22/13
FROM:	Cllr Dave Busby, Cabinet Member Assets & Investments Cllr Peter Gould, Cabinet Member Assets & Investments	DATE OF MEETINGS: BDC: 19 July 2022 MSDC: 21 July 2022
OFFICER:	Emily Attack – Director Assets & Investments, Managing Director CIFCO	KEY DECISION REF NO. N/A

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

1. PURPOSE OF REPORT

- 1.1 This report presents the trading activity for CIFCO Capital Ltd (CIFCO) for 2021/22. Appended to the report (Confidential Appendix C) is the draft business plan 2022/23 which, subject to Council approval, will form the basis of CIFCO's trading in 2022/23. A redacted copy of the business plan is attached as Appendix B. CIFCO's performance against its 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 2022/23 CIFCO business plan for its adoption by CIFCO or to recommend amendments to the business plan.
- 2.2 The business plan has 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 and the Councils' Joint Overview & Scrutiny Committee on the 2th June 2022 confirmed that:-
- the current performance of CIFCO delivers good value to the Councils
 - the KPIs are appropriate measures of performance
 - the business plan is robust and appropriate for the next 12 months
 - there is sufficient confidence in the management of CIFCO

<p>3. RECOMMENDATIONS</p> <p>3.1 That Council notes CIFCO Capital Ltd trading activity and performance for the year to 31st March 2022.</p> <p>3.2 That Council approves CIFCO Capital Ltd's 2022/23 Business Plan for adoption by CIFCO Capital Limited.</p> <p>3.3 That future CIFCO business plans are scrutinised by the Councils' Joint Overview & Scrutiny Committee and only reported to Council if the Committee is not satisfied with the Company's business plan and performance or if a decision is required that is reserved to Full Councils.</p>	<p>REASON FOR DECISION</p> <p>To provide appropriate governance and performance monitoring for the operation of CIFCO Capital Ltd.</p>
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4. KEY INFORMATION

- 4.1 CIFCO has been trading since 2017, CIFCO has completed the second phase of investment which was approved by Council in 2019. CIFCO now holds 21 diverse commercial assets primarily in the industrial and office sectors. Details of these assets can be found on the CIFCO website <https://cifcocapital.com/our-portfolio/>.
- 4.2 A summary of the portfolio is set out below:

Category	Q1 2022			
Total Asset Value	£94,110,000			
Contracted Rent p.a.*	£5,355,618			
ERV	£5,912,985			
Number of Assets	21			
Number of Tenants (Units)	78 (88)			
WAULT	To break: 6 years 6 months To expiry: 6 years 7 months			
Initial Yield	5.00%			
Equivalent Yield	5.86%			
Reversionary Yield	6.28%			
Void Rate (ERV)	2.01%			
Running Yield**	5.36%			
ERV = Estimated Rental Value. WAULT = Weighted Average Unexpired Lease Term				
Notes:				
Asset values Knight Frank valuation as at 31.03.2022.				
* As at 1.5.22				
** Yield on gross purchase price.				

- 4.3 CIFCO is a trading company that was set up jointly by Babergh and Mid Suffolk District Councils to acquire commercial property to generate a revenue stream. CIFCO is jointly owned by BDC (Suffolk Holdings) Ltd and MSDC (Suffolk Holdings) Ltd which in turn are each 100% owned by their respective councils. An ownership structure chart is set out at Appendix B. Commercial properties are acquired by CIFCO with funding provided by the Councils by way of loans (90%) and equity investments (10%). The loans are secured against the properties acquired and shares are issued in respect of equity investments made with each new acquisition. The value of the shares (equity investment) fluctuates in line with the value of the portfolio. As the portfolio matures and the costs of acquisition (fees, stamp duty etc) are recovered, dividends will be payable to the Holding Companies and their respective Council owners as a return on the equity investment as well as revenue being generated through loan repayment.
- 4.4 Overall, the portfolio is recovering well from the impacts of the pandemic, due to the work of the board and professional team, the quality of the assets and diverse portfolio. Rent collection on a quarterly basis has been well above industry norms and exceeds our KPI, the company has continued to make full debt repayment to our shareholders.

4.5 The 2022/23 business plan focuses on the on-going management of the fund and the company to maximise revenue and return to our shareholders and to seek out opportunities to enhance the value of the portfolio wherever possible. The board continues to seek to maximise the sustainability of its portfolio and has seen some successes this year as detailed in the business plan. The board is proposing to align its sustainability KPI to proposed changes to MEES /EPC legislation – namely to ensure all properties within the portfolio have an EPC rating of C or above by 2027.

4.6 The 2022/23 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 key portfolio risks and attributes.
- The Business Plan incorporates high level financial cashflow back to the Council through loan repayments. CIFCO borrows at 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 the quarterly portfolio analysis report from JLL which 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

5. KEY PERFORMANCE INDICATORS (KPI)

5.1 The key performance indicators were set within the **2021/22** Business Plan, these are set out below together with performance against these targets:

KPI	Description	Target	Actual
1	Increase contracted rent from £5m p.a. by 1 st April 2022	CPI + 1% (6.2%+1%=7.2%)	£5,368,674 (7.27%)
2	Equivalent Yield (EY)	6%	5.86%
3	Reduce EPC Portfolio Score from 7034 (Average D)	7034 (D)	6963 (D)
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%	Q June- 1.56% Q Sept- 1.76% Q Dec- 1.27% Q March- 2.00% *

*This figure will change by the end of the March quarter as monthly rental payments are made and further arrears collected.

6. KEY PERFORMANCE INDICATORS (KPIs) 2022/23

6.1 The board propose to change the key performance indicators to reflect the continuing emphasis on portfolio management, focusing on income growth, return on investment, sustainability and rent collection.

KPI	Description	Target
1	Increase contracted rent from £5,368,674 per annum by 1 st April 2023	>1%
2	Portfolio Equivalent Yield (EY) aligns with or above All Property Yield (currently 5.3%)	5.3%
3	All properties have an EPC rating (Currently 41.8% of portfolio are rated C or above)	C or above by 2027
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%

7. LINKS TO JOINT CORPORATE PLAN

- 7.1 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 delivering an important income stream into our districts to support the delivery of services and projects within our districts.
- 7.2 The investment in CIFCO is a long-term investment which will create a legacy for future generations.

8. COMPANY STRUCTURE AND IN-YEAR REPORTING

- 8.1 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 previously reviewed by The Joint Overview & Scrutiny Committee and subsequently approved by the two parent Councils usually in July each year. Please see appendix A for a company ownership structure.
- 8.2 The Board meets regularly to review performance of the assets and fund, make portfolio decisions, appoint corporate advisers, and to 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 2020 the Board have been holding virtual Board meetings. This year the strategy day was held in person for the first time since 2019.
- 8.3 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.
- 8.4 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 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 Joint Overview & Scrutiny Committee and subsequently to both full Councils for final consideration. Subject to the approval, it is proposed that subsequent business plans will only be considered by Full Councils if required by Joint Overview & Scrutiny Committee. A redacted annual business plan will continue to be published on the CIFCO website.

9. FINANCIAL PERFORMANCE AND ACQUISITION PROGRESS

9.1 The Councils have received total net income of circa £9.27m since CIFCO's incorporation in 2017, details are set out in the table below:

CIFCO (Babergh)						
	£ 000					
	2017-18	2018-19	2019-20	2020-21	2021-22	Cumulative
Revenue Impact						
Interest Received	(86)	(782)	(1,245)	(1,551)	(2,209)	(5,873)
Interest Paid	11	119	316	277	235	958
Net Interest	(75)	(663)	(929)	(1,274)	(1,974)	(4,915)
Other income/ Recharge	(9)	(25)	(32)	(35)	(35)	(136)
Total Revenue	(84)	(688)	(961)	(1,309)	(2,009)	(5,051)
	£ m					
	2017-18	2018-19	2019-20	2020-21	2021-22	Cumulative
Capital Movement						
Capital Borrowed	12.38	13.71	4.05	19.44	-	49.58
Loans Repaid	-	-	-	-	-	-
Gross Borrowing	12.38	13.71	4.05	19.44	-	49.58
Loans Made to CIFCO	11.15	12.34	3.64	17.50	-	44.63
Loans Repaid	-	(0.08)	(0.12)	(0.15)	(0.22)	(0.57)
Equity	1.23	1.37	0.41	1.94	-	4.95
Gross Investment	12.38	13.63	3.93	19.29	(0.22)	49.01
Net Capital Movements	-	0.08	0.12	0.15	0.22	0.57

CIFCO (Mid Suffolk)						
	£ 000					
	2017-18	2018-19	2019-20	2020-21	2021-22	Cumulative
Revenue Impact						
Interest Received	(86)	(782)	(1,245)	(1,551)	(2,209)	(5,873)
Interest Paid	11	235	541	533	468	1,788
Net Interest	(75)	(547)	(704)	(1,018)	(1,741)	(4,085)
Other income/ Recharge	(9)	(25)	(32)	(35)	(35)	(136)
Total Revenue	(84)	(572)	(736)	(1,053)	(1,776)	(4,221)
	£ m					
	2017-18	2018-19	2019-20	2020-21	2021-22	Cumulative
Capital Movement						
Capital Borrowed	12.38	13.71	4.05	19.44	-	49.58
Loans Repaid	-	-	-	-	-	-
Gross Borrowing	12.38	13.71	4.05	19.44	-	49.58
Loans Made to CIFCO	11.15	12.34	3.64	17.50	-	44.63
Loans Repaid	-	(0.08)	(0.12)	(0.15)	(0.22)	(0.57)
Equity	1.23	1.37	0.41	1.94	-	4.95
Gross Investment	12.38	13.63	3.93	19.29	(0.22)	49.01
Net Capital Movements	-	0.08	0.12	0.15	0.22	0.57

9.2 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 the Councils' finance costs, as illustrated in the table below for 2021-22:

<u>BDC</u>	£m	<u>MSDC</u>	£m
<u>CIFCO Tranche 1 £26.097m</u>		<u>CIFCO Tranche 1 £26.097m</u>	
Interest Receivable (From CIFCO)	-1.156	Interest Receivable (From CIFCO)	-1.156
Interest Payable		Interest Payable	
Short term loans Average rate 0.05%	0.004	Short term loans Average rate 0.51%	0.003
£5m 10 Year loans @ 1.71%	0.065	£10m 10 Year loans @ 1.71%	0.13
£6.25m 50 Year loans @ 2.63%	0.16	£12.5m 50 Year loans @ 2.63%	0.32
Total Interest Payable	0.229	Total Interest Payable	0.453
Net Return	0.927	Net Return	0.703
<u>CIFCO Tranche 2 £23.492m</u>		<u>CIFCO Tranche 2 £23.492m</u>	
Interest Receivable (From CIFCO)	-1.053	Interest Receivable (From CIFCO)	-1.053
Interest Payable		Interest Payable	
Loans Average rate 0.05%	0.006	Loans Average rate 0.51%	0.014
Net Return	1.047	Net Return	1.039

BDC		MSDC	
Total Net Return Tranche 1 and 2	1.974	Total Return Tranche 1 and 2	1.741
Total Capital borrowed	49.58	Total Capital borrowed	49.58
Percentage return	3.98%	Percentage return	3.51%

- 9.3 The Councils' investment in CIFCO was completed by 31st March 2021, with a total of c.£99.2m being drawn down by CIFCO over the full investment period.
- 9.4 CIFCO's draft year end accounts for 2021/22 are set out in Appendix 3 of the Business Plan. These accounts are currently being audited and will be submitted to Companies House as soon as practical. CIFCO's annual accounts (year ending March 2022) show a profit of £6.5m because of the increase in value of the portfolio over the period. The accounts also show that operating costs including finance costs currently exceed income from the fund. This is primarily a consequence of CIFCO continuing to make full debt repayments to the Councils. It is anticipated that operating cost will exceed income for the next 2 years based on full debt repayments being made, thereafter fund income levels will exceed pre-pandemic levels and the Company's income will exceed operating costs.
- 9.5 The portfolio was revalued as at 31st March 2022 by Knight Frank as independent valuers for the fund. The portfolio value has increased in value by 12.15% overall (£10.192m). Capital growth has been seen primarily within our industrial assets and Princes Gate in Harlow which has recovered following the impact of the pandemic last year.
- 9.6 The Councils' total interest repayments in respect of loans taken out to fund CIFCO equated to £703,000 in 2021/22 which is equivalent to an average of approximately 13% of the current contracted rent payable to CIFCO (4.5% Babergh DC & 8.9% Mid Suffolk DC). Rental collection by CIFCO would need to fall significantly before it was insufficient to cover the Councils' related debt.
- 9.7 The capital investment for the first phase of funding from Babergh and Mid-Suffolk District Councils is scheduled to be repaid in full by December 2068 with the second phase being repaid by 2071. During 2020/21 and 21/22 CIFCO has been able to maintain full debt repayment to the Councils, however CIFCO is still recovering from the impacts of the pandemic and is looking to make further capital improvements to the portfolio to enhance its sustainability. It is therefore helpful to continue to have the flexibility agreed with its shareholders last year in relation to debt repayments for the subsequent 2 years, namely the opportunity, if required, to defer debt repayments of 11% in 22/23, and 6% in 2023/24. Any deferred repayments will be accrued in the Councils' accounts and additional interest will be payable to the Councils in relation to these delayed repayments. The table below sets out the debt repayment schedule for the next 2 years together with additional interest charges.

Financial Year	Amount of Repayments to be Deferred	Full Repayment	Adjusted Repayment	Additional Late Payment Interest Payable by CIFCO on deferred amount
2022/23	£538,570	£4,867,981.25	£4,329,410.93	£15,876.58
2023/24	£293,493	£4,869,970.99	£4,576,478.47	£2,982.78
			Total	£18,859.36

10. 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	3	6	The adoption of the proposed business plan will provide governance, accountability, and a framework for the management of the property fund. CIFCO activity continues to be closely monitored, together with market conditions and any changes or prospective changes in government legislation.

10.1 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.

10.2 The Board continues to review the risk register regularly to ensure that risks were appropriately recorded and mitigated. This year the Board has undertaken a full review of the risk strategy and mechanism for quantifying risk to ensure that it robust and fit for purpose and has adopted some best practise improvements.

11. REVISED BUSINESS PLAN CONSULTATIONS

11.1 The Board of Directors together with the Chairs of the Holding Companies considered the 2022/23 business plan at its strategy day in March 2022 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.

11.2 The Joint Overview and Scrutiny Committee reviewed the CIFCO Business Plan on 27th June and supported the recommendations at 3.1 and 3.2 of this report. The committee did not support recommendation 3.3.

11.3 The Joint Overview & Scrutiny Committee confirmed that:-

- the current performance of CIFCO delivers good value to the Councils
- the KPIs are appropriate measures of performance
- the business plan is robust and appropriate for the next 12 months
- there is sufficient confidence in the management of CIFCO.

12. EQUALITY ANALYSIS

12.1 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.

13. ENVIRONMENTAL IMPLICATIONS

Sustainability

13.1 During 20/21 CIFCO adopted a sustainability policy. Taking action on climate change and the greenhouse gas emissions which cause it, is a critical part of building a more sustainable future – and every business must play their part. Buildings account for 40% of emissions, creating an urgent need for the real estate sector to develop and implement plans to transition to net zero carbon.

13.2 Please refer to section 14 of the Business Plan for further information.

14. APPENDICES

Title	Location
(a) Company ownership structure	Attached
(b) DRAFT CIFCO CAPITAL LTD Business Plan 2022/23 Commercially sensitive information REDACTED	Attached
(c) DRAFT CIFCO CAPITAL LTD Business Plan 2022/23 (CONFIDENTIAL)	Attached in Part 2
(d) Joint O&S Committee Minutes	Attached