

BABERGH AND MID SUFFOLK DISTRICT COUNCILS

TO: BDC Council MSDC Council	REPORT NUMBER: BC/23/15
FROM: Cllr John Ward, Cabinet Member Finance, Assets & Investments Cllr Richard Winch, Cabinet Member Housing & Property	DATE OF MEETING: BDC: 19 September 2023 MSDC: 21 September 2023
OFFICER: Emily Atack, 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 2022/23. Appended to the report is the draft business plan 2023/24 which, subject to Council approval, will form the basis of CIFCO's trading in 2023/24. 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 2023/24 CIFCO business plan for its adoption by CIFCO or to recommend amendments to the business plan.

The business plan has been prepared by the Board of CIFCO in consultation with its fund managers Jones Lang LaSalle (JLL).

3. RECOMMENDATIONS

- 3.1 **That Council notes CIFCO Capital Ltd trading activity and performance for the year to 31st March 2023.**
- 3.2 **That Council approves CIFCO Capital Ltd.'s 2023/24 business plan for adoption by CIFCO Capital Limited.**

REASON FOR DECISION

To provide appropriate governance and performance monitoring for the operation of CIFCO Capital Ltd.

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, alongside previous years:

	March 2020	March 2021	March 2022	March 2023
Total Asset Value	£52,490,000	£83,918,000	£94,110,000	£82,500,000
Contracted Rent p.a.	£3,393,112	£5,004,824	£5,355,618	£5,530,981
ERV	£3,609,037	£5,556,641	£5,912,985	£6,545,589
Number of Assets	14	21	21	21
Number of Tenants	38	90	78	81
WAULT (years)	To break 6 years 8 months To expiry: 8 years 5 months	To break 7 years 0 months To expiry: 8 years 6 months	To break 6 years 6 month To expiry 6 years 7 months	To break 4 years 6 month To expiry 5 years 8 months
Initial Yield	5.78%	5.60%	5.00%	6.30%
Equivalent Yield	6.41%	6.16%	5.86%	6.98%
Reversionary Yield	6.40%	6.24%	6.28%	7.44%
Void Rate	3.96%	5.72%	2.01%	3.64%
Running Yield*	5.97%	5.20%	5.36%	5.75%

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 were acquired by CIFCO with funding provided by the Councils by way of loans (90%) and equity investments (10%).

The loans to CIFCO are secured against the properties acquired and shares are issued in respect of equity investments made with each 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 High inflation and the resulting increases in interest rates have impacted commercial property capital values, particularly since Autumn 2022. Investment transaction levels have fallen by 22% compared to the previous year and are 8% lower than the 10 year average. The occupational market remains fairly robust, although CIFCO has experienced some tenant failures this year. Overall, the portfolio is holding up well in the current market, due to the work of the board and professional team, the quality of the assets and diverse portfolio. Rent collection on a quarterly basis continues to be above industry norms and exceeds CIFCO KPI, and void levels remain below the industry benchmark.

4.5 The 2023/24 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 key strategic objectives for the forthcoming years are to reduce and mitigate future portfolio voids, continue ESG improvement path, manage portfolio risk and deploy capital strategically to enhance value and income.

4.6 The 2023/24 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 budget and 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

- 4.7 CIFCO provides a long-term income stream for the Councils to use to support the delivery of services within the District. This forms part of a portfolio of investments delivering income to the Councils including CCLA, Schrodgers and others.
- 4.8 In addition, the Councils also invest directly in property in their districts for regeneration, housing delivery and income purposes. In Mid Suffolk examples include the acquisition of the Former Aldi Unit at Gipping Way in 2018, which has been redeveloped and now delivers car parking and rental income to Council and the acquisition of 11 Market Place which is now let to The John Peel Centre. It has also invested in Gateway 14 in Stowmarket and the redevelopment of its former HQ site in Needham Market delivering affordable and market homes. In Babergh examples include Borehamgate Shopping Centre, employment land in Hadleigh and the redevelopment of the former HQ in Hadleigh. The Councils have also built or acquired 572 new Council Houses in the districts over the last 8 years.
- 4.9 MSDC are committed to strong governance, risk management and oversight of CIFCO operations and will undertake a thorough review of operations prior to the next business plan cycle to inform MSDC's longer term strategy. The governance arrangements and MSDC long term strategy will be reviewed with our partners Babergh District Council working together to deliver the best outcomes for our residents.

5. KEY PERFORMANCE INDICATORS (KPI)

- 5.1 The key performance indicators were set within the **2022/23** Business Plan, these are set out below together with performance against these targets:

KPI	Description	Target		Target	CIFCO KPI 2023
1	Increase contracted rent from £5,368,674 pa by 01 April 2023	£5,422,360		1%	£5,530,981 (+3.02%)
2	Equivalent Yield (EY)	MSCI All property 6.6%		Target at or above market Equivalent Yield	6.98%
3	Improve EPC Portfolio Rating	100%		All Properties have an EPC rating of C or above by 2027	46.4%
4	Quarterly Rent Arrears of less than 5.00% (Data as at 20 March 2023)	Current Arrears (£):	£57,727	Measured by the amount of rent outstanding at the end of the quarter as a percentage of	*Q1 1.63%
		Current Arrears (%):	3.63%		
		5% Target:	£79,570		

		Target:	-£21,843	the total rent due that quarter	*Q3 4.75%
		Total Income for Quarter:	£1,591,397		*Q4 3.63%

*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) 2023/24

6.1 The board propose to retain the existing key performance indicators which 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 £5,530,980 per annum by 1 st April 2024	>1%
2	Portfolio Equivalent Yield (EY) aligns with or above All Property Yield (currently 6.6%)	6.6%
3	All properties have an EPC rating of	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 Babergh and Mid Suffolk Councils are currently resetting their Corporate Plans following the change in administrations in the May 2023 elections.

7.2 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' Medium-Term Financial Strategies delivering an important income stream into our districts to support the delivery of services and projects within our districts.

7.3 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 the business plan 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, portfolio management, delegations and procurement. The Board meets virtually for quarterly Board meetings and in person for a strategy day once a year. The strategy day was held on 19th June, this year and was a good opportunity to welcome new Councillor directors to the board.
- 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.

9. FINANCIAL PERFORMANCE AND ACQUISITION PROGRESS

- 9.1 The Councils have received total net income of circa £11.511m since CIFCO's incorporation in 2017, details are set out in the tables below:

CIFCO (Babergh)							
	£ 000						
	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	Cumulative
Revenue Impact							
Interest Received	(86)	(782)	(1,245)	(1,551)	(2,209)	(1,942)	(7,815)
Interest Paid	11	119	316	277	235	523	1,481
Net Interest	(75)	(663)	(929)	(1,274)	(1,974)	(1,420)	(6,334)
Other income/ Recharges	(9)	(25)	(32)	(35)	(35)	(35)	(171)
Accrued interest receivable	-	-	-	-	-	(255)	(255)
Total Revenue	(84)	(688)	(961)	(1,309)	(2,009)	(1,710)	(6,761)
£ m							
	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	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)	(0.24)	(0.81)
Equity	1.23	1.37	0.41	1.94	-	-	4.95
Gross Investment	12.38	13.63	3.93	19.29	(0.22)	(0.24)	48.77
Net Capital Movements	-	0.08	0.12	0.15	0.22	0.24	0.81

CIFCO (Mid Suffolk)							
	£ 000						
	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	Cumulative
Revenue Impact							
Interest Received	(86)	(782)	(1,245)	(1,551)	(2,209)	(1,942)	(7,815)
Interest Paid	11	235	541	533	468	850	2,638
Net Interest	(75)	(547)	(704)	(1,018)	(1,741)	(1,092)	(5,177)
Other income/ Recharges	(9)	(25)	(32)	(35)	(35)	(35)	(171)
Accrued interest receivable	-	-	-	-	-	(255)	(255)
Total Revenue	(84)	(572)	(736)	(1,053)	(1,776)	(1,382)	(5,604)
£ m							
	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	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)	(0.24)	(0.81)
Equity	1.23	1.37	0.41	1.94	-	-	4.95
Gross Investment	12.38	13.63	3.93	19.29	(0.22)	(0.24)	48.77
Net Capital Movements	-	0.08	0.12	0.15	0.22	0.24	0.81

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 2022-23:

<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)	-1.150	Interest Receivable (From CIFCO)	-1.150
Interest Payable		Interest Payable	
Short term loans Average rate 4.08%	0.126	Short term loans Average rate 3.51%	0.103
£5m 10 Year loans @ 1.71%	0.057	£10m 10 Year loans @ 1.71%	0.114
£6.25m 50 Year loans @ 2.63%	0.158	£12.5m 50 Year loans @ 2.63%	0.317
Total Interest Payable	0.341	Total Interest Payable	0.534
Net Return	0.809	Net Return	0.616
<u>CIFCO Tranche 2 £23.492m</u>		<u>CIFCO Tranche 2 £23.492m</u>	
Interest Receivable (From CIFCO)	-1.048	Interest Receivable (From CIFCO)	-1.048
Interest Payable		Interest Payable	
Loans Average rate 4.08%	0.182	Loans Average rate 3.51%	0.317
Net Return	0.866	Net Return	0.731

<u>BDC</u>		<u>MSDC</u>	
Total Net Return Tranche 1 and 2	1.675	Total Return Tranche 1 and 2	1.347
Total Capital borrowed	49.58	Total Capital borrowed	49.58
Percentage return	3.38%	Percentage return	2.72%

*Average Loan Rates are as at 31 March 2023.

- 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 2022/23 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 gross income of £5.8m, company costs (excluding the portfolio revaluation) of £5.63m and a pre-tax loss of £11.4m and an after-tax loss of £10.2m (reflecting the reimbursement of corporation tax paid quarterly in advance). This loss is due to the reduction in value of the CIFCO portfolio at the end of March 2023. This loss would only be realised if the properties are sold.

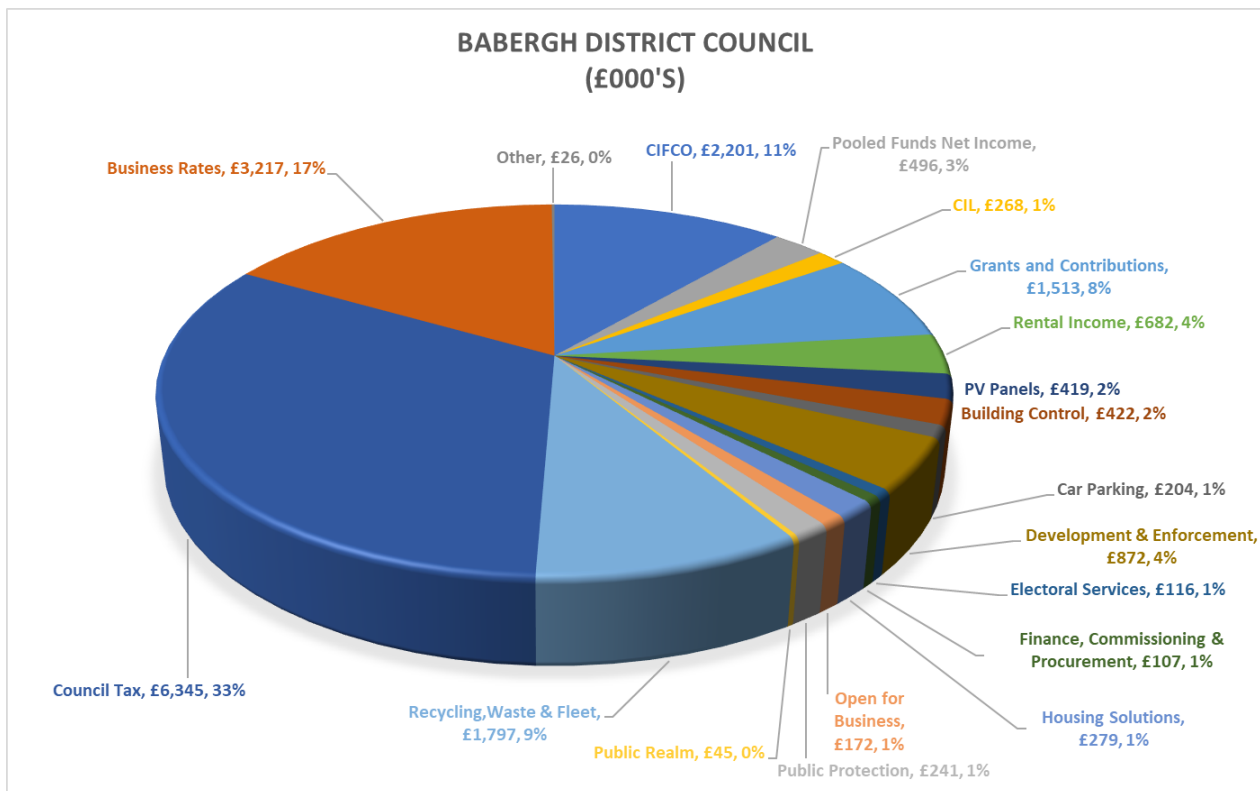
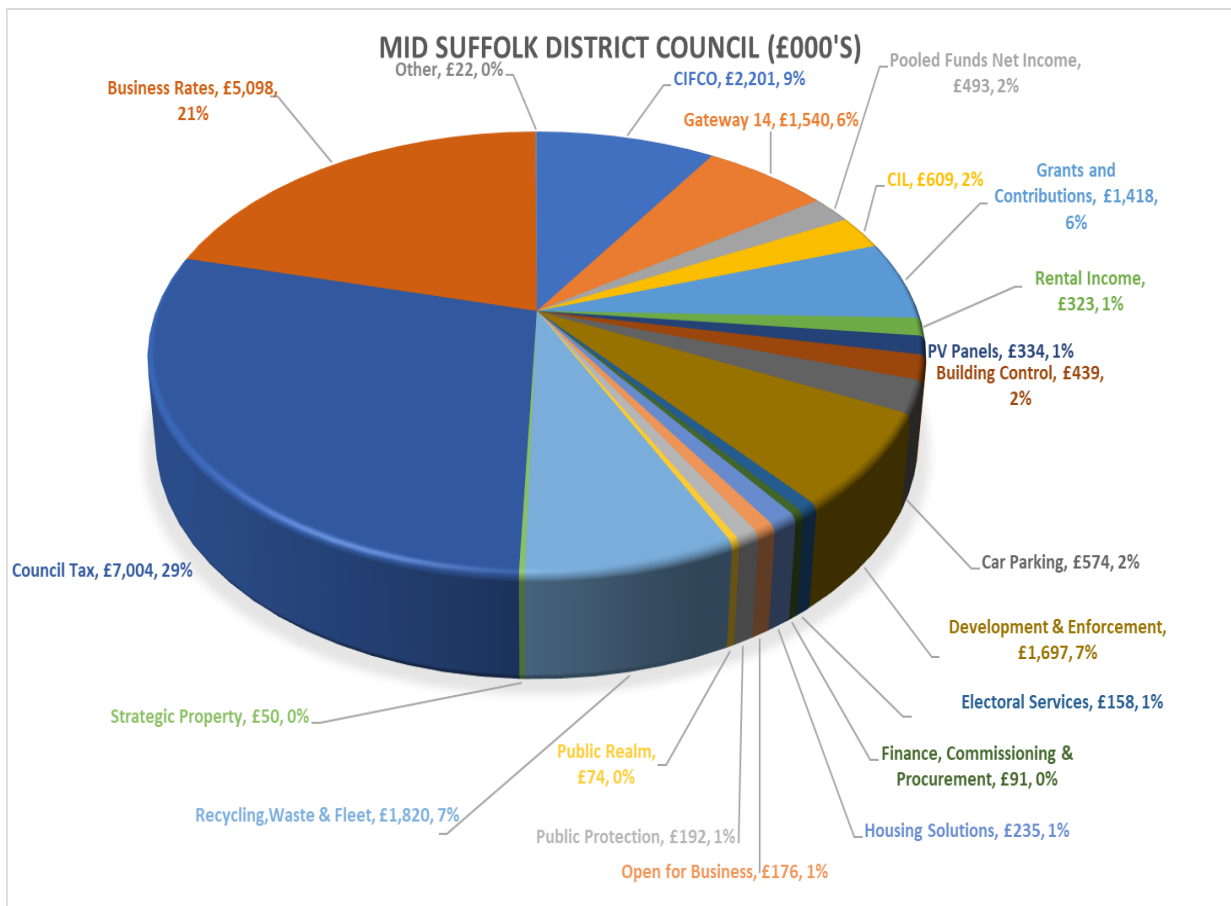
- 9.5 The portfolio was revalued as at 31st March 2023 by Cushman & Wakefield as independent valuers for the fund. Cushman & Wakefield has replaced Knight Frank, the previous fund valuers, in line with good practise to ensure that valuers remain independent and objective.
- 9.6 The portfolio value has decreased this year by 12% overall (£11.6m) primarily due to the market responding to high inflation and increasing debt costs. The MSCI All Property Benchmark shows a reduction in portfolio capital values of 16.8%, so whilst the CIFCO portfolio has reduced in value it has outperformed the market benchmark.
- 9.7 The Councils' total interest repayments in respect of loans taken out to fund CIFCO equated to £1.373m in 2022/23 which is equivalent to an average of approximately 25% of the current contracted rent payable to CIFCO (9% Babergh DC & 15% Mid Suffolk DC). The Councils' debt costs have increased significantly over the last 12 months. Income from CIFCO exceeds the Councils' cost of debt delivering a net income for the investment in services across the districts. Net income in 2022/23 was £2.51m (Babergh £1.42m and Mid Suffolk £1.09m) plus accrued interest and recharges as set out in the table above.
- 9.8 One of the most significant factors outside of the Councils' control is the level of interest rates, interest payable is being closely monitored. The table below shows the sensitivity analysis of percentage increases in interest rate costs for the Councils, assuming annual increases of between 0.25% and 1.5%.

					Increased Total Debt Costs / Rate Increase					
					2023/24	+0.25%	+0.5%	+0.75%	+1%	+1.5%
					Total Annual Cost of Debt	£000				
					£000					
Mid Suffolk	Interest Rate	Loan Amount	Total Loan %							
CIFCO PWLB 50 Year annuity	2.63%	£12.5m	25.2%	£329	no cost change long term fixed rate until 2068 @2.63%					
CIFCO PWLB 10 Year annuity	1.71%	£10m	20.2%	£171	no cost change 10 year fixed rate until 2028@1.71%					
CIFCO Short Term Borrowing	3.51%	£27.1m	54.6%	£1,187	£1,226	£1,265	£1,305	£1,344	£1,423	
Total Borrowing Costs				£1,687	£1,726	£1,765	£1,805	£1,844	£1,923	
Gross Income from CIFCO				£2,288	£2,288	£2,288	£2,288	£2,288	£2,288	
Net Income				£601	£562	£523	£483	£444	£365	
Babergh										
CIFCO PWLB 50 Year annuity	2.63%	£6.25m	12.6%	£164	no cost change long term fixed rate until 2068 @2.63%					
CIFCO PWLB 10 Year annuity	1.71%	£5m	10.1%	£86	no cost change 10 year fixed rate until 2028@1.71%					
CIFCO Short Term Borrowing	4.08%	£38.3m	77.3%	£1,741	£1,789	£1,836	£1,885	£1,932	£2,028	
Total Borrowing Costs				£1,991	£2,039	£2,086	£2,135	£2,182	£2,278	
Gross Income from CIFCO				£2,288	£2,288	£2,288	£2,288	£2,288	£2,288	
Net Income				£297	£249	£202	£153	£106	£10	

- 9.9 The interest rate risk relates mainly to the short-term portion of the debt. The Councils have different treasury management approaches, Mid Suffolk has fixed loans for 45.37% of the total debt and Babergh has 22.69% of its debt to fixed long term loans with PWLB. The sensitivity analysis above shows that the Councils will continue to benefit from full debt coverage and still receive a net income if rates increase by a further 1.5%. Arlingclose, the Councils' treasury advisors, are forecasting that the interest rates will rise from 5% to 5.25% in August and peak at 5.50% in September and will start to come down again in the following Autumn to around 3%.
- 9.10 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. In line with previous business plans, during 2022/23, CIFCO made reduced debt repayment to the Councils of approximately £250,000 per Council. This equates to a reduction in debt repayments of approximately 11%. Reduced payments will continue to be paid throughout 2023/24- this reduction will be based on a 6% reduction in debt repayment. CIFCO will continue to invest the deferred repayments in the portfolio to make further capital improvements and to enhance its sustainability. 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 2022-2024 together with additional interest charges to CIFCO of circa £19,000.

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

- 9.11 The Councils receive income from different sources including grants and contributions from Government, service income such as fees for council tax, business rates, planning, licensing and building control as well as income from waste services and other investment income. In 2022/23 the Gross Income from CIFCO was 9% of Mid Suffolk's total income and 11% of Babergh's total Income. CIFCO income for both Councils are included under Investment and the amounts include some deferred interest that CIFCO has not yet paid of circa £255k for each Council.



10. RISK MANAGEMENT

This report most closely links with the following Significant Risk:

Risk Description	Likelihood	Impact	Score	Mitigation Measures	Risk Register and Reference
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.	Significant Risk Register SRR001

- 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 and best practise for risk management is adopted.

11. REVISED BUSINESS PLAN CONSULTATIONS

- 11.1 The Board of Directors together with the Chairs of the Holding Companies and representatives of the Ultimate Shareholders considered the 2023/24 business plan at its strategy day in June 2023 with its adviser JLL. The Business Plan has subsequently been developed with the Board of CIFCO for approval.
- 11.2 The Business Plan was considered by Joint Overview and Scrutiny Committee on 21st August 2023. Members of the Committee asked comprehensive questions of the CIFCO representatives and asked that Councils consider the minutes from the meeting. The minutes are as attached in the appendices.

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) DRAFT CIFCO CAPITAL LTD Business Plan 2023/24 Commercially sensitive information REDACTED	Attached
(b) DRAFT CIFCO CAPITAL LTD Business Plan 2023/24 (CONFIDENTIAL)	Attached in Part 2
(c) Joint Overview & Scrutiny Committee Minutes 21/08/23	Attached