BABERGH AND MID SUFFOLK DISTRICT COUNCILS

TO:	**Babergh Council** **Mid Suffolk Council**	**REPORT NUMBER:**	**MC/19/51**
FROM:	**Cllr David Busby, BDC Cabinet Member for Assets & Investments;** **Cllr Peter Gould, MSDC Cabinet Member for Assets & Investments**	**DATE OF MEETING:** **BDC - 21 July 2020** **MSDC - 23 July 2020**	
OFFICER:	**Emily Atack – Assistant Director Assets & Investments, Managing Director CIFCO**	**KEY DECISION REF NO. N/A**	

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 C) 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 and reviewed by the Joint Overview & Scrutiny Committee who supported the recommendations being made to Council.

3. RECOMMENDATIONS

3.1 That Council notes CIFCO Capital Ltd trading activity and performance for the year to 31st March 2020.

3.2 That 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 2020/2021period.**

4. KEY INFORMATION

4.1 CIFCO 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 A summary of the portfolio is set out below:

	Q1 2020
Total Asset Value	£52,490,000
Contracted Rent p.a.	£3,393,112
Estimated Rental Value	£3,609,037
Number of Assets	14
Number of Tenants	38
WAULT (years)	To break 6 years 8 months To expiry: 8 years 5 months
Initial Yield	5.78%
Equivalent Yield	6.41%
Reversionary Yield	6.40%
Void Rate	3.96%
Running Yield**	5.97%

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 the 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 Since the last business plan was approved in July 2019, 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.

4.5 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.

4.6 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.

4.7 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 <u>not</u> specifically target Capital growth and its projections are not based upon such growth, but a focus on income growth.

4.8 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.

4.9 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 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

4.10 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 slightly 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

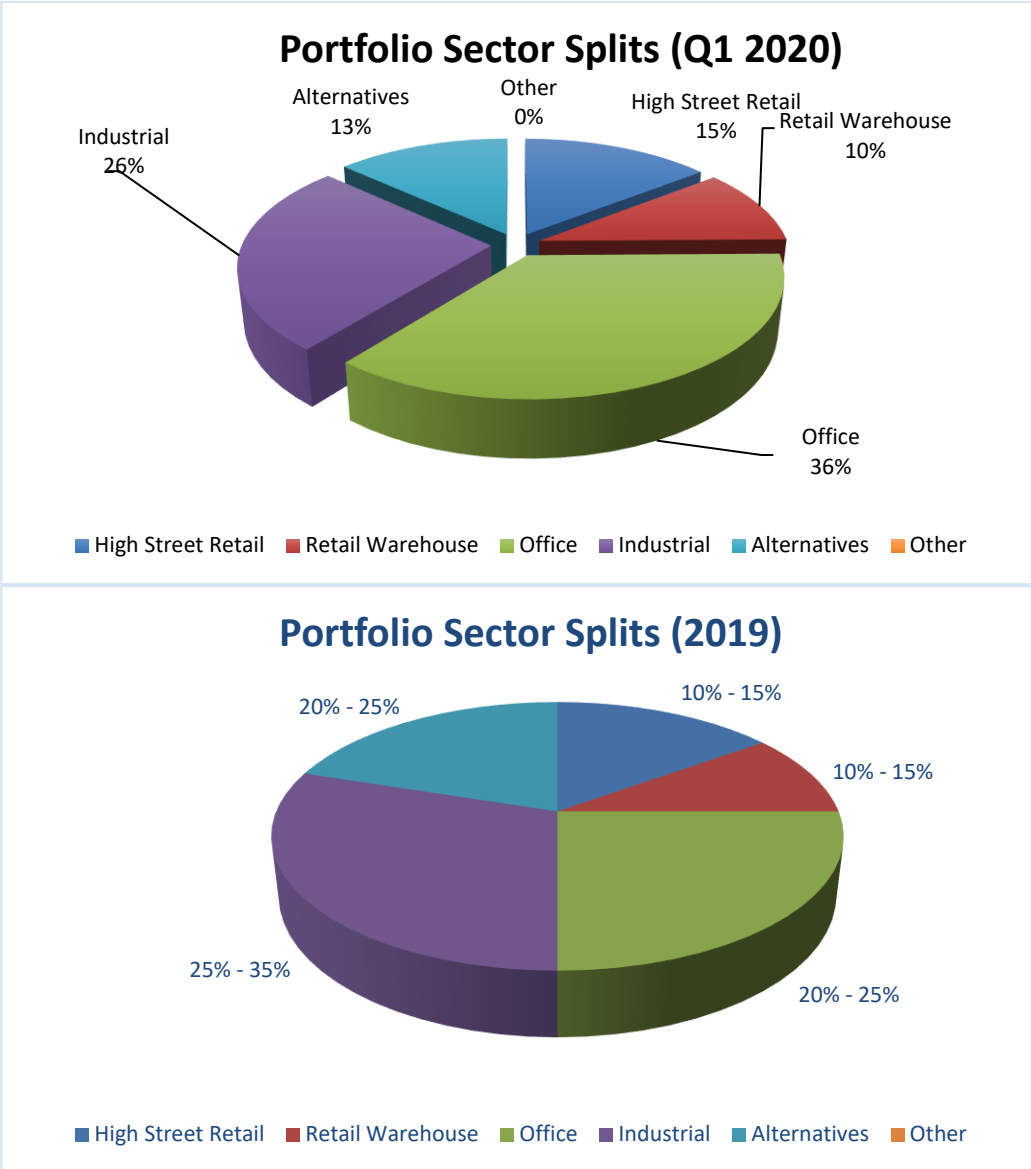


Figure 1

4.11 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- 27.14%

5.2 Rent arrears were ahead of 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 & 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 the Councils' 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**
*NB. £11.25 PWLB borrowing **not yet** taken*		*NB. All £22.5m PWLB borrowing taken*	
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**
NB.PWLB borrowing taken		*NB.PWLB borrowing taken*	
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. This is a capital loss as a result of the reduction in the value of assets held on the company's balance sheet. The value of this company is effectively the same as the value of the assets (properties) it owns and as such the company value (and equity or shares within it) will fluctuate in line with the property values.

This “paper loss” does not require any additional capital or equity to be invested within the company (other than as planned through the acquisition programme) and would only be realised in the event that properties are sold whilst the market values are depressed. The reduction in value of the portfolio and costs of acquisition are recorded as an impairment within the trading accounts. This impairment is also reflected in the shareholders accounts to reflect the changing value of the company. The total loss across the company structure in this regard is £3.5m for 2019/20.

10.4 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.

10.5 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. To date over 60% of rents due for the June quarter have been collected which has enabled the full debt repayment to be made to the Councils for this quarter also, with further income expected to CIFCO as the quarter progresses by way of monthly payments.

Type	**March Percentage**	**June Percentage**	**Comment**
Rent Collected	72.86%	65.51%	As at 7th July 2020
Monthly Payment Plan	5.01%	11.58%	Tenants already paying monthly or monthly agreed for March quarter
Deferral	20.70%	4.43%	No further payments expected this quarter. 3 month rent deferred
High Risk	0.00%	7.33%	No further payments expected. Either no communication from the tenant or unable to offer/agree a rental concession
Other	1.44%	11.15%	Inc rent stop or In Admin
Total	100%	100.00%	

10.6 Whilst rent collection is likely to continue to be challenging throughout the next financial year, 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 an average of approximately 25% of the current contracted rent payable to CIFCO (19% Babergh DC & 32% Mid Suffolk DC). Rental collection by CIFCO would need to fall considerably before it was insufficient to cover the Councils related debt.

10.7 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 and for clarity the proposal do not prevent Councils from making yielding investment but do prevent the use of PWLB funds in a financial year by authorities who make yielding investments in that year. Alternative funding sources will be investigated with the shareholders, should PWLB funds no longer be available for investment for yield purposes.

10.8 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.

10.9 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.

10.10 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.

10.11 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) Company ownership structure	Attached
(c) DRAFT CIFCO CAPITAL LTD Business Plan 2020/21 (CONFIDENTIAL)	Attached in Part 2 of the Agenda
(d) Recommendations and draft Minutes from BMSDC Joint Overview and Scrutiny Committee	Attached

Appendix A

1. Future Investment Strategy

1.1 Following the commitment by our Shareholders in March 2019 to invest a further £50m in CIFCO Capital over a 24- month period, the board has been progressing further acquisitions during the course of the last financial year in accordance with the approved investment strategy. The investment strategy for 2020/21 has been devised to reflect the on-going investment, the performance of the existing portfolio and current market conditions in light of COVID 19. Working with its Fund Managers and Investment Advisers (JLL), the Board has reviewed the investment strategy, which is set out below.

2. Key Investment Criteria

2.1 The strategy for 2020/21 does not differ materially from that adopted in the previous year. The aim remains to acquire assets with the following fundamental characteristics:

2.1.1 Target Portfolio Yield of circa 5.75% - 6.00%

- With current market uncertainty the direction of travel will remain to invest in secure income against strong asset fundamentals of quality and location. Focus to remain on Core assets that provide stability.

2.1.2 Lot size optimum range £3m to £12m.

- This has reduced from £15m to provide a more even balance to the portfolio once fully invested.

2.1.3 Regional bias

- Weighting towards Eastern region to be maintained

2.1.4 Quality location

With limited supply and underlying occupier demand. Critical to ensure a building is re-lettable to reduce exposure to long void periods and revenue volatility.

2.1.5 Modern fabric with occupational flexibility.

- Minimising depreciation, capital expenditure, sustainability, retaining occupier demand. Avoid bespoke buildings.

2.1.6 FR & I lease structure to quality tenants or occupiers suited to location

- Rent secured on tenants with strong financial profiles to protect income. This is particularly important with the current COVID 19 challenges.

2.1.7 RPI or open market upwards only reviews

- Considered particularly attractive. Protects income and provides for revenue certainty and growth.

2.2 Key Assumptions

- Further £40m of capital to invest
- From April 2019 – increase period from 24 months to 30 months for full investment
- Regional bias towards the Eastern Region maintained
- Investment property only - No speculative development

Target Core Weightings

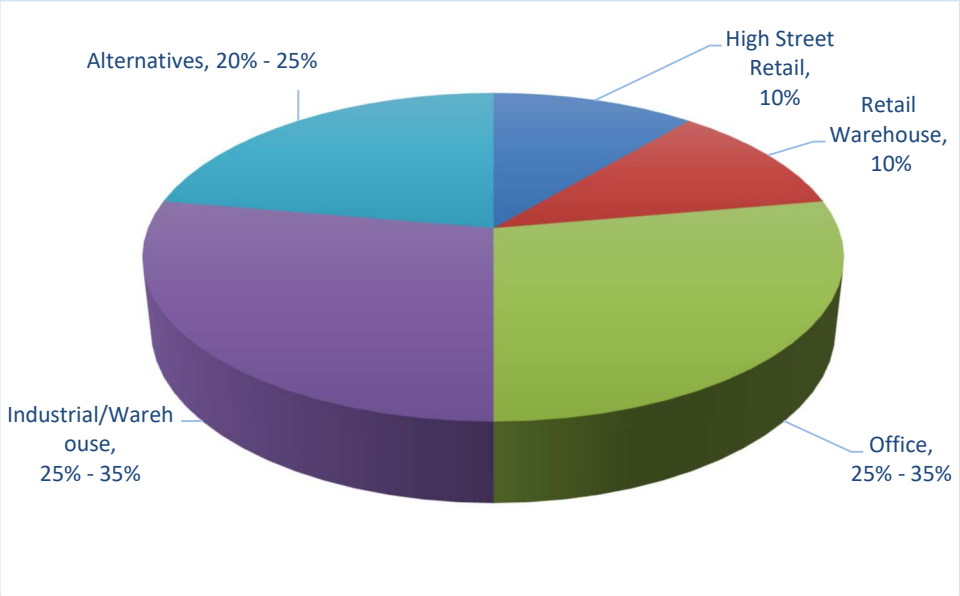


Figure 5

Indicative sub-sector weightings

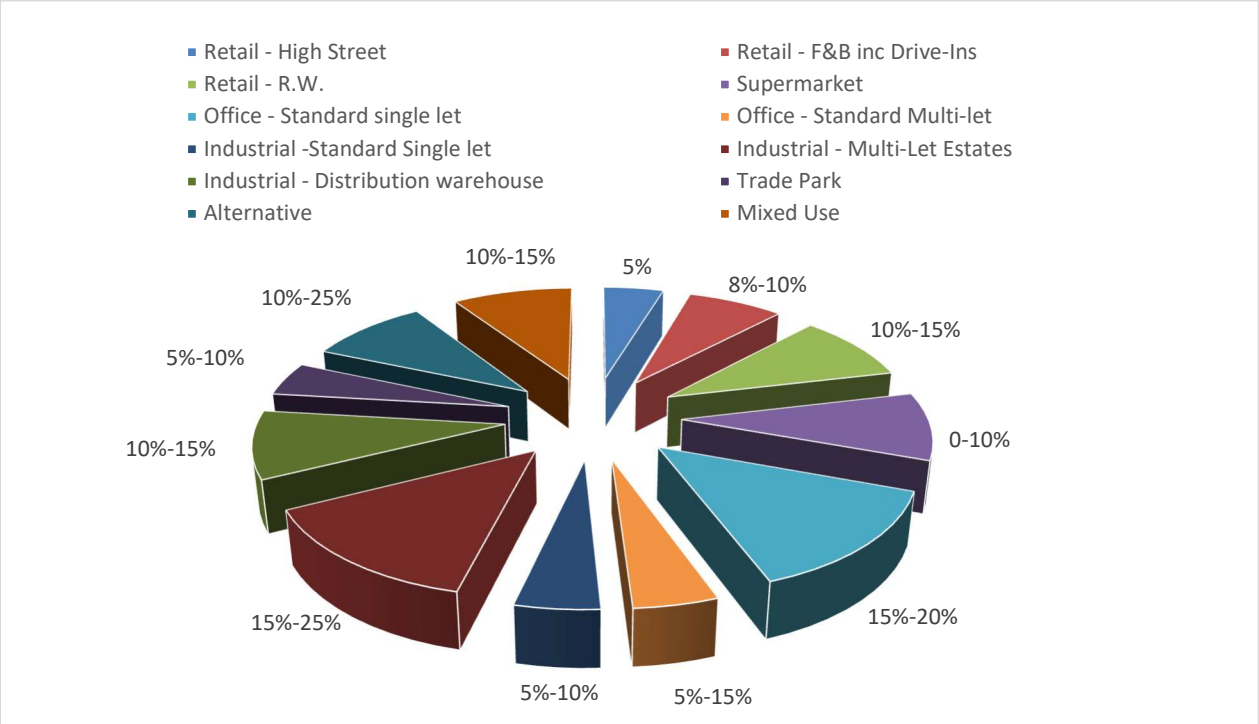


Figure 6

3. On-going Portfolio Risk Mitigation

3.1. To control and limit risks within the portfolio, the following mitigation strategies are to be adopted:

Income security

- spread risk through covenant diversification and lease length. A single tenant to account for no more than 10% of total income.

Development

- no speculative development and limited exposure of up to 10% of funds to be directed towards new build.

Locational (town/area)

- no more than 15% invested in any one town

Sector exposure

- no more than 35% held in any one core sector with a maximum of 25% in any sub-sector

Value/Income volatility

- invest for long term in modern buildings fit for purpose, with a focus on income

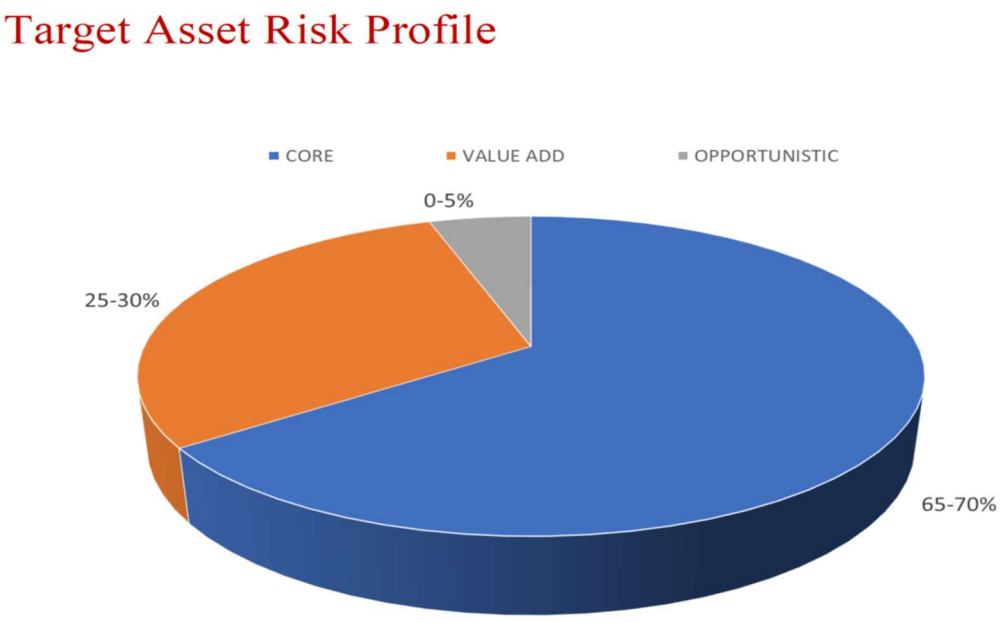


Figure 7

4. Principal Changes to Investment Criteria

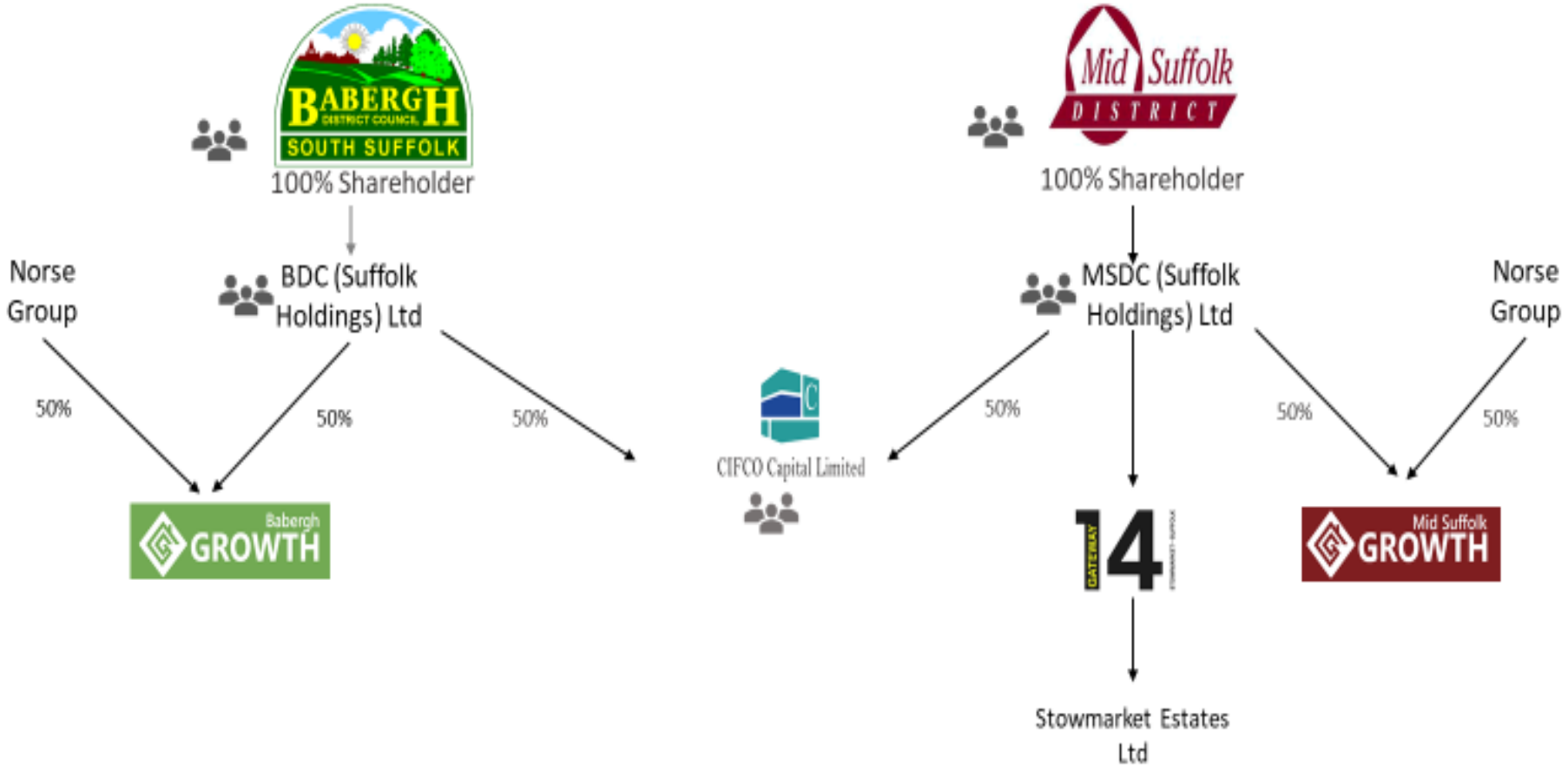
- Increased investment period from 24 months to 30 months (Full investment by October 2021)
- Maximum lot size decreased from £15m to £12m
- Even greater emphasis on tenant strength and income security
- In final phase of investment particular emphasis to maintain asset weighting towards achieving a balanced portfolio

5. Investment Strategy Summary

- Capital growth likely to be through asset management and rental growth rather than yield compression.
- Diversify asset profile through a move into sub-sector markets such as supermarkets (local), trade, drive-ins
- Look to diversify income risk through acquisition of multi-let properties, industrial, offices and alternatives
- Avoid highly reversionary assets save where rents are clearly established and affordable
- Investment in core towns and cities and within prime or strong locations
- Favour investments with good residual values
- Seek long term income security with strong covenants. Look towards RPI structures if can be found at value.

Appendix B

Trading Companies' Structure



TO:	**COUNCIL**	**APPENDIX D TO PAPER MC/19/51**
FROM:	**Joint Overview and Scrutiny Committee**	**DATE OF MEETING: 23 July 2020**
OFFICER:	**Henriette Holloway Governance Support Officer**	**KEY DECISION REF NO. N/A**

COUNCIL ARE ASKED TO CONSIDER THE RECOMMENDATIONS BELOW FROM THE JOINT OVERVIEW AND SCRUTINY COMMITTEE HELD ON 22 JUNE 2020 FOR:

JOS/19/31 CAPITAL INVESTMENT FUND COMPANY (CIFCO CAPITAL LTD) BUSINESS TRADING AND PERFORMANCE REPORT 2019/20

CONFIDENTIAL APPENDIX B – CIFCO BUSINESS PLAN 2020/21

RECOMMENDATION **That the Joint Overview and Scrutiny Committee endorses the Capital Investment Fund Company (CIFCO CAPITAL LTD.) Business trading and Performance Report and Business Plan.**
REASON FOR DECISION The Committee scrutinised CIFCO Business Trading and Performance Report 2019/20 and the Confidential Business Plan.

APPENDICES

Title	Location
A) Draft Minute – JOS/19/31 Capital Investment Fund Company (CIFCO Ltd.) Business Trading and Performance Report 2019/20 (there are no confidential minutes)	Attached

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DRAFT MINUTE RELATING TO THE RECOMMENDATION TO COUNCIL FROM JOINT OVERVIEW AND SCRUTINY COMMITTEE HELD ON 22 JUNE 2020

JOS/19/31 CAPITAL INVESTMENT FUND COMPANY ('CIFCO CAPITAL LTD') BUSINESS TRADING AND PERFORMANCE REPORT 2019/20

42.1 The Chair advised Members that the Committee would be examining the Business plan only, and not the governance structure of CIFCO, or the terms under which CIFCO was set up. Any decisions relating to that, or its terms or reference, any questions relating to these areas would be the responsibility for Full Council.

42.2 The Chair then introduced the Board Members present:

Chris Haworth – Chair of CIFCO CAPITAL LTD.

Henry Cooke - Director of CIFCO CAPITAL LTD

Mark Sargeantson – Director of CIFCO CAPITAL LTD

Councillor Rick Meyer – Director of CIFCO CAPITAL LTD

Councillor David Busby - Director of BDC (Suffolk Holdings) Ltd and Cabinet Member for Assets and Investments

Councillor Gerard Brewster – Director of MSDC (Suffolk Holdings) Ltd.

Councillor Peter Gould – Mid Suffolk Cabinet Member for Assets and Investments

Nigel Golder - Director - Strategic Asset Management JLL (Jones Lang LaSalle)

Neville Pritchard - Director - Capital Markets JLL (Jones Lang LaSalle)

Emily Atack – Managing Director of CIFCO and Assistant Director for Assts and Investments

42.3 The Chair invited Councillor Peter Gould, MSDC Cabinet Member for Assets and Investments, introduce Report JOS/19/31.

42.4 Councillor Gould detailed the income and benefits provided to the Councils, including that CIFCO had provided the Councils with approximately £3m of net income since its inception in 2017. Approximately £1.6m was received in the last financial year, equating to approximately 10% of the Councils workforce costs or 13.5% of Council Tax income. This income was essential in enabling the Councils to continue to invest and deliver services within our districts. CIFCO collected over 70% of the March quarter rent and were consequently able to make the full debt repayment to the Councils in March. Whilst difficult times remain ahead with the continued impact of COVID-19, the proposed business plan seeks to continue the investment of the 2nd tranche of funds approved by Council last year, and in doing so to further diversify the portfolio away from High Street retail focusing on the industrial and alternative sectors and to continue to deliver and grow this important revenue stream for the Councils.

42.5 The Chair invited the Chair of CIFCO, and the Managing Director to present the presentation for CIFCO.

Note: A short adjournment between occurred 10:10am and 10:15am.

42.6 The Chair invited Members to ask questions.

42.7 Councillor Carter asked in relation paragraph 4.1 what the actual geographical percentage split of asset value was between Eastern region and the rest, noting that Milton Keynes was not in the East.

42.8 Councillor Carter asked that CIFCO seemed to have gone into the office sector just as this sector lost favour due to home working. Similarly, it now seemed that CIFCO was buying high street properties, as this sector went into decline. Were properties attractively priced because others were divesting. Further as there was the same amount of office space available, but a reduced number of workers due to homeworking, how would CIFCO be investing based on this. He also enquired when CIFCO would invest in renewable energy.

42.9 The Chair of CIFCO responded that this was a new market and it was inappropriate to be the first to invest in this market, but it would be a consideration for the future. The Assistant Director for Assets and Investments added that only one renewable energy had come forward and that this was not right for the portfolio.

42.10 Nigel Golder and Neville Pritchard both agreed that the Covid-19 Pandemic was likely to change the way office space would be utilised in the future. Demands for meeting rooms, coffee platforms, alternative office space in which staff would be able to work would increase, although they did not believe that homeworking would entirely replace office work. Regional headquarters and hubs would still be required. During the 2008/09 recession office space declined, resulting in a small surplus, therefore companies had to utilise the space available differently. Leisure and creative activities would also be requiring office space in the future.

42.11 Concerns over serviced offices were also part of the mix and the cost per office desk had increased, as the rise in hot desking had grown in popularity. However, this way of working might not be possible to continue, as it may have an impact on the available office space and the resulting increase in rents.

42.12 In addition, a regional bias to the Eastern Region was not advantageous when building a robust property portfolio as town centers were small and lacking strong commercial centers. The number of profitable opportunities, which meet the criteria set for CIFCO were smaller and bidding for these opportunities might not be successful.

42.13 The Chair for CIFCO advised Members that in the past year CIFCO had reviewed 65 opportunities and had proceeded to bid on 16 whilst being successful in acquiring 2 properties.

42.14 Councillor Jane Gould referred to page 47 in the report and asked how investing in the food and beverages sector, including drive-ins, corresponded with the statement on page 43, which stated there was no environmental impacts from the new business plan. She enquired, if CIFCO would be looking more deeply for green assets to invest in in the future.

42.15 The Assistant Director for Assets and Investment responded that the Board of CIFCO was aware that both Councils have declared a Climate Emergency and that the Board was currently working with its advisers JLL to draft a Sustainability Policy. It was not just a question of how 'green' the required assets were, but also how the current portfolio was managed and how tenants were supported to make decisions about sustainability going forward.

42.16 In response to several questions for availability of the annual accounts for CIFCO, Members were informed that they would be available in July/August 2020 and filed at Companies' House.

42.17 Councillor Jane Gould's additional question for what the alternative funding might be, the Assistant Director, responded that the PWLB funding was just one type of funding included in the range of short and long-term borrowing used by the Council. It was currently too early to say, what the alternative funding types would be.

42.18 Councillor Jane Gould continued with questions and asked if there was an exit plan in place for CIFCO, to mitigate the risk of the investments losing too much in value.

42.19 The Assistant Director – Assets and Investments, responded that the investments continued to deliver and that the current losses were book losses. These losses would only be realised if the assets were to be sold. It was up to the Board of Directors to manage the portfolio. Different assets might be considered for sale if it was the right move for the asset at that time. However, growth in income and continuing capital value for property investments tended to increase long-term.

42.20 Councillor Grandon asked the following questions, which in part had been responded to previously by Nigel Golder. Why over 40% of the properties purchased to date by CIFCO were not in the stated 'geographical area targeted for acquisitions' i.e. in the East of England, and why was the CIFCO Board unable to find enough sustainable investment properties in the East of England using East Anglian ratepayers' money.

42.21 The Assistant Director – Assets and Investment, explained that it was the Council, which borrowed funds from sources such as PWLB and other loan sources, which funded the investments. The gross income generated from CIFCO to the Council had been £2.33m, generated from investments outside the District. The net-profit brought an income to the Council, which could be invested in the District. (paragraph 4.2). The £3.5m loss (paragraph 10.3) had been predicted and included in part £0.5m acquisitions costs and the requisition of the two newly required assets.

42.22 Councillor Muller referred to the 70% successful collection of rent in the March quarter and inquired how much would be collected for the June quarter.

42.23 The Assistant Director – Assets and Investment responded that it was estimated that between 45%- 50% would be collected for the June quarter. Some tenants were not affected by the Covid-19 lock down, and some retailers would be able to trade again. The situation was changing daily. CIFCO was able to repay the full debt repayment to the Council in March and hoping to be in a position to be able to make a greater debt repayment than percentage collected in June. Some tenants have had their rental payment deferred and CIFCO was working with tenants to manage the rent payments.

42.24 Councillor McLaren asked what financial direction CIFCO would take in 2020/21 in relation to the Covid-19 pandemic and if portfolio investments would be re-evaluated. Also, if the Section 151 Officer could detail the relationship between the Council and CIFCO as an independent enterprise.

42.25 The Section 151 Officer explained that CIFCO was a public independent company registered at Companies' House and accounts were published on their website. The Councils were sole shareholders in CIFCO. The income received from CIFCO was an important income stream for the Council and there was currently a deferment rather than non-collection of rents for CIFCO. If there was going to be a long-term default with the repayment of the loan for CIFCO, the Council would need to address this with CIFCO. Currently, she did not have any concerns in relation to Section 114 for CIFCO.

42.26 Councillor McCraw asked about the breakeven point for the overall income for the two councils. He asked what the percentage of rent arrears would have to be for CIFCO to be unable to repay the debt payments to the Council.

42.27 The Section 151 Officer responded that the position of break even had been considered and it would be 40% for Mid Suffolk and 29% for Babergh. The position was different for the two Councils due to the different loan arrangements.

42.28 The Assistant Director – Assets and Investment responded to Councillor McLaren's second question and that the Board of CIFCO in co-operation with the fund managers evaluates the assets on a quarterly basis. Assets were revalued on the 31 March each year. The evaluation process was part of the Board's function. The Council would also consider future income from investments, there was still £40m available as agreed by the Councils last year.

42.29 Councillor Welham asked several questions including what would happen if the collection of rents went below the 40% for Mid Suffolk; what was the total loss since CIFCO was set-up; what the predicted losses for 2020/21 might be and when losses would cease .

42.30 The Assistant Director – Assets and Investments explained that if the rent collections deferment went below 40%, the loan repayments would be met but there would not be any net-income for the Council. The losses for last year was

£3.1m and that included £1.5m cost acquisition and £1.5m of revaluation adjustments. Further costs were predicted until the investment programme had been completed, and included the cost of acquisitions, which was approximately 6.75% and included stamp duty. This cost would in effect be losses or impairments until the investment programme had been completed. The future value of the portfolio was difficult to predict, as this depended on the market value, and such predictions should be discouraged, especially as the current market conditions were unstable.

42.31 Councillor Welham asked what the flow of funds were between the Council and the MSDC (Suffolk Holdings) Ltd. in terms of the value of equity held on behalf of the Council.

42.32 The Assistant Director – Assets and Investments explained that the CIFCO was set-up with 90% loan and 10% equity. Each Council held 5% equity. The equity value was dependent on the value of the portfolio and would fluctuate in line with portfolio value fluctuation. The 5% equity held by MSDC (Suffolk Holdings) Ltd. was the same 5% equity held for each Council in CIFCO.

42.33 Councillor Welham asked for clarification of what the losses were at present; the Assistant Director – Assets and Investments explained that the accounts were presently being prepared for CIFCO and would be included in the Councils' own accounts and would be published in July/August 2020.

42.34 Councillor Welham then asked it the rent collection went below the 40%, and the Council only received the debt repayment and not net-profit should that not be included as a risk in the CIFCO Business Plan, and if it was reasonable to set the same KPIs as last year's this year.

42.35 The Assistant Director – Assets and Investment responded that the risk was part of the reports risk assessment and formed part of the Council's significant risk register.

42.36 The Board of CIFCO retained the same KPIs for the current year to enable consistency and to measure performance. The report did detail that the KPI 4 would be challenging to meet, but that this was for long term aspiration for CIFCO to return to the 5% target.

42.37 Councillor Welham enquired if there was a 'business reduction plan' within the Business Plan to show the actions that would be necessary should one of the Councils wish to reduce their equity, the total investment or withdraw completely.

42.38 The Company structure was governed by the company articles of the Holding Company's operations, specifically by the equity subscription agreement between the two Councils and this would govern arrangements if one of the Councils wished to change their equity subscription. In response to a follow-up question from Councillor Welham, the Equity Subscription Agreement was not a public document, as it formed part of the Holding Company's governance and it would

be for the Holding Company to decide if this document should be shared more widely.

42.39 Further questions from Councillor Welham included reference to paragraph 6.2 in relation to the income from CIFCO and Gateway 14 and

42.40 The income from CIFCO, as stated in the report, helps to fund other property projects within the Councils. Gateway 14 was a development project, which did not currently generate an income in the short-term, whereas CIFCO was an income generating project for the short, medium and long term, from which the income generated could be spent short-term on projects such as Gateway 14. In turn Gateway 14 would generate an income and capital receipts in the longer term. However, income received by the Council from CIFCO could be spent on any projects or costs incurred within the Council.

42.41 Councillor Welham then enquired why the risk register did not include an evaluation of the risk of continuing company losses, as company losses would continue.

42.42 The Assistant Director explained that the risk did not generate the forecast investment returns, so it could be interpreted as both income and capital and was a broad risk, hence included in the significant risk register.

42.43 Councillor Osborne thought the presentation had been excellent and questions and responses had been good.

42.44 Councillor Carter enquired if the Council as landlords was responsible for the environmental aspects of the properties in the portfolio and if properties required to be brought up to standard would affect the value of the portfolio. He questioned if CIFCO would be investing in social housing and whether they would be new build or if the Council would be investing in carbon neutral properties.

42.45 The Assistant Director explained that tenants held the responsibility for full repair and insurance and in that respect, they held the environmental responsibility for the properties. However, CIFCO had made sure that properties in the portfolio meet standard environmental requirements.

42.46 She stated that CIFCO had no intentions to acquire or build any social housing.

42.47 Councillor Jane Gould asked in relation to CIFCO investment in drive-ins, food and beverages outlets and that these out-lets had an impact on carbon emissions. How could Members influence the Board if they felt that the investments did not follow the Council's wishes.

42.48 Councillor McCraw responded that Full Council would be looking at the Business Plan collectively in July 2020 and that Members of the Council sat on the Board of CIFCO representing the wishes of the Council. They would be the best way to influence the Board

Members debated the issues and raised several points including:

- That CIFCO was producing an income and continued to do so.
- That the use of renewable sources and low carbon emissions would be addressed by the Climate Taskforce.
- That the report did not contain enough information about the risk, equity and losses and that this should be clearly addressed in the risk register and explained in the report.
- Concerns for the losses and the impact on the Council's income.
- If it was possible to ensure that the current deferment of the rents and shortfall would actually materialise, especially if the tenants' trading positions changed over the coming year.
- Concerns for the deferment of rents due to the current financial instability.
- The portfolio value might divest for the short-term, but if the debt could still be serviced and an income received, then CIFCO served its purpose.
- That there was no requirement for an exit strategy, as there was no intention of selling the assets. The investments were long-term investments.
- Rental income was not likely to come down, the most likely risk for rental income would be the loss of occupancy of the properties.

42.53 Councillor Welham returned to the question of equity, losses and risks. He was concerned that if CIFCO had an income loss and would only be able to fulfil the debt repayment, then the benefit of investing in CIFCO would be diminished as the cash-flow from CIFCO to the Council would be reduced. He was also concerned about the reduction of equity. He clarified that a reduction strategy was not necessarily an exit strategy, but a way the Council could decide not to provide funds to invest in for instance car sales, coffee shops or restaurants.

42.54 The Chair asked if Councillor Welham was asking for specific sectors to be included in the Business Plan or to be removed, to which Councillor Welham responded, that he did not want to alter the Business Plan, but asked how the Business Plan would reflect if there was a particular sector the Council did not want to be involved in. It would be an advantage to include a reduction of assets strategy to adhere to such adjustments.

42.55 On the request of the Chair, Councillor Caston explained that the Climate Taskforce would deliver its report to Cabinet next month and included general investment strategies for climate change.

42.56 Councillor Carter thought it was important to invest for the future and that an exit strategy should be included, as circumstances were changing and the way of working now would have an impact on the investment for the future.

42.57 Councillor Hadingham MOVED recommendation 3.1 to 3.2 in the report and Councillor Osborne SECONDED it.

42.58 The Chair considered if it was necessary to proceed into a closed session and Members agreed it was not.

42.59 The Monitoring Officer advised that the recommendations in the report were for the Councils consideration and that the Committee would have to adjust the recommendations to reflect they endorsed the report and Business Plan.

42.60 The Proposer, Councillor Hadingham and the Seconder, Councillor Osborne agreed to the suggested adjustment.

42.61 Councillor Welham then proposed an amendment:

That more information be added in the report regarding risks, equity and risks and made available to Councillors, when they discuss the Business plans at their respective Council meetings.

42.62 The Chair asked if the Proposer and Seconder accepted the amendment.

42.63 Councillor Hadingham, the Proposer, and Councillor Osborne the Seconder both refused the proposed Amendment.

42.64 Councillor Carter SECONDED the proposed Amendment, which was put to Members for voting and the vote was LOST by 5 votes to 6 votes.

42.65 The recommendation that the Committee endorsed the Capital Investment Fund Company (CIFCO CAPITAL LTD.) Business trading and Performance Report and Business Plan, was put to Members for voting and the vote was CARRIED.

By 8 votes to 1 and 2 abstentions.

It was RESOLVED:-

That the Joint Overview and Scrutiny Committee endorses the Capital Investment Fund Company (CIFCO CAPITAL LTD.) Business trading and Performance Report and Business Plan.

42.66 The Chair expressed the hope that the CIFCO Board and Officers would address the concerns raised within the meeting, and those expressed in the defeated amendment, in their final reports to the Councils.