Investment Board

Date	13 December 2021
Report title	Enhancing CIF and RIF
Portfolio Lead	Finance - Councillor Bob Sleigh
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Report has been considered by	Investment Panel - 22 November 2021

Recommendation(s) for action or decision.

The Investment Board is recommended to:

(1) Note the success of CIF and RIF to date.

(2) Approve that CIF and RIF are allowed to flexibly expand beyond their respective funding ceilings of £140m and £70m provided that at no time combined commitments exceed the existing £210m limit.

(3) Approve an increase in the delegated authority of Investment Board to approve individual loans, or the sum of loans to companies in the same control, up to £20m (from £10m) provided that these are endorsed by WMCA and the Investment Panel and with the proviso that the Investment Board may always refer to WMCA Board for guidance and that WMCA Board will receive notification of decisions in the IB minutes at Board.

(4) Approve that loans may be made to Borrowers with Investment properties where they seek to improve the environmental credentials of the building(s) over a period of up to 5 years.

(5) Approve that loans may be made to Borrowers seeking finance for “Green industry” projects such as solar farms, where this is asset backed lending sharing similar characteristics to the real estate sector.

(6) Approve an increase in loan term to up to 5 years to allow Developers to build in the confidence that they have a stabilisation period to generate income and sell the asset.

(7) Revolving Credit Facilities (RCF's) are not explicitly recognised as available within the CIF or RIF and the Board is asked to approve explicitly their availability.

(8) Loans to Owner Occupiers are not explicitly recognised as available within the CIF and the Board is asked to approve explicitly their availability.

(9) Participation with other lenders to fund large projects is not explicitly recognised within the CIF or RIF and the Board is asked to approve explicitly their availability.

(10) Approve the small number of technical amendments proposed for the timely processing of loan applications whilst still applying the principles of the Single Commissioning Framework

1. Purpose

1.1 The purpose of the report is to outline proposed measures to increase the efficiency and effectiveness of the CIF and RIF Debt Funds.

2. Background

2.1 The West Midlands Combined Authority Collective Investment Fund "CIF" was approved by WMCA Board in August 2016, with the first investment being committed in December 2016. The key focus of the CIF being to accelerate commercial development within the West Midlands conurbation.

2.2 Initially a revolving loan fund of £70m the primary objectives being a brownfield first approach driving regional investment with strong economic outputs of job creation, new commercial floorspace and economic wealth generation.

2.3 The Fund is managed by West Midlands Development Capital "WMDC" (wholly owned subsidiary of WMCA) and externally promoted to developers and professionals by Frontier Development Capital "FDC". FDC are authorised and regulated by the Financial Conduct Authority.

2.4 FDC successfully targeted its existing client base, the real estate professional community and well-established regional property developers who were able to demonstrate a strong track record of successful project delivery. Maximum individual project investment was restricted to 10% of the fund (£7m per transaction at that time).

2.5 The CIF is set up with the capability to transact and complete projects using Senior Debt, Mezzanine and Equity funding instruments.

2.6 With the ongoing success of the CIF, in January 2019, WMCA decided to widen the scope and increase the fund size to include residential projects where developer access to standard commercial debt funding was proving difficult and delaying housing projects.
The WMCA Single Commissioning Framework "SCF" was launched in April 2019 after consultation with local authorities and industry throughout 2018. The SCF with all new WMCA funded projects applying the SCF.

2.7 The Residential Investment Fund "RIF" was launched, initial fund being £70m to accelerate overall housing supply, with a minimum 20% on-site affordable housing on each project on brownfield land only amongst other examples of best practice including design and construction methodology.

2.8 The Collective Investment Fund was renamed "Commercial Investment Fund" to more accurately reflect the target market. The CIF fund was increased to £140m maximum commitment.

2.9 WMCA repayable revolving debt funds total £210m (CIF & RIF the "Funds").

3. Progress to Date

3.1 CIF & RIF Highlights & Achievements for the period December 2016 to 1st October 2021 are noted below (delivered or in course of construction):

- Brownfield acres regenerated; 112.83
- Commercial floorspace; 1,836,738 (sq ft)
- Housing Units; 1719
- Jobs created; 4,445
- Business Rates; £6,559,493
- Initial Private Sector Leverage; £121,221,000
- Total Approved Funding £157,236,000
- Gross Interest Returned to WMCA £5,053,566 (at 1/10/21)
- Nil Provisions & No Bad Debts – portfolio risk performance is good.
- 33 projects approved/11 projects fully repaid

3.2 As can be seen from the data highlighted above the WMCA loan funds have made a very significant contribution to the Gross Value Added within the regional economy with excellent economic outputs and a healthy financial return to the WMCA with no losses or bad debts, indeed performance of both funds has been strong despite the uncertainties of Brexit and the Covid-19 pandemic.

3.3 A detailed breakdown of fund investments and individual projects is available on the CIF & RIF Dashboards which are attached and updated/circulated monthly to Investment Panel and Investment Board.

4. Proposed Changes and Clarifications

4.1. The funds invested have been an undoubted success, however a review by WMCA has resulted in WMDC, as fund manager, recommending some changes and enhancements to the fund guidelines to increase deployment and value to the region, developers and WMCA.

4.2 WMDC will continue to proactively manage and advise on all projects thus ensuring a robust selection and risk profile continues as part of any new investment application.

4.3 The following changes are proposed, and it is opportune to make explicit some of the activities that we believe are currently allowable by inference but not explicitly stated in the original approval of the Funds.

4.3.1 Flexibility of limits between CIF (£140m) & RIF (£70m) within the £210m existing ceiling.

The CIF commercial (job creation) fund has been very well received by regional property developers funding twenty-seven individual projects across the region, local developers and professionals are now fully aware of this fund and there is a steady flow of new schemes coming forward.

The RIF (residential housing) fund has had a lower take-up than expected which may be due to the availability of suitable market facing finance at this present time. However, as sectors fall in and out of fashion, it may be more in demand in the future.

It is proposed to operate CIF & RIF as separate funds but to allow flexibility within the limits, provided the total does not exceed the existing £210m. This will allow future flexibility to ensure that either CIF or RIF is not restricted by its individual limit if opportunities arise that skew deployment to one or the other. Alongside the other proposed changes, this will improve the external marketing and perception of the fund.

4.3.2 Concentration Risk and Approval Limit

Concentration risk policy was introduced to ensure that the Funds do not over extend to projects where a single point of failure of one party could have consequences for a large number of loans. There are a number of Developers that may require multiple loans to deliver schemes. This is welcome as it enables them to spread their equity to deliver projects simultaneously, however can create issues if a particular party suffers financial difficulty (which may be as a result of external factors not associated with a WMDC loan).

Currently WMCA loans are restricted to a concentration risk limit of £10m without referral to full WMCA board who may approve loans above this figure. Concentration risk being individual loans on specific projects above £10m and multiple loans to the same developer in excess of £10m. This is applied irrespective of the financial strength of the Borrower. The financial strength can vary enormously and it is perceived that a “blanket” approach is no longer appropriate.

WMDC are seeing supportable projects above this £10m limit and also have good relationships with financially strong regional developers who wish to increase the amount and number of projects that WMCA fund.

It is therefore proposed that the concentration limit be increased to £20m (9.5% of fund) to be sanctioned via the current Investment Panel “IP” and Investment Board “IB” process without the necessity to refer to WMCA Board. It will always be within the IB’s discretion to refer any loan of any size to WMCA Board should it feel the circumstances justify this and guidance is desirable, however this is expected to be rare.

Any loan applications above the £20m figure will be referred to WMCA full board if supported by IP & IB.

The rationale for this change is that CIF and RIF are designed to work on a commercial basis where time is of the essence in making decisions. Developers seeking private debt can generally expect a decision within 2 weeks. The existing process of IP and IB is fast and efficient for the public sector at c.3 to 4 weeks, however the ratification of an IB recommendation by WMCA Board can necessarily add an additional month due to the Board cycle and paper release dates.

All loans will continue through the rigorous risk assessment, mitigation and due diligence undertaken by WMDC and the existing WMCA processes. IP is well attended by senior Met Officers and IB is constituted by senior members of the Constituent and Non-Constituent Authorities and LEPs, consequently it is believed that the new process will still provide for sufficient scrutiny and transparency.

4.3.3 Environmental, Social & Governance

The built environment generates nearly 40% of annual global CO2 emissions. Of those total emissions, building operations are responsible for 28% annually, while building materials and construction (typically referred to as embodied carbon) are responsible for an additional 11% annually.

WMDC collect data on all projects to assess and encourage developers to promote "green" projects, indeed occupational demand for both commercial and residential projects deem that new build or refurbishment projects have a key focus on energy efficient and low carbon emissions in all new build/refurb schemes.

WMDC will report on all "green" elements of new loan applications and will also endeavour to provide more flexible terms (facility term, lower cost, lower equity contribution) where a developer can demonstrate that improved environmental impact considerations has added to project cost and therefore reduced viability e.g., Building Research Establishment's Environmental Assessment Method (BREEAM) good and excellent rated commercial buildings.

Whilst CIF and RIF have largely been constructed to face into Development schemes, it is proposed to extend the Fund to facilitate Investment projects where a) the traditional lenders are not actively courting business and b) the Investor is planning to substantially improve the energy efficiency of a building. The criteria for improvement being an output that results in an improved BREEAM (Building Research Establishment Environmental Assessment Method) or significantly improved NDEPC (Non Domestic Energy Performance Certificate). In such cases it may be necessary to provide up to a 5 year loan term to accommodate the phased updating of a building around occupier lease terms.

It is also recommended to allow future loans to be made to be made for green or environmental projects within the region that share similar characteristics with the real estate projects that have been the staple of the fund. The Fund manager will consider projects that have will be specifically targeted e.g., solar, wind, energy and waste recycling etc. to help accelerate net zero carbon achievement across the West Midlands. It is important that they will offer a similar risk profile to that of a real estate project, in that they offer a defined income stream and first charge security over land. Whilst this will be a limitation on the amount of projects to be considered, it is appropriate as CIF and RIF are real estate funds and it is necessary to ensure a similar risk profile across the portfolio of investments in these Funds.

4.3.4 Development Loans and Stabilisation or Revolving Loans – Term extension

CIF & RIF approved loans have to date been purely development only loan facilities, these by their nature only fully draw at or near to practical completion of the development project and are then repaid when the development is completed, sold and/or refinanced. This means facility term is usually only two/three years and quite often repaid within this term. It is proposed that the term of loans be extended to up to five years in totality for the right facility and only if recommended by WMDC. The loans will, of course, be subject to all the appropriate risk considerations (valuation, security, covenant strength and WMCA return) and will only be offered in selective circumstances. The extended term post development or stabilisation period will provide additional comfort to the developer/owner as it allows an extended time for the Developer to exit by means of sale or refinance of the property.

Recent examples of these type of facilities are Chase Midlands Sheldon and Complex Telegraph, Coventry, both of which were extended due to the Covid-19 pandemic however are well secured and have provided an appropriate level of income to WMCA commensurate with the risk inherent in the project.

WMDC also recommend that CIF loans should be offered on a Revolving Credit Facility "RCF" on a term of up to five years providing the purpose of the loan is to fund development and/or inward investment into the West Midlands region, again these loans will be well secured and priced accordingly. An RCF is different to a standard Term Loan. For a standard term loan any sales receipt first repays the loan and only after the full loan is repaid will the Developer receive receipts. An RCF allows for receipts to be recycled into further project costs in order to construct a larger scheme. They are frequently used by housebuilders where the first tranche of housing is sold and receipts pay for the second tranche etc. There are commercial real estate applications for larger multi-phased developments also.

4.3.5 Extension to Owner Occupiers

WMDC via FDC will also market development loan facilities direct to owner occupiers, these loans will also be offered up to a five-year term allowing the borrower time to construct and deliver their new unit and also a period of stabilisation ahead of refinance to their bank.

The CIF terms do not explicitly exclude this activity and therefore no approval is required to adopt this activity, however it is opportune to note this specific intention within the paper.

4.3.6 Loan Participation

The CIF and RIF terms do not preclude participation in lending with other lenders and again, it is not necessary to seek explicit consent, however it is opportune to note that WMDC intend to explore the potential to bring forward larger projects with participation.

Where the risk profile of a potential project is the same as would be undertaken under CIF or RIF and only quantum of the lending is preventing our support, it is intended to explore opportunities to partner another lender on the same terms. All risk and return would be shared and proportionate to the amounts input. This is known as parri passu.

In any proposal brought forward to IP, IB and potentially (due to quantum of proposed lending) WMCA Board, the partnering party would be identified and strict due diligence would be conducted. It is likely that only the best institutional lenders will be partnered given that a key to such lending is maintaining a robust relationship with shared ethics and reputational risk. For the avoidance of doubt IB would approve loans based upon its delegated limit as opposed to the total lending including the other participant lender.

4.3.7 Changes to Application of the Single Commissioning Framework

CIF and RIF were included, alongside Grants to Built Environment projects in the Single Commissioning Framework (SCF) approved in a paper to WMCA Board 22nd March 2019.

Where practical, achievable and relevant, the overarching criteria and requirements of SCF are intended to apply in future, however the process for approving loans through CIF and RIF requires amendment.

Loans differ from Grants in many ways, of particular relevance is the frequent requirement for a Developer or Investor to move quickly to acquire a property. In order to transact, the party requires certainty of finance and therefore a quick decision regarding whether support will be made available, subject to due diligence.

It is intended to revert to the process arrangements prior to the introduction of SCF in 2019. The Fund Manager will still conclude the Assessment against SCF but this will be presented at Investment Panel (now the successor panel to what was formerly IAG). Investment Panel will offer the opportunity to challenge the assessment by the Fund Manager and remove the requirement for additional processes prior to Panel. Engagement by the Fund Manager with WMCA is still expected for loan applications where fulfilment of SCF criteria is not clear cut. For clarity, the steps for approval at and beyond Investment Panel remain as existin

The SCF document also refers to the £ quantum of approvals and whether these are at Investment Board or WMCA Board. Subject to approval of proposals above, an approval to changes here (4.1.2) will have the effect of amending limits for CIF and RIF under the SCF.

5. Financial Implications

5.1 There are no immediate financial implications as a result of approving the recommendations within this report.

5.2 Each loan the WMCA Investment Board consider is evaluated and approved on its own merit with specific regard to the unique risks, mitigations (e.g. security) and rewards the potential investment offers. This follows a period of thorough due diligence which is supported by specialist, sector specific fund managers.

5.3 The adjustments to the investment parameters are intended to allow WMCA to further maximise the potential of the loan fund offering in a considered and measured way. This in turn is expected to allow WMCA to achieve higher overall yields and better quality outcomes whilst retaining the proven investment decision making practices which have made the fund successful to date. As detailed above, risk will continue to be evaluated on a case by case basis as proposals are submitted to Investment Board and the monthly dashboards submitted to Investment Board will continue to provide the opportunity to evaluate the overall risk profile at a portfolio level.

5.4 The proposal to manage the commitment cap as a total of £210m is supported on the basis it will allow investments to be entered into where there is evidence for the highest need or demand.

5.5 Whilst there have been no defaults to date, provisions for defaults will continue to have a first call on any surpluses from the fund based on the latest accounting standard requirements and the unique characteristics of the individual loans.

6. Legal Implications

6.1 There are no legal implications as a result of this proposal.

7. Equalities Implications

7.1 There are no equalities implications.

8. Inclusive Growth Implications

8.1 CIF and RIF are managed with reference to the Single Commissioning Framework. There are no changes proposed as a result of what is detailed in this report.

8.2 The Board may wish to note that SCF includes a requirement for residential development to provide a minimum of 20% Affordable Housing.

9. Geographical Area of Report’s Implications

9.1 The CIF extend to both Constituent and non-Constituent Local Authorities.

10. Other Implications

10.1 There are no other implications.

11. Schedule of Background Papers

11.1 Not applicable