Cabinet

27 January 2023

Warwickshire Recovery Investment Fund Investment Strategy and Business Plan

Recommendations

That Cabinet:

1. Approves the Warwickshire Recovery Investment Fund (“WRIF”) Investment Strategy attached at Appendix 4;

2. Approves the WRIF Business Plan attached at Appendix 5;

3. Delegates to the Strategic Director for Communities in consultation with the Portfolio Holder for Finance and Property authority to make such additional changes to the Investment Strategy as he considers necessary but only where such changes do not reduce or remove any of the current checks and balances on investments included within the Strategy or Business Plan; and

4. Delegates to the Strategic Director for Communities in consultation with the Portfolio Holder for Finance and Property authority to update the process for BIG Fund assessments as set out in Section 4.5.

1. Executive Summary

1.1 The Warwickshire Recovery Investment Fund (WRIF) was set up in 2021/22 with the purpose of providing additional finance to support and encourage the local economy and local employment in the face of the prevailing economic challenges.

1.2 The WRIF is governed by an Investment Strategy and Business Plan. The purpose of this report is to seek approval of the updated WRIF Investment Strategy and Business Plan for 2023/24-2026/27.

1.3 The Objectives of the WRIF are detailed in Appendix 1 but in summary are to support the local economy in weathering the adverse economic circumstances which were driven by Covid. Economic and political/social circumstances nationally and globally have been volatile since the inception of the WRIF and the challenges presented by Covid have been compounded more recently by high inflation and rising interest rates, the cost of living increases, and the prospect of recession in the UK. Issues also remain in respect of supply chain, competition for labour, skills shortages, and competition between different areas of the UK seeking to promote business in their local areas. Therefore, although the original driver for the creation of the WRIF (Covid) has at least for the time being subsided in the UK, it has been replaced by other drivers of economic uncertainty and so the fundamental need to support and promote the local economy remains. The ability of the WRIF to deliver this support remains.

1.4 The WRIF is made up of 3 “pillars” which are summarised below and detailed in Annex A of Appendix 4.

- The **Business Improvement Growth Fund (BIG)** - designed to support larger and more established businesses with local growth plans.
- The **Property Infrastructure Fund (PIF)** - designed to forward fund infrastructure investment.
- The **Local Communities Enterprise Fund (LCE)** - designed to provide small business loans.

1.5 2022/23 is the first full year of operation of the WRIF and a significant amount of activity has been undertaken to implement the activities of the three pillars and generate active investments.

1.6 Demand for WRIF funds has been variable in the first full year and an assessment of demand is a key component of the strategy looking forwards.

- With the LCE now operational this fund has seen the most consistent demand (203 enquiries since inception). This is largely because it is revenue in nature, it is targeted in a space where demand remains clear, and because the types of investment for which the LCE is intended are by their nature high volume / low value and therefore demand will normally present more consistently.

- The BIG Fund has considered 38 investment opportunities during 2022/23 and some of these have progressed a long way through the process. However, although one loan was approved in 2021/22, at the time of writing none have reached approval this financial year. Demand for the BIG has been lower than expected due to a number of factors including the changing economic situation affecting the confidence of co-investors, preference for revenue funding rather than capital, and borrowers choosing to pursue alternative investment vehicles. However, the fund is by its nature high value / low volume and demand can be expected to be volatile. Over a short period of time, one or two high value bids succeeding or not succeeding for marginal reasons can make the position of the fund appear very different. Reasons for the low conversion rate include for example that companies may be looking for grants and soft loans, or looking for revenue instead of capital, companies may not in an appropriate situation (for example they have too much debt already), or they may find alternative finance on preferable terms elsewhere.

- PIF activity is planned to commence in 2023/24, and although its launch has taken time, demand is expected to be strong for this Fund.

1.7 Demand for the LCE and PIF are considered sufficient to maintain the overall investment targets at their original levels (£10m and £40m). The emphasis of the PIF will be on the bringing forward of new employment land and commercial space or the enabling of this.

1.8 Mainstream commercial sources of funding can still be difficult to access. For example, small and medium sized enterprises may struggle to get loans from traditional banks if they don't already have an existing relationship, lenders may be wary of giving unsecured loans, and many businesses now carry high levels of debt as a hang-over from the government backed lending during the early stages of Covid which makes taking on further loans a higher risk for lenders. These issues are then compounded by inflation on the costs of operating a business and higher interest rates on the cost of financing a business.

1.9 The WRIF is still considered to be a positive and complementary option for supporting the economy alongside other vehicles for example the Midlands Engine Investment Fund, The British Business Bank, Funding Circle, etc.

1.10 Demand for the BIG is considered to be lower than the original target and the size and shape of the BIG fund is proposed to be amended, down from a £90m capital fund to a £50m capital plus a £4m revenue fund.

2. WRIF Activity to Date

2.1 The WRIF was profiled to involve investments being made over a five-year period. WRIF activity during 2021/22 was largely focused on setting up the operations of the fund. Investment activity began in Quarter 4 of 2021/22. In summary during 2022/23 the following WRIF activity has occurred:

1. Service contracts with external specialist providers have been put in place to undertake anti-money laundering compliance activity

2. The Investment Panel has met regularly throughout the year to ensure oversight and governance of the Fund and to consider investment bids to the BIG Fund.

3. As at December 2022 there had been 38 verified enquiries to the BIG fund since inception. Of these, 8 have progressed to the Stage 1 business case, and 2 had reached the Stage 2 due diligence phase, of which one was approved, and one was withdrawn by the borrower. At the time of writing one BIG opportunity for an investment of up to £2.5m is at Stage 2 and may progress to Cabinet for consideration.

4. Additional oversight and support to the WRIF is being provided from the Commercial Delivery Group, focusing on strategic input, and the wider

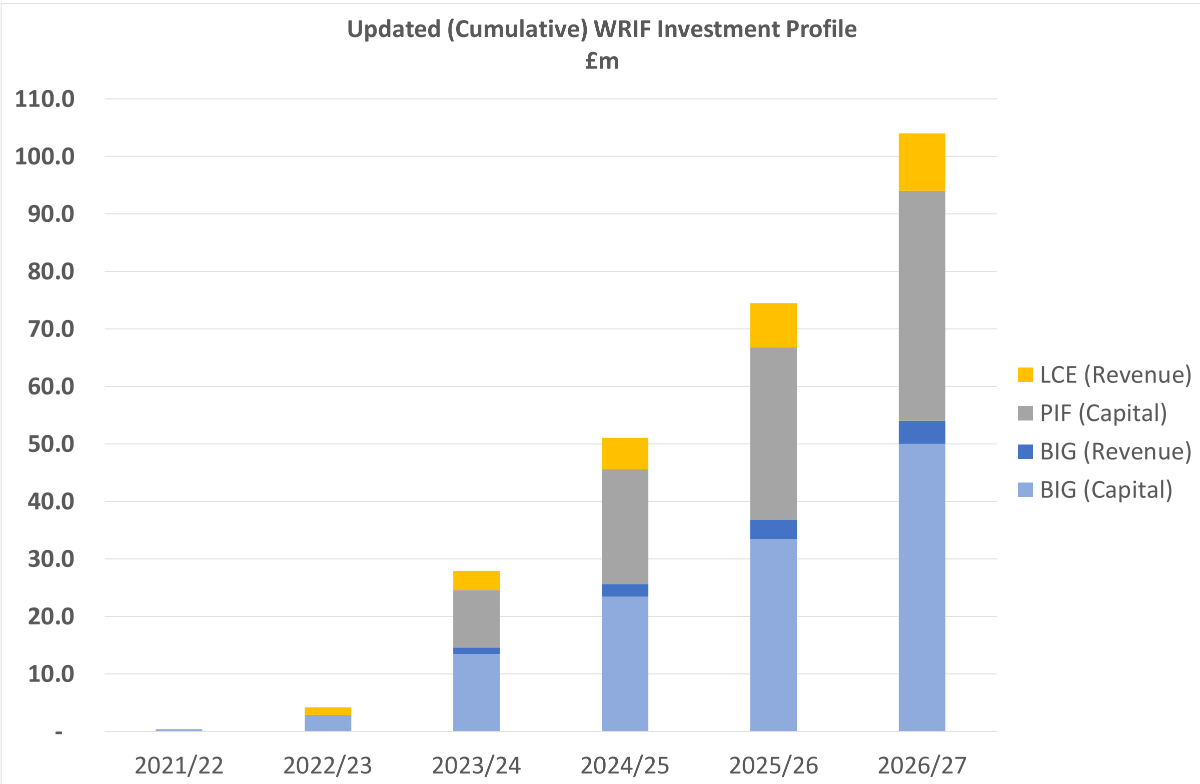
governance and resourcing of the WRIF.

5. CBRE Indirect Investment Services Ltd (CBRE) were appointed as the Fund Advisor for the PIF Fund and have been engaging with officers on refining the policies and processes for the management of the fund, to align more with industry norms. The PIF will look to make is first investments from 2023/24.

6. Coventry and Warwickshire Reinvestment Trust (CWRT) have been operating the LCE Fund from June 2022, and the forecast is to have placed £1.2m of investments by the end of the 2022/23 financial year.

3. Investment Profile

3.1 The planned investment profile has been reprofiled to reflect the forecast demand, allowing for the forecast activity in 2022/23 and is summarised in the chart below.



4. Strategy Updates

4.1 Appendix 2 lists the key updates to the WRIF Investment Strategy, and Appendix 3 lists the key changes to the Business Plan. The main changes are summarised below.

4.2 **BIG Fund Value and Capital / Revenue Split**– The fund value is reduced from £90m to £54m with £40m of capital being taken out and £4m of revenue being added in. This change is made to better reflect the demand for funding seen to date. Although this makes the BIG fund smaller, the overall risk profile will remain broadly unchanged as revenue investment is generally significantly higher risk than capital investment. The reasons for revenue investment risk being higher include that the impact of default is directly upon the Council's income and expenditure account immediately and in full, whereas the impact of a capital investment default would be spread over a period of years, and the fact that capital investments by their nature will be investments into assets that will generate future revenues, whereas a revenue investment will be used on revenue funding that may not necessarily promote any future activity. A capital asset may also be taken as security against a loan, but security is much less likely to be an option for revenue loans.

4.3 **PIF Fund Size and Duration** – The shape of the PIF Fund has been updated to better reflect demand in the market. To this end the maximum duration of a loan will be 5 years rather than 10 years (the shorter maximum duration also significantly reduces risk to the Council).

4.4 **PIF Fund Governance** – The process for consideration of PIF investment opportunities has been reviewed and an amended process that better reflects industry norms is proposed. In summary all of the required steps to consider an investment still occur but are conducted in a different sequence which enables those parts of the process that cause costs to the borrower to be placed at the back end of the process to minimise the risk of sunk costs to the borrower. This makes the Fund easier to access as borrowers are less put off by the risk of incurring costs and then failing to secure the investment.

4.5 **BIG Fund Governance** – Officers will continue to consider whether the BIG Fund process would benefit from adopting some or all of the process changes that are being adopted by the PIF. This review cannot be undertaken in time for the approval of the strategy. However, this option will be investigated and proposals to implement changes will be brought forward if considered appropriate. No changes would be undertaken that undermine the current checks and balances which must still occur at some point before entering into a loan agreement. It is proposed that the final decision on adopting process change and implementing the same be delegated to the Strategic Director for Communities in consultation with the Portfolio Holder for Finance and Property, subject to Finance and Legal input. Should any of the current checks and balances be proposed to be removed then the proposed revised policy would be brought back to Members for approval.

4.6 **Cost Recovery** – The lower overall fund value results in less opportunity to recover administration costs through fees as a significant proportion of costs are fixed. However, the WRIF is required to operate on normal commercial terms and administration costs, the Council's cost of borrowing, and the cost of defaults are still planned to be covered by appropriate generation of income through interest and fees charged. The BIG and PIF funds will also continue to have the planned option to make a net positive return on investment of up to +3%.

4.7 **WRIF Objectives** – The objectives of protecting and promoting jobs within the county has been explicitly added to the list of WRIF objectives (Appendix 1, Objective 8), although job protection and creation has clearly always been a part of the purpose of the WRIF. In addition, the objectives have been amended to reflect that benefits may be delivered over the long term (Objective 4).

5. Financial Implications

5.1 The WRIF fund is in total £104m, to be invested mostly via senior and secured loans, but with the potential for other forms of investment.

5.2 The WRIF is required to operate on normal commercial terms, all costs are planned to be recovered in the round from a combination of interest rates and fees.

5.3 There are two overarching financial risks to the financial position of the WRIF that could result in pressure on the Medium Term Financial Strategy:

- That investment losses experienced are more than expected (the main drivers being if investment risk is not accurately assessed or managed).
- That the costs of operating the WRIF are not fully recovered (the main driver being if total investment activity is lower than planned resulting in not enough fee income being generated).

5.4 The nature of the WRIF is to invest in companies where alternative sources of finance may be less available, and where companies are facing more challenging circumstances. Investing entails a risk that some or all of any given investment may not be repaid, for example through a default on a loan, or through a fall in the value of an equity stake. However, the governance arrangements for the WRIF are designed to mitigate risk, and the original business case expects a small surplus to be made that provides a mitigation against losses. The commercial risk reserve also provides some risk mitigation.

5.5 The Council operates a commercial risk reserve with a current balance of £8.758 million. This is maintained to cover the financial risks of WRIF and Warwickshire Property Development Group activity, and additionally any other commercial risks WCC may be exposed to. Use of the reserve to manage WPDG activity is reported elsewhere on this agenda.

5.6 The WRIF is forecast to recover its fixed and variable costs across the life of the fund. Any surplus generated by WRIF activity will first be used to replenish drawdowns from the commercial risk reserve to cover start-up costs of the WRIF. Due to the inherent volatility of the lending profile and only one loan agreement being entered into so far by the BIG fund, any projected surplus is not currently planned to be used to underpin wider MTFS funding, however this policy may change as loan agreements are entered into and more certainty on returns is achieved.

6. Environmental Implications

6.1 Environmental implications are a consideration for investment decisions. This is articulated in a specific Ethical Investing Policy which is part of the WRIF Investment Strategy (refer to Appendix 4 Section 4).

7. Supporting Information

7.1 None.

8. Timescales associated with the decision and next steps

8.1 The WRIF Investment Strategy and Business Plan sit underneath and must be aligned to the overall Warwickshire County Council Investment Strategy and Treasury Management Strategy. Those two strategies are being presented elsewhere on this agenda for consideration and they form a component of the set of wider medium-term financial strategy reports. Those strategies, subject to being approved/recommended by Cabinet, are then reported to full Council for final approval.

8.2 Subject to approval the WRIF Investment Strategy and Business Plan would come into effect on the 1st April 2023.

Appendices

Appendix 1 – WRIF Objectives (and summary of updates)
Appendix 2 – Summary of WRIF Investment Strategy Updates
Appendix 3 – Summary of WRIF Business Plan Updates
Appendix 4 – WRIF Investment Strategy 2023/24-2027/28
Appendix 5 – WRIF Business Plan 2023/24-2027/28

Background Papers

1. None.

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The report was circulated to the following members prior to publication:

Local Member(s):
Other members:

WRIF Objectives Appendix 1

1. Fill gaps in and provide additional access to finance that helps businesses in Warwickshire start, grow and scale up; or helps businesses locate to the county. Businesses located just outside of the county may be considered for finance, if there are clear benefits to Warwickshire subject to compliance with any applicable legal and/or financial frameworks;

2. Leverage additional resources or funding for the county through the investment and support of key growth businesses;

3. Secure an ongoing financial return, commensurate with risk;

4. Make investments that deliver benefits and social value to the residents and communities of Warwickshire in both the short term (0-12 months), medium term (1-5 years), and long term (up to 10 years);

5. Support investments that make a contribution towards meeting net zero carbon goals; and

6. Support the delivery of the Council's strategic goals and priorities.

7. To help to make Warwickshire an accessible and competitive location for businesses.

8. Protecting jobs within the county and promoting new jobs within the county.

Summary of Updates to WRIF Objectives

WRIF Objectives	Summary of Update	Commentary
Objective 4	Extended - benefits may be over the long term	Benefits were articulated as being expected over the short and medium term (up to 5 years) but in reality, benefits may be realisable over the long term as some investments may be up to 10 years in duration.
Objective 6	Simplified	This objective made reference to specific Council plans at a point in time, for example the Covid Recovery Plan. It has been simplified to refer to the Council's strategies and priorities without naming them specifically.
Objective 8	Explicit reference to jobs	Additional objective making explicit reference to job protection and creation (this has always been an objective, but this update gives this a clear profile of its own)

Summary of WRIF Investment Strategy Updates — Appendix 2

Section	Summary of Update	Commentary
Section 1	Background	Some of the commentary explaining the background to the WRIF has been shortened / simplified and updated to recognise current economic circumstances.
Section 2	WRIF Objectives	Same updates as set out in Appendix 1 above.
Section 3	PIF Strategy updates	Updates to align with a revised approach that has been developed in collaboration with the Fund Advisor (CBRE) Removal of specific target/priority business sectors, to enable the Fund to consider the widest opportunity set that may deliver its objectives.
Section 5	Types of investment	Equity investment funding deleted from PIF funding options as it is not a feature of the revised PIF strategy Corporate guarantees funding deleted from PIF funding and added to BIG funding (Table 5.4), as this type of funding is revenue in nature
Section 8.1	Revised investment profile	BIG Capital fund reduced from £90m to £50m BIG revenue fund created, to the value of £4m Total WRIF Fund reduces from £140m to £104m
Section 8.2	Annual investment limits	Capital limit reduced from £50m p.a. to £40m p.a. to reflect the reduction in the BIG fund but to still allow significant headroom on the BIG and PIF funds. Revenue limit increased from £3m p.a. to £5m p.a. to reflect the introduction of a revenue fund for the BIG pillar.
Annex A	PIF	PIF maximum single investment size – corrected from £40m to £10m PIF Priorities – updated in the same was as Section 3.3 above
Annex A	Maximum investment durations	The maximum duration of investment for each pillar has been added (BIG 10 years, PIF and LCE 5 years). Note that the maximum loan duration is reduced from 10 years to 5 years.
Annex A	Business Support	Deletion of a section setting out wider business support activity. This activity is not funded by the WRIF or managed within the governance infrastructure of the WRIF. Hence it is considered more appropriate to take the opportunity to simplify and remove this activity from the WFRIF strategy (however the activity will still continue as planned).
General	Fund values	All references to the total value of the WRIF amended from £140m to £104m All references to fund value of the BIG amended from a £90m total of which all was capital, to a £54m total fund of which £50m is capital and £4m is revenue

Summary of WRIF Business Plan Updates — Appendix 3

Section	Summary of Update	Commentary
Section 1	Simplified	Simplified and removal of duplication with the WRIF Investment Strategy.
Section 2	Outcomes	Outcomes and benefits reprofiled to align with the updated investment amounts and profile The expectations for the number of jobs created per amount invested has been adjusted downwards to align more closely with benchmarks from other funds. The expectations for leverage are also reduced to better reflect current experience.
Section 3.1	Investing Profile	Amended to reflect the revised investment targets for the BIG fund and the shorter loan durations for the PIF Fund
Section 3.3	Investing Limits	Capital limit reduced from £50m p.a. to £40m p.a. to reflect the reduction in the BIG fund but to still allow significant headroom on the BIG and PIF funds. Revenue limit increased from £3m p.a. to £5m p.a. to reflect the introduction of a revenue fund for the BIG pillar.
Section 3.5	Peak Debt	Peak debt is expected to be significantly lower (£79m in 2026 instead of £109m), primarily driven by the reduction in the size of the BIG Fund.
Section 4.1	Financial Plan	Commentary added clarifying that the Council may earn arbitrage on interest costs (but also takes interest rate risk)
Section 4.4	Financial Plan	Updated to reflect the revised investment, cost, and income profiles
Section 4.8	Net Margins	Highlights the option to target a +3% net return on the BIG and PIF Funds, on a discretionary basis, but no net return is targeted for the LCE fund.
Section 5	Risk	Updated for changes in risk. Overall risk levels are considered to be slightly lower looking forwards. The risk appetite statement remains unchanged.
Section 6	Key Activities	Updated to reflect current priorities including: • Implementing the updated PIF governance arrangements • Reviewing the governance of BIG fund bids • Reviewing communications • Considering co-investment opportunities
General	WRIF Objectives and Principles	These are no longer reproduced in the business plan, to avoid duplicating the WRIF Investment Strategy document.