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Subject: GM Housing Investment Loans Fund – Revised Investment Strategy

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PURPOSE OF REPORT

This report sets out a revised Investment Strategy for the GM Housing Investment Loans Fund (GMHILF).

RECOMMENDATIONS:

The GMCA is requested to approve the revised Investment Strategy for the GMHILF.

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BACKGROUND PAPERS:

Housing Investment Fund (report to GMCA, 27 February 2015)

GM Housing Fund – Investment Strategy (report to GMCA, 26 June 2015)

GM Housing Fund: Updated Investment Strategy (report to GMCA, 29 July 2016)

GM Housing Fund Surpluses Paper (Report to GMCA, 14 December 2018)

1 INTRODUCTION

- 1.1 The £300m GM Housing Investment Loans Fund (“GMHILF” or “the Fund”) was approved by the GMCA in March 2015 along with the initial Investment Strategy. The Fund was publicly launched in June 2015, and targets the delivery of 10,00 to 15,000 homes over its 10 year lifecycle in support of Ministry of Housing, Communities and Local Government (MHCLG) targets for housing growth. The Fund can only be used to make ‘recoverable investments’, i.e. debt or equity, in private-sector led schemes. Under the terms of the GMHILF loan agreement with MHCLG, the GMCA has underwritten repayment of a minimum of 80% of the Fund (£240m) to MHCLG when the Fund comes to an end in 2028.
- 1.2 The original Investment Strategy was updated and approved by the GMCA in July 2016. The previous strategies focussed on investing in projects as debt to ensure that lower risk investments were being made and limit the risk of any loss from the GMHILF being greater than 20%.
- 1.3 In line with original intentions, the GMHILF was novated to the GMCA in April 2019. The Fund has now been operational for four years and the GM Housing Strategy has been launched. This paper focusses on the future Investment Strategy for the GMHILF.

2 PROGRESS OF THE GM HOUSING INVESTMENT LOANS FUND

- 2.1 The GMCA has approved GMHILF investments, as at the end of June 2019, of £435.4m into 49 projects that will bring forward 5,985 additional housing units across GM. A large proportion of the Fund’s first cycle of investments has been in city centre developments, and these funds will start to be recycled from 2019 onwards to fund projects being identified as part of the ongoing pipeline development. Investments have to date been predominantly as debt and to date no losses have been incurred by the GMHILF demonstrating that the governance arrangements put in place for managing the Fund and the risk profile have been appropriate.
- 2.2 The Fund is in its fifth year of operation and the full £300m of funding has been drawn from MHCLG giving the GMCA access to the £60m of funding which has not been underwritten by the GMCA. This therefore allows the GMCA to take a higher degree of risk in relation to investments being made.
- 2.3 GMHILF investments have generated revenues that can be retained by GM and deployed to support delivery of GM’s housing objectives. The GMCA agreed in December 2018 to ring-fence the majority of these surplus revenues to support the delivery of the GM Housing Strategy.

3 RESTRICTIONS

- 3.1 The GMHILF loan agreement entered into with MHCLG contains terms that restrict how the Fund is utilised. The key terms that impact on the Investment Strategy are as follows:

- Funds must be invested in projects on a recoverable basis, i.e. as debt or equity;
- The GMCA has underwritten 80% of the Fund and must therefore ensure a minimum of £240m is repaid to MHCLG;
- The Fund must be used to support the delivery of housing.
- The Fund can only be used to support schemes being led by private-sector entities.

3.2 These funds cannot, therefore, be used to provide grant to projects. Riskier GMHILF investments can, however, be made into projects where this is considered justifiable with the intention that the risk profile of the investments is managed to ensure that the expected loss from the Fund never exceeds 20%.

4 REVISED INVESTMENT STRATEGY

4.1 The primary objective of the Fund moving forward is to support the Greater Manchester Housing Strategy, launched in June 2019. This will create the platform for housing growth, increase the number of houses being delivered across GM and accelerate projects to deliver a greater number of houses in the medium term. However, GM's ambitions also relate to ensuring appropriate tenure type and housing mix, and tackling homelessness and temporary accommodation challenges as part of GM's wider housing objective of addressing the issue of need.

4.2 While a credible pipeline of projects into which the recycled GMHILF funds could be invested is being developed, defining the types of projects and specific investment structures that can, and should, be supported by GMHILF in the absence of a detailed pipeline is challenging. In order to support the developing ambitions of GMCA to support mixed housing tenure across the whole of Greater Manchester, the revised approach is for all debt and equity investment structures to be considered. This will enable propositions and structures to be considered on a case by case basis and for appropriate, project specific structures to be adopted where the investment supports the delivery of projects aligning with GM's Housing Strategy.

4.3 This approach leaves all avenues of support available to projects provided they comply with the terms of the MHCLG loan agreement and that the risk of loss from the GMHILF portfolio remains within the £60m risk buffer that is not underwritten by the GMCA. The Fund will continue to invest in projects that support housing delivery, such as infrastructure and City Centre schemes, and all tenure types will be considered and supported where such viable propositions come forward. The Fund will continue to make higher risk investments through its small loans portfolio.

4.4 The use of the revenues generated and retained by GMHILF investments is not restricted. Continued successful investment of the GMHILF will generate further surpluses that can be utilised in the future to support GMs housing objectives.

5 GOVERNANCE

- 5.1 The Core Investment Team is responsible for managing the GMHILF. Both the Gateway Panel and Credit Committee have been set up and have been operating over the four years of Fund operation to review proposals and provide the necessary approvals before recommending the projects for approval by the GMCA. As part of good governance the Gateway Panel membership was rotated and two new members were appointed at the start of 2019.
- 5.2 The role of the independent Gateway Panel is critical to ensuring external scrutiny of projects being approved. The Panel is considered to include all the necessary expertise to provide the appropriate level of scrutiny to projects.
- 5.3 Projects are fully developed before being presented to the Gateway Panel such that they review all the detailed information prior to approving projects. This results in two separate committees reviewing the detailed proposals for investments of more than £2m before approval is recommended to the GMCA.
- 5.4 The governance arrangements for Small Loans (<£2m) differ from larger loans as proposals are not reviewed by the Gateway Panel but are subject to review and approval by the Credit Committee. Given the non-negotiable nature of the terms being offered for Small Loans these governance arrangements are considered robust and adequate.
- 5.5 GMCA will enter into loan agreements with counterparties that are common across other UK government programmes and which therefore require information sharing to mitigate shared risks. The existing governance arrangements for the GMHILF include regular sharing of management information with government departments to allow for national monitoring of counterparty exposure. These arrangements will continue while the Fund is operational.

6 FUND RISK MANAGEMENT

- 6.1 The management of risk in relation to each individual project will primarily be focused on the following:
- Risk will be mitigated as far is reasonably practicable
 - Structural risk mitigation measures will be used to limit project risk
 - Robust exit strategies will be required
 - Robust due diligence will support all investment decisions
 - Private sector leverage will be maximised
 - Loans will be priced to reflect the risk of each project
- 6.2 Individual project investment decisions will be taken with consideration to the impact on the Fund risk profile. Project structures are assessed on a case by case basis and approved through the governance process to ensure project risks are acceptable, within acceptable tolerances and monitored at a Fund level.

- 6.3 A City Centre review was undertaken by JLL in January 2019 to underpin further City Centre investment. The review concluded that demand continues to outstrip supply and supports the City Centre investment decisions taken to date and to be made in the short term. City Centre schemes being considered in the future and non City Centre schemes will continue to be subject to location specific Red Book Valuations to confirm demand for specific projects prior to investment decisions being finalised. The City Centre review will continue to be undertaken on a biennial basis as a minimum.
- 6.4 An annual review of the Fund's processes and procedures by the MCC Internal Audit team is undertaken. The review undertaken in April 2019 provided "positive assurance" over the Fund arrangements. This will review will continue to be undertaken annually.
- 6.5 Critical to the success of the Fund is the ongoing monitoring of projects and ensuring timely repayment of funds. The identification of the early warning signs of project distress will be achieved through the covenants set out within the loan documentation and be highlighted through the monthly monitoring undertaken by the team, supported by an external monitoring surveyor. A bad debt policy has been developed to ensure appropriate protocols exist in the event that projects do not perform as anticipated. This has been the subject of review by MCC Internal Audit in March 2016. To date the Fund has not incurred any bad debts.
- 6.6 A separate monitoring team with appropriate skills and experience has been created within the Core Investment Team to provide focussed technical oversight of all loans being provided. A technical support role has been recruited to the team to provide necessary additional technical resource to undertake this function. The Risk Director continues to sit on the Credit Committee and Gateway Panel and review scheme approvals. A risk team set up within the Core Investment Team ensures compliance of arrangements as loans are entered into and reviews monthly monitoring reports produced for each project. These arrangements are considered satisfactory. The arrangements will be reviewed as capacity constraints are identified.

7 LEGAL CONSIDERATIONS

- 7.1 The proposed operation of the Fund under the updated Investment Strategy remains within the parameters of the legal agreement with MHCLG.
- 7.2 The pricing of all types of loans will be risk-based, following an assessment of the borrower's financial covenant together with the strength of collateral available for the loan. In order to ensure that lending complies with EU State Aid regulations, minimum interest rate margins will be determined using the state aid table published under 'Communication from the Commission on the revision of the method for setting the reference and discount rates' (2008/C 14/02)'.

8 FINANCIAL CONSEQUENCES – REVENUE

- 8.1 Borrowers are required to meet the Fund's legal, due diligence and monitoring costs associated with investments and there is no requirement for additional revenue expenditure by GMCA in addition to the approved Core Investment Team budget.

9 FINANCIAL CONSEQUENCES - CAPITAL

- 9.1 The proposed investments deployed in line with this revised Investment Strategy will be sourced from the £300m GM Housing Investment Loans Fund, including the recycling of loans made by the Fund which have now been repaid.
- 9.2 The risk profile of the GMHILF investments made will be managed by the Core Investment Team to ensure that the risk of losses from the Fund are less than 20%.

10 RECOMMENDATIONS

- 10.1 The GMCA is recommended to approve the revised Investment Strategy for the Greater Manchester Housing Investment Loans Fund as set out in this report.