
Title: North East Investment Fund – Project Extension – North East Property Development Fund
Report of: Mags Scott, Director of Finance and Investment
Portfolio: Finance and Investment

Report Summary

The purpose of this report is to provide an update on the delivery of the North East Property Development Fund and to request approval of an extension of two years to March 2027. The Fund provides loans of up to £2 million for a maximum duration of 24 months, to enable small-scale residential and commercial developments. The Fund has been designed to meet market failure in the provision of loan finance for small and micro developers looking to bring forward these sites in the region, including in rural areas.

The Fund is managed by FW Capital and has achieved significant economic returns, including more than 1,000 jobs, 245 new homes and 7750sqmt of commercial development. There have been no defaults on any of the loans made by the fund.

Extension of the fund will enable it to make further investments into new projects over the next two years. It is proposed that, during this time, work is undertaken into the case for the development of a new Fund – including a market assessment and to consider the case for any changes in the delivery model (for example, maximum loan size or duration). This process will be undertaken alongside a wider review of a range of investment funds launched by the North East CA and its predecessor organisations and also take into account evolving national Government policies, which we understand are likely to promote this type of investment arrangement. The process for, and findings of, such a review will be brought to Finance and Investment Board in due course – timings for this are to be agreed.

Recommendations

The Chief Executive is recommended to approve the proposed two-year extension of the North East Property Development Fund.

A. Summary of Proposal (Context)

1. Background

The North East Property Development Fund (NEPDF) invests in projects with local developers to enable them to bring forward small-scale residential and commercial developments. The Fund provides between £200k-£2m of secured investment on commercial terms, with loans of up to 24 months.

The Fund is currently £16.1m in size, with £15.7m of investment from the Combined Authority and £400K from the Fund Manager, FW Capital. The investment was originally awarded from the North East Investment Fund in two stages, with £5.7m in 2017 and further £10m in 2021. Santander Bank previously contributed £4m to the Fund but they exited in Spring 2022, following a change in the bank's national lending policies.

The investment into the Fund was made in the form of a loan and at the end of the investment period repayment will be made to the North East CA and FW Capital.

The Fund Manager, FW Capital, manages the Fund in line with the investment agreement. This includes sourcing deals, financial and legal due diligence, taking proposals through first and final credit approval on an FCA compliant basis before the award of funds, implementation of legal agreements, and then monitoring of delivery through to exit of investments. For this, FW Capital draw an annual Fund Management fee of £402k during the Investment Period. For the final two years of investment realisation the Fund Management fee is tapered to £201k and then £60k. Quarterly performance reports are received on the Fund and it is proposed that these are included in future Performance Updates to the Finance and Investment Board.

The fund was designed to be ‘ever-green’, with loan repayments by developers reinvested into new projects. This has meant that, since its launch in 2017, the Fund has made almost £50m of investments, unlocking 245 homes and 7,746 square metres of commercial development. Table 1 summarises the position of the fund against business plan projection, with the fund over-performing in terms of job outcomes (including both construction jobs and jobs unlocked in the office development) despite lower than expected volumes of development.

Table 1 – Key Performance Indicators

KPI performance to 31/12/2024				
	Actual	Forecast as at 31/12/2024	Achievement %	Variance
No. of Investments	63	73	86%	(10)
Direct Investments (£'000)	49,546	47,997	103%	1549
Residential (units)	245.0	382.8	64%	(137.8)
Commercial (sq. m)	7,746.3	9,052.8	86%	(1306.5)
Total Jobs	1,062.3	989.3	107%	73.0

The Fund is approaching the final month of its investment period, with two years of monitoring and realisations of investments; repayments are then scheduled to follow before exit. Although performance to date has been below target, our assessment is that given the much higher than anticipated construction price inflation (with construction prices increasing by more than 50% over this time) the fund has performed well overall, whilst also generating a financial return. A series of assessment and assurance work has been completed over the last twelve months to inform how the North East CA proceeds with this fund to ensure we build upon its success and continue to address market failure from commercial lenders in the provision of this type of finance.

The proposal is to extend the investment period from 31st March 2025 to 31st March 2027, with a further 24 months of monitoring and repayments to 31st March 2029:

An extension of two years is being proposed as it would:

- allow for one full additional investment cycle, given that the current loans will all be repaid in the next two years. In general, an investment may take up to 6-12 months to move from enquiry through full application, credit checks, due diligence, contracting, before having 24 months for client to complete and repay on an investment.
- provide sufficient time for a strategic assessment of what type of Fund(s) are required to support the work of the Combined Authority and provide time for development of a business case and for successor arrangements to be put in place. This would avoid any potential hiatus within the market and inadvertently discouraging the small developer community and fund managers that we want to encourage to locate and grow in the region. Our experience from the North East Fund is that full market testing and the creation of a fund of this type is likely to take at least 18 months.

We propose retaining the current investment parameters. Should the strategic assessment process conclude that these should be changed during the extension period – for example by raising the loan duration or maximum size – these recommendations would be brought back through North East CA business processes for consideration by Technical Officer Group and Finance and Investment Board.

2. Impact and Case for Extension of the Fund

The extension would provide further housing outputs, private sector investment and growth; all are aligned to the North East CA’s missions and objectives. In total, the increase on current performance would be:

- £24.454m additional investment
- 20 new schemes supported

- 207 new housing units
- 251 more jobs
- £7m private sector leverage

An internal North East CA review into the case for extension has noted that the NEPDF continues to be firmly aligned to the North East CA's missions and the objectives of the Local Growth Plan, by providing through its investments much needed support to micro and small developers in the region, to build housing units and commercial property space. In addition, an independent review of the performance of the fund, by Sanderson Weatherall with JC Gill & Co Ltd made a strong case for continuing the Fund:

- The Fund has had a broadly positive impact on the Small Developer Community in the North East, and provides much needed development finance in the market for small housing scheme development in the absence of any substantial commercial lending provision.
- The Fund has been well managed by FW Capital to minimise risk and to date has achieved 100% repayments with no defaults.
- There is a strong strategic alignment with the North East CA objectives around housing and land and the cost to the public purse of the fund is largely the opportunity cost of allocating the funding for this purpose (vis a vis other uses) - any risk of default is minimised by the structure and operation of the fund.
- A gap in continuity in the fund would lose significant momentum gained over the previous years. SW recommend a short-term extension of the existing fund is approved.
- A two-year extension will allow another full investment cycle for the fund. It should also allow sufficient time for a successor fund to be in place.
- For the period of the extension, the cap on investment from the Fund should be increased to £3m, reflecting inflationary pressure on build costs since the fund was established, to allow 6-10 units to be completed with each investment (uplift for inflation).¹

Table 2 sets out the modelled financial flows from extending the Investment Period of the fund to March 2027, including both payment of interest and capital to the Combined Authority, with all investment returned to the North East CA by March 2029. Table 3 addresses the forecast repayment should the Fund not be extended.

Table 2 – Updated repayment schedule to Combined Authority if extension approved

	Forecast Income £000's						
	To Date	FY24/25	FY25/26	FY26/27	FY27/28	FY28/29	Total
Investor interest	1,043	823	824	824	721	456	4,691
Capital distribution to investors	0	0	0	2000	5000	8561	15,561
	1,043	823	824	2824	5721	9017	20252

The forecast interest payments are based upon projection. The interest calculation is determined by the performance and returns of the Fund, and Bank Base rates for that financial year; no interest payments were received before the increase in the size of the fund in 2021. Interest payments are expected to fall in 27/28 and 28/29 as the size of the fund falls, due to capital repayments being made back to NECA.

Table 3 below sets out the current forecast repayment profile should extension not go ahead.

Table 3 – Repayment to Combined Authority without extension approval

	Forecast Income £000's
--	------------------------

¹ Please note that we are not proposing to raise the investment limit in this paper, but this is one of the issues which would be considered in more detail in the full market assessment.

	To Date	FY24/25	FY25/26	FY26/27	Total
NEPDF (end 31/03/27)					
Investor interest	1,043	823	628	314	2,808
Capital distribution to investors	0	0		15,561	15,561
	1,043	823	628	15,875	18,369

3.Updated Outputs / Key Performance Indicators

Table 4 illustrates the updated proposed contracted Key Performance Indicators for the Fund as a result of the 24 month extension. These have been calculated with regard to performance to date on the basis of expected outputs per £1m of the Fund (which have been affected by construction price inflation), and the original contract targets. The fund is expected to unlock an additional 207 homes compared to current performance (and 50 more than originally contracted) and 250 more jobs (200 above original contracted level). Although not a contracted KPI, we expect to achieve an additional £7m of private sector investment as result of the extension. Consultations with FW Capital on the extension confirm that market interest is firmly in bringing forward small residential plots, rather than commercial property at the moment which is less viable. However as and when commercial property enquiries arise they will be progressed in line with the Investment Operating Guidelines.

Table 4 – Update Gross Outputs for NEPDF to 2029

KPI	Actual to 31.12.24	Original Contract Output Target for Fund to 31/3/2025	Revised Output Target with 2yr Extension to 31/3/2027
Investments £k	49,546	54,000	74,000
Housing units	245	402	452
Commercial (sqm)	7,746	9,440	9,440
Total Jobs	1,062	1,113	1,313
Private Sector Leverage	£20m	0	£27m

B. Potential Impact on North East Combined Authority Objectives

The Fund continues to be firmly aligned to the core missions of the North East Combined Authority. Primarily it supports our missions to deliver a growing and vibrant economy, and a North East we are proud to call home, by providing through its investments much needed support to micro and small developers in the region, to build housing units and commercial property space. In addition the extension, will provide the opportunity for the CA to give further consideration to how this type of Fund can best assist in further delivery of our objectives for the Housing and Land Portfolio in the future, through a potential successor fund.

C. Key risks

Main risks in relation to this proposal are being mitigated following extensive evaluation and assessment. Risks fall into two areas.

First, risk relating to default on individual investments made by FW Capital as the fund manager. This is mitigated not only through the extensive financial and legal diligence processes FW Capital continue to operate on the fund, but also through the security taken on each investment made, so that should a default arise, FW Capital have ability to step in and have first charge over land/assets involved. To date there have been no defaults on 63 investments, and none are in the pipeline.

Second, the theoretical cashflow impact on the Combined Authority of deferring the repayment of the capital. This has been reviewed as part of the wider North East CA Fund Review with the Chief Finance Officer, and this is not considered to be a material risk to the Combined Authority on the basis of surpluses across other funding streams and the current level of reserves.

D. Financial and other resources implications

Table 5 below summarises updated forecast repayment profile for NEPDF as result of the 24 month extension of the Investment Period.

Table 5 Updated Forecast Repayment Profile

		Forecast Income (£000's)					
	To Date	FY24/25	FY25/26	FY26/27	FY27/28	FY28/29	Total
Interest to NECA	1043	823	824	824	721	456	4,691
Capital repayment to NECA		0	0	2,000	5,000	8,561	15,561
Total		823	824	2,824	5,721	9,017	20257

The £15.7m within North East Property Development Fund, is already contracted and committed from the North East CA North East Investment Fund, having been invested by the North East LEP originally in 2017 and 2021. The decision in this report relates to an extension of the investment period for the Fund from 31 March 2025 to 31 March 2027, with final realisation of the investment by 31st March 2029.

E. Legal implications

The views of North East CA Legal and the Monitoring Officer have been reflected in this report.

F. Equalities implications

The North East CA complies with the Public Sector Equality duty and is conscious of the need to achieve the objectives set out under s149 of the Equality Act 2010. In June 2024 the North East CA adopted equality objectives to reflect the different roles of the Combined Authority as an employer, a commissioner and deliverer of services, and a civic leader. There are no direct equalities implications arising out of the recommendations in this report

G. Consultation and engagement

Technical Officers Group (TOG) were consulted on the outcome of the independent evaluation in September 2024. Finance and Investment Board are being consulted on this decision following agreement at North East CA Senior Leadership Team.

H. Appendix 1: Further detail of the Independent Evaluation

Sanderson Weatherall completed an independent evaluation in June 2024 to inform future operation of the North East Property Development Fund. The outcome of the evaluation was reported to North East CA TOG in September 24. The purpose the evaluation was to assess the performance of the NEPDF to date covering four key elements:

- Fund Structure;
- Governance and management of the Fund;
- Financial performance;
- Key Performance Indicators (Housing Units, Jobs, Commercial Space, private sector leverage) and strategic impact

The conclusions and recommendations of the evaluation for future operations are summarised below.

NEPDF Evaluation Conclusions and Recommendations
The fund provides much needed development finance in the market which is not readily available elsewhere and has been well managed by FW Capital to minimise risk and to date has achieved 100% repayments with no defaults.
In principle the cost to the public purse is the opportunity cost of allocating the funding for this purpose and any risk of default which is minimised by the structure and operation of the fund. In practice the fund has actually produced a positive return with just over £1 million in profit to date.
In addition to delivering a positive financial return, the scheme has delivered a number of hard output targets in terms of residential housing units and commercial floorspace. Whilst it is fair to say the fund took some time to gear up in the early years, it is now operating efficiently against a backdrop of high build costs which was not forecast at the outset of the scheme. Although housing numbers are a lower than forecast, we would still consider the fund to be successful, given that it has had to negotiate the Covid 19 pandemic and the turbulent subsequent economic background.
The funds' ability to continue operating and delivering new housing and commercial floorspace in the challenging economic background is a very positive indication of the benefit and need for the fund to continue. Any gap in continuity in the fund would lose significant momentum gained over the previous years and we would therefore recommend a short-term extension of the existing fund is approved, providing the objectives are still valid and in particular have strategic fit for the new North East Combined Authority who now have responsibility for the fund.
A two-year extension will allow another full investment cycle for the fund. It should also allow sufficient time for a successor fund to be in place. Due to lead in time of the deals, FW Capital would probably have to stop proactively marketing the fund about 6 months before the end of the investment period as it is unlikely that they would be able to complete deals before the end date. The 2-year period would allow at least another 18 months of proactive marketing to maintain momentum in the market.
Sanderson Weatherall recommend when considering any short-term extension of the fund that the cap on investment should be raised to £3million per developer, as the significant rise in build costs means that schemes of 6 to 10 units are difficult to fund.
There is an opportunity to embed environmental and sustainability credentials into the fund. This could be achieved by offering incentives for better energy efficiency through discounts in exit fees based upon proven delivery e.g. As built EPC ratings.
Should North East CA be minded to secure a successor fund SW recommend early consideration of issues including impact of any IP owned by FW Capital, subsidy control issues and structures for delivery including of consideration of any impacts of the new Procurement Act 2023 which is now operational. This would also be an opportunity to explore options to scale up the fund in partnership with a local public sector pension fund. As evidenced in Wales there may also be advantages to having discussions with a North East based building society to gauge their appetite for emulating The Principality Building Society fund.

I. Background papers

Not Applicable

J. Contact officers

Name: Matthew Ebbatson

Title: Programme Manager

Email address: Matthew.Ebbatson@northeast-ca.gov.uk

K. Glossary

NEPDF – North East Property Development Fund

NEIF – North East Investment Fund

EZ - Enterprise Zone

FWC – Finance Wales Capital Ltd

North East CA – North East Combined Authority
North East LEP – North East Local Enterprise Partnership

L. Consultee

Cabinet Member:	Director/Head of Service:	Director of Finance and Investment:	Monitoring Officer:
Yes	Yes	Yes	Yes