

FUTUREBUILDERS ENGLAND LTD

**Investment Plan 2008 – 2011
Revision 1: 2009/10**

Introduction

This is the first annual review of the 2008-2011 Investment plan. The purpose of this review is to ensure that changes to our investment policy, including our response to latest market conditions are captured for the next financial year. The plan sets out how we will invest the Futurebuilders Fund between now and 31 March 2011. The Plan will be reviewed and updated annually.

The aim of the Futurebuilders England Fund is ***to invest in third sector organisations so they can win contracts to deliver public services***. We do this by providing finance, mainly in the form of loans. As an engaged investor, our role is to provide support and advice as well as finance.

We are a mission investor, our mission being two fold

1. Market mission – to invest in third sector organisations (TSOs) to win public service contracts
2. Internal Futurebuilders mission – to maintain the integrity of the fund

Mission investing shares some of the characteristics of commercial lending, but differs significantly in other ways. There is more detail on this in the relevant section of this plan.

Futurebuilders is investing in third sector organisations because it believes that they

- can often provide better public services than those currently on offer, particularly where their strengths – innovation, user engagement and responsiveness are prominent
- sometimes need investment to make them more robust so they can win and deliver contracts in the long term
- cannot always get sufficient funds to grow despite having viable plans that could support repayable finance. Banks might previously have judged these investment opportunities as too risky given the fragility of the market for public service contracts and this has been exacerbated by the recession. We exist to take more risks and support them.

Futurebuilders regards success as:

- helping our investees win contracts to deliver high quality public services
- disbursing our funds responsibly and in a timely fashion so that they are being used to benefit the users of public services
- receiving good feedback from our customers about their experience of working with Futurebuilders.
- having a wide range of investees (across market sectors and type of organisation) and products
- understanding the effect of different types of Futurebuilders interventions so that we can learn from experience and continue to develop our funding strategies

Changes affecting our investment plan:

There have been several significant changes since we wrote the first version of this plan that affect how we invest going forwards. These can be divided into internal and external changes.

Internal

We have:

- Completed a review of our investment practices. This has streamlined the application and assessment processes, and led to the creation of a specialist portfolio management team.
- Strengthened our team of specialist advisers to include property and in-depth performance analysis (including forensic accountancy)

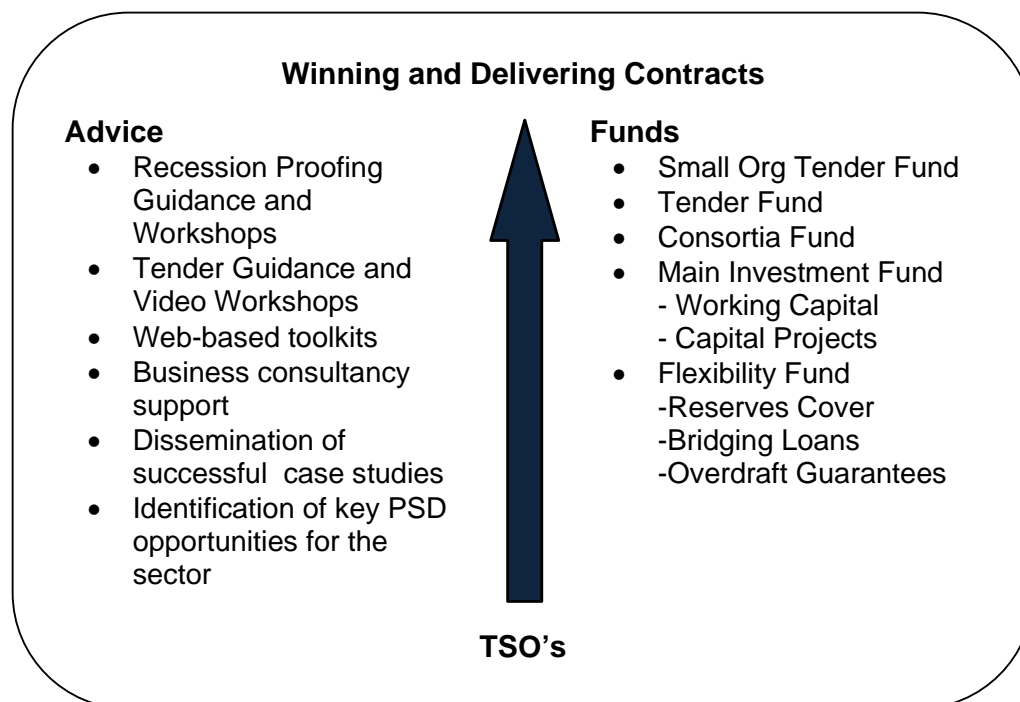
External

The credit crunch and recession have led to a sea change in both the demand for services from our investees – particularly those active in the employment sphere, and in funding provision and requirements. Some organisations are finding the environment very challenging, and need to re-structure their business model and practices

Meeting our success parameters:

We have developed our thinking over the year and plan to prioritise our investments going forwards into those which meet our first two priorities – winning contracts and drawing funds. During the year we have tested several new interventions – for example the tender loan fund – which has been very successful, and also looked hard at some other offers – such as equity, which may not produce returns as a main product (although it might in a very small number of cases). So, whilst we are open to new means of investing, we think we and the sector will be best served by concentrating on the products shown in the table below.

In addition to this mainstream work, we are now one of the key stakeholders delivering the Cabinet Offices' Action Plan, which will support the sector through the recession, via the **Modernisation Fund**, which is described in more detail under products.



Mission Investing

All financial investors share certain approaches towards their clients. Mission investors however, use their mission to drive their activities, as opposed to the fiscal drivers influencing the behaviour of commercial investors. The table below summarises this.

	Similarities	Differences
Mission	Market expertise/ targeting Due diligence	Maximise mission Sustainable investees Default rates to optimise mission Re-invested returns Grow market
Commercial	Balanced portfolio Loans repaid	Maximise financial return Sustainable fund Default rate to maximise profit Profit distribution Exploit market

At Futurebuilders, we have two missions: one external – our market mission, and one internal, our fund mission.

1. Market Mission - To create sustainable organisations that win contracts.

We will achieve this through:

Marketing

Our intention is to actively market the fund, and search out high quality applicants so we can invest in those we believe to have the greatest potential.

Listening to the sector

Futurebuilders will evolve its offering to meet market needs. To do this, we will need to listen to, and stay in close contact with TSOs and commissioners.

Timely and effective distribution of the fund

For contracts to be won, we need to distribute the fund and get it working in the sector. Obviously, this will be done with care, and mindful of the fact that we are looking to make a wide range of investments in a wide variety of TSOs

An engaged investor approach

Futurebuilders will work with its investees to support their long term sustainability and success. Futurebuilders can assist TSOs in many of the issues that will face them as they grow, bid for and deliver public contracts.

Financial packages

Futurebuilders aims to put together financial packages that will leave TSOs stronger than they were prior to a Futurebuilders investment. Each investment is tailored to the particular needs of the recipient investee. Futurebuilders will also launch specific financial products that help TSOs to win contracts e.g. The Tender Fund.

2. Internal mission – To create a credible, well managed and innovative fund that is balanced and impactful.

We will achieve this through:

Launching innovative products

We have, and will continue to launch innovative financial products that help to overcome the impediments that TSOs face.

Operating with an acceptable default rate

Futurebuilders is a risk fund, investing in projects that are fundable, but not bankable. As such it is likely to have a default rate higher than commercial investors. There is more detail on this in the section on default rates.

Having our loans repaid

Futurebuilders will expect the loan element of its investments to be repaid and will take out security, where appropriate, to safeguard them.

A balanced portfolio

Futurebuilders is an experiment to test the market for third sector commissioning. As such it needs to make a range of investments across organisations of different sizes in different sectors.

In summary Futurebuilders aims are:

- To drive demand and invest in the best
- To get the money into the sector rapidly and judiciously, so that contracts can be won
- To create strength in our investees – so they can deliver contracts (short and long term)
- To lead in financial products and react to market developments and customer demand – so our investees have the right base to win contracts
- To achieve a balanced and diverse portfolio – by size of organisation/investment, investment type, market sector and risk profile – so we help grow the market, test and refine our products and manage our risk – our fund integrity
- To have loans repaid and operate with an acceptable default rate

Eligibility

We will only invest in proposals that meet the following criteria:

1. Investments must be in third sector organisations.

We use the government definition (see Office of the Third Sector website): value-driven, non-governmental organisations which principally reinvest any surpluses on their activities to further social, environmental or cultural objectives, and includes, without limitation, voluntary and community organisations, charities, social enterprises, cooperatives and mutuals. Investments must be organisations that are independent and accountable i.e. we won't deal with a branch of an organisation that isn't sufficiently independent of the main organisation to be accountable for the investment. We can invest in consortia as long as one organisation takes responsibility for the investment.

2. Investments must be in organisations that are likely to win contracts to deliver public services

Public services are defined as services that are wholly or partly funded, from the 'public purse' (money raised through taxation). A public service is one which benefits the public, the environment or society and is wholly or partly funded, now or in the near future, from the 'public purse' (money raised through taxation).

To decide whether an application fits our definition we apply the following questions:

- 1) "Do the cash flow projections for the proposal show a realistic likelihood that at least 51% of the income flowing from the proposed service, once up and running, will come, directly or indirectly, from the public purse. a full list of acceptable funding sources is updated on our website, but in essence this means we allow EU funding, benefits paid to individuals from a statutory body for a specific purpose (e.g. housing benefit, working family tax credit and disability living allowance). We don't count more general benefits or lottery funding.
- 2) "Will contracts be won within a reasonable timeframe – generally within 12m of us making an investment – but as a maximum before our fund management contract expires in 2011"

3. We won't invest in 'bankable' deals

That is deals that a mainstream bank would do and the trustees of an organisation should reasonably accept. We mean by this that money for the project cannot be raised commercially. If we believe that it is bankable in whole or part then we will liaise with other funders to achieve the correct mix of investment. We have developed a set of guidelines with Royal Bank of Scotland to help assess whether an organisation should be able to raise the funds through a commercial route, and these are published on our website. Where there is doubt, we will send details of potential investments to banks which have joined our "funders forum" to encourage them to co-invest: this can be the best solution for all parties. Applicants are asked to give a general consent to us sharing information with other funders, but there is always an opt-out clause. If we can't test "bankability" this way you will need to show that you have tried yourself to obtain finance elsewhere.

4. Investments must be viable

In particular, though we do take greater risks than banks, investees must be likely to be able to repay the loan element of their investment. Organisations can choose from what source of funds the loan is repaid, but we do expect to see evidence that the services we are supporting are ultimately likely to be sustainable.

Investment readiness is a combination of factors, which may vary in their weighting. Many potential investees come to us at a stage where they are not investment ready: one of our tasks is to identify which of those we should invest time and/or money in so that they can become investment ready, and we have (very limited) development grants etc to support this. The further away from the above an organisation is, the less likely we are to be able to support them. In particular, we need confidence in the people, as they deliver success for both themselves and us.

Put at its simplest, an investment ready organisation has:

- the right people to win and deliver contracts, run the organisation competently and work with us. This includes a strong board and executive team, and good systems – particularly financial management.
- services – either now or in development that they can sell to commissioners within 6-12 months of an investment. This means services that are well defined, well delivered and likely to be bought by commissioners– i.e. the organisation knows its marketplace.
- a sensible business and financial plan that is well developed, tested and is achievable.

5. The ultimate beneficiaries of our investments must predominantly live in England

What we offer:

FBE strives to be responsive to the sector it serves so we will trial new products as opportunities emerge and will alter the way we provide existing products where the response from the sector suggests it valuable to do so.

Loan/grant split

The current loan/grant portfolio split is 83% loan, 17% grant. Loans will continue to be the dominant part of any investment, although the overall split may change, and we will tailor each investment to the needs of the organisation to ensure that in investing in it, we make it stronger. Grants are normally only available for capital expenditure.

Product split

We have allocated budgets to each of our products for guidance: we do not intend to formally “ring-fence” funds other than as either capital or revenue for treasury purposes. We will be reviewing the allocations regularly to reflect demand for both existing and new products. The exception to this is the modernisation fund which has an allocation of £9.5m for 2009/10

We currently offer the following loan funds:

1. Property Fund

Loans for organisations that need to buy, lease and/or refurbish property. We will only invest in property deals where there is a clear link to contracts and drawdown begins within 6m of offer.

2. Development Capital

Loans for organisations that need funds to invest in more staff, service development or other development costs ahead of forecast income.

3. Working Capital

Loans for organisations that are growing but struggling with cashflow.

4. Bridging finance

Loans for organisations that need a bridge to fundraising results, sale of existing premises, grant aid, contract income, etc?

For all these we can provide loans at 6% interest, fixed for an initial period of 3 years. At the end of that 3 year period a review of the interest rate payable will be undertaken which will take account of the Borrower's then financial and operational position.

We can make funding available in a form acceptable to Islamic faith.

5. Modernisation Fund

This is a new fund, to be launched in April/May 2009 as part of the Cabinet Offices response to supporting the sector through the recession. Specifically for the 2009/10 financial year, the fund will offer loans to third sector organisations with a turnover of £750,000 and over. These loans will focus primarily upon mergers and collaboration, and activities related to organisations taking steps to become more sustainable through the recession (either growth or re-structures) and the financial and capacity issues associated with these. Loans will be offered between £30,000 and £500,000 and will be for up to 5 years at 0% interest. Repayment holidays for the first 12 months of the loan will be considered where appropriate.

We can also offer:

A. Guarantees

We can provide guarantees (via deposits) to your bank as a way of providing working capital during times of growth. We charge between 1% and 2% p.a.

B. Capital Grants

Sometimes we can offer capital grants as a part of a bigger investment from us to help your viability and manage our risks. By capital we mean property lease or freehold, purchase or refurbishment including associated costs, equipment,

intellectual property and working capital (i.e. anything that would appear as capital on the balance sheet).

C. Revenue grants

We have a very limited amount of revenue grant funding to offer alongside bigger investments. They would be used to build capacity in the organisation to help viability, build skills and/or to manage risks. This might include the costs of, for example, financial staff to support the growth in the organisation or the evaluation of work to help demonstrate the outcomes of the work to purchasers.

D. Equity type investment

For a small number of projects and organisations loan finance is not appropriate, but an equity type investment is – for example where it makes sense to link repayment directly to performance. This type of investment means that both the organisation and FBE share the risk and returns on an investment: the more successful they are, the more we share in that, with the opposite also applying. If they do not have a share based legal structure we may be able to offer you an investment that provides us with royalty payments once certain income thresholds are met, based upon a percentage of income and capped to a negotiated maximum. We will structure this so that it allows the organisation build a reasonable level of reserves.

E. Tender Fund

If an organisation has a clear opportunity to bid for a public service contract, that they have a realistic chance of winning, but cannot afford the costs of preparing the bid, then we can help. We will provide a loan at 0% interest of up to £50,000 (depending upon the size of the contract). We can also provide advice and support in choosing advisors to work with. There is a limited pot of £1m available for this fund. In exceptional circumstances we may be able to increase the amount offered.

F. Small Organisation Tender Fund

Offers grants to small third sector organisations who need small sums of money to help them tender successfully for specific public sector contracts. Grants are invested in amounts up to 10% of the contract, with a maximum investment of £15,000.

Eligible criteria include; turnover of <£250,000 in last financial year; the public service contract must be worth a minimum of £30,000 and the organisation must have a good chance of winning the contract.

Funding for this support is provided jointly by FBE and the National Programme for the Third Sector Commissioning.

G. Consortia Fund

Offers a combination of loan finance and professional support specifically for consortia groups aiming to work together to win public service contracts. Consortia are defined as two or more organisations that enter into a formal agreement, or form a separate entity to jointly bid for, and deliver, public service contracts.

This Fund operates in a similar way to our Full Investment Fund, in that investment packages are tailor-made to suit the individual needs of the consortium. There is no upper limit to the size of investment, but the minimum investment package is £50,000

H Agreement in Principle

We no longer offer this product to new investees.

Advice Services

Alongside our financial investments we offer a range of advice services to help organisations thrive and prosper. These include:

- Recession Proofing Guidance and Workshops
- Tender Guidance and Video Workshops
- Web-based toolkits
- Business consultancy support – including property and financial expertise
- Dissemination of successful case studies
- Identification of key Public Service Delivery opportunities for the sector

By matching these services to funding we believe that our investees have access to unparalleled support – it is the engaged investor approach.

Investment Policies

1. Minimum and maximum size of Investment

For all but the Modernisation and Tender Funds the minimum size of investment is £50,000; below this the transaction costs are proportionately too high. There is no maximum size of investment but we do not expect to make many investments of £10m or above because it is important to spread the risks we take across the portfolio.

2. Default rates

We operate in the zone between un-bankable and un-fundable, and accept that we inherently invest in riskier projects and organisations. That said, we would not invest in any organisation where we anticipated default at the time of the investment decision. Once we have invested, our principle of engaged investor leads us to minimise a) the number of organisations that fail and b) the amount of money lost.

The actual total amount of write-offs and provisions at March 2009 is 5.3% of drawn loan funds (June 2008 was 5%)

In reality we would expect there to be a lower level of default in the early years given the way the deals are structured.

We monitor default rates in comparable and commercial funds, and feel that our engaged investor approach and our market combined with the lag effect of interest and capital repayment holidays justifies the rate above.

3. Security

We will take security wherever appropriate but not normally for investments of less than £200,000 unless circumstances dictate, and we will normally limit this to the assets associated with the new service as opposed to the organisations' wider assets. Our principle intention for taking security is to allow us to play an influential role in crisis situations, which experience tells us can lead to a better outcome for both the organisation and the fund, but primarily for the beneficiaries. In some cases, taking security can impact on the level of State Aid that we may be providing, which can have an effect on our ability to invest. There is more on State Aid below.

Our current Terms and Conditions include a 'negative pledge' which requires investees to obtain our permission before using an asset to borrow further funds.

4. Personal liability

One of the challenges that Futurebuilders considers is the third sector's own approach to risk and, in particular, the reservations of many organisations regarding loan finance. We fully recognise the concerns organisations have about personal liability, the financial risk to their activities and the ability to achieve the contract revenues needed to support a loan.

The personal liability of trustees can be limited through the protection afforded by company status. We will not require personal guarantees from trustees for our loans. Trustees will thus be protected unless they have acted recklessly or fraudulently.

5. Fees and charges

We ask investees to pay for the costs of security. This is to meet the costs of external advisors and to help reduce the burden on our revenue budget; freeing funds for revenue grant elements of our investments. Whilst we do not charge initial arrangement fees, where we are asked to substantially change a proposal after we have agreed it, or if drawdown takes a longer time than initially agreed, we will seek to recover our costs for any additional work. This may be between 1-2% of the offer.

6. State Aid

State Aid reflects European Commission legislation restricting the use of public money to distort competition in trade or service delivery across all member states. At its simplest, you cannot use public money to give one organisation an unfair advantage over another where they might be operating in a competitive marketplace. Giving aid illegally can have serious results – the recipient has to pay it back with interest, and the giver (and in our case both the fund and the Office of the Third Sector) would see their reputation suffer.

Having said that, we believe – and have worked with OTS, the Treasury and BERR on this – that most of our investments do not involve aid. If we think an investment might be problematic then we will discuss it with you, although you should also use independent advisers if the risk of aid is significant.

Structuring Investments

Each investment is tailored to the specific needs of the investee: the investments are predominantly loan finance (or other product that provides a return to FBE).

Where grants or other subsidy is provided we will carefully consider the potential for challenge under state aid legislation and the extent to which it undermines the pressure on purchasers to offer contracts or fees that cover the costs of delivery and allow providers to make a reasonable surplus.

Investments will be structured so that the preconditions and conditions attached to different elements of the investment help to manage the risks for both the investee organisation and us.

Investment Mix

From 1 April 2008 Futurebuilders is able to invest in a wider range of public service areas; indeed anything where the third sector is active for the benefit of people in England.

We will strive to invest in a wide range of types of third sector organisations because we want to explore how well the Futurebuilders investment mix can be applied across the sector. However, we will not operate a series of quotas to achieve this. Rather we will monitor the spread we achieve naturally and if necessary market to niches of the sector where we struggle to make investments. In particular we will monitor:

- BME led organisations
- Organisations serving rural areas
- Each of 5 original public service areas: Crime, Community Cohesion, Children and Young People, Health and Social Care, and Education
- Small organisations (annual income <£100k)
- Local or regional organisations
- Geographic spread.

And other characteristics that seem appropriate.

Portfolio Management

We have already stated that we would not invest in any organisation where we anticipated default at the time of the investment decision. Once we have invested, our principle of engaged investor leads us to minimise a) the number of organisations that fail and b) the amount of money lost. Our portfolio management reflects this approach, from our investment committee, through drawdown and on to managing active investments.

1. Investment Committee

All investments over certain thresholds (currently £350k) are approved by an investment committee, which is a sub-group of our board. The majority of clients will be asked to present their proposal to this committee and engage in a question and answer session. We strongly believe that we invest in people as much as projects and our committee is looking to substantiate the information presented by the investment team. They will generally be trying to answer four questions:

- Is the project viable and likely to repay the fund – do the numbers add up?
- Is the organisation fit for purpose - ie has the right governance, an engaged board, good financial systems etc?
- Are the people leading and delivering the project competent?
- Has the organisation taken due account of risks and how are they mitigated

Anyone invited to our committee should expect to be robustly challenged on their plans.

2. Set up of our Investments

Once an investment has been agreed we will help the investee with any clarification needed to understand what it means to enter into an agreement with Futurebuilders, for example addressing any uncertainties over taking loan finance for the first time.

3. Drawdown (payments by FBE)

The phasing of drawdown will be discussed as part of the assessment and the investment set up process. Payments may be made in a single drawing or they could be phased in line with the achievement of certain conditions or milestones. Whilst we can provide some flexibility on drawdown timing we expect organisations to meet projected spend as closely as possible.

Each investment will have some pre-conditions attached; these are similar to those used by other finance providers. For example, payments towards property builds will typically be monitored against architects' certificates.

4. Support for Our Investees (Capacity Support)

We recognise that our investees operate in a challenging and rapidly changing marketplace. We will help our investees with practical support where required, for example by supporting the development of financial systems or strengthening their governance. This support can take place either before funds are advanced or after.

5. Monitoring

We monitor progress throughout the lifetime of each investment, in a way that is proportionate to the organisation and the risks. Generally we will simply require information that an organisation is (or should be) providing to its trustees or governing body. The monitoring will broadly consist of three main areas:

- Regular financial management accounts and annual audited accounts.
- Progress reports on the social outcomes and benefits being seen by the project(s), using a light touch methodology that captures impact without burdening the organisation
- Regular progress reports on the number of public sector contracts investees have successfully been awarded.

In the early days of an investment, where the risks are higher, we may ask for information to be provided more often than at later stages. We will however, always undertake an Annual Review with each of our investees. This gives both our investees and us an opportunity to discuss how things are progressing and what plans and support investees may require for the forthcoming 12 months.

6. Social Return on Investment (SROI)

We intend to invest in organisations that will produce a positive and substantial social return on investment. Whilst we will look for evidence of this in our due diligence process, the formal evaluation of SROI will be done by our evaluator – Sheffield Hallam University.

7. Variations

Our investees operate in a rapidly changing environment and need to be flexible in how they respond. Additionally, other issues – such as delays in planning consent or the recruitment of key personnel may mean that objectives – including drawing funds from us – are changed in some way. In such cases we aim to be flexible and will work to find a solution agreeable to both parties. This may involve agreeing to vary the terms, conditions or even the amount of an investment in order that our investee can continue with the project. In some cases the changes are so large that we may treat the request as a new application.

8. Learning

Futurebuilders is an experimental fund and as such we want to learn and share learning from our investments. Some of the questions we will be seeking to answer include.

- How effective are we at helping our investees to win public sector contracts?
- Are we good at getting appropriate investments out into organisations and making the money work?
- How have we helped organisations become stronger and more sustainable in the delivery of public service contracts?
- Do we have effective processes and how are they perceived by our external stakeholders?
- How good are we at reaching a wide range of third sector organisations who are / have the ability to deliver public sector contracts?

9. If problems arise

Futurebuilders aims to make loans that will be repaid. We want to help voluntary and community organisations develop the disciplines required to manage their financing arrangements in a business-like way.

We want to support our investees as much as we can if problems arise – and we will go to considerable lengths to do so. Where repayment cannot be made in accordance with the original agreement, each case will be dealt with in the light of its own particular context. We will be supportive, seeking ways of working with investees to seek a positive outcome.

We do expect investees to be open and honest with us. If we cannot share in all relevant information, then we will not be able to support the organisation through a difficult period. It is also the case that if there is any evidence that the investee has acted recklessly or imprudently, not complied with the other terms and conditions of the loan or is simply unwilling to repay, then FBE may terminate the loan and demand repayment.

Whilst we treat bad debts in the same way as a bank does when it comes to writing them off, the way that decision is made can be different. Banks will normally write-off a debt when the business has failed completely, Futurebuilders can take a more holistic view and if it is a particular project that has failed through no fault of the organisation we will try to ensure that it does not bring the whole organisation down, i.e. the project may fail and the Futurebuilders debt be written-off, but the organisation survives. Every case will be assessed on its individual merits.

Exceptions

Futurebuilders England is an experimental fund and as such we believe it important to explore new ways of doing things. Consequently, in some cases we may make exceptions to the approach outlined in this plan.