

**REPORT TO:** Cabinet

**MEETING DATE:** 13 January 2015

**BY:** Depute Chief Executive (Partnerships and Community Services)

**SUBJECT:** Scottish Local Authority Business Loan Fund

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## **1 PURPOSE**

- 1.1 To advise Cabinet of the proposal to establish a Scottish Local Authority Business Loan Fund and seek in principle approval to participate in the Loan Fund.

## **2 RECOMMENDATIONS**

- 2.1 Cabinet is asked to approve the Council's membership of the new loan fund, in principle.
- 2.2 Cabinet is asked to delegate authority to the Head of Council Resources and Interim Head of Development to consider and assess the operational aspects of the Loan Fund as these become available and to agree the Council's ultimate participation or otherwise.
- 2.3 Cabinet is asked to note the commitment of between £30,000 and £60,000, in principle, to the Fund, annually for 3 years.

## **3 BACKGROUND**

- 3.1 An opportunity exists for all of Scotland's local authorities to be part of a national Scottish Local Authority Business Loan Fund, through proposals drawn up by the Scottish Local Authority Economic Development group (SLAED). The target 'go live' date for the new Fund is 1 April 2015.
- 3.2 The Scottish Government has committed £40m to Financial Instruments for the first 3 years of the 2014-2020 European Structural Funds Programme. The proposals form part of the new European Regional Development Fund (ERDF) business competitiveness intervention being developed in partnership with Scottish Enterprise and are also in line with

the Scottish Government's Economic Strategy. These funds are to be used to create an SME Fund specifically for:

- Recapitalisation of the Scottish Investment Bank
- Recapitalisation of Local Authority Loan Funds

A further £40m ERDF is potentially available for 4 years thereafter.

3.3 Nationally, a collective ERDF bid from Scottish Local Government through this programme is being actively encouraged by the Scottish Government and the fund is targeting an initial award of £7.2m. This may generate further contributions through a £5.4m private sector contribution from the Banking sector and up to a further £5.4m through member local authority contributions, creating an overall Fund of £18m to be available for investment during the period 2015-2018.

3.4 The proposed fund would be able to increase the supply of loan capital to new and growing, small and medium sized businesses (SMEs) across Scotland. This will contribute directly to improving the business birth rate and creating the growth potential of those supported. The new fund would offer gap-funding to SMEs within its geographic area of operation up to a maximum of £100,000 and where its contribution or the aggregate of all sources of public sector funding would not exceed 75% of the total funding package.

3.5 Whilst there is an apparent adequacy of 'supply side' in the market, evidence from a range of sources suggests that this is not necessarily the case. A lack of available match funding from the Banks remains a major challenge. Banks continue to appear reticent to lend where there is any perceived risk and lending is based on the banks requiring full security including personal guarantees as a matter of course. There is evidence that deals are taking longer to finalise with increased due diligence by banks and the requirement to take security slowing the process further, aligned with increased legal costs. The SME Finance Monitor for Q1, compiled from a survey of 5000 businesses, shows that:

- Only 33% of SMEs used any form of external finance in the last 12 months;
- Use of core 'traditional bank lending' is 27%, a drop of 5% on the same period in 2013;
- While most applications for renewed facilities are successful, the gap between these and successful new applications is widening. 96% of renewals were successful but only 37% were new applications;
- Smaller, newer businesses remained less likely to be successful and those declined reported limited support options being offered as an alternative;

- SMES are still discouraged to apply for bank lending as there remains an assumption amongst new business in particular, that if they approached the bank for funding they would automatically be turned down due to their credit history and size and therefore did not ask;
- Generally the SME population is still showing signs of pressure in a difficult economic climate in terms of profitability, external risk rating, credit balances and use of overdraft facilities; and
- In the last 12 months, 36% had seen an injection of personal funds from the owner/director into the business with half of these (18%) saying this was something they felt they 'had' to do

3.6 The success of the Fund will ultimately be determined by its measurable economic impact. A range of indicators and targets will need to be agreed with the Scottish Government as part of the ERDF application and approval process. Before the end of its third year, the Fund will be required to undertake an independent economic impact assessment and evaluation to measure the Fund's performance.

3.7 Proposed key targets for the Fund for 2015/16 are as follows:

- o Lend £6m;
- o Support c. 150 businesses;
- o Create 4 new/safeguarded jobs per business supported; and
- o Achieve a leverage of 1:3 from private sector match funding

3.8 The Fund will be able to support any legally formed, trading business, including the following:

- Sole traders;
- Partnerships;
- Limited companies;
- Limited Liability Partnerships;
- Co-operatives; and
- Social Enterprises

3.9 The primary focus will be businesses engaged in the Business to Business (B2B) and Business to Consumer (B2C) categories. Generally the eligible sectors can be classified as:

- Manufacturing;

- Service to manufacturing;
- Construction;
- Wholesale;
- Transport and Distribution;
- Software;
- Agriculture linked to farm diversification;
- Tourism and Tourism Infrastructure; and
- Service based

3.10 Each member authority will be responsible for the delivery of the fund within its own area. This includes local promotion of the fund to eligible business and stakeholders, identification of potential applicants, supporting businesses through the application process, appraising and determining applications and maintaining contact with/providing after care to loan recipients.

3.11 It is proposed the new company will:

- Comprise 32 members;
- Be a company Limited by Guarantee (NEWCO);
- Operate across Scotland utilising the model developed by the West of Scotland Loan Fund (WSLF) and East of Scotland Investment Fund (ESIF); and
- From an operational perspective, be organised regionally (East Lothian being in the East Region)

3.12 It is proposed that the founding principles currently operated for the WSLF and ESLF are adopted:

- Each member authority's contribution is exclusively ring fenced to be invested by that authority in their area only;
- Each member authority retains the right to determine the outcome of applications up to £50,000 at the local level following their own delegated authority procedures; and
- Applications above £50,000 will be referred to a regional investment panel

3.13 It is proposed the Fund's governance structure consists of five elements:

- Board of Directors;
- Corporate Governance Working Group;

- Regional Management Group;
  - Regional Investment Panel; and
  - Regional Officer Group
- 3.14 East Lothian Council is not a member of the East of Scotland Investment Fund so will have to join the new Fund, as opposed to transferring membership which is the case in other local authority areas.
- 3.15 Although local authorities will be able to join the fund at any time, only those authorities who are Members of the Fund at the time of the ERDF allocation will be able to benefit from the initial 3 year ERDF allocation. Any authorities joining subsequently would have to wait for the second ERDF allocation which the Fund would expect to receive, subject to satisfactory performance, following the mid-point review of the EU funding programme in 2017/18.
- 3.16 The European Commission has proposed an off the shelf model which can be used for financial instruments which offer loan, equity and guarantee funds. Advice and information has been sought from Scottish Enterprise/Scottish Government and further work is required to understand the EU model and identify the differences between that and this proposal. If such a model is not appropriate for the Scottish loan fund, work will have to be done to demonstrate how the Fund is State Aid compliant and State Aid Unit approval sought.
- 3.17 To deliver an operational Fund by the 1<sup>st</sup> April 2015, the following milestones will need to be met:
- 13 February 2015 – all Scottish local authorities intending to participate in the fund have secured necessary committee approval and indicated their annual lending targets for inclusion in the ERDF application
- 20 February 2015 – Articles of Association and Members Agreement signed by participating LAs
- 6 March 2015 - New members match funding transferred to NEWCO bank account
- 3.18 The Council's Treasury Management and Investment Strategy was approved by Council on the 25<sup>th</sup> February 2014. Any decision to invest in the Local Authority Loans Fund will need to be considered within the broader context of the Council's wider Investment Strategy, and this position will continue to be explored. As such, it is not therefore necessary to indicate/identify a budget for the Council's contribution; rather, this contribution will be handled as part of the Council's wider Investment Strategy. In principle, a contribution of between £30,000 and £60,000 will need to be committed to the Fund annually for the period 2015/16-2017/18.

## **4 POLICY IMPLICATIONS**

- 4.1 Membership of the Fund supports the East Lothian Community Planning Partnership's Single Outcome Agreement and the East Lothian Economic Development Strategy 2012-2022.

## **5 EQUALITIES IMPACT ASSESSMENT**

- 5.1 This report is not applicable to the well being of equalities groups and an Equalities Impact Assessment is not required.

## **6 RESOURCE IMPLICATIONS**

- 6.1 An investment of between £30,000 and £60,000 is required annually for a 3 year period which will be managed within the Council's approved Treasury Management and Investment Strategy.
- 6.2 Staff resources will be required to support the Governance structure and responsibilities set out in 3.10. Further work is required to establish that staff resources required can be met from existing capacity.

## **7 BACKGROUND PAPERS**

<b>AUTHOR'S NAME</b>	Esther Wilson
<b>DESIGNATION</b>	Service Manager - Economic Development and Strategic Investment
<b>CONTACT INFO</b>	ewilson@eastlothian.gov.uk
<b>DATE</b>	24/12/14