

Membership of the proposed Scottish Local Authority Business Loan Fund

1.0 EXECUTIVE SUMMARY

- 1.1 The Council has agreed to support in principle the creation of a Scotland wide local authority loan fund via the papers submitted to SMT Business (4th August 2014) and Policy Resources Committee (21st August 2014) and as noted by the Full Council (25th September 2014).
- 1.2 The main purpose of this paper is to outline the options for Argyll and Bute regarding membership of the proposed Scottish Local Authority Business Loan Fund (SLABLF).
- 1.3 The SLABLF proposal is being led by the West of Scotland Loan Fund (WSLF), of which Argyll and Bute Council is already a member, in partnership with the East of Scotland Investment Fund (ESIF). The proposal has been shared with all local authorities across Scotland.
- 1.4 The proposal is to merge both WSLF and ESIF into SLABLF. Argyll and Bute Council's allocation within the existing WSLF could transfer into the new loan fund.
- 1.5 SLABLF is seeking to benefit from an award of £7.2 million from the European Regional Development Fund (ERDF). Matched with funding from a bank loan of £5.4 million and contributions from the member authorities totalling £5.4 million, a fund of £18 million will be created to be invested over a three year period to 31st March 2018. Annually, the Fund will have the capacity to invest circa £6 million, support circa 150 businesses and help create over 600 new jobs.
- 1.6 Each local authority is being asked to indicate their support for the proposal, or otherwise. Approval was given in principle by the deadline of Friday 13th February 2015 subject to formal approval by the Policy and Resources Committee, with the minute of the Policy and Resources Committee being endorsed by the full Council.
- 1.7 There are two options open to Argyll and Bute Council:
- a) confirm support for the proposed SLABLF and the transfer of the existing WSLF allocation into the new fund; or
 - b) confirm that the Council is not seeking membership of the SLABLF at this point in time.
- 1.8 **It should be noted that the Articles of Association for the WSLF prevent any funds being returned to the member authority.** Therefore, any surplus funds after all liabilities have been settled will go to a 'like-minded' organisation such as the SLABLF, given that the WSLF will be wound up. In respect of the above

point, no contribution was originally provided by Argyll and Bute Council to the WSLF.

- 1.9 The option will exist for authorities to join at any point in the future. However, it is unlikely that any authorities not involved at the time of the ERDF submission would be able to benefit from the initial three-year ERDF allocation.
- 1.10 To proceed with membership the following is required:
- a non-binding note of the Council’s intent to pursue approval to join SLABLF; and
 - an indication of the value of loans the Council would be looking to issue over the first three years.
- 1.11 Evidence from the existing ESIF and WSIF shows this type of supportive investment vehicle has a positive impact in terms of creating new employment opportunities as well as preserving existing jobs. This new fund means local authorities are better placed to meet the needs of many of Scotland’s “start-up” and “growing” businesses. **The proposed SLABLF has considerable resources to invest in SMEs and is substantially addressing the “access to capital” barrier that exists for so many businesses in starting up, expanding and maintaining sustainability.**
- 1.12 It is therefore recommended that the Policy and Resources Committee:
- a) endorses the proposal to join SLABLF;
 - b) approves the proposed transfer of existing WSLF monies (currently £183,702), to SLABLF; and
 - c) endorses the estimated demand for loans over the initial three year period at £300k

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2.0 INTRODUCTION

- 2.1 An opportunity exists to create a pan Scotland local authority loan fund modelled on the successful West of Scotland Loan Fund (WSLF) and East of Scotland Investment Fund (ESIF). A pan Scotland Loan Fund is highly likely to be eligible to secure ERDF funding from the next European Structural Funds Programme 2014-2020. A collective bid from Scottish Local Government is actively being encouraged by Scottish Government.
- 2.2 Scottish Government has committed £40 million to Financial Instruments for the first three years of the 2014-2020 European Structural Funds. The fund will to be used to create a SME Fund specifically for recapitalisation of Scottish Investment Bank and recapitalisation of local authority loan funds. A further £40 million ERDF is potentially available for the four years thereafter.
- 2.3 The Scottish Local Authority Business Loan Fund (SLABLF) proposal is being led by the West of Scotland Loan Fund (WSLF), of which Argyll and Bute Council is already a member, in partnership with the East of Scotland Investment Fund (ESIF). The proposal has been shared with all local authorities across Scotland.
- 2.4 The proposal is to merge both WSLF and ESIF into the new national SLABLF. This innovative public-private partnership finance instrument fund will help accelerate the growth of businesses in Scotland, complementing other private and public sector forms of funding, creating significant leverage effects and engineering valuable growth in SMEs. As well as standardising the product offering, it will greatly increase the scale and operational efficiency of delivering a loan fund to Scotland's SMEs. **Overall, the SLABLF aims to ensure that good, commercially viable proposals do not fail from a lack of access to finance. Additionally, it will encourage and support the creation, development and growth of businesses, which will in turn be able to contribute to, and strengthen, their local economy in terms of jobs, growth and wealth.**
- 2.5 Each local authority is being asked to indicate their support for the proposal, or otherwise. The deadline for securing formal Council approval to participate in SLABLF was Friday 13th February 2015. Approval was given in principle, subject to formal approval by the Policy and Resources Committee, with the minute of the Policy and Resources Committee being endorsed by the full Council.

- 2.6 The proposed financial product to be offered by SLABLF is:
- loans up to £100,000, most likely operating in the range £10k to £100k;
 - secured by Standard Security, Bond & Floating Charge and / or Personal Guarantee;
 - some loans may require no security i.e. under £20k (discretionary); and
 - Interest rate fixed at 6% per annum.

3.0 RECOMMENDATIONS

- 3.1 The Policy and Resources Committee endorses the proposal to join SLABLF.
- 3.2 The Policy and Resources Committee confirms approval for Argyll and Bute's allocation of funds within WSLF (currently £183,702) to be transferred to SLABLF.
- 3.3 The Policy and Resources Committee endorses the estimated demand for loans over the initial three year period at £300k.

4.0 DETAILS

- 4.1 Full details of the proposal are available in the SLABLF business plan. The key points are summarised below.

How would the new fund operate?

- 4.2 The option of using either WSLF or ESIF to manage the fund is possible but given both Funds are still subject to ongoing European or other audits this could create complexity. The proposal is therefore to incorporate a new company limited by guarantee to manage the SLABLF.
- 4.3 It is proposed that ESIF and WSLF will continue to exist as legal entities in order to deliver their investment targets under the 2007-2013 EU Structural Funds Programme. Once those targets have been achieved both funds will continue to exist as legal entities in order to collect the outstanding loan repayments due from the existing portfolios and a decision on closure will then be taken by the board of the new fund. However, recent advice from the Scottish Government indicates that they would be comfortable with the transfer of all business, including loan activity, to the new company on the proviso that the new company's board of Directors formally accepts the conditions of grant associated with WSLF/ESIF current ERDF funding. This would allow the earlier winding up of WSLF/ESIF. This option is now being investigated further.
- 4.4 It is proposed to offer "Membership" of SLABLF to all 32 Scottish Local Authorities. As a company limited by guarantee, its members would be the Local Authorities.
- 4.5 It is proposed a new set of Articles of Association and Members Agreement be prepared and adopted by the new Member Authorities. Both documents will be based on the existing Articles of Association and Members Agreement for WSLF and ESIF and will be customised accordingly.
- 4.6 With up to 32 Local Authorities as Members of SLABLF, it is not realistic or desirable to have each Member represented on the Board. It is proposed to seek

nominations from three operational areas namely, East, West and Highlands and Islands, to stand as Directors of the new company. Each of the Local Authorities will be given an opportunity to agree amongst themselves to nominate between two to three people to represent their “region” forming a board of six to nine directors. Representation on the Board from other Stakeholders and the private sector should be considered in due course.

- 4.7 It is proposed that SLABLF from an operational perspective be organised regionally and that each region would effectively operate as a “Fund within a Fund” and be resourced accordingly.

The Local Authorities would fall within the following regions identified in the **Table 1** below.

Table 1: Local Authority Membership by Region		
East	West	Highlands & Islands
Angus	East Ayrshire	Argyll and Bute
Dundee	North Ayrshire	Highland
Perth & Kinross	South Ayrshire	Eilean Siar
Edinburgh	North Lanarkshire	Orkney
Midlothian	South Lanarkshire	Shetland
West Lothian	Inverclyde	Moray
East Lothian	Renfrewshire	
Stirling	East Renfrewshire	
Falkirk	Glasgow	
Clackmannanshire	East Dunbartonshire	
Fife	West Dunbartonshire	
Aberdeen City	Dumfries & Galloway	
Aberdeenshire		
Scottish Borders		
Total local authority membership by region		
14	12	6
Population		
2,500,230	2,312,190	487,480
Business base		
86,670	62,380	22,435

Source: SLABLF Prospectus

- 4.8 It is proposed that the founding principles which work for WSLF and ESIF are adopted for the Member Authorities of SLABLF namely:
- each Member Authority’s contribution is exclusively ring fenced to be invested 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 comprising a quorum of at least three people with appropriate skills and experience to appraise such loan applications.
- 4.9 It is proposed that the scale of the new Fund will be sufficient to justify the recruitment of a dedicated fund Solicitor to perform this role for all loan applications, thereby removing any additional burden from Local Authority legal teams and

helping ensure consistency of approach across the Fund. However, local authorities will retain the right to use their own legal services should they wish to do so.

What is the requirement of local authorities?

- 4.10 There is a requirement, in terms of eligibility under the 2014-2020 European Structural and Investment Funds Programme, for the fund to achieve sufficient participation to be considered a pan-Scotland intervention. This is likely to require a minimum of 28 out of 32 authorities to participate.
- 4.11 It is estimated the amount of lending across all 32 Local Authorities would be in the region of £5m to £6m per annum. As the European funding is initially for a three year period this could create a fund valued at £15m to £18m. The Fund will need to achieve a scale of at least £15m over the initial three year period to be financially viable.
- 4.12 With a £15m loan fund, a 3% management fee would be sufficient to cover the overheads. The costs will be split by applying each member's percentage share of the total fund value to the overhead costs. As the proposed financial model includes performance related remuneration for the ERDF contribution, there is a chance that the quoted annual overhead figure could increase slightly if targets are not reached.
- 4.13 The amount of match funding available from the Member Authorities will determine if any private sector match funding is required e.g. bank loan. A bank loan is not a requirement of the ERDF programme but it is known that up to a 30% contribution to the value of the Fund is viable. This could mean a bank loan of between £4.5m to £5.4m, probably over a five year term. The key factor will be the cost of borrowing such an amount.
- 4.14 Member Authorities would be required to collectively contribute between £4.5m to £10.8m depending on the size of the Fund and whether a bank loan is required.
- 4.15 Estimated demand for SLABLF loans across Argyll and Bute is £300k over the initial three year period. This may be optimistic given there have been no applications to the West of Scotland Loan Fund in the previous three years – although availability was restricted to Helensburgh area only until recently. The increased demand is based on widespread promotion of the new fund, across all of Argyll and Bute.
- 4.16 Based on this estimated demand for loans of £300k in total over the initial three year period 2015 to 2018, Argyll and Bute Council would need to contribute circa £100,000 to the Fund.
- 4.17 Argyll and Bute Council's contribution could be made by transferring its allocation within the existing WSLF, currently £183,702, into the new Loan Fund.

WSLF current status

4.18 As at 30th October 2014 WSLF allocation for Argyll and Bute stands at:

Cash at bank	£278,031
Investments / Loans	£0
Unspent ERDF	(£94,329)
Net position	£183,702

4.19 In August 2014 the Policy and Resources Committee approved the extension of WSLF to cover all of Argyll and Bute, if demand in Helensburgh and Lomond remained below target. This decision was noted by the full Council in September.

4.20 This widened eligibility has been promoted from October via press releases, ezines, leaflets and face-to-face through Business Gateway Advisers. This has generated six recent enquiries, of which two have potential to progress to application stage, with a combined total loan value of £120,000. However, no applications have been made to date and current indications are that the enquirer looking for the £100,000 loan will not apply before March 2015.

4.21 If no WSLF loan applications are made and approved before the end of March 2015, the £183,702 currently allocated to Argyll and Bute within WSLF could be transferred to SLABLF.

4.22 Based on an estimated SLABLF loan demand of £300,000 across the first three years from businesses in Argyll and Bute, the Council would need to make no additional financial contribution to SLABLF if all the current WSLF funds are transferred, as the £183,702 more than meets the £100,000 contribution required.

4.23 If WSLF applications are approved before the end of March 2015, the funds will be withdrawn from the Argyll and Bute allocation. If loans worth £120,000 were made before March 2015, the transfer from WSLF would reduce to £63,702. The Council would therefore need to contribute £36,000 to SLABLF, or reduce the size of the loan fund available to Argyll and Bute businesses for the first three years to circa £190k. However, as no new WSLF applications have been received to date and given the average 12 week lead time from application to approval, it is unlikely that the WSLF allocation will be significantly reduced before transfer.

4.24 An investment target of £300,000 over the first three years of SLABLF would appear optimistic based on the historical low demand for WSLF support in the Helensburgh and Lomond area. It is too early to accurately confirm demand from the rest of Argyll and Bute - the recent widening of the eligibility from October 2014 has certainly generated an increase in enquiries but these have not yet yielded applications.

What are the benefits?

4.25 Evidence from the existing ESIF and WSIF shows this type of supportive investment vehicle has a positive impact in terms of creating new employment opportunities as well as preserving existing jobs.

- 4.26 Additionally, income generated by interest repayments on loans would be recycled to a member authority's ring fenced balance for reinvestment in local businesses.

Option appraisal

- 4.27 **Option 1:** Transfer WSLF funds allocated to Argyll and Bute into SLABLF. By becoming members of the scheme, **growing businesses in Argyll and Bute will have access to a local authority loan scheme at no additional direct cost to the Council.** If demand for loans exceeds £100k per year there will be insufficient funding available, but demand for WSLF over the last 5 years has been significantly lower than this.
- 4.29 **Option 2, Do nothing.** WSLF will cease at the end of March 2015 and businesses based in Argyll and Bute will have no access to local authority loan funding. **The Articles of Association for the WSLF prevent any funds being returned to the member authority.** Therefore, any surplus funds after all liabilities have been settled will go to a 'like-minded' organisation such as the SLABLF, given that the WSLF will be wound up. In respect of the above point, **no contribution was originally provided by Argyll and Bute Council to the WSLF.**

5.0 CONCLUSION

- 5.1 Joining SLABLF will provide businesses across Argyll and Bute with access to finance, building on the established WSLF model.
- 5.2 Assuming that no significant WSLF loans are approved before the end of March 2015, the WSLF monies transferred to SLABLF should cover the contribution required from the Council to cover anticipated demand.
- 5.3 It is therefore recommended that the Policy and Resources Committee agrees to become a member of SLABLF and agrees to transfer the WSLF funds currently allocated to Argyll and Bute to SLABLF, to cover estimated demand.

6.0 IMPLICATIONS

6.1 Policy

Making a local authority loan fund available to businesses across Argyll and Bute will support the Council's overarching Economic Development Action Plan 2013-2018 objective of assisting more businesses to start-up and grow. Furthermore this will align with the SOA Delivery Plans, in particular Objectives one and three.

6.2 Financial

If a Scottish Local Authority loan fund is developed, it is proposed that existing WSLF monies would transfer (currently £183,702). This would form the Argyll and Bute contribution to SLABLF, leveraging EU funding and creating a loan fund sufficient to meet the estimated £300k demand without further funds required from the Council.

If the WSLF monies are not transferred they cannot

be accessed by the Council after WSLF closes and would effectively be lost.

- 6.3 Legal Articles of Association and a Members Agreement for the new Fund have been drafted. These need to be reviewed by the Council's legal team. Operationally a dedicated fund Solicitor has been proposed, so there should be no further burden on Local Authority legal teams.
- 6.4 HR The existing 3.2 FTE advisers within the Business Gateway team have the skills to provide the required business support. Currently one FTE within the team is trained in WSLF processes and systems. Training would be provided by the Fund should more of our Advisers require this. No additional personnel within the Business Gateway Team are required to support the Pan Scotland Loan Fund delivery.
- 6.5 Equalities This will have no adverse impact on key equality groups. Wider provision of loan funding will comply with all Equal Opportunities policies and obligations.
- 6.6 Risk Due to the operational overlap between the current method of Business Gateway delivery and the proposed Loan Fund delivery, there is limited risk for the Council as it is well placed to provide the services required.
- 6.7 Customer Services Greater provision of affordable loan finance to businesses and the removal of inequalities between the administrative areas of Argyll and Bute will have a positive impact and contribute to an improved customer experience.

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