Executive Summary:

The Coventry and Warwickshire Duplex fund will provide a new type of financial product to small businesses that combines grants and loans. The net effect for the applicant is a loan at a very attractive rate. The fund will be managed by Coventry and Warwickshire Reinvestment Trust (CWRT), a local “community bank” that lends to businesses which struggle to access finance from banks. As loans to applicants are repaid, this will make cash available for new loans later in the lifetime of the fund. An important benefit of the proposal is that grant funding which under normal circumstances would be used once would instead form part of a ten-year programme of business support. The grant element of the funding will come from UK government sources such as Growth Deal.

This report seeks approval for the Council to offer CWRT a loan for up to £2m as its contribution towards the fund. This cash will be used to support Coventry businesses, and Warwickshire County Council are currently considering a proposal for a comparable investment in the fund to provide complete Coventry and Warwickshire coverage. Grant funding worth £5.4m will also be allocated, bringing total public investment in the fund to just under £10m. This will allow £20m in financial support to be offered to businesses as the fund recycles itself over a ten year period.

The Council’s investment will be protected by having a strong presence on the credit committee which will award funding from the scheme, setting an interest rate in the loan arrangement that reflects the risk, and by seeking appropriate security from CWRT. In addition, a business support fund like this one can also be protected by a government-backed guarantee scheme.
Over the ten-year life of the fund, it aims to:

- Provide £20m in financial assistance to Coventry and Warwickshire Businesses
- Create just over 1400 jobs
- Support over 360 small and medium businesses

**Recommendations:**

**Cabinet is asked to recommend that Council:**

1. Agree to capital investment of £2m in the Coventry and Warwickshire Duplex Fund in the form of a loan arrangement.

2. Delegate authority to the Executive Director Place and the Section 151 Officer in consultation with the Cabinet Member for Strategic Finance and Resources and the Cabinet Member for Jobs and Regeneration to:
   - Negotiate the detailed terms of the loan arrangement and appropriate security, ensuring state aid compliance.
   - Make such amendment and variations to the loan arrangement as is deemed necessary over the lifetime of the loan period subject to the overall capital investment not exceeding the sum of £2 million pounds.

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**List of Appendices included:**

*None.*

**Other useful background papers:**

*None.*

**Has it been or will it be considered by Scrutiny?**

*No*

**Has it been or will it be considered by any other Council Committee, Advisory Panel or other body?**

*No*

**Will this report go to Council?**

*Yes, 14 March 2017*
1. **Context (or background)**

1.1 The Coventry and Warwickshire Duplex Fund (Duplex Fund) is being proposed by Coventry and Warwickshire Reinvestment Trust (CWRT) who are the local Community Development Financial Institution; a local, not for profit lender for both business and personal customers.

1.2 CWRT has previously delivered small business loan programmes on behalf of the Council / Coventry and Warwickshire Local Enterprise Partnership (CWLEP) and are currently running a small business loans programme for Warwickshire County Council (WCC).

1.3 The Duplex Fund will offer a new type of financial product which has the potential to support a large number of local businesses, and if successful could act as a pilot for a model that could be adopted nationally. The product would be available to small and medium enterprises (SMEs) and consists of a mixture of grant and loan funding.

1.4 The net effect for the applicant business is a very attractive loan arrangement. Coventry City Council’s Legal Team has reviewed the proposals to date, and will ensure that the arrangements put in place are legally compliant when the fund is made available for businesses.

1.5 The Duplex Fund proposal will cover the entire CWLEP area, and will operate for a total of ten years.

1.6 The proposed public investment in the scheme will come in the form of:

   o £4m in loans from local authorities in the CWLEP area, including £2m from Coventry City Council covered in this report.

   o £5.4m in grants from UK government sources such as Growth Deal. Suitable grant funding to support the first five years of the fund’s operation is readily available.

1.7 This investment could allow the Duplex Fund to:

   o Provide £20m in financial assistance to Coventry and Warwickshire Businesses in the form of loan and grant arrangements

   o Create just over 1400 jobs

   o Support over 360 businesses

1.8 In comparison to grant funding, the Duplex Fund will be far more efficient in terms of economic impact for public investment. A standard benchmark for jobs created by traditional publicly funded business grants schemes is £10,000 per new job. The expectation is that the Duplex Fund will create a new job for every £3,000 that is invested in the fund, offering far better value for money than a grant-only scheme.

2. **Options considered and recommended proposal**

2.1 The Council could choose to decline the opportunity to invest in the Duplex Fund, and continue with its existing business support programmes. Currently, the Council is running a
European funded Business Support Programme which offers grants to businesses as part of a wide range of support activities. The programme is the cornerstone of the Council's business support activities, and is expected to make a very important contribution to the local economy over its lifetime. However, relying solely on existing provision is not the preferred option for two reasons. Firstly, although Government has announced that it will bankroll European funded projects until at least December 2018, the referendum result last year means that EU funding cannot be relied on for medium-long term planning. Secondly, it is important that access to finance provision is expanded beyond simply providing grant funding. Grants are attractive to businesses and should form part of the overall picture, but the Council must invest in other forms of support which allow the initial public investment to be recouped and reinvested many times.

2.2 Another option would be for the Council to run a loan scheme or the Duplex Fund itself without forming a partnership with CWRT. This option has been discounted because any organisation which wishes to offer loan facilities of this type must be licensed by the Financial Conduct Authority (FCA). Although there are some exceptions allowing Local Authorities to make loans, this would involve the appointment of staff with specialist knowledge which CWRT already employs. This option would put the Council in competition with CWRT and could undermine a valuable community asset.

2.3 The preferred option is for The Council to work in partnership with CWRT and WCC to establish a fund that covers the entire CWLEP area, and has access to the necessary expertise from the start to make it a success. The Duplex Fund would provide an important step towards life after European funding, and would also show partner's willingness and ability to provide access to finance facilities beyond traditional grant funding.

2.4 The Council’s loan offer to CWRT will be structured so that the performance of the Duplex Fund can be reviewed annually, with the option for the Council to withdraw from the fund if the performance is not satisfactory. The first two years of will effectively form a pilot to test the operation of the scheme.

2.5 The loan agreement will also stipulate that only Coventry businesses will be supported; WCC’s investment in the scheme, which is currently being discussed as part of their budget setting proposals will be used to support businesses in the County and give full Coventry and Warwickshire coverage. It would be possible to run a “Coventry-only” version of the scheme, but the preference of all partners is to cover the entire Local Enterprise Partnership Area.

2.6 The current proposal is that the Council will offer a loan to CWRT on the following basis:

- £2m total loan value
- Revolving facility, allowing CWRT to borrow and repay as required over the ten-year lifetime of the fund.
- Interest will be payable to the Council at a commercial rate. This rate will only be approved once a detailed state aid assessment has taken place to ensure that it is compatible with the market for this type of finance.

3. Results of consultation undertaken

3.1 The Council’s business support staff, and those at partner organisations have been discussing the potential for a Duplex Fund with SMEs for almost a year. This “soft market testing” has shown that there is a real demand for businesses for a fund of this type.
Although grant funding often dominates the landscape of publically funded access to finance activities, the demand for borrowing from SMEs amounts to over £24bn a year.

4. **Timetable for implementing this decision**

4.1 Once the Council’s investment in the fund is approved, the Executive Director, Place will to negotiate the details of the loan which will be provided to CWRT. In parallel, officers at WCC are proposing that investment in the Duplex Fund is included in the County’s capital programme. The target is that legal agreements will then be drawn up between the Council, WCC and CWRT to allow the fund to open for business over the summer.

5. **Comments from Director of Finance and Corporate Services**

5.1 **Financial implications**

The loan required by CWRT is proposed to be funded from corporate capital resources. There are no net financing costs for the Council’s investment in the scheme as the Council will receive a higher return on its loan than the equivalent current borrowing cost, such that it will generate a modest amount of income during the lifetime of the fund. The interest rate charged to CWRT will need to be kept under review to ensure this remains the case.

There are of course some financial risks involved, as there are when entering into any loan agreement. These risks and how they can be mitigated are covered in Section 6.2 of this report.

Finance officers will be closely involved with the monitoring of the fund, and with the recommendation to members about whether to proceed after the pilot phase.

External grant funding will be sought to fund the interest element of the loans provided to SME’s, a significant element of which is already secure.

5.2 **Legal implications**

5.2.1 There are various statutory powers available to the Council when considering to make a grant and/or investment, they are:

- The Council has a specific power to invest under Section 12 of the Local Government Act 2003; and

- The Council also has a general power to make investments/and or a grant under the powers of general competence contained in Section 1 of the Localism Act 2011.

5.2.2 The loan of 2 million is for a “commercial purpose” for the purposes of the Localism Act 2011.

5.3 **State Aid risk**

5.3.1 Article 107 (1) of the Treaty on the Functioning of the European Union ("Treaty") states: 
"...any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market."
5.3.2 The Treaty does not define in any more detail what constitutes state aid. However, the term has been interpreted to include the provision of grants, loans on favourable terms, the transfer of assets at less than the market rate, and tax advantages. Not all state aid is unlawful, and it is possible to justify some types of financial assistance under pre-approved mechanisms.

5.3.3 It is possible that a third party (and/or European Commission) who has not received state aid could bring legal proceedings in the UK courts for damages. Such a claim could, for example, be brought by a competitor who feels it has suffered loss because it has not been given aid.

5.3.4 A recipient can be ordered to repay all aid received over a ten-year period if the European Commission finds it has been provided unlawfully. It is no defence that repayment may force the recipient into insolvency.

5.3.5 Market Economy Investor Principle ("MEIP") can provide an appropriate mechanism to potentially justify aid to any third party following the Council's loan. A Loan does not automatically constitute state aid if the Council carries out prior due diligence that demonstrates that investments are likely to generate sufficiently high returns and that a private prudent investor would have made the same investment. i.e the Council can invest in the proposal in return for an appropriate commercial return which would satisfy the expectations of a private prudent investor.

5.3.6 The risk of state aid is not dependent upon whether the financial return is actually ever achieved by the Council, as whether state aid exists or not is assessed at the time of the funding advanced, but there must be a realistic prospect of the financial return being achieved by the Council.

5.3.7 Accordingly the Council will be inserting relevant provisions within the loan documents and undertaking a detailed state aid analysis in order to mitigate the risk of a state aid challenge.

6. Other implications

6.1 How will this contribute to achievement of the Council's Plan?

This Duplex Fund will make an important contribution to the Council's aim to support the growth of local businesses as set out in the 2016 Council Plan. It will also form part of the way in which the aims of CWLEP's Strategic Economic Plan (SEP) are realised. The SEP calls for the establishment of a business investment fund which supports the expansion of businesses where traditional funding sources are failing, and the Duplex Fund will form an important part of that provision.

6.2 How is risk being managed?

There is always a risk associated with the provision of any loan to a third party. One such risk could be that either the capital or interest repayments cannot be met by the borrower, which would leave the Council as the lender out of pocket. There are ways in which these risks can be mitigated:

- Repayments due to the Council from CWRT rely on the Duplex Fund operating as planned, including the successful collection of repayments due against the loan component of the awards to applicant businesses. No loan fund ever collects 100% of the capital or interest repayments due to it, and the CWRT’s forecasts for the fund
have write-offs built into their financial forecasts. Even with these write-offs taken into account the fund is expected to be in a position to make its repayments to the Council.

- The interest rate charged by the Council will be set in a way that reflects the overall risk in the establishment of the fund and provide an appropriate financial return.

- The Duplex Fund’s governance will be established so that Council officers with the appropriate background are strongly represented on the Credit Committee that awards funding through the programme. This should reduce the risk that the loans from the Duplex Fund are not repaid, which could in turn place the Council’s investment at risk.

- The Council will be seeking appropriate security for the loan which form part of the state aid analysis.

- The loan facility will be “revolving”, meaning that CWRT can repay and re-borrow funds as necessary to maintain the fund’s operation. This reduces risk for both parties because the Council’s exposure to the loan would be reduced, and it will also reduce the borrowing costs to CWRT.

- The loan facility will be granted so that the cash will be made available to CWRT in tranches over the early years of the fund’s operation. This will considerably mitigate risk to the Council.

6.3 What is the impact on the organisation?

There are no Human Resources or other impacts expected as a result of this proposal. Some existing staff in Place directorate will be asked to serve on the Duplex Fund Credit Committee, but this will be within the scope of their existing job description and will not require recruitment or any special training.

6.4 Equalities / EIA

This proposal is not expected to have any negative equalities impact.

6.5 Implications for (or impact on) the environment

This proposal is not expected to have any negative environmental impact. Access to Finance support can produce a positive environmental impact as companies often replace old inefficient buildings or equipment with newer ones that have fewer negative effects on environment.

6.6 Implications for partner organisations?

WCC have been approached by CWRT with a similar investment proposal to allow the fund to cover Warwickshire as well as Coventry. Should WCC choose to invest an assessment of the risks and benefits will have to be made in the same way as it would for any Local Authority investment.

CWRT would benefit from the establishment of the fund because it would provide them with the certainty of a ten-year programme (subject to break clauses) and give them the backing of the area’s two upper tier Local Authorities. No negative implications are expected for CWRT.
Conversely, because CWRT are the only community lender of this type in Coventry and Warwickshire, the establishment of the fund will not place other local organisations in difficulties.

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**Other members**

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