

Creation of a Pan Scotland Local Authority Business Loan Fund – Progress Update

Report by Ian Johnson, Head of Communities and Economy

1 Purpose of Report

- 1.1 The purpose of this report is to provide an update on progress with the creation of a Pan Scotland Local Authority Business Loan Fund (Business Loans Scotland) and to outline the course of action that has been taken, to date, in terms of Midlothian Council's participation in the new Loan Fund.

2 Background

- 2.1 At its meeting on 31 May 2016, Cabinet considered and approved the content of a report entitled 'Creation of a Pan Scotland Local Authority Business Loan Fund'.
- 2.2 The report highlighted that since Autumn 2014, detailed discussions have been underway at a national level to create a Pan Scotland Local Authority Business Loan Fund modelled on the successful East of Scotland Investment Fund (ESIF) and the West of Scotland Loan Fund (WSLF). These discussions have involved representatives from the Scottish Local Authorities Economic Development Group, the Scottish Government and the Fund Managers for ESIF and the WSLF. A collective bid from Scottish Local Authorities has been actively encouraged by the Scottish Government. The initial aim was to have the new Fund operational from April 2015, with lending commencing around July 2015. Unfortunately a time lag has been encountered during the setting up process due to delays regarding the availability of European Structural Funds support and the associated tendering process. However, these issues have now been resolved and the operating contract was signed off by the Scottish Government in late October 2016 with an effective project commencement date of 1 November 2016.
- 2.3 No formal launch date has yet been set for Business Loans Scotland although it is anticipated that there will be a Ministerial launch in the near future to formally declare the Fund open for business. A website has been established for the Fund and it will be launched in the near future. Fund marketing material is also currently being finalised. Whilst access to the Fund will be available for a wide range of Midlothian businesses, it is planned that intensive marketing efforts will centre on businesses along the Borders Railway corridor and also businesses in and around the Midlothian Science Zone (Easter Bush area). This will give a degree of complementarity with existing and planned economic development related initiatives in both of these areas.
- 2.4 Business Loans Scotland will build on the successes of the East of Scotland and West of Scotland Loan Funds. Midlothian Council has been involved in ESIF since its inception in 2010. ESIF comprises nine Councils which have worked together to provide loan finance to new and growing businesses within the East of Scotland. The Council's Economic Development Manager has served as a member of the ESIF Board and also it's Corporate Working Group.

- 2.5 The West of Scotland Loan Fund has operated since 1996 and together with ESIF, these Funds have made a substantial contribution to economic development and business support / growth in East and West Scotland in line with national, regional and local strategies.
- 2.6 In terms of background to the establishment of the new Fund, on 5 January 2016, the tender for the “Fund Managers Service for the Scottish Government” was published in the Official Journal of the European Union (OJEU) and on the Scottish Government’s Public Contracts Scotland website. The Scottish Government sought to competitively select up to six organisations to become Fund Managers, with at least one Fund Manager for microfinance, at least one for debt finance and at least one for early stage equity. Business Loans Scotland targetted the debt finance strand. The Scottish Government held an Open Day on the procurement process on 15 January 2016 and on 3 February 2016 a Pre Qualification Questionnaire (PQQ) was submitted to the Scottish Government by Business Loans Scotland. On 11 March 2016, the Scottish Government advised that Business Loans Scotland had been successful in qualifying from the PQQ stage of the Fund Managers Service. The tender was released on 21 April 2016 with a closing date of 26 May 2016. The initial tender encompassed the delivery of a Fund size of £ 11.75 million by a contract end date of 31 December 2018. Unfortunately due to delays and slippage in the contract delivery period, which were out-with the control of the participating Local Authorities, it simply was not possible to accept the initial offer of European Regional Development Fund (ERDF) support to deliver a Fund size of £ 11.75 million. After careful deliberation and consultation amongst participating Local Authorities, a revised Loan Fund size of £ 7.158 million with a corresponding management fee of £ 0.975 million was notified to the Scottish Government on 5 October 2016. On 17 October 2016, notification was received that the Scottish Government had accepted the reduced Fund size with a contract commencement date of 1 November 2016 and end date of 31 December 2018.
- 2.7 Once fully established and operational, Business Loans Scotland will be a consortium of most of Scotland’s 32 Local Authorities, incorporated as a company limited by guarantee and providing loan finance of up to £100,000 to new and growing small and medium sized enterprises across Scotland. Details of the proposed operation of the new Loan Fund, a draft Business Plan 2015-18 and a Members Agreement in respect of the operation of the new Fund have previously been placed in the Members’ Library. It should be noted that the documentation is currently subject to update and refinement prior to the anticipated formal launch of the new Fund. A copy of the latest Financial Model for the Fund has been placed in the Members library. Additional documentation will follow when available.
- 2.8 Key points to note from the Business Loans Scotland Fund documentation include:
- A new company, limited by guarantee, was incorporated in December 2014 with the name Scottish Local Authority Business Loan Fund, with the option to trade as Business Loans Scotland.
 - A Members’ Agreement and new Articles of Association have been drafted for adoption by the new company. These documents will regulate the running of the new company. Copies of the documentation have previously been scrutinised and approved by staff in the Council’s Legal Section.
 - The existing business and assets of the West of Scotland Loan Fund and the East of Scotland Investment Fund will be transferred to the new company.

- Any cash contained within the West of Scotland Loan Fund and the East of Scotland Investment Fund, together with monies received from debtors in these companies will be transferred to the new company. **It is emphasised that monies allocated to a Local Authority will be held exclusively for that Local Authority. Additional funds are not being requested from the Council for Business Loans Scotland;**
- The new Loan Fund is seeking to benefit from an award of £ 3,253,200 from the European Regional Development Fund. Matched with funding from a Bank Term Loan (either Royal Bank of Scotland or Bank of Scotland) of £ 1,094,800 and financial contributions from Member Authorities totalling £ 3,785,000, a Loan Fund of £ 7,158,000 will be created to be invested over a contract length period to 31 December 2018. The management fee for managing / overseeing the Fund totals £ 975,000. The Loan Fund plus management fee totals £ 8,133,000. Revisions are currently being made to targets such as investment, supported businesses and job creation to reflect the reduced timeline of the Fund. It is anticipated that these revised targets will be available in the near future.
- Fund management duties will be undertaken by staff from the WSLF management services.
- The Fund and its Local Authority members will operate across three regional delivery areas covering the whole of Scotland. These are East, West, and Highlands and Islands areas; and
- The Fund's governance structure will consist of five elements:
 - i) The Board of Directors.
 - ii) Corporate Governance Working Group.
 - iii) Regional Management Group.
 - iv) Regional Investment Panels.
 - v) Regional Officers Groups.

The Council's Economic Development Manager has represented the Council at meetings of the Business Loans Scotland Regional Management Group. Four Director nominations were sought to cover the undernoted East of Scotland areas:

- Fife.
- Edinburgh and the Lothians.
- Forth Valley.
- Aberdeen / Angus / Dundee / Perth and Kinross.

Edinburgh and Lothians will be represented by an Elected Member from The City of Edinburgh Council. With regard to Midlothian Council involvement in the governance arrangements for Business Loans Scotland, the Council's Economic Development Manager represents the Council on the Regional Management Group, the appropriate Regional Investment Panel(s) and the appropriate Regional Officer Group(s).

- 2.9 As is the current practice with ESIF applications made to the Council, the initial Business Loans Scotland application appraisal will be undertaken by suitably trained / briefed Business Gateway staff members from this Council's Economic Development Section. An appropriate report will be prepared for Cabinet recommending approval or rejection of the loan application. In line with the Fund's

Articles of Association and Members Agreement, final decisions for loans between £50,000 and £100,000 will be the responsibility of the (currently being formed) Regional Investment Panels.

- 2.10 The new Fund will use a web based online loan application system, allowing loan applications, appraisals, compliance checking, approval, drawdown, customer care and monitoring to be undertaken online. Appropriate staff training has recently commenced to effectively utilise these systems.

3 Report Implications

3.1 Resource

In terms of human resource implications, participation in the new Fund will be undertaken by Economic Development Section staff, particularly those staff working on Business Gateway issues, in close liaison with Council officer colleagues and the managing body for the new Fund. Business Gateway staff will be involved in loan application appraisal and monitoring.

In addition, the Council will be represented by the Economic Development Manager on the undernoted Business Loans Scotland governance groups:

- Regional Management Group
- Regional Investment Panel(s)
- Regional Officer Group(s)

With regard to financial resource implications, the (draft) Business Plan 2015-18 for the new Local Fund highlighted an ambition to put in place an overall Fund of circa £18 million. This figure has been revised substantially downwards, due to delays in setting up the Fund which has reduced the effective operating period, to £ 8,133,000 and comprises:

- £ 3,253,200 European Regional Development Fund support;
- £ 1,094,800 Bank Term Loan funding support; and
- £ 3,785,000 Member Authorities funding support.

Each Council will transfer the balance from its current business loan accounts into the new Fund. For Midlothian this would comprise funds currently held in its East of Scotland Investment Fund. Figures previously highlighted in the Members Agreement, prepared by Wright, Johnston and Mackenzie (Solicitors) on behalf of Business Loans Scotland showed that Midlothian's anticipated size of Fund was likely to be circa £ 350,000. However, this figure has recently had to be revised downwards to £ 225,000 to take account of the shortened time period of the Fund. To leave the Fund level at £ 350,000 would have run the risk of the target figure not being met by the close of the shortened Fund period.

3.2 Risk

There is a risk that the Council's failure to participate in the new Loan Fund will reduce the potential access to loan funding to enable Midlothian based businesses to develop and grow. Midlothian Council's participation in ESIF has been active since December 2010.

In any loan scheme of this nature, there is an inherent risk that businesses will default on loan payments. This risk will be mitigated by rigorous credit checks, due diligence controls, the taking of appropriate security and regular after care monitoring visits. The (draft) Business Plan for the new Fund proposes the implementation of a debt management policy with the aim of acting swiftly to safeguard the interests of the Fund.

There is also a relatively low risk that the Fund contract will be terminated, at some stage, by the Scottish Government during the contract period. If that eventuality did occur then the ESIF and WSLF Boards would have to reconvene to consider an alternative course of action. One option might be the continuation, in some shape or form, of both Loan Funds.

3.3 **Single Midlothian Plan and Business Transformation**

Themes addressed in this report:

- ☐ Community safety
- ☐ Adult health, care and housing
- ☐ Getting it right for every Midlothian child
- ☒ Improving opportunities in Midlothian
- ☒ Sustainable growth
- ☒ Business transformation and Best Value
- ☐ None of the above

3.4 **Impact on Performance and Outcomes**

A supportive business environment is a strategic priority highlighted in the Scottish Government's Economic Strategy. The Strategy includes the provision of advice and support to help small and medium sized enterprises grow. This supports Ambitious Midlothian (Midlothian Economic Recovery Plan) and the Single Midlothian Plan 2016/17 by contributing to economic growth and business support within Midlothian.

3.5 **Adopting a Preventative Approach**

In assisting businesses to grow, the new Loan Fund may save the business from ceasing to trade and may, as a consequence, safeguard jobs as well as create them.

3.6 **Involving Communities and Other Stakeholders**

Appropriate consultation has been undertaken with other Council staff during the preparation of this report. Once the new Loan Fund is fully operational, staff from the Fund management body will be fully consulted throughout the application process and be fully advised of caseload developments.

3.7 **Ensuring Equalities**

Appropriate checks will be undertaken to ensure that applicants comply with employment legislation.

3.8 **Supporting Sustainable Development**

All businesses participating in the new Loan Fund will be informed about services to enable their uptake of good environmental practice. This has been standard practice during the operation of ESIF. Relevant schemes include the Green Ticks scheme

operated by the Business Partnership. The proposed funding model for the new Loan Fund consists of investment in the Fund by Member Authorities, a Bank Term Loan (to be advised) and the European Regional Development Fund. The proposed revolving nature of the new Fund, consisting of capital and interest loan repayments, will help to ensure its sustainability as successive generations of borrowers meet their debt obligations to the Fund.

3.9 IT Issues

There are no IT issues although it should be noted that it is planned that the new Fund will use a web based online loan application system. It is not anticipated that this will pose any problems from an IT perspective.

4 Recommendations

4.1 It is recommended that Cabinet:

- Notes progress with the establishment and operation of Business Loans Scotland, in particular the revised Fund size of £ 8.133 million;
- Agrees that the Council continues to fully participate in Business Loans Scotland activities;
- Agrees that the Council's Economic Development Manager continues to represent the Council's project governance interests on the Business Loan Fund Regional Management Group, appropriate Regional Investment Panel(s) and appropriate Regional Officer Group(s); and
- Requires that further progress reports be submitted to Cabinet to advise on the establishment, development and operation of the proposed new Pan Scotland Local Authority Business Loan Fund.

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Background Papers:

Scottish Local Authorities Business Loan Fund