

ANGUS COUNCIL

POLICY AND RESOURCES COMMITTEE – 7 JUNE 2016

EAST OF SCOTLAND INVESTMENT FUND AND BUSINESS LOANS SCOTLAND LTD

1. OVERVIEW

- 1.1 This report updates Committee on the East of Scotland Investment Fund (ESIF) and the establishment of its successor, Business Loans Scotland Ltd (BLS). Both organisations were established to offer business loans to small and medium sized enterprises. The report also explains why BLS will not be active in Angus.

2. BACKGROUND

- 2.1 There has been a loan fund available to Angus businesses since 1997. Originally it was the Angus Loan Fund, started by a contribution of £30,000 from Angus Council and an equivalent amount from Scottish Enterprise – total £60,000. In 2010 the Angus Loan Fund was closed with £44,000 of cash reserves transferred to ESIF – a new fund created by ten east of Scotland local authorities - and an outstanding loan of c£13,000, subsequently fully repaid, transferred to Angus Council.
- 2.2 Reference is made to Article 8 of the minute of meeting of the Development and Enterprise Committee of 20 January 2015. The Committee agreed:-
- (i) to approve, in principle, that Angus Council participate in the National Loan Fund (NLF), a new company, and become a member of the NLF;
 - (ii) to authorise the Service Manager – Economic Development, in consultation with the Head of Legal and Democratic Services and the Head of Corporate Improvement and Finance, to agree with other Scottish local authorities the creation and operation of a NLF to support businesses;
 - (iii) the Service Manager – Economic Development in consultation with the Convener of Development and Enterprise, or the Depute Convener in her absence, be delegated to approve all loans offered to Angus businesses through the NLF;
 - (iv) the maximum loan from the NLF to Angus companies be set at £50,000;
 - (v) the proposal to wind up the ESIF and approve the transfer of remaining ESIF funds to the NLF;
 - (vi) to approve the allocation of an additional £50,000 into the NLF for Angus; and
 - (vii) to note that the Service Manager – Economic Development would inform the Committee of the progress in establishing and operating the NLF via future information reports.
- 2.3 The National Loan Fund (NLF) has been named Business Loans Scotland Ltd (BLS). It is a loan fund financed and operated by Scottish local authorities aimed at supporting small and medium sized companies with loans from £20,000 to £100,000. The basic European Union (EU) classification of a small company is one with 10 to 49 employees and a turnover from €2 to less than €10 million (approximately £1.58 million to £7.9 million). The classification of a medium sized company is one with 50 to 249 employees and a turnover from €10 million to less than €50 million (approximately £7.9 million to £39.5 million).

- 2.4 It should be noted that both ESIF and BLS are considered to be 'lenders of the last resort' ie potential borrowers should have exhausted all other means of raising finance, including bank borrowing. As a general rule ESIF and BLS will only fund up to 50% of the value of an investment project. Borrowers are expected to raise the rest of the finance from other sources and this would normally include a contribution from directors/shareholders.

3. CURRENT POSITION – EAST OF SCOTLAND INVESTMENT FUND

ESIF - Regional

- 3.1 ESIF issued a total of 105 loans with a value of £4,180,852 up to the end of 2015. From data gathered it can be confirmed the loans have helped create 331 new jobs, safeguard 633 jobs and the turnover of borrowers has increased by £21.7 million. It is anticipated the number of new jobs created will grow as more data is collected. It can be considered a creditable performance and demonstrates a need for such funding. However, the value of loans issued missed the target of £4.4 million which was required to retain all of the European Regional Development Fund (ERDF) monies drawn down to support the fund. As a consequence it was necessary to repay £219,148 of the £1,400,000 received from ERDF.
- 3.2 ESIF has declared 15 loans to be bad debts with a total of £443,864 owing to the company. A further 7 borrowers have missed loan payments, or asked for payments to be re-scheduled. It can be anticipated the number of bad debts will rise, with some of these struggling businesses failing to survive. While it is always disappointing to write-off loans, it has to be remembered ESIF is a 'lender of last resort' and as such has frequently offered loans to businesses with good projects but with greater risks than many other lenders are willing to accept. The original ESIF business plan was prepared with an allowance for bad debts of up to 20% of total lending and the application for ERDF support was submitted on this basis.
- 3.3 Each local authority continues to have any financial contribution to ESIF ring-fenced for use in its own area and representatives from the local authorities always make the final decision on whether loans should be offered. The exception to this is any loan from £50,000 to £100,000 which must have final approval from a panel consisting of 3 or more ESIF Directors.
- 3.4 ERDF support for ESIF finished at the end of 2015. In effect ESIF has stopped lending as it awaits the commencement of BLS, and hopefully approval of new ERDF financial support.
- 3.5 A small number of loans issued by ESIF have been £25,000 or less and made to individuals (acting as 'sole traders'). Such loans became classified as 'regulated loans' from 1 April 2014 when new legislation and the Financial Conduct Authority (FCA) came into being. This resulted in such loans being deemed as consumer credit and because of this ESIF and its Directors came under the control of the FCA. ESIF was initially granted a temporary licence to operate but this expired 31 March 2016. After extensive investigations into ESIF becoming 'authorised' by the FCA to offer and manage 'regulated loans', the Directors of ESIF made the decision at the end of 2015 that the process, the administrative burden on and the responsibilities of Directors would far outweigh any benefit to be gained from 'authorisation'. At this time ESIF had three 'regulated loans' loans on its books and the Fund Manager was instructed to find an 'authorised' third party willing to accept a transfer of these loans on agreeable terms. Such a party was identified and an outline agreement was negotiated. However, it was not possible to finalise a legal agreement to the satisfaction and comfort of both parties. Given the looming deadline of 31 March 2016 the Directors of ESIF took the reluctant decision to terminate the three loans and write-off the balances owing totalling £34,910. One of the loans was to an Angus company (see paragraph 3.9).
- 3.6 It is intended ESIF will continue as a company but will not provide any further loans. With the establishment of BLS, its role going forward will merely be managing the existing loan portfolio and collecting monies due. At appropriate times excess funds within ESIF will be transferred to BLS. It is anticipated that after around 4 years ESIF will cease to trade entirely and the company will be wound up. However, should BLS be unsuccessful with its ERDF bid the future of ESIF will need to be re-considered?

ESIF - Angus

- 3.7 Angus Council's contribution to ESIF was a transfer of £44,000 from the Angus Loan Fund and £6,000 from the Economic Development revenue budget. This was supplemented by a share of the ERDF monies amounting to £40,485 (total £90,485). Angus was the smallest contributor to ESIF making up less than 3% of the total contributions from the 10 east of Scotland local authorities.
- 3.8 Four ESIF loans have been made to Angus businesses with a total value of £85,000. The loans have provided part funding for project investment totalling £314,000.
- 3.9 Two of the borrowers continue to make regular payments. Unfortunately it has been necessary to write-off the other two loans before they have been fully repaid. As reported to the Development and Enterprise Committee 20 January 2015 (report 31/15 refers) a loan with an outstanding balance of £21,667, was declared a bad debt (initial loan £25,000). In March 2016 a 'regulated loan' to the value of £20,000 was terminated and written-off prior to the expiry of ESIF's temporary licence to operate (see paragraph 3.5). However, by that time the business had already ceased trading and had stopped making loan repayments. Action was taken to recover the loan, including freezing the company's bank account and an attempt to seize equipment left behind at the rented premises. However, asset value was minimal and there were other creditors. In effect and regrettably, regardless of the decision of ESIF Directors to terminate and write-off the loan because of a looming breach of statutory financial regulations, it would most likely have been declared a bad debt.
- 3.10 The positive aspects of the loans provided in Angus are that they have aided the creation of 14.5 full time equivalent jobs and helped safeguard 5 jobs. It is worth noting that the first loan to be declared a bad debt provided funding to a business to improve a leased property and equip it as a bakery/kitchen/café. Although the business failed, the improved 'ready to occupy' premises were ideal for a second new start bakery business. This business continues to trade successfully. There is also a second business operating from the improved site/property and between the two they have created 10.5 of the 14.5 new jobs reported.
- 3.11 The local authorities that failed to hit their loan targets were required to contribute to the repayment of the ERDF monies amounting to £219,148. Based on performance against target, Angus had to return £14,854 of the £40,485 allocated. In addition to this Angus has contributed £15,248 (2.3% of £750,000) to fund management costs over a 5 year period.
- 3.12 The following table provides a summary of all ESIF financial transactions relating to Angus (up to 31 March 2016):

Description	Income	Expenditure	Balance
Transfer from Angus Loan Fund	44,000		
Transfer from EcDev revenue account	6,000		
ERDF allocation	40,485		
Loan Repayments – capital and interest	12,800		
Total	£103,285		£103,285
4 loans issued – total value £85,000 - bad debt / write-off £41,677		85,000	
Fund management costs (5 years)		15,248	
Repayment of ERDF		14,854	
Legal fees – debt collection		2,999	
Total		- £118,101	- £118,101
			= - £14,816
<u>Projected Future</u> loan repayments – capital and interest	37,867		£37,867
Angus Council net assets currently held within ESIF			£23,051

- 3.13 The demand for loans in Angus from ESIF has been weak and, given the failure of two of the four borrowers, its success in Angus can be questioned. However, the facility to occasionally offer business loans to smaller companies with good investment projects, that have the potential to add value to the Angus economy, can be an important business support tool.

4. CURRENT POSITION – BUSINESS LOANS SCOTLAND LTD

BLS – National

- 4.1 BLS was incorporated 17 March 2015. Angus Council is now a Member of the company, along with all other Scottish local authorities. The Scottish Government remains supportive of a nationwide business loan fund and has been encouraging in the establishment of BLS. They are also encouraging the establishment of two additional funds with other parties. A fund for micro-businesses offering loans of up to £20,000 and a fund offering loans and equity investments above £100,000.
- 4.2 BLS is governed by a board of up to 12 directors, with three regional management groups operating below the main board - Highlands and Islands, west of Scotland and the east of Scotland. Each regional management group may put forward a maximum of 4 local authority representatives to sit on the board as directors. Angus Council is represented on the eastern management group by the Business Manager – Investment and Skills from the Economic Development team. Every local authority will have a representative on one of the regional management groups but not all will be represented on the board. There will be a Fund Manager and support team to administer the fund – these are staff transferred from the West of Scotland Loan Fund Management Services (who were and will remain fund managers for the ESIF and the West of Scotland Loan Fund).
- 4.3 It had been hoped that BLS would be operational in the second half of 2015. However, matters were delayed by a revised timetable to bid for funding from the ERDF 2014-20 programme. It was decided that bidding for funds had to be a tender process. BLS submitted a pre-qualification questionnaire to the Scottish Government and was then invited to submit a full tender bid. The bid, which is seeking £5.7 million of ERDF support towards a £14 million loan fund, is now with the Scottish Government and it is anticipated a contract will be awarded in June 2016. It is not known if there are any other bidders. Should BLS be successful with the ERDF tender bid, the fund should be open to applications within a month of notification of tender acceptance. If BLS is unsuccessful with the ERDF tender, further consideration will be given to the future role of BLS.
- 4.4 Each local authority will have its own contribution to BLS, and any European match funding, ring-fenced for use in its own area.

BLS – Angus

- 4.5 Angus Council officers have played an active role in the formation of BLS and were of the opinion that the £50,000 allocated to the project by the Development and Enterprise Committee 20 January 2015 should be invested in the new fund, thus making loans available to Angus businesses. However, over recent weeks the operation of BLS and the terms and conditions of loans and ERDF funding have been more clearly defined. After careful consideration, the Service Manager – Economic Development, in consultation with the Head of Legal and Democratic Services and the Head of Corporate Improvement and Finance, is now of the opinion that Angus Council should remain a Member of BLS but it should not, at present, invest in the company. As a result Angus Council, along with two other local authorities that have also chosen not to commit funds, will be classified as an Associate Member of BLS.
- 4.6 The reasons for not investing in BLS at the present time are:
- There was little demand from Angus businesses for ESIF loans and there is no evidence that demand will increase with the launch of BLS.
 - The criteria for borrowing from BLS are more restricted than originally anticipated (thus lessening demand further). Borrowers, as well as demonstrating a viable business project, must now demonstrate growth and export potential (defined as trading outside of Scotland).

- The minimum BLS loan value is to be £20,000 – it would have been preferable for the minimum loan to be £15,000.
 - Borrowing from BLS will not be available to micro- businesses. Most Angus businesses are classified as micro-businesses - the basic EU classification of a micro-business is one with 9 or fewer employees and a turnover below €2 million (approx. £1.58 million).
 - It could be difficult to achieve ERDF targets, which would result in the repayment of ERDF grants (as happened with the ESIF).
 - There will always be financial risk in loaning to businesses, as evidenced by the record of ESIF in Angus. Consideration needs to be given as to whether the outcomes outweigh the risks and potential losses.
 - There would be considerable call on officer time in training to become familiar with BLS procedures, promoting the loan fund and managing what would be a relatively small number of loans (say 4 to 6 in Angus over an initial 30 month period).
- 4.7 While businesses in Angus will not have access to loans from BLS, which will be promoted as a national loan fund, officers will be able to direct businesses to other sources of finance, including the new micro-finance loan fund that will be launched at approximately the same time as BLS. Angus Council, as one of only three Scottish local authorities not investing in BLS, may be open to criticism of failing to offer a national loan fund in the area and not drawing down ERDF monies to the value of c£40,000. However, there will be the opportunity to invest in BLS at a future date if sufficient demand is identified.
- 4.8 The funds already ringfenced for BLS ie £50,000 was to be transferred to BLS if the ERDF tender submitted to the Scottish Government were accepted. £50,000 was carried forward from the 2014/15 Economic Development revenue budget into 2015/16 and then carried forward again into 2016/17.
- 4.9 Consideration will now be given to whether the £50,000 is held pending a future transfer to BLS or if this could be better used to support local businesses via an alternative business support programme. A further report will be brought to committee with recommendations.
- 4.10 Consideration will also be given to accessing and utilising the Angus assets held within ESIF. Assuming both existing loans are fully repaid this will amount to £23,051, less any charges yet to be incurred. A further report will be brought to committee with recommendations.

NOTE: The background papers, as defined by Section 50D of the Local Government (Scotland) Act 1973 (other than any containing confidential or exempt information) which were relied on to any material extent in preparing the above report are:

- Article 15 of the minute of the meeting of the Infrastructure Services Committee of 13 October 2009.
- Article 15 of the minute of the meeting of the Infrastructure Services Committee of 14 June 2012.
- Article 6 of the minute of the meeting of the Infrastructure Services Committee of 9 October 2012.
- Article 8 of the minute of meeting of the Development and Enterprise Committee of 20 January 2015.

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