

To: Customer & Communities Policy Overview & Scrutiny Committee

By: Mike Hill, Cabinet Member Customer & Communities and Amanda Honey, Corporate Director Customer and Communities

Date: 20 January 2012

Subject: Kent Big Society Fund

Classification: Unrestricted

Summary: This report informs Customer & Communities POSC of progress on Key Decision number 11/01755 which was taken by the Cabinet Member for Customer & Communities on 16 December 2011. The decision is to agree to make a charitable donation of £3m with conditions (sequenced annually) to the Kent Community Foundation to establish and operate the Kent Big Society Fund, a loan finance scheme for social enterprises in Kent.

The on-going relationship with the Kent Community Foundation concerning the Kent Big Society Fund will be managed by Customer & Communities Directorate.

1. Background

Bold Steps for Kent, the Medium Term Plan until 2014/15 committed KCC to establishing a Kent Big Society Fund to support the development of new and existing social enterprises. County Council agreed a one-off budget allocation for the Big Society Fund of £5million in February 2011. In developing options for the establishment of the Kent Big Society Fund, it was further considered important that:

- a) The Kent Big Society Fund should support the transformation in the shift in the voluntary, community and social enterprise sector from dependency on grant towards more sustainable business models, including supporting them in managing the increased use of payment-by-results contracts within the public sector.
- b) That it should be principally a social finance loan scheme as the best mechanism to create a recyclable fund and maximise the longevity of the fund and resources available.
- c) That in order to make the fund attractive to other funding philanthropic and government funding sources, it should seek a partner with an existing social finance intermediary to operate and manage the fund and that any partner should be Kent based.

Having considered the limited options available given the relative immaturity of the social finance sector, it is recommended that KCC should establish the Kent Big Society Fund through the Kent Community Foundation (KCF).

Kent Community Foundation is a registered charity with the Charity Commission for England and Wales. Charities are permitted to accept donations with terms or conditions so long as those conditions do not breach or bring into question its charitable status. The decision to accept conditions is a matter for the trustees of any charity. It is proposed that the establishment of the fund and the transfer of monies to the KCF are undertaken through making a charitable donation to the KCF with conditions. The conditions being the establishment of the Kent Big Society Fund to the principles and operating model set out in this report, and in a formal agreement between KCC and the KCF to be agreed by the Director of Law and Governance.

2. Relevant priority outcomes

The relevant priority outcomes for the Kent Big Society Fund are:

- That new social enterprises are either created or existing social enterprises become more active in Kent which will benefit the economic, social and environmental vibrancy of Kent and the quality of life for its residents.
- Social enterprises accessing the Kent Big Society Fund are making a visible contribution to helping Kent residents by providing greater employment opportunities.
- The Kent Big Society Fund is, in whole or in part, recyclable, as social enterprises repay loans made by the fund which are then used to fund further loans
- Additional monies are leveraged from other sources such as Big Society Capital (the Government's proposed Big Society Bank)
- Promotes a greater balance between the social and voluntary sector and the private and public sector in Kent

3. Financial Implications

A one-off allocation of £5million for the Big Society Fund was agreed at County Council in February 2011. In considering options for the establishment of the Kent Big Society Fund two issues have become clear. First, whilst there is an expectation of demand for social finance from existing and new social enterprises, that demand cannot be guaranteed and may not materialise to the level anticipated. Secondly, the financial commitment from KCC is significant compared to other schemes established across the local government sector and a £5m commitment might prove excessive given the relative immaturity of the social finance market. Other local authority arrangements include:

- Essex County Council has established a £1.4m Big Society Fund linked to the creation or improvement of new community assets or community initiatives through a rebranded version of their 'Community Initiatives Fund'
- Oxfordshire County Council has established a £600k Big Society Fund to support their budget strategy around youth, community transport, day initiatives and assets linked to voluntary and community provision of services around these areas.
- The Mayor of London has committed £2m of Greater London Authority monies to support greater volunteering in London with match funding from the Reuben foundation.
- The London Borough of Wandsworth has established a £200k Big Society Fund for community projects (on a match funded basis).

- West Lyndsay District Council has pledged £4.5m for Big Society projects, but the immediate budget allocation is £1.25m for a community assets fund, and £150k for a loan finance scheme.
- Buckinghamshire County Council has committed £350k to support the establishment of a Big Society Bank providing social finance facilities.

Given the above, it is proposed the total commitment to the Kent Big Society Fund from KCC should be capped at £3million and that the sequencing of monies to KCF should be sequenced annually (see paragraph 8.1) so that should the expected demand to the Kent Big Society Fund not materialise, KCC will be free to reconsider any further planned donations into the fund. Members should be aware that in the model the interest received on each loan made through the fund is used to recapitalise the fund and provide further loans.

KCC is currently considering options around utilising the remaining £2million earmarked in the 2011/12 budget against the Big Society Fund to respond to the significant growth in youth unemployment in the County. This clearly aligns to the intended outcomes set out in *Bold Steps for Kent* to support young people out of welfare dependency and into employment, but will be subject to a separate key decision.

4. Legal Implications

KCC will use the Wellbeing powers conferred to principal authorities under Section 2 of the Local Government Act 2000 to make the charitable donation to the KCF. To use the Wellbeing provisions in this way it is necessary to have due regard to Sustainable Community Strategy. The Sustainable Community Strategy for Kent 2011-2021 aligns closely with the aims and ambitions set out in *Bold Steps for Kent*. The draft Sustainable Communities Strategy identifies supporting social enterprises as a priority stating *“We are working with representatives of the voluntary and community sector at both county and district levels to enhance the sector’s capacity so that it can become more innovative. We have ambitious plans to encourage the growth of charities and social enterprises that can take on more responsibility for providing services”*

Using the Wellbeing provisions for this purpose matches similar approaches adopted by other authorities in establishing similar social finance schemes. However, it is important to note that once monies are transferred to KCF to create the Fund, full legal responsibility for those monies becomes a matter for the trustees of KCF and it will not be possible to reclaim monies once donated.

5. What will the Fund do?

Given the charitable status of KCF, in particular the ability to provide significant tax and gift aid financial incentives to corporate and private donors investing through the Foundation. KCF’s structure lends itself well to supporting the aim of leveraging additional monies into the fund from a range of philanthropic and other sources. KCF’s network and contacts place it in a strong position to use this network to leverage additional monies into the fund where possible.

The fund will predominantly make unsecured loan finance available to new and existing social enterprises that have a robust and sustainable business case which meets the aims of the fund. Where the finance is used to secure property to support

the social enterprise, KCF may take a charge on that property in order to secure an 'asset lock' to ensure the proceeds from any sale of that property are then used to support the purpose of that social enterprise, which is common in the social financing sector. There may be some scope for providing an element of grant funding alongside loan finance in order to support development of business plans/new enterprise where appropriate. This will be decided on an application-by-application basis, but the ratio will be weighted towards loan financing, and would not be expected to exceed 4:1. Offering an element of grant funding may be used to stimulate enterprise in particular priority areas such as reducing youth unemployment.

6. Interest Rate on Loans

Repayment periods and interest rates will be decided on a range of factors and will take into account the strength of the business case put forward by the applicant. Most loans are expected to be for between 2-5 years. The interest rate range will normally be between 12-15% (APR). Such a range remains competitive compared to similar unsecured loans offered within the social finance market. The Big Society Fund is likely to be meeting demand currently not provided for by commercial banks, given the fund will not price for risk in the same way, and therefore direct competition is expected to be limited.

Some social finance providers have experienced difficulty with applicants using similar schemes as short-term bridging facilities limiting the ability of the lender to gain interest on the loan. Rather than put in place early redemption penalties across the board (when early repayment may benefit some applicants) many social finance providers require an upfront administration fee as a deterrent to using schemes in this way, which can then also be used to fund initial overheads relating to establishing loan and recharged to the loan amount if required. Where applicable, an upfront fee may be charged on loans made by the Big Society Fund, but where this occurs, a reduction in the APR will be calculated to compensate.

7. Eligibility for the Fund

There is no firm legal definition of a social enterprise as such bodies are defined by the social purpose they provide as opposed to their structure. A social enterprise might include:

- Charities
- Community interest companies
- Mutuels
- Co-operatives (part of mutuels)

This can include a variety of legal structures:

- Company limited by guarantee
- Company limited by shares
- Company limited by guarantee & registered charity
- Company limited by guarantee & registered CIC
- Company limited by shares & registered CIC
- Industrial & Provident Society- for benefit of community
- Industrial & Provident Society- bona fide co-op
- Limited liability partnership

- Charitable incorporated organisation
- Charitable Trust

To access the fund the social enterprise should be undertaking trading activities and these should form a significant part of its income (ideally with the aim of trading providing being 50% or more of the social enterprises income in the future), has a clear social purpose at its core and is noted in its articles of association or registration with Companies House or the Charity Commission, and where 50% or more of any profits are reinvested in support its social purpose. This aligns to guidance from the Chartered Institute of Finance and Public Accounting (CIPFA).

The fund will be accessible to any social enterprise that has a recognisable social purpose, is appropriately registered with relevant authorities and operates within the administrative boundaries of Kent County Council. As a social enterprise it will be supporting employment opportunities for Kent residents. Employment opportunity can mean full and part-time employment, voluntary work, work-based training, apprenticeships or other such employment related activity.

In practice, we expect the fund to be providing loan financing for:

- Existing small scale social enterprises that wish to grow their earned income to become self sufficient
- Charities or voluntary groups that want to increase income from payment from their activities, including those transitioning to outcomes based funding
- Social enterprises formed to transfer or build a physical asset, such as a community shop
- Completely new start up social enterprises
- New ventures specifically targeted at supporting highly disadvantaged or marginalised people (eg. ex offenders)

The Fund might not fund all social enterprises that apply to it. This maybe because the level of finance is beyond that considered acceptable relative to the business case submitted, or where there are specific pre-existing funding routes for the social enterprise, or where the enterprise would be better suited to funding through a commercial bank. The KCF trustees through the Investment Panel will have the right to refuse to provide loan finance as they see fit.

Social enterprises not registered in Kent are not precluded from making an application to the fund but the social enterprise for which the application is made must be evidently operating within the Kent County Council administrative area and be utilising the loan finance to benefit Kent residents.

The KCF will have responsibility for all due diligence in regards to applications made to the fund and assuring itself of the social purpose of any enterprise. The KCF will develop a triage process to ensure applicants meet the criteria for accessing the fund and business cases are sufficiently robust to proceed into the full application process.

The size of the loans provided will be decided on an application-by-application basis. However in order to maximise the longevity of the Fund there will be a minimum loan threshold of £10,000 to discourage spurious applications, whilst the maximum threshold should not normally exceed £100,000.

Where an application made to the Fund involves the proposed purchase of property or other capital investment the threshold might be increased but KCC would expect this to be on an exceptional basis and where the business plan is sound and confidence in repayment of any loan is high. KCF may seek a charge on the property and an 'asset lock' (see section 5).

The Fund will not exclude, restrict or preference access from social enterprises that might be seeking funding in support of utilising the Community Right to Challenge, Right to Provide and Community Right to Buy set out in the Localism Act. These applications will be judged on the same basis as any other application to the Fund.

8. Sequencing

As noted earlier, in order to manage risk it is suggested that the total commitment to the Fund be capped at £3million and sequenced on an annual basis, as set out below:

- Start up (January 2012): £1million
- 12 months (January 2013): £1million
- 24 months (January 2014): £1million

Before each annual donation is made, KCF will report to KCC on the operation of the Fund through an annual report which will include an analysis of the market appetite for ongoing financing from the Fund. KCC reserves the right not to make further donations to the Fund if market appetite is not evident, if it feels that the Heads of Term agreement has not been sufficiently adhered to by the KCF or if it concludes the Fund is not delivering the outcomes expected. However if appetite for the Fund is strong, and the need for additional funds are required to meet demand, KCC may choose to bring forward the donations if requested by the KCF.

9. Governance arrangements

Upon making the donation, responsibility for managing and operating the Kent Big Society Fund becomes the responsibility the trustees of KCF. However, KCF will establish an Investment Panel to develop Investment Strategy, which will set out the criteria and processes by which investment decisions are made (aligned to the conditions set out in this report and the formal agreement) to ensure openness and transparency. The Investment Panel will also decide on individual applications. The KCF will offer to co-opt two/three elected KCC Members, nominated by KCC, onto the Investment Panel. Ultimately, however, it should be recognised that the Investment Panel operates in an advisory capacity and the final responsibility lies with the trustees of the KCF.

In seeking to lever additional money into the Kent Big Society Fund from private and corporate donors, KCF might offer the opportunity for new donors to sit on the Investment Panel. The panel will remain broadly proportionate to the investment committed to the Fund, but may also include social entrepreneurs and other financial experts able to support policy development and investment decisions.

KCF will make an annual report to the County Council on the operation of the Kent Big Society Fund and will be willing to attend County Council or its Committees to discuss the operation of the Fund as necessary. KCF will report to the details of the decisions made and operation of the Fund to the relevant Cabinet Member (Cabinet Member for

Customer and Communities) after each meeting of the Investment Panel. This report will be available to all KCC Members, and should individual Members wish the operation of the Fund to be considered by a KCC Committee, can seek to add the issue to the agenda in the normal way.

Should KCF suggest altering the parameters of the Kent Big Society Fund (as set out in this report and formal agreement) in response to market conditions or to support leveraging additional monies into the Fund, KCF will notify KCC in writing of the suggested changes, reasons and timescale, so KCC can consider and agree to those changes before making further donations are made into to the Fund.

10. Key Fund

Kent Community Foundation will take full responsibility for the management and operation of the Kent Big Society Fund. KCF is developing its capability in social finance, as more Community Foundations across the country move towards social finance model in addition to their grant-making role. KCF propose to partner with an experienced social finance intermediary – the Key Fund – to provide back office support to support them in the shift towards a social finance scheme.

Whilst the contractual relationship will be between the Key Fund and the KCF and is not part of the formal conditions attached to the donation from KCC, this sub-contractual arrangement is an important part, in the first instance, of KCF capacity to run the Big Society Fund.

The Key Fund is a well established social enterprise which provides both social finance and business support to social enterprises. It has a strong track record over 12 years of developing and managing a social enterprise fund along very similar lines to the Kent Big Society Fund and KCF are keen to build a partnership with the Key Fund so they can benefit and learn from their experience where relevant, at least until the Kent Big Society Fund is well-established.

The areas where the KCF envisages the Key Fund providing back office support, particularly in the early stages of the Kent Big Society Fund, include:

- Assisting with the formulation of the investment policy, strategy and planning, including tactics to stimulate social enterprises
- Helping prepare templates for application form, loan agreements etc
- Advising on the due diligence of applicants and preparing reports for the consideration of the the KCF Investment Panel
- Back office processing of loan documents, payments etc.

All loans will be with the KCF. Key Fund will provide back office support only. In cases of default, Key Fund will deal with the initial loan recovery administration but will pass cases of delinquency back to KCF to deal with locally if not resolved quickly.

Undoubtedly the Key Fund role adds some cost to the administration of the Fund. KCF feel given the scale of KCC investment into the Fund and also the potential size of the loans this arrangement offers a level of assurance that loans from the Fund are based on sound business case analysis with a strong expectation of repayment. The Key Fund's write off rate is 10% which is relatively low for the social finance sector given funding is unsecured and normally targeted on high risk start ups. In the longer term,

the KCF are to explore the possibility of the developing capability to provide such a back office function in-house.

11. Operating Costs

No monies were identified in the budget by KCC to cover the operating costs of the Kent Big Society Fund and it is accepted operating costs must be drawn from the Fund capital itself. KCF will draw down monies from the Fund capital to cover the operation of the Fund including:

- Work to stimulate the growth of social enterprise in Kent, marketing and promotion (on-going marketing will be critical to keep up the momentum), local networking to establish fund, face-to-face meetings with and support to potential borrowers
- Offering one-to-one support and capacity building to social ventures pre- and post-loan eg. borrowers and potential borrowers. This may well include recruiting mentors from the business community.
- Leveraging additional monies into the fund
- Management and governance

KCF expect their annual operating costs to be approximately £76,000 or 7.6% of the initial £1m donation from KCC and these monies will be drawn down from the Fund capital. It is expected that the annual operating costs will not normally exceed this 7.6% rate. This will cover salaries, governance, marketing and promotion and other overheads. An additional one-off cost of £25,000 to cover set-up of the fund eg. establishing processes and structures, templates for applications, training and consultancy from the Key Fund, developing investment policy and establishing investment panel will also be drawn from the Fund. In regards to covering the costs in relation to the Key Fund it is proposed this will be based on a percentage of loans made with 1% of outstanding loan debtors as an on-going annual back office cost. Key Fund costs associated with due diligence on individual applications and establishing loans will be covered by the upfront administration fee recharged to the loan amount if required.

12. Leverage

One of the stated aims for the Fund in *Bold Steps for Kent* is it should lever additional monies into the Fund. The KCF will be responsible for using its own networks to lever additional monies into the Fund where possible taking advantage of the opportunity of tax breaks and gift aid benefits for private and corporate donors.

KCC has committed in *Delivering Bold Steps* to leveraging additional monies to the Fund, principally through bids to Big Society Capital and also through other funds where the opportunity arises, such as the recently announced European Investment Fund from the European Investment Bank. Both bodies have announced their intention to provide finance to social enterprises through existing social finance intermediaries. KCC will lead on bids to such bodies and KCF will support these applications.

13. Start Date

The aim is to open the Fund to applications in January 2012, with the first round of loan decisions being made in late March after the first KCF Investment Panel has met to consider the applications.

14. Communications

A media protocol will be agreed by the KCF and KCC to support both parties' communications regarding the operation and use of the Fund. Customer and Communities Directorate will be responsible for the ongoing relationship with the KCF.

Ongoing publicity to encourage applications to the Fund and lever monies into it will be the responsibility of the KCF.

15. Risk and Business Continuity Management

It is important to note the risks that exist for the successful operation of the Big Society Fund, these include:

- a) *That the expected demand for social finance from social enterprises does not materialise.* This is a risk, but through sequencing the donations to the KCF, the County Council will be able to understand the success and future appetite for finance from the Fund and review its position accordingly on an annual basis.
- b) *That the Fund does not remain competitive in the social finance or commercial finance market.* It is unlikely that the Fund will directly compete with commercial high street banks as commercial banks focus on recapitalisation and limit exposure, pricing out social enterprise from commercial loans. Alternatively, the social finance market might become competitive very quickly, making the Kent Big Society Fund uncompetitive. However, this is unlikely to occur in the short-to-medium term given the relative immaturity of the social finance market, and KCF trustees through the Investment Panel will monitor the competitiveness on an ongoing basis.
- c) *That the launch of Big Society Capital is further delayed and does not invest through social finance intermediaries.* This risk is more likely to be realised given the ongoing delays in its establishment and some indication that Big Society Capital might choose to invest in the sector principally through Social Investment Bonds. However a mixed approach is likely to be adopted by Big Society Capital and alternative capital investment programmes for social finance intermediaries are still emerging.

16. Recommendations:

- Members are asked to note the contents of the report.
- Members are asked to note and comment on the governance arrangements outlined in Section 9.

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