By:	Mark Dance, Cabinet Member Economic Development Barbara Cooper, Corporate Director – Growth Environment and Transport
To:	Growth, Economic Development and Communities Cabinet Committee – 13 December 2016
Subject:	Recycling Regional Growth Funding - Kent and Medway Business Fund
Decision Number	16/00107
Classification:	Unrestricted

Past pathway of paper: None

Future pathway of paper: Cabinet Member Decision

Electoral Division: All

Summary

This paper describes the programme for reinvesting the repayments of loans to businesses that were previously made by Kent County Council from the Government's Regional Growth Fund.

It is estimated that £5-£7 million will be available to reinvest each year for the next five years.

It is proposed that a 'Kent and Medway Business Fund' (KMBF) will replace the existing schemes. The previous Regional Growth Fund loans were made under three geographically targeted schemes: Expansion East Kent (EEK), Escalate (West Kent) and TIGER (North Kent). The future schemes will retain the same geographical focus whilst taking on board lessons from the previous funds.

The KMBF will not seek to replace commercial sources of finance, but will seek to work alongside other forms of investment. Applicants must have a viable business case and be able to demonstrate that commercial finance is not available to cover the full value of the investment. The scheme will normally provide finance for up to 50% of total eligible costs, with the balance funded through other sources, including bank lending. Security for the loans will be required.

Loans will generally be offered interest-free, within the state aid rules. However, to cover administrative costs an arrangement charge will be levied.

KCC will remain the accountable body for the new scheme, as part of its existing contract with Government. KCC will therefore continue to manage the application, appraisal, decision-making processes. KCC will also be responsible for issuing loan agreements, payments and monitoring of the loans, as well as reporting performance to the Department for Business, Energy and Industrial Strategy (BEIS).

As with the three former RGF schemes, performance reports will continue to be provided to the Cabinet Committee.

Recommendations
The Cabinet Committee is asked to consider and endorse, or make recommendations to the Cabinet Member for Economic Development on the proposed decision (as shown at Appendix A) to:

a) delegate to the Director of Economic Development the authority to launch a new scheme on behalf of KCC to invest recycled RGF loan repayments to eligible organisations in the Kent & Medway area; and
b) implement the governance arrangements for the Kent and Medway Business Fund as detailed in this report.

1. Background

1.1 Since 2011, £55 million has been allocated to Kent County Council from the Regional Growth Fund (RGF). This enabled the delivery of three direct business finance schemes which offered loans, equity investment and in a small number of cases, grants:

- Expansion East Kent £35 million
- TIGER £14.5 million
- Escalate £5.5 million

1.2. The three schemes were similar, and were managed by the same KCC team. However, they operated to slightly different criteria, and each had a separate advisory board responsible for making recommendations to the Accountable Body (Kent County Council) for project approval or rejection.

1.3. All three schemes have now closed. KCC's contract with BEIS permits KCC to recycle the funds received from the RGF schemes. There is £39.6 million scheduled to be repaid by 2021, which will mean that subject to bad debt there will be up to £5-7 million per year to reinvest. Recycled RGF loan repayments have been received and pending the approval of governance and management arrangements, a new scheme will be launched to applicants on 12th January 2017.

2. Lessons Learned from EEK, Escalate and TIGER

2.1. Following an assessment of the three previous schemes, lessons have been taken on board and consideration has been given within the design of a new successor scheme in addressing the following:

a) *Sustainability*: The administration costs of the three previous schemes were covered by KCC (and the other participating local authorities in the case of TIGER). However, this will not be viable in the future, and a new scheme will need to recover costs.

b) *Capital availability*: While £5-7 million per year is a significant sum, it is less than the sums available over a short period of time in the earlier schemes. The design of a new scheme will need to reflect this lower amount of capital.

c) *Market demand and experience*: The original schemes were set up at a time of recession and significant credit constraints. A review of demand has been carried out to assess current need by Regeneris Consulting, who were engaged by KCC to carry out research into the supply and demand of finance to SMEs in Kent and Medway in July 2016. The Regeneris research utilised the 2015 & 2014 Small Business Survey as its basis and its analysis suggests:

- There are approximately 20,500 SMEs in Kent and Medway, of which over 10,000 were seeking finance on an annual basis. 83% of these SMEs are micro-sized businesses.
- Around 6,100 of the SMEs seeking finance encountered difficulties obtaining finance.
- Almost 2,000 SMEs were unable to obtain any of the finance they were seeking (19% of the total number of businesses seeking finance).
- 220 SMEs that sought finance obtained some, but not all the finance that they required. This includes SMEs that were unable to obtain any finance, businesses able to obtain some of the finance they requested but not the whole amount, and businesses that obtained the full amount requested but reported problems at some stage during the process.
- Approximately 4,500 SMEs in Kent and Medway did not apply for finance despite identifying a need for funding, with around 2,000 (44%) of these businesses not applying because they thought they would be rejected.

This analysis shows that total unmet demand across Kent and Medway could amount to £490m each year. If we assume that only 10% of these proposals would be viable, this would imply a finance gap of £49 million per annum. Suggesting the "funding gap" is much larger that the proposed budget of this scheme (£5-7 million per annum).

d) *Government funding conditions and regulations*: Recycled funds will continue to be subject to Government monitoring and regulation. This includes the state aid rules, with which any new Fund must comply.

e) *Applications*: There will be additional checks undertaken at the full application stage to assess the financial viability of those submitting applications.

f) *Appraisal*: Most loans will be required to provide security equivalent to the value of the loan, therefore there will be additional checks at the full application stage on the value and suitability of the security offered.

g) *Payment and Monitoring:* Applicants who are consistently late with their monitoring and/or repayment will be called to a face-to-face meeting and expected to enter into a formal "loan action plan", which will involve a combination of regular on-going meetings, access to business support, more intensive monitoring and possible interest charges on their outstanding loan repayments. Revising the contractual agreements with the business on a continuous basis will provide the optimum level of protection for the investment and also ensure appropriate business support can be provided to meet the needs of the business.

3. The Kent and Medway Business Fund

3.1. Based on these considerations, it is proposed that a new **Kent and Medway Business Fund (KMBF)** will be created to provide loans for small and medium-sized enterprises to support new jobs and business growth and to stimulate innovation and improve productivity. As RGF loans are repaid, they will be recycled into the KMBF. The funds recycled from the original Expansion East Kent (East Kent), TIGER (North Kent) and ESCALATE (West Kent) Schemes will again be allocated for projects in those three areas.

3.2 The KMBF will operate as a single scheme, across Kent and Medway, using a single application form and decision-making process. Funding will be initially available to spend until 31st March 2021. There will be two types of funding directly available to individual businesses:-

- Repayable Loan Finance: This means loans to business offered (in most cases) on an interest free basis, with monies recycled to maintain the KMBF over a longer period. It is envisaged that the majority of the funding will be offered on this basis.

- Equity: This is funding provided in return for a stake in the applicants business. This shareholding may then be sold at some stage in the future e.g. within 3-5 years, although these shares may be retained over a longer period. KMBF equity investment could form a part of an investment package working alongside loans. Applicants who request the option of equity finance will be assessed for their suitability for equity investment as this form of finance is not suitable for every business. Should an applicant be identified as being suitable for equity investment this option will be discussed with them during the appraisal/approval process.

3.3 The terms and conditions of our existing contract with BEIS stipulate all funding applications awarded by KCC as the accountable body must:-

- Demonstrate job creation and good value, and all proposals will be assessed against clear criteria;
- Be made against specific investment proposals, which would be fully appraised before funding is issued;
- Secure private sector matching investment (KMBF will only pay for a portion – no more than 50% - of total eligible costs)
- Be fully compliant with state aid legislation.

4. Kent and Medway Business Fund (KMBF) Governance

4.1 As per the contract agreement with BEIS KCC will continue as the accountable body or KMBF. The scheme will be managed internally within KCC utilising the staff currently employed under the former RGF schemes (this core team is now in place). The following paragraphs set out how this role will be fulfilled and how transparent governance and management roles will be maintained.

The diagram below sets out the proposed operational structure. This aims to maintain a balance between independent, private sector advice and clear accountability.

Kent County Council
Accountable body for KMBF
Approved contracts and funding
Responsible for monitoring and evaluation

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Independent Appraisal
Contracted to KCC
Individual application appraisals
Makes recommendations to KMIAB

↓

Kent and Medway Investment Advisory Board (KMIAB)
Responsible for strategy and direction
Responsible for recommending on applications following the independent appraisal

Details of each element of the structure from application to funding approval are listed below:

4.2 *Initial application:* Businesses wishing to apply for KMBF support will be able to submit an initial expression of interest online. This will then be checked for eligibility by the KMBF programme management team employed directly by KCC. Eligible applicants will then be invited to submit a full application. This initial process will ensure that applicants will not waste time on ineligible projects.

4.3 *Full Application*: Those applicants requested to submit a full application with supporting documents.

4.4 *Appraisal*: All applications will be independently appraised. KCC is currently conducting a procurement exercise to appoint an external company to act as an independent appraiser. The role of the independent appraiser will be to assess applications and provide a report providing the following information:

a) *RAG Ratings*: Related to the following areas – Additionality; Value for Money; Funding; Financial Viability/Sustainability; Jobs created and safeguarded; State Aid Compliance.

b) *Client/Track record*: Focusing on the directors and/or management team, their experience, the role of investors/shareholders and previous trading or business history.

c) *Purpose*: Establishing the purpose of the investment is clear and in line with the full application and supporting documentation and that this is consistent with the objectives of the scheme.

d) *Funding Rationale*: That the level of funding requested is appropriate to the objectives contained in the full application and supporting documentation.

e) *Serviceability*: Current/future liabilities and are they serviceable. An assessment of their current/projected performance based on their business plan and cashflow projections.

f) *Risk/ Reward*: Potential jobs created/safeguarded. The potential impact of the investment on the applicants trading position and risks posed by this investment.

g) *Security*: What is being offered and an initial assessment of the value of that security.

h) *Credit Search*: A current business credit search undertaken on the applicant.

4.5 *Kent and Medway Investment Advisory Board (KMIAB):* Following appraisal, all applications will be considered by a public/ private Kent and Medway Investment Advisory Board (KMIAB). The responsibilities of the KMIAB will be to:-

a) Provide advice, monitor and review the KMBF whilst drawing on their business and commercial experience.

b) Make recommendations to KCC whether to endorse the report submitted by the independent appraiser to approve, reject or defer individual applications for funding.

c) Keep under review the performance of the programme against the outputs and leverage levels specified by BEIS.

4.6 *Membership of the Kent and Medway Investment Advisory Board*: The Accountable Body must be represented on the Board by elected representatives and Board Members from other local authorities must also be elected representatives. All elected representatives who are Board Members will be drawn from the membership of the advisory panels established for the former RGF schemes. The majority of Board Members shall be from the private sector.

A number of public and private sector representatives have been approached to join the Board, with the aim of achieving a balance of knowledge and expertise. It is anticipated that the KMIAB will be established over the next month.

The draft Terms of Reference (ToR) provide the detail on the management of the Board are contained in Appendix B.

4.7 *Approval*: KCC as the accountable body will approve the allocation of all funds, taking into account the recommendations of the KMIAB. The final decision to: approve, approve with conditions, reject or defer loan applications are to be made by the Chair of the KMIAB or the Vice-Chair of the KMIAB in the absence of the Chair. The decisions will then be counter-signed by the KCC Delegated Officer (Director Economic Development - Growth, Environment and Transport).

4.8 *Payment and monitoring*: KCC shall be responsible for the payment of loans and their recovery where appropriate. KCC shall also be responsible for monitoring all allocations, ensuring that funds are used for the purposes intended, monitoring employment and other outputs and reporting spend and outputs achieved to BEIS as required.

4.9 *Strategy and oversight:* To ensure that the KMBF remains relevant to market demand for business investment and supports those businesses and sectors with the greatest potential for growth and job creation, KCC in consultation with the KMIAB will prepare an annual Investment Strategy.

In addition to its role in considering individual applications, the KMIAB shall perform an independent strategic oversight role. This shall involve (in addition to the Board's role in recommending determination of applications to the KMBF).

a) Providing advice, monitoring and reviewing the overall Investment Strategy for the use of the KMBF whilst drawing on the Board's business and commercial experience.

b) Keeping under review the performance of the programme against the outputs and leverage levels specified by BEIS.

5. Risks

5.1. The main risks are:

- *Insufficient number of high quality applications:* This will be mitigated through the a strong pipeline of bids, marketing and work with officers and members of local Districts and Boroughs and local partners and business support agencies using the experience gained in managing the three former RGF schemes:

- *Decreasing amounts of loan repayments from the three former RGF schemes*: Quarterly monitoring of loan repayments provides sufficient information to undertake action to adjust future budgets and agree the scale of further bidding rounds. In the longer term there may be possible opportunities to raise additional external funds from the government or the British Business Bank. The extent of these future opportunities will be better understood when the new government industrial strategy is published in 2017.

- *Fraud and mis-representations by those applying for funds*: All applications are subject to robust appraisal and monitoring, any suspected fraud and mis-representation are referred immediately to KCC Internal Audit. If evidence suggests that a criminal offence has been committed, then the matter will be referred quickly (and following KCC internal procedures) for possible legal action.

- *None–repayment of loans*: This will be mitigated by seeking security for loans, robust appraisal and an effective monitoring process, drawing on experience to date.

- *Unsustainable administrative costs to KCC:* Costs will be recovered through arrangement fees. At this stage, it is not anticipated that the scheme will need to charge interest to recover costs.

6. Next steps

6.1. It is anticipated that the new scheme will be launched on 12th January 2017, with a view to initial loans being agreed by the end of March 2017. Ahead of this, work is underway to develop detailed scheme guidance, appoint an independent investment advisory board and develop, with local partners, an appropriate marketing strategy.

6.2 To ensure the schemes will be delivered in line with KCC's Equalities Strategy and Policies an Equalities Impact Assessment (EqIA) has been completed. It has been judged that the scheme has low or no impact on groups identified (on the basis of Age, Disability, Gender, Gender identity, Race, Religion or belief, Sexual orientation, Pregnancy and maternity, Marriage and Civil Partnerships and Carer's responsibilities).

6.2. In addition, it should be noted that the original RGF schemes also covered Thurrock and part of East Sussex. Discussions are underway with the local authorities in these areas.

6.3 BEIS have formally agreed the business case for the recycling of funds and for KCC to retain operating costs of up to 5% per year of all funds repaid and reinvested into businesses within Kent and Medway. There are no additional conditions contained in the BEIS contract.

7. Recommendations

The Cabinet Committee is asked to consider and endorse, or make recommendations to the Cabinet Member for Economic Development on the proposed decision (as shown at Appendix A) to:

a) delegate to the Director of Economic Development the authority to launch a new scheme on behalf of KCC to invest recycled RGF loan repayments to eligible organisations in the Kent & Medway area; and
b) implement the governance arrangements for the Kent and Medway Business Fund as detailed in this report.

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