ACCESS
The Foundation for Social Investment

# The Growth Fund Guidance

A programme developed in partnership between Big Lottery Fund, Big Society Capital, Access – the Foundation for Social Investment

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Transforming social investment

# Guidance

## What's it all about?

The social investment market has grown significantly over the last 5 years enabling a greater number of voluntary, community and social enterprise organisations (VCSEs)[1] to access the finance needed to create an impact on society. There are now over 20 Social Investment Financial Intermediaries (SIFIs)[2] offering a range of investment products across the UK and for organisations delivering social impact for different beneficiary groups. There is also a range of support available for VCSEs that are looking to take on investment.

However there remains a lack of higher risk social investment below £150,000. Recent research[3] reveals this to be the most demanded but the least available type of finance by small and medium sized VCSEs.

The Growth Fund aims to increase the social impact of those VCSEs across England for whom taking on some degree of repayable finance is appropriate. It will do this by providing loan and grant funding to SIFIs, to offer more affordable investments of up to £150,000 to VCSEs which are unlikely to have accessed social investment but need investment to support them in their activities. These investments to VCSEs may be in the form of a loan, grant and loan or some other form of appropriate financial package.

## What are we looking for?

Access is looking for proposals from SIFIs that use the grant and loan available from the Growth Fund in order to widen access to social investment for VCSEs. SIFIs applying to the Growth Fund must have a clear idea of the market gap they're trying to fill, a strategy for how the use of the grant and loan will enable them to meet unmet demand for finance from VCSEs and a clear articulation of the offer to VCSEs (both financial and through additional support and improved customer service).

## Who can apply?

You can apply to the Growth Fund if you are a SIFI – an organisation that provides finance and/or support to VCSEs. You may not apply if you are a VCSE. If you are a VCSE looking for social investment you can find out more about funds open for investment at www.bigsocietycapital.com/open-funds.

We expect applicants or the partners they are working with to have evidence of providing support to VCSEs and to have some experience of providing finance to VCSEs.

We also expect and actively encourage applications from new partnerships between , for example, an umbrella organisation with considerable experience in supporting VCSEs and a lender with

1 By VCSEs we mean independent organisations not including local government or other statutory authorities, which are established for charitable purposes that add value to the community as a whole, or a significant section of the community and which are not established primarily to distribute a profit.

2 By SIFIs we mean independent organisations which provide investment or lending and/or support to organisations for the purpose of creating social outcomes

3 CAF Venturesome: In Demand (2014); ClearlySo and NPC: Investment Readiness in the UK, (2012)

experience of supplying finance to this same group. By working together, the partnership may have greater reach to VCSEs and clearer understanding and experience of supporting VCSEs before and during the lifetime of their investments.

## What can you as a SIFI apply for?

SIFIs can apply for grant and loan funding, based on the following requirements:

**Loan requirements:** You can apply for a loan from Big Society Capital (BSC) at 5% interest rates. The amount of loan you apply for must always be greater than the total amount of grant.

**Grant requirements:** The Growth Fund was set up to address barriers that prevent VCSEs secure the type of finance they need. These include the availability of social investment of less than £150,000, the appetite for risk which SIFIs have and the internal risks of taking on investment when revenue streams are unclear. To address these barriers, SIFIs will be able to apply for three uses of Big Lottery Fund grant alongside a loan:

| | |
|---|---|
| A | To support operational costs that are associated with awarding social investment of less than £150,000 to VCSEs |
| B | To take on some of the risk at the SIFI level in deals perceived to be riskier |
| C | To offer as a grant directly to frontline VCSE alongside or within a loan. |

You may match your own investment with a Growth Fund investment if the use of the grant will not create intentional private benefit to the source of that investment.

Your application must demonstrate efficient use of the grant, providing a clear justification for why that amount of grant is necessary to meet your proposed investment strategy.

It is important that the use of grants, in the context of the Growth Fund should be an investment tool, and should not be used to plug a revenue shortfall for statutory services.

## Grant use A to support operational costs:

A critical factor behind the decision to set up the Growth Fund is the challenge of providing social investment deals of up to £150,000, given the higher costs of writing and managing this business. SIFIs can apply for limited grant funding to support deal costs which, combined with fees and interest, should help to make the activity financially sustainable. We expect operating costs to include staff costs for origination of deals, due diligence and on-going management of the investments, to maximise the likelihood of generating financial and social returns.

The aim of the operating cost grant is to ensure:-

- you are able to extend the reach of VCSEs which often requires more time and resource
- you provide proportionate due diligence before and monitoring during the lifetime of the investment, examining the social and financial impact whilst ensuring
- you provide technical assistance and business support for organisations that have taken on investment.

We expect the operating cost top-up to vary between different types of SIFIs and the range of requests from SIFIs to be from 3%

up to a maximum of 10% for an exceptional case. Any request for use of Grant A must be justified in terms of service offered by SIFIs to VCSEs and will be carefully scrutinised during the due diligence. It is expected that more established SIFIs will be applying for an operational cost top-up at the lower end of that range. The breakdown of these costs are asked for in Table C of the application form.

Over the course of the Growth Fund, we will be prioritising SIFIs that are actively developing models of lending that focus on becoming more efficient and are less costly.

## Grant use B to mitigate SIFIs' risk of lending:

You can apply for grant funding to help cover the risk of making investments into VCSEs with less of a track record and higher potential risk. The aim of this portion of grant funding is to widen the reach of current investment activity.

From your experience of lending and supporting VCSEs, we would like you to clearly justify what assumptions you will use to determine the amount of grant you need to cover additional risk. In particular we would like you to cover expected financial default rates, the evidence behind those rates and the ways in which you will balance the potential social impact created with your on-lending activity with the possible financial risks. The table below may be helpful for you to assess the likely proportion of grant required alongside loan from Big Society Capital lent at 5%, given certain anticipated default rates.

| **Anticipated cumulative default rate**[4] | **Portion of grant** |
|---|---|
| 5% | 15% – 20% |
| 10% | 20% – 25% |
| 15% | 25% – 30% |
| 20% | 30% – 35% |
| 25% | 35% – 40% |
| 30% | 40% – 45% |

Explanation of assumptions used to generate the table are provided in footnote 4

A financial model will be available on request at application form stage to help you assess the amount of grant you will need based on those assumptions.

If losses are higher than expected, it is expected the loan capital would be impaired. Given this pool of grant funding is aimed at SIFIs taking on significantly more risk than historically, there is a likelihood BSC could lose some of its capital on a number of investments. If the default rates are significantly lower than expected, BSC's financial return remains capped and the SIFI will be able to submit a short application to keep any leftover grant for further on-lending (in line with the parameters of the Growth Fund). Your track record as a SIFI in investing in line with the Growth Fund's objectives, particularly those around risk taking and customer service, will be considered in your application to retain and on-lend the remaining grant.

4 This sensitivity table has been put together with the following assumptions in mind: Interest rate 8%, average investment size 60K, no repayment holidays, amortising loans, 4 year term. Default rate is defined as % of defaults of total disbursement value

## Grant use C to pass on to VCSEs in the form of grant:

As a SIFI, you can apply for grant to pass directly to VCSEs in the form of a loan/grant product. The aim of that product is to encourage appropriate risk taken by management and trustees in taking on capital and also to strengthen their capacity to achieve sustained social impact. These products have been commonly used by organisations such as Key Fund and Social Investment Scotland to support charities at earlier stages of considering social investment.

You will need to consider the potential impact that the grant will have and the types of organisations will most benefit from having a grant alongside a loan.

## How much funding is available for each application?

The aim of the Growth Fund is to reach VCSEs previously not reached by social investment but for whom taking on some degree of repayable finance is appropriate. In achieving that aim, the Growth Fund will have at least £45m to create a diverse portfolio of 10-15 investments (made up of loan and grant funding) into existing SIFIs as well as new partnerships between SIFIs and other local organisations. To ensure the grant is not exhausted on a single investment it is expected the maximum total grant (across all three pools of funding) which a SIFI can apply for in any one application will not exceed £3m and the total loan and grant package applied for should not exceed £10m. Repeat applications will be considered in view of likely geographical spread along with our usual investment criteria.

## What loans can SIFIs make to VCSEs?

**Types of products:** The aim of the Growth Fund is to enable SIFIs to provide simple and flexible products that meet the needs of VCSEs. The products most in demand were developed from consultation with the VCSE sector.

In the first year of the Growth Fund we expect to see SIFIs provide (1) unsecured loans and (2) unsecured loans alongside a grant. In some cases, we will be open to SIFIs proposing products which share any VCSE success (financial and / or social) with the SIFI. In particular we would like to see the use of products that incentivise and encourage the creation of social impact.

**Size of products:** We expect each investment to VCSEs to be up to £150,000 (in a grant loan product this should be inclusive of the grant component). We believe there are other existing funding sources offering loans larger than £150,000 and therefore the size cap is designed to ensure maximum added value and to prevent market distortion for SIFIs offering loans with no subsidy.

**Interest rates:** The aim of the Growth Fund is to use grant capital to provide finance to VCSEs that would otherwise be unable to access it.  We therefore expect the interest rates offered to VCSEs by SIFI's using the Growth Fund to be in line with interest rates offered elsewhere in the social investment market – 6.5-12% inclusive of all fees. Keeping interest rates in line with these levels will enable the grant to be used to create maximum impact and so reach a larger number of VCSEs. Other drivers in setting a range of interest rates for the Growth Fund include:

| Attractiveness of such a product | | Types of organisations requiring it |
|---|---|---|
| **Unsecured loan** | - Makes product to VCSEs more affordable<br>- Simple loans easy to understand for traditional VCSEs<br>- Less costly to design and structure | VCSEs undertaking riskier product or service innovation |
| **Unsecured loan + Grant** | - Provides "breathing space" for VCSEs with less robust immediate revenue streams<br>- Affordability | VCSEs organisations with little or no trading history developing new revenue streams |
| **Equity like risk capital** | - Enables organisation and investor to share in the financial and social risk and reward of growth at the earlier stages of organisation's development<br>- Potentially does not burden early stage organisations with debt on balance sheet;<br>- Could be used to incentivise social impact creation | Developing high growth VCSEs; Organisations providing distinct measurable social outcomes or where revenue figures are more variable or are dependent on external factors |

- **Sustainability** – if SIFIs, with funding from the Growth Fund, charge interest rates for comparable loans at much lower rates than are currently offered in the market, it would reduce the sustainability of SIFIs that are charging a higher interest rate to cover their cost of capital and their operating fees;
- **Affordability** – with the average size of loan delivered through the Growth Fund expected to be less than £100,000, we anticipate a small reduction in the interest rate would not have a significant impact on the affordability to VCSEs, which is a key consideration for Access.

## Which VCSEs may SIFIs lend Growth Funds to?

The types of VCSEs which we expect that SIFIs will support through the Growth Fund include earlier stage, smaller VCSEs, as well as more established charities which are developing new ways of generating income. Eligible VCSEs can be regulated or unregulated, as described below.

**Regulated organisations are charities, Community Interest Companies or Community Benefit Societies which pursue charitable objective(s).**

Unregulated social sector organisations (such as CLGs, CLSs, and IPSs) may be eligible, if the business:-

### Mission lock and activities

- has a clear social mission which meets a charitable objective that addresses a social issue or need
- carries out trading activities in support of and which are causally linked to its social mission
- in the case of a sale of the enterprise, the directors make best efforts to preserve the social mission under new ownership.

### Profit distribution and asset lock

- distributes less than 50% of post tax profits
- mainly reinvests surpluses into pursuing their social mission
- has a constitutional or contractual lock on its Social Objects, dividend policy and an “asset-lock”.

### Public benefit and private gain, use of public funds

- offers its products and services for general public benefit without restrictions and barriers, such as affordability
- can be established that private gain is incidental and minimal as a result of Access’s support.
- no state aid issues identified (de Minimis may be used where appropriate)

### Transparency

- articulates, evidences, measures and reports on its social impact and charitable purpose
- is open to undertaking an independent social impact audit.
- has remuneration and benefits policy which it is willing to make open, and which is reasonable and proportionate relative to the market practice for social sector organisations.

## State Aid

If use of Growth Funds could give an advantage to you over other organisations offering similar services, or if the activities undertaken with support from the Growth Fund could affect trade between EU member states, then the funding might be considered to be ‘State Aid’. There are strict rules governing State Aid so it’s important we check projects carefully so that we can follow those rules where necessary.

Summary information is provided below to guide your thinking and should not be solely relied on. If you are in any doubt as you proceed through the application process for Growth Funds, you will need to seek legal advice about State Aid rules and how they have been addressed at both SIFI and VCSE level of the Growth Fund. As we expect State Aid will be a consideration for many SIFIs applying to the Growth fund and for the VCSEs they will be on-lending to, Access intends to work with partners in the sector to develop more detailed supporting guidance than is currently available on this issue in the latter half of 2015.

In particular, there are two levels at which state aid should be considered for SIFIs:

1 / For the grant used to support operating costs of the SIFI (Grant Use A) to deliver the Growth Fund, there are certain state aid exemptions that ensure that grant is state aid compliant. These are summarised in the table below:

## Summary of exemptions for use of grant to cover operating costs

| **Argument** | **Requirements to demonstrate no unlawful State Aid at SIFI level** |
|---|---|
| The grant is treated as scouting costs under General Block Exemption Regulation (GBER) - Article 24 (Scouting Costs) (exempted aid to SIFI see pages 62 – 67) | - If the types of VCSEs which could benefit are limited to those defined in Articles 21 and 22 (i.e. Risk Finance aid to SMEs and aid to start-ups), then:<br>- 50% of the eligible costs (initial screening and formal due diligence undertaken by managers of financial intermediaries or investors to identify eligible undertakings) can be paid for without being considered State Aid, but this is likely to be a straightforward threshold to fulfill. |
| The grant is De Minimis | The aid to each SIFI would have to be below the de Minimis threshold of EUR 200,000 per SIFI over a three year period. The SIFI applicant must not have received in excess of this amount aid in the course of three years ( available amount from Growth Fund is 10% of maximum of grant pot of £3m) |

2 / For the use of the Growth Fund to provide loans and grants to VCSEs, there are a number of structures that SIFIs could use to calculate the extent of aid provided to the VCSE and to ensure the funds are state aid compliant. Further detailed guidance will be made available at the application stage.

Allocation of the Growth Funds will be based on the assumption that, although the finance provided constitutes public resources, the purpose for which it will be used will not lead to it being considered as unapprovable State Aid. In such an event, Access may need to reclaim this from you on behalf of its funders. For more information about State Aid visit www.bis.gov.uk/policies/europe/state-aid

## Regulatory requirements

We expect SIFIs to have appropriate Financial Conduct Agency (FCA) and Prudential Regulation Authority (PRA) regulatory approvals to undertake the lending activity outlined in the proposal. To check if you need additional regulatory approvals please see **www.fca.org.uk/firms/about-authorisation/do-i-need-to-be-authorised**

SIFIs with not for profit status may also check this site for guidance:

**www.fca.org.uk/static/fca/documents/credit-ready-not-for-profit-limited-or-full-permission-decision-tool.pdf**

Applicants can consider taking their own independent legal advice on regulatory issues.

## Investment Structure

- If your organisation does not have charitable status, you will be obliged to place any Growth Funds that you secure in a separate bank account to your normal operating account You will be asked in the application form to confirm that you will meet this obligation.
- You can apply to lend directly from your balance sheet or to manage a separate fund to make the investments (subject to regulatory requirements which you must clarify in advance – see Para 9 above).

## Investment term

We expect most SIFIs to be applying for an investment period of up to 3 years (i.e. the active lending phase) and a run off period of 3-4 years. You will need to monitor your investments throughout this period.

## Contract arrangements for successful SIFI applicants

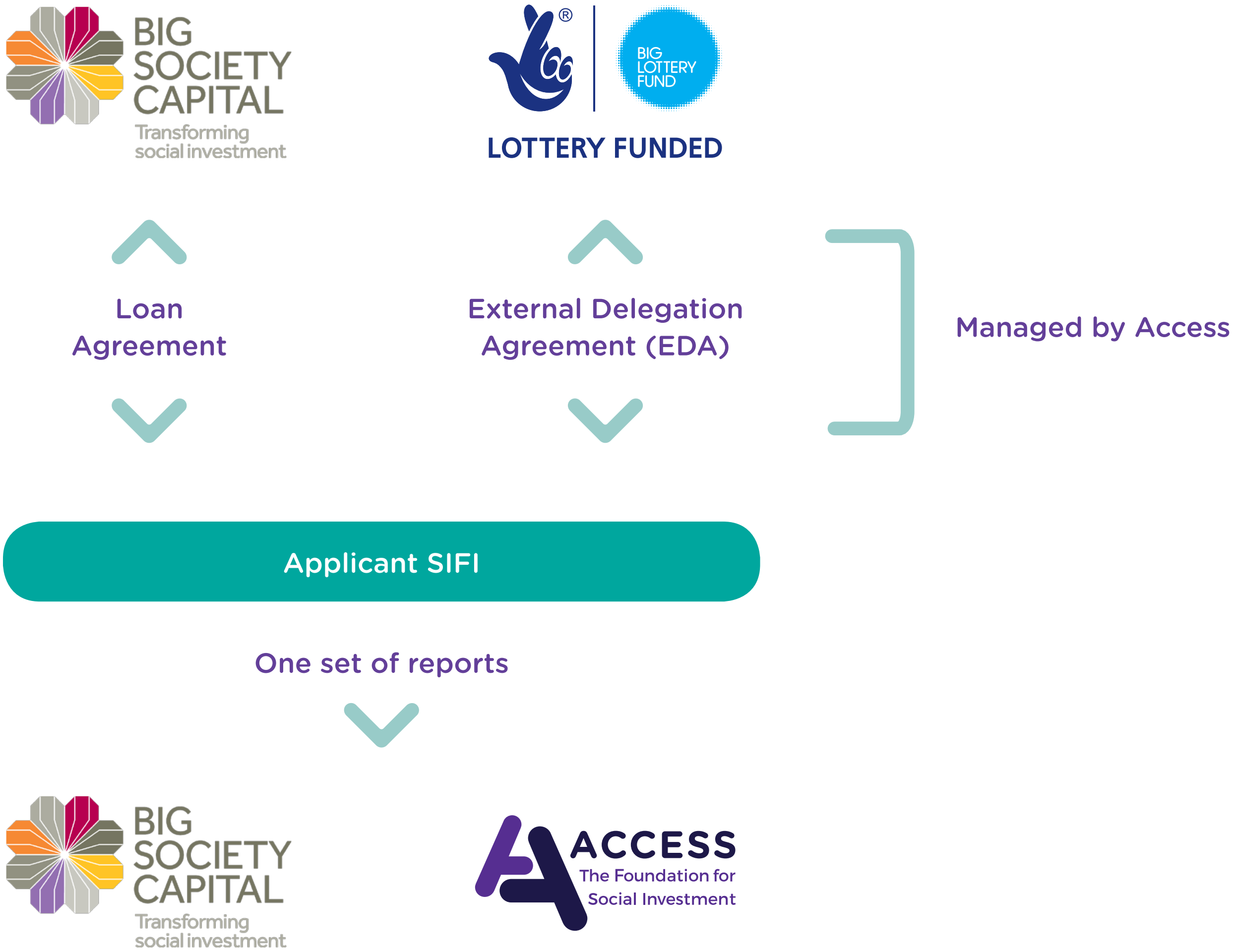
A successful SIFI will enter into a contract with Big Society Capital for its loan finance, and a grant agreement with the Big Lottery Fund for its grant allocation. This is irrespective of how the grant will be used by the SIFI to provide finance for VCSEs.

The agreement with Big Lottery Fund will be in the form of an External Delegated Agreement (EDA). A template will be made available during the application process for you to read. You will need to accept the terms of the EDA if you are successful in the application. The EDA will allow you to make funding decisions on the recipients of any lottery funds, as an external delegate, you must be specifically given this power to distribute National Lottery funding. As part of that arrangement, you will need to appoint an Accountable Officer for the management of the grant funding provided through the Growth Fund.

Access will operate as the facilitator of the EDA process between Big Lottery Fund and the SIFI. Access will ensure that the terms of the grant agreement drawn up between the Big Lottery Fund and the SIFI are met and maintained throughout the life of the investment.

Successful applicants will be reporting simultaneously to Big Society capital and Access through one set of reports.

The contractual arrangements for SIFIs receiving Growth Funds is shown on page 10.




## Application process

The screening, selection and decision making process for the allocation of Growth Funds is described on Access's website: see www.access-socialinvestment.org.uk/growth-fund/for-sifis/

## Investment Objectives

Each application from a SIFI will be assessed against the following areas:

A / **The market gap that your proposal is addressing (Section 1 on application form). Assessment will focus on :-**

- How you describe the demand for the type of finance you will offer
- The types of organisations you plan to reach out to and how you plan to reach them
- The extent to which your proposal will add value to current provision through the existing social investment market.

B / **Your proposed solution (Section 2 of the application form)**

- Your proposed products and evidence on the appropriateness of those for the VCSEs to whom you will be providing investment
- Your assumptions on default rates and projected financial returns
- Appropriateness of your grant/loan request from the Growth Fund for the investments you intend to make into VCSEs

C / **The social impact of the proposal (Section 3 of the application form)**

a / Your theory of change

b / Your strategy of assessing the social impact of applicant VCSEs

c / Your strategy of monitoring the social impact through the life of the fund

d / Your strategy of considering the tradeoffs that influence the social impact generated

D / **Your ability to deliver on the proposal (Section 4 of the application form)**

E / Financial and social risks, at SIFI and VCSE level

F / The wider benefits to the VCSE sector and the social investment market.