Flexible Finance for the Recovery

Recruitment of First Development Cohort for Experienced Social investors

1 OVERVIEW

In May 2020 Access received £30m of grant funding from dormant accounts to create new blended finance programmes in the social investment market. That funding has been earmarked for two main purposes:
1) Grant to provide blend to support emergency lending to charities and social enterprises, facing financial challenges due to the impacts of Covid-19 ("Emergency Lending")
2) Future blended finance initiatives, which create more sources of more patient and flexible repayable finance, to serve the capital needs of charities & social enterprises ("Flexible Finance for the Recovery")

This application process relates to the second of these initiatives, to which Access will commit at least £21m.

Access is a wholesaler of grant subsidy into social investment funds and other initiatives. Therefore we do not make funding available to charities and social enterprises directly. If you are a charity or social enterprise looking for support, or to find out more about social investment, please visit https://www.goodfinance.org.uk/.

2 CONSULTATION TO DATE

The Flexible Finance for the Recovery programme represents a unique opportunity to create new, more patient and flexible forms of finance, and to widen the reach of social investment into underserved parts of the charity and social enterprise sector. We launched our "Call for Ideas" with the Connect Fund in early July in order to consult the market on the best way to design this fund so that we ensure we maximise the opportunity that it represents, enable the right interventions to be created, and provide the flexibilities that social investors will need.

We have been encouraged by the responses to the Call for Ideas, and the subsequent discussions and roundtables. Highlights include:

- The need to embed diversity and inclusion across the programme and reach charities and social enterprises led by BAME individuals and other groups who have typically had less access to social investment
- Importance of new methods and partnerships if we want to achieve different outcomes
- Importance of closer relationships with investees as part of patient/flexible schemes, and a desire to build in post-investment support
- Need to address complexity and gaps, yet create simple to understand products and pathways

Through this process we have ascertained that only a minority of potential partners in this programme are close to having a viable and ready proposition to consider for investment, and in most cases a period of further discussion and co-design is likely to be needed. Therefore, rather than open for direct investment applications as originally intended, we now feel that the market will be better served if we adopt a slightly different approach, recruiting to a first development cohort.

3 FLEXIBLE FINANCE STRATEGIC OBJECTIVES

The programme is seeking to address gaps in the supply of more patient and flexible social investment products for charities and social enterprises which are not widely available in the current market place. This is partly caused by the low or uncertain expected financial returns of these investments (for the borrower, social investor and capital providers). It aims to address a different, longer term, and potentially riskier financing need than is met by (for example) the Growth Fund or other Access programmes, whilst also trying to attract capital providers with differing risk appetites to blend with our grant.

There will be some organisations in the sector for whom this gap is more of an issue, particularly in the context of the COVID recovery, and we need to understand more about the underlying business models of those organisations and the capital they need. The form of capital (e.g. equity or debt) is less important than simply focussing on what financing organisations need. The product presented to the borrower should be as simple as possible even if the underlying structures for the social investor have some complexity to them.

Our intention is that this programme has a focus on equality and inclusion through its design, by supporting access to capital for charities and social enterprises led by and/or serving minority groups, in as much as their capital needs fit within the definition above.

We are making grant available as blend in order to allow other sources of capital to be more flexible and patient, and to enable those products to reach to the organisations which need them. Therefore social investors should not solve for how the Access grant delivers the above products, but rather how our grant enables other capital to provide these products via a blend. Leverage of other capital is therefore critical. The grant is the bridge between the financing needs of the business models of the charities and social enterprises we want to serve and the requirements of the capital which will meet that need. Social investors will need to be clear about both sides of the gap. In designing how grant should be applied to form this bridge there are numerous trade-offs between the greater flexibility which a higher proportion of grant can provide and the opportunity for replication and market development which greater proportions of capital can provide. Much of our co-design process will be about finding that right balance. While we can be flexible about where this matching capital comes from it is not in Access's long term strategic interest to be diverting either philanthropic money or existing capital providing social investment which is already meeting needs in the sector. Therefore there is an emphasis on attracting new capital.

We need to learn about the different ways grant can be used to attract new capital, increase the supply of capital to end users and create a sustainable eco-system for flexible finance by building the knowledge base around how blend can be optimised.

First Development Cohort participants will be selected by an investment committee with assessment scoring based on responses given to questions set out in section 10. Consideration will also be given to creating a balanced and diverse portfolio that addresses an array of different borrower needs, to maximise learning across the programme as a whole.

4 ORGANISATIONAL FORM OF BORROWERS

In general we expect to adopt eligibility requirements similar to previous Access grant and blended investment programmes. We have listened carefully to arguments put forward that these requirements may in some cases represent a barrier to achieving the diversity of reach that we are seeking. There may therefore be the potential for certain exemptions to be negotiated to these terms. However these would be by exception and in circumstances where exemptions are demonstrated to be crucial to supporting equality of access and where other mechanisms of assurance to mitigate private benefit could be agreed. Therefore it should be assumed that our existing requirements will apply in the vast majority of cases.

Organisations will be eligible if they are:

- Social sector organisations which are “regulated” such as registered charities, community interest companies or Community Benefit Societies which pursue charitable objective(s); or

- “Unregulated” social sector organisations, such as a company limited by shares, where the organisation is able to demonstrate that it:

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 and reinvests at least 51% surpluses into pursuing its 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

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

5 FIRST DEVELOPMENT COHORT

We are currently recruiting for a First Development Cohort to start in autumn 2020 and expected to run until March 2021 by which time we would expect partners to have developed their proposition to a point that they can submit an investment application.

Those in First Development Cohort will have access to modest development resource, an advisory panel of experts, an ongoing process of co-design with Access, an opportunity to hear from other participants about their emerging fund proposals, and an opportunity to work jointly on areas of common challenge, such as identifying which parts of the sector most need these products. Although this is a development/co-design cohort, participants will still be able to submit investment proposals as soon as they are ready. Being recruited into the First Development Cohort will not guarantee however that a full investment proposal will be successful, or even invited. But only those in the First Development Cohort will be able to submit formal proposals in this initial period.

We intend that the budget for the First Development Cohort will be sufficient to progress any fund that we ultimately wish to support, therefore we do not see that participants are in competition with each other for available resource.

In order to be invited to join this **First Development Cohort**, organisations will need to demonstrate three criteria via an **“Application to Cohort” process:**

1. Are an existing and experienced, social investor (FCA regulated or unregulated) which has established investment portfolios, and have some track-record of undertaking similar types of activity to what has been proposed, “Experienced Social investors”

2. Are likely to be in a position to submit an investment proposal within this financial year (i.e. by March 2021)

3. Are pursuing a concept which appears to have the potential to be closely or sufficiently aligned to Flexible Finance Strategic Objectives (set out above)

Participation in the cohort comes with requirements to engage in a development process and does not guarantee success at the end of that process. As such Access will provide a grant contribution of £10k to each participant to cover internal development costs and engagement with Cohort Collaboration Areas.

6 FURTHER INVESTMENT APPLICATIONS AND DEVELOPMENT COHORTS

We are keen to pave the way for a second round of investment applications in mid 2021 and will potentially recruit a second development cohort in the Spring.

Around 60% of the £21m Flexible Finance budget will be ringfenced to be committed by March 2021 to ensure that those not included in the First Development Cohort (and those in the Cohort that do not progress quickly enough) can still work towards a future application.

Organisations which are **<u>not</u>** invited to join this first cohort will be given feedback either that:

- The concept is of some interest and potentially aligned. Access would like to continue to liaise if the concept is pursued and it may be a candidate for a future cohort. In some cases organisations will be invited to apply for a Connect Fund development grant to support development outside of the first cohort

OR

- The concept is not felt to be sufficiently aligned to our long term objectives for the programme, and Access would not expect to be able to support an investment proposal or offer a place in a Development Cohort in the future.

7 DESIGN CHALLENGES AND COHORT COLLABORATION AREAS

Though some partners will be able progress through the proposal development/ co-design cohort phase at an accelerated pace, all programme participants will be expected to commit to proactively engage with these areas of collaboration with the aim to optimise outcomes and share learning at portfolio level. Cohort partners are therefore expected to be open and transparent with their peers sharing insights, processes and data sets as relevant.

1. **THE FINANCE NEEDS OF CHARITIES AND SOCIAL ENTERPRISES IN THE RECOVERY PHASE (see table section 8):** there is a need to better understand the challenges that arise from the capital structures underlying different business models prevalent in the sector to see how patient capital can be designed to fill these gaps. We expect cohort partners will bring diverse perspectives on this issue depending on the organisations they plan to work with. This should result in a range of solutions which meet both these financing needs of charities and social enterprises and which, through the use of grant in a blend, also meet the needs of other capital providers.

2. **ENGAGING ALL PARTS OF THE CHARITY AND SOCIAL ENTERPRISE SECTOR**: we have expressed a clear desire that our new programme has a focus on equality and inclusion and supports access to capital for charities and social enterprises led by and/or serving minority groups. In practice this may mean an emphasis on supporting black and ethnic monitory led enterprises in particular as this has come through strongly in the call for ideas. In addition to any funds which might specifically prioritise this area, we are looking to partners to work together to develop and share best practice to embed equality and inclusion into the sourcing, assessment and award of all investments.
3. **METHODS OF CONNECTING WITH THE RIGHT AUDIENCE AND BUILDING PIPELINE**: the product offerings designed with the support of this programme need to reach the right organisations. Yet as evident from the call for ideas, there is a lot of uncertainty about which organisations need what sort of financial products. We expect partners to adopt and test different deal origination approaches to find the right organisations to work with and believe there is value in sharing learnings from this process.
4. **SOLVING COMMON CHALLENGES FOR THE FLEXIBLE FINANCE ECO-SYSTEM:** cohort partners have identified many common challenges such as the need for grant to subsidise legal/structuring advice for product development and an increased level of operational support required for a riskier profile of investment (e.g. due diligence, technical assistance, investment monitoring, data sharing). We would like to involve cohort partners in the co-design and, if appropriate, shared application of systems to help solve these issues.
5. **THE STRUCTURE OF INVESTMENT FUNDS AND PRODUCT:** we are making grant available as blend in order to allow other sources of capital to be more flexible and patient. While we can be flexible about where this matching capital comes from it is not in Access's long term strategic interest to be diverting either philanthropic money or existing capital providing social investment which is already meeting needs in the sector. Therefore there is an emphasis on attracting new capital. These co-investors will have their own requirements that should be factored into fund and product design. The objective would be that co-investor partners are involved at the design stage to enable social investors to account for their needs when formulating their investment proposals.
6. **LEARNING ABOUT THE VALUE AND USE OF GRANT SUBSIDY (see table section 9):** the provision of grant may look to address one or multiple barriers that capital providers, social investors and borrowers face in making more flexible and patient capital available for the sector (e.g. capital risk, affordability, organisational capacity, ongoing monitoring obligations, legal risk etc). We are inviting cohort partners to closely examine how grant can be used to leverage new capital, support operators and borrowers so that learnings are shared and captured for the long term benefit of the eco-system.

8 THE FINANCE NEEDS OF CHARITIES AND SOCIAL ENTERPRISES IN THE RECOVERY PHASE

Rather than design a product that is simply "patient and flexible", we are keen to understand what need the capital is addressing in the business model and how "patient and flexible" features will meet this need. We are open to suggestion on the legal form of products that are developed so long as they are designed to meet a specific need and also consider the implications on risk and return for borrowers, social investors and co-investors to thus ascertain how grant could most efficiently be allocated. We will consider products that have been tested in the market however need further development, concepts which are borrowed from other market places, or entirely new products.

Potential need	Potential use	Typical sources
Core costs: minimum operating reserves (e.g. 3-6mo operating expenses)	Revenue shortfalls Unexpected demands on resources Opportunistic initiatives Absorb losses Need to pivot a business model	Unrestricted donations from individuals or corporations Retained earnings (surplus profits/efficiencies) Unrestricted investment income Allocation of costs to grant funded "projects"

Rescue: accumulated operating shortfall	Significant/sustained shock to operating reserves Budgeting shortfalls	Emergency grant Borrowing
Steady state: planned expenses	Investment (e.g. in new equipment, technology to support existing operations) Maintenance, Repair & Replacement	Operating reserves Restricted grants Borrowing*
Steady state/growth: working capital	Payments Seasonal effects Inventory Growth etc	Operating reserves Restricted grants Borrowing*
Growth: new strategic initiatives	Planned expenses and investment to support new venture	Operating reserves Restricted grants Borrowing*

*Some debt products already available in the social investment market including via the Growth Fund

9 LEARNING ABOUT THE VALUE AND USE OF GRANT SUBSIDY

The provision of grant may look to address one or multiple barriers that capital providers, social investors and borrowers face in accessing repayable finance for the recovery. Below are some possible examples:

Financial Risk	Where the proposed risk of default or non-payment is too high for an investment to make sense, for example where future income streams are deemed too speculative & high-risk, or long term & low return, or repayment terms are potentially complex
Borrowing cost	Where the risks of a transaction make the borrowing costs unaffordable for an organisation to accept, for example due to tight margins in the organisation's business model
Organisational capacity	Where transactions are higher risk, it is expected that investors will require more detailed due diligence. This may put more burden on both the social investor and the borrower
Deal structures/ legal	This programme allows for new products to be developed. Looking across to other markets, there are legal considerations regarding how this form of capital would exist alongside other forms of capital, payment features and legal form given the variety of organisational structures that exist in the sector
Operational support	Where the long nature of these transactions will require a long term relationship with the borrower (particularly with key person risk), and ongoing monitoring / reporting of investment performance. The complexity of transactions may also expose originating organisations to execution risk if deals do not go ahead

10 APPLICATION TO COHORT QUESTIONS

Applying to the First Development Cohort is a pre-requisite for the consideration of investment proposals requesting grant to support a flexible finance offer to charities and social enterprises in England until March 2021 under this programme. To do so please complete this form.

We will aim to close the application window by **Friday 30 October 2020** at **12pm**. Keep an eye on our website and twitter feed for the latest information.

As this programme expects proposals to significantly develop through the co-design process, **we do not expect everyone to have full answers to each question**. However the level of detail provided will however help us assess whether an organisation has a proposal sufficiently developed to participate in the First Development Cohort. **Please answers all questions in no more than 3000 words in total.**

1. **NAME:**
2. **ORGANISATION:**
3. **PROPOSAL:** please provide as detailed a description as possible of the product(s) you are planning to offer including: the types of organisations you expect to work with (e.g. age, size, business model), how you expect the capital you are providing will support and improve the financial resilience of those organisations (referring to the "Capital Structure" table above). Please include details such as average expected deal size, duration, how the proposed product will allow for flexibility in receipt and/or repayment. **As part of responding to this question please provide a real/hypothetical case study illustrating the kind of organisation, capital requirement, and product type you intend to target and which would not otherwise be available.**
   Do you expect any overlap with any other products or services you are currently offering, or organisations you are already lending to? What level of financial return do you expect to generate over the horizon of each investment on average? How do you expect to be remunerated/cover costs? What preparation is needed to launch and do you have a timeframe in mind?
4. **EQUALITIES:** how do you plan to make your offering inclusive?
5. **CO-INVESTMENT:** Have you already identified a co-investment partner(s)? If so, are you aware of their investment requirements (e.g. return, reporting etc)? What is the quantum of capital they are looking to contribute?
6. **USE OF GRANT:** please describe how your proposal will use grant, and what problems/risks the grant is expected to solve (for fund-manager, co-investor or borrower). What are the quantum and optimal timings for disbursement of grant in your opinion?
7. **EXPERIENCE:** please tell us about your track-record delivering social investment and why you are interested in creating a flexible finance offer. Please describe the types of products and organisations you, or any partners you plan to collaborate with, have typically worked with in the past (age, size, business model) and whether these are similar to the organisations you plan to work with your proposed flexible finance offer. If yes, how does your proposed offer fit with your existing relationships? If no, how do you plan to identify and reach your target audience and know the offer suits their needs? Please outline how your operational plans are able to support the monitoring and management of the types of products you are proposing to offer for their duration. If you are planning to work with any partners please tell us how this will work and what the arrangement is.
8. **CHALLENGES**: what are the biggest risks and challenges to the successful launch and take-up of your offer? How are these best managed? Are there any system wide risks, challenges or efficiencies you believe can be addressed collectively? How can other market participants benefit from the learning your product will create?

Please send your submission by the deadline to neil.berry@access-si.org.uk