

Date: 31 January 2020

Subject: Social Enterprise Investment Framework for the GM Investment Fund

Report of: Councillor David Molyneux, Portfolio Lead Leader for Investment and Resources and Eamonn Boylan, Portfolio Lead Chief Executive for Investment

PURPOSE OF REPORT

This report seeks Greater Manchester Combined Authority (“Combined Authority”) approval for a new Investment Framework which will support the analysis of applications for funding from Social Enterprises from the GM Investment Fund. The Investment Framework also proposes outline terms and conditions on funding to Social Enterprises.

RECOMMENDATIONS:

The GMCA is requested to:

Approve the Social Enterprise Investment Framework to be used when considering applications for funding from Social Enterprises from the GM Investment Fund.

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BACKGROUND PAPERS:

TRACKING/PROCESS		
Does this report relate to a major strategic decision, as set out in the GMCA Constitution		YES
EXEMPTION FROM CALL IN		
Are there any aspects in this report which means it should be considered to be exempt from call in by the relevant Scrutiny Committee on the grounds of urgency?		NO PUBLIC DOMAIN RELEASE DATE: 31 JANUARY 2035
GM Transport Committee	Overview & Scrutiny Committee	

Equalities Implications – n/a

Climate Change Impact Assessment and Mitigation Measures – n/a

Risk Management – see paragraph 3

Legal Considerations – see paragraph 4

Financial Consequences – Revenue – see paragraph 5

Financial Consequences – Capital – see paragraph 6

1. INTRODUCTION

- 1.1 The Combined Authority maintains and develops a pipeline of projects submitted by applicants seeking funding from the Combined Authority's Core Investment Funds allocation. These projects are assessed against criteria based on the GM Investment Strategy, developed to underpin the economic growth of GM.
- 1.2 This assessment incorporates:
 - a) an appraisal by the GM Core Investment Team; and
 - b) a review by a sub group of GM Chief Executives.

2.0 RATIONALE FOR SUPPORTING SOCIAL ENTERPRISES THROUGH GMCA RECYCLED FUNDS

- 2.1 This proposed framework sets out the key principles to be applied to investments sought by entities that operate within the Social Enterprise sector and identifies some of the common challenges Social Enterprises face when seeking funding, typical operational differences between the Social Enterprise sector and private business and, in light of those factors, criteria for assessing the applications from the sector. It also sets out the underlying rationale for lending to the sector.

The aim of the GMCA supporting Social Enterprises is to:

- Help address market failures within the key sectors of the Local Industrial Strategy.
- Enable Social Enterprises to develop and expand trading activities so that they can become strong, sustainable businesses making a major contribution to their community by reinvesting surpluses made into the organisation or community to further their social and economic aims, in line with aims of the Mayor of Greater Manchester and Local Industrial Strategy.
- Help investees achieve financial sustainability for themselves: this means that they can boost the local economy and community through increased economic activity and by delivering services of benefit to the community.
- Make investments that will support the creation of new jobs, safeguard existing jobs, increase financial viability, enable capital purchase, support bidding for and winning new contracts and other sales activity.

2.2 *Issues effecting the access to funding*

Social Enterprises face various barriers when trying to raise funding:

- Security: lenders may not be able to obtain security, increasing the risk of any funding. This is discussed further in the next section.
- Asset lock: entities registered as Community Interest Company ("CIC") are subject to an asset lock, which means that assets must be retained within the CIC to be used for the community purposes for which it was formed. If they are transferred out of the CIC, the

transfer must satisfy criteria which restrict who the assets can be sold to – again such a restriction deters lenders.

- Management: directors may not have the same level of financial sophistication and commercial experience as commercially focused companies. This can lead to weaker financial controls.
- Motivation: Social Enterprises are set up to help the community, rather than make profit. This can sometimes lead to decisions to undertake projects that lose money or make the entity less financial stable. This investment framework seeks to encourage the sector to apply a commercial lens in order to increase the impact they have on the community.
- Financial viability: income sources may not be as certain, or could be reliant upon a single source of income (or ongoing endowments). This limits the certainty of financial viability.
- Underinvestment in operation and physical infrastructure: There are limited funds to invest as surpluses are invested in the service provision.
- Income: the balance of income might be skewed to Business to Consumer or public sector contracts.
- The above factors combine to limit available finance from mainstream finance providers. The strong social impact that CIC's can have and the limited sources of finance available support the recommendation that the GMCA should consider funding applications from Social Enterprises, in specific circumstances. Given the differing nature and objectives of Social Enterprises, however, it is necessary to apply a different lens to funding applications, compared to those that are purely commercial in nature.

2.3 *Social Enterprises and security*

Not all Social Enterprises can provide the usual debenture or fixed charge security that private companies can due to their incorporation status or individual constitutions. Others are unwilling to provide security to ensure the social outcomes they want to provide are not jeopardised by placing the entity into financial distress. This increases the risk profile and deters lenders to the sector.

It may not be possible for GMCA to take the normal suite of debenture and fixed charge security. Security will be taken when available.

Unlike in private sector organisations where directors can provide personal guarantees, it is not appropriate for trustees of Social Enterprises to provide personal security.

2.4 *Criteria and eligibility*

GMCA's investments can support varied organisational costs, including capital to purchase a building, capital for the development and/or refurbishment of a building, capital to purchase equipment (including software) or growth capital to increase the capacity of an organisation.

The investment terms will be based on risk and affordability. GMCA will offer a repayment plan that takes account of the applicant's needs.

Social Enterprises applying to the fund must:

- Have been operating for at least two years and be generating their own income streams from providing goods or services to external users;
- Be able to repay the loan within a maximum of 5 years;
- Have their principal place of business or a material part of their operations, people or trading based in Greater Manchester;
- Be economically viable and not in financial difficulty;
- Be able to demonstrate that they can repay the loan, plus interest, within the agreed repayment term;
- Operate within the key sectors or foundational economy as identified within the Greater Manchester Local Industrial Strategy;
- Not use the loan to pay for repay existing funding or any expenditure which may cause reputational harm to GMCA;
- Be able to demonstrate the proposal they are seeking investment for is "un-bankable" i.e. unable to secure the finance through mainstream/ commercial investors/lenders;
- Be able to demonstrate that the investment is not being used to replace funding already earmarked by existing agencies and the project would not take place in the same form without the investment;
- Be able to demonstrate that the investment will directly help improve their organisation's performance, substantially contribute to the economic growth of GM (e.g. creation of new jobs or safeguarding existing jobs), and delivers activity that benefits their community and delivers social value; and
- Not be wholly reliant on public sector funding or income.

In addition to the above eligibility criteria, when assessing an application, the following characteristics must be present:

- The majority of income derived from "business to business" services.
- An independent board of trustees or non-executive directors which is able to challenge and provide guidance to the management team, or is actively taking steps to achieve this position.
- A member of the independent board of trustees or non-executive directors must be responsible for financial control and have suitable qualifications and experience.
- A strong executive management team with proven capability to deliver commercially successful organisations.

- The financial control environment of the Social Enterprise must follow industry standard best practice, adopt the principles of IFRS or other relevant accounting standards and be led by a suitably qualified or experienced member of the executive management team.
- A viable business plan and financial projections linked to the utilisation of the loan.
- The remuneration of the executive management team must be in line with market norms and dividends should not be paid to management.
- Address a private sector market failure.

2.5 *Economic, social and financial return*

In all cases the following economic outcomes will be required:

- Increase in new jobs created.
- Existing jobs safeguarded.
- Growth in organisation turnover and generation of operational surpluses.

Measures of improved performance could include:

- New or improved products, processes or services.
- Increased annual turnover;
- Increased value of assets held;
- Increased unrestricted reserves;
- Increased surpluses from trading.

In all cases the following social outcomes:

- Increased numbers of service users.
- Improved quality of existing activities/services/facilities provided.
- Increased social impact of the Social Enterprises' desired field.

2.6 *Outline funding parameters*

Loans will be structured on the following basis:

- Secured and unsecured loans;
- Between £150,000 to £250,000;
- Drawn down in tranches linked to performance;
- Interest margin of at least 6.5%, increasing to typical maximum of 8%;
- Repayment terms of up to 5 years;

- Repayment holiday of up to 18 months; and
- Co-investment with other funders/investors.

The fund will provide predominantly unsecured loan finance. However, it would take security if it is available and/or make it more affordable for the applicant.

3. RISK MANAGEMENT

Following the adoption of the Social Investment Enterprise Framework, any application for investment from the Social Enterprise sector will be assessed against the criteria proposed. The assessment will be governed under the wider investment appraisal framework that includes several levels of review and ongoing monitoring of performance.

4. LEGAL CONSIDERATIONS

Any investment approved following the adoption of the Social Enterprise Investment Framework will be subject to legal agreements. The legal agreements will be based upon the existing templates for the GM Investment Fund, amended for the specific requirements of the individual funding arrangements.

5. FINANCIAL CONSEQUENCES – REVENUE

There are no revenue implications.

6. FINANCIAL CONSEQUENCES – CAPITAL

There are no capital implications.