GREATER**LONDON**AUTHORITY

REQUEST FOR MAYORAL DECISION – MD2237

Title: Establishing a legal entity for new SME Fund and temporary payment of its management costs and fees.

Executive Summary:

SME Wholesale Finance London Limited (a GLA subsidiary trading as Funding London) was awarded EU funding to establish a fund of funds (i.e. a fund that invests in other funds) to make repayable investments in London's SMEs. Funding London recommends that the fund of funds be established as a company limited by guarantee, with it as the sole member. Mayoral approval is required to set up a new company as set out in MD2146, which approved the acquisition of Funding London and its governance arrangements.

The development of the business plan for the fund of funds identified a funding need to temporarily cover management costs and fees, during the first few years of operation. The proposal is for GLA to invest up to £2.5 million towards this; on the basis that it would be repaid from returns generated from investments.

Decision:

It is requested that the Mayor approves:

1. SME Wholesale Finance London Limited (SMEWFL) establishing a company limited by guarantee that will operate solely as a fund of funds (i.e. a fund that invests in other funds), and for SMEWFL to become its sole member;
2. the delegation to the Executive Director of Development, Enterprise and Environment to approve the Articles of Association of this new company limited by guarantee, via a Director Decision; and
3. the investment (on commercial terms) of up to £2.5 million, from returns associated with European Regional Development Fund's (ERDF) allocation to the London Green Fund, to be used for management costs and fees during the first few years of operation of this new fund of funds.

Mayor of London

I confirm that I do not have any disclosable pecuniary interests in the proposed decision, and take the decision in compliance with the Code of Conduct for elected Members of the Authority.

The above request has my approval.

Signature:

Date: 2/3/18

PART I - NON-CONFIDENTIAL FACTS AND ADVICE TO THE MAYOR

Decision required – supporting report

1. Introduction and background

1.1 The Greater London Authority (GLA) was designated as an Intermediate Body (IB), by the Ministry of Housing, Communities and Local Government (MHCLG), to manage London's allocation[1] from the 2014-20 European Regional Development Fund (ERDF) England Operational Programme (OP). This role was approved in MD1583.

1.2 MD2086 approved the award of £32 million from London's ERDF allocation to SME Wholesale Finance London Limited (trading as "Funding London") to set up a fund to provide repayable finance for London's small and medium-sized enterprises (SMEs). It also approved the acquisition of Funding London, by GLA becoming its sole member; and this approval was formally actioned in subsequent MD2146.

1.3 In August 2017, Funding London submitted a business plan for the development of the fund. The recommendations of the two *ex ante* assessments (see paragraphs 4.7 and 4.8 below), which underpin the proposals in the business plan, is that the fund should be established using the 'fund of funds' model. In this model, funding from different sources are placed in a single legal entity (the fund of funds) before being invested in sub-funds – see the diagram in Appendix 1.

1.4 The proposal is to combine the £32 million ERDF with £50 million from the European Investment Bank (EIB); £7 million from London Waste and Recycling Board (LWARB); £9.5m of returns from previous funds managed by Funding London; and £1.5m from sub-fund managers to create a £100 million[2] fund of funds ("London SME Fund of Funds" or "LSF"). The monies in LSF will be allocated to four sub-funds that will provide loan and equity finance to help address the SME finance gap in London. Further details of the sub-funds, including their size and the range of investments to be made, are set out in the table of Appendix 1.

1.5 Funding London are responsible for procuring professional fund management organisations to set up and invest the monies that will be allocated to the sub-funds.

Management costs and fee

1.6 The business plan included a funding model developed by a consultant hired by Funding London. It is based in part on the conditions of the funders outlined in paragraph 1.4, especially those of ERDF and EIB. The model includes estimated annual investments to be made to SMEs, as well as estimated costs and fees for managing LSF and the sub-funds – see summary in tables 1 and 2 in Appendix 2. The proposal is that the entire £100 million committed to LSF will be invested directly in SMEs. This approach satisfies one of EIB's conditions - that its funding can only be used for making investments and be equally matched by funding from other sources. (This is a similar approach to the fund of funds established by the British Business Bank (BBB) and local authorities in North-East England, using EIB funding). There may be other Brexit-related conditions attached to the EIB funding, please see paragraph 4.4 and 6.4 for further details.

1.7 The estimated costs that Funding London will incur for setting up and implementing LSF is based on their previous and current experiences of being a fund of funds manager, as well as the estimated costs of taking on and servicing EIB's loan. The estimated fees that could be charged by the sub-

[1] London was allocated approximately €204 million from the 2014-20 European Regional Development Fund (ERDF) England Operational Programme for England. ERDF aims to strengthen economic and social cohesion in the European Union by correcting imbalances between its regions.

[2] This will increase to £102 million if the Decision is approved.

fund managers are based on the fund management fee benchmarks included in the ERDF Regulation but also take account of Funding London's experience of their previous funds. The actual fees will be determined as part of the procurement exercise to select the sub-fund managers.

1.8 As noted in paragraph 1.6 above, the entire £100 million will be invested in SMEs. The funding model in the business plan is therefore predicated on costs and fees being paid mainly using interest repayments from loans made to SMEs; but also from other monies held by Funding London. It will take time for the sub-funds to be fully operational and generate interest repayments, and the current forecast is that there will be insufficient interest repayments to pay management costs and fees during the first two years. However, this is forecast to reverse in subsequent years.

1.9 It is therefore proposed that funding from returns to the London Green Fund (LGF) is made available to cover this temporary deficit. Given the uncertainty around what the sub-fund managers fees will be (as this will be determined as part of the sub-fund manager procurement) it is suggested that up £2.5 million is made available, which could be reduced if the deficit turns out to be less. This would be invested in LSF on similar terms to those of the other funding sources outlined in paragraph 1.4, in that it would be repaid from any returns generated on investments made by the sub-funds – see forecast in Appendix 2. This would increase the size of LSF to £102.5 million.

1.10 The model produced by Funding London estimates an almost break-even position for LSF once EIB is fully repaid. This estimate is based on conservative performance assumptions for the sub-funds, which could be revised following the procurement of the sub-fund managers. Once EIB is repaid, investment returns, less cost and fees, will be distributed to the rest of the funders, including GLA, in proportion to the amounts invested. The current estimate is that GLA would get back at least 93% of its money, depending on the performance of the sub-funds and the level of fees. The schedule of repayment to the GLA would in line with the other funding sources, apart from EIB's; which is repaid first.

London Green Fund returns

1.11 The LGF was established, using the fund of funds model, with funding from GLA, the 2007-13 ERDF programme and LWARB. It provided equity and loan finance for low carbon infrastructure via three sub-funds (focusing on waste, energy efficiency in public buildings and social housing). Returns from the sub-funds have been paid directly to the GLA since we took over management of the LGF from the EIB last year.

1.12 ERDF rules require that investment funds established using ERDF must include an exit and wind-up strategy setting out how the returns will be reused. For the LGF, its strategy includes provisions for reusing the returns attributable to GLA's and ERDF's investments in similar activities, or other activities[3] as agreed by the GLA. Returns attributed to LWARB's investments are repaid to them. The returns repaid so far amount to £7.2m: £6.2m attributed to ERDF and £1m to GLA.

1.13 The energy efficiency activities of the LGF will continue under the new Mayor of London's Energy Efficiency Fund (MEEF); a £143m fund (£43m from 2014-20 ERDF and potentially up to £100m from EIB) to be supplemented by £260m from private sector investors. MEEF will be invested over the next five years and based on its proposed investment profile, it is not anticipated that there will be any immediate call on LGF returns for additional investment (although provisions are included for this).

1.14 However, one of LSF's sub-funds will provide investments for SMEs in the circular economy, which will lead to reduced waste and pollution by keeping products in use for as long as possible. As such, it is proposed that some of the LGF returns from the waste sub-fund, which is attributable to ERDF, be used to cover the deficit.

[3] Mayoral approval was granted, in 2015, for returns attributed to the GLA to be used to fund the 'RE:FIT' energy efficiency project and Decentralised Energy Enabling Project (DEEP).

Creating a Special Purpose Vehicle (SPV)

1.15 The legal advice obtained by Funding London proposes that LSF be set up as a special purpose vehicle (SPV) but as a separate legal entity. This would result in the SPV becoming the borrower from EIB and being responsible for repayments. The repayments to EIB will be made using the returns generated from investments by the sub-funds. As a senior lender to LSF, EIB will be repaid before other funders outlined in paragraph 1.4; and the GLA's £2.5 million investment. None of Funding London's investment returns from its existing funds, such as the London Co-Investment Fund (LCIF) will be used for repayments. Where applicable, any borrowing or repayment arrangements will comply with the Local Government Act 2003; and Funding London will seek legal advice on this. The EIB is familiar with using a SPV in this way as this structure has been used for establishing other fund of funds (including those created by the BBB) to which the EIB lends.

1.16 The SPV will be established as a company limited by guarantee and will be a wholly-owned subsidiary of Funding London, as its only member. Appendix 2 shows how the SPV would relate to each of the funding partners and the sub-funds. Each funding partner will make their commitment to the LSF through an agreement (either grant or loan) directly with the SPV, rather than with Funding London. However, EU rules and MD2086 which committed the £32 million ERDF to Funding London requires that they, as LSF manager, will also need to be party to the ERDF funding agreement. The SPV will be the entity that contracts directly with the sub-fund managers, once they are selected.

1.17 Funding London currently operates as an arms-length company from the GLA and the SPV, as a subsidiary of Funding London, will be one step further removed from the GLA. Notwithstanding this, the governance arrangement that will be established for the SPV will ensure that the GLA have proper oversight and scrutiny, as well as the ability to monitor performance directly or via Funding London.

1.18 The broad governance arrangements for the SPV will be outlined in its Articles of Association (AoA). The proposal is that Funding London's Board, as the SPV's sole member, will appoint the directors. The GLA will be consulted about all potential appointees and will have the ability to deselect any candidates, prior to any recommendations being made to Funding London's Board.

1.19 The SPV's AoA will include similar provisions to those in Schedule 3, Section 11 of Funding London's AoA, whereby GLA's prior approval is required for certain activities. This includes borrowing over a certain limit, changing the AoA or entering into any litigation that is material to the SPV. As with Funding London, approval will be granted via a Mayoral or Director Decision. Further details of this will be outlined in the Director Decision (DD) proposed in paragraph 1.20 below.

1.20 Paragraphs 4.5 to 4.9 of MD2146 concluded that Funding London is excluded from Part F of the 'Mayoral Decision-Making in the GLA' (MDM). This will also apply to the SPV. Part F of the current draft of the MDM deals with GLA's Subsidiary Companies, specifically Greater London Authority Holdings Limited (GLAH) and GLA Land and Property Limited (GLAP). However, given the difference in the nature of the activities of Funding London and the proposed SPV, and how they run compared to GLAH and GLAP, the SPV should be expressly excluded from Part F. This clarification and the proposal in paragraph 1.19 above will be incorporated into the MDM document at the point of its next update for ease of reference; but will irrespective apply from the point at which this MD is approved by the Mayor.

1.21 The SPV's AoA will be approved by the Executive Director of Development, Enterprise and Environment (DEE), via a DD. The ongoing governance oversight for Funding London and the SPV will be led by teams within the DEE Directorate and details of this will be outlined in the DD.

1.22 It is not envisaged that the SPV will employ staff, as Funding London will be responsible for its operations. They will be required to put in place adequate governance and management arrangements for the SPV to enable the successful implementation of LSF; and its sound legal and finance management. Funding London will also be required to update its internal scheme of delegation, which must be approved by GLA, to set out how they will take decisions on behalf of the SPV; and which decisions will be taken by the SPV's Board.

2. Objectives and expected outcomes

2.1 The adoption of the decisions above will enable the creation of LSF to help drive economic growth and job creation in London. The overarching aim of LSF is to provide finance for innovative SMEs to allow them to scale-up, achieve their growth ambitions and long-term sustainability. Through the sub-funds, LSF will provide equity and loan finance to SMEs operating in sectors that are important in enhancing London's competitiveness, including the emerging circular economy. LSF will provide finance to at least 220 SMEs, which should lead to the creation of approximately 3,400 new jobs in London.

2.2 A low carbon circular economy is one in which as much value as possible is extracted from resources, through their use and reuse. The Mayor's draft Environment Strategy highlighted the development of a low carbon circular economy as one of the strategic approaches to make the most of environmental opportunities now and in the future. LSF will help to boost the circular economy by making at least £14 million available for businesses in this sector.

2.3 The investments from LSF will be repayable and so, in addition to supporting economic growth and job creation, the fund will generate a financial return that can be reused to support the next generation of high growth businesses.

3. Equality comments

3.1 The England ERDF Operational Programme (OP) sets out requirements for equalities 'cross-cutting' themes and Funding London, the SPV and the managers of the sub-funds will be required to promote equality in accordance with European Union and national requirements in targeting investments to businesses.

3.2 Furthermore, the GLA as a public authority must comply with the Public Sector Equality Duty set out in section 149 (1) Equality Act 2010. This provides that, in the exercise of their functions, public authorities must have due regard to the need to:

- Eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Equality Act 2010;
- Advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it; and
- Foster good relations between persons who share a relevant protected characteristic and persons who do not share it.

3.3 The obligation in section 149(1) is placed upon the Mayor, as decision maker. Due regard must be given at the time a decision is being considered. The duty is non-delegable and must be exercised with an open mind.

3.4 This duty applies to GLA's role as an ERDF Intermediate Body and means that delivery of the OP must consider the needs of all individuals and have due regard to the need to eliminate discrimination, advance equality of opportunity, and foster good relations between different people. LSF will not directly focus on people but rather on businesses. However, the ERDF funding agreement will require Funding London, the SPV and sub-fund managers to take steps to prevent discrimination based on racial or ethnic origin, religion or belief, disability, age or sexual orientation during the development and implementation of the funds.

3.5 As set out in the Mayor's draft Economic Development Strategy, SMEs led by women, disabled people and people from BAME communities face particular barriers in accessing finance. To help improve the supply of finance from LSF to such businesses, a requirement will be included in the ERDF funding agreement for Funding London to produce a detailed action plan, in consultation with GLA, to raise awareness and increase take up from SMEs run by people from underrepresented groups. Funding London will be required to capture relevant data to monitor the effectiveness of the plan.

4. Other considerations

a) Key Risks and Issues

4.1 The risks and issues highlighted in MD2146 are also relevant to the proposals in this Mayoral Decision, and for the establishment of LSF. The risks for the GLA are:

a) Uncertainty about timing and value of returns: Funding London operates on the basis that its operations are funded from the projects it delivers for the GLA and any returns from previous investment funds. As noted above, the proposal is that management costs and fees will be financed from interest repayments but as the timings and values of these repayments are uncertain at this stage, there is a risk that the deficit may be larger and/or extended to more than two years. This may result in Funding London approaching the GLA for further support to smoothen its cash flow and/or reduce the amount repayable from the £2.5m.

To help mitigate this, GLA officers will work with Funding London to (i) procure good quality sub-fund managers that have excellent track record in making sound investments and delivering returns; and (ii) to monitor LSF's costs and fees and ensure that these are kept to the minimum needed.

b) Reputation: The new SPV will be a wholly-owned subsidiary of Funding London, which is itself a subsidiary of the GLA. As such, the GLA will be closely associated with LSF and its activities. To manage any reputational risks of this association, officers will ensure that GLA has proper oversight and is able to monitor the SPV through means including: having appropriate clauses in its AoA to require certain decisions to have the GLA's prior approval; ensuring adequate governance arrangements are in place; and contractual controls in the ERDF funding agreement.

c) Financial Consolidation: Funding London is a wholly-owned subsidiary of GLA, and its accounts and those of the new SPV will be consolidated within GLA's accounts. This means any debt, either existing or new will be included on the GLA's balance sheet; and the GLA will need to assess any financial risk if and when they arise.

4.2 Funding London's governance relationship with the GLA was set out in MD2146. There is no intention to make any significant change to those arrangements in relation to the establishment and operations of the SPV. However, as Funding London is now a 'Regulated Company' of the GLA under the Local Authorities (Companies) Order 1995, so will be the new SPV. As such, the SPV will be subject to legislative requirements, such as application of the Freedom of Information Act 2000, access to the GLA's auditors and identification of the GLA as the controlling authority on its business communications.

4.3 In December 2017, the UK Government agreed to continue implementing EU funded programmes beyond Brexit for their full term, until December 2023. The ERDF funding agreement to facilitate the awarded of £32 million ERDF to LSF will be concluded accordingly. Even in the event of 'no-deal' with the EU, we could still provide ERDF funding on the basis that the government confirmed in October 2016 that it would guarantee EU funding for agreements signed before the UK's departure from the EU, even when these projects continue after the UK has left the EU. Adopting the decisions above will enable an ERDF funding agreement to be concluded with Funding London and the SPV ahead of Brexit.

4.4 The EIB has also indicated that as the UK is still a member of the EU, it continues to be eligible for the £50m investment that was agreed by its Board. However, this is subject to their due diligence and final approval of their management committee, after the sub-fund managers are selected. Following a pause in lending to the UK after Article 50 was triggered, the EIB has since agreed to lend to entities in the UK, where their activities will continue after Brexit. GLA officers will work with Funding London to ensure that the investment is concluded ahead of Brexit. The final EIB loan agreement will be subject to a separate Mayoral Decision once the details are known.

b) Links to Mayoral Strategies

4.5 The establishment of LSF is in line with the overarching vision and objectives outlined in the Mayor's draft Economic Development Strategy (EDS) and 'A City For All Londoners'. It will help to address the SME finance gap in London. Indeed, the draft EDS states that '…the Mayor will work with partners such as the European Investment Bank to establish a new SME Fund. The fund will focus on those businesses seeking to scale-up and achieve their growth ambitions and those aiming for long-term sustainability.'

4.6 LSF will also help to achieve the Mayor's ambition of London becoming a zero-carbon city by 2050 as set out in the draft Environment Strategy. LSIF will support the development of the Circular Economy (CE) ecosystem by providing early stage finance to CE businesses.

c) impact assessments and consultations.

4.7 EU regulations require that *'ex ante'* assessments are carried out in respect of ERDF-backed investment funds to demonstrate market failures and funding needs. Initial work was carried out by Regeneris Consulting Ltd, in conjunction with EIB, and further work was done by PwC on circular economy businesses. These studies found an estimated unmet demand for SME finance of £300m per year.

4.8 The *'ex ante'* assessments also included a review of current finance provisions and detailed consultation with key stakeholders and market players. This led to the recommendation to establishment of a fund of at least £100m to provide debt and equity finance to SMEs at different stage of development, using a 'fund of funds' model.

5. Financial comments

5.1 This decision requests the establishment by SME Wholesale Finance London Limited (SMEWFL), of a company limited by guarantee that will operate solely as a fund of funds (i.e. a fund that invests in other funds), and for SMEWFL to become its sole member. It is proposed to be set up as a special purpose vehicle (SPV) but as a separate legal entity which will be consolidated into the GLA's Group accounts.

5.2 This decision also requests approval of expenditure up to £2.5m to cover management costs and fees during the first two years whilst the funds are becoming established. It is proposed to fund the £2.5m from returns associated with European Regional Development Fund's (ERDF) allocation to the London Green Fund, with a view this would be repaid from future returns generated from investments.

5.3 Future returns generated from interest repayments are subject to uncertain timings and values. This may give rise to a risk that the £2.5m deficit may be larger and/or extended to more than the two years. This may result in SMEWFL approaching the GLA for further support to smoothen its cash flow and /or reduce the amount repayable. Any additional budget request will be subject to further GLA approval.

6. Legal comments

6.1 The GLA's principal purposes, under section 30 of the Greater London Authority Act 1999, are to promote economic development and wealth creation, promote social development, and the improvement of the environment, all in Greater London. The GLA has the power to do anything which it considers will further any one or more of its principal purposes. The investment activities of Funding London fall within these principal purposes.

6.2 Once Funding London have set up this new subsidiary, this subsidiary will also be regarding as a "Regulated Company" under the Local Authorities (Companies) Order 1995 (as amended) which imposes duties on the company including as regards the identification of it as a GLA subsidiary on its company documentation, the access of the GLA auditors to its accounts and also the right for GLA elected members to inspect its meeting agendas and minutes.

6.3 The terms of the investment by the GLA of £2.5 million to the SPV are designed to ensure it is compliant with state aid rules.

6.4 Officers have indicated in paragraph 4.4 that the EIB loan will be subject to a separate Mayoral Decision. We understand that the EIB is currently reviewing its loan arrangements following the triggering of Article 50 of EU Treaty and is putting in place 'Brexit Clauses' which may impose additional conditions in relation to the EIB loan with Funding London's SPV. Officers will need to carefully consider the implications for the GLA and Funding London once these conditions are known before any such agreements are signed and seek appropriate legal advice.

7. Planned delivery approach and next steps

The following key activities will lead to the establishment of the LSF and its sub-fund:

Activity	Timeline
Launch of procurement to select fund management organisations to set up and invest the capital allocated to the sub-funds.	March 2018
Establish SPV	March 2018
Issue ERDF Funding Agreement.	March 2018
Select fund management organisations for sub-funds.	June 2018
EIB completes due diligence and get their management committee approval.	July 2018
Obtain Mayoral approval for EIB lending to SPV	August 2018
Launch Sub-funds	October 2018

Appendices and supporting papers:

Appendix 1: Proposed Fund of Funds model and details of sub-funds
Appendix 2: LSF Estimated Management Costs and Fees and SPV structure (Part 2 Confidentiality)

Background Papers:

MD2086 Part 1 and 2 (not appended)
MD2146

Public access to information
Information in this form (Part 1) is subject to the Freedom of Information Act 2000 (FOI Act) and will be made available on the GLA website within one working day of approval.

If immediate publication risks compromising the implementation of the decision (for example, to complete a procurement process), it can be deferred until a specific date. Deferral periods should be kept to the shortest length strictly necessary. **Note**: This form (Part 1) will either be published within one working day after approval <u>or</u> on the defer date.

Part 1 Deferral:
Is the publication of Part 1 of this approval to be deferred? NO
If YES, for what reason:

Until what date: (a date is required if deferring)

Part 2 Confidentiality: Only the facts or advice considered to be exempt from disclosure under the FOI Act should be in the separate Part 2 form, together with the legal rationale for non-publication.

Is there a part 2 form – YES

ORIGINATING OFFICER DECLARATION:	Drafting officer to confirm the following (✓)
Drafting officer: Kenroy Quellennec-Reid has drafted this report in accordance with GLA procedures and confirms the following:	✓
Assistant Director/Head of Service: Alex Conway has reviewed the documentation and is satisfied for it to be referred to the Sponsoring Director for approval.	✓
Sponsoring Director: Fiona Fletcher-Smith has reviewed the request and is satisfied it is correct and consistent with the Mayor's plans and priorities.	✓
Mayoral Adviser: Rajesh Agrawal has been consulted about the proposal and agrees the recommendations.	✓
Advice: The Finance and Legal teams have commented on this proposal.	✓
Corporate Investment Board This decision was agreed by the Corporate Investment Board on 26 February 2018.	

EXECUTIVE DIRECTOR, RESOURCES:
I confirm that financial and legal implications have been appropriately considered in the preparation of this report.
Signature M. D. Elle **Date** 28.2.18

CHIEF OF STAFF:
I am satisfied that this is an appropriate request to be submitted to the Mayor

Signature D. Bellamy **Date** 28/2/2018