

GREATER **LONDON** AUTHORITY

REQUEST FOR MAYORAL DECISION – MD2086

Title: 2014-20 European Regional Development Fund (ERDF) programme: London SME fund

Executive Summary:

This Mayoral Decision seeks approval for the award of up to £32m from London's European Regional Development Fund (ERDF) allocation to SME Wholesale Finance London Limited (SMEWFL trading as "*Funding London*"- a company limited by guarantee) to make loan and equity investments in small businesses.

It also proposes the GLA acquisition of SMEWFL – by GLA becoming its sole member.

Decision:

It is requested that the Mayor approves:

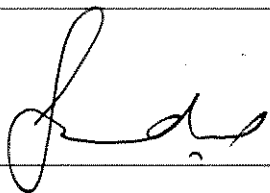
1. The commitment and award of up to £32m European Regional Development Fund to SMEWFL;
2. The acquisition of SMEWFL by means of the GLA becoming its sole member.

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:

30/5/12

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) has been designated as an Intermediate Body (IB) by the Department for Communities and Local Government (DCLG) for the award, management and administration of European Regional Development Fund (ERDF) of the London component of the 2014-20 European Structural and Investment Funds England programme.
- 1.2 The Government has stated that ERDF funding agreements entered into prior to UK exit from the EU will be honoured.
- 1.3 The former London Enterprise Panel committed up to £32m from the 2014-20 London ERDF programme towards an access to finance initiative for small and medium sized enterprises (SMEs). This will be done through the development of a financial instrument (FI) which will make recyclable loan and equity investments to London SMEs, building on the two previous ERDF-backed SME funds managed via SME Wholesale Finance Ltd (SMEWFL, trading as 'Funding London').
- 1.4 SMEWFL has a good track record of delivering the type of FIs envisaged for this programme. Its structure, however, reflects its origins when it was established by the London Development Agency. It is appropriate to bring the structure up to date, fully within GLA's control. The mechanism for ensuring this control is for the GLA to become SMEWFL's sole member, with the other five members resigning and appropriate changes being made to the company's Articles of Association to accommodate that.
- 1.5 The requirement for Mayoral approval of amendments to SMEWFL's Memorandum and Articles of Association dates back to a Mayoral Decision of 2003, MA1377.
- 1.6 If this Mayoral Decision is agreed, then GLA's governance structures as they apply to subsidiaries will need to be reviewed to accommodate SMEWFL and a further decision will be requested of the Mayor in that regard. It should be noted that the two decisions are, therefore, connected.
- 1.7 Further implications of this and other options for selecting an organisation to set up and manage the SME Fund are attached at Appendix 1. Further information on SMEWFL and its governance is at Appendix 2.

Previous Mayoral Decisions

- 1.8 This request follows on from Mayoral Decision 1583 (March 2016) where the previous Mayor:
 - approved the designation of the GLA as an IB for the 2014-20 ERDF programmes, and the entering into a Memorandum of Understanding (MOU) between the GLA and DCLG; and
 - approved the delegation limits for administration of the approved ERDF expenditure.
- 1.9 Subsequent Mayoral Decisions 1613, 2016 and 2094 (March and October 2016, April 2017) have committed and/or awarded up to £380m of ERDF and European Social Fund to co-financing organisations and projects.

2. Objectives and expected outcomes

- 2.1 All ERDF applications are required to meet the objectives of the England ERDF Operational Programme (OP) – focussing on investment to support economic growth and job creation.
- 2.2 The OP was drafted by DCLG and agreed with the European Commission in 2015. ERDF applicants must explain how they will contribute to the overall expenditure targets and outputs of the London share of the England ERDF programme.
- 2.3 This 'Fund of Funds' project will make recyclable loan and equity investments to London SMEs, utilising funding from ERDF, the European Investment Bank (EIB), London Waste and Recycling Board (LWARB), previous returns and the private sector. The potential structure of the SME Fund and its rationale is set out at Appendix 3.
- 2.4 The acquisition of SMEWFL will facilitate the above project; while also providing an opportunity to further strengthen existing governance arrangements.

3. Equality comments

- 3.1 The EC and DCLG-agreed ERDF OP sets out the requirements for ensuring adherence to ERDF mandatory equalities 'cross-cutting' themes. ERDF will promote equality in accordance with European Union and national requirements.
- 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 had at the time a particular decision is being considered. The duty is non-delegable and must be exercised with an open mind.
- 3.4 This duty applies in the delivery of ERDF and means that delivery of the OP at local level, including in London, 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. Where a project has a particular objective to work with people with specific protected characteristics, this will be inherent in the project application. Grant recipients such as SMEWFL will be expected to capture this data as part of their project management.

4. Other considerations

a) key risks and issues

- 4.1 The amount of ERDF allocated to SMEWFL may be revised during the approval process as officers negotiate the Funding Agreement. However, it is not expected to exceed the £32million stated on the cover page of this Mayoral Decision; any increase would be approved in line with the delegations listed in Mayoral Decision 1583.

- 4.2 Once ERDF Funding Agreements have been issued and signed between the GLA and SMEWFL as Grant recipient, GLA officers will monitor the delivery of the operations to ensure activity takes place and outputs are achieved. It is common for ERDF operations to seek one or more contract variation during their lifetime; officers will manage this process in accordance with the change process set out in the Funding Agreement by ensuring a GLA officer with appropriate delegated authority approves any variation.
- 4.3 As set out in Appendix 1, the alternative to awarding ERDF directly to SMEWFL would be to hold an open competitive OJEU process to appoint a 'fund of funds' manager. This would extend contractual negotiations by over a year, putting both the project and its European Investment Bank matchfunding at risk, given the Brexit timetable. It would also risk a disjointed approach for GLA-backed provision of SME Finance; with SMEWFL operating separately from any new fund, as returns from their previous activities must be used for similar activities.
- 4.4 External legal and financial due diligence reports were commissioned to understand the risks of acquiring SMEWFL. Neither report raised issues that affect the recommendations set out in this decision, but both flagged useful ancillary matters which are now in the process of being addressed – summarised in the Part 2 paper with this decision.
- 4.5 The GLA will set out the most appropriate model of ownership and review SMEWFL and the GLA's governance arrangements in the subsequent Mayoral Decision proposed at paragraph 1.6. There is no intention to make any significant change at this time to the arrangements, subject to SMEWFL being a 'Controlled Company' of the GLA under the Local Authorities (Companies) Order 1985. Therefore SMEWFL will be subject to legislative requirements, such as application of the Freedom of Information Act 2000.
- 4.6 All ERDF projects must be matchfunded. Match funding from EIB has been agreed in principle but will not be formalised until SMEWFL's business plan in respect of the fund is further advanced and the ERDF is committed. In the event that EIB were subsequently to withdraw their offer, or agreement could not be reached on their terms; then alternative domestic match funding would be sought. The acquisition of SMEWFL is not therefore dependent on provision of EIB match.

b) links to Mayoral strategies and priorities

4.7 The projects approved for ERDF contribute to London's share of the England ERDF OP targets. As part of their appraisal all projects, including this proposed SME Fund, are assessed on their alignment with the London European Structural and Investment Fund (ESIF) Strategy which, in turn, supports Mayoral economic objectives for a competitive and fairer London. A consultation on the ESIF Strategy was undertaken in 2013; the feedback was taken on board in the final drafting of the strategy submitted to DCLG in January 2014. All ESIF Strategies were re-submitted, following changes in the formatting of the document, at Government's request in April 2016.

c) impact assessments and consultations.

- 4.8 To inform how the ERDF is used, EU regulation required that an 'ex ante' assessment was carried to demonstrate, among other things, the market failures and funding gaps relating to SMEs finance. Regeneris Consulting, working with the EIB, produced an analysis of the SME finance market in London. They were able to generate indicative estimates of unmet demand of £300 million per year, assuming that 10% of the SME base surveyed had viable business plans.
- 4.9 The above analysis was supplemented with a review of current finance provision and detailed consultation with key stakeholders and market players. Following this, the consultants have recommended the establishment of a fund of at least £100 million to cover debt and equity finance for SMEs at different stage of development, using the 'fund of funds' model.
- 4.10 An assessment was also carried out into using ERDF to address the market failure in financing businesses in the circular economy. The recommendation from this report was that it would be better to incorporate a circular economy fund within a wider SME fund; to reduce costs and achieve better synergies.

5. Financial comments

- 5.1 SMEWFL's core business of investing in early stage unsecured SMEs to facilitate their growth is inherently risky and in acquiring the company the GLA's main risk is whether sufficient return can be generated for re-investment and there are no shortfalls for operational costs or liquidity issues.
- 5.2 The carrying value of the current funds provides reassurance over the re-investment objectives, although the largest fund, the London Co-Investment Fund (LCIF) has only invested just over half of its approved funding to date. The GLA has approved funding of £25 million for LCIF following recommendation from the former London Enterprise Panel on the expectation that this is fully repaid and re-invested on what would now be the LEAP's priorities. These returns are only likely to begin once the fund is fully invested after 2018 and would not be fully repaid until the early 2020s. The financial position can be formally reviewed as part of the GLA's approval of its business plan and investment activities.
- 5.3 The proposed application of the £32 million ERDF funding in this decision is to create a new £100 million 'fund of funds' to provide loan and equity investments. This would involve a £50 million loan from the EIB and therefore the scale of its investments would eventually more than double Funding London's current investment activity.
- 5.4 The financial due diligence noted initiatives that have been taken to improve Funding London's financial management and this will need to be reviewed as part of the on-going oversight arrangements given the scale of the proposed future activity. The loan and its terms would be subject to a separate GLA decision. It is not anticipated that the GLA would be required to provide any guarantee to the EIB (which would need to satisfy itself over repayment), but as a company controlled by the GLA, Funding London would be consolidated in the GLA's group statement of accounts, which will include any EIB borrowing. The key risk for the GLA would be exposure to having to provide the necessary cash flow in the event that Funding London did not have sufficiently liquid resources to

repay the EIB, for example from the timing of investment returns. Exposure to liquidity problems is also relevant in respect of current activities. The financial due diligence highlighted that although Funding London's cashflow position is well monitored and managed, this risk remains relatively high.

- 5.5 Funding London's insurance arrangements have also been reviewed by the GLA's insurance adviser. This highlighted several issues that are currently being taken forward by Funding London. Confirmation of any changes in cover will need to be in place before acquisition.
- 5.6 Financial due diligence also highlighted that the level of LCIF management fees is considered to be relatively high and therefore the scope for seeking reductions should be addressed.

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 power to do anything which it considers will further any one or more of its principal purposes. The investment activities of SMEWFL under ERDF and other funding programmes fall within these principal purposes.
- 6.2 Under section 34(1) the GLA may do anything it considers will facilitate or is conducive or incidental to the exercise of the section 30 principal purposes. Sections 30 and/or 34 provide the legal powers for the GLA to become the sole company member of SMEWFL on the resignation of the other members, and thereby for the company to become a wholly owned subsidiary of the GLA.
- 6.3 As a wholly owned subsidiary SMEWFL is 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.
- 6.4 The Mayor can authorise a GLA director to exercise the GLA's rights as a company member at company general and board meetings in order to acquire sole ownership and control of the company.

7. Planned delivery approach and next steps

- 7.1 Following Mayoral approval, SMEWFL will need to undertake a number of steps to permit the GLA to be the sole member and owner of SMEWFL; the amendments to the Articles of Association need to be approved by SMEWFL, and all the current members (apart from the GLA) will need to resign to give effect to the GLA being the sole member.
- 7.2 Following the activities listed in paragraph 7.1, SMEWFL will prepare a business plan, the European Programme and Management Unit (EPMU) will issue a ERDF Funding Agreement to SMEWFL, and SMEWFL will undertake a OJEU procurement process to procure fund manager/s.
- 7.3 EPMU will then manage operations in line with DCLG instructions and guidance; and in respect of the delegation limits set out in Mayoral Decision 1583.

Appendices and supporting papers:

Appendix 1 - SME Fund Selection Options

Appendix 2 - History of SMEWFL

Appendix 3 - London SME Fund of Funds

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 or on the defer date.

Part 1 Deferral:

Is the publication of Part 1 of this approval to be deferred? NO

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:

Alex Conway has drafted this report in accordance with GLA procedures and confirms the following:

✓

Sponsoring Director:

Martin Clarke has reviewed the request and is satisfied it is correct and consistent with the Mayor's plans and priorities.

✓

Mayoral Adviser:

Rajesh Agarwal 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 the 30th May 2017

EXECUTIVE DIRECTOR, RESOURCES:

I confirm that financial and legal implications have been appropriately considered in the preparation of this report.

Signature

M. D. Billa

Date

30.5.17

CHIEF OF STAFF:

I am satisfied that this is an appropriate request to be submitted to the Mayor

Signature

D. Bellamy

Date

30/5/2017.

