

GREATER LONDON AUTHORITY

REQUEST FOR MAYORAL DECISION – MD2367

Title: Greater London Investment Fund's Management Costs and Fees

Executive Summary:

SME Wholesale Finance London Limited (a GLA subsidiary trading as Funding London) was awarded £32 million from the European Regional Development Fund (ERDF) to combine with £50 million from the European Investment Bank (EIB) to establish an investment fund to support London's SMEs. The funding model for the investment fund (to be called Greater London Investment Fund (GLIF)) is based on management fees and costs being mainly paid from interest returns generated from investments.

In July 2018, EIB expressed concern, as part of their due diligence, that some of the assumptions in the GLIF's funding model were too optimistic compared to those seen in other SME funds they have supported in the UK. They asked for the model to be modified with more conservative figures. This resulted in a shortfall in the estimated interest returns that would be generated to cover costs and fees. To reduce the shortfall, EIB requested that GLA provided additional funding to Funding London to be used in GLIF. They also asked the GLA to provide a financial guarantee to cover any shortfalls in the latter years in the event that GLIF performs poorly.

Decision:

It is requested that the Mayor approves:

1. The award of a further £3 million from London's European Regional Development Fund (ERDF) to SME Wholesale Finance London Limited for commitment to the Greater London Investment Fund (GLIF);
2. The investment (on commercial terms) of a further £2 million from returns associated with the 2007-13 ERDF programme's investment in the London Green Fund, to SME Wholesale Finance London Limited to cover GLIF's management costs and fees;
3. The authorisation for the Executive Director of Resources to provide a financial undertaking ("guarantee") to EIB that GLA will provide funding, up to £1.2 million if needed, to SME Wholesale Finance London Limited for GLIF's management costs and fees after the initial amounts set aside for this purpose have been used;
4. That in the event the guarantee is needed, the monies will be provided (on commercial terms) from returns associated with ERDF's allocation to the London Green Fund to SME Wholesale Finance London Limited; and
5. The proposal not to proceed with the micro loan sub-fund of GLIF, as set out in Appendix 1.

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:

25/7/10

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 allocation¹ 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") (a GLA subsidiary) to set up a fund (to be called Greater London Investment Fund (GLIF)) to provide repayable finance for London's small and medium-sized enterprises (SMEs). The £32 million ERDF will be combined with £50 million from the European Investment Bank (EIB); £7 million from London Waste and Recycling Board (LWARB); and £11 million of returns from previous funds managed by Funding London, to make GLIF a £100 million fund.
- 1.3 In August 2017, Funding London submitted a business plan to the European Programmes Management Unit, within the GLA, outlining how GLIF will be developed and implemented. The proposal was for GLIF to be established using the 'fund of funds' model. In this model, the funding from different sources are placed in a single legal entity (i.e. fund of funds) before being allocated to four sub-funds – see the diagram in Appendix 1.
- 1.4 The monies allocated to the sub-funds will provide loan and equity finance to help address the SME finance gap in London. Funding London was granted approval, via MD2237, to establish a company limited by guarantee that will operate solely as the fund of funds. The company, which is a wholly owned subsidiary of Funding London, has now been established and is called GLIF Limited.
- 1.5 In March 2018, Funding London launched a procurement exercise to select professional fund management organisations to set up and invest the monies that will be allocated to the four sub-funds. This is currently at preferred bidder stage.

Management costs and fees gap

- 1.6 The GLIF's business plan included a funding model developed by a consultant hired by Funding London and set out estimated operating costs for GLIF and fees for managing the sub-funds – see table 1 in Appendix 2. The funding model was developed on the basis that costs and fees would be paid mainly using interest repayments from loans made to SMEs but also from other monies held by Funding London. This approach would allow the entire £100 million allocated from the different sources (outlined in paragraph 1.2 above) to be invested in SMEs – this is a key requirement of EIB in respect of their £50m loan.
- 1.7 As it will take time for the sub-funds to become fully operational and start generating enough interest repayments, approval was granted in MD2237 to provide up to £2.5m to cover the estimated gap in amounts available to pay costs and fees (i.e. the potential "fees gap" – any shortfall in the estimated interest repayments needed to pay costs and fees).

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.

- 1.8 This potential fees gap was exacerbated by EIB's request for GLIF's funding model to be amended to include a significantly more conservative forecast performance for the sub-funds. EIB did not request this on the basis of Funding London's actual performance in respect to support to business provided over the last 15 years; which has covered the costs required to pay fund managers' fees without further funding being required. Rather they looked at the track record of previous SME funds outside London that they have supported in the UK. This approach means that the estimated interest returns would be less, resulting in a potential larger fees gap.
- 1.9 As a result, in July 2018 the Mayor wrote to EIB's President to highlight the importance of GLIF and EIB's matchfunding; and our willingness to work with EIB to agree a way forward. This included, if necessary, providing additional funding to Funding London to cover the fees gap.
- 1.10 Since then, there have been detailed discussions with EIB to agree a revised funding model. The model preferred by the EIB is our 'worst-case scenario' version. In this model, the estimated returns to be generated by the sub-funds is reduced by about 50%. While there is also an overall reduction in management fees (due to less performance linked fees being paid) the potential fees gap becomes larger due to the significant reduction in the estimated interest returns – see table 3 in Appendix 2.
- 1.11 In order for the EIB to obtain internal approval from their credit team, ahead of approval from their management committee in October 2018, EIB has requested that:
- Additional funding is made available to Funding London to reduce the potential fees gap; and
 - GLA provide a financial guarantee of £1.2 million that the GLA would pay Funding London for any potential fee gaps in later years and this would only be used if further cover is needed.

Reducing the Fees Gap

- 1.12 As part of the discussion to reduce the potential fees gap, it was proposed that we no longer proceed with the £5 million micro loan fund, as outlined in Appendix 1. This is mainly because the micro loan fund contributed disproportionately to the potential fees gap. Additionally, EIB was wary of the higher level of risk associated with the micro loan fund. The £5 million will be allocated equally to the other loan funds. Table 4 in Appendix 2 shows the resulting potential fees gap without the micro loan fund.
- 1.13 The micro loan fund was geared towards addressing the debt funding gap, between £10K and £100K, faced by to new, young or established businesses. However, the impact of not proceeding with it should be mitigated by the start-up loans provision now provided by the British Business Bank. The micro loan fund was expected to support 57 businesses and create at least 114 jobs. Given that GLIF, as a whole, is projected to create 3,350 jobs, it is felt its removal will not significantly affect GLIF's overall outcomes.
- 1.14 As noted in paragraph 1.7, £2.5 million has already been committed to cover the fees gap. However, to reduce the fees gap further and improve the financial viability of GLIF, EIB requested that at least a further £5 million should be committed to GLIF. In his letter to the EIB's president the Mayor noted that should it be necessary, the fees gap could be covered by allocation of further ERDF and/or returns from returns associated with the 2007-13 ERDF programme's investment in the London Green Fund.
- 1.15 Recently, MHCLG adopted a new exchange rate for determining the sterling (£) value of the 2014-20 ERDF Programme. This has resulted in an increase in London's ERDF allocation. It is therefore proposed that an additional £3 million ERDF is allocated to Funding London for GLIF. The principle of allocating further ERDF was agreed in principle by the LEAP² sub-committee responsible for

² The London Economic Action Partnership (LEAP) is the local enterprise partnership for London.

strategic monitoring of EU funding. It is also proposed that a further £2 million is allocated to Funding London to go to GLIF from the GLA's share of returns associated with the original 2007-13 ERDF programme's investment in the London Green Fund, on the same basis as that set out in paragraphs 1.11 to 1.14 of MD2237.

GLA Guarantee

- 1.16 While the additional £5 million allocation as explained above will reduce the potential fees gap considerably, it would not eliminate the risk entirely if the worst-case scenario model were to materialise. As such, EIB has asked that GLA provide a guarantee to Funding London to cover any further fees gap in the event that the sub-funds perform as poorly as envisaged by the worst-case scenario model. This amount is currently estimated to be just over £1 million. In the event that this guarantee is called upon, it is proposed that this would also be paid from the returns to the GLA associated with the London Green Fund.
- 1.17 As noted above, the proposed funding and guarantee in the above paragraphs 1.14, 1.15 and 1.16 will be committed to Funding London for GLIF and will not go directly to the fund management organisations that are currently being procured. If and when needed, the funding will be made available to Funding London.

2. Objectives and expected outcomes

- 2.1 The adoption of the decisions above will enable the creation of GLIF to help drive economic growth and job creation in London. The overarching aim of GLIF 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, GLIF will provide equity and loan finance to SMEs operating in sectors that are important in enhancing London's competitiveness, including the emerging circular economy. GLIF will provide finance to at least 220 SMEs, which should lead to the creation of up to 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 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. GLIF will help to boost the circular economy by making at least £14 million available for businesses in this sector.
- 2.3 The investments from GLIF 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 principles and commitment outlined in the Equality Comments section in MD2237 and DD 2251 are still relevant for this MD. Specifically, GLIF and the organisations procured to manage the sub-funds will be required to promote equality in accordance with European Union and national requirements in targeting investments to businesses.
- 3.2 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. The activities of GLIF will focus on businesses rather than directly on people. However, the ERDF funding agreement require Funding London, GLIF and the sub-fund managers to take steps to both prevent discrimination based on racial or ethnic origin, religion or belief, disability, age or sexual orientation during the development and implementation of the funds and advance equality of opportunity and foster good relations between people who share a protected characteristic and those who do not³.
- 3.5 The current ERDF funding agreement also includes a requirement for Funding London to produce a detailed action plan, in consultation with GLA, to raise awareness and increase take up of GLIF's investments from businesses run by people from underrepresented and/ or protected groups.

4. Other considerations

a) Key Risks and Issues

- 4.1 As this MD will enable the implementation of the decisions in MD2237, the risk and issues highlighted therein are almost the same. In summary, these are:

a) Uncertainty about timing and value of returns: GLIF will operate on the basis that management costs and fees will largely 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 fees gap may be larger. This may result in Funding London approaching the GLA for further support to smoothen its cash flow and/or increase the guarantee.

To help mitigate this, GLA officers will work with Funding London to ensure that the fund managers deliver the proposals that were included in their bids. EIB will also take a more active monitoring role by being an observer on the advisory committee of the sub-funds.

b) Reputation: GLIF 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 GLIF and its activities. To manage any reputational risks of this association, relevant provisions to allow GLA to have proper oversight has been include in the Articles of Association for GLIF Limited. This has been supplemented by the contractual controls in the ERDF agreement.

c) Financial Consolidation: Funding London is a wholly-owned subsidiary of GLA, and its accounts and those of GLIF Limited 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 risks if and when they arise.

³ Protected characteristics under the Equality Act are age, disability, gender re-assignment, pregnancy and maternity, race, religion or belief, sex, sexual orientation, and marriage or civil partnership status (the duty in respect of this last characteristic is to eliminate unlawful discrimination only). This may involve, in particular, removing or minimising any disadvantage suffered by those who share a relevant protected characteristic, taking steps to meet the needs of such people; and encouraging them to participate in public life, or in any other activity where their participation is disproportionately low, including tackling prejudice and promoting understanding. In certain circumstances compliance with the Act may involve treating people with a protected characteristic more favourably than those without the characteristic.

- 4.2 Funding London is now a 'Regulated Company' of the GLA under the Local Authorities (Companies) Order 1995 and so is GLIF Limited, as its wholly owned subsidiary. As such, it 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 The UK Government has confirmed it will continue to implement EU funded programmes beyond Brexit for their full term, until December 2023; even in the event of 'no-deal' with the EU on the terms of the UK's current proposed draft withdrawal agreement. As such, ERDF funding will still be available after the UK's departure from the EU in both 'deal' and 'no deal' scenarios.

b) Links to Mayoral Strategies

- 4.4 The approval of the decisions in this MD will enable the establishment of GLIF to help address the SME finance gap in London. As such, it is in line with the overarching vision and objectives outlined in the Mayor's draft Economic Development Strategy (EDS). It will also help to achieve the Mayor's ambition of London becoming a zero-carbon city by 2050, as set out in the Environment Strategy, by providing early stage finance to circular economy businesses.

c) impact assessments and consultations.

- 4.5 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. The 'ex ante' assessments also included a review of current finance provisions and detailed consultation with key stakeholders and market players.

5. Financial comments

- 5.1 MD2237 approved the establishment of Greater London Investment Fund Limited (GLIF Ltd) which is a wholly owned subsidiary of SME Wholesale Finance London Limited (trading as "Funding London") to operate solely as a funds of funds.
- 5.2 Appendix 1 details the GLIF Funds of Funds model which consists of £32m from London's ERDF allocation to SME Wholesale Finance London Limited, £50m from the European Investment Bank (EIB), £7m from London Waste and Recycling Board (LWARB); and £11m of returns from previous funds managed by Funding London. The total fund value of £100m will be allocated by GLIF Ltd to three sub-funds (revised from four – see paragraphs 1.12 and 1.13).
- 5.3 MD2237 approved expenditure of up to £2.5m to cover management costs and fees during the first two years whilst the funds were becoming established which was met from the returns to the GLA - associated with the earlier 2007-2013 ERDF programme investment in the London Green Fund.
- 5.4 In order to meet management cost and potential fees gap, this decision seeks approval that an additional £3m ERDF funding is allocated to GLIF (agreed in principle by the LEAP sub-committee responsible for strategic monitoring of EU funding). This decision also seeks approval for a further £2m allocation to GLIF from the returns to the GLA - associated with original 2007-2013 ERDF programme (see MD2237 paragraphs 1.11 to 1.14).
- 5.5 In the worst-case scenario (appendix 2), in the event that the additional funding mentioned in 1.15 does not fully cover management cost and fees gap, a further £1.2 million will be drawn down from the returns to the GLA associated with original 2007-2013 ERDF programme. This is referred to as the GLA guarantee under paragraph 1.16 within the body of this report.

5.6 The overall fund size is now therefore £108.7m.

6. Legal comments

- 6.1 The decisions requested of the Mayor concern the GLA's principal purposes, under section 30 of the Greater London Authority Act 1999. These 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 of more of its principal purposes. 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. By the GLA providing an additional £5 million and the financial guarantee facilitates the promotion of economic development and wealth creation as the investment activities of GLIF; namely investing in SME's in London falls within these principal purposes.
- 6.2 In taking the decisions requested, the Mayor must have due regard to the Public Sector Equality Duty; namely the need to eliminate discrimination, harassment, victimisation and any other conduct prohibited by the Equality Act 2010, and to advance equality of opportunity between persons who share a relevant protected characteristic (race, disability, gender, age, sexual orientation, religion or belief, pregnancy and maternity and gender reassignment) and persons who share a relevant protected characteristic and persons who do not share it (section 149 of the Equality Act 2010). To this end, the Mayor should have particular regard to section 3 (above) of this report.
- 6.3 The terms of the investment by the GLA of £2m and the financial guarantee are designed to ensure it is compliant with state aid rules.
- 6.4 Officers must ensure legal advice is sought to review such financial guarantee before this is entered into.
- 6.5 The Mayor may, under section 38 of the Act, delegate the exercise of the GLA's functions to the Executive Directors of Resources as proposed.

7. Planned delivery approach and next steps

The following activities will lead to the establishment of GLIF's sub-funds:

Activity	Timeline
EIB completes due diligence and obtains internal management committee approval.	17 October 2018
Obtain Mayoral approval for EIB lending to GLIF.	November 2018
Funding London contracts with fund management organisations.	December 2018
Funding London Launches Sub-funds	February 2019

Appendices and supporting papers:

Appendix 1: Proposed Fund of Funds model and details of sub-funds

Appendix 2: Estimated Costs Fees and Returns (Part 2 Confidential)

Background Papers:

MD2237

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

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 Quellenec-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:

Lucy Owen 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 24 September 2018.

EXECUTIVE DIRECTOR, RESOURCES:

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

Signature

Date

Tom Middleton on behalf of MARTIN CLARKE

24 09 18

CHIEF OF STAFF:

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

Signature

Date

D. Bellamy

24 / 9 / 2018.