

## **The Graham Review of the Small Firms Loan Guarantee**

Response from local CDFI ART (Aston Reinvestment Trust) which has been providing loan finance to small businesses and social enterprises, targeted to disadvantaged communities and areas in the Birmingham area for 7 years.

Replies are based upon our practical experience and following the delivery of £3.3m loans in total ranging from £2k to £64K (Average £20k), all loans being made after decline from Banks, some being provided as part of a financing package which has included sflg loans provided by a Bank.

ART Loan rates are 8%/Base for for-profit SMEs and 3/Base% for not-for-profit-distribution organisations. The rate for SMEs reflects the additional risk, but only in part. Being above the UK hurdle rate, ART investment in SME's does not fall within State Aid restrictions. ART default rate to date is 10 overall (measured as a % of all loans delivered to date), within the range of those reported at the 2003 CDFA Conference. Some of this is underwritten by Policy Guarantee Funds including some allocated from regeneration initiatives in deprived communities.

**The different approach to the provision of targeted loan finance in disadvantaged communities and sectors to SFLG lending, using Policy Guarantee Funds as a tool for use in regeneration activity and economic development has been advocated by ART 's Directors and staff for a number of years. The approach was first highlighted in the Policy Guarantee Fund paper 1998 attached.**

The benefits of the use of PGF'S are also attached (PGF BENEFITS PAPER) together with a paper highlighting the possibility of their use on a Regional basis in draft form dd 20/4/1999.

A recent paper highlighting the various types of policy guarantee funds in use is also attached.

N.B The papers have been attached as submitted to various public sector partners over a period of years to provide context and have not been updated to reflect updated positions.

ART staff and Directors have also been regularly involved in strategy and policy debates regarding access to finance for enterprise across a range of interventions at European, UK, regional and local levels.

We do not propose to answer fully your comprehensive questionnaire as ART directors and staff have provided responses in other capacities and ART addresses only a small part of the total market.

However from a CDFI practitioner perspective we submit a wider response, first included in our response to Bridging The Finance Gap relating to the provision of SFLG scheme finance by CDFI's and our Policy Guarantee Funds proposal with its specified policy benefits continues to be advanced as a more closely targeted alternative to extending the SFLG scheme to CDFI's and others, which would in our view bring about conflicting messages and drivers and reduce joint working with the banks. :

### 2.iii COMMENT:

In summary by comparison we believe that:

1. CITR reduces individual investor risk/reward perception.
2. SFLGS reduces bank institutional risk
3. Guarantee funds from deprived community regeneration initiatives reduce risk of investing in such communities.
4. Social investment (e.g. ART) can accept more risk as it faces less pressure for commercial rates and timing of returns.

All four levels may be required to meet the HMT/SBS stated policy objectives, but mutual exclusivity may inhibit impact on enterprise in deprived communities.

CDFI's by their own mission statements are tackling a form of disadvantage either geographic or thematic **in addition** TO THE FAILURE OF THE BUSINESS TO OBTAIN FINANCE . They address the policy need for SME's as much as the needs of SME's.

After considerable discussion between practitioners and others with an interest in the policy fields of SME finance, we would strongly recommend that in examining the potential to include CDFI's within the framework of widening access to finance to disadvantaged groups that the use of the SFLG be examined within a meeting between at minimum the Banks, CDFI's and SBS and Treasury officials to collate the issues arising from interaction of the criteria in different schemes and decide upon practical steps forward.

This could be organised by CDFA and should include those practitioners who already use the SFGL outside CDFA membership, which could enlighten all with regard to the complex overlapping issues arising.

### **Major points of Issue:**

1. SFLG CANNOT CURRENTLY BE USED WITH CITR nor can any public sector guarantee. A major flaw with conflicting drivers, which increases the management burden and costs on CDFI's, and threatens early take up of CITR.
2. Relationship with Banks is vitally important to most CDFI'S either by way of funding providers (revenue and capital) or referrals or co-investors. The introduction of SFLG to CDFI ACTIVITY puts an element of competition into the debate and could we believe lead to Banks not being so willing to support CDFI's and their clients. In any case CDFI clients need banking facilities and the capability of evidencing their improved track records.
3. Current status of all CDFI lending supported by Phoenix Fund and /or CITR dictates that borrower MUST have been declined by a Bank BEFORE CDFI considers lending. This will lead to difficult conflicts and problems for borrowers and puts in jeopardy CDFI sustainability. If CDFI markets SFLG to their target market, in our view they must be able to then undertake loans without reference to Banks' refusals. This has major policy and investment appraisal systems and criteria implications (e.g. the UK and EU additionality model vs. USA CDFI model of almost competitive support).

A CDFI providing as part of the package subsidised support either directly or indirectly to a borrower to improve the borrower's investment readiness is not then going to gift the borrower to the Bank. This has implications to future support from public or private sector and /or sustainability of CDFI and/or the socio-economic impact of CDFI's and/or businesses progression into the mainstream. The benefits from these trade-offs against different policy objectives requires consideration.

4. Segmentation of market may need to be considered e.g. Social Enterprise. If Banks unwilling to enter this market then allow CDFI's a free hand. Banks could then partner CDFI'S with portion they are comfortable with and leave CDFI free to lend under SFLG.
5. Interest rate differentials between Banks and CDFI's will need to be considered. ART addresses the issue of access to finance and in line with EU and OECD recommendations ART lends to SME's at above the standard rates at which a Bank would usually have lent to the proposition.

However, a number of cases have received finance, which could have been described as of a mezzanine type and these cases have then been at rates, which could be considered lower than a Bank would have applied to such higher risk cases. . In either case the returns are well below those venture capitalist expectations. ART has and still continues to consider the use of alternative financial instruments in this significant gap.

A higher rate of interest charged by a CDFI encourages a return/progression to Bank support as soon as possible, whilst also providing the CDFI with an increased chance of achieving operational sustainability.

The SFLG rate is currently at around 4/base including the premium which would rise to 9.5/base if ART was to adopt this instrument.(i.e 8/b + premium ).

The implications of the interactions of access to and price of finance may have to be considered and made more transparent to meet all the stated policy objectives.

There remains from ongoing practical experience no consistent approach to SFLG from branch to branch within BANKS let alone Bank to Bank.

**Other comments:**

**3 ii WE WOULD AGREE WITH THE POLICY OF OUTSTANDING LOANS AT ANY ONE TIME NOT EXCEEDING £250K.**

Point of contact Steve Walker Chief Executive

Aston Reinvestment Trust  
The Rectory  
3 Tower Street  
Birmingham  
B19 3UY

Tel: 0121 359 2444

Fax: 0121 359 2333

Email [reinvest@gn.ap.org](mailto:reinvest@gn.ap.org)