

Regional Growth Fund consultation: response from the Community Development Finance Association

6 September 2010

The Community Development Finance Association (**cdfa**) is pleased to respond to the joint governmental consultation on the Regional Growth Fund.

The **cdfa** is responding on behalf of its 70 Community Development Finance Institution (CDFI) members. CDFIs are social enterprises which deliver credit and financial service to those in greatest need.

CDFIs serve three markets: social enterprises and civil society; businesses in disadvantaged communities; and financially excluded individuals, providing credit to those unable to access finance from banks and other mainstream financiers.

Our response has been instructed via direct consultation with our membership.

Overview

The goals espoused by the Regional Growth Fund – supporting projects offering significant potential for sustainable economic growth and creating new private sector employment – mirror the mission of Community Development Finance Institutions (CDFIs).

The Fund is designed particularly to help areas and communities currently dependent on the public sector make the transition to private sector led growth and prosperity. CDFIs support business investment and entrepreneurship in areas which have become overly reliant on public sector employment, creating jobs and stimulating growth.

CDFIs are unique. They are currently the only entities delivering and recycling capital into poor communities through loans to enterprises unable to access finance from mainstream sources.

With over ten years of experience, local expertise and a track record in lending to deprived communities, CDFIs are ready to deliver the Regional Growth Fund now.

Since 2003:

- CDFIs disbursed 54,000 loans totalling £672m
- Over 100,000 jobs have been created and safeguarded
- CDFIs helped lever an additional £590 million of finance for their customers
- Over 34,000 CDFI customers have benefited from advice and training

From Inside Out 2010, as yet unpublished

Consultation Questions

1. Are there benefits to be had from allocating different elements of the fund in different ways?

Fund administrators would benefit from taking stock of successful vehicles already in place to encourage private sector and enterprise. The tried and proven vehicle, devoted to meeting the needs of local communities, is the Community Development Finance Institution (CDFI).

- CDFIs exist to build entrepreneurship and lasting wealth in and amongst the UK's disadvantaged communities currently underserved by mainstream financial institutions.
- CDFIs provide loans and support to businesses and social enterprises in disadvantaged communities which are unable to access mainstream finance. Unlike high street banks,

CDFIs don't operate to maximise commercial returns, instead recycling finance again and again back into the communities they serve. Wealth created by CDFIs stays in the community rather than being siphoned off to international financial centres.

- For over a decade CDFIs have been quietly injecting finance into some the most disadvantaged regions of the UK, and are proven vehicles for delivering results at the local level. Although the majority of CDFIs (60%) operate at the local or sub-regional level, even those that operate across larger geographic realms (regionally or nationally) adopt a community-focused approach.
- CDFIs seek to redress the market failure created by mainstream banks' inability to provide financial services to certain communities, both disadvantaged places as well as socio-demographic groups. CDFIs are the only alternative to pawnbrokers, pay-day lenders and illegal loan sharks.

Designating elements of the fund either directly to CDFIs or to an entity with direct links and understanding of the sector, such as the CDFI trade representative body, the Community Development Finance Association (**cdfa**), would improve efficiency relative to delivering funding via other intermediaries. The **cdfa** is not only ideally placed to manage funds for use by the CDFI sector but would also serve as an efficient means of collating and reporting utilisation of funds back to fund administrators on behalf of the CDFI sector.

Should Local Enterprise Partnerships (LEPs) play a significant role in dispersing funds, as has been suggested, LEPs must have not only a common goal but also a common understanding of the need to utilise proven models for delivery at the local level.

LEPs should be directed to recognise the efficacy and value of the CDFI sector. In this way, LEPs will ensure that they allocate funding to CDFI intermediaries. Enterprise lending CDFIs and personal lending CDFIs providing micro-finance are already well positioned in the market and are experts in providing start-up capital for businesses.

In addition, LEPs would be well placed to identify communities lacking access to CDFI services and direct funding towards establishing and capitalising new CDFIs.

A combination of both grants and affordable loan finance, both for operational capacity and on-lending, would need to be assessed at the local level and agreed depending on the size and business model of the CDFI being funded. For example a new CDFI delivering finance may need more grant support than a more established CDFI. Similarly, micro-finance lenders may need alternative funding structures to that of SME enterprise-lending CDFIs.

2. What type of activities, that promote the objectives outlined above, should the fund support and how should the fund be best designed to facilitate this?

Regional Growth Fund objectives share direct and clear affinity with Community Development Finance Institutions (CDFIs). CDFIs have demonstrated great efficiency in converting public grant funding into capital that is used repeatedly, not just once, as opposed to when such funding is allocated to one-time use. In this respect, CDFIs or their representative body – the **cdfa** – are perfectly placed to work directly with the Regional Growth Fund, ensuring that finance is delivered in the right places in order to create economic growth and create jobs.

Independent research commissioned by BIS and OTS in March 2010 demonstrated that "...CDFIs are generally efficient vehicles for the delivery of capital to businesses..."^[1] and that for each £1 of public expenditure CDFIs create or safeguard £8.57 at the local community level. This does not take into account the role of capital recycling, that capital is repaid and re-lent. Extrapolating from

^[1] *Evaluation of Community Development Finance Institutions (CDFIs)*, BIS and Cabinet Office, GHK, March 2010. p. 79

this, it is likely that for each £1 invested into CDFIs an estimated £15 gross value added would be delivered following a three-year lending cycle.

A mix of grants and low- or no-interest loans allocated for both on-lending into communities as well as expanding CDFI operational capacity and geographic reach would increase these outputs and outcomes many times over.

Support in the form of a guarantee fund to cover first losses will also help CDFIs scale up to near sustainability whilst also keeping focus on their mission to serve distressed communities.

Loans provided to businesses and social enterprises where market failure exists must include provision for business support services in the form of mentoring and training programmes if results are to be sustained. Injecting capital into local economies is only one part of the equation for success, and enterprise support services must be recognised as the other critical component.

The void created by the demise of Business Link must be addressed. Mentoring schemes should be provided to deliver ongoing after-care to start-up businesses, as well as provision of revenue funding to allow CDFIs to increase capacity and continue to meet the needs of businesses and social enterprises in England.

Whilst CDFIs primarily provide loans to enterprises and individuals to set up businesses, many also provide business support. 80% of CDFIs offer ad hoc support during the loan process and almost half (45%) offer formal mentoring schemes. Support for these schemes through the Regional Growth Fund is essential in promoting enterprise and maintaining a healthy loan book.

In terms of delivery, direct investment into the CDFI sector should prove more efficient than doing so via intermediaries such as LEPs. Some enterprise lending CDFIs, such as PRIME, who lend solely to older people to set up business operate nationally. Many other CDFIs have expanded to serve across multiple regions. Delivery in these cases through single LEPs will be unduly complex and uncoordinated, whereas a single, centrally-administered 'CDFI fund' may be most fit for purpose in growing the capacity and the financial and social impacts of English CDFIs.

3. Do you think that these are the right criteria for assessing bids to the Regional Growth Fund?

The proposed criteria are constructed and pitched in the correct manner and with the right approach, and should ensure success in delivering the goals of the fund. The system also appears to set a level playing field for applicants.

Care must be taken to allow for bids from a level above the strictly local milieu, perhaps with a proviso that such applicants deliver locally. The proposed bidding process seems to focus primarily on applications either from LEPs or from within LEP-established boundaries.

The bidding regime should take into account regional or national bodies that can act as efficient delivery mechanisms for organisations operating at supra-local levels throughout England. In order to achieve their objectives, LEPs should not only consider supporting CDFIs to deliver the Fund but also recognise the need to coordinate their efforts. Early intelligence into the proposed LEP structure would mean that many CDFIs would need to engage with numerous, depending on their geographic reach.

Some CDFIs, especially those operating across multiple regions or the entire country, found engaging with multiple RDA challenging at best. Care must be taken to not only avoid replicating the outgoing splintered and uncoordinated approach, but also ensure that the situation is not exacerbated. Those CDFIs currently operating within an English RDA would find it an unwelcome challenge if they were required to now engage with multiple LEPs.

4. Do you think we should operate a two-stage bidding process?

A two-stage process is sensible. The Phoenix Fund, which helped spawn the growth of the Community Development Finance Institution sector, operated successfully utilising a two-tier process.

A potential advantage of a two-tier system is that those beneficiaries of the first round which are enabled to launch or expand service provision are then permitted the time to augment funding into their operational structure and apply again for round two from a stronger position.

5. Should a Regional Growth Fund become a long-term means of funding activity that promotes growth?

Provided the fund is able to deliver on its objectives, a long-term element would be prudent and indicated. A tried-and-tested methodology should not be retired simply because it was devised as a short-term programme.

Some government projects have suffered from a short-term view. Community Development Finance Institutions (CDFIs) which were launched through Phoenix Fund money after 2001 were expected to become self-sustaining within a few short years – clearly impossible if they were to keep to their original remit of reaching the highest-risk disadvantaged areas. Some have closed, some been taken over, and , although the fittest are surviving, many still need support now, several years on.

Not only can the RGF capitalise existing CDFIs but also help to establish new CDFIs in areas lacking them where current lending to enterprise is low. New entities require longer term support and further rounds of bidding, and technical assistance through grants and operational capital over a sustained period of time is essential to scale CDFIs up towards sustainability.

The **cdfa** looks forward to working with Department for Business, Innovation and Skills, Communities and Local Government and HM Treasury to devise a sustainable and effective vehicle to support businesses and communities across England.

Regards,



Bernie Morgan
Chief Executive