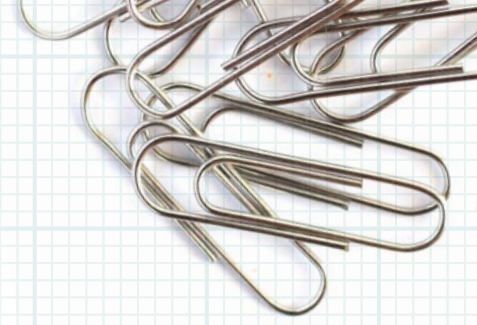




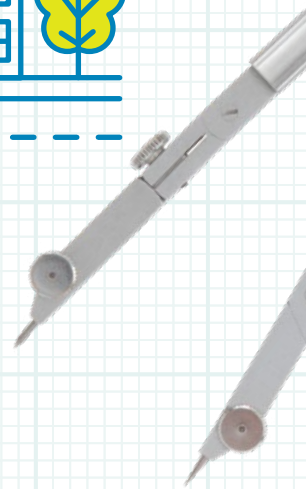
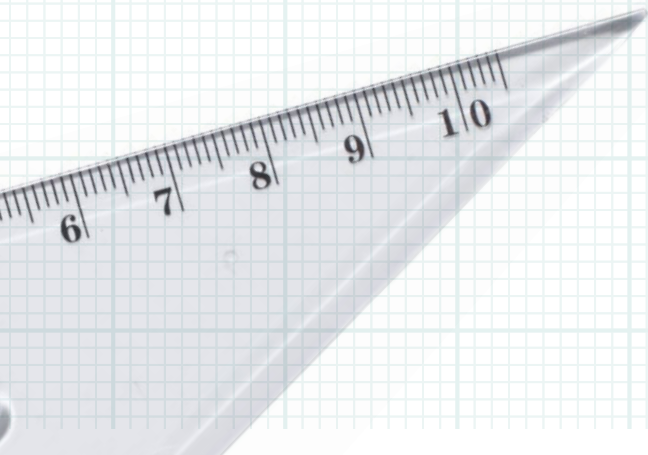
power to  
**change**

business in  
community  
hands



# Investing in Localism

## How Local Authorities Can Provide Good Finance For Community Business



A Working Paper prepared for the Power to Change Research Institute		SUPPORTED BY: 
WRITTEN BY: Pagura, S. Pollock, R. and Mussani, S.	DATE: June 2018	<b>NATIONAL LOTTERY FUNDED</b>

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## About this report

Last year, Power to Change published *Uncharted Investment*, a research working paper that explored the sources of finance for community business. That work pointed towards a number of unexpected or previously underestimated sources, including lease finance, crowdfunding, equity finance – even credit cards and bank account overdrafts featured as part of the overall picture. Local authority lending was one of the sources of finance identified by the research, and this piqued the interest of the audience at a roundtable event we held to discuss the working paper findings. To probe this further, we commissioned Social Finance to explore the extent to which local authorities were borrowing from the public purse in order to lend to community businesses or social enterprises. This working paper draws together their findings and reflections on the future potential of this funding source.

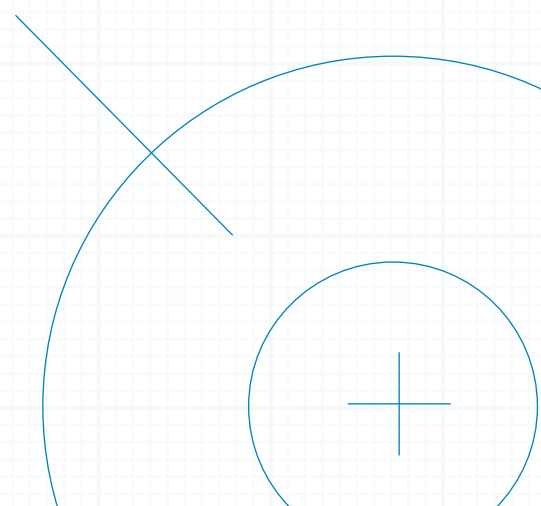
The information contained in this report has not been prepared, and is not intended as financial advice. This report is based on current market conditions and is based on those prevailing as of the date of this report, changes in which may have a material impact on any recommendations.

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## About the authors



Social Finance is a not for profit organisation that partners with the government, the social sector and the financial community to find better ways of tackling social problems in the UK and beyond. Since it started in 2007, Social Finance has mobilised over £100 million of investment and designed a series of programmes to tackle social challenges. These include support for 2,000 short sentence offenders released from Peterborough Prison, 380 children on the edge of care in Essex, 4,500 young people at risk of becoming NEET, 3,000 isolated older people, 2,500 people with severe mental health issues, and 1,400 homeless youth and rough sleepers.



## Foreword



**Vidhya Alakeson**  
Chief Executive, Power to Change

Last year, Lawrence D. Fink, the founder and Chief Executive of major investor Blackrock, called on companies to align their pursuit of financial return with social purpose. We call on local authorities to do the same and become local impact investors.

Traditionally, local authorities invest commercially for the benefit of remote shareholders – often outside of their local area – and use the returns from these investment to fund local economic development, welfare and public services. Local impact investing provides a smarter alternative. Local authorities can invest in community businesses that deliver economic, social and environmental benefits for council tax payers at the same time as delivering a financial return for councils.

We want to see more local authorities using their balance sheets and access to cheap finance from the Public Works Loan Board to benefit community businesses. A thriving community business sector can enable cash-strapped councils to continue to meet their objectives. There are many examples of community businesses successfully running public services, providing community spaces and supporting local employment and economic development.

But local impact investing is about far more than plugging holes left in local government by ongoing austerity. It provides a way of reinvigorating local democracy and here there is some urgency.

A survey conducted by YouGov for the Localism Commission, set up by Power to Change and Locality, found that nearly three quarters of those polled felt they currently have little or no say over the decisions that affect their neighbourhood. The gulf between those with power and those they govern has grown too wide for a healthy democracy. Too many people currently feel disconnected from, and disillusioned with, power.

The solution is not bureaucratic tinkering with the structures of local government but a real commitment to the devolution of power locally to communities. This is what was envisaged under the 2011 Localism Act but as the Localism Commission identified, progress has stalled. Support for community business provides a route through which councils can effectively give back control to local people.

The case studies in this report highlight local authorities such as Hull City Council and Enfield Council who are already acting as impact investors to support community business. We at Power to Change look forward to working with councils who want to embrace this call to action and join us in supporting the community business market to grow and thrive.

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## Executive summary: Councils as social investors

In straitened times shouldn't we expect more authorities to use their balance sheets, borrowing powers and expertise to invest in services run for and owned by local communities; and to help to grow more inclusive local economies?

“

*Councils already invest to generate income to fund services. If the sector can develop the right skills and an entrepreneurial mindset there's no reason why we can't become successful impact investors too. We are best placed to understand community needs, can access capital affordably and have a stake in the local economy. That puts us in a great place to generate a social and financial return for council tax payers.*

— Cllr, Patrick Edwards, Chair of Economic Scrutiny Committee,  
London Borough of Waltham Forest

Councils that invest in community businesses help to provide public goods – supported and social housing, green v, community spaces and leisure facilities. As the case studies in this report illustrate, these investments can achieve significant social, economic and environmental benefits for local communities. Not only that, local authorities can shape and grow markets in public goods in partnership with community businesses, social enterprises and charities, and most importantly their residents. In doing so, they are building sustainable enterprises that support the vulnerable and disadvantaged, deliver on stated policy objectives, or simply provide valuable public spaces for the community to come together.

In many of the examples in this report, the local authority is playing the role of a social investor, bringing risk capital and expertise aligned to a public mission. These distinctly modern interventions have their roots in the entrepreneurialism that emerged during the co-operative movement of the 1840's, and the municipalism of the Victorian period often associated with Joseph Chamberlain.



**'Mini' case study:**  
**Goodwin Development Trust and Hull City Council**

Goodwin Development Trust is a social enterprise employing 200 local people in Hull.

The Trust offers a full suite of services, including: children's centres and nurseries, a state-of-the-art conference centre, a community college, disability care facilities, sports pitches, a youth & arts centre, performance space, and community meeting rooms.

The Trust will shortly break ground on the construction of the city's first social eco-housing. To do this, the Hull City Council offered the Trust a loan at a fixed 3.5% interest rate for 30 years so that they could finance the housing development, which will provide more than 40 new homes to the community. Hull City Council were able to source the capital required from the Public Works Loan Board.

Community businesses looking for financing often need to look beyond the banks and the traditional social investment community for funding. The local community, friends and family, digital funding and finance platforms are all viable options, but one largely unexplored area has been local authorities. Community business' contribution to place making means that their objectives often naturally align with the mission of local authorities – to promote the economic and social well-being of an area through empowering communities, and to meet the needs of its residents. This positions councils perfectly to be informed and impactful social investors.

Central government policy not only recognises that local government may have mixed-motives for investment, but actively acknowledges that local authorities may have a different risk appetite to other actors investing solely for yield. The case studies in this report demonstrate that appetite exists; and, that the municipal entrepreneurialism of the past is not only possible, but alive and kicking. It just requires the commitment of local champions, the right expertise, and a willingness to take measured risks in partnership with local communities and social organisations.

We found that these social investments are made easiest when local authorities leverage existing partnerships, with organisations that have a clear track record of success and good financial stewardship. We also found that investments by local authorities were often predicated on the fact that there was an underlying asset that an investment could be secured against. As local authorities look for potential investments, owning assets is a good indicator of a potential investment opportunity.

Perhaps most critically, it was important for councils and their investees to articulate the level of risk they are willing to take on in any transaction. For councils, this means outlining return expectations, both in terms of rates and timing. While local authorities can borrow at very low interest rates, on long dated terms; they may not be willing to on-lend on similar long dated terms. For community businesses, they should articulate at what borrowing rates their operations remain economically feasible, to ensure that the council as a social investor understands fully the economics of the investment. It is also crucial that both parties make clear what they are willing to accept as security, and have those conversations early in the investment process.

For this market to move forward, councils and community businesses need to take initiative, and proactively seek out opportunities for collaboration. For councils, this means there needs to be a culture change that emphasises their role as impact investors. Local authorities should embed and foster a culture that enables staff to take measured risks alongside social entrepreneurs within their communities. To do this, local authorities need to build skills internally to be able to develop and execute transactions like the ones highlighted in this report. And relatedly, there needs to be more data made available about this market, so the local authorities can learn from each other, and share best practice.

Councils have the opportunity to become social investors that can achieve significant value for local taxpayers, and impact for their communities. Forward thinking councils with an entrepreneurial mindset can work with and enable communities to become more self-sufficient, and self-fulfilled. This working paper has provided positive evidence that councils can, and have, successfully invested in community business, and we look forward to seeing where other innovative local authorities take these best practices.



# 1. Introduction

Businesses often require an injection of capital to grow – be it a move to a larger space, to hire more employees, or to upgrade equipment. For smaller businesses, accessing capital can be challenging given their smaller operating margins, or limited assets to use as security. Many small business owners turn first to friends and family. Community businesses, of which a vast majority are small, are no different. Helping them thrive is critical because they play a crucial role in making places better. They make neighbourhoods better places to live in, they provide economic opportunities in deprived areas serving local needs, improve community cohesion, and empower local communities to make positive change.

But what do we mean when we say community business? Power to Change (Hull *et al.*, 2016) has defined the four key features of a community business as:



**Locally rooted:** They are rooted in a particular geographical place and respond to its needs. For example, that could be high levels of urban deprivation or rural isolation.



**Trading for the benefit of the local community:** They are businesses. Their income comes from things like renting out space in their buildings, trading as cafés, selling produce they grow or generating energy.



**Accountable to the local community:** They are accountable to local people, for example through a community shares offer that creates members who have a voice in the business's direction.



**Broad community impact:** They benefit and impact their local community as a whole. They often morph into the hub of a neighbourhood, where all types of local groups gather, for example to access broadband or get training in vital life skills.

Community businesses can take on many forms, from community shops, to local venues, housing associations, or even local community transport companies. One thing they all have in common is that they play a crucial role in community cohesion founded out of passion for community improvement.

Their leaders, volunteers, and staff are deeply embedded in their locality. Not only does this mean they are well-placed to address their community's needs, but also that they are able to tap into local sources of knowledge, expertise and funding.

Access to growth finance is a significant barrier for community businesses. Grants, loans, or equity can be the difference between sustainability or a hand-to-mouth existence that inhibits longer-term, strategic decision making and social impact.



While local development agencies and some specialist supporters, particularly for heritage projects, provide grants there appears to be demand for more sustained and strategic support, such as lending to community businesses (Floyd and Gregory, 2017).

### 1.1 Striking a balance between profits and purpose

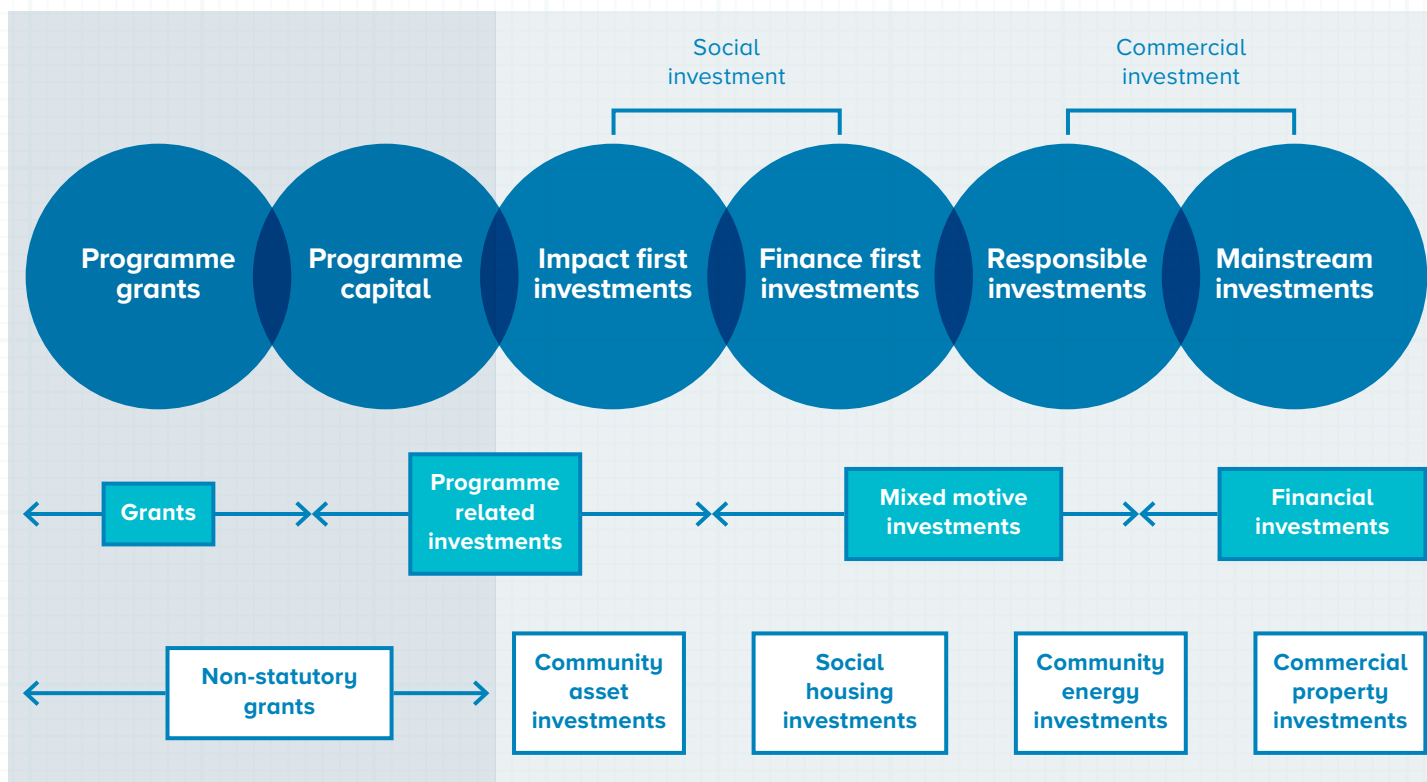
Community business' contribution to 'place making' often naturally align with the mission of local authorities – to promote economic and social well-being of an area (Local Government Act 2000). Although local authorities are usually one of the larger stakeholders of community business, they are not often seen as potential investors.

Many local authorities are already sophisticated investors with asset management strategies integrated into their budget and tax raising processes. Local government investments tend to be on a commercial basis linked to local business growth, property development, and infrastructure. However, as the central government's revenue support grants dwindle, to be replaced by local business rate retention, councils have been in the news for their growing investment in commercial property. This revenue generating activity has been an important source of funding to reduce the gap between resources available and local need.

For example, Portsmouth City Council launched a £108 million property fund in November 2015, which targets quality income generating investments to fund council services (Portsmouth City Council, 2016). These range from £7.25m invested in a logistics warehouse in Yorkshire, £11.5m in a bed factory in the West Midlands, to £16m in a retail park in Portsmouth. After costs, the portfolio has generated £4.3m profit for services, including libraries, museums, weekly rubbish collections, community wardens, homelessness and school crossing patrols.

In response to austerity, local government has developed sophisticated asset management strategies and is creating investment funds to generate income for core services. Where these investments are locally based there may be strong arguments that they provide valuable capital to drive local economic growth. However, many are simply freehold or leasehold investments that do not generate new economic activity. The sole purpose is to generate valuable income to fund local services.

The idea of profit with purpose or investments that seek to drive a financial as well as a social or environmental return does not figure strongly in most asset management and local authority investment strategies. However, this concept has been gaining traction in the asset management and private equity industry for some time, and is often referred to as impact investing. The global market in impact investing is now estimated to have grown to ~£85bn (Mudaliar, A., Schiff, H., Bass, R., & Dithrich, H, 2017).



Source: Social Finance

However, unlike the private sector, local authorities are public bodies with a diverse set of statutory and policy responsibilities that should naturally lead them towards mixed-motive and socially-motivated investment activity.

As local government financing moves to greater retention of local business rates, councils will have a much stronger incentive to grow a sustainable tax base by attracting new businesses or supporting existing business to grow. Many councils are already pursuing this strategy. The more enlightened and capable are co-creating new community businesses through investments that can provide a financial return, additional business rates, and deliver a social or community benefit, instead of annual revenue expenditure.



**‘Mini’ case study:  
The Dolphin Pub and Bishampton  
and Throckmorton Parish Council**

After the Dolphin Pub in Bishampton closed down in 2013, the local community applied to the Parish Council to use its powers to grant the pub ‘Asset of Community Value’ status, and asked for advice on how they might buy the pub.

The council suggested that it could play the role of investor, and buy the pub using funds from the Public Works Loan Board. Their application for £300,000 received unanimous support and was ultimately successful. The main requirement for securing the loan was a robust business plan, which demonstrated how the pub would pay back the loan with or without a tenant. A tenant signed a 15-year lease, and the pub is once again a flourishing part of the local community.

Councils have the opportunity to become social investors that can achieve significant value for local taxpayers. In doing so they can invest in the provision of public goods and services they would otherwise struggle to fund through annual grants. This is not a panacea for reductions in spending. However forward-thinking councils with an entrepreneurial mindset can become investors and enable communities to become more self-sufficient and self-fulfilled.

This working paper provides positive evidence that councils can, and have, successfully invested in community business. The aim of this report is to provide innovative local authorities, and successful community business with best practices that can be emulated, and replicated across the UK. Section Two provides case studies that demonstrate successful investments in social and affordable housing, energy and community assets, and Section Three draws together best practice. Section Four outlines the sources of capital and borrowing products available to local authorities; and Section Five provides some recommendations for local government, community businesses and central government. Finally, the Annex provides additional supplemental details.

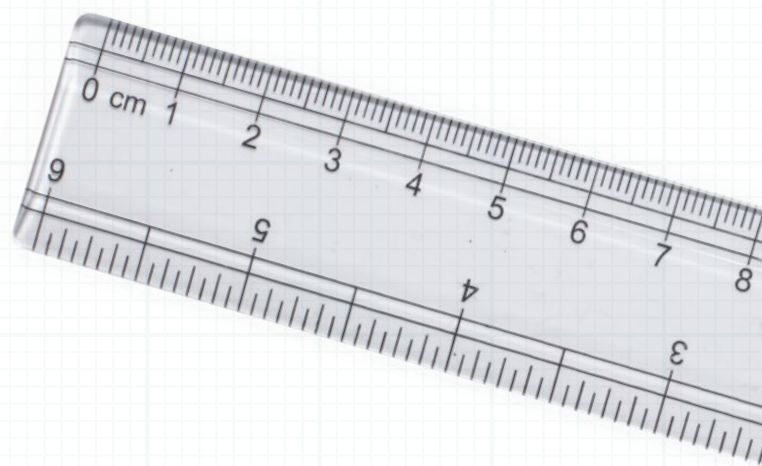
## → 2. The art of the possible: Case studies in local investment

With access to relatively inexpensive financing, local authorities are well placed to consider competitively priced investments into local community businesses that are looking to grow. As community businesses are such strong contributors to their local community, and are often providing some form of public good, local authorities should see them as natural allies as they go about investing in local 'place making'.

What follows are six examples of local authorities and community businesses, collaborating, taking shared risks, and ultimately delivering on a shared social mission driven by innovative financing. From a wide-ranging market survey, this section has examples from the housing, energy, and 'community asset' sectors. Each offer their own set of best practice, and share common ingredients for success:

- A strong existing partnership
- Clear understanding of the terms required for successful investment
- A clear track record, both financial and social
- A shared mission
- Community buy-in
- Willingness for both parties to take on an appropriate level of risk

While each case is different, and will have some mix of the best practices evidenced, crucially some mix of these is clear in each case. In the case of the energy examples – while changes to the regulatory environment mean that economics of these investments have changed; the examples included still offer insights into how local authorities can engage with their communities around renewables, and other areas of community interest. Each sector has its own underlying market drivers, but across all three – housing, renewable energy, and community assets – local authorities have found ways to play an impactful role financially.



## 2.1 Housing

### Latch, St. George's Crypt and Leeds City Council

#### Key facts



**Council:**  
Leeds City Council



**Community business:**  
Leeds Action to Create Homes (Latch), and St. George's Crypt



**Investment amount:**  
£3,030,000



**Investment type:**  
Loan



**Financing terms:**  
~3.75% interest, 25 year tenure



**Additional financing:**  
Unspent Right-to-Buy receipts



**Social outcomes:**  
Increased supply of affordable accommodation for vulnerable individuals and families

#### Latch, and St. George's Crypt overview

Leeds Action to Create Homes (Latch), a registered community benefit society, purchases empty and rundown houses and refurbishes them to create good quality homes. Established in 1989, Latch has been working with Leeds City Council (LCC) to reduce homelessness for nearly 30 years now. Most of the refurbishment work is done by Latch staff and unemployed trainees, many of whom learn new skills as they work on site. Renovating rundown, empty houses in Leeds also supports the local economy.

St. George's Crypt is a registered charity that works with the homeless, the vulnerable and those suffering from addiction. It started when the church's crypt was opened as a shelter during the economic depression of the 1930s. It has a total of 54 bed spaces, which are available year-round. The charity works with rough sleepers to help them gain the skills and confidence to find a job or voluntary work. It works in partnership with local organisations and the council to share its resources and maximise social impact.

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### Previous council support

Both Latch and St. George's Crypt have worked with Leeds City Council to reduce homelessness.

Latch has previously leased properties from the council, revitalised them, and offered them as affordable housing to the local community. The council helped Latch to secure grant funding from the Homes and Communities Agency's (HCA – now Homes England) Empty Homes Programme. Latch was able to buy vacant properties, renovate them and bring them into residential use, which contributed to the council's Empty Property Strategy.

Leeds City Council also granted a portion of its right-to-buy receipts to Latch and St. George's Crypt. The council can only fund 30% of new social and affordable housing developments using right-to-buy receipts, which cannot be used alongside any funding from Homes England. This can limit development opportunities. If receipts from right-to-buy are not spent within 3 years and 3 months the funds must be returned to the Treasury. These restrictions and rising levels of rough sleeping and homelessness in Leeds led the council to explore how best to maximise the impact of right-to-buy receipts with Latch, and St. George's Crypt.

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### Lending process

Latch had previously suggested borrowing directly from the Council's balance sheet. Although Latch had an established business model and had repaid commercial loans from Triodos Bank, borrowing from a local council was considered novel. Positive examples of other local authorities supporting community housing developers through Public Works Loan Board (PWLB) lending, such as Kingston upon Hull City Council and the Goodwin Development Trust (see page 9), provided a strong precedent. The rising cost of the council's housing-related support services for vulnerable individuals and families, and the established working relationship between St George's Crypt and Latch and the Council's Adults and Health Commissioning Team helped to move the process forward.

In Autumn 2017, St George's Crypt and Latch approached Leeds City Council with a proposal to access loan funding to support the acquisition and development of 45 new affordable, supported living units. This would be the first time the Council acted in a lending capacity to provide funding to support new supply of affordable, supported housing in the city. It used PWLB borrowing to on-lend to both organisations.

St. George's Crypt planned to demolish their existing 'short-term stay' building, and re-build a 14-unit 'move-on' apartment development. In addition, St. George's had also recently gained approved for the construction of a 24-unit apartment development, comprised of 12 two-bed and 14 one-bed self-contained apartments.

Latch planned to build, or acquire and refurbish, eight empty properties to provide affordable homes for people who are homeless or in housing need.

Detailed business plans were submitted by both organisations, and were reviewed as part of a comprehensive due diligence and risk assessment process undertaken by the Council. The Council asked Latch and St. George's to pay for the due diligence costs. The financial component of the due diligence included a comprehensive review of the financial model and an assessment of the financial standing of each organisation. The review considered financial performance over the past five years, each organisation's credit rating and a detailed review of their business plans.

The council also asked for security arrangements to recover any debts if the organisations failed to make repayments as outlined within the proposed loan agreements. This was a mix of the projects to be developed, and existing property already held by the organisations.

The total requested loan amount was £3,030,000. St George's Crypt requested £2,354,000 and Latch £676,000 loan funding. The interest rate on the loan facility was fixed at ~3.75%, with a tenure of 25 years, and an option for early repayment without penalty. The competitive, and long-term fixed rates provided by the Council's loan will enable both St George's and Latch to stretch their resources further. Additional financial benefits include lower set-up costs than private sector financing options.

While the interest rate differential between the Council and commercial lenders was negligible, it was the entire loan structure that made this arrangement attractive for both developers. Right-to-buy grants will also be used by both organisations as part of the funding package for the planned development, further leveraging available financial resources.

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### Final outcome

The process was swift, with final approval from the Council's Executive Board in early February 2018. As St. George's Crypt and Latch both have a strong track record of working with the Council, and assets that could act as security, the Council was able to move through due diligence rapidly.

Security for the loans was a critical consideration. That agreement required careful negotiation between the Council and both organisations. The Boards of both organisations were clear about the implications of potential default, and were willing to take on that risk. Where possible, reducing duplicative surveying work on planned developments will in future speed up the process if the Council chooses to act as a lender again.

The legal arrangements of the deal took the most time to agree but in future should take less time now that a process is in place. The risk associated with longer term lending is something the Council must also manage, as borrowers often want longer terms, while the Council has its own risk threshold which makes it difficult to go beyond the 25 to 30-year loan tenure range.

## → Housing Gateway and Enfield Council

### Key facts



**Council:**  
Enfield Council



**Community business:**  
Housing Gateway Limited



**Investment amount:**  
+£100m



**Investment type:**  
Loan



**Financing terms:**  
~3.75% interest, 25 year tenure



**Additional financing:**  
None



**Social outcomes:**  
Increased supply of affordable accommodation for vulnerable individuals and families

### Housing Gateway overview

Housing Gateway Limited (HGL) is a wholly-owned company of the London Borough of Enfield. It was established in 2014 to acquire and manage a property portfolio to enable the local authority to fulfil its statutory housing duties. HGL's objective is to improve the quality, availability and security of private rented accommodation for homeless households or households at risk of homelessness; and reduce reliance on the use of expensive nightly paid accommodation. It operates on a commercial basis and has set exemplary landlord standards. Most of the organisation's board is comprised of local Councillors, and local authority staff, with two independent directors to provide additional scrutiny. The Board delegates decisions on the acquisition of properties to an Investment Committee, with input from the council's Property, Finance, and Housing team.



Housing Gateway offers one-year assured shorthold tenancies at local housing allowance rates. Properties range in size from studios to five bedrooms (although most are two or three bedroom properties) and include standalone flats, terraced homes, semi-detached houses, maisonettes and ex-local authority homes.

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### Council interest

Enfield was facing significant temporary accommodation budget pressures of up to £7.8m driven by the increased demand for temporary accommodation coupled with rising house prices. This acute financial pressure, together with the poor quality of accommodation provided via expensive bed and breakfast rentals, was the catalyst for the local authority to innovate.

HGL was set up as a private company, as permitted under section 75 of the Local Government Act 2003 – a local government trading company. This simple structure met the needs of the council, and reduced the complexity of the project.

The council initially required that the company focus on acquiring existing properties due to immediate budget pressures, but did permit the use of funding for new build developments over time if deemed to be financially viable. However, the enterprise required capitalisation and so the council looked to access PWLB financing to raise necessary funds.

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### Lending process

During the feasibility stage of the project, Enfield Council used grant funding from Department for Communities and Local Government (now Ministry of Housing Communities and Local Government) to undertake a feasibility study and develop a business plan. This allowed the council to assess exactly what kind of funding HGL would need to procure property efficiently in Enfield.

After assessing capital need, the council facilitated a series of loans to the company, through its access to PWLB financing. In the first 3 years of operation, HGL borrowed over £100m from the council, which lent to it at fixed PWLB rates less 20 basis points (e.g. 0.2%). That discount is provided via the “Certainty Rate” (as explained in the financing section on page 17).

The loan facility is secured against the properties the company purchases. Enfield could on-lend PWLB funding at cost, as HGL provides a service of general economic interest to the council, in the form of the provision of social housing at below-market rates. HGL, however, must comply with State Aid legislation which adds a level of legal complexity to the process (see the State Aid outline in the Annex). The repayment profile of the PWLB borrowing has also been structured to ensure it meets the council’s Minimum Reserve Policy.

A phased approach to the acquisition of properties was adopted to manage risks and enable the council to test the effectiveness of the model. Housing Gateway also takes a cautious and prudent approach to the capital appreciation of its housing portfolio. Unlike most private investors, who would usually pay interest on debt rather than reducing the debt itself and assume a level of capital appreciation – HGL does not.

### What is State Aid?

State Aid is any advantage granted by public authorities through state resources on a selective basis to any organisations that could potentially distort competition and trade in the European Union (EU).

A full explanation of State Aid can be found in the Annex.

Because HGL is a private company, the properties it purchases – although used by the council to meet its statutory needs – cannot be purchased by occupants under the right-to-buy scheme. This allows the council to retain the stock of affordable housing it is purchasing through HGL. The council can also discharge its statutory duty to provide accommodation for homeless households efficiently, which has helped it to reduce spending on temporary accommodation, and ultimately save ~£1.3m per annum.

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### Final outcome

As of December 2017, Housing Gateway had purchased 410 properties (946 bedrooms), of which 379 properties are tenanted. HGL is paying back its loans to the Local Authority, and is looking to expand. The company has recently embarked on a scheme to provide homes for tenants with learning difficulties, enabling them to live independently. Demand for housing in Enfield continues to rise due to changes in benefit caps, rising local housing prices and rents, and HGL is now looking for new ways to meet that demand.

HGL is only economic with PWLB funding, and even so must compete with the ever-increasing cost of purchasing in the Greater London housing market. The primary driver of this innovation was the savings case delivered via cost avoidance, and the discharge of statutory duties. Other councils looking to apply a similar structure should be fully aware of complexities involved with State Aid, and its legal implications. Around 42% of local authorities have now set up housing companies, demonstrating the value of the model.

## 2.2 Energy

### Plymouth Energy Community and Plymouth City Council

#### Key facts



**Council:**  
Plymouth City Council



**Community business:**  
Plymouth Energy Community



**Investment amount:**  
£2,870,000



**Investment type:**  
Loan



**Financing Terms:**  
20 years, with a competitive interest rate fixed for the term of the loan



**Additional financing:**  
Community Share Offer



**Social outcomes:**  
Reduction in fuel poverty, and reduced carbon emissions

#### Plymouth Energy Community overview

Plymouth Energy Community (PEC) is a community benefit society established in June 2013 with initial support from Plymouth City Council (PCC). PCC recognised that cheaper and greener community energy could help to reduce fuel poverty and carbon emissions. It provided a start-up loan and grants to enable PEC to get off the ground.

After significant community engagement PEC acquired 100 founding members and developed a business plan for a new community energy group in the city. The council was then able to pass entire control of the process to a newly-formed Board of volunteer Directors drawn from the community, so that PEC could become a standalone entity. To support the newly independent organisation, the council put in place a unique service-level agreement with PEC that provided staff expertise from their low carbon and business support teams.

PEC's mission is to give the people of Plymouth the power to transform how they buy, use, and generate power in the city. Membership of the cooperative is free, and membership has grown from that initial enthusiastic 100 to over 1200 individuals and organisations. PCC considered its involvement in helping to set up PEC as meeting electoral pledges, and as a strategic investment in its local community and economy.

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### Previous council support

PEC wanted to make its first investment in renewables in 2014. To do this, they set up a special purpose vehicle, PEC Renewables Limited, as a community benefit society. Members of the public were invited to buy community shares with a minimum purchase of £50. The initial community shares offer was supported by a £500,000 loan from PCC. The terms of this loan were below commercial rates – the interest rate was linked to consumer price inflation, and the loan had a tenure of over 20 years. That loan allowed PEC Renewables to raise an additional £600,000 through the community share offer.

The capital raised was used to install 22 solar photovoltaic (PV) arrays on schools, community buildings, and health or business premises across the city. This scheme generates revenue through feed-in-tariff payments for the electricity generated, as well as from charging the building users at a lower rate for electricity on the premises. In some cases, electricity is also exported to the grid.

The income generated is sufficient to cover running costs, repay investors at an estimated 6%, and repay the PCC loan, while also generating a surplus to fund new energy-related initiatives. After the successful capital raise in 2014, an almost identical arrangement was made in 2015 to finance more rooftop solar installations. This involved another £500,000 loan, and a £850,000 community share raise.

After successfully implementing its rooftop solar programme, in late 2015 PEC and PEC Renewables ambitiously looked to turn derelict land in Ernesettle into a solar farm. This process needed to be done quickly, as government was in the process of removing intake subsidies that had previously been provided to the renewable sector. Using a mix of grant (£30,000) and loan (£80,000) funding from the Plymouth Social Enterprise Investment Fund, PEC Renewables undertook the initial feasibility and business planning work.

To finance the installation, PEC secured short-term bridge financing loans from Leapfrog Bridge Finance Limited, and Social & Sustainable Capital. This loan enabled the Ernesettle project to be commissioned in time to secure a Renewables Obligation subsidy for 20 years, prior to its termination in March 2016.

The project was subjected to the external scrutiny of independent technical experts engaged as part of Leapfrog Bridge Finance's due diligence. In March 2016, the 4.1megawatt (MW) ground-mounted array in Ernesettle was complete, and is now generating enough clean energy to meet the annual needs of 1,000 homes. This community-owned installation allows investor members to receive a return, while also providing low-cost clean energy.



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### Lending process

As PEC and PEC Renewables had a strong relationship with Plymouth City Council they asked the local authority to refinance the bridge loan they had taken from Leapfrog. To do this, PEC Renewables required £2.87m, roughly 70% of the project cost. To leverage this borrowing, PEC launched a community share offer to cover the remaining 30% of the project costs.

The relationship between the council and PEC made these initial conversations easier, as the council was comfortable with PEC as a potential borrower, and it had a strong business model with community support that had undergone external due diligence. Although the initial external due diligence helped to 'de-risk' the project for the council, they still needed to undergo their own due diligence process, which PEC as the borrower had to fund. This included a technical assessment of the project, financial due diligence on the business model PEC Renewables had developed for the solar farm, and legal due diligence on contracts held by the project. Some of these costs were shared by PEC and the council, to reduce the burden on PEC.

A long-term loan was agreed over 20 years with interest fixed for the term of the loan. While the council could draw down PWLB money at reduced market rates, to cover their own costs and comply with State Aid regulations, a competitive interest rate was offered.

The council required that they be given first call on revenue generated after operating costs were paid for. Additionally, the council has security over the shares in the Ernesettle solar farm, and a charge over key project agreements including: the operations & maintenance contract, a 17-year power purchase agreement (backed by a PEC guarantee), the grid connection agreement, and the project's lease.

Once the terms were agreed to, the full council approved the loan by vote. The process was relatively smooth; the solar farm was already built, and had received loans from external financiers, which meant that a level of due diligence had already been undertaken before PCC got involved. In addition, although PEC had considerable expertise within their team, the council recognised following the technical due diligence phase, that the key risk was not the infrastructure failing, but rather mismanagement of the assets. As long as the underlying asset was functioning, the council could recoup its investment.

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### Final outcome

The Ernesettle solar farm is forecast to generate an estimated £2,900,000 of additional income for PEC to tackle fuel poverty and climate change. It generates enough power to meet the annual needs of 1000 homes in the local community, and provides 18 acres of biodiverse wildflower meadows.

A mix of both community shares, private loans, and borrowing from the council was required in order to get the project mobilised. No one source of capital would have been sufficient. The bridge loan was made available on relatively short notice in order to capitalise on a closing window of government support, the community shares offer was able to raise a significant sum of money through community engagement, and council on-lending meant a secure long-term financing solution. PEC is paying back the interest on the loan, and the interest owed to members via the community shares offer.

### → Swansea Community Energy and Enterprise Scheme and Swansea Council

#### Key facts



**Council:**  
Swansea Council



**Community business:**  
Swansea Community Energy and Enterprise Scheme



**Investment amount:**  
£100,000



**Investment type:**  
Community Share Purchase



**Financing terms:**  
Expected 6% return



**Additional financing:**  
Wider Community Share Offer



**Social outcomes:**  
Reduction in fuel poverty, and reduced carbon emissions

#### Swansea Community Energy and Enterprise Scheme overview

The Swansea Community Energy and Enterprise Scheme (SCEES), is a community benefit society, which was developed by Swansea Council with the aim of using community-owned solar energy to help regenerate deprived wards in the city. Now independently managed, it has established ten solar PV systems on community buildings owned by local people through a new social enterprise. Profits from the scheme are used to support local projects that help people develop skills, enterprise, economic growth and job creation.

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### Previous council support

In late 2014, the council undertook detailed feasibility studies to confirm that community solar generation through solar panel installations was a viable option to meet growing energy demands in the city. Initial studies were funded by the council to first identify suitable assets, and second to map those assets against most in need areas of the community. From a shortlist of 60 buildings, 18 were identified as sites that were likely to still be in operation in 20 years. A number of insights were then drawn out through community consultation workshops:

- carbon reduction for its own sake was not a priority concern for community members;
- a community fund was appealing as it gave unrestricted income that could support wider community needs;
- skills building and job opportunities were a key area of interest;
- broad buy-in and a sense of ownership were critical factors to any new proposition, and;
- citizens also wanted to be consulted in how money would be distributed.

The council created a stand-alone social enterprise that would manage a community-owned energy scheme. In concert with the council, a local council officer and a number of other community leaders established the Swansea Community Energy and Enterprise Scheme (SCEES).

With technical and financial support from the Welsh Government's Local Energy service, and a strong level of community support, the council was able to secure regulatory approval and register for tax relief for SCEES within 7 weeks. However, due to the short timescales involved, SCEES had insufficient time to complete a community share offer in advance of the PV installations, and therefore required bridging finance to fund its installation work. SCEES borrowed the required funds from Robert Owen Community Banking.

During August and September of 2016, SCEES installed solar PV panels on nine schools and one care home in and around the wards of Townhill and Penderry in Swansea. These installations were able to provide cleaner and more affordable electricity for each of the building hosts, as well as a valuable educational resource for the local community.



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### Lending process

Building on their successful start, SCEES ran a community share offer to raise £425,000 to pay off the short-term construction loan from Robert Owen Community Banking. Using income secured from feed-in-tariff payments, and the sale of some of the electricity on-site, SCEES offered investors a projected 6% annual rate of interest, with profits after repayment going into a Community Benefit Fund. SCEES anticipated this fund would generate over £500,000 during the lifetime of the project to support the growth of renewable energy and enterprise development in the local community. SCEES looked to the council for investment during the community shares offer. As initial due diligence was conducted and approved by the council when it was assessing whether to invest previously, this streamlined the approval process.

The council invested £100,000 during the community share offer, which provided not only financial backing, but also gave SCEES a council endorsement which encouraged local investors.

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### Final outcome

SCEES launched their community share offer in December of 2016, and successfully raised £467,000 in just 7 weeks. This allowed them to pay off the initial construction loan from Robert Owen Community Banking. Over 170 people invested during the share offer raise, with two thirds of the investors living the Swansea Area.

The unique structuring of SCEES required a culture shift within the council, from being complete owners of assets, to being part owners alongside the community. Equitably sharing the benefits of that arrangement required a lot of negotiation.

Key ingredients for success included, having a clear view on what sites were available in the community for renewable power generation and the willingness of local government officers to work with the local community.



## 2.3 Community Assets

### The Cheese and Grain and Frome Town Council

#### Key facts



**Council:**  
Frome Town Council



**Community business:**  
The Cheese and Grain



**Investment amount:**  
£86,000



**Investment type:**  
Loan



**Financing terms:**  
~3% interest



**Additional financing:**  
None



**Social outcomes:**  
Wider social, cultural benefits, and a rejuvenated community gathering place

#### The Cheese and Grain overview

The Cheese and Grain (C&G) is a not-for-profit, member-owned social enterprise and registered charity located in Frome. While primarily a music venue, the C&G also hires out its site for markets, weddings, and festivals. It has an onsite café and bar, and the building has a number of rooms to hire for local businesses.

#### Previous council support

In 1997, Frome Town Council planned to transform a derelict agricultural market hall originally built in 1870, into a music venue (now occupied by the C&G). To do so, Frome Town Council negotiated a lease to take over the ownership of the hall from Mendip District Council, who were the owners at the time. The town council then refurbished the building, including installing a new roof and sound-proofing to reduce noise pollution for local residents. To ensure the valuable community asset was sustainable, a small local charitable trust was established to take over the operation of the building in 2003, enabling the business to save on business rates and access new funding opportunities.

The Cheese & Grain's main aim is to enhance the social, cultural and economic environment for the community of Frome. The C&G's building is leased from the Frome Town Council on a 25-year basis, and to support its aims, the council provided a grant of £35,000 per annum to the organisation.

While the subsidy was enough to help C&G operate, it was not sizeable enough to fund large one-off expenditures, nor enough to help C&G on a path to business sustainability. The council had, at one point, even considered running the business themselves, but instead decided to support the Cheese and Grain with alternative financing options, and in doing so provide a longer term solution.

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### Lending process

As a parish council, Frome Town Council can borrow money from the Public Works Loan Board at very low interest rates. The Council saw this as an opportunity – it could borrow from the central government and on-lend to the C&G.

The Cheese and Grain management and Frome Town Council staff worked alongside each other to put together a proposal to be passed through the council's Internal Affairs Committee, and ultimately the council as a voting body. The proposal faced significant scrutiny through regular governance, as well as more rigorous due diligence from internal and external auditors.

The Cheese and Grain borrowed £86,000 from the council at an interest rate of ~3%. This was enough to enable the C&G management to renovate the venue, with the hope that it would in turn contribute to increased revenues. An additional benefit for the C&G in receiving funding in this way was the security that came with it. Unlike the annual grant subsidy it used to receive, the investment could not be withdrawn.

With the economic case for this investment being so sound, there was broad buy in from the council. With a clear process of lending outlined by MHCLG, the council found that borrowing the funds was a quick and easy process.

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### Final outcome

The Cheese and Grain has continued to be a mainstay of the community in Frome, and has been able to attract many major performers to the venue. Crucially, the Cheese and Grain has also been paying back its loan to the Council. After the success of the first loan, the C&G negotiated a second PWLB financed loan in 2015 to install a new LED lighting system, sound desk and digital equipment. This led to a reduction of electricity costs by 80%, and meant the C&G could attract better-known acts than it would have previously.

Frome Town Council also recently invested a third PWLB financed loan, alongside a grant from Power to Change, into constructing new assets, most notably a new recording studio. Professional music acts will be charged to use the studio, the profits from which will be used to subsidise its use by the local community. The studio will also be used to train and formally accredit young people from the community, particularly women, in music recording industry skills.

The Cheese and Grain is not the only case where Frome Town Council has utilised PWLB borrowing to invest in its local community. It has used its prudential borrowing ability to finance the purchase of the Town Hall back from the county council, and has also recently purchased land in the middle of Frome, which it may use for community housing in the future. The success of the investment in the Cheese and Grain has spurred the council to look for new ways they can use PWLB funding to make sustainable investments into community assets and social enterprises.

### → Halo Leisure Services and Herefordshire Council

#### Key facts

**Council:**

Herefordshire Council

**Community business:**

Halo Leisure Services

**Investment amount:**

£9,000,000

**Investment type:**

Loan

**Financing terms:**

3.6% interest, to be paid over a 25-year period

**Additional financing:**

Sport England grants

**Social outcomes:**

Improved leisure services for local residents

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### **Halo Leisure overview**

Halo Leisure is a not-for-profit social enterprise that runs 22 sport and leisure centres throughout Herefordshire, Bridgend County Borough, Shropshire and Swindon on behalf of local authorities and other partners. In the early 2000's, it became clear to Herefordshire Council that the status quo of leisure delivery was not providing the best value to residents, and that the council did not have the skill base to provide an improved level of leisure services. Halo Leisure, an independent social enterprise, was launched in 2003 with the help of Herefordshire Council, and was commissioned to provide leisure services.

Halo offers a range of services, from the traditional gym to spa services, but prides itself on also promoting social inclusion and community safety. They also encourage young people to use their services, so that children are able to form relationships with peers and older people in the community, in a bid to help address anti-social behaviour.

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### **Previous council support**

Alongside the initial support, Halo also received a yearly management fee from the council to support the costs associated with providing the community's leisure services. Due to public sector cuts, Herefordshire council decided it would end this support, but recognised how it would pose a challenge to Halo's sustainability, and negatively impact the public.

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### **Lending process**

The council was willing to make a loan to Halo using money from PWLB, but needed them to offer a strong business case as to why upgrading leisure centres would result in greater profitability. To do this, Halo first undertook an internal assessment of its services and customers to better understand where there were potential efficiencies. Halo also hired external consultants to do a deep dive into the leisure market in Herefordshire, allowing them to build new service models to maximize the market potential of any changes. Halo chose five leisure centres for upgrade investments, worked with designers on what was possible, and then with the council's property team to build out budgets for each leisure centre. Halo then submitted detailed business cases for capital investment to the council.

A third party was commissioned by the council to provide independent assurance that the income projections were sufficiently robust, included suitable contingencies, and to review the assumptions that there was a sufficient level of latent demand to support of the higher membership base projections made by Halo. Consensus was reached on the projections for Halo and was then approved by Councillors.

The council approved a £9m loan to Halo Leisure, at an annual interest rate of 3.6%, to be paid over a 25-year period. It took about 9 months from initial conversations to final approval, very quick considering the level of due diligence that was conducted and the major changes made to Halo's business model.

Once the loan was approved, the council and Halo worked together to secure additional grant funding from Sport England to support the revitalisation work – resulting in an additional £1 million grant being awarded.

The procurement process was paid for and managed by the local authority, with a requirement for Halo to then pay them back. One contractor won the contracts for all five leisure centres and the projects were staggered so as to not disturb leisure service provision too drastically.

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### Final outcome

In addition to financing, the council also helped Halo in 'in-kind' ways as they worked together as partners – e.g. the council also provided Halo Leisure with the rights to two car parks outside the leisure centres. This was mutually beneficial, giving Halo an additional source of revenue to support their loan repayment, and transferred the management of those assets away from the council.

Halo ended up only using £8.7m of the loan provided by the council, helped by the Sport England grant. As of April 2016, Halo was no longer taking in a management fee from the council, was in a strong position to pay back loans in full, and was able to keep all of its facilities open.

The council for its part was able to eliminate its immediate liabilities on leisure centres, whilst allowing for increased quality of leisure provision in the area. Halo's concessionary pricing scheme for marginalised groups was maintained to ensure social engagement remained a core part of its services.

The lease agreement between Halo and the council was set to expire in 2027, but the two parties have now locked in a lease agreement for 75 years. This will ensure that Halo continues to be a central part of Herefordshire's community for many more years.

## 3. Emerging best practice for successful social investment

As the case studies show, local authorities have successfully used a variety of investment products, many funded through PWLB borrowing, to finance the growth and expansion of community businesses. While varied, these examples of innovative thinking, and pragmatic action from local authorities and community businesses do have several common features.

As councils look at their existing relationships with community businesses as potential pipeline for social investment, the following best practices should help to provide guidance on where potential partnerships might be most fruitful.

### Strong existing partnerships

Across most of the cases studies, the precursor to successful local authority investment in community businesses was a strong existing relationship between the two parties. These relationships have taken on many forms, from local authorities sharing staff with community businesses, to seeding the business within the council originally, to ongoing grant support from the council. As investment requires deep knowledge of a business and its management, these relationships are key to getting broad buy in within any council.

Additionally, where grant funding is provided by the council to a community business on an on-going, yearly basis, longer term financing might help those community businesses to become more sustainable; by making long term investments beyond just the next grant funding cycle. On-going, and recurring grant funding is a great place for local authorities to look for potential longer-term investments.

### Address loan terms and risks early on

The negotiation process on investment terms can be difficult to navigate, particularly when neither party has expertise in the area. For councils, this means outlining your return expectations, both in terms of rates and timing. While local authorities can borrow for very long periods of time from the PWLB, they may not be willing to on-lend on similar long dated terms because of the associated risks. On the flip side, community businesses should articulate at what borrowing rates their operations remain economically feasible, to ensure that the council as a social investor understands fully the economics of the investment, and how that impacts the community business' ability to deliver for its stakeholders. It is also crucial that both parties make clear what they are willing to accept as security, and have those conversations early in the investment process.

### Clear track records

Related to the point on relationships, a clear track record of delivery and good financial stewardship is also critical when local authorities assess potential investment opportunities. For a community business, social enterprise, charity, or

voluntary organisation to warrant investment, it must be able to use that investment capital wisely, and manage the business growth that the capital can bring.

Where the council did seed fund the organisation initially through grants, or other forms of financial support, larger downstream investments were predicated on proven results. Being able to show results and strong management therefore are crucial to gaining the momentum required to get investments across the finish line.

### **Shared mission**

Contributing to a shared mission was another key factor in bringing local authorities to the table. Showing that an investment in a community business will allow a council to better provide for their local community, makes it easier to get broader buy in within the local authority. For community businesses, this means explicitly showing how the two parties will benefit from investment (for example through a business case) and how that investment will contribute to the community is crucial. As the investment process can be long, and the due diligence and negotiation processes taxing at times, having a shared mission can help to uphold momentum, and focus both parties on why they embarked on this process to begin with.

### **Community buy-in**

Local citizens too must be able to hold their councillors to account over how they spend public monies. When local authorities are considering an investment in a community business, it is important that they consult constituents on the investment in an open and transparent manner. As community businesses rely on their connection to the local community to thrive, it is important for both parties that the community at large see the value in the use of public funds for investment.

### **Willingness to take appropriate risks**

All investments involve risk, but those risks don't fall just on the party putting up the capital. Yes – the local authority must be clear on the level of risk it is willing to take on in a given investment, and do appropriate due diligence to mitigate those risks – but community businesses are taking on risks too. They often secure a loan against their assets, which therefore may be taken from them if they default, halting their operations.

With that said, investments by local authorities were often only possible because there was an underlying asset that a loan could be secured against. As local authorities look for potential investments, owning assets is a good indicator of a potential investment opportunity. In the case of social housing for example, a new development could be managed by the community business in the best-case scenario, or by the council in case of default.

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## 4. How to borrow to invest?

Local authorities have powers to invest under section 12 of the Local Government Act in 2003, though most social entrepreneurs would not consider their local council as a source of investment. The Act states “a local authority may invest – (a) for any purpose relevant to its functions under any enactment, or (b) for the purposes of the prudent management of its financial affairs”.

While any investment a local authority makes must comply with Secretary of State for Housing, Communities, and Local Government guidance, and those investments must be made prudentially, councils regularly invest successfully in their communities. While these investments can take many forms, what we found in our research was that councils are most comfortable with debt investments as they are typically less risky when backed by security, and require minimal involvement in management.

Councils, like any firm or individual, can lend from their own surplus revenues – and local government revenue reserves in England stood at £24.7bn at end of fiscal year 2016. While this is possible in theory, in practice shrinking council budgets due to cuts in funding from the central government can mean that surplus revenues are harder to come by, which makes the provision of capital to invest from revenues challenging. This leads councils to borrow to fund capital investment.

### Borrowing for capital investment

The Local Government Act, 2003, gives local authorities the power to borrow. Much like the powers to invest, councils can borrow; “(a) for any purpose relevant to its functions under any enactment, or (b) for the purposes of the prudent management of its financial affairs”. However, Local authorities are prohibited from borrowing to fund day-to-day services under the Local Government Finance Act of 1992, and the same Act also requires an authority’s revenue budget be balanced without the use of borrowing.

Local authorities must determine annually, and keep under review, how much money they can afford to borrow. To comply with this mandate to review their borrowing position, authorities must have regard to the Prudential Code for Capital Finance in Local Authorities (Prudential Code) published by the Chartered Institute of Public Finance and Accountancy. The Prudential Code requires that any borrowing undertaken by a local authority be prudent, affordable and sustainable.

Local authorities must also appoint a statutory Chief Finance Officer under Section 151 of the Local Government Act 1972, who is responsible for signing off on all borrowing in accordance with the Prudential Code.





With any borrowing, a local authority must also set aside a minimum revenue provision to repay debt. This means that a local authority must set aside cash from its revenue budget sufficient to ensure it can repay its debts for the length of the borrowing period.

There are two main sources of capital local authorities can borrow from: the private market, and central government.

### **Borrowing from the market**

There are two main kinds of long term borrowing local authorities can undertake from the private market: borrowing through bond issuance, or from banks and other financial intermediaries.

Bonds allow local authorities to raise substantial sums of capital fairly rapidly, which they repay at specified points in the future. Unlike in other countries, in the UK municipal bond issuance is still in its embryonic stage.

Local authorities can also borrow from banks or other financial intermediaries to fund capital investment so long as they follow the Prudential Code. As local authorities are statutory bodies with minimal risk of outright default, lenders can offer local authorities lower interest rates than community businesses on their own would receive.

### **Borrowing from central government**

Central government is the largest, and most readily available source of capital for local authorities. Central government funding is made available through the Public Works Loan Board (PWLB), a statutory body that issues loans to local authorities, with capital coming from the National Loans Fund (central government's main borrowing and lending account).

While the PWLB is a statutory body with twelve commissioners appointed by the Crown, these Commissioners are ceremonial in nature, and are only in place to comply with statute. In practice, the PWLB function is carried out by the Debt Management Office (DMO). PWLB has an aggregate limit for outstanding loans of £70 billion, which can be increased to £95 billion with authorisation from the Treasury.

The government recently consulted on changes to the PWLB's governance arrangements and announced that the PWLB as a statutory body will be abolished, and its functions will be transferred to the Treasury. This transition is unsurprising as the PWLB's interest rates are already determined by the DMO on the Treasury's behalf. The National Loans Act 1968 gives the Treasury the power to determine the rate of interest at which the PWLB can make loans, but requires that "the rate must

be sufficient to avoid a loss to the National Loans Fund, calculated by reference to the Treasury's own costs of comparable borrowing" – i.e. the cost of borrowing the central government can expect in the bond market.

PWLB lends to both major local authorities, and smaller authorities, though the lending process for each is slightly different. Since 2004, major local authorities have been able to borrow without government consent, provided that they can afford the borrowing costs.

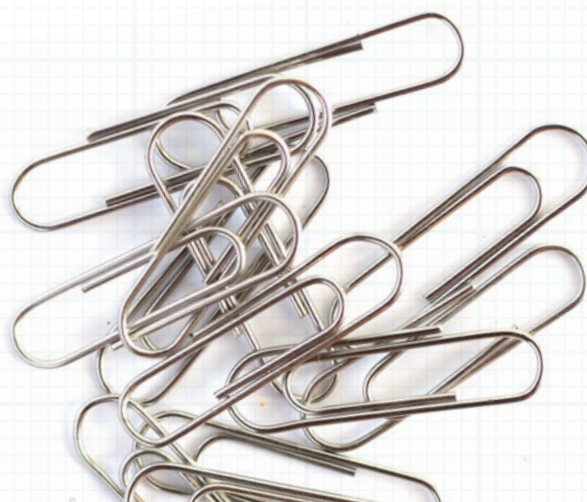
### How does PWLB classify local authorities?

Major local authorities include: the councils of all counties and districts in England, the councils of all counties and county boroughs in Wales, the councils of local government areas in Scotland the councils of all London boroughs, the Greater London Authority and its functional bodies, any combined authority established under the Local Democracy, Economic Development and Construction ACT 2009, among others.

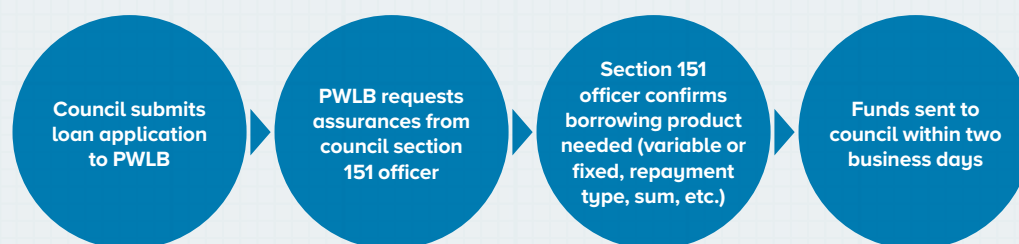
Smaller authorities include: parish councils, community councils, charter trustees, or drainage boards.

A full list can be found in the annex.

Councils are required by law to "have regard" to the Prudential Code. The Prudential Code has been developed by the Chartered Institute of Public Finance and Accountancy as a professional code of practice to support local authorities in taking investment decisions. Authorities are required by regulation to have regard to the Prudential Code when carrying out their duties in England and Wales under Part 1 of the Local Government Act 2003, in Scotland under Part 7 of the Local Government in Scotland Act 2003 and in Northern Ireland under Part 1 of the Local Government Finance Act (Northern Ireland) 2011. The PWLB requires assurance from the authority that it is borrowing within relevant legislation and its borrowing powers. The PWLB does not require information on the purpose for a loan, as responsibility for local authority spending and borrowing decisions lies with the locally-elected members of the council.



### Public works loan board lending process



Loans to local authorities are automatically secured by statute on the revenues of the authority as a whole, rather than by reference to specific revenues, assets or collateral. As with other types of borrowing, the PWLB requires that the local authority's chief financial officer (statutory section 151 officer), or staff nominated by the authority's chief financial officer, submit the borrowing application.

Loan applications to the PWLB must be made by telephone, and only within the PWLB's hours of operation. The terms of the loan, sum required, date of final repayment, and the rate of interest on a fixed rate loan – or the formula for a variable rate loan – is agreed to at the time of the application. Once confirmed, the loan will be advanced within 48 hours (excluding weekends and bank holidays). In 2016-17 PWLB lent more than £3.6 billion to local authorities, making it one of the largest lenders to local authorities in the country (Debt Management Office, 2018).

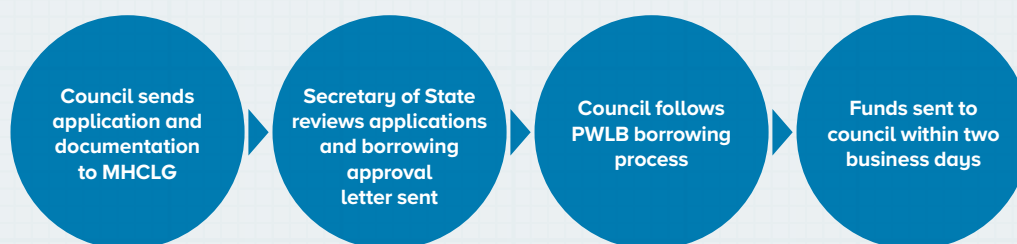
### Public works loan board borrowing for smaller local authorities

For parish and town councils in England, and town and community councils in Wales, the process of borrowing is slightly different. While funding still comes from the PWLB, any loan taken out by smaller councils must first be approved by the Ministry of Housing, Communities and Local Government (MHCLG). This borrowing process is governed by schedule one to the Local Government Act of 2003.

To secure approval, parishes and town councils must principally show four things in their application; i) that residents have been consulted, ii) that the full council has approved this loan application, iii) that the council's budget includes provisions made to meet the loan cost, and iv) a business case for the loan.

The business case should include the proposed downstream activity the loan will fund, estimated costs, financial planning to fund the loan repayments, and steps the council has in place to mitigate the risks associated with not being able to meet repayments. If that repayment plan includes an increase in the local precept (a form of council tax), the council must show evidence of public support for this.

### Public works loan board lending process for small authorities



The formal decision on each application rests solely with the Secretary of State within MHCLG. If the application is approved, MHCLG will send the council a borrowing approval letter, setting out conditions that need to be fulfilled for the council to borrow, how much the council can borrow, and the maximum term of the loan period. Borrowing approvals are valid for 12 months, but can be extended.

With this borrowing approval letter, councils may borrow from any willing lender – including banks. But as outlined above, in practice most councils borrow from the PWLB because of the ease of access to funding, and the competitive rates of interest. The PWLB will need to see the original borrowing approval before processing any application from smaller authorities, but once that is confirmed the borrowing process outlined above is followed. In 2016-17, PWLB lent more than £19m to parish and town councils (Debt Management Office, 2018).

There is no set national limit on the total annual amount of borrowing available to local councils in England. However, the amount that an individual town or parish council can borrow is normally limited to £500,000 in any one financial year.

### Products available through PWLB

PWLB offers both fixed and variable rate loans with different repayment options. The interest on fixed rate loans is fixed for the life of the loan, and is payable at half-yearly intervals. The interest on variable rate loans vary at one, three or six-month intervals. The interval period is selected by the borrower, but once chosen remains the same for the life of the loan.

Fixed rate loans are repayable by one of three methods:

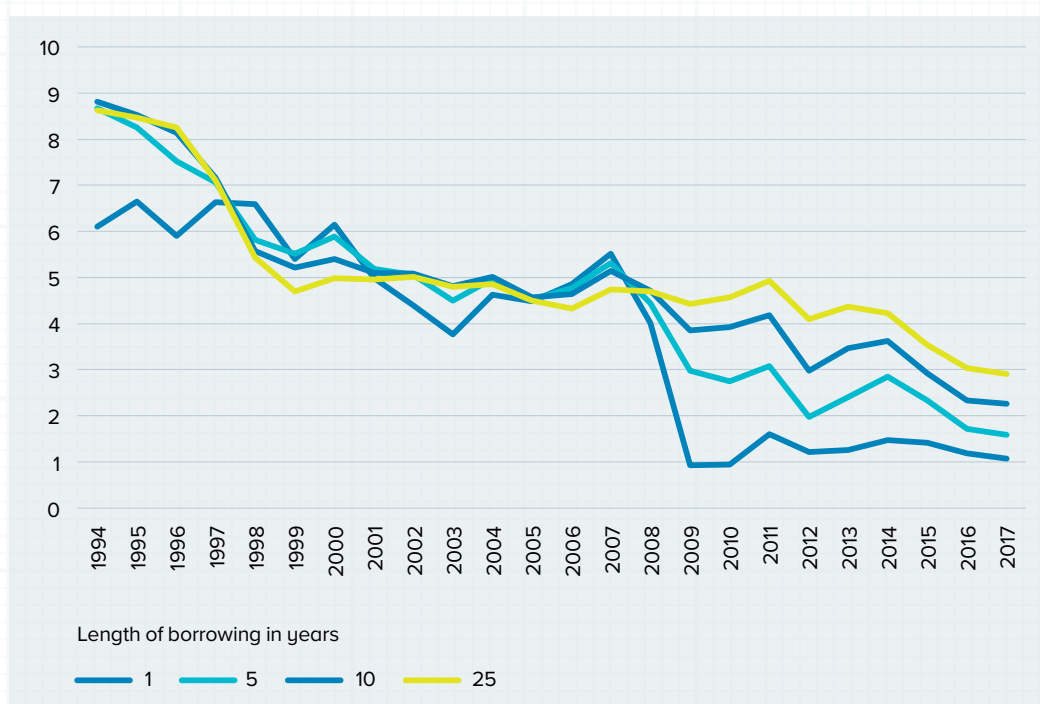
1. Annuity or Equal Repayments (ER): fixed half-yearly payments to include principal and interest;
2. Equal Instalments of Principal (EIP): equal half-yearly instalments of principal together with interest on the balance outstanding at the time; or

3. Maturity: half-yearly payments of interest only with a single repayment of principal at the end of the term.

Variable rate loans are repayable by one of two methods:

1. Equal Instalments of Principal (EIP): equal monthly, quarterly or half-yearly instalments of principal together with interest on the balance outstanding at the time; or
2. Maturity: monthly, quarterly or half-yearly payments of interest only with a single repayment of principal at the end of the term.

### PWLB interest rate, by length of borrowing



Source: Debt Management Office

The rates of fixed interest loans are determined daily; those of variable interest loans are based on the sum of the current cost of Government borrowing and a margin, which are announced daily. The rates of interest on fixed rate loans, and the margin on variable rate loans, remain unchanged throughout the period of the loan.

### Borrowing Products Available Through PWLB

Loan Instrument	Available with Fixed and or Variable Loans?	Description	Strengths	Weaknesses
<b>Annuity or Equal Repayments (ER)</b>	Only Fixed	Both interest and principal paid back over the life of the loan, with principal repayments increasing over time.	<p>Fixed total payments each month, so cash-flow is known.</p> <p>Principal repaid over life of the loan which lowers risk of shortfall at end of project.</p>	<p>Higher monthly payment compared to Maturity repayment due to principal being paid down over time.</p> <p>May result in negative net cash flow for earlier years of the project.</p>
<b>Maturity</b>	Fixed and Variable	<p>Fixed interest payments.</p> <p>No repayment of principal until the end of the loan.</p>	<p>Fixed interest payments, so known cash-flow.</p> <p>Lower cash-flow demands (until the final period).</p> <p>Positive net cash flows once rent stabilise, offering potential to deliver income yield.</p>	<p>High concentration of risk at maturity date, where 100% of principal is due.</p> <p>Highest risk if value of project declines over the loan period.</p>
<b>Equal Instalment of Principal (EIP)</b>	Fixed and Variable	<p>Similar to an annuity, principal is repaid throughout the life of the loan.</p> <p>Unlike in an annuity, the principal repayments are fixed and the interest payments vary.</p>	<p>Fixed principal repayments, but variable total payments as interest payment reduces in line with the reducing average balance.</p> <p>Principal repaid over life of the loan which lowers risk of shortfall at end of project.</p>	<p>Highest monthly cash-flow requirement in the initial years.</p> <p>Payment profile least well matched to potential project cash flows.</p>

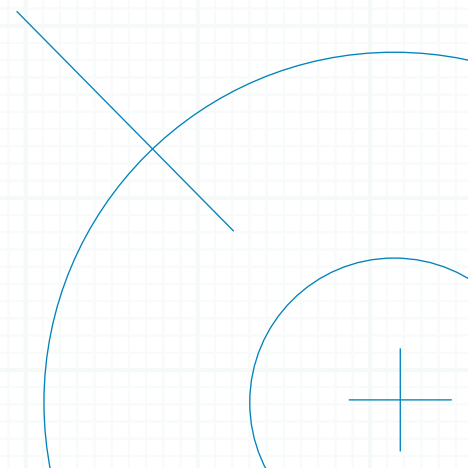
The local authority can choose the final repayment date for the loan, but it must fall within the following limits placed on the given borrowing product:

		Minimum period (years)	Maximum period (years)
<b>Fixed rate loans</b>	Maturity	1	50
	Annuity or EIP	2	50
<b>Variable rate loans</b>	Maturity	1	10
	Annuity or EIP	2	10

From 1 November 2012, the Government reduced interest rates on loans from PWLB by 20 basis points (0.20%), for principal local authorities who provided detailed information as required on their plans for long-term borrowing and associated capital spending (the 'Certainty Rate'). Eligibility for access to these concessionary rates is determined by the Treasury, and the PWLB require confirmation from borrowers that they have been granted this approval (HM Treasury, 2013).

Repayment amounts are calculated on the assumption that the loan will run to maturity and normally a loan is repayable only by the regular payments due under the agreed terms. PWLB cannot renegotiate a loan and, while it will usually accept a premature repayment in whole or in part, in all instances the terms will not favour the borrower over the National Loans Fund.

The ease of borrowing, and the comparatively inexpensive financing terms makes PWLB a very attractive option for local authorities looking for sources of investment capital.



## 5. Concluding recommendations

The case studies provide very positive examples of how local authorities have successfully invested in community business. However, the majority of local government's investment activity is commercial. According to research by the Local Government Chronicle, 94 councils have invested at least £2.4bn in property specifically to generate an income since 2010 (Local Government Chronicle, 2017). The target rate of return, for those councils that have published their strategies, tends to range from between 5 and 10%. The likely source of this investment capital is, according to commentators, central government borrowing through the Public Works Loan Board (PWLB) – though comprehensive data is not available to substantiate this.

In some cases, commercial property investments dominate a council's balance sheets. Spelthorne Borough Council borrowed £350m to fund the purchase of the BP campus in Sunbury-on-Thames. That is around four times the value of all its other assets. The council used a 50-year fixed-rate loan at around 2.5% from the PWLB to finance this activity (Financial Times, 2017).

In response to the growth of PWLB borrowing to invest in commercial property, the government has issued new Statutory Guidance on Local Government Investment, under section 15(1)(a) of the Local Government Act 2003, which came into effect from 1 April 2018.

### **'Mini' case study:**

#### **PossAbilities and Rochdale Borough Council**



PossAbilities is a social enterprise supporting vulnerable adults to 'live the life they choose'. Rochdale Borough Council identified gaps in supported accommodation options for people with learning disabilities. PossAbilities responded by bringing together a series of developments including a one-acre wellbeing garden and an urban farm; 'The Social Lounge', a drop-in centre for vulnerable adults; micro enterprises; and the construction of the 16-unit Cherwell Village apartments. This housing development will create a place where people can live, work, volunteer and socialise, making them an integral part of a vibrant neighbourhood.

Rochdale Borough Council supported the project by transferring the site through a Community Asset Transfer to PossAbilities, and also provided a 25-year mortgage using PWLB monies. The Cherwell Village Apartments will be completed in the first half of 2019.



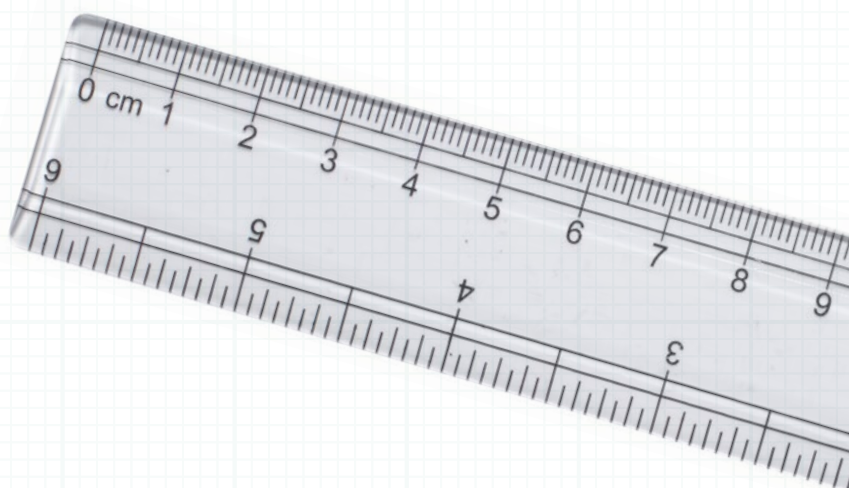
The guidance will require local authorities to be more transparent and more accountable for their investment decisions, which should in the future be approved by the full council. As well as being published on local authority websites, investment strategies should outline:

- the contribution their investments make towards service delivery objectives and their place making role, and;
- indicators that allow councillors and the public to assess risk exposure, including how investments are funded and rate of return received.

The guidance also provides for local authorities, “to make loans to local enterprises, [and] local charities... even though those loans may not all be seen as prudent if adopting a narrow definition of prioritising security and liquidity”. The government is also trying to curb the practice of local authorities borrowing in “advance of their needs purely to profit from the investment of the extra sums borrowed”.

Taken together, the guidance provides a strong incentive for local government to consider its role as a social investor. It also encourages local authorities to develop the appropriate capacity, skills, and information to take informed decisions, against local strategic objectives and overall risk exposure. In that context, it would not be unreasonable for a £100m local authority investment vehicle to diversify risks, for example, by seeking up to 10% of investments to be made in socially-motivated ventures for the benefit of the community, which also support core policy objectives, rather than purely income generation.

Some local authorities, such as those referred to in the case studies, may choose to go further and provide detail on how their investment strategies directly contribute to social objectives. There are a number of frameworks available, including the HM Treasury Green Book, which provide comprehensive criteria for assessing the social, environmental and wider public value generated by investment activity, in addition to yield or return on investment.



## 5.1 Recommendations

There are a number of actions that based on the research undertaken we believe will develop the market of local authorities acting as investors. They converge around a few interconnected themes, and fall on various stakeholders in the space.

**Taking initiative and ownership** – there is undoubtedly a great potential for community businesses to benefit from borrowing from the public sector. Capitalising on these potential benefits, both to businesses and local authorities, relies on both parties taking the initiative to kick start the processes. For local authorities, this may mean reviewing the grants they give out and assessing which ones might work more effectively as loans instead be loans, or seeking out investment opportunities in local businesses that provide social benefit. For community businesses and others, this may simply mean thinking of their local council as an investor, and proactively approaching them with an investment proposition and business plan.

There are other actors that should see themselves as stakeholders in this space – industry bodies and sector networks could play a critical role raising awareness to promote this method of financing. Combined authorities could use their status to borrow from the PWLB and give larger loans for bigger initiatives, benefiting from greater economies of scale, such as for housing developments, potentially drawing on Right to Buy receipts.

**Gathering and sharing data** – Currently, PWLB loan data is limited to the loan amount and the borrower. We believe there would be value in councils providing data on PWLB funds borrowed to invest in their local communities. Improved data availability would undoubtedly benefit councils and communities across the country. Firstly it would provide greater transparency on size of investments; and second, the opportunity to learn about what works. There is an opportunity for central government, industry bodies and network organisations to play a crucial convening role as the market looks to amalgamate data to facilitate the latter to help develop the market” (e.g. what works).

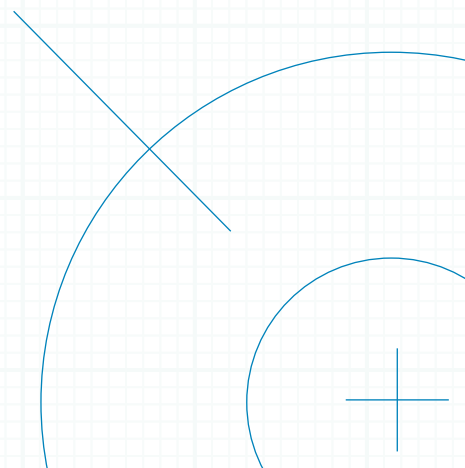
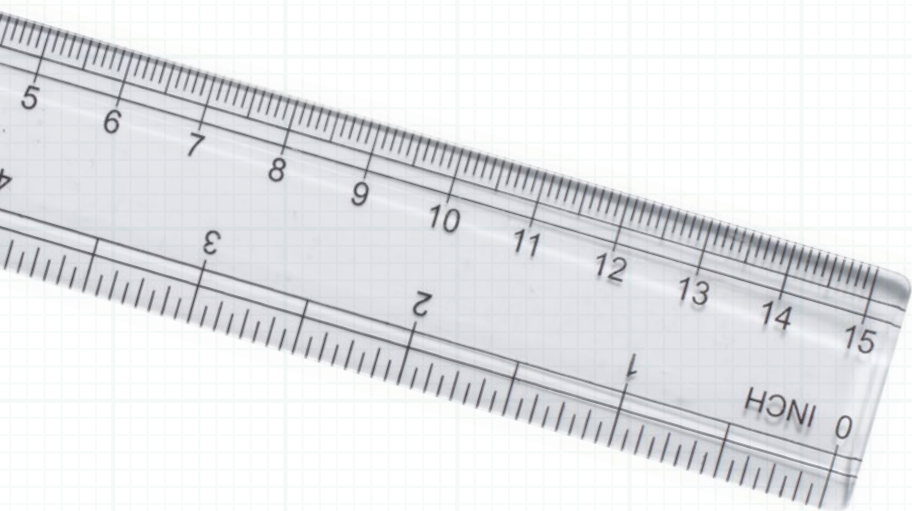
**Market monitoring** – The new statutory guidance on local government investment is welcome. It should create greater transparency and encourage a more strategic approach. The guidance should be reviewed in two years to consider whether it has achieved these aims.

The review should consider whether additional support for mixed motive investment by local government, such as concessionary PWLB rates, would support the market to development.

**Culture** – There needs to be a shift in culture across local government to recognise its role in building and shaping local markets through strategic investment. Local authorities should embed and foster a culture that enables staff to take measured risks alongside social entrepreneurs within their communities. To do this, local authorities need to build skills internally to develop and execute transactions. This need for skill building presents an opportunity for funders to offer capacity building support to not only councils, but also to community businesses, charities, and voluntary organisations to help them become investment ready. Power to Change is already contributing to this effort through grants which help businesses to undertake pre-feasibility work and reach investment readiness. There is undoubtedly scope for more of this kind of funding.

### **Conclusion**

Councils have the opportunity to become social investors that can achieve significant value for local taxpayers, and impact for their communities. Forward-thinking councils with an entrepreneurial mindset can work with and enable communities to become more self-sufficient, self-fulfilled, and overall better places to work and live. This working paper has provided positive evidence that councils can, and have, successfully invested in community business, and we look forward to seeing where other innovative local authorities take these best practices.

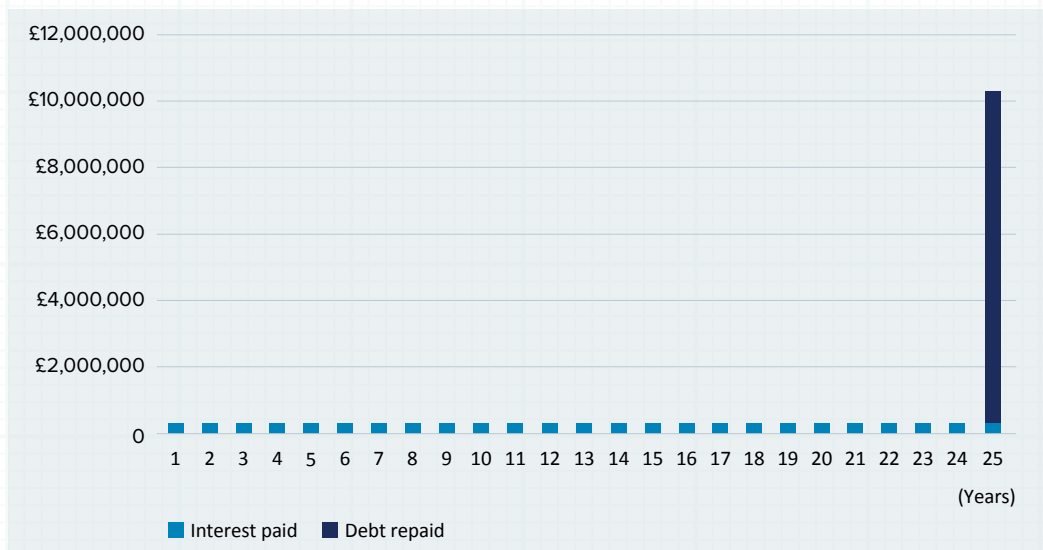


## 6. Annex

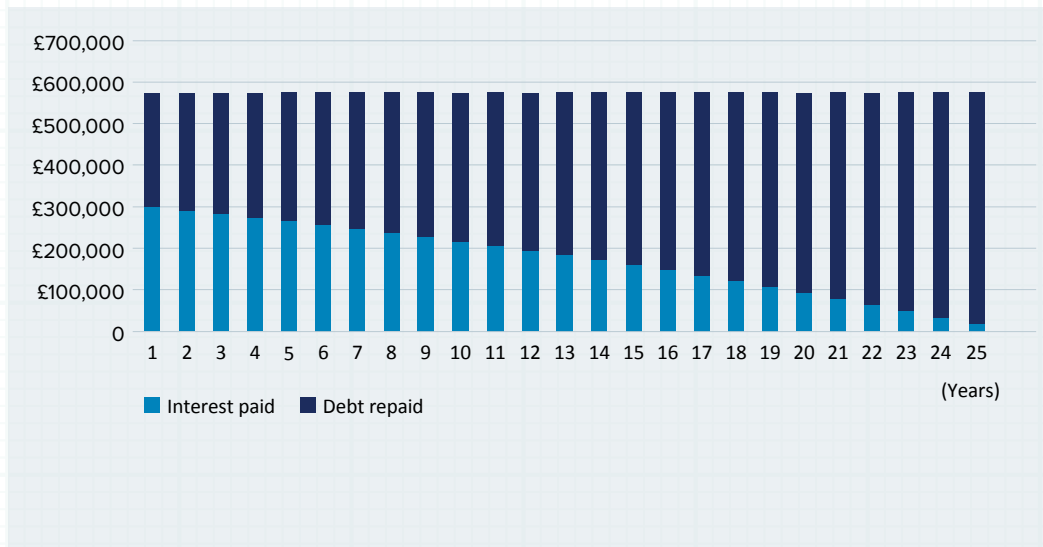
### 1. PWLB lending product repayment profiles

Below are three graphical representations of the lending products available through the PWLB. The graphs below represent the repayment profile of a 25-year, £10,000,000 loan from the PWLB, at a rate of interest of ~3%.

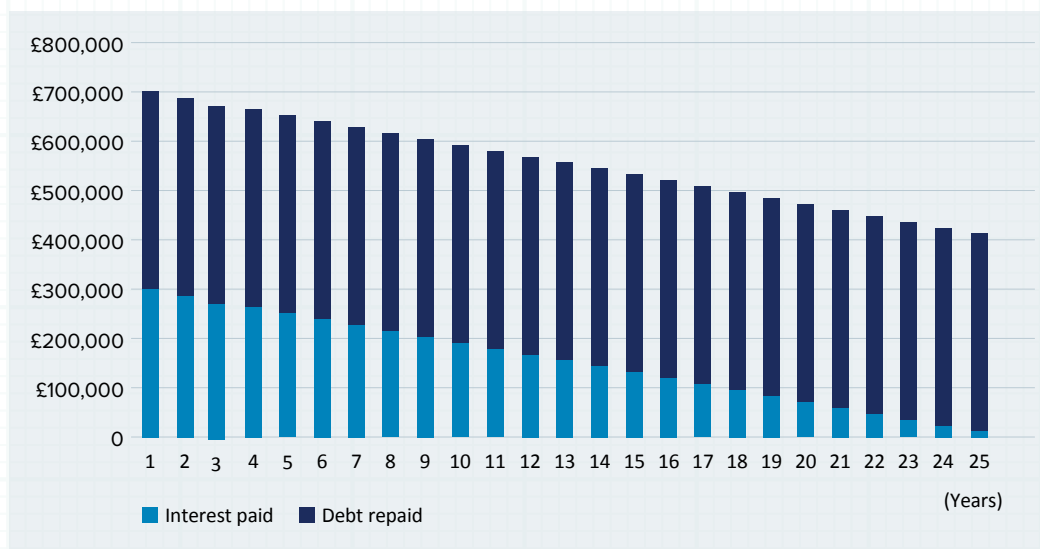
#### 1.1 Payment Profile Example: Maturity



#### 1.2 Payment Profile Example: Annuity



### 1.3 Payment Profile Example: Equal Instalment of Principal (EIP)



## 2. List of PWLB Eligible Local Authorities:

- the councils of all counties and districts in England
- the councils of all counties and county boroughs in Wales
- the councils of all London boroughs
- the Common Council of the City of London
- the Greater London Authority and its functional bodies
- the councils of local government areas in Scotland
- the Council of the Isles of Scilly
- the Broads Authority
- National Park Authorities established under the Environment Act 1995
- Integrated Transport Authorities
- A Combined Authority established under the Local Democracy, Economic Development and Construction Act 2009
- Passenger Transport Executives
- Police & Crime Commissioners
- Fire & Rescue Authorities
- Waste Disposal Authorities
- Port Health Authorities

- Regional Transport Partnerships in Scotland
- other authorities in England, Wales or Scotland having power to levy council tax or to issue a precept or levy

### 3. What is State Aid?

Under the Treaty of the Functioning of the European Union (TFEU) any aid granted by a Member State or through “state resources” in any form, which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods, insofar as it affects trade between Member States, could be deemed to constitute unlawful State Aid and be incompatible with the EU common market.

What is deemed to constitute State Aid is very broad, and this can include the provision of loans at a rate below market standard, grant funding, lenient taxation regimes, sale of assets at an undervalue, or the provision of certain types of guarantee. The TFEU sets out four elements, all of which must be satisfied if a measure is to constitute State Aid. These are:

- (a) State awards** – the aid must be awarded by a Member State or through state resources (which is likely to include the council).
- (b) Selectivity** – the aid must favour certain undertakings or the production of certain goods. In this context an undertaking is an entity engaged in economic activity, and an economic activity is an activity for which there is a market in comparable goods or services.
- (c) Distortion of Competition (or threaten to distort)** – the key criterion is that the aid strengthens the position of the recipient in relation to its competitors.
- (d) Affects trade between Member States** – as most services are traded between Member States, this criterion is easily satisfied unless the aid is to a small, defined local market where cross border trade is not possible.

An exemption from the need to notify the European Commission about aid granted through state resources, if the scope of funding falls within the operation of “services of general economic interest”. This can include the provision of services of general economic interest meeting social needs (i.e. social housing). These services can be operated by either public or private entities, the European Commission acknowledges that Member States have a wide margin of discretion in defining what are classed as “services of general economic interest”.

Additionally, in order to ensure that councils comply with State Aid regulations, administration fees are normally applied during the on-lending process.

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