North East Combined Authority

Leadership Board

DATE: **20 September 2016**

SUBJECT: **North East JEREMIE 2 Fund**

REPORT OF: **Interim Head of Paid Service, Interim Chief Finance Officer and Monitoring Officer**

EXECUTIVE SUMMARY

The Leadership Board received a report on the 19 April 2016, this provided details of the delivery of the JEREMIE 2 scheme in the North East; and approved the commencement of the procurement process of Investment Fund Managers. This also recommended that a further report be brought to the Leadership Board detailing the final structure of the Implementing Body for the JEREMIE 2 Investment Funds.

The JEREMIE 2 scheme will continue the successful JEREMIE 1 scheme and providing access to up to £120m of loan/repayable finance to Businesses in the North East. It is expected that this will help provide financial support for an estimated 600 businesses; help create an estimated 3,500 jobs over the next five years and deliver a legacy fund of up to £80m over the next 10 years to help provide further financial support to businesses in future years. The scheme is proposed to be fully funded by £58.5m of European (ERDF) funding, a loan from the European Investment Bank of up to £60m and legacy funding from previous loan schemes. In order to secure the European funding for this scheme it is necessary to establish the Implementing Body in October and secure Government approval to the ERDF funding before the Autumn Statement in November.

The purpose of this report is to seek agreement from the Leadership Board to the proposed structure and governance arrangements for the implementation of the JEREMIE 2 Investment Funds.

The report proposes that the Constituent Authorities of NECA become members of the Implementing Body of the JEREMIE 2 funding project, which will be a publically owned Special Purpose Vehicle (SPV), a company limited by guarantee and will hold the investment funds.

The report also provides an update on the procurement of fund managers for the JEREMIE 2 programme.

North East Combined Authority

Leadership Board

RECOMMENDATIONS (DRAFT)

It is recommended that, subject to the agreement of each Constituent Authority, the Leadership Board:

1) Agree to the establishment of the Special Purpose Vehicle, as set out in the report;

2) Agree to the proposed governance arrangements for the Special Purpose Vehicle as set out in the report;

3) Agree, subject to a successful ERDF application, that the funding received from the Department for Communities and Local Government is passported to the Special Purpose Vehicle;

4) Agree to support the Leaders (or their nominees) of the constituent authorities in overseeing the establishment and activity of the Special Purpose Vehicle and agree that an officer of NECA or its constituent authorities can be members of the shadow SPV Board, together with the appointed of a suitably experienced Board member as a 'key responsible person' to satisfy funder requirements, until the full board of the SPV can be appointed;

5) Agree to delegate the implementation arrangements to the Interim Head of Paid Service in consultation with the Interim Chief Finance Officer, the Monitoring Officer and the Chair of NECA.

1 Background Information

1.1 Background

1.1.1 The North East JEREMIE 2 Fund will provide a successor to the Finance for Business North East (FBNE) JEREMIE 1 fund, which currently provides access to finance to Small and Medium Sized Businesses in the North East. The JEREMIE 1 scheme was extended with access to finance for business now due to end in December 2016.

1.1.2 The investment phase of the JEREMIE 2 fund is intended to start early in the new year, providing access to an additional £120m of finance for business over the next five years until 2022/2023, with a further period of up to five years of portfolio activity (business support and repayment of the investment funds). The objective of the fund is to provide access to finance for businesses, to support business growth. This will help to increase the number and quality of private sector jobs in the economy as a key proposition to meet the objectives in our Strategic Economic Plan.

1.1.3 Other regional JEREMIE funds are being consolidated into the Northern Powerhouse Investment Fund (NPIF), with the British Business Bank acting as the Implementing Body (Fund of Funds Holder), which will be operated from Sheffield. The North East opted not to join NPIF, preferring to create a successor fund based in the North East, utilising existing expertise and infrastructure and received Government approval in principle in 2015 to establish a North East fund operated by an Implementing Body located in the North East.

1.1.4 The North East JEREMIE 2 Fund is proposed to make £120m of investments, which will be financed by an ERDF grant of £58.5m, and £1.5m of legacy funds from previous loans schemes, which will be matched by £60m of loans from the European Investment Bank (EIB). EIB also provided the loan finance for the current JEREMIE 1 fund. The costs of the scheme over the next ten years are estimated to be up to £25m and are to be fully funded by legacy funds generated from previous loans schemes.

1.1.5 Following North East LEP approval and NECA's approval to commence the procurement of fund managers on 19 April 2016, the Project Board and Project Team have worked as quickly as possible with key stakeholders including DCLG, the European Investment Bank, and BEIS to operationalise the fund and avoid a hiatus in the availability of suitable finance for North East SMEs. Senior officers from all of the Constituent Authorities have been kept informed of progress on a regular basis.

1.1.6 A fully compliant OJEU procurement of Fund Managers commenced in late April 2016. Currently initial tenders have been received and a series of negotiation meetings will be undertaken prior to final tenders being obtained. The procurement process for the Fund Managers is currently underway and will be complete by November 2016.

1.1.7 Since April 2016 the Project Team has submitted a final outline proposal to DCLG and BIS (British Business Bank) to secure £58.5m million of European funding and the release of legacy funds from previous loan schemes.

1.1.8 The report presented in April 2016 detailed that a compliant Implementing Body would be required to deliver the JEREMIE 2 fund. This report provides a further update and recommends proposals for the Implementing Body structure.

1.1.9 It was originally envisaged in April 2016 that the NECA would be the sole member of the SPV. Further investigations have lead the team to conclude that this is not appropriate as NECA does still not have the required economic development borrowing powers. This report provides an update as to the proposed structure of the SPV.

2. <u>The Proposed Approach</u>

2.1 <u>The Special Purpose Vehicle (SPV)</u>

2.1.1 The Implementing Body will have a legally compliant structure and will comply with guidance from the European Commission. The body will have the capability, capacity and experience to be 'appointed' as the Implementing Body by DCLG / EIB. In order to comply with European Guidance this structure Body is required to be 100% publically owned and with 80% of its activities in the performance of tasks related to the JEREMIE2 fund.

2.1.2 The Implementing Body (Special Purpose Vehicle), would be wholly publically owned and in accordance with EU Guidance 80% of the activities

2.1.3 in the role would include:

- Responsibility for overall project delivery and regulatory compliance (for comparison, over 20 audits have been carried out on JEREMIE1 to date)
- Act as European Regional Development Fund (ERDF) grant recipient
- Act as European Investment Bank (EIB) borrower, which would need appropriate borrowing powers
- Monitoring and management of fund managers
- Reporting to all stakeholders and investors
- Responsibility for marketing overall programme and building local networks and 'ecosystem'
- Treasury management of idle funds.
- Potential to be responsible for management of Legacy Funds of JEREMIE2

2.1.4 Initially 3 options were considered for the SPV. They included:

i) NECA acting as the sole member of the SPV. NECA is currently unable to act as the sole owner of an SPV if it is to borrow, as NECA does not currently have borrowing powers for economic development activity (it can only borrow for Transport schemes). Consequently, being the owner of an SPV which then sought to borrow could be deemed to be overreaching the vires of NECA;
ii) A constituent authority acting as sole member of the SPV. Legal advice was sought and whilst this is possible, the jurisdictional issues are considered too great for one constituent authority to proceed on its own; and
iii) The constituent authorities of NECA acting as members of the SPV, which, after careful consideration, is the recommended option

2.1.5 If the SPV is set up with the 7 local authorities (NECA constituent authorities) as members, the SPV would be the borrower for the purposes of the EIB loan. The SPV would be a company limited by guarantee. This is possible as each member has borrowing powers, the SPV may only act within its powers and as a wholly owned subsidiary of the constituent authorities would have the same borrowing powers. Each local authority would guarantee the liabilities of the SPV; this would however be limited to a nominal sum (i.e. £1 each). The local authorities would not guarantee the loan to the SPV. The ERDF funding from DCLG would be passported to the SPV from the NECA. The SPV would borrow the funding from the EIB and it would be repaid as a first call on the repayment of loans/financial support that had been given to businesses over the next 5 to 10 years.

2.1.6 Advice received and previous experience in JEREMIE 1 Funds nationally, is that no indemnity or guarantee is required from the EIB as it is a commercial loan. Risks associated with ERDF clawback will be managed within the SPV and its contractual arrangements with fund mangers. The local authorities' liabilities will be limited to their £1 membership guarantee of the SPV. Their borrowing limits will not be affected and their involvement in the company will appear as a relatively simple narrative in their annual accounts.

2.1.7 An outline proposal has been shared with DCLG which outlines the Project Board’s proposal for the appointment of an Implementing Body as a publically owned Special Purpose Vehicle which would meet the requirements set out in EU regulations.

2.1.8 The existing JEREMIE 1fund has had significant impact across the region and in some areas investment has been greater than in other areas. It is proposed that in setting up and operating JEREMIE 2 there is a significant increase in the level of effort and resource committed to ensuring that the Fund has an impact on businesses in every part of the NECA/NELEP area. This will include an enhanced role for the Implementing Body holding the funds, as well as additional requirements for the fund managers.

2.2 <u>Enhanced Role of the Implementing Body holding the funds</u>

- To prepare an annual report to each local authority area, to include levels of investment (deals done and in the pipeline), networking and engagement activity and narrative regarding proposed improvements;

- Formal twice-annual meetings with each of the seven Economic Development Teams;

- Intensive launch / awareness-building programme (to be agreed with Economic Development teams) for the first 12 months;

- At least one 'investment fair'/ investment readiness workshop in each Local Authority per annum;

- Local Stakeholder liaison director (possibly full-time) in a high level role focussed on aligning with devolved (mayoral) and Local Authority agendas – e.g. Enterprise Zones, Growth Hubs, complementary funds etc;

- Two (part-time) marketing co-ordinators (rural/urban or north of Tyne/south of Tyne), following a similar model used to great success in Tees Valley under the current programme. There may be potential for these posts to be part-funded by fund managers and their focus would be primarily organizing events, co-ordinating fund manager activities, networking with intermediaries and others;

- Web links to local business networks and organizations and dedicated Local Authority level pages on the main North East Finance site

2.3 Role of the Individual Fund Managers

2.3.1 The key responsibilities of the Fund Managers (following an open procurement)) include:

- Marketing individual funds
- Managing funds in accordance with investment policy
- Sourcing deal flow and undertaking investments (Financial Conduct Authority regulated)
- Negotiation of investment terms and completing investments by drawing down funds from the Implementing Body
- Managing post investment relationship with investees and reporting of investment performance to the Implementing Body

2.3.2 Additionally under the JEREMIE 2 arrangements fund managers will be required:

- To report on Local Authority level engagement and networking activities as part of quarterly monitoring
- To meet specific assessment criteria related to plans to address Local Authority level investment, including activity to improve investment levels in ‘underserved’ Local Authority areas to be included in fund business plans

2.4 Role of Leadership Board

2.4.1 The SPV and the members will have an agreement with the Leadership Board which will set out the Leadership Board’s role and responsibilities in relation to the SPV.

2.4.2 NECA would apply for the ERDF grant as the accountable body of the North East LEP.

2.5 Governance

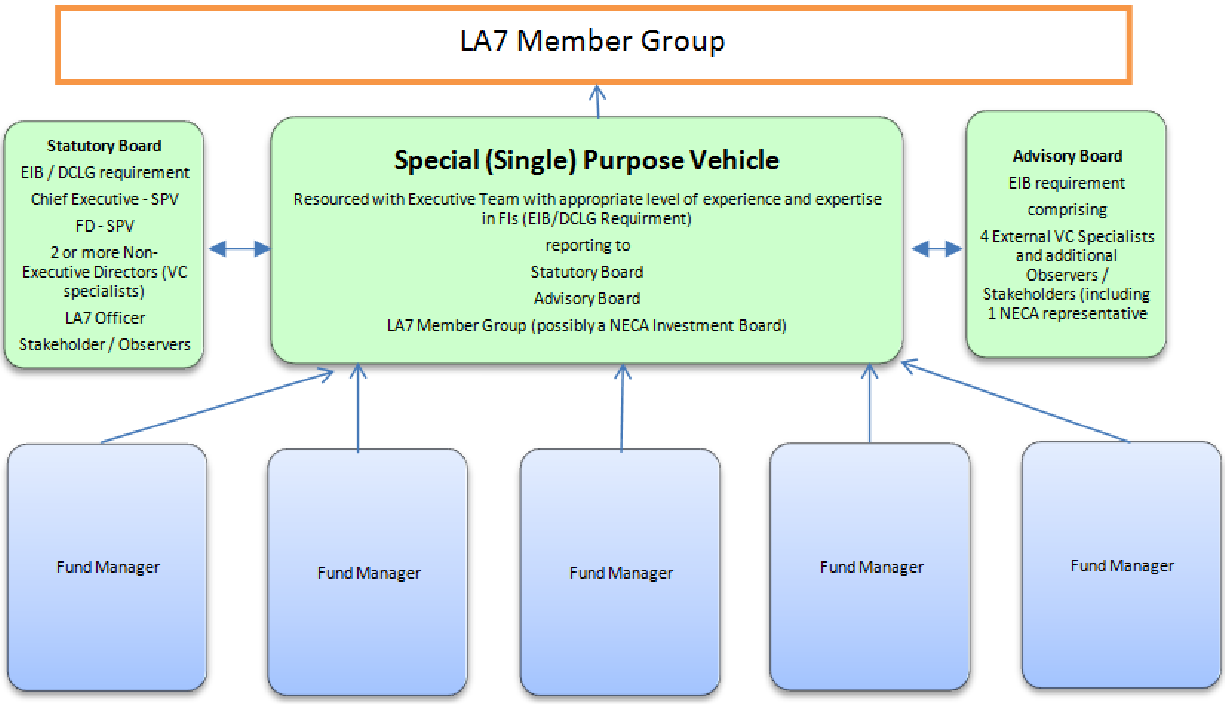
2.5.1 The local authorities shall be the members of the SPV. They in effect will be the owners of the company and will retain strategic decision making over the SPV. The operational funding decisions will be taken only by the SPV and their contracted fund managers. The company will be registered with

Companies House. The overseeing Members group will comprise of representatives of the member constituent authorities, potentially the Leaders of each authority (or their nominee) to receive information about the performance of the fund and will enable a local strategic monitoring of the SPV.

2.5.2 The members will adopt the articles of association and will enter into a Members Agreement. This will detail how the company will function and identify key decisions which will be retained for members, further details are set out at paragraph 1.6.7 below.

2.5.3 Members will meet at least annually and provide strategic oversight to the company, however this will be detailed in the articles of association and directors of the company will deal with the day to day running of the company.

2.5.4 The company will have a statutory board of directors, subject to conflicts of interest it is proposed this is made up of the SPV's appointed Chief Executive and Finance Officer, a director who may be an officer representing the Leadership Board, together with some independently appointed directors who have appropriate investment expertise.. The Directors are to be appointed by the Leadership Board. Initially some may be secondees from the JEREMIE 1 delivery arm. There is an option for an officer representative of the LA7 authorities to be appointed to the statutory board of directors and for a member to be an observer on the SPV's advisory board. This is illustrated in the chart below.



2.5.5 It is preferable that NECA's Statutory Officers are not appointed as directors in the authority controlled structure to ensure a clear separation of their roles and their advice to the NECA. It is therefore proposed that an approach is taken to initially establish the SPV with a single director to enable the signature of the tri-partite agreement prior to appointing the full board of directors with the appropriate balance of skills and experience.

2.5.6 The SPV will also have an advisory board, which is an EIB requirement and will be made up of a number of experts with suitable investment expertise and will include observers and key stakeholders including British Business Bank, the Department for Business Innovation and Skills and the European Investment Bank. This is currently in place with JEREMIE 1. There would also be an option for an observer from the Leadership Board, such as the portfolio holder for economic development and regeneration to be on the advisory board.

2.5.7 The SPV could itself report regularly into a NECA Governance structure – which would include members from each of the Local Authorities acting as a shareholder group.

2.5.8 The constituent authorities will enter into a Members Agreement, this will detail the following:

- Voting rights;
- Ability to direct the Board of Directors;
- Reservation of matters for the Members;
- Nomination of Directors (by the NECA);
- Adopting a scheme of delegation for the SPV.

2.6 Timetable

2.6.1 Currently the ESIF Committee will make a recommendation about the ERDF funding by written representation in early October 2016. Approval to the establishment of the SPV is needed at this stage. This is necessary to support the ERDF funding application to DCLG, which will be subject to an accelerated appraisal and approval process to secure the funding approval before the autumn statement.

2.6.2 The SPV will be required to enter into a tri-partite funding agreement with either all the members or one member and DCLG.

2.6.3 The SPV will need to be established and at least 1 director appointed to sign the agreement on behalf of the SPV before the end of October, with appropriate experience to satisfy the funders including EIB. Other directors could be appointed at a later date.

2.7 Transitional arrangements

2.7.1 The peak transition period is anticipated to be between 2016 and 30 September 2018. To enable the Project to progress effectively and expeditiously during this period it is proposed that an additional temporary resource will be retained. This additional temporary resource will provide support across the finance and compliance function over the longer-term succession planning will be developed as appropriate.

2.7.2 To maximise the efficient, and ensure best value for money, utilising existing experience from the Jeremie 1 Project, it is proposed that the current Chief Executive of NEF, who deliver the Jeremie 1 Project, will continue in this role through to the end of the transition period and supervise a smooth transition of responsibility for the JEREMIE 2 programme.

2.7.3 A full succession plan proposal will be developed during the first period of operation of the SPV. Continuity at the senior level in line with stakeholder requirements is paramount for the fund and a requirement of DCLG

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3 Next Steps

3.1 The Leadership Board is invited to agree to the recommendations set out above.

3.2 If the Leadership Board notes and agrees this report and the Constituent Authorities agree to become members of the SPV the SPV shall be created. The proposed Articles of Association of the SPV shall be developed and finalised under delegated authority of NECA and the constituent authorities.

4 Potential Impact on Objectives

4.1 As described in the Strategic Economic Plan, increasing the number and quality of private sector jobs in the economy is a key proposition in our European strategy and strategic economic plan. These are reflected in the strategic priorities for investing in growing our businesses and key to this is ensuring North East businesses have the access to finance to support growth and expansion plans.

4.2 Evidence suggests that small businesses tend to remain in the region if they can secure the capital they need and successful small businesses also source locally and employ locally.

4.3 The delivery of a Financial Instrument is strongly aligned to UK and European policy

4.4 Financial Instruments are designed to deliver equity, loan and mezzanine investments to underserved geographic areas, and are a way of increasing the efficiency of European Structural and Investment Funds. Financial instruments can make these funds go further by leveraging in additional public, private or social finance and by creating legacies for future use. They can bring in additional expertise which increases the efficiency and effectiveness of the use of public money and they can enable the recycling of funds for long term benefit in localities.

4.5 Financial instruments are expected to achieve[1]:

- Leverage of resources and increased impact
- Efficiency and effectiveness gains due to revolving nature of funds, which stay in the programme area for future use for similar objectives
- Better quality of projects as investment must be repaid
- Access to a wider spectrum of financial tools for policy delivery & private sector involvement and expertise (including using private sector financial institutions and investors to make the investment/lending decision)
- Collateral benefits to SMEs though contact with financial and sector experts – even where there is ultimately no investment

A move away from a 'grant dependency' culture.

4.6 Based on the success of JEREMIE 1, it is estimated that –

- around 600 small and medium seized enterprises should benefit from financial support, with many hundreds more benefiting from advice;
- 3,500 jobs should be created, with over 2,000 existing jobs protected; and
- a legacy fund of c £80m could be created to fund future financial support to business beyond the end of this programme.

5 Finance and Other Resources

5.1 Over the life of the JEREMIE 2 Programme, it is envisaged that £120m will be provided as Financial Instrument support to Businesses in the first five years. The cost of the fund managers over a longer 10 to 12 year period, will also provide important support and guidance to businesses and work with businesses to secure the return of the funding, is estimated to cost up to £20m, with a provision for the cost of operating the SPV over the 10 to 12 year period of up to £5m, an average of £0.5m a year.

The envisaged costs and funding for this is summarised below.

Estimated Costs and Funding

	ERDF Grant	**EIB Loan**	**Legacy Funds**	**Total**
	£m	£m	£m	**£m**
Financial Instruments to Businesses (Loans/equity)	58.5	60.0	1.5	**120.0**
Fund Manager Costs over 10 years			20.0	**20.0**
IB / SPV costs over 10 years			5.0	**5.0**
Total	**58.5**	**60.0**	**26.5**	**145.0**

[1] Financial Instruments in ESIF programmes 2014-2020, European Commission, December 2014.

5.2 The estimated costs of the scheme have been based on the costs of JEREMIE 1 with some savings that have been identified in the operation of JEREMIE 2 . The estimated costs have been scrutinised by the funders and approved in principle, with final approval being given when the ERDF grant and EIB Loan facility are agreed. The costs and performance of the Fund will be heavily scrutinised by the funders over the period, who have observers on the SPV Advisory Board; receive quarterly reports; and carry out audits on the fund over its life. The current JEREMIE 1 scheme has been subject to over 20 Audits so far, with positive outcomes.

5.3 The business model assumes that the payback from businesses over the 10 year period will recover the full cost of the Fund of £145m. The first receipts must be used to repay the EIB loan facility, with further payments creating a legacy fund in the SPV to fund future rounds of financial support to business. The EIB are making a purely commercial loan with repayment at their risk, with this decision being based upon their assessment of the track record of previous loan schemes and their confidence in the robust and experienced fund management arrangements that they require to be established. No guarantee for the loan facility will be given by the owners of the SPV and there is therefore no loan liability for the local councils.

5.4 Two legacy funds are being used, which requires the approval of Government Departments. Single programme Legacy Funds, with at least £6m and up to £8m expected to be available, where approval has been sought from the IDAB committee (responsible to DCLG and BEIS) and approval is expected on 8th September. The balance of the £26.5m will be funded from ERDF legacy funds from previous loan schemes, which has been conditionally approved by DCLG.

5.5 An application for ERDF funding of £58.5m has been submitted by NECA on behalf of the LEP. The application is being considered by written procedure of the ESIF committee at the beginning of October 2016. The ESIF Committee will give advice to DCLG about the strategic use of regional funds. The final decision and application approval rests with the Managing Authority (DCLG).

5.6 The arrangements described above comply with the advice and guidance being received from DCLG. Equally important is that the arrangements are also EIB compliant, as they are the match funder, providing the loan at their risk. Once approved, ERDF funding will be awarded to NECA and passported to the SPV, being drawn down over the life of the programme.

ERDF match funding of £60m is to be achieved through a loan from the European Investment Bank direct to the SPV. Advice received and previous experience in JEREMIE 1 Funds nationally, is that no indemnity or guarantee is required from the EIB. Risks associated with ERDF clawback will be managed within the SPV and its contractual arrangements with fund managers, so there is not expected to be a clawback risk for the local authority owners of the SPV.

5.7 The local council's liabilities will be limited to their £1 membership guarantee of the SPV. Their borrowing limits will not be affected and their involvement in the company should appear as a narrative note in their annual accounts.

5.8 The performance of the JEREMIE 1 fund is positive and it is on track to repay its EIB loan soon and to generate legacy funds broadly in line with projections. The main financial implications of the estimated £145m investment payback not being received in full is that it will reduce the level of legacy funds available to be used to fund future access to finance schemes in future periods.

5.9 Give the potential of volume of jobs to be created and protected and the impact on the growth in the region's economy, the scheme is considered to represent very good value for money.

6 Legal

6.1 A legal representative for NECA is part of the Project Team and contractual agreements will be subject to the approval of the NECA Monitoring Officer.

6.2 The Special Purpose Vehicle shall be established as the Implementing Body for the fund in accordance with legal advice, which has been obtained regarding the appropriate structure. The creation of the SPV shall comply with EU Procurement legislation and EU Commission Guidance.

6.3 The Fund Managers will be appointed following an EU compliant procurement process. Those bidders providing the most economically advantageous tender shall be appointed. This will be assessed in accordance with procurement criteria, to cover matters such as quality and value for money.

7 Other Considerations

7.1 Consultation/Community Engagement

7.1.1 The proposals for the extension of Financial Instruments are the result of an independent assessment report, development of the Strategic Economic Plan and the ESIF strategy, all of which included wide consultation and engagement processes.

7.2 Human Rights

7.2.1 There are no specific human rights implications arising from this report.

7.3 Equalities and Diversity

7.3.1 There are no equalities and diversity implications in relation to this report.

7.4 Risk Management

7.4.1 The risk for the Financial Instrument are being managed in common with other Financial Instruments, including the British Business Bank's Northern Powerhouse Investment Fund and previous regional financial instruments (JEREMIE1)

7.4.2 If the North East JEREMIE2 does not proceed as envisaged, there is a risk that the Government will decide that the Financial Instrument should be provided through the Northern Powerhouse arrangement, managed in Sheffield, which would result in a loss of dedicated funding and a reduced influence for the North East.

7.4.3 Financial

7.4.3.1 As previously stated, a detailed financial model has been developed for the NE Fund of Funds Programme by the Project Team which outlines how the project will be financed, how it will invest funds, create jobs and ultimately repay its creditors. The risk of individual investments not being repaid will fall on the level of legacy funds generated. EIB will take the risk of their loan not being repaid in full, limited to the income and assets of the SPV.

7.4.3.2 The European grants would not be clawed back if job outcomes were less than envisaged. However, it is important that the normal risk of clawback of European grants due to improper procurement arrangements is managed and mitigated though following proper procurement practices; through the limited liability of the Special Purpose Vehicle structure and by application of legacy funds.

7.4.4 State Aid

7.4.4.1 The JEREMIE2 programme will be structured so that it can operate in accordance with the risk finance provisions of the General Block Exemption Regulation (GBER 651/2014), and so will not need to be notified to the European Commission. The JEREMIE2 structure will be established to operate in accordance with Articles 17, 19, 21 and 22 of GBER, and the *de minimis* regulation (depending on the recipient of the aid, the level of aid and its use) – with fund managers also having the discretion to complete individual investments on a suitable "no aid" basis, with oversight by the Implementing Body.

7.5 Crime and Disorder

7.5.1 There are no specific crime and disorder implications arising from this report.

7.6 Environment and Sustainability

7.6.1 There are no specific environment and sustainability implications arising from this report.

8 Background Documents

8.1 Confidential report to the Leadership Board dated 19 April 2016. Outline ERDF grant application to DCLG

9 Links to the Local Transport Plans

9.1 Non

10 Appendices

10.1 None.

11 Contact Officers

11.1 Paul Woods, NECA CFO paul.woods@northeastca.gov.uk 07446936840

12 Sign off

- Head of Paid Service
- Monitoring Officer
- Chief Finance Officer ✓