Providing finance that charities and social enterprises need:

Lessons learnt in how the Growth Fund is blending grants and loans to provide affordable finance to the voluntary sector

A thematic report produced as part of the independent evaluation of the Growth Fund.

Edward Hickman, February 2021

Introduction

The programme

- The Growth Fund (GF) was launched in May 2015 by a Programme Partnership made up of Access – The Foundation for Social Investment (Access) , Big Society Capital (BSC) and The National Lottery Community Fund (The Fund).
- GF was designed to provide flexible unsecured loans of up to £150,000 for charities and social enterprises and make them affordable by combining grants with loans. GF blends a commitment of £22.5m of grant from the Fund with at least £22.5m of loan funds from BSC, plus some additional loan funds from other co-investors. Access manages the end-to-end programme in a wholesale capacity, working with a number of social investors who manage funds under the programme and provide investments to charities and social enterprises.
- In addition to providing relevant finance to over 700 organisations, the Growth Fund aims to make a significant contribution to the learning about how grant subsidy can best be used to develop the social investment market.

The evaluation

- In 2016 the Programme Partnership commissioned Ecorys and ATQ to conduct an independent evaluation of the Growth Fund. As a part of the evaluation, Ecorys and ATQ is producing a set of thematic insights and this report is focused on understanding how GF's **structured subsidy model** has worked in practice in the period since the launch of the first social lending funds in 2017 through to March 2020 (further described on the proceeding slide). The findings from this research are based on:
  - data from social investors' regular reporting (up to March 2020) to the Programme Partnership;
  - interviews with eleven of the fifteen GF social investors. These were completed in February and March 2020; and
  - evidence captured as part of the wider evaluation, such as surveys and case study visits with charities and social enterprises that received investment.
- **It is important to note that these are only interim findings and cover the period to end of March 2020 i.e. before the global pandemic**. We believe that these pre-Covid-19 findings remain relevant and instructive for the design thinking about any future subsidised blended loan funds.
- It should be noted that the Programme Partnership has made rapid and substantial adjustments to Growth Fund in response to the widescale economic consequences of the Covid-19 pandemic. The situation remains dynamic and adjustments to the structured subsidy model continue to be made in response. These will be the subject of future evaluation reports.

Synopsis

> This report firstly details the GF's subsidy structure and explains how the Grant element of GF was designed to work in practice. The Grant was divided into three distinct 'pots' with specific objectives as follows:
  - Grant A helps to contribute towards social investors' costs of making lots of small loans
  - Grant B allows social investors to be able to afford for some of the loans to fail
  - Grant C allows social investors to offer grant alongside loans to charities and social enterprises.

> We then outline social investors' performance since each respective Fund's launch, their respective operating costs and analyse in detail how Grants A, B and C have worked in practice from the social investors' perspective (and to some degree charities and social enterprises).

> Next, we outline the ideas that social investors have developed about the design of any future blended funds based on their experiences operating within the parameters of GF.

> Finally, the evaluators share their conclusions and recommendations.

Report structure, glossary and use of quotes

> The report is structured as follows:
  - Introduction to Growth Fund and the design of its subsidy structure
  - Social investor Funds' performance
  - Analysis of operating costs and data on Grants A, B and C along with findings from social investors' experiences as reported in the interviews
  - Ideas for future blended funds
  - Conclusions, implications and recommendations.

> Glossary
  - Throughout the following slides, where we refer to *social investors*, we mean the organisations or partnerships offering blended loan and grant finance as a *Fund* to charities and social enterprises. Where we refer to a *Fund* or *Funds*, these are the respective Growth Funds that the social investors are operating.

> Use of quotes
  - Throughout this report, we have anonymised the social investors and not attributed "***quotes***" to respondents (which are typed in "***bold italics***") as they were promised anonymity in the research process.
  - All "***quotes***" are the views of the respondents in respective contexts and are not those of the evaluators although, of course, we do draw on them in arriving at our conclusions.

Introduction to Growth Fund and The Design of its Subsidy Structure

Structured subsidies and the financial model

> The Programme Partnership established the Growth Fund in response to a well-researched and documented need for smaller-scale unsecured loan financing and in recognition of the fact that loans below £150,000 require a subsidised model to offer attractive enough terms to borrowers and enable social investors to operate on commercially viable terms.

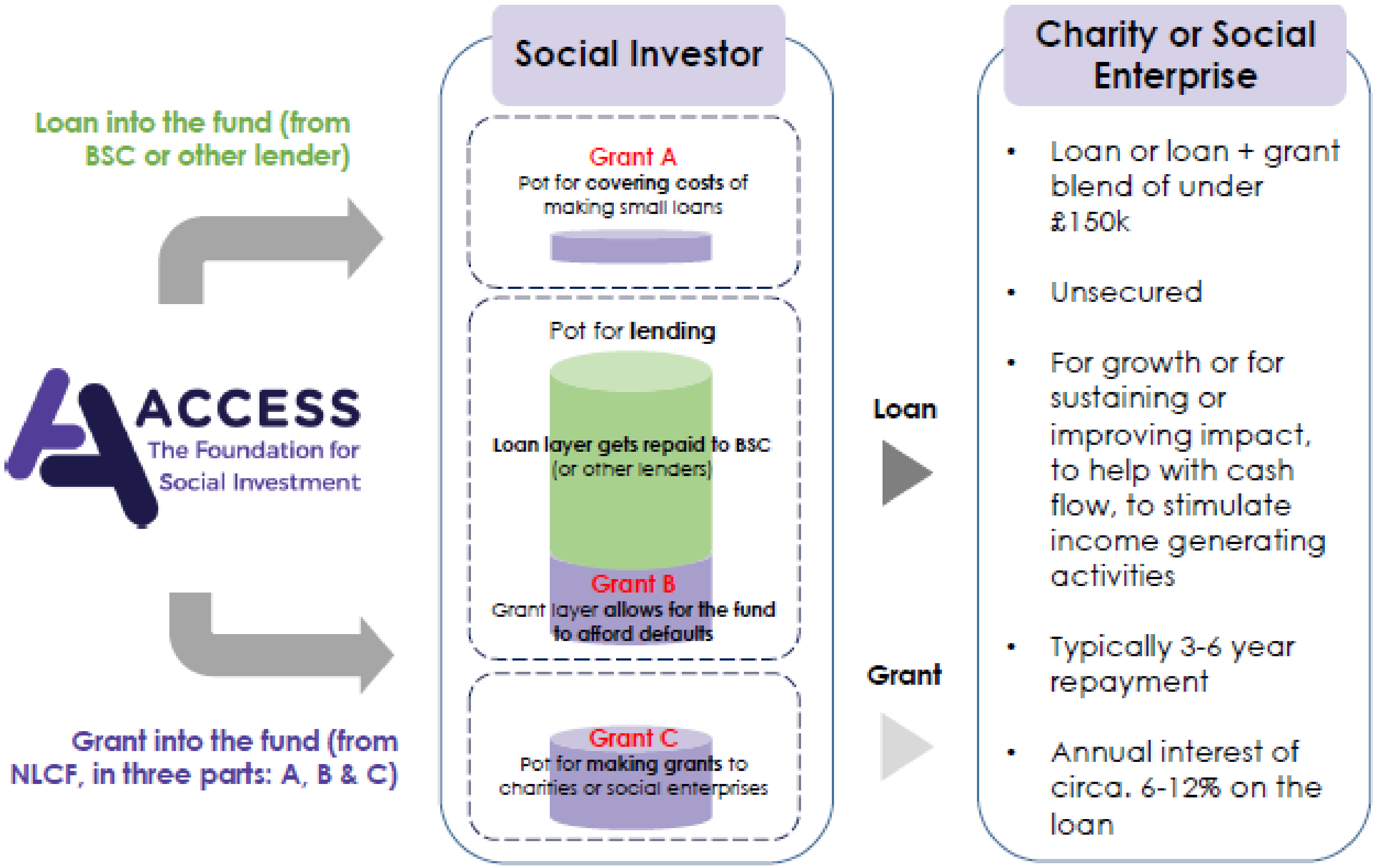
> Previously this type of finance had not been readily available, mainly because social investors had not felt able to afford to make these small loans. The costs of promoting the fund to prospective borrowers, undertaking due diligence and managing the loans are broadly similar no matter what the loan value, so the economics of operating only at smaller loan values are such that without a subsidy arrangement, no social investor would be able to operate commercially.

> The Growth Fund tackles this availability gap by blending loan and grant funding for social investors. The grant allows those social investors to offer these smaller loans as follows (shown diagrammatically overleaf):

- Grant A – helps to contribute towards the costs of making lots of small loans; so that the social investor can afford the proportionally higher transaction costs that can often exceed interest / fee income at this level (this use of the grant is a small proportion of the total grant amount), thus reducing the risk for them in managing the Fund. Grant A was originally set provisionally at 10% of the total grant within each Fund (total of A+B+C) although this has subsequently been flexed higher when required.
- Grant B – allows investors to be able to afford for some of the loans to fail; by blending grant and debt in the fund the social investor can afford for the portfolio as a whole not to break even and therefore will be willing to take greater risk on the loans that they make, thus reducing the risk of the provider of debt in the Fund not getting their money back. The proportion of Grant B in each fund varies according to risk.
- Grant C – allows investors to offer grant alongside loans to charities and social enterprises; this reduces the amount of loan finance required so that revenue streams are robust enough for repayment. The proportion of Grant C in each fund varies according to need.

> The grant must total less than 50% of the overall investment into the social investor.

Grants A, B and C



Structured subsidies and the financial model (ctd.)

- There are some constraints in the way that Grants A and B were designed to work in practice and these constraints were built into the Growth Fund's standardised financial model used for all social investor applications. The model has evolved over time and has been used with actuals data for all subsequent monitoring of performance and fund restructuring.
- Although sophisticated internally, the model was designed around some basic parameters including: investment period; deployment forecast; repayment forecast; investment terms and fees; and investors' operating costs.
- The grant contributions to operating costs (Grant A) was modelled with the intention of enabling social investors to deploy sufficient loans during the Grant A runway phase; this was typically around 12 months (but could have been longer). The expectation was that interest and capital repayments and arrangement fees flowing back in would cover agreed operating costs thereafter. Delays in loan deployment, particularly in the early stages, and similarly early defaults can therefore impact a Fund's ability to afford their operating costs, creating challenges.
- Although the model allows operating cost shortfalls to be covered directly by BSC capital drawdowns, this can create challenges in meeting the Asset Coverage Ratio (ACR) (detailed below), which social investors are required to maintain after the initial 12 months runway period.
- The ACR level that Funds are required to maintain varies between Funds but are general around 1.2 – 1.3, in order to ensure that there are always sufficient assets to meet investors' repayment obligations to BSC (and / or co-investors if applicable).

The ACR is calculated as:

Net (of default) outstanding capital and interest repayments plus cash balance less next 2Qtr's operating costs

Outstanding BSC drawdown and cumulative interest amounts

Structured subsidies and the financial model (ctd.)

- The other financial covenant in the programme is the 70% deployment target – requiring investors to meet at least 70% of their deployment targets over the previous two calendar quarters combined. The deployment ratio is the main early warning trigger of potential issues. If it falls consistently below 70%, then this may mean there are fund viability issues.
- Grant B allows for a certain level of VCSE default without impacting the investors' ability to meet their own repayment obligations. The proportion of Grant B in each fund varies depending on the level of expected risk but is always drawn down by the investor in a fixed proportion. For example, a fund with a 35:65 ratio of Grant B to BSC loan would drawdown £35 of Grant B from the Fund (via Access) at the same time as each £65 drawn down from BSC. The Funds are then initially on-lent to charities and social enterprises in that ratio, with VCSE repayments then sometimes recycled and re-lent by the social investor.
- As can be seen, the key initial dependency of the model is the amount and speed of loan deployment. Other dependencies such as loss ratios i.e. proportion of total loans that have been written down or lost, become important only once a loan book has been built up.
- It is also important to note that, whilst the intention was for social investors to deploy sufficient loans during the Grant A runway phase such that interest payments and arrangement fees flowing back in would cover agreed operating costs, it was always recognised that for many Funds operational costs would still need to be covered by loan capital repayments as well. The alignment of operating costs and interest income alone would never be perfect across the social investors. We explore this in more detail in the next section of this report.

Details on Fund size and Grants A, B and C for each social investor

> As mentioned, throughout this report we have anonymised the social investors and not attributed "***quotes***" as respondents were promised anonymity in the research process. In the table below, the social investors have been grouped by their prior experience and this informs the analysis on the following slides. It is important to note that the size of funds and grant allocations were those agreed at the start point of each Fund.

> As shown, Growth Fund attracted a wide range of social investors – 15 in total which between them launched 16 Funds. They varied from highly experienced social investors to completely new ventures. Some investment Funds focused nationally or on regional geographies and / or specific sectors such as sports and housing or social issues such as homelessness or health and wellbeing. Some Funds also focused on early stage enterprise funding.

> Some Funds were increased in size and others restructured down in size over the life of the Growth Fund to March 2020; this is expanded on further in the data analysis section of the report. Funds C and L did not apply for any Grant C funding, which is explained further in the analysis of Grant C.

	Prior experience	Investment focus	10% of fund's total grant	Grant A operating cost subsidy	Amount of Grant A as % of maximum allowed	Amount of Grant A as % of investor's total grant	Grant B for loans to VCSE	Amount of Grant B as % of Total loan component plus Grant B	Grant C passed on as grant	Approved Growth Fund total	Loan component from BSC	Co-investment loan component from other sources	Total loan component	Total fund size (loan and Grant B)
Fund A	Experienced social lender	Location and sector specific	£171,825	£125,000	72.7%	7.3%	£1,305,248	29.5%	£288,000	£1,718,248	£2,719,320	£400,000	£3,119,320	£4,424,568
Fund B	Experienced social lender	Non-specific	£266,259	£200,000	75.1%	7.5%	£1,358,589	33.5%	£1,104,000	£2,662,589	£2,696,900		£2,696,900	£4,055,489
Fund C	Experienced social lender	Non-specific	£144,084	£140,000	97.2%	9.7%	£1,300,844	26.4%	£0	£1,440,844	£3,626,594		£3,626,594	£4,927,438
Fund D	Experienced social lender	Non-specific	£162,134	£125,000	77.1%	7.7%	£1,268,339	35.5%	£228,000	£1,621,339	£2,304,448		£2,304,448	£3,572,787
Fund E	Experienced with grants and loans	Location specific	£49,118	£49,000	99.8%	10.0%	£67,178	10.0%	£375,000	£491,178	£0	£604,606	£604,606	£671,784
Fund F	Experienced with grants and loans	Location specific	£50,754	£50,000	98.5%	9.9%	£205,543	25.0%	£252,000	£507,543	£0	£616,629	£616,629	£822,172
Fund G	Grants experience, new to loans	Specific sector focus	£223,767	£200,000	89.4%	8.9%	£1,075,170	32.4%	£962,500	£2,237,670	£2,246,193		£2,246,193	£3,321,363
Fund H	Grants experience, new to loans	Location specific	£101,245	£100,000	98.8%	9.9%	£492,452	32.5%	£420,000	£1,012,452	£1,022,785		£1,022,785	£1,515,237
Fund I	Grants experience, new to loans	Location specific	£60,610	£55,800	92.1%	9.2%	£280,299	31.0%	£270,000	£606,099	£323,892	£300,000	£623,892	£904,191
Fund J	Grants experience, new to loans	Start-ups early stage	£134,432	£133,000	98.9%	9.9%	£791,320	30.0%	£420,000	£1,344,320	£1,846,414		£1,846,414	£2,637,734
Fund K	Grants experience, new to loans	Start-ups early stage	£90,040	£87,852	97.6%	9.8%	£542,544	32.0%	£270,000	£900,396	£1,152,906		£1,152,906	£1,695,450
Fund L	Grants experience, new to loans	Specific sector focus	£125,037	£120,000	96.0%	9.6%	£1,130,367	31.5%	£0	£1,250,367	£2,458,100		£2,458,100	£3,588,467
Fund M	New social lender	Non-specific	£195,412	£190,000	97.2%	9.7%	£684,122	25.0%	£1,080,000	£1,954,122	£2,052,365		£2,052,365	£2,736,487
Fund N	New social lender	Specific sector focus	£113,179	£105,000	92.8%	9.3%	£1,026,786	34.5%	£0	£1,131,786	£1,949,406		£1,949,406	£2,976,192
Fund O	New social lender	Location(s) specific	£121,435	£120,000	98.8%	9.9%	£621,849	26.0%	£472,500	£1,214,349	£1,769,877		£1,769,877	£2,391,726
Fund P	New social lender	Location specific	£124,557	£119,500	95.9%	9.6%	£826,069	29.2%	£300,000	£1,245,569	£2,002,934		£2,002,934	£2,829,003
			£2,133,888	**£1,920,152**	**92.4%**	**9.2%**	**£12,976,719**	**29.0%**	**£6,442,000**	**£21,338,871**	**£28,172,134**	**£1,921,235**	**£30,093,369**	**£43,070,088**

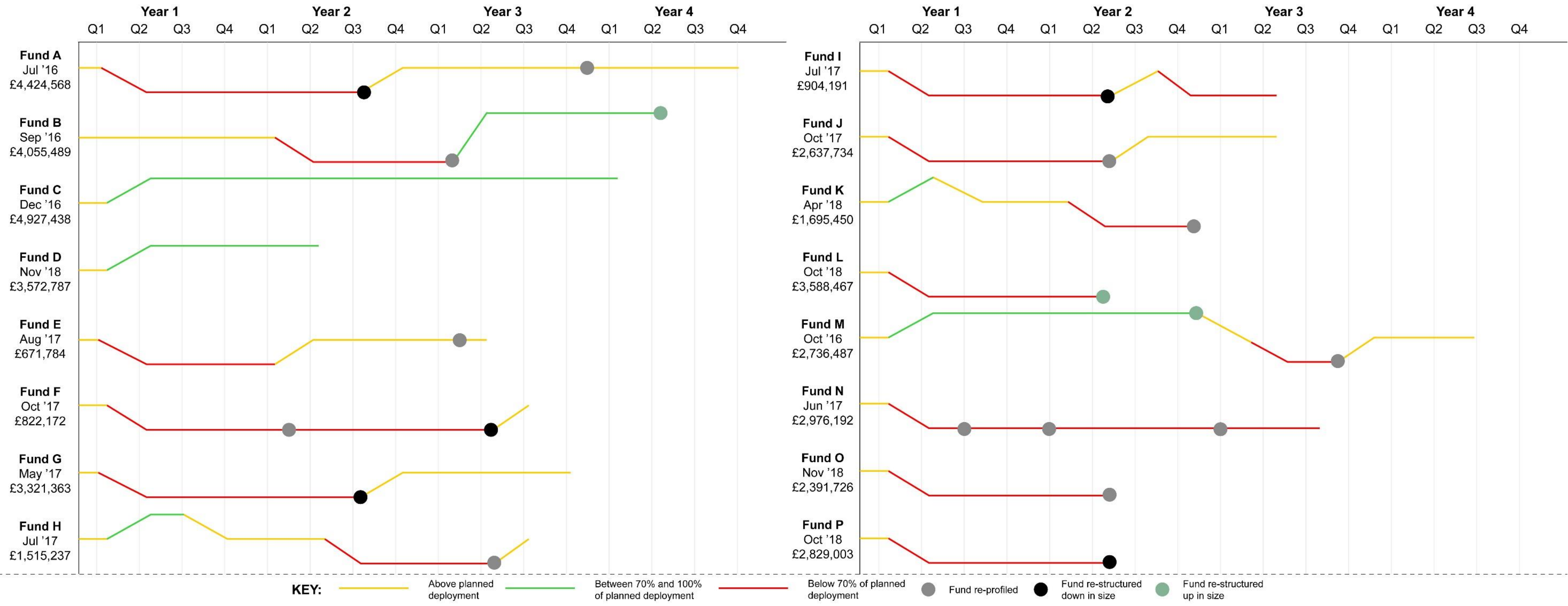
Sources of Growth Fund loan capital

- BSC is the main source of wholesale capital for GF contributing, over £28m at the time of launch of each Fund.
- BSC's mandate is to "act as an investment wholesaler and generally to promote and develop the social investment marketplace in the United Kingdom" and GF was an important opportunity to fulfil the mandate.
- BSC's GF wholesale capital accumulates interest at a rate of 5% compound per annum and is capped at this level for each individual Fund on repayment. (In response to Covid-19, the rate at which BSC accrues interest has been lowered). When initially setting the price of BSC capital, BSC was trying to ensure that:
  - the GF risk/return profile was in line with what private investors would seek when investing in this market;
  - it did not undercut the market such that other funds could not compete for investees; and
  - the level was set at a rate which meant that BSC could seek to preserve its capital, cover costs and thus continue to recycle capital to grow the social investment market.
- GF blended grants were also available to other sources of capital either stand-alone or in conjunction with BSC's wholesale capital. One health funding partner and three Community Foundations have between them added a further £1.9m of co-funding contribution as follows:
  - Fund A applied to GF with a health funding partner and invested on the same terms as BSC's capital
  - Fund E had delivered a social enterprise loan fund in its county beforehand. It joined GF in order to blend grant from The Fund with capital from the County Council and did not take any BSC wholesale capital. The County Council does not charge interest on its capital and effectively provided a grant which Fund E can also use to cover its operating costs
  - Fund F's County Council also provided capital for the Fund and took no BSC wholesale capital. Similarly to Fund E, the County Council charges no interest and also subsidises the majority of Fund F's operating costs. This arrangement was already in place before Fund F joined GF and at that point it added grant subsidy from The National Lottery Community Foundation into its Fund
  - Fund I was the only Community Foundation fund to have originally utilised BSC wholesale capital as well as its own (although this status has changed subsequently and BSC's wholesale capital has been repaid).

Social investor Fund performance

- The chart on the following slide shows the size at the outset and performance of each Fund since its respective start point to March 2020. The respective start points were spread over a four-year period between 2015 and 2018. The chart shows by quarter how each fund has performed against the 70% deployment indicative target (described previously).
- As can be seen, six Funds (B, C, D, H, K and M) have performed above 100% of target for one or more quarter period and two (B & M) have increased fund size, with a third social investor establishing a new second fund (Fund D).
- Six Funds (A, E, F, G, I and J) performed below the 70% deployment indicative target at the outset but have achieved over 70% following either after re-profiling (adjusting deployment targets and extending life of funds) or restructuring (reducing the size of the Fund) or, in Fund A's case, both.
- Four Funds (L, N, O and P) have not been able to achieve the 70% deployment indicative target. These four are amongst the later Funds to launch and investors managing Funds N, O and P are new to social lending.
- In total across all the Funds from time of respective launch to March 2020 there have been:
  - 13 re-profiling exercises (which were expected to happen over the Fund);
  - two increases in Fund size (three more were under discussion at March 2020); and
  - five restructures including one leading to an agreed Fund closure (Fund P).
- This wide range of Fund performances is in line with the Programme Partnership's overall expectations as it would have been naïve to expect all Funds to perform in line with predicted deployment volumes all the time.
- The deployment, re-profiling and restructuring picture outlined above provides context for the data analysis, social investor feedback and conclusions on how Grants A, B and C have worked in practice detailed in the rest of this report.

Fund performance against plans as revised



Use of Grant A:
Grant to Support Social Investor Operating Costs

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What are the costs of setting up GF?

> As noted in earlier evaluation findings and so not re-visited in depth here, there were two main costs in the set-up stage (application process up to point of go-live):
>
> - Legal fees which are a direct cash cost
> - Senior management team (SMT) time which is an opportunity cost only (i.e. at the cost of other calls on SMT time rather than a cash cost).

> Legal fees were typically reported as higher than original expectations. Many organisations budgeted £20-25k for legal fees and most reported coming in above this budget and so they appear to have underestimated the amount of work involved. At the extreme, one social investor ended up spending £70k, although this was mainly due to multiple party involvement on its side which made it unique.
>
> - One lesson for any future fund is to decide on the approach to legal documentation (either bespoke to each lender or standard contract templates) as any change of mind during the process can cause additional legal expense.

> Clearly the social investors were interested in becoming Growth Fund providers and it was their decision to commit SMT time even if this had an impact on their other work or projects. Other costs were less significant except in a couple of cases where the investment manager(s) were employed a month or two prior to go-live.

> The cash costs in the range between £20k to £70k were paid from the parent organisation~~’~~s’ respective internal resources.

What are the costs of running a GF Fund?

- The running costs of GF are predominantly the direct personnel costs of the investment management team, which was noted in the interviews as between one and three full-time equivalents (FTE). Other direct resources needed include for the investment committee, accounting and reports, and Senior Management Team (SMT) including line management time on governance / supervision.
- The average reported operational costs so far drawn down by all social investors is £27k each per quarter or approximately £110k per annum – as shown in the next slide. This does appear to be largely covering actual costs – the social investors were invited to complete a cost template identifying unplanned 'subsidies' and only four social investors have formally elected to fund more than their model's agreed operational costs as follows:
  - The extreme example is Fund O which has approval to spend £100k per annum to provide pre-deal support (Reach Funding, provided separately by Access, was no longer available) as well as further funding for a financial analyst position
  - Fund J has also hired an extra resource to manage the portfolio and has so far spent an additional £50k
  - A partner organisation has separately fund-raised to cover its contribution towards Fund K activities
  - Fund A has drawn down £156k from its BSC loan allocation in order to fund its operational costs. This is repayable and incurs BSC's interest cost on the same basis as other BSC funding. The Grant B component was also automatically drawn down and it has been agreed with GF that this can be lent out.
- Where there are temporary cashflow needs in meeting operational costs, parent organisations may provide funds and / or act as guarantors so that the GF operating companies can continue.
- Indirect support is provided by social investor parent organisations on an opportunity cost basis. This is, for example, when SMT time is 'diverted' to GF around exceptional events such as re-profiling and from Marketing / Finance / HR / IT support activities. Anecdotally, these opportunity costs can be substantial. They vary considerably according to how each social investor is set up and changing short-term operational needs – but are not easily estimated or quantified and so not analysed in this report.

Growth Fund operational costs

- Operational costs are shown in the Table below. The costs of Funds E and F appear high as a percentage of total Fund size because neither is taking any BSC loan and both are using other funding sources instead. Their quarterly operational costs conversely are low in comparison to others because their running costs are being met from either a Community Foundation or by a County Council – in that latter case to the tune of approximately £80k per annum for salary costs.
- At the outset, it was expected that total operational costs would amount to 26.7% of total Fund size (using the original financial modelling figures i.e. before later re-profiling). This is indicative of the need for operational cost subsidy to support social investors serving the GF market.

	Prior experience	Investment focus	Original operational costs	Original Op costs % of Total fund size (loan and Grant B)	Projected operational costs	Average quarterly operational costs drawn down
Fund A	Experienced social lender	Location and sector specific	£1,218,585	27.5%	£856,198	-£30,157
Fund B	Experienced social lender	Non-specific	£524,121	12.9%	£827,638	-£27,466
Fund C	Experienced social lender	Non-specific	£1,257,211	25.5%	£1,141,211	-£62,971
Fund D	Experienced social lender	Non-specific	£647,750	18.1%	£647,750	-£25,875
Fund E	Experienced with grants and loans	Location specific	£365,500	54.4%	£365,500	-£7,689
Fund F	Experienced with grants and loans	Location specific	£580,364	70.6%	£143,155	-£9,073
Fund G	Grants experience, new to loans	Specific sector focus	£748,677	22.5%	£457,970	-£16,919
Fund H	Grants experience, new to loans	Location specific	£540,780	35.7%	£514,780	-£28,957
Fund I	Grants experience, new to loans	Location specific	£134,800	14.9%	£134,800	-£8,517
Fund J	Grants experience, new to loans	Start-ups early stage	£1,533,118	58.1%	£778,040	-£42,388
Fund K	Grants experience, new to loans	Start-ups early stage	£328,694	19.4%	£328,694	-£11,148
Fund L	Grants experience, new to loans	Specific sector focus	£841,564	23.5%	£851,564	-£41,936
Fund M	New social lender	Non-specific	£749,101	27.4%	£1,076,278	-£39,521
Fund N	New social lender	Specific sector focus	£588,896	19.8%	£535,342	-£23,515
Fund O	New social lender	Location(s) specific	£660,018	27.6%	£660,018	-£30,583
Fund P	New social lender	Location specific	£793,038	28.0%	£793,038	-£28,250
			£11,512,217	**26.7%**	**£10,111,976**	**-£27,185.36**

How was Grant A allocated?

> Grant A was designed to subsidise social investor operating costs during the start-up runway stage – anything up to 24 months - and was provisionally set at 10% of the grant total for any applicant. The average Grant A was £120k and the range was £49k to £200k. The maximum Grant A allocation was set relative to each social investor's modelled total Fund size. The average proportion of Grant A compared to the maximum allocation available over all the 16 funds was 92.4%.

> Further analysis of the data in the Table below shows that, as might be expected, there was a lower proportion for the more experienced social investors of between 72.7% to 77.1%. The exception was Fund C, but this is explained by the fact that it did not have any Grant C allocation. Fund D, which does have a Grant C allocation, is nearer the norm for the more experienced social investors (albeit a small sample).

> All less experienced or new social investors were allocated between 89.4% to 99.8%, so the intent of Grant A to support new social investors was reflected in this view of the data. It should be noted that new social investor Funds were smaller too which meant a higher % of maximum allowed was needed to give enough Grant A.

	Prior experience	Investment focus	Grant A operating cost subsidy	Amount of Grant A as % of maximum allowed	Total fund size (loan and Grants B)	Original operational costs	Original Op costs % of Total fund size (loan and Grant B)	Current fund size after re-profiling	Projected operational costs	Grant A as % of projected operational costs after any revisions
Fund A	Experienced social lender	Location and sector specific	£125,000	72.7%	£4,424,568	£1,218,585	27.5%	£2,353,201	£856,198	14.6%
Fund B	Experienced social lender	Non-specific	£200,000	75.1%	£4,055,489	£524,121	12.9%	£5,959,140	£827,638	24.2%
Fund C	Experienced social lender	Non-specific	£140,000	97.2%	£4,927,438	£1,257,211	25.5%	£7,840,110	£1,141,211	12.3%
Fund D	Experienced social lender	Non-specific	£125,000	77.1%	£3,572,787	£647,750	18.1%	£4,877,868	£647,750	19.3%
Fund E	Experienced with grants and loans	Location specific	£49,000	99.8%	£671,784	£365,500	54.4%	£745,000	£365,500	13.4%
Fund F	Experienced with grants and loans	Location specific	£50,000	98.5%	£822,172	£580,364	70.6%	£696,800	£143,155	34.9%
Fund G	Grants experience, new to loans	Specific sector focus	£200,000	89.4%	£3,321,363	£748,677	22.5%	£2,278,000	£457,970	30.6%
Fund H	Grants experience, new to loans	Location specific	£100,000	98.8%	£1,515,237	£540,780	35.7%	£1,613,020	£514,780	19.4%
Fund I	Grants experience, new to loans	Location specific	£55,800	92.1%	£904,191	£134,800	14.9%	£267,299	£134,800	37.9%
Fund J	Grants experience, new to loans	Start-ups early stage	£133,000	98.9%	£2,637,734	£1,533,118	58.1%	£1,664,000	£778,040	17.1%
Fund K	Grants experience, new to loans	Start-ups early stage	£87,852	97.6%	£1,695,450	£328,694	19.4%	£1,527,410	£328,694	26.7%
Fund L	Grants experience, new to loans	Specific sector focus	£120,000	96.0%	£3,588,467	£841,564	23.5%	£3,100,000	£851,564	14.1%
Fund M	New social lender	Non-specific	£190,000	97.2%	£2,736,487	£749,101	27.4%	£4,594,320	£1,076,278	17.7%
Fund N	New social lender	Specific sector focus	£105,000	92.8%	£2,976,192	£588,896	19.8%	£2,965,000	£535,342	19.6%
Fund O	New social lender	Location(s) specific	£120,000	98.8%	£2,391,726	£660,018	27.6%	£2,700,000	£660,018	18.2%
Fund P	New social lender	Location specific	£119,500	95.9%	£2,829,003	£793,038	28.0%	£0	£793,038	14.2%
			£1,920,152	**92.4%**	**£43,070,088**	**£11,512,217**	**26.7%**	**£43,181,168**	**£10,111,976**	**20.9%**

How was Grant A allocated? (ctd.)

> However, if we take another look at the proportion of operational costs covered by Grant A, then the new social investors were not subsidised to a higher proportion of operating costs than established players. On average Grant A covers around 20% of total forecast operational costs (after taking into account re-profiling adjustments).

- There is a wide range from 12.3% to 37.9% but 11 of the 16 Funds show the proportion covered at below 20%. The high % outliers are either not using BSC monies or have re-profiled Fund size down after spending most or all of Grant A.

> This analysis suggests that the level set around 10% may have proven to be too tight for new players to establish themselves. This opinion is supported by the evidence from the social investor interviews – see slide 23. As attracting new social investors is one of GF's objectives, this has implications for any future subsidy model design.

	Prior experience	Investment focus	Grant A operating cost subsidy	Amount of Grant A as % of maximum allowed	Total fund size (loan and Grants B)	Original operational costs	Original Op costs % of Total fund size (loan and Grant B)	Current fund size after re-profiling	Projected operational costs	Grant A as % of projected operational costs after any revisions
Fund A	Experienced social lender	Location and sector specific	£125,000	72.7%	£4,424,568	£1,218,585	27.5%	£2,353,201	£856,198	14.6%
Fund B	Experienced social lender	Non-specific	£200,000	75.1%	£4,055,489	£524,121	12.9%	£5,959,140	£827,638	24.2%
Fund C	Experienced social lender	Non-specific	£140,000	97.2%	£4,927,438	£1,257,211	25.5%	£7,840,110	£1,141,211	12.3%
Fund D	Experienced social lender	Non-specific	£125,000	77.1%	£3,572,787	£647,750	18.1%	£4,877,868	£647,750	19.3%
Fund E	Experienced with grants and loans	Location specific	£49,000	99.8%	£671,784	£365,500	54.4%	£745,000	£365,500	13.4%
Fund F	Experienced with grants and loans	Location specific	£50,000	98.5%	£822,172	£580,364	70.6%	£696,800	£143,155	34.9%
Fund G	Grants experience, new to loans	Specific sector focus	£200,000	89.4%	£3,321,363	£748,677	22.5%	£2,278,000	£457,970	30.6%
Fund H	Grants experience, new to loans	Location specific	£100,000	98.8%	£1,515,237	£540,780	35.7%	£1,613,020	£514,780	19.4%
Fund I	Grants experience, new to loans	Location specific	£55,800	92.1%	£904,191	£134,800	14.9%	£267,299	£134,800	37.9%
Fund J	Grants experience, new to loans	Start-ups early stage	£133,000	98.9%	£2,637,734	£1,533,118	58.1%	£1,664,000	£778,040	17.1%
Fund K	Grants experience, new to loans	Start-ups early stage	£87,852	97.6%	£1,695,450	£328,694	19.4%	£1,527,410	£328,694	26.7%
Fund L	Grants experience, new to loans	Specific sector focus	£120,000	96.0%	£3,588,467	£841,564	23.5%	£3,100,000	£851,564	14.1%
Fund M	New social lender	Non-specific	£190,000	97.2%	£2,736,487	£749,101	27.4%	£4,594,320	£1,076,278	17.7%
Fund N	New social lender	Specific sector focus	£105,000	92.8%	£2,976,192	£588,896	19.8%	£2,965,000	£535,342	19.6%
Fund O	New social lender	Location(s) specific	£120,000	98.8%	£2,391,726	£660,018	27.6%	£2,700,000	£660,018	18.2%
Fund P	New social lender	Location specific	£119,500	95.9%	£2,829,003	£793,038	28.0%	£0	£793,038	14.2%
			£1,920,152	**92.4%**	**£43,070,088**	**£11,512,217**	26.7%	**£43,181,168**	**£10,111,976**	20.9%

Have social investors succeeded in covering operating costs as intended?

> Before looking at the data on the following slides, it is worth repeating how operating costs are covered.

> The respective models that social investors are working to allow operating costs to be drawn – within the viability limit – from any of the following sources:
- Grant A as detailed earlier
- Interest and arrangement fees
- Capital repayments.

> As noted before, the key initial dependency of the model is amount and speed of loan deployment. The intention was for social investors to deploy sufficient loans during the Grant A runway phase such that interest payments and arrangement fees flowing back in would cover operating costs thereafter.

> It was also expected that social investors' operating costs would also be met from loan capital repayments once received. Recycling of capital repayments into further lending was built into the modelling i.e. lending without recourse to BSC funding. As capital repayments include the Grant B component, there is a potential 'surplus' to recycle if default rates are lower than expectations too. However, the more capital repayments are needed to fund operating costs, then the less scope there is for recycling capital and the extra interest income this would earn.

> Clearly, at the end of the Fund's life, the capital repayments are needed also to repay BSC's principal (outstanding loan funding) at 5% compound interest. Compound interest (or compounding interest) is the interest on a loan, calculated based on both the initial principal and the accumulated interest from previous periods.

> The Table overleaf shows performance to date for each Fund and how many have managed to generate sufficient interest, arrangement fee and capital repayments to cover costs.

Operational cost coverage with and after Grant A

- The Table below shows how much of each Fund's operational costs have been met by the combination of Grant A, interest and capital repayments up to March 2020. This includes the Grant A drawdown period and after Grant A as applicable.
- Where Grant A has finished, three of the first four funds to launch – Funds B, C and M – are covering their operating costs from interest and arrangement fee income alone. All other Funds which have completely drawn down Grant A, except for Fund N, are covering their operating costs if capital repayments are also taken into account. Use of loan capital repayments to cover operational costs is expected, especially for later launched Funds - and only a problem when the amount is so high as to break the viability tests in the financial model (as explained previously). However, use of capital repayments for operational costs reduces any capital available for recycling and the potential additional returns that this creates for the social investors.

	Prior experience	Investment focus	Original operational costs	Original Op costs % of Total fund size (loan and Grant B)	Projected operational costs	Average quarterly operational costs drawn down	To date % of operational costs covered by Grant A and interest / arrangement fees	To date % of operational costs covered by Grant A, interest / arrangement fees and capital	Operational costs post Grant A	Interest and arrangement fees post Grant A	Capital repayments post Grant A	To date % of operational costs covered after Grant A finished from interest and arrangement fees	To date % of operational costs covered after Grant A from interest, arrangement fees and capital
Fund A	Experienced social lender	Location and sector specific	£1,218,585	27.5%	£856,198	-£30,157	78.0%	103.9%	-£277,150	£201,096	£109,321	72.6%	112.0%
Fund B	Experienced social lender	Non-specific	£524,121	12.9%	£827,638	-£27,466	136.1%	439.1%	-£128,092	£160,229	£552,071	125.1%	556.1%
Fund C	Experienced social lender	Non-specific	£1,257,211	25.5%	£1,141,211	-£62,971	117.0%	593.1%	-£555,563	£714,405	£3,348,868	128.6%	731.4%
Fund D	Experienced social lender	Non-specific	£647,750	18.1%	£647,750	-£25,875	168.8%	281.7%	n/a				
Fund E	Experienced with grants and loans	Location specific	£365,500	54.4%	£365,500	-£7,689	91.6%	210.6%	-£32,684	£14,732	£57,245	45.1%	220.2%
Fund F	Experienced with grants and loans	Location specific	£580,364	70.6%	£143,155	-£9,073	86.4%	121.8%	-£22,583	£12,685	£25,718	56.2%	170.1%
Fund G	Grants experience, new to loans	Specific sector focus	£748,677	22.5%	£457,970	-£16,919	126.4%	185.2%	-£42,120	£39,238	£23,581	93.2%	149.1%
Fund H	Grants experience, new to loans	Location specific	£540,780	35.7%	£514,780	-£28,957	62.3%	120.4%	-£156,247	£57,560	£149,918	36.8%	132.8%
Fund I	Grants experience, new to loans	Location specific	£134,800	14.9%	£134,800	-£8,517	108.1%	137.5%	n/a				
Fund J	Grants experience, new to loans	Start-ups early stage	£1,533,118	58.1%	£778,040	-£42,388	69.2%	75.7%	-£42,088	£31,160	£17,301	74.0%	115.1%
Fund K	Grants experience, new to loans	Start-ups early stage	£328,694	19.4%	£328,694	-£11,148	104.7%	109.5%	n/a				
Fund L	Grants experience, new to loans	Specific sector focus	£841,564	23.5%	£851,564	-£41,936	73.9%	74.1%	n/a				
Fund M	New social lender	Non-specific	£749,101	27.4%	£1,076,278	-£39,521	114.1%	206.7%	-£75,629	£104,397	£218,166	138.0%	426.5%
Fund N	New social lender	Specific sector focus	£588,896	19.8%	£535,342	-£23,515	64.2%	65.1%	-£116,054	£43,704	£2,108	37.7%	39.5%
Fund O	New social lender	Location(s) specific	£660,018	27.6%	£660,018	-£30,583	103.2%	103.2%	n/a				
Fund P	New social lender	Location specific	£793,038	28.0%	£793,038	-£28,250	100.0%	100.0%	n/a				

Grant A data analysis findings

- It is important to remember that these are interim findings and only cover the period to end of March 2020.
- Fund M is the first example of a new social investor that has succeeded in generating sufficient loan volume to cover its operational costs from interest payments alone. It is noteworthy that Fund M focused on lending to more mature social enterprises and so was able to deploy at a larger average loan size and this may well have contributed to its relative success in deploying its Fund. At the opposite extreme so far is Fund N which has faced challenges from the outset in generating demand from charities and social enterprises for loans from its grant-oriented sector.
- Two others have been very successful – Funds B and C – but both were already highly experienced social investors with established networks, pipelines and investment management processes.
- The narrative is more mixed for less experienced and later established operators:
  - Funds A, G, H and J have all had issues but are covering operational costs once capital repayments are included.
  - As of March 2020, six of the sixteen funds are still or have just finished receiving Grant A. Of these, Fund D is continuing strongly where its previous Fund C led, Fund P has ceased operations, and Fund I re-profiled and scaled down its lending ambitions considerably in 2019.
  - The remaining three social investors – Funds K, L and O - have also all recently re-profiled in the light of lower than planned deployment since launch. It is still early enough in the Fund's respective deployment windows and so it remains to be seen whether they will develop a sufficient pipeline and loan volume to generate the interest and capital repayments to cover operational costs.
  - The remaining two Funds – E and F – are operating under different co-investor and operating cost arrangements and so are not entirely comparable.

Grant A – interview findings

- Interviewees reported that Grant A certainly helped make becoming a GF social investor a more attractive proposition. Funds A, H, J, K, M, N and O were all interested in using GF ***"to test the new waters"*** or ***"build up a social lending skill set"*** in their respective organisations and any subsidy was of help.
- Interviewees also reported that the availability of BSC money was also a key attraction. This meant that funds did not have to be raised from either internal or other external resources**.**
- Organisations said that ***"they expected to put skin in the game themselves"*** given that Grant A did not subsidise any application phase costs and, once launched, they did not expect to necessarily cover operational non-cash costs such as SMT time, central finance or HR support or contributions towards overheads. As mentioned earlier, four have explicitly allocated further resources to try and ensure success.
- However, some of the time covered by Grant A was spent by new social investors on GF required activities such as formalising investment manuals and ***"this took resources away from pipeline development activities".*** This was specifically mentioned by two Funds.
- The combination of Grant A and the limit on operational expenditures that the financial model allows means that investors that were behind in deployment were effectively unable to add the capacity needed to make a push to try and catch up. Several newer social investors reported having ***"to employ fewer FTE investment managers than originally planned"*** due to this constraint. Three Funds specifically mentioned this factor.
- It was observed by more experienced social investors that ***"the deployment phase of any Fund will always be loss making"*** and fund managers can only start to make returns at the tail end of deployment and after Funds have been deployed. These more experienced social investors noted that the model's limits on operational drawdowns ***"may not allow enough flexing in line with needs, over the life of a Fund, for newer, less experienced social investors"***.

Use of Grant B: Grant to Cover Some of the Fund Losses

Grant B

- Grant B was designed to provide first loss cover for the social investors, BSC and other capital providers. It was set for each social investor on the following basis:
  - Expected loan default % as proposed by the social investor in their application
  - Circa 5% added for contingency.
- As can be seen from the table below, the average Grant B was 29% of total fund size (loan and Grant B). Fund E is the outlier for a specific reason linked to its unique community foundation funding model.

	Prior experience	Investment focus	Grant B for loans to VCSE	Amount of Grant B as % total fund size	Loan component from BSC	Co-investment loan component from other sources	Total loan component	Total fund size (loan and Grant B)
Fund A	Experienced social lender	Location and sector specific	£1,305,248	29.5%	£2,719,320	£400,000	£3,119,320	£4,424,568
Fund B	Experienced social lender	Non-specific	£1,358,589	33.5%	£2,696,900		£2,696,900	£4,055,489
Fund C	Experienced social lender	Non-specific	£1,300,844	26.4%	£3,626,594		£3,626,594	£4,927,438
Fund D	Experienced social lender	Non-specific	£1,268,339	35.5%	£2,304,448		£2,304,448	£3,572,787
Fund E	Experienced with grants and loans	Location specific	£67,178	10.0%	£0	£604,606	£604,606	£671,784
Fund F	Experienced with grants and loans	Location specific	£205,543	25.0%	£0	£616,629	£616,629	£822,172
Fund G	Grants experience, new to loans	Specific sector focus	£1,075,170	32.4%	£2,246,193		£2,246,193	£3,321,363
Fund H	Grants experience, new to loans	Location specific	£492,452	32.5%	£1,022,785		£1,022,785	£1,515,237
Fund I	Grants experience, new to loans	Location specific	£280,299	31.0%	£323,892	£300,000	£623,892	£904,191
Fund J	Grants experience, new to loans	Start-ups early stage	£791,320	30.0%	£1,846,414		£1,846,414	£2,637,734
Fund K	Grants experience, new to loans	Start-ups early stage	£542,544	32.0%	£1,152,906		£1,152,906	£1,695,450
Fund L	Grants experience, new to loans	Specific sector focus	£1,130,367	31.5%	£2,458,100		£2,458,100	£3,588,467
Fund M	New social lender	Non-specific	£684,122	25.0%	£2,052,365		£2,052,365	£2,736,487
Fund N	New social lender	Specific sector focus	£1,026,786	34.5%	£1,949,406		£1,949,406	£2,976,192
Fund O	New social lender	Location(s) specific	£621,849	26.0%	£1,769,877		£1,769,877	£2,391,726
Fund P	New social lender	Location specific	£826,069	29.2%	£2,002,934		£2,002,934	£2,829,003
			£12,976,719	29.0%	**£28,172,134**	**£1,921,235**	**£30,093,369**	**£43,070,088**

Grant B – interview findings

- Investors reported that their default rate up to March 2020 (i.e. prior to any Covid-19 impact) was less than the Grant B award level (up to 35.5%) – some still at zero and most well below 10%. One investor remarked that, **"*It is too early to draw any definitive conclusions about the effectiveness of Grant B*".** All funds have an expected period before any defaults in their model and, at any point in time, a proportion of loans are enjoying a capital repayment holiday of usually 12 but up to 24 months. As noted by several social investors, it is usually only **"*at the point where capital repayments start that issues tend to emerge*"**. Clearly, the Programme Partnership's timely response to Covid-19 in offering interest and capital holidays to the social investors means that any future analysis will have to take this into account.
- The clarity about Grant B and its purpose is well understood by the social investors and **"*the level of first loss cover is good*".** Social investors confirmed that it has **"*set the risk appetite wider than they would otherwise have been*"** without Grant B.
- The amount of Grant B available to each social investor does not directly impact on investment committee decisions when looking at individual proposals. Although the Growth Fund is designed to increase social investor's risk appetite and tolerance, it is nonetheless seen as a dangerous practice to make approval decisions on an assumption that it may default as, when you do, it usually does. Proposals are evaluated on their merits and according to social investors' respective lending approval criteria including, of course, level of social impact.
- However, once loan volume builds up (and capital can start to be recycled), investment committees can and do take the current balance of their portfolio into account. This does mean that **"*some slightly riskier ventures (perhaps earlier stage) can be funded*"** because the overall portfolio has some lower risk loans and / or the **"*prior repayment experience [of similar proposals] has been good*".**
- Investment committee decisions do evolve based on experience too. There are examples reported by social investors where loans were offered which **"*would not necessarily gain approval if they came up again*"**. There were also examples where loans have defaulted that would be lent to again on the same basis if they came up. This just goes to show that unique changes in circumstances are often the issue behind each default. (Again, the whole economy impact of Covid-19 means all parties are facing the same change in circumstance, which will change the analysis post March 2020.)

Grant B – interview findings (cont.)

- As mentioned, Grant B is considered by all parties to offer ***"a good level of cover"***. Given this good level of first loss insurance, the criticism of Grant B is around ***"which organisation's potential losses are ultimately being protected"*** and whether this relates to the cost of BSC loan funding.
- If BSC's risk is the ultimate risk that Grant B is protecting, then some social investors question ***"why the rate of interest charged was set at 5% compound"***:
  - This means that the headline rate of interest that social investors use to start discussions with potential borrowers can be around 8%, although some begin at a lower rate than this and, across all the Growth Funds, the average rate of interest charged is 7%.
  - Clearly, by blending Grant C with loan ***"the true cost of money to borrowers can be much lower"***, but the headline interest rate level was reported as ***"off-putting"*** and ***"affecting pipeline development"***.
- BSC loan funding is non-recourse to the social investors which means any losses above the Grant B level will fall to BSC and, clearly, this may become much more of an issue for BSC with the impact of Covid-19. For social investors their risk lies with any operating cost coverage shortfalls (i.e. they do not generate as much interest from the loan repayments, and so they have less overall money to cover their operating costs). It is worth noting that Grant B covers all capital providers including that provided by other investors in four of the Funds.
- The other difficulty with Grant B arises if there is a default early in the life of a Fund before much of Grant B has been repaid; a larger early default means that the Fund may be in breach of its Asset Coverage Ratio (ACR) (explained earlier). The rigidity in the way that Grant B ***"can only be drawn down in proportion with each loan and only useable once repayments have been received"*** creates a potential issue for all social investors, although it has only affected one social investor to date.
- Pre-Covid-19's impact, the Programme Partnership had an expectation that Funds would have some surplus Grant B in the capital repayment account at the end of a Fund's life. This expectation appeared to be well founded before March 2020 but clearly it is now more questionable.

Use of Grant C: Discretionary Grant to Support Charities and Social Enterprises

Grant C findings

- The table below shows the level of Grant C awarded to each social investor.
- Grant C is the discretionary grant funding that enabled social investors to offer a blended grant / loan facility to charities and social enterprises.
- All except Funds C, L and N took up Grant C.
  - Fund C did not take any Grant C but the social investor has taken Grant C for Fund D.
  - Fund N's view was that there was enough grant funding available in its specific sector already. It has approved loans to organisations that have brought grant funding from other sources alongside.

Prior experience	Investment focus	10% of fund's total grant	Grant A operating cost subsidy	Amount of Grant A as % of maximum allowed	Amount of Grant A as % of investor's total grant	Grant B for loans to VCSE	Amount of Grant B as % of total fund size	Grant C passed on as grant	Approved Growth Fund total	Loan component from BSC	Co-investment loan component from other sources	Total loan component	Total fund size (loan and Grant B)
Experienced social lender	Location and sector specific	£171,825	£125,000	72.7%	7.3%	£1,305,248	29.5%	£288,000	£1,718,248	£2,719,320	£400,000	£3,119,320	£4,424,568
Experienced social lender	Non-specific	£266,259	£200,000	75.1%	7.5%	£1,358,589	33.5%	£1,104,000	£2,662,589	£2,696,900		£2,696,900	£4,055,489
Experienced social lender	Non-specific	£144,084	£140,000	97.2%	9.7%	£1,300,844	26.4%	£0	£1,440,844	£3,626,594		£3,626,594	£4,927,438
Experienced social lender	Non-specific	£162,134	£125,000	77.1%	7.7%	£1,268,339	35.5%	£228,000	£1,621,339	£2,304,448		£2,304,448	£3,572,787
Experienced with grants and loans	Location specific	£49,118	£49,000	99.8%	10.0%	£67,178	10.0%	£375,000	£491,178	£0	£604,606	£604,606	£671,784
Experienced with grants and loans	Location specific	£50,754	£50,000	98.5%	9.9%	£205,543	25.0%	£252,000	£507,543	£0	£616,629	£616,629	£822,172
Grants experience, new to loans	Specific sector focus	£223,767	£200,000	89.4%	8.9%	£1,075,170	32.4%	£962,500	£2,237,670	£2,246,193		£2,246,193	£3,321,363
Grants experience, new to loans	Location specific	£101,245	£100,000	98.8%	9.9%	£492,452	32.5%	£420,000	£1,012,452	£1,022,785		£1,022,785	£1,515,237
Grants experience, new to loans	Location specific	£60,610	£55,800	92.1%	9.2%	£280,299	31.0%	£270,000	£606,099	£323,892	£300,000	£623,892	£904,191
Grants experience, new to loans	Start-ups early stage	£134,432	£133,000	98.9%	9.9%	£791,320	30.0%	£420,000	£1,344,320	£1,846,414		£1,846,414	£2,637,734
Grants experience, new to loans	Start-ups early stage	£90,040	£87,852	97.6%	9.8%	£542,544	32.0%	£270,000	£900,396	£1,152,906		£1,152,906	£1,695,450
Grants experience, new to loans	Specific sector focus	£125,037	£120,000	96.0%	9.6%	£1,130,367	31.5%	£0	£1,250,367	£2,458,100		£2,458,100	£3,588,467
New social lender	Non-specific	£195,412	£190,000	97.2%	9.7%	£684,122	25.0%	£1,080,000	£1,954,122	£2,052,365		£2,052,365	£2,736,487
New social lender	Specific sector focus	£113,179	£105,000	92.8%	9.3%	£1,026,786	34.5%	£0	£1,131,786	£1,949,406		£1,949,406	£2,976,192
New social lender	Location(s) specific	£121,435	£120,000	98.8%	9.9%	£621,849	26.0%	£472,500	£1,214,349	£1,769,877		£1,769,877	£2,391,726
New social lender	Location specific	£124,557	£119,500	95.9%	9.6%	£826,069	29.2%	£300,000	£1,245,569	£2,002,934		£2,002,934	£2,829,003
		£2,133,888	**£1,920,152**	**92.4%**	**9.2%**	**£12,976,719**	**29.0%**	**£6,442,000**	**£21,338,871**	**£28,172,134**	**£1,921,235**	**£30,093,369**	**£43,070,088**

Grant C – interview findings

> As Grant C is used at the discretion of social investors, the interviewees reported its deployment in a variety of ways including:
  - de facto relief of interest cost;
  - directly funding a social impact role or activity;
  - fixed asset loan-to-value gap financing i.e. where there is a gap between a property mortgage loan offer and the sum required to make the purchase;
  - funding a necessary role for a new venture;
  - cashflow funding for public sector contracts;
  - funding upfront costs for opening or refurbishing premises that are otherwise difficult for charities and social enterprises to finance through borrowing;
  - as quasi-equity with repayment linked to exceeding agreed performance thresholds only and so a form of lower pressure financing; and
  - on a repayable basis.

> Fund G offers the same Grant C component to all approved loans as a way of granting relief of interest cost. For all the other social lenders using Grant C, it is offered on a case-by-case basis and usually from the outset. However, Grant C is sometimes discussed with potential borrowers only at the end of the application approval process and, in rarer cases, not discussed or offered at all.

> Grant C has been well received by the social investors and the ***"flexibility with which it can be deployed"*** has been of great help. Interviewees reported that Grant C is ***"an important differentiator"*** and ***"very helpful in the marketing"*** of GF loans (although it is not permitted explicitly to promote Grant C as relief of interest costs).

Grant C – interview findings

> Where offered, Grant C blend ranges between 15 to 30%.
  - Potential borrowers are often still applying for grant funding at the same time as applying for a loan and, according to social investors, anything above 20% is helpful in attracting organisations new to loan funding.

> From the evaluation's separate longitudinal research with a selection of loan recipient VCSEs, Grant C is reported as beneficial. Almost half (42 out of 86) of VCSEs responding to a survey sent as part of the evaluation stated that they were interested in this investment in particular because grant funding was part of the package. Of the nine VCSEs that feature as case studies and received a grant, most perceived Grant C as reducing the overall cost of finance and / or enabling additional investment to enhance their respective business proposition.

> All social investors are keen to see a social impact linked to any Grant C funding and view Grant C as **"*important in helping us fulfil our wider social mission*"**. This was highlighted by three Funds and examples include supporting new ventures in deprived areas and start-ups.

Interactions of Grants A, B and C

Interaction of Grants A, B & C – interview findings

> The distinct purposes of Grants A, B & C are clear to the social investors. They are seen as complementary to each other and, for social investors, there are "***always fund design parameters within which we have to work***".

> However, the structured approach means that there are some specific implications from the rigidities around Grants A and B particularly. The lack of flexibility in the way that Grants A and B work "***means that deployment [in order to cover operational costs] has been the main driver of activities and decisions***". This is especially the case as reported by the newer social investors:

- After Grant A, the operational cost drawdown limit is "***so tight***" that effectively there is "***no room for more than pipeline and administration activities. There is no scope for post-implementation engagement and support.***" Social lenders see this kind of capacity building support as potentially a key part of their offer.
- The pressure to meet deployment targets means that there is a possible tendency towards approving loans that have a marginal risk assessment. There is then a potential call on Grant B early in the life of the Fund when not enough reserve has built up from other loan capital repayments and the fund breaching its ACR.
- The focus on deployment means that social investors report they have "***not necessarily been able to focus on social impact as much as we would have liked***'; though it is worth highlighting that our previous evaluation report also found limited appetite amongst social investors to monitor the social impact of loans after deploying the loan, and so we think capacity constraints is not the only reason.
- The loan capital repayment holiday is a parameter set by the social investor and could be applied flexibly. However, where it was set as an all-or-nothing parameter and for a fixed period, it proved to be a further rigidity as it was then unable to flex in line with, for example, delays in a venture's building project.
- "***Nor is there the flexibility to deploy Grant C over the life of the loan***" and this "***has limited the scope for any innovation***" in terms of blended grant / loan models.

> It is worth mentioning here the availability of the Reach Fund (although not subject of this thematic report) which social investors apply for separately to fund support to charities and social enterprises with finalising business plans in the loan application process. Anecdotal feedback on the availability of support through Reach Fund was positive for the earlier Funds, although the separate application process was seen as an additional hurdle to cross.

Social Investors' Ideas on how to Design Future Blended Finance Programmes

Future blended finance programmes – interview feedback and ideas

- From the interviews, several ideas were put forward with respect to the design of any future subsidised blended loan fund as follows:
  - Grants A and C are the essential grants for supporting a social investor base and providing a blended loan offer to charities and social enterprises. Grant B is ***"only needed if the funder requires first loss cover"***. One alternative would be to de-risk loans by offering a greater proportion of Grant C to mitigate default risk. There are examples of 50:50 loan / grant funds e.g. some local authority enterprise support programmes.
  - A future fund "***should not be a one size fits all model"***. Grant A set around 10% across all types of social investors is ***"not necessarily sensitive to the needs of either new entrants or those targeting niche lending markets"***. It may be simple and it was set at 10% to allow for differentiation between social investors but ***"may be too low a cap if the intention is widening the number of players"*** in the market. Suggested options are for:
    - a higher level of Grant A funding with a proportion of it repayable against successful deployment and capital repayment criteria and possibly also from any Grant B surplus. By way of example, Grant A base of £125k with a potential to draw down an additional £75k on a repayable basis would bring the total up to £200k; or
    - an ability to draw down from Grants A, B and C against needs as they vary over the life of the fund and, in a similar vein, use Grants A, B and C as a revolving credit facility that provides the social investors with the ability to draw down, repay, and draw down again within a limit.
  - As well as higher levels of operational grant funding, there is a need for ***"more pro-active support"*** of new players. ***"It is all a learning curve"*** and much more initial support for developing a pipeline would be a good example of where pro-active support could help. This is a key skillset and the critical initial success factor for any new social investor.
  - Improved capturing and measuring the social impact of loans is something that could be built into future blended finance programmes. It was noted as currently ***"a second order effect of the lending and not the focus that it could be"***.

Future blended finance programmes – interview feedback and ideas (ctd.)

> Social investors also consider that "***more headroom for capacity building support***" could be an explicit part of any future subsidy model. The Growth Fund social investors and applicants could apply for pre-deal capacity building support from the separately managed Reach Fund.

- Although Reach Fund is not directly a subject of this evaluation, its usefulness pre-deal was noted by many of the social investors. Nearly all applicants need some level of support to get their business plans in shape for investment committee approval.

> Provision of post-investment support is also seen as a "***weakness in the current model***" and is an area where charity and social enterprise needs and support costs "***have proven to be high***". There is a "***virtuous circle***" in supporting charities and social enterprises with their development through regular contact and responding early to any problems and issues arising. This activity grows with the portfolio of lending. Suggestions would be for:

- Reach fund criteria to be extended to cover post-deal sustainment of investments (especially accountancy and capacity building) as well. Both would be helpful with risk mitigation too.
- Incorporate the separate Reach Fund funding into the operational subsidy model for each social lender from the outset.

> If some or all of Grant B was available up-front then it would prevent early default issues potentially affecting social investors. It would also potentially enable earlier recycling of funds if the loan default incidence was consistently below expectation. Further suggestions are:

- For social investors to be able to adopt a risk-based approach to loan due diligence requirements i.e. less rigorous for smaller loan exposures such as below £50,000
- A minority suggestion would be to vary Grant B against each loan decision according to a risk matrix. This would have to be a standardised or accredited tool to work across social investors and the argument against this is that social investors should balance their portfolio risks themselves.

Future blended finance programmes – interview feedback and ideas (ctd.)

- There was a consensus that "***the vanilla loan product is good***", as it "***keeps things simple***" with borrowers who are not necessarily that experienced. However, the maximum term length of 5 years is tight for example when co-investing against a capital project i.e. funding a loan-to-value gap.
- Suggestions include:
  - Applying different rules for recycled capital so that follow-on funding (possibly above £150k) could be offered or longer terms or other products such as quasi-equity (a loan repayable only when certain financial outcomes are exceeded);
  - Ability to bring in co-investors and other monies e.g. High Net Worth individuals (HNWs) taking advantage of Social Investment Tax Relief (SITR) into individual deals for values above £150,000.

Conclusions, Implications and Recommendations

Conclusions, implications and recommendations

- At the time of this interim snapshot of GF in March 2020, the performance of the various social investors against their respective expectations at the outset has been mixed. The Programme Partnership certainly did not think that all new social investors would perform evenly, as GF social investors are a widely differentiated group in terms of prior social lending and grant experience, sector focus, geography and, where relevant, funding partners.
- What this means is that the design of GF's subsidy model needed to encompass a broad set of needs and most of the interview feedback reflects the respondents bumping up against the limitations and boundaries set by its design. It also informs the ideas for any future blended finance programmes.
- The intended impact of Grant A is clear and the availability of Grant A was a key attraction to the social investors in applying to be GF intermediaries, more especially the new entrants**.** The difference in percentage allocation of Grant A between experienced and less experienced providers was less real than it appears at face value. The proportion of operational costs met by Grant A was in a similar range across the different levels of social lending experience.
- So far one new entrant, Fund M, has clearly achieved what Grant A and the modelling suggested should happen by covering operating costs through interest payments alone. All other nine new entrants have drawn on capital repayments as well to cover operating costs. As noted earlier, this is expected and only becomes an issue if the overall Fund viability indicators and tests are broken. In this context though, three of the new entrants have had to restructure in the light of lower-than-expected loan deployment and one Fund has, in fact, agreed to close.
- All the other new entrants have re-profiled once and Fund N has now re-profiled three times. Funds were not expected to operate entirely in line with forecasts over their whole lives and an annual review and possible re-profile was always part of GF's performance management regime.
- In the evaluator's opinion based on the evidence to date, Grant A set around 10% has not allowed enough runway funding for new entrants to develop their pipelines and deploy the volume of loans required to generate operational cost covering interest payments. The upper limit imposed by the model on operational costs post Grant A and especially after any re-profiling has led to a cycle of constrained resources with less capacity to generate sufficient loan deployment and interest earnings potential.

Conclusions, implications and recommendations (cont.)

- In effect, once deployment falls behind plan, the viability tests built into the model may be generating their own downward pressure. It does not allow for adding resources in order to catch up. Re-profiling discussions between social investors and the funding partnership have, for example, extended deployment windows but either not allowed for additional costs or demanded further operational cost reductions.
- In addition, according to social investors, the focus on deployment has reduced the capacity to focus on other issues of importance to the Partnership such as reporting on social impact.
- For the funding partnership, there is a value for money question when agreeing to reduce the size of a Fund whilst at the same time allowing for higher operating costs. However, in the evaluator's opinion, this issue points to the need for a differentiated approach to subsidy of new lenders vs established players. If one of the purposes of Growth Fund is to build new social investor capability in the market, then the subsidy model needs to support that objective.
- Grant B does fulfil its purpose (as outlined on slide 6) to support an overall risk appetite and has widened the availability of unsecured loan finance to VCSEs. Grant B is perceived by the social investors to be set at a generous level and has clearly been well received by the social investors. Its impact also means that VCSEs are gaining access to affordable unsecured loan finance that would not otherwise be available.
- The interviewee criticisms about Grant B should inform thinking about future fund subsidy design particularly regarding its timely availability in the case of defaults. It will only become apparent at the end of each Funds' respective repayment periods whether the level of Grant B was set too low, too high or about right. The level of any residual Grant B depends on actual write down experiences in each Fund and clearly the long-term impacts of the Covid-19 pandemic are still unknown.
- The appropriate level of subsidy will be a key question for this evaluation to address at the end of the Growth Fund programme and will cover Grants A and C as well.

Conclusions, implications and recommendations (cont.)

> The issue about pricing of BSC's wholesale capital, the risk BSC is bearing and how much Grant B protects either BSC or the social investors (or both) is a subject for lively debate as it goes to the heart of the risk / reward conundrum that providing unsecured loans to potentially high-risk ventures presents. In GF, social investors' estimated defaults were in the range of 10 to 32% (pre-Covid). BSC does bear a risk over and above the extent that the Fund's Grant B provides first-loss protection, and so the rate of interest charged (i.e. pricing) is driven by this as well as its own objectives to develop the social investment marketplace whilst at the same time preserving BSC's capital.

> As noted, the availability of BSC's wholesale capital was a key attraction of the Growth Fund to social investors as they did not have to go out and raise funds separately. However, the headline rate of interest has had a reported impact on pipeline development and, where social investors are new, this only adds to their challenges.

> As stated, Grant C has been well received by the social investors and the flexibility with which it can be deployed at the start of a loan has been of great help. For social investors, the ability to use Grant C over the life of a loan would be an additional flexibility that would be welcomed and a consideration for future fund subsidy design.

- As it happens, the Programme Partnership has since March 2020 temporarily allowed more flexible use of Grant C as one of several Covid-19 response adaptations.

> For any future fund, the priority between creating new social investor capacity in the market versus deployment of loan volume will need to be finessed. Growth Fund has set out to achieve both objectives but, in the evaluator's opinion, consideration needs to be given to a differential subsidy approach to new social investors and the markets they intend to service. That is not to say that organisations wishing to test a new loan-making venture for themselves should not also have some skin in the game, but there are ways of sharing risk and reward (such as quasi-equity arrangements) that would allow for any extra Grant A to be recovered based on exceeding success criteria.

> No matter what or how many objectives any future blended finance fund has, there are fundamental risks and trade-offs for all parties involved that will inform the structure. In order to grow this market it is important that both grant and capital funders continue to ask some key questions:

- What risk is the grant protecting against?
- Given this risk, is the cost of capital set at an appropriate level?

> It is also important to then ensure that the structures, risks and trade-offs are understood by those operating in the market. In this context, the interests of the grant and capital sources should not make for unnecessarily complicated features in the set up and administration of any future blended finance programme.

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