The Solutions Collective

Insights Forum 1

Guarantees: How can we use government backed guarantees to support more social lending?

Context

Loan guarantees are another tool to increase and improve the flow of social finance to reach people, organisations and communities that would otherwise be excluded.

How Government Guarantees work

Session agenda:

'Government guarantees – how they work and what we are trying to achieve?'
- James Burrows, Big Society Capital

'Guarantees in action – what does this mean in practice to an investor and the investee?'
- Rob Benfield, Social Investment Business

Discussion and Q&A: how guarantees are relevant to your organisation and to explore how they might be used in the future. Insight to inform scheduled conversations with BBB and HMT

Slides used during the session can be found here

Recording of presentations can be accessed here

The history

- Government guarantees are a well-established lever, having been in use for over 30 years (since early 80s) in providing concessionary capital to small, medium enterprises (SME) to enable lending to small businesses when the banks retreated
- Big Society Capital's first experience of using Enterprise Finance Guarantee (EFG) came via our investment in the Community Investment Enterprise Facility (CIEF) – enabling Community Development Finance Institutions (CDFI) via the provision of a guarantee to lend into disadvantaged communities with the additional risk incurred
- During the pandemic EFG was the foundation for CBILS – Coronavirus Business Interruption Loan Scheme – enabling the same flow of capital during challenging times

The mechanics

- Recognising the importance of understanding where the guarantee actually interacts in the investment process which is at investor level
- The government guarantee underwrites a proportion of any losses that the investor might have by enabling them to take more risk with their lending
- Effectively this extends the opportunity for borrowing to social enterprises and charities where others would not have the risk appetite to lend (effectively acting as alternative finance provision for non-bankable lending)
- Key achievement when joint lobbying resulted in British Business Bank (BBB) changing the criteria of 50% income through trading to exempting charities. This opened up eligibility to much broader use by the social sector
- Lender needs to have £3 million of lending per annum to be 'big' enough to meet the eligibility criteria for administering criteria with max loan term currently 6 years (to this point there are only two accredited social lenders who can utilise guarantees to support their lending)
- Under EFG BBB had more guarantee capacity than was being used so needed more accredited lenders and had lower threshold of 500K lending per annum to enable CDFIs to lend under the scheme

The cost

- On average (pre-pandemic) government guarantee liability was approx. £300M a year since early 80s different scale of risk
- Currently the scale is £70 billion potential impact on government balance sheet
- The guarantee is risk sharing and not first loss (as sometimes wrongly referred to) currently with CBILs 70% guaranteed v 30% lost
- **BUT for the investee they are liable for 100% of the loan**
- Lender doesn't get the guarantee for free; they have a currently 1% fee per annum for social lenders (2% for private lenders) in order to use the guarantee
- Operational cost – auditing and also criteria for lending
- All of this helps to support (but not to mandate) a lower cost of capital making it affordable but not necessarily the cheapest form of borrowing particularly in relation to the risk

The opportunity

- The current Recovery Loan Scheme is due to end June 30^{th} 2022
- Treasury are consulting now with current providers (including Responsible Finance and SIB) on the next iteration of guarantees – this has a time sensitive opportunity to influence and input into their thinking
- To potentially leverage more institutional investment and combine it with other levers like Community Investment Tax Relief (CITR)
- Learning from what didn't work well:
    - Changing fund criteria including reducing turnover figure for lending and minimum loan size
    - Providing technical assistance support
    - Making the money reach those experiencing the greatest barriers to accessing finance including diverse communities and their leaders/organisations
- Having used the current CBILs scheme to test use of guarantees for social sector this is our (sector) opportunity to share learning and evidence to support our call for use of government guarantees

Key insights: To test and research the real cost of guarantees and evidence of impact:

- Over last 30 years what are the net costs to the taxpayer of guarantees?
- Has the British Business Bank made more money from fees than paid out in claims?
- What is the real risk compared to the opportunity cost?
- What is the cost to the taxpayer as an interesting metric, given the types of organisations social investment supports?
    - What is the direct cost versus the value for example contributed to local economies?
    - Or additionally the money saved to the public purse as a result of what those organisations do

Were there any points raised during the discussion or speaker presentations that have influenced or further informed your thinking around the subject of guarantees?

The concept of long-term, planned access to guarantee funds, rather than schemes stopping and starting, is very attractive. Being able to build expertise in the use of guarantees and therefore planning strategic growth in both the supply of funds and demand from charities and social enterprises.

Niamh Goggin, Director Small Change

Other reading and resources referenced during the discussion:

- Recovery Loan Fund: https://www.sibgroup.org.uk/recovery-loan-fund
- Recovery Loan Fund case studies: https://www.sibgroup.org.uk/impact
- https://www.goodfinance.org.uk/case-studies/autism-plus
- https://www.goodfinance.org.uk/case-studies/royal-society-blind-children
- St Johns Ambulance Wales https://www.youtube.com/watch?v=W7WC7PLlY58
- Community Investment Enterprise facility: https://bigsocietycapital.com/portfolio/community-investment-enterprise-facility/
- Social Lending: https://bigsocietycapital.com/latest/social-lending-ambitions-direction-and-levers/

Our Social Lending Strategy

We want to see a social lending market that meets the needs of a diverse range of social purpose organisations and investors alike. To do this we are exploring a range of tools and levers including the use of guarantees, tax, catalytic capital in order to increase the supply of concessionary capital.

We recognise the importance of partnership and of ensuring that user insight and lived experience are embedded in our design and development processes. The Solutions Collective is an initiative to support the growth of the social lending market in the UK.

Suggested Solutions Collective Future Topics:

1. Convening social investors (trusts & foundations T&F) who do or don't provide guarantees to learn from each other

2. Convening trusts and foundations and social investors (non-T&F) to discuss using charitable funds to guarantee social investment clearly targeting excluded people, organisations and communities and not to cover Big Society Capital (or other lender's) return requirements (this potentially a red line for many T&F)

3. Tax reliefs and putting tax to work to increase access to finance

4. Catalytic capital – prioritising capital to reduce barriers to social lending

To register your interest for future Solutions Collective events or suggest topics please register here