Southwark Pioneers Fund – Technical Analysis
3. Fund Overview

What categories of loan terms (interest rate, default terms, re-payment period and holiday period) and equity/quasi-equity investments would be appropriate to achieve the primary aim of the Fund?

The existing proposed setup of the fund comprises three types of funding mechanism; Grants, Loans and Equity Funding. It should be noted the Fund is also considering quasi-equity investments, a hybrid model, such as convertible loan notes (effectively a loan that can be converted into preferred shares in a later funding round), equity that can be converted into a loan on maturity or revenue participation notes; an unsecured loan where interest payments are determined by revenue performance.

A summary is provided below of the primary considerations associated with each option;

Grants

Example £500k allocation

Assumed 5 grants per quarter; full allocation used by the end of year 5.

Grants can be provided to businesses; these can either be provided on a basis of being spent on a particular purpose (ring-fenced) or without any obligations.

- Highest potential for social value return
- No financial burden applied to businesses
- Can be ring-fenced or targeted for specific purposes
- Overall positive impact on SME's through providing them with increased support, allowing new businesses to thrive in the local economy
- No recyclability of capital in the Fund

Loans

Example; £500k Loan allocation

A 5% Interest Rate on a 3 year, £500k loan with a default rate of 20% would return £433k.

Loans can be provided to business with a variety of terms. Forms of quasi-equity can also be provided, which include loans with share-purchase options.

- Comparatively secure financial return
- Terms can minimise burden placed upon businesses
- Supports recyclability of capital within the Fund
- Overall positive impact on SMEs through providing them with increased support, whilst also enabling SMEs to benefit from total ownership
- Dependent on terms, loans can hamper businesses with onerous debt obligations
- Flexibility on terms can also reduce the return derived by the Council
- The Council's capital may be at risk should the business fail, depending on the security and seniority of the debt

Equity

Example; £500k allocation

5 x £100k investment forecast to be valued at £666k in its fifth year, utilising the following assumptions;

1 Scalable (25% annual growth), 3 Stable (5% annual growth), 1 Failure.

Equity investments can also be undertaken. This would result in the Council becoming a shareholder of the specific entity.

- Have the potential to derive the greatest financial return for the Council
- Provides the Council with a stake in a business, with the potential for greater say in decision making if desired
- Equity investments have low liquidity, requiring a market for sale
- Returns are also dependent on profitability of businesses invested in, with dividends potentially unlikely whilst the business is in investment phase
- The Council's capital is at risk should the business fail

Southwark Pioneers Fund – Technical Analysis

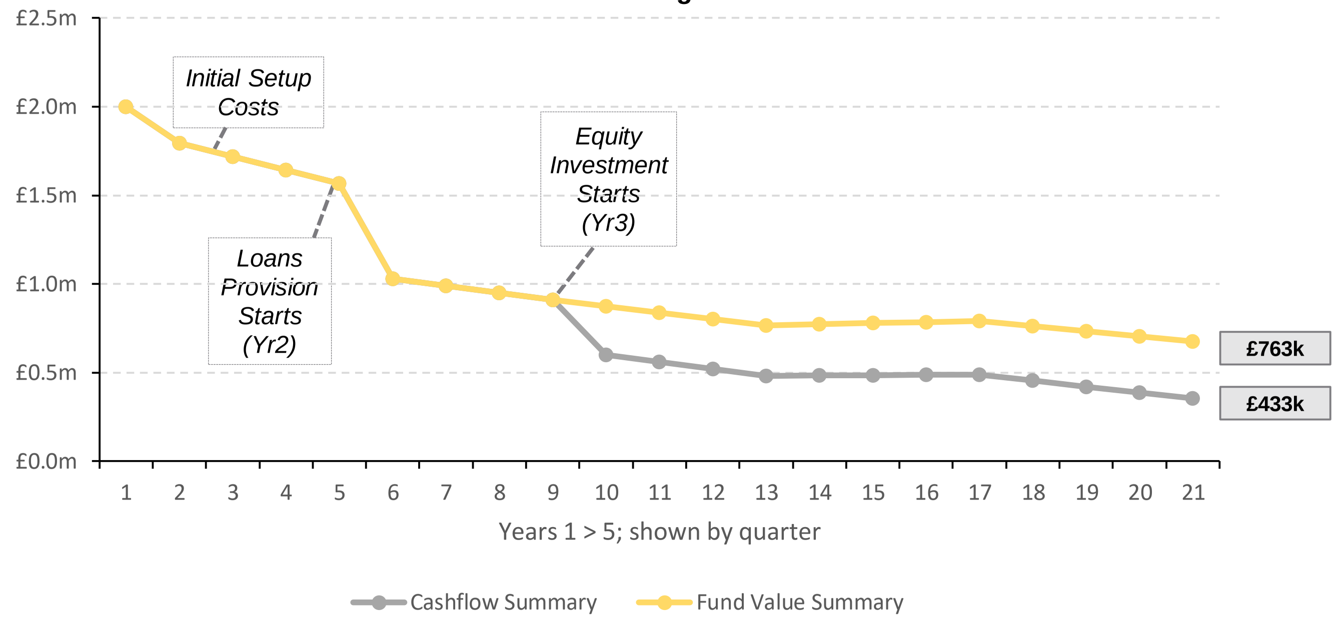
3. Fund Overview (contd.)

What categories of loan terms (interest rate, default terms, re-payment period and holiday period) and equity/quasi-equity investments would be appropriate to achieve the primary aim of the Fund?

The following table employs the setup and operational data (shown within Appendix A), and employs a series of assumptions provided on the Grant, Loan and Equity provision to forecast the fund position across the first five years of its existence;

Starting Cash Position	**£2,000,000**
Total Outflows (Years 1-5)	
Setup & Operational Costs (Appendix A) *	-£350,000
Business Support Costs	-£500,000
Grants Provided	-£380,000
Loans Granted	-£500,000
Equity Invested	-£270,000
Total Outflows (Years 1-5)	**-£2,000,000**
Total Inflows (Years 1-5)	**£433,240**
Cash Position (As at Year 5)	**£433,240**
Value of Equity Held (As at Year 5)	£330,288
Value of Fund (As at Year 5)	**£763,528**

Fig. 6 Five Year Fund Cash Flow and Fund Value



Observations

- Anticipated 'Setup and Operational Costs' of £430k across the 5 years reduce the £1.5m originally anticipated to be dedicated to Grants, Loans and Equity investment
- Should Equity investment begin in Year 3, the liquidity of the fund is reduced. This could impact the ability of the Fund to provide loans at shorter notice.
- Business Support costs represent 25% of Fund expenditure; balance to be struck between ensuring value for money, and increasing each business' likelihood of being successful through the Business Support function.
- ***Set-up & Operational Costs (Appendix A):*** *set-up and operational costs included represent set-up costs at the lower range for the fund, as illustrated in Appendix A. Depending on the complexity of the fund, set-up and operational costs could be as high as £1.22m over the five-year period.*

Southwark Pioneers Fund – Technical Analysis

4. Equity & Loan Terms

What categories of loan terms (interest rate, default terms, re-payment period and holiday period) and equity/quasi-equity investments would be appropriate to achieve the primary aim of the Fund?

Prior to considering terms it seems critical to evaluate the differences between the three different funding mechanisms, the legal documents employed when injecting finance and being cognisant of the role that the Fund will need to play depending on whether grant, loan or equity is chosen.

Mechanism	Comment / Detail	Grant	Loan	Equity
Primary Driver for Choice of Mechanism	*Social Funder, Lender, Angel Investor*	No financial return expected. Could enforce outcomes reporting.	Debt financing focussed on generating interest returns.	Fund wishes to take an investor relationship. The Fund may wish to play an 'active shareholder' relationship; having a role in strategy and planning.
Key Financing Document	*Legal Document for Funding*	Grant Agreement	Term Sheet	Share Agreement
Proposed Allocation Band	*Increasing loan values should increase due diligence, and credit score of applicant*	£0 > £5k *To benchmark this proposed value; 1 FTE paid a full year at London Living Wage cost is £19k.*	£50 – 100k *In an example of a £1m loan fund; utilising this range a maximum of 20 businesses could be supported (£1m / £50k). £50k would equal 2.5 FTE's.*	£75 – 150k *IN an example of a £1m equity fund it should be noted that a maximum of 14 businesses could be supported (£1m / £75k). £50k would equal c. 4 FTE's.*
Allocation Ceiling	*Expected allocation of funding*	£500k	£1m; likely at least £500k will be earmarked for loans	
Level of Financial Return	*Observations on the different range of financial returns.*	£0 Financial Return	Financial return limited by interest rate	Wider financial return range; depending on business valuation, and any dividend arrangements. Dividends typically unlikely in first 3-5 years, as business seeks to reinvest profits toward growth.
Realisation of Financial Return	*Consideration towards the complexity of the Council deriving a return from the fund*	n/a	**Low Complexity; low risk mechanism with returns that are time-bound.** Credit status of applicants is particularly key.	**High Complexity, investment viewed as longer-term and financial return dependant on a wider range of factors, such as;** - The business being successful / gaining market share - An agreed valuation point for the business at the time of sale, in order to value shares - A market or individual operating with the appetite to purchase shares for this business, or appetite for buy back of shares by the business itself.

Southwark Pioneers Fund – Technical Analysis
4. Equity & Loan Terms (contd.)

What categories of loan terms (interest rate, default terms, re-payment period and holiday period) and equity/quasi-equity investments would be appropriate to achieve the primary aim of the Fund (contd.)?

Funding Mechanism	Comment / Detail	Grant	Loan	Equity
Costs Associated with Realising Gain	*Social Funder, Lender, Angel Investor*	n/a	Requires the setup of a loan term sheet, and credit collection agency for escalating and recovering any payments that are not made.	- Increased administrative costs for share sales . - Arrangements for Dividends
Restrictions	*Notes on any entity structures that could prohibit investment*	n/a	n/a	If a business is currently setup as a sole trader, a limited company would need to be incorporated to create a share structure that could be owned by the Fund. Providing a CIC is set up as a company limited by shares, it can issue shares to raise capital, including the option of employing multiple share classes. A CIC limited by shares can pay dividends up to a 'dividend cap'.
Note on Valuations	*For equity / share sales a valuation point would need to be agreed*	n/a	n/a	Business valuations is a complex area for the Fund to consider. Noting requirements for readiness above, a valuation would need to be developed for the business – three common models exist; 1. Discounted Cashflow – Forecasting future cashflows for the business 2. Market Approach - Comparable Company Analysis or reviewing precedent transactions 3. Cost Approach – Cost to build or replace This is often technical work where specialist support could be required.

Southwark Pioneers Fund – Technical Analysis
4. Equity & Loan Terms (contd.)

What does this mean when evaluating terms for the various investments?

The authority should ensure the investment allocation framework evaluates the appropriateness of the funding mechanism being requested, alongside the traditional evaluation of business objectives, credit worthiness or payback periods.

A Loan Term Sheet should apply the following considerations :

Typical Term Sheet	Definition	Considerations for the Fund
Annual Interest Rate	*Interest charged on the loan*	A fixed annual interest rate is typically applied based on the outcomes of due diligence. Social Finance usually fixed at a range between 3.5%-6.5%, informed by secured status, however actual interest rates are dependent upon a number of factors including the current Bank of England base rate and factors related to security and level of risks associated with each loan.
Term	*Length of loan*	Range between 2-5 years, typical repayment 3 years (not including payment holiday). Term should be based on cashflow forecasts of the business, and when return on investment begins, rather than Borrower request. Any assessment of an applicant should undertake detailed analysis on their ability to repay. Several ratios are of key interest; *Debt Service Coverage Ratio* – This is the businesses annual net income divided by the repayment; usually a minimum of 1.1 *Interest Coverage Ratio* – If existing margin is lower than the interest repaid on an existing loan this would be a key flag on ability to repay, unless a significant jump in margin can be shown.
Secured / Non-secured	*If loan is secured against an asset; in the event of default the fund would have first obligation to the asset. An asset could be equipment, facilities, products or equity.*	Typically Social Finance does not secure against assets. However not all loans are to entities with a social purpose; would evaluate securing a loan, where purpose is; - Purchase equipment - Purchase products with proven risk of resale - Business turnover to loan value ratio low (less than 3 to 1) - Business less than 6 months old
Flexibility	*A payment holiday is often appropriate for Social Financing.* *Early repayment fees are rarely charged with Social Finance.*	A payment holiday should be offered of between 3 and 6 months dependent on; - Loan Purpose; if for recruitment of staff 3 months could be appropriate - A given loan threshold being requested - Payback period is excessively long Early repayment fees should not be charged.
Standby Facilities	*An additional facility can be provided to give additional facility headroom. Often a charge is applied if not used.*	If employed typical standby facilities are 2% non utilisation fee charged pro-rata for undrawn facility.

Southwark Pioneers Fund – Technical Analysis

4. Equity & Loan Terms (contd.)

Typical Term Sheet	Definition	Considerations for the Fund
Fees	*Typical loan fees are;* *Up front arrangement fee usually to cover legal fees (payable up front)* *Total loan drawdown fee (payable across the length of the loan term)*	Up front fees should be charged based on recovery of legal costs associated with the term sheet (Typically £500). Typical total loan drawdown fees are 0.5% to 1%.
Warrants	*This is a right to buy company shares at a fixed price in the future.* *This could include a debt for equity swap.*	Can be applied when loaning to a commercial organisation; worth consideration for SPF if a high-growth firm.
Covenants	*Covenants can be positive or negative.* *Positive covenants include sharing financial statements, or meeting local regulations.* *Negative covenants stop particular activities. Incurring new debt for example.*	SPF should seek to build a standard set of covenants that reflect the purpose of the loan, whilst protecting their loan principle in the future. For example, does SPF view repayment should be prioritised ahead of other creditors? Does the Council expect to be consulted in the event the business wishes to take on further debt? Covenants should be considered for changes in financing, equity, leadership and potentially major strategic changes. As noted on slide 5; covenants are a key area to drive Social Value principles; whilst punitive a Social Financier could request immediate repayment of a loan is a Social Value is not achieved or reporting of Social Value is missed for example.
Events of Default	*The activities that allow a lender to suspend, terminate or recall a loan. For example non-payment.*	In the event of default SPF should ensure their rights, as likely the only major source of finance, are prioritised. As a lender with social motives however, consideration should be given to whether creating prioritised repayment over other local creditors is appropriate. For a Fund of this nature, it is unlikely that a local authority would expect personal guarantees from Directors for loans, although they may wish for some form of security which may be enforced on a case by case basis.
Material Adverse Change	*Details the escalation and remedial activities when particular events occur.*	SPF should evaluate a series of triggers for this clause, and the subsequent activities that should take place. For example in the event revenue projections are not met, SPF is informed and remedial action taken.

Southwark Pioneers Fund – Technical Analysis

4. Equity & Loan Terms (contd.)

The following terms are relevant for consideration when providing finance for equity;

Typical Equity Terms	Definition	Considerations for the Fund
Share Type and Value	*Term sheet will define a stock type, and specify the number of shares purchased and value per share paid. Stock types include;* • *Common – Single shares.* • *Preferred – Priority over common stock if company is purchases, or liquidated and assets resold.* • *Convertible – A loan that can be converted into shares at a given time in the future.*	Early investors in start-up entities typically insist on preferred stock which should be the default option for SPF. Considerations on the level of equity sought by SPF should be based on a range of financial, strategic and economic factors. Primary considerations include: - Sector and market company operates within - Growth rate to date of company - Investment risk - Payback period *Typical equity expectations range from 5-40% based on revenue, pre and post money valuations and risk.*
Anti-dilution rights	*An event where further shares are created, usually at a lower valuation.*	SPF should seek to protect themselves against anti-dilution through either; leading involvement in the decision on issuance of new shares or ensuring they are able to participate in further rounds.
Participation Rights	*Permission to participate in future financing rounds, usually at current share ratios*	SPF should ensure they are able to participate in future financing rounds; if for example they have a 25% equity stake in the business, 25% of any future shares should be available for purchase by SPF.
Right of refusal and co-sale	*Clauses to provide a first option to buy shares where investors wish to sell.*	In the event there are multiple investors in the existing business, SPF should ensure they have a right of refusal if other investors wish to sell.
Dividends	*Decisions on dividend payouts are made by the Company's Directors. They maintain trust between the business and investors, there is no obligation by management to pay.*	SPF should clarify with management the likely dividend policy and target timeframes alongside expectations regarding reinvestment of profits.
Board Structure	*Social Financers often request a seat at the Board of the Company / Enterprise, offering additional support in the objectives of the finance and assurance on company strategy.*	SPF should evaluate where they can play an active role as a Board member. This should be where they see the entity playing a key societal role, or where the use of the entity is to drive
Liquidation Rights	*The ownership of Shares entitle an investor to partial ownership of assets.*	In the event of purchase, bankruptcy or sale SPF should ensure their rights as a Shareholder are prioritised. As a lender with social motives however, consideration should be given to forcing prioritisation over creditors or banks based locally.

Southwark Pioneers Fund – Technical Analysis
5. Set up and operational costs

There are a range of factors that determine potential set up and operational costs. Consideration is applied to initial set up requirements along with options for on-going and operational matters.

Set Up

A primary phase of set up would need to consider the following tasks:

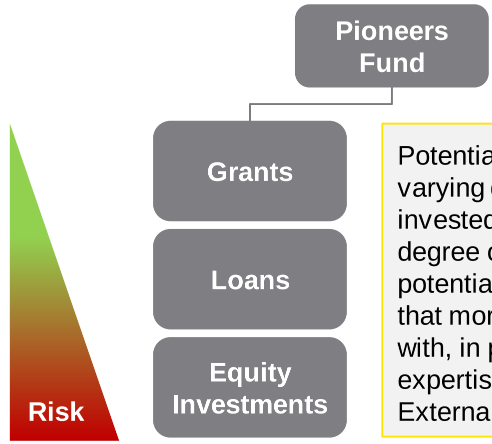
- The establishment of a robust **Fund Strategy**, providing clarity of purpose and proposed means through which objectives will be achieved.
- The development of comprehensive **appraisal frameworks** that allow the Fund to effectively scrutinise proposals to support decision making.
- The development of an appropriate **marketing strategy** which incentivises SME's to apply for funding. The strategy must achieve a match between what SME's want or need and what the Council is willing to provide from the Fund.
- The development of an appropriate **performance reporting framework**, focused on risk, social value, return and outcomes.
- Drafting of required **legal documentation**, including loan or grant agreements and potential terms of reference.
- **Administrative tasks**, including the setting up of a bank account and associated processes.

Operational

Operational and on-going tasks will depend on the proposed support model being considered. As a minimum, the following tasks are required:

- **Review of proposed investments** for grant, loan or equity funding, ensuring suitability, compliance and risk.
- **Administration of proposed investments**, including communication and progression with proposed fundees. Investments can be sourced proactively or via an application process. Ongoing administration of the fund assumes self-sufficiency through online administrative tools.
- **Portfolio monitoring and reporting**, providing clarity to stakeholders on risk, social value, return and outcomes.
- **Value Gateways –** As the fund reaches various portfolio milestones; £250k, £500k it would be appropriate to evaluate the overall credit risk and whether bandings or loan terms should be revisited.

The means through which the Council ensures effective capability to review and scrutinise potential funding should be determined on a risk basis:



Potential application of the Fund will bring varying degrees of risk to the capital invested. Whilst in principle, the greater the degree of risk, the greater the degree of potential return, the Council should recognise that more complex investments associated with, in particular, equity, would require expertise unlikely to be available in house. External capability may be required.

Business Support

We understand that the Council is keen to establish the provision of business support to successful applicants to the Fund. This should be aimed at enhancing the degree to which the Fund achieves its broader social value and financial objectives but should also acknowledge that some businesses may just desire advice rather than financial support.

It is recommended that the Council aims to commission external capability for the provision of such advice. However, it is further recommended that the Council aims to ensure the external provider provides support an in integrated manner with the Council's core services, potentially founded on a hub and spoke type model.

The costs incurred in the set up and operational phase of the Fund are dependent on whether the Council pursues a Loan and Equity or just a Loan model. They are also impacted by the Council's risk appetite and desired level of in-house versus external support. In appendix A we have provided a breakdown of estimated setup costs, with one-off costs ranging from £170-£260k (9% - 13% of total fund value), and £100k to £200k of ongoing costs (5% - 10% of total fund value). Further clarity should be sort as the Council enhances the proposed details of the initiative. Overall, it is important to note that at least 17.5% of the total fund value (for either/or a loans or grant fund) is expected to be utilised on both set-up and operational costs.

Southwark Pioneers Fund – Technical Analysis

6. Social Return

The Fund aims to provide a wide array of benefits to the wider community of Southwark beyond just generating a financial return for the Council.

There are two primary mechanisms through which the Council can drive improved social value and social return from the Fund. Firstly through building an allocation framework which properly evaluates the business social value credentials. Secondly through embedding social return within key aspects of the funding agreements, ensuring the Council is moving toward an operating model and fund strategy that is closer aligned to a social financer than corporate lender.

The steps to create an effective fund allocation framework that properly embeds social value are shown below;

Identify Strategic Outcome → **Identify Social Value Principle** → **Social Value Outcome / Commitment** → **Social Value Measure** → **Weight each Measure** → **Assessment**

Over the subsequent two pages, social value principles are explored, alongside key social value measures that the Council should include within the development of its allocation framework, ensuring that organisations contributing to wider social and public goals are positively scored.

How can the Fund display the attributes of a Social Lender?

Within the Payment Terms (Q3) a number of references are made to aspects of the Loan or Equity terms where the Council may wish to demonstrate increased flexibility than that of a Corporate Lender, examples include;

Payment Holidays – Generous Payment Holidays are often employed by Social Finance, Bridge Ventures and others in the, facilitating space for the business to drive ROI.

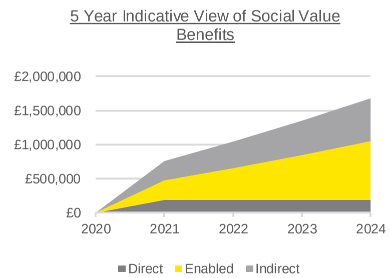
Interest Rates – Lenders seeking to drive social outcomes often lend at interest rates more favourable than the market, noting the state aid risk (Q7).

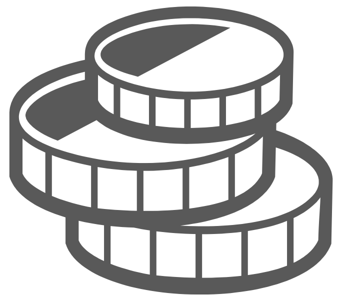
Creditor Funds – Social investors will recognise that the risk of business failure to the wider public and private sector is high, likely driving different liquidation rights.

Share buyback – For equity schemes Social Lenders will provide more avenues for the business to buyback shares.

Business Support – The fund is proposing a significant level of business support to advise businesses how to scale.

Social Value View – Indicative View on 5 Year Benefits of the Fund





£4.6m of economic benefits

56 new jobs supported

£400k in additional business rates

**A detailed breakdown of the assumptions employed are shown within Appendix B*

Southwark Pioneers Fund – Technical Analysis
6. Social Return (cont.)

The Fund aims to provide a wide array of benefits to the wider community of Southwark beyond just generating a financial return for the Council.

Primarily, an assessment of social value should be made against the Council's proposed objectives for the Fund. Furthermore, it is recommend that analysis of social value does not necessarily need to be monetised to aid decision making and monitor performance. Rather, a robust assessment of a number of key performance indicators, linked to outcomes, should be established to track the broader social value of the fund. These can be weighted according to Council priorities if required. A number of suggestions are provided below:

Social Value Principle	Potential Value Measures	Potential Fund Value
Diversity of business entrepreneurs	▸ Diversity (across a range of measures) of business entrepreneurs in Southwark; informed by the ongoing Equality Impact Assessment.	An assessment should be undertaken as to where diversity shortfalls exist within the entrepreneurs operating within the borough. Investment and associated support can then be targeted towards improving diversity in these areas.
Creation of quality employment	▸ No. of local people employed for whole year ▸ No. of employees taken on who are rehabilitating offenders ▸ No. of jobs created for people with disabilities ▸ Number of vacancies and subsequent jobs for residents of Southwark ▸ Jobs adhering to the Living Wage ▸ Qualitative collection of job satisfaction feedback from employees	The Fund should aim to increase vacancies and subsequent jobs for within the businesses supported. This should include ensuring that employers adhere to Living Wage obligations. The Fund should also aim to improve job satisfaction amongst employees of business supported.
Increase the skills and capabilities of Southwark residents	▸ Number of qualifications or qualification equivalents ▸ Number of apprenticeships or Youth Contracts started and completed ▸ Local Schools and college visits ▸ Utilisation of Training Hubs or Centres of Excellence within Southwark / Southwark based providers ▸ Operate in innovative or growth sectors within the Borough	The Fund should seek to ensure value measures are embedded into the framework that are evidenced by gaps from a labour market intelligence survey.
Improve business resilience across the Borough	▸ Business survival rate of businesses supported ▸ Total amount spent by business on Southwark supply chain ▸ Number of voluntary hours donated to support Southwark enterprises	The Fund should assess business survival of businesses supported, aiming to ensure it trends above the geographic sector average.
Attract inward investment to the business and Borough	▸ Subsequent investment in business achieved ▸ Inward investment strategy ▸ Engagement with key Local Economic Partners; GLA, London Councils, RTI	An assessment should be made of subsequent investment from external parties to the businesses.

Southwark Pioneers Fund – Technical Analysis
6. Social Return (cont.)

The Fund aims to provide a wide array of benefits to the wider community of Southwark beyond just generating a financial return for the Council. (cont'd)

Social Value Principle	Approaches to scoring value	Potential Fund Value
Increase business connectivity	► Collaborative knowledge sharing sessions held	The Council should measure attendance at collaborative knowledge sharing sessions held between entrepreneurs and associated providers and Council officers.
Impacts on wider Public Sector costs	► Number of employees recruited from complex or sub-optimal backgrounds, such as those who missed education, or offenders. ► % of people taken on who are long-term unemployed ► No of employees taken on who are not in employment, education or training (NEETs)	For effective measurement of Social Value, early identification of these measures and reporting them through the monthly governance route will be key to added value.
Contributing toward a clean, positive environment	► Signatory operates a Carbon Credits or notional carbon credits regime ► Involvement in carbon monitoring / commitment ► Promote a cycle to work or relief travel scheme ► Voluntary time dedicated to support of green spaces	The Council must drive business behaviour toward the environment through the funding agreements provided. Early expectations and measures will ensure any applicant can be confident they can deliver against requirements.
Broader Social Impact	► Positive impact on health and wellbeing; for example through providing a forum for isolated people to socialise or encouraging healthy lifestyle.	The framework could promote investment through its framework weighting in initiatives to engage people in health interventions (e.g. smoking, obesity, alcohol) or stronger community investments through weighting entities operating in this area.

EY's Societal Return on Investment methodology helps to appraise the social value of initiatives. This identifies that an assessment should be made of:

- Direct financial return
- Economic impact – including increase in economic output and tax revenues
- Social and personal return – including improved wellbeing, job satisfaction

Southwark Pioneers Fund – Technical Analysis

7. Loan Defaults

The viability of a repayment or interesting bearing loan portfolio within the Fund would need to consider potential default rates.

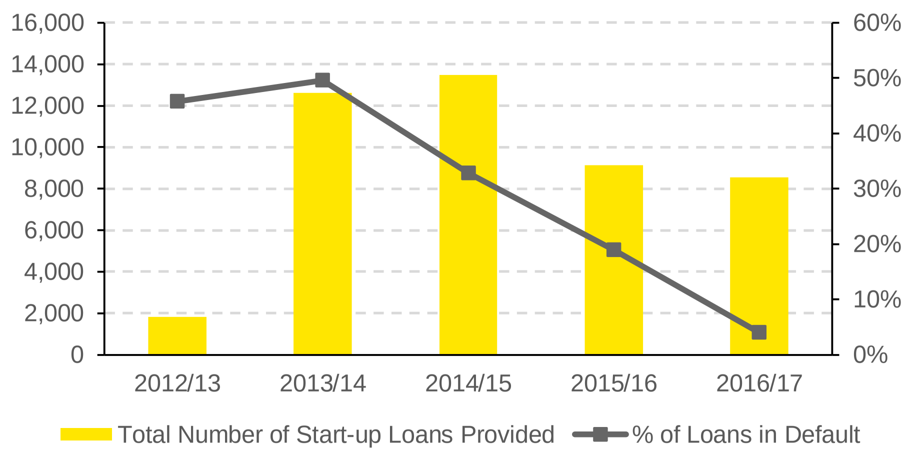
Loan default rates are driven by a number of factors, including business performance, macro-economic conditions and the type and security of loan in question.

The array of factors which can contribute to a default rate mean that it is difficult to assess with clarity as to what an expected default rate would be. However analysis has been undertaken of the default rate of the Start Up Loan initiative, a Government backed initiative with a similar proposed objective to the Fund.

The analysis (Fig. 7) indicates that over a five year period (2012 to 2017), the default rate ranged from 4% to 50%. It is assumed that the improved default rate over recent years has emerged through an enhanced process of scrutiny towards the suitability of applicants.

Fig. 7 Start Up Loans; Number of Loans and Associated Default Rate

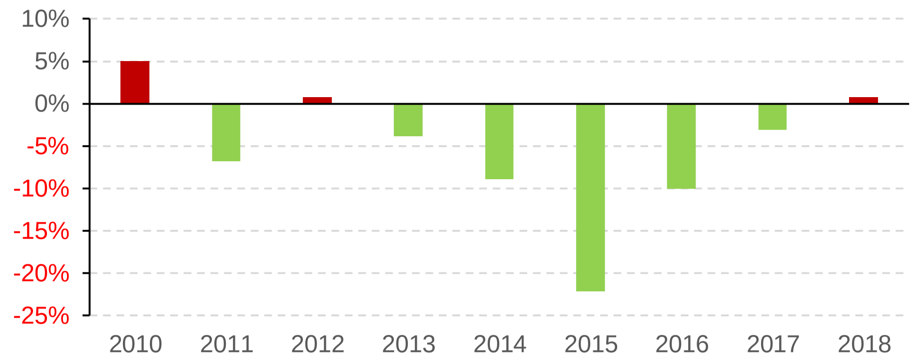
Source: Business Advice



At a macro level, an assessment of the trend of loan default rates indicates worsening performance for small business across the UK. Likely driven by uncertainty and difficult trading conditions, the change in default rate turned negative in 2018 following a trend towards that since 2015 (Fig. 8)

Fig. 8 Average Change in 3 Month Loan Default Rate; Small Businesses

Source: BoE Corporate Lending 2018



The Council's assumed potential loan default of 20% is considered reasonable. However, the following areas of focus should be applied to the Council to minimise default risk:

- No particular types of commercial enterprise are likely to default more than others. However, enterprises with no credit history and less robust cash and revenue streams are more likely to default.
- A robust credit assessment of applicants can help to identify those who are deemed more likely to default.
- The Fund can achieve security through securing debt against applicant's assets, or via personal guarantees; although due consideration should be made towards the degree to which this aligns with the Fund's social objectives.
- The Council should assess default risk at a portfolio level, adjusting risk appetite in response to default rates and macro-economic conditions.

Southwark Pioneers Fund – Technical Analysis

8. Decision Making and Regulations

There are a number of options available to the Council with regards to hosting or structuring the Fund. None of these necessarily remove decision making authority from the Council.

The Council may wish to establish a dedicated fund vehicle to host the Fund. This is the recommended approach, allowing a clear distinction of responsibilities between the Fund and the Council, and reducing the likelihood of conflicts of interest or strategic duplication.

This would likely be in the form of a company limited by shares or a limited liability partnership. Neither of these arrangements would require the Council to cede decision-making powers, although this will depend on the governance arrangements established between both parties. There are a number of potential commercial benefits that may be derived through establishing a separate vehicle to host the Fund.

The Council may also opt to establish a funding framework thereby setting aside capital within its own organisational boundaries. This is likely to be the most cost effective option and also ensures the retention of decision making authority with the Council. However, speed of decision making may be impacted and will be dependent on the Council's internal governance procedures.

The Council will need to have due consideration to the following financial regulations with respect to the proposed initiative:

- The Local Government Act (LGA) 2003 provides Local Authorities with the power to invest for any purpose relevant to its functions, or for the purposes of the prudent management of its finances.
- Section 1 of the Localism Act 2011 (The General Power of Competence) enables a Local Authority to make loans under this Act. This power is not relied upon as a specific power to invest but rather to supplement Section 12 of the LGA 2003.
- Public bodies are advised to have regard to the credit ratings issues by all three main agencies (Fitch Ratings, Moody's, & Standard & Poor's Ratings Services) and to make their lending decisions based on their ratings. Ratings should be kept under review and 'review watch' notices acted upon.
- The CIPFA Code of Practice on Treasury Management is clear that organisations should not rely solely on credit ratings when determining where to invest and that they should make use of generally available market information, such as the quality financial press, market data and information on government support for banks.
- The Council will need to be mindful of unfamiliar regulations were they to consider more innovative corporate structures, such as company accounts requirements.

Southwark Pioneers Fund – Technical Analysis
Appendix A: Set Up and Operational Cost Breakdown

Estimated proposed costs are provided for elements of the required set up and operational tasks. These proposed costs are indicative and should be seen as a guidance for the Council to begin to consider budgeting requirements. The quantum of cost will be heavily dependent on a number of variables which are as yet unknown.

Activity	Proposed Indicative Cost (estimated)	Comment	Cost impact of running Loan vs. Equity Fund
Fund Strategy Development	£30k	One off set up cost (One-off set up cost expected to be delivered in-house)	Same cost anticipated
Appraisal Framework Development	£30k	One off set up cost (One-off set up cost expected to be delivered in-house)	Same cost anticipated
Marketing Strategy Development	£20k	One off set up cost – depends on the scale of proposed marketing strategy (One-off set-up cost expected to be delivered in-house)	Same cost anticipated
Reporting Framework Development	£20k - £60k	One off set up cost - dependent on complexity and breadth of proposed monitoring and reporting	At lower range for Loan only, higher range for Equity & Loan
Legal Documentation Drafting	£20k - £40k	One off set up cost. The inclusion of potential equity investments will be a driver to this cost	At lower range for Loan only, higher range for Equity & Loan
Administrative Set Up	£10k - £40k	One off set up cost – should this include potential online presence and/or portal for the fund, this will be a driver to this cost	At lower range for Loan only, higher range for Equity & Loan
Investment Review	£20k - £90k	Annual operation cost – dependent on number and complexity of potential investments	At lower range for Loan only, higher range for Equity & Loan
Investment Administration	£20k – £60k	Annual operation cost – dependent on number and type of investments	At lower range for Loan only, higher range for Equity & Loan
Portfolio Monitoring and Reporting	£20k - £50k	Annual operation cost – dependent on complexity and breadth of proposed monitoring and reporting	At lower range for Loan only, higher range for Equity & Loan

One off fees total £130k at lower range, and £220k at upper range. Ongoing fees total £60k at lower range, £200k at upper range.

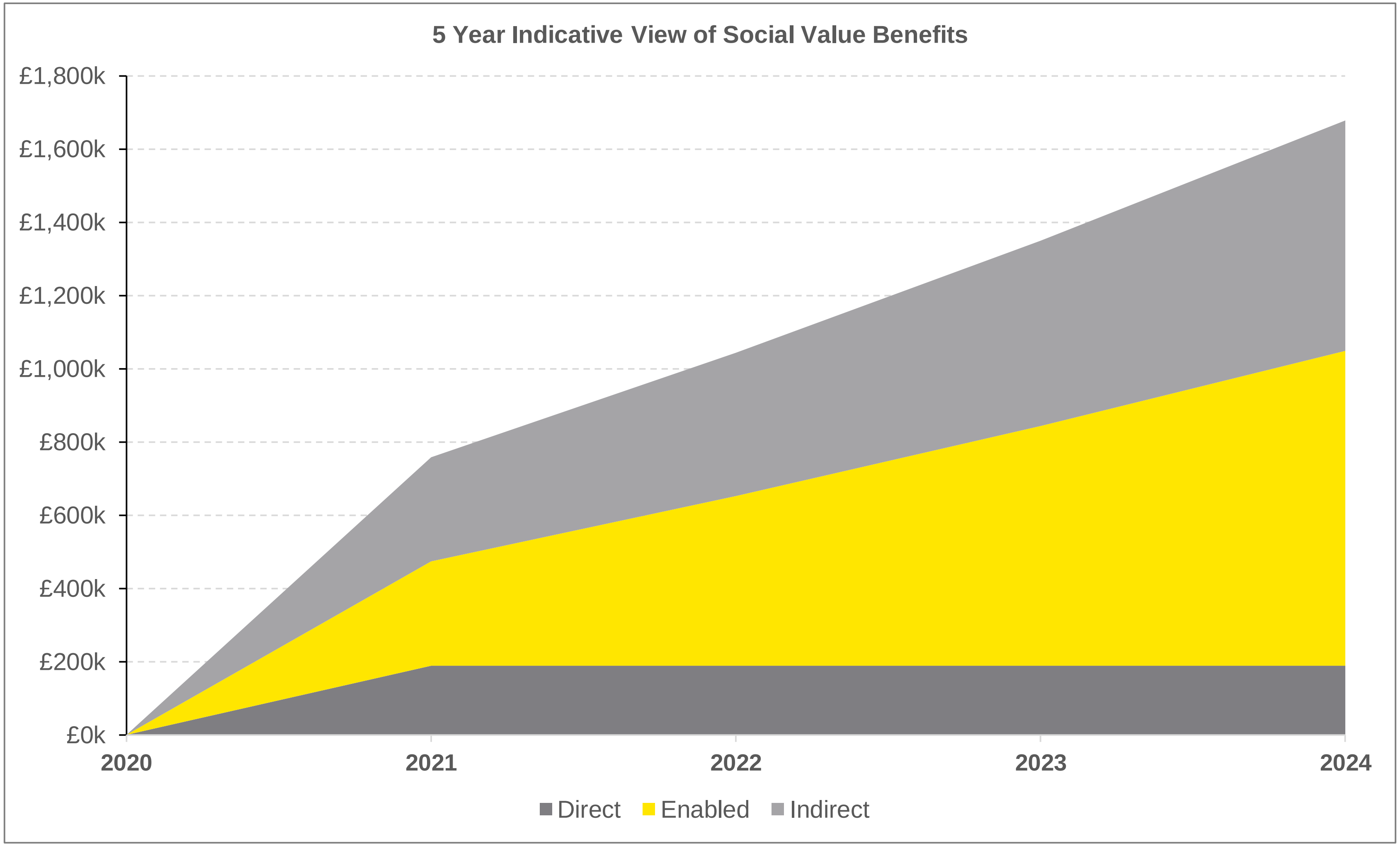
Southwark Pioneers Fund – Technical Analysis
Appendix B: Social Value Estimates

The key assumptions for the indicative view of Social Value benefits are listed below;

Assumption	Proposed Indicative Cost (estimated)	Comment
London Living Wage for all new employees	£19,890	It is assumed for the purpose of this analysis that all new employees are paid, on average, the London Living Wage
Multiplier Effect	1.6	It is assumed for this analysis that the impact of an additional £1 spent on employment from the Fund will result in additional economic impacts of 60p due to new workers also becoming consumers and therefore contributing further to the local economy.
Proportion of Fund money spent on staff wages	66.66%	It is assumed that two thirds of all fund grants, loans or equity is utilised to increase headcount within micro-businesses. This will be heavily dependant on the sector the business operates within, and the Funds final allocation framework which could for example prioritise job creation.
Annual growth rate of firms that 'scale'	20%	This is in-keeping with the Council's assumptions.
Annual growth rate of firms that are 'stable'	5%	This is in-keeping with the Council's assumptions.
Proportion of firms that 'scale'	20%	This is in-keeping with the Council's assumptions.
Proportion of firms that are 'stable'	60%	This is in-keeping with the Council's assumptions.
Proportion of firms that become insolvent	20%	This is in-keeping with the Council's assumptions.

Southwark Pioneers Fund – Technical Analysis
Appendix B: Social Value Estimates (cont.)

The graph below shows the estimates of Social Value benefits delivered by year and split between Direct, Enabled and Indirect benefits. Direct benefits are those attributable directly to Fund money – where Fund money itself is providing increased economic activity. Enabled benefits are the benefits assumed to be achieved by the growth of firms receiving Fund money. Indirect benefits are wider economic benefits achieved through positive externalities of greater economic activity both directly and indirectly coming from the Fund.



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