

London European Structural Investment Funds (ESIF) Committee

Date of meeting: **20 July 2017**

Title of report: **Financial Instrument Update – Mayor’s Energy Efficiency Fund and the London SME Fund**

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Classification: **Public**

1 Executive Summary

- 1.1 This paper provides members with an update on the work being done to establish two new funds: one focusing on low carbon and the other on SMEs.

2 Recommendation

- 2.1 That members note the progress being made to set up two new funds for the 2014-20 programme.

3 Introduction and Background

- 3.1 The Committee will recall that £75m ERDF was allocated for deployment via financial instruments (FIs). This will enable equity and loan finance to be provided for low carbon infrastructure projects as well as SMEs seeking to growth their businesses. Over the past few months, EPMU have been working closely with match funders such as European Investment Bank and London Waste and Recycling Board to clarify the focus and agree the delivery structure of the two FIs that will be established. The EC guidance sets out two routes for selecting an organisation to establish and manage a FI: procurement or direct appointment. This report outlines the focus of the two FIs and the route being used for their establishment.

4 Issues for Consideration

Mayor of London's Energy Efficiency Fund (MEEF)

- 4.1 The procurement exercise for MEEF was launched in November 2016 with the publication of a notice in the Official Journal of the European Union (OJEU). This invited bids for establishing MEEF and managing the capital (ERDF and other resources) committed to it. MEEF will help to address market failures and achieve London's low carbon strategic ambition of 60% reduction in CO₂ emissions by 2025. MEEF will provide loans and equity finance for projects valuing at least £400m, which involve:
- building retrofit and energy efficiency measures in public, commercial and residential properties;
 - production and distribution of low carbon energy, including combined heat and power, tri-generation and communal / district heating generation and/or networks; and
 - small scale renewable energy generation.
- 4.2 The procurement exercise is being carried out using the competitive dialogue procedure, which can be seen as having three main stages. Firstly, bidders were required to complete and submit a selection questionnaire (SQ). Four organisations initially submitted SQs but one later withdrew. The SQs were evaluated by officers within the GLA as well as by people outside the GLA who have knowledge and experience of the development and implementation of such funds.
- 4.3 All three organisations were invited to go to the next stage of the process, which was the submission of a detailed solution of how they would meet the requirements outlined in the procurement documents. The detailed solutions were also assessed by GLA and external officers and 'dialogue meetings' were held between the GLA and the bidders to clarify any matters arising. Following the dialogue meetings all three bidders were then invited to submit final tenders; one bidder subsequently decided to withdraw.
- 4.4 Final tenders were received at the start of June 2017 from the two remaining bidders and these are currently being assessed in relation to three main areas: technical detail, price, and commercial/legal terms. The expectation is that a preferred bidder will be selected in July.
- 4.5 Once a preferred bidder is selected, this will allow us to seek relevant approvals, including for strategic fit from this Committee; and agreement from the Mayor to commit the £43m ERDF. This will also allow the European Investment Bank (EIB) to finalise their due diligence process before seeking sign-off for their £100m commitment from their management committee. It is anticipated that MEEF will be established in autumn.

London SME Fund

- 4.6 Since the last update, the GLA has received legal advice as to whether an organisation established by the-then London Development Agency (LDA) – SME Wholesale Finance London Ltd (SMEWFL, trading as Funding London) – can be used to establish the SMEs fund of funds, as set out in *ex ante*

assessments. SMEWFL has a good track record of establishing and implementing these type of funds, having carried out this role during the previous two ERDF programming periods. Also, using SMEWFL as the fund of funds manager would allow returns from the previous ERDF-sponsored funds to be recycled into this new fund.

- 4.7 Directly appointing an organisation to act as SME ‘fund of funds’ manager is the general approach that has been taken by the Managing Authority (MA). For example, they have appointed the British Business Bank as fund of funds manager for two SME funds that cover the Midlands and the north of England.
- 4.8 SMEWFL’s current structure dates back to its origins when it was established by the LDA. We are now bringing the structure up to date, fully within GLA’s control, informed by recent legal and financial due diligence reports. The mechanism for ensuring this control is for the GLA, as an existing member, to become SMEWFL’s sole member. To this end, in May 2017, the Mayor agreed to the acquisition of SMEWFL by the GLA becoming the sole member.
- 4.9 SMEWFL is now working on a business plan for the development of a £100m fund of funds taking account of the recommendations from the *ex ante* assessment done by Regeneris and EIB, and further work done by PwC on circular economy businesses. The work is also being informed by the recently British Business Bank report on Small Business Finance Markets. The report highlighted continued structural problems with the supply of finance: higher rejection rates for bank loans for younger, small businesses and for those looking to scale-up; and evidence of a later stage venture capital funding gap, which is holding back growth companies from scaling-up.
- 4.10 The overarching strategy of the new fund of funds will be to focus¹ on providing financing solutions for innovative SMEs to allow them to scale-up and achieve their growth ambitions. Businesses that are seeking to scale-up can play a key role in supporting economic growth and job creation. The table below sets out the sub-funds to be established.

Proposed Sub-Funds	Size	Investment Range	Brief Description
Venture Fund, including funding for Circular Economy (CE). (pre-Series A to series A)	£45m (with £14m ring-fenced for CE)	£100K to £2m	This fund will focus on the sectors of strategic importance to the London economy, including support for early stage SMEs in the circular economy.
Debt/Loan Fund	£25m	£100K to £500K	This fund will provide loans to enterprises seeking debt facilities to

¹ Support can also be provided to those SMEs aiming for long-term sustainability.

(Small Loans Focus)			expand their business.
Mezzanine Fund (Larger Loans Focus)	£25m	£500K to £1m	This will provide loans to enterprises seeking debt facilities to expand their business with larger funding requirements.
Microloan Fund	£5m	£10K to £1000K	This will focus on microenterprises, providing loans for new, young or established enterprises.

4.11 Once the business plan is completed, SMEWFL will submit this to GLA for assessment in line the MA's criteria. This will then allow us to seek relevant approvals, including for strategic fit from this Committee. As part of the approval to acquire SMEWFL, the Mayor also agreed to the commitment of the £32m ERDF but this is subject to assessment of the business plan and agreement on strategic fit. The London Waste and Recycling Board, which is providing £7m towards this fund, will also seek to sign off the business plan at the same time.

4.12 After an ERDF agreement is issued, SMEWFL can then carry out an OJEU procurement exercise to select managers to set up and manage the sub-funds outlined in the table above. As with MEEF, EIB will finalise their due diligence process - for their £50m commitment - once the fund managers are selected, before seeking sign-off from their management committee. Taking account of the time to procure the managers it is anticipated that the sub-funds will not be established until Spring 2018.

5 Equality comments

5.1 The ERDF Operational Programme sets out the requirements for ensuring adherence to a mandatory equality 'cross-cutting' theme. ERDF will promote equality in accordance with European Union and national requirements. The 2010 Equality Act provides the framework to effectively tackle disadvantage and discrimination. The Public-Sector Equality Duty applies in the delivery of ERDF and means that delivery of the Operational Programme at local level, including in London, must consider the needs of all individuals and have due regard to the need to eliminate discrimination, advance equality of opportunity, and foster good relations between different people. Where a project has a particular objective to work with people with specific protected characteristics, this will be inherent in the project application.

6 Risks arising / mitigation

6.1 The long-term effect of the vote to leave the EU in relation to the ERDF programme is as yet unknown. This paper is drafted on the basis that contractual arrangements can continue to be entered into (and matched by the

EIB) until the point of Brexit, as per the Chancellor's announcement on 3rd October 2016.

7 Financial comments of the Executive Director Resources

- 7.1 Following its acquisition by the GLA, SMEWFL will be consolidated within the GLA's group accounts. The fund of funds will be a significant step change in SMEWFL investment activity and GLA approval will be required for the EIB loan and the supporting business plan.

Appendices:

None