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Lending to the Social Enterprise Sector

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Foreword

As Minister for Small Business and Enterprise, I am delighted to introduce this report illustrating some of the ways in which banks and community development finance institutions have provided loan finance to the social enterprise sector.

Supporting and promoting social enterprise is a key part of delivering the DTI's aim of 'prosperity for all' and the Small Business Service's objectives of: building an enterprise culture; improving access to finance for small businesses; and encouraging more enterprise in disadvantaged communities and under-represented groups. The Government believes that social enterprises can make a valuable contribution to the economy, while actively benefiting the communities and wider society in which we all live. Improved access to appropriate forms of finance is crucial to success, at all stages of their development.

Following recommendations made in the Bank of England Review on financing of social enterprises in May 2003 and expert contributions from many of the leading banks, community development finance institutions and charitable trusts and foundations at meetings of the DTI Social Enterprise Unit's Finance and Funding Working Group, we have produced this report containing detailed case studies highlighting different forms of loan finance. We hope this research will help more financial institutions understand the particularities of the social enterprise market and the potential benefits from engaging more with this sector.

I want to take this opportunity to thank all of those who were involved in these workshops and those who contributed case studies to this project; their knowledge and expertise has been critical throughout.

Nigel Griffiths
Parliamentary Under-Secretary of State
for Small Business and Enterprise
Department of Trade and Industry

May 2004

Banking: a superficial overview of a large and complex industry

In order to make the most effective use of bank loans, an enterprise must understand the role that banks play in the general economy, as well have an appreciation of the parameters within which any bank works.

The essential mission of a bank is to serve as a financial intermediary by gathering funds from depositors and redistributing those funds throughout the economy in the form of loans. That economic mission imposes certain responsibilities on both sides of the bank's balance sheet. The deposit function imposes a responsibility for the safekeeping of depositors' funds. The availability of the deposit protection scheme highlights the responsibility by extending the bank's obligation beyond its own depositors to the taxpayer. The credit function imposes the responsibility to invest depositors' funds with prudence and efficiency in order to safeguard the deposits and to achieve maximum economic leverage.

These dual responsibilities lie at the heart of a populist mythology of banking. The common assumption is that banks credit policies are unnecessarily conservative because the bank is out to protect its own money. Without defending the conservatism of any particular bank, it must be recognised that it is not the bank's money or even its shareholders'. It's yours, your neighbour's and your grandmother's.

A second misconception is a derivative of the first, and it pertains to the bank's autonomy in crafting credit policies. The assumption often is that banks are largely free to set their own policies based on market conditions and institutional preference. The truth of the matter is that banking is a highly regulated industry. Credit policies and practices are the subject of intense scrutiny by regulatory agencies.

A third set of factors involves an understanding of risk assessment. This is considerably more complex because it can vary from one bank to another depending on an individual bank's experience. A bank's 'appetite' for certain types of loans or sectors is most often based on its internal capacity and its previous experience. That may be – and often is – consummately unfair to a particular borrower, but it is a fact of economic life that must be acknowledged, if not always respected. It can also depend upon a bank's capacity to handle certain types of loans. This is most often determined by the background, interest and talent of the staff they appoint to undertake the task. Past experience (or lack of same experience) is also a key determinant. Banks will categorically refuse to consider loans to certain types of enterprises if a significant number of loans to such businesses have resulted in loss to the bank.

In short, if banks are conservative – and, of course, they are – it is because: (1) it is not their money; (2) the regulator is watching; and (3) they have been burned before.

But I have never been one to defend the status quo.

This short, sharp study shows that banks are lending to social enterprises. There is demand. It is profitable business. It doesn't require the dilution of credit standards. Nor does it require subsidised interest rates. However it can be a painful process for both sides.

Lessons for social enterprises – understanding the realities of banking and a pragmatic approach will result in better proposals and more confident negotiations. It is also important to bring the bank into the discussion early so that the planning and packaging process can accommodate what the bank will need to make the project fundable.

Lessons for banks – it is quite likely that each of these deals might have been declined after an initial analysis by any bank. This is not due to any particular bias, but simply because the idiosyncratic nature of the sector can require substantial time, interest and expertise, as well as a knowledge of relevant public and philanthropic programmes.

Lessons for the public sector – any step change in bank support for the social enterprise sector will go hand-in-hand with the growth of specialist intermediaries with a mission to make a deal work when conventional approaches seems unworkable.

Andrew Robinson
Chair, DTI Social Enterprise Finance & Funding Working Group

Introduction

In May 2003, *The Financing of Social Enterprises: A Special Report by the Bank of England*, recommended a closer study into bank lending to social enterprises. As a result, the Social Enterprise Unit of the Department of Trade and Industry (DTI) commissioned Shorebank Advisory Services UK to conduct further research. This study uses case studies of specific deals to illustrate some of the factors involved in lending to social enterprises and summarises the key findings revealed by the research.

The Government's definition of a social enterprise is a 'business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or community, rather than being driven by the need to maximise profits for shareholders and owners'*. Social enterprises tackle a wide range of social and environmental issues and operate in all parts of the economy. By using business solutions to achieve public good, the Government believes that social enterprises have a distinct and valuable role to play in a helping create a strong, sustainable and socially inclusive economy.

Currently only very limited information exists about the size of the social enterprise sector in the UK, but there is evidence from ongoing research by DTI and others that interest in social enterprise has increased in recent years, indicating considerable potential for the sector in the future. Initial crude estimates of the overall number of social enterprises suggest that at least 5,300 enterprises in the UK fit the DTI's definition and have a trading income of 50% and above. This suggests a market size that may be of commercial interest to the banking sector, as well as the communities for which the social enterprises exist to benefit.

The purpose of this study is to investigate bank lending to social enterprises and to use case studies to illustrate current practices and promote further lending to social enterprises. This study took place from December 2003 to February 2004 and involved asking both social enterprises and their banks to give examples and details of loans and the decision-making processes that surrounded them. Both high street banks and social banks (those with explicit social missions) were included. Although not a central focus of this study, community development financial institutions (CDFIs) were also contacted and one agreed to take part.

Anyone interested in financing social enterprises will benefit from reading this study, especially bank management, bank relationship managers and loan officers.

Relationship managers and loan officers may find the recommendations section, the key findings and individual case studies summarised in Appendix A to be particularly useful when considering financing for a client who is a social enterprise.

Social enterprises may derive benefit from the key findings and the individual case studies.

* *Social Enterprise: a strategy for success*. For further information: www.dti.gov.uk/socialenterprise
In March 2003 the DTI commissioned ECOTEC Research and Consulting to conduct a research project on Guidance on mapping social enterprise. www.dti.gov.uk/socialenterprise/research.htm

Acknowledgements

We extend our thanks to the following financial institutions for their participation in this study:

- Barclays
- Charity Bank
- Co-operative Bank
- Lloyds TSB
- Local Investment Fund
- NatWest/Royal Bank of Scotland
- Unity Trust Bank.

We would also like to thank the following social enterprises for their involvement:*

- Acme Studios
- Artists Studios Company
- Bramley & Rodley Community Action
- Caxton Trust
- ECT Group
- Energywise
- Genesis Social Enterprise
- Hastings Trust
- The Helepayne Foundation
- Ruralnet UK
- Ibstock Community Enterprise
- Island Volunteers Limited
- Partners of Prisoners
- The Rhoserchan Project,
- Training for Life.

A full list of organisations that participated in the 'Making the Market' and Finance and Funding Working Groups, following the publication of the Bank of England Report, is provided in Annex B. The suggestions made during these sessions were instrumental to this project.

* Two participants requested to remain anonymous. We thank them for participating in the study.

Overview

Sixteen social enterprises and their banks or CDFIs completed the questionnaires on which the study is based. Sufficient data was also gathered on two additional social enterprise loan facilities to include them in this overview. Although the sample size of 18 is small, some general observations can still be drawn. Of these cases, eight were investigated in more detail and written up in this report.

1 General points

- The average size of loans arranged with mainstream banks was over £1 million, (although this is skewed by one very large facility). The median was £555,000.
- The average size of loans arranged with the social banks was significantly smaller at £120,429; the median size was £101,000.
- The median turnover of social enterprises with a loan facility with a mainstream lender was much larger than that of those borrowing from a social bank: £1,100,000 compared to £425,000.
- There appears to be no correlation between banking with a mainstream bank and having a higher percentage of turnover derived from sales. Mainstream banks' clients derived 45.5% of turnover from sales while social lenders' clients derived 55.6%.
- However, the percentage of turnover derived from sales varies widely for clients of social lenders. Four social bank clients derive over 80% of turnover from sales while three derive less than 10% of turnover from sales. Among the mainstream banks' clients, this figure is much more consistent

2 Types of loans

- Ten of the 17 approved loans were for the purpose of buying and/or refurbishing new or existing property and were secured through a charge on the property. Two of these also included overdraft facilities.
- Three loan facilities were overdrafts used to bridge against grant funding. One loan was also a bridge against grant funding, but in the form of a six month term loan.
- Two loans were term loans for working capital needs – one for two years and one for nine months.
- The only subordinated loan was offered by a CDFI that took a second charge over specific assets. A first charge had already been taken by a mainstream lender.
- Overdrafts arranged with the mainstream banks were typically negotiated in conjunction with a mortgage and therefore benefited from asset security.
- There was one example of a social enterprise that was turned down in its request for an overdraft facility. The bank felt that it was not given enough information and that an overdraft for working capital purposes was the wrong solution to the organisation's funding needs.

3 Interest rates and fees

- Most of the loan facilities had variable interest rates that range between 1.5% and 3% over base rate. Four loans were fixed at between 6% and 7.5%; these were all with social banks. The two unsecured facilities were expensive at a fixed 18% for account excess cover and 5% over base for a six month grant bridge.
- Arrangement fees appear to be the norm and varied between 0.5% and 1.5% of the amount funded.

4 Loan Performance

- The social enterprises provided as cases by the banks and CDFI in this study were mainly well performing clients. Accordingly, the loans profiled in-depth are all repaying on time or ahead of schedule.
- In conducting the research for this report, it is clear that banks do have some loans to social enterprises that are underperforming with some social enterprises struggling to comply with loan covenants and/or capital repayment. Some social enterprises exhibit difficulties as they become more self-sufficient and cross over from grant dependency to commercial finance.
- However overall it appears that social enterprises exhibit similar creditworthiness and loan performance to mainstream businesses.

Key findings

Despite its relatively small sample size, this report identified a number of common themes affecting banks' lending to social enterprises.

1 Loans and terms

- Most commercial loans to social enterprises involve terms and security similar to those made to mainstream businesses.
- Many social enterprises have little in the way of physical security, but often have a dependable turnover or other cashflow. There is a need for more lenders to offer unsecured overdraft lines.
- The relative lack of cashflow lending to social enterprises (most of which are quite small) is comparable to lending to standard small and medium size enterprises.
- The mainstream banks tend to focus their lending on the larger social enterprises and arrange the bigger financing packages.
- All loans by mainstream banks are fully secured by real estate (or the debtor book in the case of the invoice discounting facility for ECT Group). The social banks also need security but are sometimes more flexible in the security they accept. Some of the social banks have been innovative in coming up with alternative forms of security, such as tapping individuals in the community for personal guarantees or utilising the Small Firms Loan Guarantee Scheme**.

** For more information see: www.dti.gov.uk/support/sflgs.htm

2 Social enterprises and debt

- Many social enterprises fail to shop around for the best terms; most deal with the bank where they have their current account and/or have a close banking relationship where their organisation is known and understood.
- Many social enterprises do not have a clear understanding of commercial bank funding. Most do not know what it requires or how to get it. This is a major barrier to their future growth and success.
- In many cases, trustees of social enterprises are reluctant to take on debt finance. At present, educating them in this area often falls to the CEO, with some help from the banker involved.
- Most of the social enterprises in this study have recently experienced or are experiencing rapid growth. Overdraft facilities are useful for these organisations, but many of them would prefer longer term, more flexible working capital loans.
- Many social enterprises do not distinguish between grants and contracts for services on their financial statements. Being able to analyse these sources of income separately is key to assessing the stability and self-sufficiency of the organisation.
- One specialist institution is working to fill this gap with a loan advisory service that educates social enterprises in the benefits and requirements of debt finance and introduces them to mainstream banks. It has provided this service for a number of years and has found that it pays for itself through the loan fees it generates. Charities pay for the service but the cost is often made up in the first year through lower interest payments that the process can achieve.

3 Bank decision processes and related issues

- No decisions in the study were made on a pure 'credit scoring' basis. The banks involved undertook a thorough analysis of the prospective borrower's financial statements and position, but these were never the only factors considered.
- Strength of management and of relationships with other funders (primarily government agencies) were key factors in the banks' decision to lend.
- In most cases, the relationship manager spent more time underwriting and monitoring the loans to social enterprises than they would for more standard commercial decisions.
- Banks that made loans to current account clients found the decision process more straightforward because of their ability to evaluate and monitor the organisation's financial management on a regular basis.
- Regular communication between bank and social enterprise is absolutely crucial for a successful relationship.
- Tensions can exist between the financial requirements of commercial bank funding and the social purpose of some social enterprises: for example, if an organisation exists to provide affordable work/living space, it needs to balance its desire to keep rents down with a bank's wish to see greater income to secure debt servicing.

Recommendations

Given the increasing social and economic importance of social enterprises, it would seem that much more could and should be done to provide viable and profitable funding arrangements. However, it is clear that the different structures, priorities and needs of social enterprise, need to be addressed to give social enterprises a fair chance of future stability and success. Key recommendations, to increase the level of bank support to the social enterprise sector, are made below.

1 Education

- Educating relationship managers at the branch level is essential. Efforts by senior management to increase lending to social enterprises will be more successful if those directly responsible for evaluating their loan applications understand how they operate.
- If loan officers know how to evaluate their cashflow, grant funding streams and other non-traditional sources of income, they are more likely to find and fund profitable customers. It is rare that a social enterprise and banker speak the same language. An important first step is to ensure the banker can translate what s/he is hearing (and for the enterprise to speak the right language).
- During the loan process, relationship managers and loan officers should consider the overall profitability of an account. Bank servicing fees from current accounts, as well as the float on grant funds deposited, can make a broad relationship with a social enterprise more profitable than a single loan transaction might suggest. Moreover, social enterprises value the convenience and understanding that can come from working with a single bank.

2 Outreach

- Given the demonstrated commercial success of banks servicing social enterprises, banks should show that they are interested in – and willing to lend to – social enterprises. Many social enterprises have relationships with local bankers and using these to market banking services is a simple way to initiate contact.
- Since the first step in a banking relationship is usually a current account, banks that encourage social enterprises to open current accounts with them are more likely to end up in a position where they can lend them money successfully.
- Banks whose branch loan officers regularly contact local social enterprise account customers and speak to them about their financing needs are more likely to win the business when a loan is needed.
- Once a loan is made, active communication with the enterprise will help ensure that problems are dealt with before they become a crisis. Social enterprises do not always realise how important this is.

3 Technical assistance

- One specialist organisation provides an essential loan advisory service that educates social enterprises in the requirements and benefits of debt finance and helps them prepare for a loan from it or another bank
- Mainstream banks do lend successfully to the larger social enterprises, but currently need to do more to attract the smaller ones. Provision of a similar service by other banks and CDFIs would therefore enable more and better loans to social enterprises to be made more quickly.
- The Government should also promote the value of providing such services as a matter of priority.

4 Continuity

- Continuity in the relationship between the bank and social enterprise is essential. Having the same loan officer and relationship manager work with an organisation over time enhances the relationship and may improve loan performance. Where this is not possible, other people in the branch should learn about and understand the client. Having to re-educate bankers about their activities can be very frustrating and can lead to lost business opportunities.
- Because many social enterprises may be new to loan finance, a bank that provides a continuous contact that knows and understands the enterprise will be at a competitive advantage.

5 Partnerships

- Based on this sample, most of the payment for services and other turnover generated by social enterprises comes from various government bodies. In most of the cases that follow, the loan transactions bridged the funding gap between government grants and the total amount required. Banks that build relationships with government funding bodies will know which social enterprises may need funding and will also become more comfortable with the stability of the enterprise's turnover.
- There is a strong case for urging banks to invest more in intermediaries that bring social enterprises and lenders together. These intermediaries might incorporate a number of roles such as: education, business introduction and direct lending, as provided by most CDFIs.
- CDFIs are already providing this combination of services, but are unable meet the demands of the social enterprise sector alone, because of the current size of the CDFI sector.
- There is a need to encourage more bank-CDFI partnership to develop the spectrum of relevant financial products and solutions for the social enterprise sector.
- Social banks and CDFIs can be an excellent source of deals for mainstream banks if all parties work to build relationships. These relationships may need to be financially supported by the banks, at least in the short term, but they are likely to prove a worthwhile long-term investment.

Lenders and social enterprises

This is an overview of the types of social enterprise lending that each of the participating institutions provide, as reflected in the loans profiled in the case studies and the other facilities for which information was gathered.

Mainstream banks

The three mainstream banks that participated in this study – Barclays, Lloyds TSB, and NatWest/Royal Bank of Scotland – each have a manager and/or contact person in charge of social enterprise/community banking. However, any lending to social enterprises generally originates and is covered at the branch level. None of these banks appear to have a central database relating to their overall social enterprise loan portfolios.

- **Barclays**
  The Barclays loan facility profiled is an overdraft to bridge to grant funding. While the overdraft is secured with a charge on a property, this is not a typical facility. Instead, the personal involvement of a Barclays relationship manager with the social enterprise was probably key to arranging the facility

- **Lloyds TSB**
  The three Lloyds financings presented were all long term, asset-backed facilities for the purchase and/or renovation of buildings. Two also included overdraft facilities. These deals are typical of the lending that the participating mainstream banks provide for social enterprises.

- **NatWest/Royal Bank of Scotland**
  NatWest/Royal Bank of Scotland is a fairly active lender to social enterprises. The deals profiled here were a mix of traditional 20 year plus term loans to fund building purchases and more unusual facilities, such as an invoice discounting funding line and an overdraft facility to bridge to grant funding. The bank has also established a network of community finance funds which have been carrying out research to aid the development of new products for the social enterprise sector.

Social banks

These are banks with explicit social missions.

- **The Charity Bank**
  The Charity Bank lends to organisations that are either registered or exempt charities, as well as community associations, voluntary organisations, community businesses, social enterprises and social landlords (providing the loan is exclusively for charitable purposes). They also lend to private sector businesses if the loan is for exclusively charitable purposes. Charity Bank only makes loans if mainstream banks refuse to do so, or insist on unaffordable terms or rates.

The Charity Bank offers a loan advisory service to help organisations access commercial finance and negotiate with mainstream lenders. The social enterprises in the study that had used the service were very pleased with it. The Charity Bank is the only lender in this study to have extended a term loan to a social enterprise solely against cashflows, albeit half the generated revenues of the funded project were required to be placed into a blocked account.

Co-operative Bank

The Co-operative Bank has a close affinity to the Co-operative movement, but it also funds companies limited by guarantee that have accounts with the bank. The Co-op Bank expects the business to contribute a minimum of 30% of total project costs in non-loan form. Unsecured loans are available at a fixed rate while secured loans are at a variable rate above base rate.

The social enterprise loan that the Co-op Bank presented for this study was a 25 year term loan at a fixed rate to fund the acquisition of a building for an affordable housing association.

Unity Trust Bank

Unity Trust is a niche bank providing a range of banking and financial services to charities, voluntary organisations, credit unions and the corporate sector. Unity Trust prefers to be asked to consider viable projects of £100,000 or over but will try to support existing customers, whatever their loan needs. Loans may be for a variety of uses, including re-finance, expansion finance and capital asset purchase. Unity Trust looks to take security on assets, including a fixed and floating charge if necessary and takes guarantees where appropriate. It also offers an occasional-use overdraft facility to bridge grant funding. These overdrafts can typically be used only twice a year. They are often essential for charities and social enterprises that can face working capital pressures from delayed grant funding.

Two of Unity Trust Bank's financing packages presented here were term loans for the purchase of buildings. Interestingly, they were for shorter terms (12 to 15 years) than typical property-backed loans. The other facilities are for account excess cover to cover cashflow shortfalls and a six-month bridge to a specific grant. Short-term excess cover that is not formally arranged is charged at the bank's standard debit rate, in this case a fixed 18% interest rate (with no arrangement fees). Formalised arrangements were deemed difficult to set up given the unpredictability of the requirement.

Community Development Finance Institutions (CDFIs)

CDFIs are sustainable, independent financial institutions that provide capital and support to enable individuals or organisations to develop and create wealth in disadvantaged communities or under-served markets . Of the CDFIs, only LIF participated in this study but there are a number of other specialist CDFIs whose primary market is the social enterprise sector, such as the London Rebuilding Society, ICOF, Aston Reinvestment Trust and Social Investment Scotland.

Local Investment Fund (LIF)

LIF provides loan finance to community enterprises that are economically viable but unable to raise sufficient funding from conventional sources. Applicants are expected to have tried to raise finance from conventional sources. LIF adheres to the principle of 'additionality', which is using its lending to attract other funds and therefore being only part of the total amount of funding provided. LIF loans amounts from £25,000 to £250,000 for working capital or capital expenditure. All loans are secured by the project being undertaken, although the fund will accept subordinated status and second charges.

The LIF 10 year subordinated term loan detailed in this report is typical of its objective to provide one piece of an overall financing package. The facility was provided to help purchase and renovate a building; other funders included charitable trusts, a mainstream bank and a regional development agency's community loan fund.

Case Studies

This section details eight case studies of social enterprises that successfully secured commercial financing. These cases were chosen because they provide examples of:

- **Loans made by different types of lenders: mainstream banks, social lenders and a CDFI**
- **Loans for differing purposes**
- **Different types of businesses and legal structures**
- **Social enterprises at various stages of growth and development.**

Mainstream bank loans

Case study: Ealing Community Transport Group

Bank	NatWest/Royal Bank of Scotland
Financing and purpose	£2.5 million invoice discounting facility for working capital

Key points

- ECT Group is a good example of a social enterprise that decided to decrease its dependency on grants by diversifying its activities and locations.
- ECT Group management do not believe that their structure – as a social enterprise that does not distribute profits – has prevented them from accessing commercial debt finance. Instead, they feel that the challenge in securing bank financing is that banks are balance sheet lenders and ECT Group lacks assets to offer as security.
- The invoice discounting facility used here is a good solution for any similar organisation with a high quality debtor book. It is also a very flexible structure for a growing organisation.

Background

ECT Group provides a range of community and public transport, recycling and engineering services for local authorities, public sector bodies, charities, individuals and private sector organisations. It is the UK's largest community provider of recycling services.

The Group's turnover has been growing at an annual rate of 30% for the last ten years. For the year to March 2003, turnover was £13 million and is forecast to be £22 million for 2003/2004. ECT Group employs 650 staff and operates in Oxfordshire, Warwickshire, the West Country and 10 London boroughs.

ECT Group's complex organisational structure developed from an Industrial and Provident Society (IPS) that set up trading subsidiaries as it grew. Ealing Community Transport was founded in 1979 as an IPS and was recognised as a charity in 1987. It owns all of the shares of ECT Group, which in turn owns the shares of ECT Recycling Ltd., ECT Engineering Ltd. and ECT Bus Ltd. Through ECT Recycling Ltd., it also owns 75% of Lambeth Community Recycling Ltd. The group usually donates a percentage of its profits to Ealing Community Transport under the Gift Aid scheme, with the balance re-invested in the business. Its management plan to reorganise the group and convert the trading companies into community interest companies once new legislation takes effect.

Ealing Community Transport was set up to provide accessible community transport to voluntary organisations in Ealing. During the 1980s and early 1990s, ECT Group expanded through a series of grant-funded projects. However, it then decided to grow further by taking advantage of the new trend for local authorities to outsource service provision. In 1993, nearly 60% of ECT funding was grant aid; today the grant for providing the group's transport project represents less than one per cent of total turnover.

Funding history

For its first 15 years of operation, ECT Group was heavily grant-dependent. In the mid-1990s, its management decided to widen the group's income base in order to become more financially sustainable. It expanded its geographic scope beyond Ealing and broadened its activities into recycling. Today its turnover comes almost entirely from services.

ECT Group has been able to secure commercial funding for capital outlay because finance providers can take security over the asset being financed. It uses finance leases to purchase its vehicles and, in 2003, took out a mortgage to help fund the purchase of the Acton headquarters it had built in 1990. It also borrowed £500,000 through a term loan to part-fund a £750,000 project to rebuild and refurbish its London operating centre at Greenford. As ECT Group does not own the Greenford centre, the loan could not be secured on the centre itself and was secured on the debtor book of the Group. This loan was repaid in full when the new invoice discount facility (described below) was arranged.

However, it has been more difficult for the group to secure adequate working capital funding, despite having a good working relationship with its bank. ECT Group's main clients are local authorities who are reliable payers but are sometimes slow in processing invoices. This means it has a two month lag between the operational expenses it incurs and receipt of payment for its services.

In the mid-1990s, ECT Group negotiated a £250,000 overdraft facility with NatWest Bank but, as turnover grew, this proved inadequate to support its increasing working capital needs. Talks between ECT management and NatWest on ways to finance its growing working capital requirements led to the negotiation of a £2.5 million invoice discounting facility at the end of 2003.

The deal

ECT Group's NatWest relationship manager recommended invoice discounting to ECT management and introduced them to the Royal Bank of Scotland Commercial Services (RBSCS) team. The group felt this solution was more flexible than a conventional overdraft and could also be scaleable. The structuring of the invoice discounting facility was done by RBSCS's specialist team, who analysed ECT's income sources and their diversity, its cashflows and debt service coverage ratios and assessed the group's management. The key factors for RBSCS in making its decision were the reliability of ECT's cashflows, the quality of its debtor book, ECT's financial history and NatWest's existing banking relationship with the Group.

The invoice discounting facility is structured as a £2.5 million funding line. When ECT Group invoices a client, management posts the invoice electronically to the RBSCS system. The system then makes available 65% of the total invoice amount to be drawn down, with the remaining 35% paid when the invoices are settled. RBSCS charges 2.5% above base rate for the amounts drawn down and a monthly commission of 0.11% of turnover. The facility is for an initial one year period and can be renewed or cancelled with a six month notice period. The debt drawn under the facility is senior and secured by a fixed and floating charge over ECT Group's debtors.

Looking ahead

The group's transformation from a small, but growing charity into a network of non-profit distributing businesses is almost complete. Its management believe that the group is on track to reach an estimated turnover of £100 million within the decade. They are confident that the invoice discounting facility is the solution to their expanding needs for working capital as it can be renegotiated as necessary and should therefore be able to grow as the company does. The group's CEO said: "The best and most important thing for us as a fast growing business is that it is, in principle, scaleable. As our turnover increases, our borrowing can increase, because it is based on a percentage of the value of outstanding invoices."

Case study: Hastings Trust

Bank	Barclays
Financing and purpose	£150,000 overdraft facility; £250,000 commercial mortgage approved but not drawn.

Key points

- Charity Bank initially met Hastings' Executive Director by chance and approached her for business after some time developing the relationship. At that point, Hastings did not see the need for a loan.
- The relationship between Hastings and the relationship manager at Barclays was critical to the initial establishment of their overdraft facility and Hastings does not think that it would have been approved without his input and commitment.
- Hastings' Executive Director has had to educate her trustees about the need for (and value of) debt financing. This process has been helped by the fact that the Barclays relationship manager spent a good deal of time on the charity's board and was instrumental in guiding the organisation in their use of debt capital.

Background

Hastings Urban Conservation Project was started in 1986 by Hastings Borough and East Sussex County Councils to make conservation grants for local buildings. When funding ended in 1990, it became an independent development trust. It is also a registered charity and company limited by guarantee.

Hastings Trust works with the public, private and voluntary sectors to regenerate the Hastings community. It works on projects that enhance the local environment, such as improving derelict land and renovating run-down buildings. It also owns buildings that it lets out to local agencies, community groups and social enterprises. It acts as project manager on regeneration projects run by the borough and, finally, it has recently started a social enterprise incubation centre and a community development financial institution (CDFI).

Funding history

When it was founded in 1986, Hastings Trust received £34,000 in core funding from the borough; in 2003 its annual turnover was £910,000. This consisted of approximately £500,000 from the local Single Regeneration Budget, the Neighbourhood Renewal Fund and the Community Fund; £150,000 from the European Regional Development Fund; and £100,000 in earned income from property rentals and management fees. The balance of £150,000 is from the Hastings PCT, charitable trusts and private donations.

In the early years, Hastings could only get short leases and so had to move locations regularly. This was disruptive and did not convey any sense of permanence to the wider community. A series of meetings with Charity Bank (then called Investors in Society) convinced it to borrow from the bank to buy permanent facilities. In 1997, it bought two properties with a secured loan of £110,000.

Hastings' Executive Director believes that this loan was the key to attracting government grant funding (from the SRB and European Union in particular) because it signalled that the charity was an independent, sustainable organisation. Hastings subsequently received enough grant funding to buy a third building and, now owning some concrete assets, it was commercially viable for a high street bank.

The deal

Hastings has always had its current account at Barclays. Furthermore, the bank's regional corporate relationship manager was Hastings' first chairman, so has close ties to the organisation and understands its business intimately. However, the charity's Executive Director feels that everyone she deals with at Barclays understands the organisation and the issues involved.

In 2002, a £150,000 overdraft facility was put in place, secured by the three properties. The overdraft is priced at 3% over base and there is an annual fee of 1% of the overdraft limit. A £250,000 commercial mortgage was approved late in 2003 but final terms have not been agreed and it has yet to be drawn down. The loan will allow Hastings to repay Charity Bank and buy another building.

The key question for Barclays is whether an organisation's income, whatever its source, can service the debt. To this end, the bank assessed Hastings' cashflows, management, grant and subsidy streams, as well as the overall market for its services. The main risk is that government contracts essential to the trust's income could disappear. Nevertheless, Barclays characterises these loans as standard commercial decisions, but requiring some understanding of the social enterprise sector.

Looking ahead

Going forward, Hastings would like to derive at least 50% of its revenue from earned income; that is, rental income and management fees (the figure currently fluctuates between 10% and 30% per year). The Executive Director estimates that this will require their property portfolio to expand from its current value of £500,000 to £2 million.

Case study: The Rhoserchan Project

Bank	Lloyds TSB
Financing and purpose	£530,000 term loan and £50,000 overdraft facility to purchase new premises and expand care services.

Key points

- The grant maker's recommendation that they approach Charity Bank prompted Rhoserchan to consider commercial finance in the first place.
- Charity Bank's role was crucial to educating Rhoserchan management and getting the deal done. The business manager said that she had originally thought that she would be going to the banks 'cap in hand', but that the adviser demonstrated that the banks should be competing for her business.
- The key to the financing package was the security offered by the organisation's property. This made the charitable status of the borrower much less relevant.
- In addition to looking for the best financing package, it was important for Rhoserchan management to work with a bank that understood their needs as a charity and was interested in their business.
- The previous banking experience of Rhoserchan's business manager was crucial in the organisation's decision to go through with commercial funding. Its previous management was cautious and rather uneasy at the thought of borrowing money.
- Preparing the business plan and negotiating the financing was an educational experience for Rhoserchan management and its board, and helped to build their confidence.

Background

The Rhoserchan Project in Wales was formed in 1985 as a registered charity to care for substance abusers. It opened its doors in 1988 as a 12 bed care facility providing primary rehabilitation services for substance dependent patients. It gives priority to people from local areas but attracts residents from across the UK.

In the financial year 2002/2003, 54% of its residents completed the 12 week programme, with 59% of these going on to second stage treatment centres. Average occupancy that year was 88% and the majority of fees (78%) are derived from local authorities. It needs 24 hour staffing and 11 people are employed full-time.

Before taking up a place in Rhoserchan's programme, patients must undergo a detox programme. As Rhoserchan does not offer this service, the patient must go elsewhere and this can involve a long wait: waiting list times have sometimes been as much as 18 months. As a result, Rhoserchan wishes to expand its primary care facilities to a 16 bed unit and establish six places for a detox unit.

Funding history

The capital costs for opening the Rhoserchan care facility were funded through charitable donations. These enabled it to purchase an ex-RAF timber-framed building that it converted into a residential care facility. Initially there was no land rental charge.

The Rhoserchan Project derives two-thirds of its income from fees paid by local authorities and private patients, with the balance provided by a Welsh Assembly grant and private donations. It generally operates on a break-even basis, showing either small losses or small profits each year. As a result, it has been unable to spend much on maintenance and refurbishment of the facility, although it does maintain a cash reserve for prudence.

Rhoserchan management have been unable to invest in new buildings on its existing premises since the landlord is against any expansion. They therefore decided to change premises and buy a new property. They initially intended to seek donations for the full cost of this move but, as property prices in Wales began to rise, realised it would be difficult to raise the total estimated cost of £850,000.

Rhoserchan successfully raised £330,000 and, following the advice of one of its major funders, approached the Charity Bank to discuss securing loan finance for the balance. As it had never before secured commercial funding, the bank offered to act as an advisor. It helped Rhoserchan's management compile a business plan and asked four banks to bid on the financing. It then assisted in the negotiations with the banks and advised on the implications of each offer. Lloyds TSB was selected, as it is Rhoserchan's house bank, showed both an interest in and understanding of the business, and offered the most attractive financing.

The deal

In underwriting the loan, Lloyds reviewed the business plan, assessed the management team and analysed the stability of income sources, both from donations and services. The key factors affecting the bank's decision to lend were the ability to take security over the property to be purchased; Rhoserchan's financial history and financial projections; the reliability of its cashflows; its overall profitability; and Lloyds' existing banking relationship with the charity. The main risk identified was that future charitable donations and grants might not continue at the same level as before.

The loan was structured as a 20 year amortising term loan, with a six month upfront capital repayment holiday and a 12 month revolving credit line. The loan was secured with a first legal charge over the property and the rate offered was 1.49% above the base rate.

Unfortunately, the Care Standards Inspectorate has not approved Rhoserchan's request to expand its care home. The Inspectorate will only register care homes for younger adults (the category into which Rhoserchan falls) for a maximum of 16 residents and are unwilling to view the detox wing as an additional unit, even if it is self-contained. With the maximum number of patients now limited to 16 (rather than the 16 plus six intended), the business plan is no longer viable. Rhoserchan has had to withdraw the bid on the property while it awaits the results of its exemption request. Therefore the £530,000 term loan has not yet been put into place.

Looking ahead

Regardless of the outcome of the exemption request, the Rhoserchan Project needs to relocate. The property it wants to acquire is still available and it hopes to go forward with the Lloyds financing at some point in the future. If it does not receive permission to operate at greater patient capacity, future cashflows will be lower than those projected in the original business plan. In this case, management will try to raise more themselves and borrow less than originally anticipated.

Case study: Acme Studios

Bank	Lloyds TSB
Financing and purpose	Purchase and capital refurbishment of two buildings to provide affordable housing and work space for artists.

Key points

- Acme's initial banking relationship with Lloyds developed because of personal contacts between management and one of the bank's branches. After the first Lloyds bridge loan was repaid and Acme established a successful track record of repayment, its account was moved to a City branch, where the relationship evolved more normally.
- Acme's relationship manager specialises in the public and communities sector, which has been useful in understanding its business model and strategy.
- The Arts Council's agreement to use the first freehold building purchased with its grant funding as security for the next property development was key in clinching the financing package for the third major studio building. As a result, £1.2 million of grant money has been leveraged to develop a £7 million property portfolio.
- Although commercial debt finance is critically important to the growth of a social enterprise involved in real estate development, the terms of such finance can jar with the organisation's mission. It is likely that bank finance needs to be balanced with concessionary finance to maximize the organisation's ability to achieve its goals.

Background

Acme Studios is a London-based charity that provides artists with low-cost studio and living space. Since its formation by a group of visual artists in 1972, it has helped more than 4,000 artists and is now the largest organisation of its kind in the UK.

Acme currently manages 11 studio buildings (10 in East and South East London and one in Cornwall), providing over 350 non-residential studios. It also provides 25 units of living accommodation, as well as work/live residency programmes for 20 artists. Acme has permanently acquired three of the buildings; the others are held on leases. There is a waiting list of artists looking for non-residential studios in London.

Acme Studios consists of three exempt charities registered as Industrial and Provident Societies (IPS): Acme Studios Housing Association Ltd., Acme Artists Housing Association and Acme Studios. The first IPS was formed as a housing association to be eligible for short-life housing stock owned by the Greater London Council in the early 1970s.

Funding history

Acme received funding from the Arts Council shortly after it was born and receives regular support from its successor body today. In 1997, it secured funding from the National Lottery to buy and develop two of its studio buildings. The purchase and development costs for these two freehold sites totalled £1.8 million. The National Lottery granted £1.2 million towards the cost; a further £250,000 was provided for by external fundraising and the balance came out of reserves. Acme's house bank, Lloyds, provided a designated loan account facility of £90,000 to bridge the National Lottery grant money.

In April 2000, Acme bought its third major studio building. It had been renting part of the building for a number of years when the owner decided to sell the whole complex. Although the commercial value of the site was valued at £2.2 million, their long relationship caused the landlord to sell it to them for £1.9 million. Acme has since developed part of the site for commercial sale in order to subsidise the artists' studio space.

The entire project was debt-financed. To facilitate the purchase, the seller provided a vendor loan and Lloyds arranged a £1.7 million debt facility, secured on the property. As additional security, the bank also took a first charge over Acme's other two freehold properties. The Arts Council happily agreed because it could see the benefit from leveraging its initial grant to enable Acme to expand its portfolio. The vendor loan and £425,000 of the Lloyds term loan were paid down with the proceeds of the sale of the commercial units. However, in June 2002 Acme drew down £425,000 of the facility again (as agreed with Lloyds) to fund a refurbishment programme for its studios in Bethnal Green (described below). As a result, the Lloyds facility still stands at £1.7 million. It is structured as a 15 year term amortising term loan, with interest fixed at 6.66%.

In 2003, Acme entered into a partnership with Barratt East London, a property developer. Barratt gained planning permission to redevelop old light industrial and office buildings under a mixed-use scheme that will include affordable workspace for artists, as well as commercial residential units. In order to obtain planning permission, Barratt had to agree to sell the finished studio block of 50 units to Acme at a price below the construction cost of the building. Development of the project is due to be completed by May/June 2005.

The project is financed by a £1.5 million Lloyds term loan that includes £1 million for the purchase of the studio block and £500,000 to fund the second phase of the refurbishment programme at Bethnal Green. Acme is drawing down the £1 million over the course of 18 months to make staged payments to the developer. The £500,000 relating to the refurbishment was fully drawn down in September 2003. The £1.5 million facility is a 15 year term loan that has a 2_ year capital repayment holiday and is priced at 1.5% over base rate. It is secured with the 155 year lease that will be granted to Acme on completion of the development. The bank has also wrapped the security package of this facility in with the security for the £1.7 million loan and so it also benefits from security over the three other buildings.

Acme also has some studios in Bethnal Green that it has leased from the Crown since 1981. In 2000 it was granted a new 30 year lease. In return for a low rent, Acme had to carry out major improvements, phased over five years to minimise disruption. By the end of 2003, around 80% of this refurbishment had been completed. The £925,000 refurbishment programme has been funded through the two facilities described above.

The deal

In addition to the facilities detailed above, Acme has negotiated a £100,000 12 month overdraft facility with Lloyds, charged at 1.5% over the base rate. This facility is wrapped in the security package of the £1.7 million and £1.5 million term loans, so benefiting from a first charge on all three freehold properties and security over the 155 year leasehold.

Acme's relationship with Lloyds has evolved over time. The first Lloyds branch that Acme banked with was in the New Forest, as a result of a close family connection. The initial bridge financing agreed with Lloyds was negotiated with this branch and was possible mainly because of the personal relationships involved.

In1998/1999, Acme transferred its banking business to a City of London branch, where the first term loan was arranged. Management believe that a number of factors were key to securing this long-term financing: the prior relationship Acme had with Lloyds; the security of the freehold sites; the track record that Acme Studios had established of successfully developing studio space for artists; the strong business plan supported by 30 years of 100% occupancy for its sites; and the continued unmet demand for artist studio space. Within Lloyds, Acme is looked after by a relationship manager from the Public and Communities Sector unit, who they generally feel understands their business.

In structuring the term loans, Lloyds analysed income sources and assessed cashflows, management and the market for Acme's services. It also used credit scoring and took into account its existing relationship with Acme. The key risks identified were the adequacy of debt service coverage and the continuity of demand for affordable artist workspace. The main covenants are debt service coverage ratios that must remain above 120%.

Looking ahead

With long waiting times for studio space, Acme believes there is still unmet demand from artists in London. It hopes to continue acquiring and developing sites in line with its long-term strategy to replace temporary (and therefore vulnerable) leasehold buildings with permanent stock and has successfully applied for funding of £2 million from the Arts Council.

Social Bank Loans

Case study: The Caxton Trust and the Catch Up Project

Bank	Charity Bank
Financing and purpose	£40,000 loan to produce a new edition of a CD-ROM to improve children's reading skills.

Key points

- World in Need's grant of £15,000 towards the cost of producing the second CD-ROM was instrumental in bringing other funders to the table.
- The referral and support from World in Need, combined with the competence of Catch Up's Executive Director, brought an essential level of comfort to Charity Bank.
- Charity Bank was willing to make a cashflow based loan because the market for the product was easily documented and observed, and the organisation had a track record producing and distributing an almost identical product.
- The reservation of sales revenues for loan repayment is sometimes difficult for Caxton because it wants to use that money for other purposes. However, it understands that it is necessary at this stage.
- Caxton did not go to a high street bank because it was told by other charities that banks would not fund such a project.
- Caxton's turnover is all earned from sales of goods and services. The government is the primary buyer, but it does not provide operating support to the organisation.

Background

Caxton Trust was established in 1996 to launch and promote the Catch Up Project. This is a structured literacy programme designed for children aged from six to eleven who find reading and writing difficult. It consists of teacher and teacher assistant training, teaching materials (such as a video, booklists, games and activities), multimedia educational games on two CD-ROMs and parental resources. Catch Up has recently been recognised with the Basic Skills Agency Award and a National Training Award, and is used in more than 3,500 primary schools throughout the UK.

Caxton Trust is a registered charity and company limited by guarantee; Catch Up is a trading name and has no legal status.

Funding history

Caxton Trust was originally started with a three year seed funding grant of £311,000 from World in Need . During its first three years, the Catch Up Project was developed and began to generate income through selling its reading tools to Local Education Authorities and schools. In 2003, Catch Up had sales of £180,000.

The first interactive CD-ROM was produced in 1998 and was funded through grants. In 2002 the organisation was asked to develop a second version. This was expected to cost £100,000, equivalent to Caxton's total turnover at that time. World in Need made a further grant of £15,000, which helped secure another £35,000 in donations, grants and interest-free loans. The balance of the funding – £50,000 – came from a £40,000 loan from Charity Bank and £10,000 from Catch Up's own reserves.

Caxton has always banked with Barclays and CAF Bank but did not approach either for the loan because CAF Bank only provides high interest current and savings accounts for charities and because it was told that Barclays would not consider it. Instead, Caxton was introduced to Charity Bank by World in Need in September 2002 and the loan was drawn in January 2003.

The deal

In underwriting the loan, Charity Bank required a business plan for the CD-ROM, three years of financial statements and two years of financial projections. The bank analysed the financials, the cashflow projections and rationale, and the market for the second CD-ROM. It also had teachers evaluate CD-ROM 1 and met with the trustees of Caxton Trust.

The main risks it identified was that development costs could go over budget, the quality might not be as good as the first CD-ROM, sales might not be as robust as anticipated, and that duplication and pirating could occur. These risks were for the most part mitigated by the fact that the same developers were being used as for the first CD, and that almost all existing users were committed (at least verbally) to buying the updated version.

The loan was made at 6% for three years (January 2003-2006), with a six month interest-only period up front with amortisation after the initial period, and a 1% arrangement fee. As security, Caxton was required to put 50% of the sales revenue from the CD-ROM into a bank account reserved to repay the loan. This was felt necessary because Charity Bank does not hold Caxton's current account and so is unable to track money in and out of the organisation directly. The requirement may be relaxed once a positive track record has been proven.

Caxton has made all payments as required on the loan and the CD-ROM has sold very well. Charity Bank requires quarterly and annual financials and performs a yearly site visit.

Looking ahead

The Catch Up Project has seen remarkable growth and success over the past three years. Their £180,000 turnover in 2003 marked a 50% increase on the previous year and, to date, 2004 looks like continuing this trend. As a result, Caxton is busy managing and planning for this growth and in April will draft a new three year strategic plan. Plans for a third CD-ROM are currently being considered.

World in Need provides seed and growth funding to social entrepreneurs and supports those investments with a blend of skills, advice and networking.

Case study: The Helepayne Foundation

Bank	Unity Trust Bank
Financing and purpose	Various £5-10,000 short-term excess cover to bridge grant funding. £40,000 six month bridge loan to build an educational facility for which grant funding was in arrears.

Key points

- Unity Trust has always been Helepayne's banker, allowing it to become very knowledgeable about the organisation. This familiarity and track record was key to enabling the unsecured loan to go ahead. Nevertheless, the process has been extremely time-consuming.
- Helepayne's Executive Director sees Unity Trust as different from high street banks because the relationship managers take more time to get to know and help its social enterprise clients. He believes high street banks are less inclined to lend to social enterprises because relationship managers are moved before they can get to know an industry and/or client base.
- Communication between the client and the bank is essential and keeps both parties informed of problems and issues before they become critical. This is especially important given the nature of the excess cover arrangement – it is not a formalised overdraft.

Background

The Helepayne Foundation, a registered charity and company limited by guarantee, was founded in 1999 to offer training in basic skills, horticulture, information technology, and arts and crafts to people with disabilities. The Executive Director and his wife, both disabled, founded it to fill a gap that existed in programs helping disabled people in Devon, which has around 80,000 physically disabled residents. Helepayne is a collaborative partner of Bicton College and is primarily funded by the college and the Learning and Skills Council.

Helepayne currently has 18 employees (including both full- and part-time) and 22 students. To date, 22 people have been able to find work as a result of their training there.

Caxton Trust is a registered charity and company limited by guarantee; Catch Up is a trading name and has no legal status.

Funding history

Helepayne was founded with £7,000, and is currently funded entirely by grants from the Learning and Skills Council (£58,000), Bicton College (£99,357) and local government (£52,000). It used to receive funding directly from the European Social Fund as well, but the bureaucracy and timing became very onerous. Any European funding it now receives comes through the Learning and Skills Council. In addition, the Executive Director has personally contributed as and when necessary.

Helepayne was introduced to Unity Trust Bank through another local charity. Unity Trust has regional development managers throughout the country; the manager for Devon was the original contact and continues to monitor the organisation. Helepayne currently uses Unity Trust for all of its banking needs: these have primarily consisted of current account services and excess cover arrangements to bridge the receipt of grant funds.

The deal

Unity Trust Bank provides a short-term grant overdraft facility for its clients, which can be used no more than twice a year. Typically, the interest rate charged for the overdraft facility is between 2% and 5% over base, with an arrangement fee of 1 to1.5%. However, Helepayne has no formal overdraft agreement; instead, Unity Trust provides them with excess cover at an interest rate of 18%. The bank will not currently give them a formal overdraft because it sees Helepayne's primary financial issue as a lack of equity, not short term cashflow fluctuations.

In addition to the excess cover, the bank provided Helepayne with a six month, £40,000 bridging loan to fund the construction of a lecture hall until the grant funding came through. The loan was priced at 5% over base, with a 1.5% arrangement fee, and was unsecured. Despite the fact that the loan was to construct a building, it was not a typical real estate loan because the building is on private property and so has no real value to anyone else. This was an unusual deal for the bank because no security was available and so it needed to rely on the grant funding finally arriving.

Unity Trust requires quarterly and annual financial statements and performs site visits at least yearly. Helepayne provides their latest financials whenever it needs to use its overdraft facility, but its Executive Director likes to stay in regular contact with the bank and believes this eliminates any problems before they arise.

Looking ahead

Unity Trust estimates that 50 to 60% of the Executive Director's time is spent finding, acquiring and receiving funding. This time could be better spent on service delivery and strengthening the organisation. Currently, Helepayne estimates that it has £50,000 outstanding in grant payments. The Executive Director acknowledges that it is a struggle to get long-term, core operational funding. However, he is optimistic that a new fundraising and marketing initiative will improve Helepayne's core funding.

Case study: ruralnet|uk

Bank	Charity Bank
Financing and purpose	£50,000 loan for working capital as the organisation became independent of the Royal Agricultural Society of England.

Key points

- ruralnet|uk received core operating funding from the Royal Agricultural Society of England (RASE) for the first three years, but the organisation knows that this will not continue. It is actively looking for ways to expand and broaden its income base in order to become more self-sufficient.
- Even though it had a detailed business plan and financial projections, ruralnet|uk valued the objective input and feedback from Charity Bank, which reassured the charity that its plan was realistic and made sense.
- ruralnet|uk opened its current account with Triodos in the hopes that this would facilitate a loan. However, Triodos does not lend unsecured and the organisation did not have any security to provide.

Background

ruralnet|uk (formerly the National Rural Enterprise Centre) is a rural regeneration charity and was founded in 1989. It promotes a living and working countryside and finds new ways to help deprived rural communities improve and strengthen their local economies, primarily through information technology solutions and networking. One of its primary projects is to provide capacity building support for UK Online Centres, where communities can receive and share information.

ruralnet|uk started life as part of the Royal Agricultural Society of England (RASE) and is based at the National Agricultural Centre at Stoneleigh Park in Warwickshire. In 2002, it was spun off and became independent, and is now a registered charity and company limited by guarantee. It has a wholly owned subsidiary trading company, RNUK Ltd., which provides services to non-rural and non-UK clients. Any profits generated are invested back into the charity.

Funding history

When it was spun off, ruralnet|uk received three years of seed funding from RASE, totalling £150,000. Its turnover for 2003 was £1.1 million, with around £700,000 coming from payment for services through RNUK Ltd. The trading subsidiary also provided two-thirds of its total subscription fee income of £80,000 that year. On top of this, £70,000 came from grants and the balance derived from payment for services through the charity.

Following the spin off, ruralnet|uk knew that it would need initial funding because the source of future contracts was unclear. It approached its current account bank, Triodos, as well as Co-op Bank and Charity Bank about a loan. Only Charity Bank would consider lending to it on the basis of its business plan and past performance. The others required more traditional forms of security that were not available.

The deal

Charity Bank approved a £50,000, nine month working capital loan at 6% interest with a 1% arrangement fee. The loan was interest only, with flexible lump sum principal repayments dependent on when other sources of income became available. ruralnet|uk drew down just £25,000 and repaid the loan within six months. It never actually used any of the loan capital because contracts came in at a quicker pace than expected. However, it wanted to draw it down and repay it so that this was on its financial record.

ruralnet|uk does not have many fixed assets (£5,000 of IT equipment), and so Charity Bank required a guarantee from RUNK Ltd. (although at the time it was unclear how much revenue this would bring in). On top of the guarantee, the bank required that ruralnet|uk not borrow elsewhere for the duration of the loan, plus written confirmation that the grant from RASE was forthcoming and a copy of the DfES contract for the UK Online Centres work.

The primary risks identified were that there was no tangible security for the loan; that the organisation would not be fully supported by RASE in the future; an opaque cashflow picture for 2003; and high, variable costs associated with involvement in the IT sector. These risks were generally mitigated by ruralnet|uk's 15 year operational history (under

RASE's umbrella), as well as its good financial discipline and its existing provisions for IT upgrades and other anticipated costs.

In the process of underwriting the loan, Charity Bank advised and questioned ruralnet|uk about its business plan and cashflow projections. The organisation was fairly confident about the plan they had written and their financial forecasts, but found the input from Charity Bank very useful.

Looking ahead

Much of what ruralnet|uk does is very time intensive – advising, consulting, and supporting clients' IT needs. Time is a finite resource and so it is looking for other ways to grow its revenue base. It is currently recruiting marketing expertise to help grow its subscription and online service businesses, which have a low marginal cost and are easily replicable, but which currently comprise just seven per cent of its turnover. The charity eventually hopes to cover a significant proportion of its core costs with this recurring subscription income.

Since the organisation generated a surplus of £150,000 in 2003, it does not have any immediate funding needs, but is considering buying a building for office space.

CDFI Loan

Case study: Genesis Social Enterprises Ltd

Bank	Local Investment Fund
Financing and purpose	£250,000 loan, in two tranches, to fund the continued build-out and conversion of a bus depot into leisure facilities.

Key points

- This case study illustrates how the management team of a social enterprise can bring together a variety of funding sources to finance a large project. The management of Genesis and its charitable trust parent, HURT, felt that Property Trust Ltd., HSBC Bank and EMCLF/LIF were all very supportive.
- All of the finance providers wanted some form of security. HURT could use its two other existing properties – along with LIF's willingness to lend on a subordinated basis and take a second charge over HURT's assets – to provide sufficient security for the financing of HURT's trading arm, Genesis Social Enterprises Ltd.
- Some social enterprises have balance sheets and relationships that enable them to effectively shop around for debt financing; a bank with a non-credit relationship with such a social enterprise risks losing that relationship if it is not competitive when the social enterprise needs credit.

Background

His Upper Room Trust (HURT) is a community organisation active in youth work and counselling. It also trains and helps families to manage their childcare needs. HURT's childcare programme caters to more than 250 families in six villages by offering breakfast, pre-school and after-school care, and holiday clubs. It has been operating for 13 years and is a company limited by guarantee and registered as a charity.

In 2001, HURT's management started looking for facilities to expand. The building they wanted to lease could only be bought as part of a larger complex. This prompted them to consider buying the whole complex in order to redevelop it into a community and family centre, which would generate earned income for its activities. There was also the possibility of regeneration funds to help fund project costs. This led to the creation of the Genesis Social Enterprise Centre.

Genesis Social Enterprises Ltd. is the trading arm of HURT and is formed as a company limited by shares that are wholly owned by HURT. It bought an old bus depot in Alfreton in Derbyshire under long lease and converted it into office and workshop units for up to 30 start-up firms, with on-site business counselling and mentoring. The site also has a family sports centre (with a sports hall, large soft play centre, 10-pin bowling alley, café and community rooms), a catering business and conferencing facilities.

In November 2002, the centre opened with limited facilities (the sports hall, café and a few rooms). The bowling centre was inaugurated in August 2003 and has helped boost turnover from £123,356 for the year ended June 2003 to £197,000 for the seven months to January 2004. The increase is also a result of incremental income from new business tenants and the recently-opened conference and training rooms.

Funding history

HURT has historically been grant funded. One of the driving factors behind the creation of the Genesis Centre was to move the trust towards self-sufficiency by generating earned income. The full development of the site will take two years to complete and management hope that the project will be self-sustainable within this timeframe. The timetable for the project was delayed due to the late receipt of some initial funds; the final stage of redevelopment of the complex started in January 2004.

The initial capital cost of the project was £1.2 million. This included purchasing the 25 year leasehold of the complex and completing the initial refurbishment. The purchase was funded through £600,000 in grants from the East Midlands Development Agency (EMDA), a £300,000 20 year term loan from Property Trust Ltd., a £200,000 loan from HSBC Bank, and a £100,000 loan from the East Midlands Community Loan Fund (EMCLF).

Property Trust Ltd. is a charity that makes loans to churches and church-based organisations to buy property. However, its long relationship with HURT enabled it to make an exception to these rules. The loan is structured commercially and has a first charge over the leasehold of the complex, amortises over 20 years and costs 3% over base rate. The EMCLF loan is secured by a second charge on three buildings that HURT owns. The £100,000 facility is a ten year term loan, with a six month capital repayment holiday and is priced at 3% above base rate.

The HSBC facility is a 15 year term loan, is priced at 2.5% above base rate and is secured on two other buildings that the trust owns (a church and a banqueting hall). There is only £140,000 outstanding under this facility because proceeds from the sale of another banqueting hall enabled Genesis to pay down part of the debt. HURT had been banking elsewhere before the Alfreton property became available. It decided to shop around for the best terms for the loan and found HSBC to be the most responsive bank with the most competitively priced package. As a result, HURT moved all of its banking business there.

Another key factor enabling the project to go ahead was the grant money promised by the Coalfield Regeneration Trust. It pledged grants of over £328,000 in six instalments over the three years starting in December 2002. This is to be used as revenue support for the early stages of the project, to help tide it over until it reaches financial sustainability.

The deal

The second stage of the project is to build a further 10,000 sq. ft. of managed office space and to convert the remaining 15,000 sq. ft. of warehouse space into smaller workshops and leisure areas. Work started in January 2004 and is ultimately expected to generate a further £110,000 of income from tenants. The further development of this site is funded through a £150,000 loan facility arranged with the Local Investment Fund (LIF) and a £95,000 grant from the Derbyshire Economic Partnership.

The LIF facility is a term loan amortising over 10 years, with a six month capital repayment holiday. The interest charged is 3% over the NatWest base rate. The loan is subordinated to the other debt obligations of the trust and has a second charge over the trust's assets.

The EMCLF is one of LIF's regional funds, so LIF already had a relationship with Genesis and HURT before the structuring of this facility. When considering the loan request, the LIF relationship manager reviewed the business plan, assessed management and analysed its income sources, funding streams and cashflows. LIF also took into account the diversity of the income sources, the market for the services offered, the stability of the grants and the regeneration and social outputs of the projects.

The key risks identified were that the projections might be too optimistic and that the value of the security offered might not cover the value of the loan. Funding of the facilities was subject to obtaining the required planning consents and the arrangement of the security over the properties. LIF requires quarterly management accounts, annual audited accounts and site visits every six months. To date the facility has performed as expected; for their part, HURT management have been very pleased with their relationship with LIF.

Looking ahead

Although HURT secured all of the financing required to develop the site, delays in receiving some of the grant money led to a bigger loss than anticipated in the first year of operation. The first instalment of the Coalfields Regeneration Trust grant money was paid in December 2002, four months later than expected. Because these revenue support funds cannot cover costs already accrued, the organisation incurred unrecoverable costs of £60,000. This loss has also delayed the completion of the complex, which means that the centre will not be earning its maximum rental income as soon as expected.

EMDA has recently approved a further £1,540,000 grant, of which £920,000 will be used to enable Genesis to buy the site's freehold and £630,000 will be used to complete the development of the property. This will save Genesis £100,000 per year in lease expense and leave it with an asset valued at £2.8 million.

Annex A – Summary Table of Loans

Below is a table summarising all the loans examined for this report. Some organisations have loans other than those used for the case studies above and these have been included where possible. Loans to a single social enterprise are grouped together. In all cases (except for the one in which there are loans from a CDFI, loan funds, and a mainstream bank), the loans are from the same institution.

Type of Bank	Amount	Type	Term	Interest Rate	Security	Purpose
Social	£101,000	Term	3-4 years	6%	Floating Charge	Building Acquisition
Social	£50,000	Term	2 years	6%	Floating Charge	Working Capital
Social	£40,000	Term	3 years	6%	Sales revenue into blocked account	Update and produce a product
Social	£50,000	Term	9 months	6%	Guarantee from trading arm	Bridge grant funding
Social	£187,000	Term	25 years	7.2%	1st charge over property	Building acquisition
Social	£280,000	Term	15 years	2% over base	Property	Building acquisition and renovation
Social	£50,000	Term	6 months	5% over base	None	Bridge grant funding
	£5-10,000	Cover for excesses	As needed	18%	None	Account overdraws

Type of Bank	Amount	Type	Term	Interest Rate	Security	Purpose
Social	£135,000	Term	12 years	2.5% over base	1st charge over property	Building acquisition
CDFI	£150,000	Term	10 years	3% over base	2nd charge over assets, subordinate to other debt	Equipment purchase, building renovation
CDFI	£100,000	Term	10 years	3% over base	2nd charge over property	Property purchase
Loan Fund*	£300,000	Term	20 years	3% over base	1st charge over property	Property purchase
Mainstream Bank	£200,000	Term	15 years	2.5% over base	Property	Property purchase
Mainstream Bank	£150,000	Overdraft	Annual renewal	3% over base	Charge over property	Overdraft
	£250,000	Term	Not agreed	Not agreed	Charge over property	Building renovation
Mainstream Bank	£530,000	Term	20 years	1.49% over base	Charge over property	Building acquisition
	£50,000	Overdraft	Annual renewal	1.49% over base	Charge over property	Overdraft
Mainstream Bank	£40,000	Term	Unknown	Unknown	Charge over property	Building acquisition
	£10,000	Overdraft	Annual renewal	Unknown	Charge over property	Overdraft
Mainstream Bank	£530,000	Term	Unknown	Unknown	Charge over property	Building acquisition
Mainstream Bank	£2,500,000	Invoice Discounting	Annual renewal Annual renewal	2.5% over base	Fixed and floating charge over debtor book	Working capital
Mainstream Bank	£1,275,000	Term	15 years	6.66%	Property	Building purchase and renovation
	£425,000	Term	12 years	1.5% over base	1st charge over property	Building renovation
	£500,000	Term	12 years	1.5% over base	1st charge over property	Building renovation
	£1,000,000	Term	15 years	1.5% over base	155 year lease	Building renovation
	£100,000	Overdraft	Annual renewal	1.5% over base	1st charge over properties	Overdraft
Mainstream Bank	£934,000 (various)	Term	10-15 years	1.5-2% over base	Property	Property acquisition
	£200,000	Overdraft	Annual renewal	1.5-2% over base	Property	Overdraft
Mainstream Bank	£1,125,000	Term	20 years	1.25% over base	Charge over properties and leases	Building renovation
Mainstream Bank	£30,000	Overdraft	Turndown	Turndown	Turndown	Turndown

* Loan Fund means an entity established to provide loans, often with a social purpose, that was approached as part of a package of financing, but is not a mainstream bank, social bank or national CDFI.

Annex B – Working Group Members

Below is a list of those who participated in the 'Making the Market' and Finance and Funding Working Groups in Summer 2003, following the publication of the Bank of England Report.

Philip Angier	Angier Griffin
Steve Walker	Aston Reinvestment Trust
Hilary Brown	Bank of England
Emma Murphy	Bank of England
Peter Kelly	Barclays Bank
Richard Roberts	Barclays Bank
Charlie O'Malley	BigInvest
Leonie Hirst	BigInvest
Philip Newborough	Bridges Community Ventures
Andrew Shadrake	Business Link Devon & Cornwall
Paul Coleman	Business Link for London
Sarah McGeehan	Community Development Finance Association
Bernie Morgan	Community Development Finance Association
Malcolm Hayday	Charity Bank
Marion Webster	Community Foundation Network
David Carrington	Consultant
David Dickman	Co-operative Bank
David Dunn	Co-operative Bank
Keith Masson	DTI
Shantha Shanmugalingham	DTI
Nicola Pollock	Esmee Fairbairn Foundation
James Edwards	Finance South East

Eleanor Knight	Finance Wales
Alex Hook	Foursome Investments
David Gold	Glimmer of Hope
Craig Campbell	HBOS
Douglas Faill	HBOS
Ken McNaughton	HBOS
Tim Weetman	Home Office
Ben Day	HM Treasury
Louise Willington	HM Treasury
Neil Warsop	HM Treasury
John Rendall	HSBC
Steve Ford	HSBC
Andrew Hibbert	Industrial Common Ownership Fund
Brian Whittaker	Lankelly Foundation
Roger Brocklehurst	Local Investment Fund
Stephen Pegge	Lloyds TSB
Andy Walch	Lloyds TSB
Naomi Kingsley	London Rebuilding Society
Gilson Undi	London Rebuilding Society
Bruce Wood	London Rebuilding Society
David Brinsford	NatWest
Peter Ibbetson	NatWest
Andrew Robinson	NatWest/RBS
Tracy Betts	NatWest/RBS
Sarah Forster	New Economics Foundation
Keith Richardson	North East Social Enterprise Partnership (NESEP)
Fiona Ellis	Northern Rock Foundation
Frank Carson	Office of the Deputy Prime Minister
Allan Watt	RBS Group
Lucy Findlay	RISE- SW Social Enterprise Partnership
Victoria Hornby	Sainsbury Family Charitable Trust
Ellen Lederman	Shorebank Advisory Services
Bob Brennan	Small Business Service
Jonathan Bland	Social Enterprise Coalition
Ros Boyle	Social Enterprise Coalition
Megan Bingham-Walker	Social Enterprise Unit
Jonathan Holyoak	Social Enterprise Unit
Barbara Phillips	Social Enterprise Unit
Tim Reith	Social Enterprise Unit
Steve Wallace	Social Enterprise Unit
Scott Anderson	Social Investment Scotland
Sue Cooper	Triodos Bank
Gavin Smith	Triodos Bank
Nigel Price	Unity Trust Bank
John Kingston	Venturesome

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