

**Report of:** Director of Communities and Environment

**Report to:** Executive Board

**Date:** 13 February 2019

**Subject:** Long term Strategic Partnership with Leeds Credit Union

Are specific electoral wards affected?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
Are there implications for equality and diversity or cohesion and integration?	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
Is the decision eligible for call-in?	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
Does the report contain confidential or exempt information?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
If 'yes', access to information procedure rule number:		
Appendix number:		

## Summary of main issues

1. This report updates Executive Board on the Council's strategic approach to support the work of Leeds Credit Union (LCU) to tackle financial exclusion and poverty in Leeds. LCU is one of many partners in the city who work alongside the Council to help combat the problems brought about by financial exclusion. Residents and households who are deemed to be financially excluded do not have easy access to affordable banking services and in many cases are unable to access cheaper goods and services. In the more deprived areas of the city this can result in debt issues for families and getting into arrears with rent and other priority payments.
2. In 2009, as part of a set of proposals to support the LCU, the council provided a subordinated loan on a commercial basis. When it was initially provided the loan was due for full repayment in April 2019. Members of Executive Board received a further report on 21 October 2015, detailing work being undertaken between Leeds City Council and LCU to tackle poverty in Leeds and to increase access to affordable financial services. The report outlined the long-term strategy for ongoing partnership working. Approval was given by Executive Board to reschedule the loan with detailed arrangements to be determined by the then Assistant Chief Executive (Citizens and Communities). The Director of Communities and Environment (formerly the position of Assistant Chief Executive (Citizens and Communities)) subsequently agreed that the subordinated loan to LCU would be rescheduled to a ten-year loan commencing on 1 April 2016. The interest rate applied to the loan was compliant with the European Commission rules as to the provision of State Aid. However, for the first three years the amount of interest payable by LCU was reduced by £157,080, in accordance with the

rules relating to the provision of 'de minimis' aid. The current three year interest reduction will expire on 31<sup>st</sup> March 2019 and Executive Board are now asked to agree a further reduction for an additional six years until 1 April 2025 as detailed in paragraphs 4.6 to 4.9.

3. The loan to the LCU forms part of its capital reserves which LCU must maintain at a level of 10% of its total assets (which includes loan book, savings and property assets). This is a stipulation by the Prudential Regulation Authority (PRA) which has the responsibility for regulating credit unions and ensuring that they are operating in a viable way. The loan is due to be repaid in full in April 2026 and under PRA rules, the loan must be written down within 4 years of this repayment date. Therefore, LCU would need to commence writing down the loan at 25% each year in 2022.
4. The implications of this would be that the LCU capital ratio would fall below the PRA's 10% requirement and that LCU would be placed under "special measures" control of the PRA with the expectation that LCU would have to find a way to increase its capital ratio within a reasonable time period or face being closed down. Officers have been in discussions with LCU to seek to ensure that LCU will avoid breaching the PRA's 10% capital requirement. Various options have been considered that look at how the business would be able to reach sustainable levels of growth whilst remaining above the 10% capital requirement.
5. Following an assessment of the options detailed in this report, it is now proposed that the Council provides grant funding that would allow LCU to pay down the loan over a 6 year period, thus ensuring that PRA regulations are not breached, whilst also ensuring that LCU, as a key partner in helping to tackle poverty in Leeds, can continue to deliver affordable locally based financial services with additional targets been agreed for lending and further increasing the membership base of the LCU to provide genuine alternatives to the high cost credit sector. Successful and sustainable partnership working with Leeds City Council has resulted in increases to both membership and loans over the past ten years, through developing innovative customer focussed products and services. This has shown positive benefit for citizens living in the more deprived communities in the city and support for LCU is helping the council to meet its strategic objectives laid out in the Best Council Plan.

## **Recommendations**

Executive Board are asked to:

- a. Note and welcome the significant progress made and projects developed through the partnership between the Council and Leeds Credit Union;
- b. Approve the provision to Leeds Credit Union of a grant over 6 years of £198,333 per year that is linked to greater lending targets and membership levels of Leeds residents;
- c. Delegate authority to the Director of Communities and Environment in consultation with the Chief Officer Financial Services to negotiate and enter into a grant agreement with Leeds Credit Union;
- d. Agree to the amount of interest payable by Leeds Credit Union on its existing loan from the Council being reduced as set out in this report.

## **1 Purpose of this report**

- 1.1 This report updates Executive Board on the Council's strategic approach to support the work of Leeds Credit Union (LCU) to tackle financial exclusion and poverty in Leeds. The report details proposed arrangements for council support for LCU.

## **2 Background information**

- 2.1 LCU is one of many partners in the city who work alongside the Council to help combat the problems brought about by financial exclusion. Residents and households who are deemed to be financially excluded do not have easy access to affordable banking services and in many cases are unable to access cheaper goods and services. In the more deprived areas of the city this can result in debt issues for families and getting into arrears with rent and other priority payments.
- 2.2 LCU has its origins as a City Council credit union, opened to membership for all City Council employees and their families in 1987. Since that time, through changes to the common bond (the basis on which individuals are eligible for membership) and mergers with other community-based credit unions, LCU has grown to become one of the largest "live and work" city based credit unions in the UK.
- 2.3 Following the amalgamation of the White Rose Credit Union (Wakefield) and the extension of the common bond to other areas, anyone who lives or works in Leeds, Wakefield, Harrogate or Craven or anyone who works for certain organisations, or is a resident of certain Housing Associations, are eligible for membership of LCU.
- 2.4 Following the launch of the City Council's Financial Inclusion Strategy in 2005 a programme of branch expansion was initiated with the aim of providing credit union facilities in a number of Council One Stop Centres (now Community Hubs) and Housing Offices. Since 2005, LCU membership has increased significantly from 11,000 members to almost 32,000 Leeds members today. Much of this growth has been new members on low incomes or benefits. Total membership, including members of the former White Rose Credit Union now stands at almost 37,000.
- 2.5 During the last year LCU has had discussions with the Council's HR service to investigate ways in which the credit union can provide an enhanced service to the Council's workforce and assist the Council in bringing about greater financial welfare for its staff. This has resulted in a package of measures designed to provide financial services tailored to the needs of Council staff.

## **3 Main issues**

- 3.1 The Council has provided significant officer and financial support to LCU in recognition of the important part it plays in providing financial services to its 32,000 Leeds members. LCU promotes financial inclusion in Leeds and provides loans to people who would otherwise resort to the use of payday and other high cost lenders.

- 3.2 In April 2009 the Council provided LCU with a loan of £2m. This loan was originally due to be repaid in April 2019 but was rescheduled in April 2016 and became repayable in April 2026. Interest was payable at 6.92% over the life of the loan with the Council discounting the amount of interest payable for the first three years of the loan, resulting in an effective interest rate of 4.16% for that period. At the time of writing the total amount outstanding is £1.19m and the loan payments are up to date with no arrears
- 3.3 The loan forms part of LCU's capital reserves which LCU must maintain at a level of 10% of its total assets (which includes loan book, savings and property assets). This is a stipulation by the Prudential Regulation Authority (PRA) which has the responsibility for regulating credit unions and ensuring that they are operating in a viable way. The loan is due to be repaid in full in April 2026 and under PRA rules, the loan must be written down within 4 years of this repayment date. Therefore, LCU would need to commence writing down the loan at 25% each year in 2022.
- 3.4 The implications of this would be that the LCU capital ratio would fall below the PRA's 10% requirement and that LCU would be placed under "special measures" control of the PRA with the expectation that LCU would have to find a way to increase its capital ratio within a reasonable time period or face being closed down.
- 3.5 Officers have been in discussions with LCU to seek to ensure that LCU will avoid breaching the PRA's 10% capital requirement. Various options have been considered that look at how the business would be able to reach sustainable levels of growth whilst remaining above the 10% capital requirement. The options considered (including some that would not meet sustainability requirements) are set out below:
- a. Status Quo (do nothing) – the loan would be repaid in 2026 but LCU would likely breach the PRA capital requirement rules well before that date and would threaten the viability of LCU;
  - b. Rescheduling the subordinated loan – this was the option agreed in 2016 and had the effect of moving back the date at which LCU would have difficulties maintaining its capital requirement. Rescheduling the loan again would push back the date where capital requirements became an issue but would not provide a permanent sustainable solution;
  - c. Write the loan off over 4 years – the accounting impact would result in impairment of the full loan and result in the full £1.19m impacting on the Council's financial position in the first year. Writing off the loan in this way would also contravene State aid rules;
  - d. Provide a 4 year annual grant based upon objectives around increase in lending. This achieves the same result but the impact on the council's financial position would be spread across 4 years. This grant would be £297,500 per year for 4 years; or
  - e. As above but with a grant provided over 6 years at £198,333 per year
- 3.6 It is proposed that the last option (option e) is the preferred option and the mechanism for delivering this option is set out below.

## 4 Identified Risks/Opportunities

- 4.1 The rationale for agreeing to support the LCU in this way would be:
- a. Providing LCU with a secure stable base from which to further grow their business;
  - b. Build on the significant time and resources that LCC has provided to date;
  - c. LCU would be able to reduce their individual loan rating threshold thereby providing loans to some people who would not otherwise meet current lending criteria. This would increase LCU profitability above expected increase in the level of bad debts;
  - d. LCU would be able to continue to target employees of the Council/NHS and others to keep them from using payday lenders.
- 4.2 Providing a grant to LCU that is conditional on them increasing their lending and thus providing a service to the public, would be permissible under State Aid Rules relating to the provision of "Services of General Economic Interest".
- 4.3 The harsh economic climate for families over 2017/18 has meant that LCU has seen an increase in bad debt and a deterioration of people's credit scores/credit worthiness. This means it has been difficult for the credit union to provide loans where the bad debt risk was high and was likely to result in a loss for LCU. At the financial year end LCU accounts recorded a break even result illustrating that the financial position is quite tight.
- 4.4 The average bad debt across all credit union loans last year was 4.4%. However, bad debts from loans made to applicants in the lowest quartile of credit scores for the 12 months ending 30th September was 14.3%. At this level of bad debt, the credit union cannot make loans to this group of applicants, as it becomes too high a risk i.e. the interest received does not cover all the costs including administration and bad debt. Each month the credit union receives over 200 applications from individuals with poor credit scores (credit histories) and is not able to provide a loan on the majority of these. The majority of these loans will be small loan applications from low income members.
- 4.5 However, if the Council were to provide assistance as outlined in this report, LCU would be able to provide lending to a proportion of these applicants. Additional lending of between £1M to £1.3M per year has been estimated as being possible, and would be contained with the LCU's revised resourcing capacity. The benefit for the community would be an estimated £890k per annum in interest rate savings. (Compared to the same loans being taken from a prominent door step lender – the savings compared to payday lenders would be considerably more).
- 4.6 It is proposed that the Council will provide LCU with a grant of £198,333 per year for a period of six years commencing on 1 April 2019 (such money to assist LCU to provide loans to individuals who they would not otherwise be able to lend to) as well as reducing the amount of interest payable by LCU, from April 2019, under its existing loan from the Council. In exchange for this assistance, LCU will pay down its loan from the Council by the amount of £198,333 per year commencing on 1 April 2019.
- 4.7 When LCU's loan was rescheduled in 2016, the State aid compliant interest rate was 6.92%. The Council subsequently discounted the amount of interest payable for the first three years of the loan in accordance with the rules relating to the

provision of 'de minimis' aid, resulting in an effective interest rate for that period of 4.16%. The European Commission has issued 'de minimis' regulations, which allows organisations to receive aid of up to €200,000 (or €500,000 in the case of organisations providing services which are deemed to be "Services of General Economic Interest" (SGEI)) over a three year period.

- 4.8 LCU is a provider of Services of General Economic Interest, and has confirmed that it has not received any de minimis aid (other than the discounted interest previously provided by the Council which expires at 31 March 2019) within the last three years. LCU will therefore have a 'de minimis' allowance of €500,000 available for the next three years (from 1 April 2019) and it is proposed that the Council uses the 'de minimis' regulations to reduce the amount of interest payable by LCU for the remaining term of the loan. For State aid purposes the headline interest rate on the loan will remain at 6.92% but the amount of interest payable by LCU will be discounted by an amount up to the limit of de minimis aid available subject to a minimum interest rate of 4.16% (the current discounted rate) being applied..
- 4.9 It is proposed that the current rate will continue to apply until the full repayment of the loan in March 2025. The calculation of the sterling equivalent 'de minimis' value is dependent on the euro exchange rates applicable at the time the interest discount is given. In addition, the amount of any interest discount will also be dependent on the repayment schedule agreed at that time. Therefore, it is proposed that the conclusion of the detailed financial arrangements including the negotiation of a grant agreement be delegated to the Director of Communities and Environment in consultation with the Chief Officer Financial Services.

## **5 Corporate considerations**

### **5.1 Consultation and engagement**

- 5.1.1 This report has been prepared in consultation with LCU, and the relevant officers from across the council including finance and legal colleagues.

### **5.2 Equality and diversity, cohesion and integration**

- 5.2.1 A key focus of the partnership work between LCU and Leeds City Council has been to support people suffering hardship, poverty and inequality, and therefore issues of equality, diversity, cohesion and integration are key aspects of this work. The projects and initiatives outlined in the report are central to the council's financial inclusion strategy, which has been subject to a detailed Equality Impact Assessment that has been presented to the Executive Board previously.

### **5.3 Council policies and the best council plan**

- 5.3.1 The work of the Credit Union forms part of the Council's strategic policy to tackle financial exclusion and reduce financial hardship. The overarching aim of the Best Council Plan is 'Tackling Poverty and Reducing Inequalities'. The activities set out in this report support the Best City Priority of Safe, Strong Communities through:
- Keeping people safe from harm, protecting the most vulnerable.
  - Helping people out of financial hardship.
  - Tackling crime and anti-social behaviour.

- Being responsive to local needs, building thriving, resilient communities.
- Promoting community respect and resilience.

## **5.4 Resources and value for money**

5.4.1 It is proposed that the grant be funded from the Social Inclusion Fund (administered by the Communities and Environment directorate). At the moment approximately £200k of administrative staff costs are charged to this fund before the remaining amount is distributed. This was agreed a couple of years ago as a short-term measure recognising the initial work done by the team on establishing the social inclusion fund, but was not seen as a longer-term option as there is a need to ensure the fund is directed on initiatives that support the council's social inclusion agenda. The Council's budget proposals for 2019/20 include funding the financial inclusion team from base revenue funding, thus releasing £200k of social inclusion funding which can be utilised to support this proposal.

5.4.2 The proposals set out in this report will maintain the actual amount of interest payable for the remainder of the length of the loan at the same level as that levied during the first three years of the loan up to end March 2019. Therefore, the income to the Council will remain the same. However, income from the loan has been generally above market rates and is likely to continue to remain so until the term of the loan. Therefore, it is considered that overall the Council has received good value from the loan which should continue until full payment in 6 years time. At the same time, the provision is providing valuable assistance to an important strategic partner.

## **5.5 Legal implications, access to information and call-in**

5.5.1 Section 1 of the Localism Act 2011 empowers the Council to do anything that individuals generally may do, subject to any restrictions as to the use of its powers to which the Council was subject when that Act came into force or which have subsequently been imposed.

5.5.2 As regards the provision to LCU of the assistance referred to in this report, it should be noted that the activities of the Council are subject to the European Commission's rules as to the provision of State aid.

5.5.3 State aid occurs when public resources are used in a way which gives an organisation an advantage over its competitors in a way which distorts or is likely to distort competition between European member states. A number of cases have made it clear that the provision of assistance to credit unions is subject to the State aid rules and the Council will therefore have to comply with those rules in connection with the arrangements referred to in this report.

5.5.4 The rate of interest applying to the loan (before discount) was determined as being at least equivalent to the minimum rate of interest prescribed by the European Commission for loans to be considered to be State aid compliant. As detailed in paragraph 4.8, discounting the amount of interest payable under the loan will be compliant with the rules as to the provision of 'de minimis' aid.

5.5.5 The European Commission's rules as to the provision of State aid allow for assistance to be given to undertakings carrying out "Services of General Economic Interest" (services of an economic nature identified as being of particular importance to citizens). Ultimately, it falls to the body providing the aid to determine if the services which it is funding are "Services of General Economic Interest" but it is felt that LCU providing loans to people they would not otherwise

be prepared to lend to, at an interest rate which is lower than the interest rate that those people would otherwise be able to borrow at, can properly be considered to be such a service, and that the provision to LCU of an annual grant as outlined in this report will therefore be in accordance with the State aid rules.

## **5.6 Risk management**

- 5.6.1 Previous reports on this matter have fully detailed all of the principal risk management related issues regarding the loan and these remain unchanged. The principal risk identified within this report is the risk of LCU's capital ratio falling below the PRA's 10% requirement which would likely place the LCU in "special measures". A number of options have been fully considered and the proposal considered within this report is considered the best way to manage this key principal risk in order to support a key organisation supporting the city's financial inclusion priorities

## **6 Conclusions**

- 6.1 LCU is a key partner in helping to tackle poverty in Leeds, through delivering affordable locally based financial services. Successful and sustainable partnership working with Leeds City Council has resulted in increases to both membership and loans over the past ten years, through developing innovative customer focussed products and services. This has shown positive benefit for citizens living in the more deprived communities in the city and support for LCU is helping the council to meet its strategic objectives laid out in the Best Council Plan.
- 6.2 With the support of the Council, LCU has ambitions to grow their membership base and provide genuine alternatives to the high cost credit sector.

## **7 Recommendations**

- 7.1 Executive Board are asked to:
- 7.1.1 Note and welcome the significant progress made and projects developed through the partnership between the Council and Leeds Credit Union;
- 7.1.2 Approve the provision to Leeds Credit Union of a grant over 6 years of £198,333 per year that is linked to greater lending targets and membership levels of Leeds residents;
- 7.1.3 Delegate authority to the Director of Communities and Environment in consultation with the Chief Officer Financial Services to negotiate and enter into a grant agreement with Leeds Credit Union;
- 7.1.4 Agree to the amount of interest payable by Leeds Credit Union on its existing loan from the Council being reduced as set out in this report.



## Background documents<sup>1</sup>

8.1 None

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<sup>1</sup> The background documents listed in this section are available to download from the council's website, unless they contain confidential or exempt information. The list of background documents does not include published works.