Leeds CITY COUNCIL

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Report of: **Financial Inclusion Manager**

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

Date: **6 November 2018**

Subject: **Headrow Money Line, Loan Provision**

Are specific electoral Wards affected? If relevant, name(s) of Ward(s):	☐ Yes	☒ No
Are there implications for equality and diversity and cohesion and integration?	☐ Yes	☒ No
Is the decision eligible for Call-In?	☐ Yes	☒ No
Does the report contain confidential or exempt information? If relevant, Access to Information Procedure Rule number: 10.4(3) Appendix number: A	☒ **Y**es	☐ No

Summary of main issues

1. Headrow Money Line (HML) is a Community Development Finance Institution (CDFI) and was established in November 2012 to work alongside Leeds Credit Union (LCU) to enable higher risk loans to be provided to those who might not otherwise be able to get credit other than through very expensive sources. Over the last year the demand for loans has increased and HML require additional finance if it is able to meet that demand.

2. HML have been seeking to arrange additional finance from other sources and have a £150k loan from the Key Fund. The Key Fund is a social enterprise providing tailored loan investments of up to £150,000 to businesses with a social or environmental mission, throughout the North of England. The rate of interest charged by The Key Fund is 12% APR which provides a financial burden to HML.

3. It is proposed that the City Council provide a £245k loan facility to HML, at an interest rate of 3.22%. This is a state aid compliant rate and is above the safe harbour rate.

Recommendations

4. Approve a £245k loan to enable the Community Development Finance Institution - Headrow Money Line (HML) - to continue to provide loans to those unable to access more affordable forms of borrowing.

1. Purpose of the report

To seek approval of a £245k loan with the facility to draw down for the provision of loans by HML.

2. Background information

2.1 HML is a Community Development Finance Institution (CDFI) and was established in November 2012 to work alongside Leeds Credit Union (LCU) to enable higher risk loans to be provided to those who might not otherwise be able to get credit other than through very expensive sources. The establishment of HML was reported to the Council's Executive Board in September 2012 as part of a fuller report looking at the council's strategy for combatting the problems of high cost lending. A further Executive Board report was considered by Members in October 2015 which again referenced the importance of HML and its role in providing alternative sources of finance primarily to the more deprived communities in Leeds. Therefore, the policy context of support for HML has been considered by Elected Members on a number of occasions.

2.2 HML is a company limited by guarantee and a registered charity and is run by a lay board of trustees. The day to day work of HML is undertaken by LCU staff under a service level agreement between the two organisations. They are able to offer loans which are marginally higher risk than can be offered by LCU as they are able to charge higher rates of interest. They are able to provide loans to more people and help them re-build a credit history so that if they need to borrow again, they can be referred to cheaper options of credit, such as being referred back to the credit union. HML currently charge a representative interest of 79% APR on their loans.

2.3 HML initially secured a loan from Leeds Credit Union to provide them with operating capital to commence lending to their customers. Over the last five years HML have built up their business and now need more capital for their lending activities.

2.4 The motivation for setting up HML was to establish a vehicle for those who failed eligibility for a credit union loan but it was important to be able to offer an alternative rather than see LCU members go to high cost lenders. It was also envisaged that if repayments were made successfully the next time they wanted a loan they could obtain one from the credit union having created a more positive credit history.

2.5 National research conducted by the Department for Work and Pensions (DWP) confirmed this analysis. In 2006 the DWP administered a grant funding programme (called the Growth Fund) on behalf of the Government which provided funds to Credit Unions and CDFI's to lend to financially excluded families. After a number of years of operation of the scheme the DWP undertook a research survey of Growth Fund clients to determine what impact the service had and how it affected family finances. The data showed that, once someone had successfully applied for a loan from a credit union or CDFI, they were very likely to apply again and not seek to borrow from high cost lenders. In many instances, these subsequent applications could be granted at reduced interest rates because the applicants had now built up a credit history. Encouragement to save was also seen as important.

2.6 If residents can be provided with an alternative to high interest lenders they are likely to stay with that source along with the potential network of support which is then available. Also, although the initial interest charges are not low (but significantly lower that the commercial alternative), this can subsequently lead to credit being granted at much nearer to "normal" rates once a credit history has been built up.

2.7 Evidence locally from the operation of HML back up this DWP research as shown below. HML lending for the period of 6 months from January 2016 – June 2016.

172 people were awarded a loan (who had been turned down for a credit union loan). Out of these:

- 130 have since repaid their loans in full and are not in arrears.
- 31 are still repaying and are expected to repay.
- 11 are in bad debt with little expectation that they will repay.

As a result of improved credit history by paying off their HML loans, the 130 were eligible for a loan with the credit union. Out of these:

- 94 now have Leeds credit union loans (some of which have had 2 or 3).
- 4 of them have returned to HML for loans.
- 19 have not applied for a loan since.
- the remaining 13 have been refused a further loan (although they repaid their loans there were issues during the process due to a mixture of missed payments/issues with banking/change in circumstance)

So, in summary, 55% of those who were offered a loan with HML during that 6 month period are now borrowing with LCU. The 172 customers may have used high cost lenders if HML had not existed.

For the period July-December 2017, HML made 1,069 loans (value £513,350). If a similar proportion "migrate" to the credit union over the next year, then that will mean 588 people getting CU loans in 2018/19 (note – actual data on this will not be available for several months).

LCU estimate that £4.1m of loans at 79% APR (HML rate) would pay interest of £1.45m, but via a doorstep lender (at 300%) the interest would be £3.93m. Therefore the saving to the community over 3 years would be £2.48m. It should be noted that doorstep lender interest rates are relatively low compared with some of the high cost lending market. Therefore, the estimated saving to the community is likely to be an underestimate.

3. Main issues

3.1 At a meeting of Executive Board on 21 October 2015, a report was received outlining the joint work between the Council and LCU. The report also set out the long term strategy for ongoing partnership working including the work of HML, which is a major partner assisting LCU's ambition to increase membership and provide genuine alternatives to the high cost credit sector.

3.2 Loans to the value of over £100,000 are rejected by LCU each month and some of these applicants are then invited to apply for loans through HML. The gross loan book for HML (as at September 2017) was just over £272k. The total number of loans was 1,155 with a total value of £432,850 and the average loan value is £450. These all represent people who might otherwise have gone to high cost lenders and paid much higher interest rates. The majority of applicants had approached LCU in the first instance but did not meet the criteria and were therefore offered HML loans on different terms.

3.2 All HML loans are charged at an interest rate of 5% per month. This means that a £500 loan over one year is charged £177 interest, whilst the same loan from a doorstep lender would cost £410 in interest. HML is currently showing a modest surplus on its trading and the interest rate it charges is sufficient to cover its bad debt (which is approximately four times higher than the credit union's bad debt rate). HML is now gaining momentum and making a meaningful contribution and has more than doubled its lending since last year.

3.3 HML has not been publicised but consideration is now being given to a soft launch by having a website and make partners aware of its existence, as well as having a dedicated phone number.

3.4 The amount of money that LCU can lend to HML to distribute loans is legislatively limited. Current balance on LCU loan to HML is £347k. LCU can't lend any more than this under PRA regulations (LCU is limited to how much it can lend to any single borrower).

Therefore, HML have been seeking to arrange additional finance from another source and have recently been successful in achieving 'in principle' agreement for a £150k loan from the Key Fund. The Key Fund is a social enterprise providing tailored loan investments of up to £150,000 to businesses with a social or environmental objective, throughout the North of England. The fund aims to 'break down the barriers to accessing finance'. All its investments are to those organisations unable to access finance from banks or other mainstream lenders.

The Key Fund offers loans from £5,000 – £150,000 for:

- capital expenditure on assets including the purchasing and renovation of buildings
- cash flow and working capital to manage time differences between spending and receiving money
- development capital to help social businesses grow or replicate

The rate of interest charged by The Key Fund is 12% APR. This will generate additional cost for HML which is already operating with marginal surpluses and could influence decisions around interest charges as HML cannot afford to leave itself exposed to bad debt risks.

3.5 It is proposed that £245k loan facility is provided to HML. The loan will be for a five year term with interest only payments over that period and a bullet repayment of principal at the end of the 5 year term. Consideration has been given to what would constitute a commercial rate of interest. Based upon an analysis of the credit standing of HML as detailed in the confidential appendix A, a commercial rate would be between 3.22% and 5.02%. So a state aid compliant rate of interest on the loan would be 3.22%.

The safe harbour rate under state aid rules for loans with no security would be 3.20%. Therefore in providing a loan at 3.22% no state relief would be given. It should be noted that HML have confirmed that it has not received any de minimis aid since they commenced operation in November 2012.

3.6 The benefits of the continuation of the HML operation in Leeds are clear as outlined above. The HML annual report (year ended 30/09/2017) states that:

The company seeks to improve the economic and social well-being of individuals at risk of falling into the very real spiral of problems that can arise when facing financial hardship and indebtedness. HML does this by providing affordable credit to individuals who are excluded from mainstream financial services and exposed to high cost lenders.

The Directors calculate that during the course of the financial year this has saved the borrowers approximately £151,000 in interest payments, compared to obtaining the same value loan from a typical doorstep lender (this compares the interest rate charged by the company with that advertised by a typical doorstep lender. Payday lenders charge considerably more.)

In that financial year alone, HML helped with 962 new loans (prior year - 654 loans), supporting those using its services with a safe, affordable source of credit, and giving them the opportunity to improve their credit history.

The Directors intend to continue to expand the loans that it offers to the financially disadvantaged over the course of the coming year.

4. Corporate Considerations

4.1 Consultation and Engagement

The work of HML has been subject to discussions with partners via the Financial Inclusion Steering Group, which includes advice partners, social landlords and numerous other third sector organisations. A report on HML progress is made to the quarterly joint LCC/LCU joint Development Working Group which comprises officers from across all relevant Directorates. As indicated earlier in this report, the Executive Board has considered the work of HML in the context of the Council's broader strategy to combat poverty and equality on a number of occasions and the Executive Member for Communities has considered and is supportive of the recommendations in this report.

4.2 Equality and Diversity / Cohesion and Integration

A key focus of the partnership work between LCU, HML 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 th.is work. The projects and initiatives undertaken jointly are central to the Council's financial inclusion strategy, which has been subject to a detailed Equality Impact Assessment.

4.3 Council policies and the Best Council Plan

The work of the Credit Union and HML forms part of the Council's strategic policy to 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 'Building strong, cohesive communities, raising aspirations and reducing financial hardship' priority in the Best Council Plan.

4.4 Resources and value for money

The rate of interest charged will be at the lower end of the state aid range. The loan does not constitute capital expenditure and as such will be financed from the Council's balance sheet.

The maximum interest payable at 3.22% would be £39,466.62. The Council would be able to fund this loan at 2% representing a margin of £14,953.20 over the 5 years or approximately £2,990 per year to be set aside to mitigate against risk of default and the bullet repayment of principal being at the end of the loan.

4.5 Legal Implications, Access to Information and Call In

If the recommendations contained in this report are agreed the Council will enter into an agreement with HML on the terms set out in this report. In addition, the Council will also issue a letter to HML confirming the rate of interest for the length of the loan.

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.

As regards the proposals contained in this report, in so much as the Council is subject to statutory restrictions (such as its fiduciary duties to Council Tax payers) it is believed that the Council is complying with them.

This loan does not fall under the provisions of the 1973 Local Government (Land) Act, where if the Council was lending money to acquire land and/or to erect buildings or carry out work on land, it would be required to take adequate security.

4.6 Risk Management

The provision of the loan will be subject to a detailed legal agreement which provides terms which have been agreed with the Council's Chief Legal Officer. However, the loan is unsecured and this presents inherent risks in the event that HML becomes insolvent in which case the Council may not automatically be able to recover the loan either in whole or in part.

The Council works closely with HML as a partner in the work to alleviate the impact of poverty in the city and there is regular dialogue with HML. Any signs of difficulties should be identified at an early stage which could help in mitigating potential problems with the repayment of the loan.

HML has been trading for almost 6 years and has had a prudent attitude to the expansion of its business and not growing in a way that could be deemed to be unsustainable. Whilst the bad debt rate in HML is relatively high, as referenced in this report, it is not generally regarded as high compared to the market in which HML operates.

The impact of providing the loan will enable HML to avoid taking out other loan finance that would be at significantly higher interest rates than the loan provided by the Council. This would reduce operating costs and assist with the sustainable growth of HML.

Overall it is considered that the potential risks of making the loan are outweighed by the benefits to the community and the delivery of the Council's strategy to alleviate the impact of poverty in the city.

5. Conclusions

Headrow Money Line 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 and Leeds Credit Union has resulted in an increasing number of borrowers and loans since its inception.

The loan to HML will keep them on a firm financial footing and ensure that loans can continue to be awarded and therefore prevent their borrowers from turning to the high cost alternatives.

6. Recommendations

Approve a £245k loan to enable the Community Development Finance Institution - Headrow Money Line (HML) - to continue to provide loans to those unable to access more affordable forms of borrowing.

7. Background documents[1]

7.1 None

[1] 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.