Committee: Funding Committee of the Bridge House Estates Board	Date: 11 September 2023
Subject: Strategic Initiative: Responsible Finance	**Public**
Report of: Sacha Rose-Smith, Chief Funding Director	**For Decision**
Report author: Tim Wilson, Funding Director and Social Investment Fund Manager	

Summary

The September 2022 Committee meeting approved a support package for funded organisations to help manage persistently high inflation. The paper also noted that increased living costs were leading many low-income households to turn to short-term debt, and that officers would investigate how City Bridge Trust (CBT) could support access to affordable credit. This paper proposes an approach to strengthen the lending capacity of three Community Development Finance Institutions and build a more robust evidence base for future support from Government.

Recommendation

It is recommended that the Funding Committee, in discharge of functions for the City Corporation as Trustee of Bridge House Estates and solely in the charity's best interests:

i) **Award £788,000 over two years** to Responsible Finance to provide a first loss allocation to three Community Development Finance Institutions (CDFIs) to leverage additional investment to focus on lending to London residents facing financial insecurity and build the policy case for Government support to the community lending sector.

Main Report

Context

1. In Committee's September 2022 paper on high-inflation, officers noted that CBT would look at ways to support the work of London-focused responsible low-cost community lenders. Since then, CBT has examined what it could do via grant finance to boost flexible credit facilities for the most vulnerable, and this proposal recommends a way forward.

Background

2. Persistently high inflation started at time of economic vulnerability for many households. In March 2022, StepChange reported that around 20% of UK adults had less than £100 in savings and that more than 1 in 5 people expected to be driven into problem debt over the year with 31% expecting to struggle to pay for essentials such as healthy food and weather appropriate clothing. There is evidence of growing reliance on unsecured credit to cover essential living costs. In January 2022, the Office for National Statistics reported that almost 1 in 8 people surveyed said they were using more credit than usual because of rising living costs. Consumer borrowing costs reached a monthly total of £1.5bn in February, the highest since records began in 1993.

3. Since 2013 there has been an 86% drop in commercial subprime lending (e.g., from providers such as Wonga). Whilst much of this decline was the consequence of new regulation from the Financial Conduct Authority (FCA) to protect consumers through enhanced affordability checks and price caps, the diminution of this sector left little alternative provision. Low-income households are generally excluded from mainstream credit provision and disproportionately reliant on high interest 'buy now, pay later' providers or illegal credit from loan sharks. Low-income households risk entering debt-traps where further credit is needed to service the costs of existing loans.

4. Community credit providers deliver flexible and supportive finance to those who are otherwise unable to access commercial provision. Whilst this can be people receiving benefits, there is also growing reliance on credit from those with variable incomes (i.e., 'gig' workers). Typically, users would not have access to overdrafts or credit cards from high street banks. Credit helps support with emergency or unexpected payments beyond budget such as repairs to broken white goods or purchase of school uniforms. This can be especially important where households cannot afford insurance and where people would otherwise need to spread the cost of expensive items over months using high-interest credit from retailers. The 'poverty premium' refers to the higher prices people in poverty must pay for goods and services compared to those on higher incomes. Whilst the total value of loans from community credit providers are at an all-time high, their own lending capacity is constrained by their own capitalisation and is unlikely to be able to meet demand in the months ahead.

Proposal

5. Responsible Finance (RF) is the working name of the Community Development Finance Association, a company limited by guarantee without share capital (number 04111603). It is the umbrella organisation for Community Development Finance Institutions (CDFIs) working to develop the sector and act as an advocate to Government and the finance industry for its membership.

6. CDFIs are locally focused social enterprises lending to people and businesses who cannot access bank finance. Prospective borrowers are typically on low income, may have limited or poor credit history, meaning they either cannot access mainstream credit, or can only access at very high cost. CDFIs aim to provide a more personalised approach to risk assessment, transparency about the costs of borrowing and lend in such a way that finance is repaid. The demographics of people CDFI's work with are similar to those borrowing from illegal lenders.

7. In 2022, CDFIs lent a total of £248m and reached almost 95,000 customers[1]. This is estimated to have saved low-income households £28m in interest payments compared to borrowing from high-cost lenders.

8. Whilst the Government confirmed that financial inclusion would remain a named cause of its expanded Dormant Assets Scheme, and this will channel additional

[1] Representing £117m to 416 social enterprises, £81m to 3,230 start-ups, £46m to 90,630 individuals, and £4m to 465 homeowners.

monies in the CDFI sector, this has been provided mainly as capital to lend. Funding to cover lending risk and scale up lending at greater scale remains scarce. The FCA estimates that around 1.3m UK adults do not have a bank account. This represents a substantial number of people who lack access to banking services and credit from regulated sources when needed.

9. 'First loss' finance is used by CDFI's to absorb loan losses when customers cannot repay. It is also catalytic, leveraging more money by providing comfort to lenders who are looking to back a CDFI. Responsible Finance states that every £1 of first loss grant funding allows a CDFI to secure additional investment from a bank to then lend onwards to customers.

10. RF has worked with three London-focused CDFI members, Fair Finance, Salad Money, and Fair For You, to model the leverage they could generate on a first loss grant from City Bridge, the lending they could provide as a result, the Londoners they could support, and the savings this could represent for low-income households. The amount of total lending varies depending on how long each CDFI expects to need to secure match funding. CDFI 1 expects to need longer, whilst CDFIs 2 and 3 expect to be able to start lending immediately and recycling the loan finance at least once. The table below illustrates anticipated impact whilst anonymising the members given that borrowing discussions are ongoing:

	CDFI 1	CDFI 2	CDFI 3	Total
First loss grant from City Bridge	£200,000	£200,000	£200,000	**£600,000**
Total private investment leveraged over 2-year period.	£800,000	£935,000	£2,500,000	**£4,235,000**
Expected total lending enabled.	£1,000,000	£3,900,000	£5,491,000	**£10,391,000**
Number of Londoners supported.	2,857	5,308	5,491	**13,656**
Forecast savings for borrowers (compared to borrowing from commercial lenders).	£880,000	£1,634,864	£1,691,228	**£4,206,092**

11. The recommended £600k would help absorb loan losses when customers cannot repay and strengthen the CDFI balance sheets to enhance their borrowing capabilities. Modelling by the CDFIs indicates that the £600k would have a multiplier impact of just over 7x by attracting £4.2m of private investment. Additional to the £600k, is £60k to cover the CDFIs legal costs for securing private match, marketing, and reporting costs.

12. Alongside the work to scale responsible credit provision in London, funding is also recommended towards an external evaluation of first loss finance the programme to evidence the impact on the CDFI balance sheet as well as on the customers. The intention is to provide evidence to Government for support to the CDFI sector, and following discussions with others in the financial inclusion sector, officers recommend resourcing this work appropriately, so it has greatest potential to influence HM Treasury. This means a robust benefit-cost ratio, likely delivered by an economics consultancy with experience of working to HM Treasury's green book method, and able to provide evidenced analysis of the wider impacts of CDFI lending.

13. As the grant-holder responsible for onward funding to the CDFIs as well as management and reporting, the recommendation to Committee includes provision for RF's own costs.

    The recommended grant breakdown is as follows:

Element	Amount (£)
First loss finance	600,000
Evaluation	108,000
CDFI support costs	60,000
Responsible Finance management	20,000
Total	**788,000**

Financial Information

Year end as at 31st December	2021 Signed accounts £	2022 Signed accounts £	2023 Budget £
Income & expenditure:			
Income	185,364	258,931	351,695
- % of Income confirmed as at	100%	100%	54%
Expenditure	(179,480)	(226,155)	(323,386)
Total profit/(loss)	**5,884**	**32,776**	**28,309**
Balance sheet:			
Net assets/(liabilities)	180,907	213,683	241,992
Of which:			
Income & Expenditure reserves	180,907	213,683	241,992
Total reserves	180,907	213,683	241,992
Months' expenditure covered by I&E reserves	12.095	11.342	9.576

14. RF does not have a formal reserve policy but aims to ensure that expenditure matches resources, and that good financial health is maintained. 2021 accounts show reserves equivalent to just over 12 months' expenditure, and this is expected to fall slightly to just over 9.5 months' by end 2023.

15. The primary driver of growth between 2021 and 2023 was membership income with RF gaining 3-5 new members each year. In 2022, RF increased member fees in consultation with its membership to make the organisation more financially sustainable. In 2021 membership fee income was £130k and in 2023 RF expects

this to be over £200k. A 2-year grant awarded by the Impact Investing Institute in 2022 accounts for £30k pa in that year and 2023.

16. The organisation aims to maintain income at £350-370k and aims to recruit new posts to develop membership, project, and investment support posts to the team. 54% of the organisation's income has already been confirmed for 2023.

Recommendation

17. As the umbrella organisation for the CDFI sector, Responsible Finance offers an excellent route for CBT to support both the scaling of affordable credit provision to low-income Londoners as well as the evidence case for further investment in supportive lending. Members saw the scale at which low-income households were turning to unsecured credit in the September 2022 paper and the overall lack of savings held by UK households. Inflation remains high and exclusion from mainstream banking services particularly impacts on poorer Londoners, increasing their risk to the impact of financial shock and to paying a 'poverty premium' for credit. The recommended grant would be catalytic, helping to draw in additional capital to build the responsible credit sector in London.

18. Whilst CBT does not normally fund private companies, officers have reviewed the organisation's Memorandum and Articles of Association and can confirm that there are no issues of potential private benefit, that its objects are focused on membership development and Government engagement, and that it has an appropriate dissolution clause. CBT has precedent of funding work delivered by a private company, for example, through its grants to the Charity Tax Group.

Conclusion

19. It is recommended that the Funding Committee approve a grant of £788,000 over two years (£724,000; £64,000) to Responsible Finance to cover the costs of a first-loss allocation across three Community Development Finance Institutions, cost-benefit, and impact assessment, as well as management costs.

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