

**TITLE OF REPORT:** North East JEREMIE 2 Fund

**REPORT OF:** Paul Dowling, Strategic Director, Communities and Environment

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### **Purpose of the Report**

1. The purpose of the report is to inform Cabinet and provide detail retrospectively on the exercise of urgent delegated executive powers to approve the participation of Gateshead Council ("the Council") in a Special Purpose Vehicle (SPV), which will be a company limited by guarantee, alongside other NECA constituent authorities in order to enable the creation of the North East JEREMIE 2 Fund.

### **Background**

2. In April 2016 the North East Combined Authority (NECA) Leadership Board considered a report and agreed next steps towards the implementation of a North East Investment Fund (referred to as the JEREMIE 2 Investment Fund).
3. Officers from NECA and the North East Local Enterprise Partnership (NELEP) have been working with the Business Innovation and Skills Department (BIS), the Department for Communities and Local Government (DCLG), European Investment Bank (EIB) and HM Treasury officials to develop the most appropriate way of implementing the fund.
4. The North East Combined Authority Leadership Board met on 20 September 2016 and endorsed the creation of a Special Purpose Vehicle (SPV) as the implementing body to deliver the fund and receive and utilise the ERDF funding. Subsequently the North East local authorities took a decision to become the members of the SPV to enable the proposals to be implemented.

### **Proposal**

5. The overall position of the seven authorities needed to be determined by written procedure of DCLG's ESIF (European Structural Investment Funds) Committee and as a result there was insufficient time to seek approval from Cabinet.
6. In order for this matter to be taken forward it was necessary to exercise delegated executive powers to ensure that the Council's participation in the scheme is guaranteed.

### **Recommendations**

7. It is recommended that Cabinet:
  - (i) Notes the content of the report.

- (ii) Endorses the decision taken by the Acting Chief Executive following consultation with the Strategic Directors, Corporate Resources and Communities & Environment to ensure that the Council's participation in the scheme is guaranteed.

### Policy Context

1. This proposal is consistent with the aspirations set out within the Gateshead Strategic Partnership's Sustainable Community Strategy, Vision 2030 and supports the Sustainable Gateshead outcome of working towards a sound economic future.
2. The proposal contributes towards the vision of Prosperous Gateshead – a thriving economy for all and the outcome of more and better paid jobs and more people in work and more investment.
3. The proposal also supports increasing the number and quality of private sector jobs in the economy which is a key proposition in our European Strategy and Strategic Economic Plan. These are reflected in the strategic priorities for investing in growing our businesses and key to this is ensuring North East businesses have the access to finance to support growth and expansion plans.

### Background

4. The proposed North East JEREMIE 2 Fund will provide a successor to the JEREMIE 1 fund, which currently provides access to finance (equity and mezzanine loans funds) to Small and Medium Sized Businesses in the North East. The JEREMIE 1 scheme is due to end in December 2016. Other regional JEREMIE funds are being consolidated into the Northern Powerhouse Investment Fund (NPIF), with the British Business Bank acting as the Implementing Body, which will be operated from Sheffield. The North East Combined Authority (NECA) Leadership Board opted not to join NPIF, preferring to create a successor fund based in the North East, utilising existing expertise and infrastructure and which would enable greater local decision making. In 2015 Government approval, in principle, was provided to establish a North East fund operated by an Implementing Body located in the North East.
5. European Commission guidance has indicated that an entity to be entrusted as the Implementing Body should satisfy a number of 'public control' tests (*Directive 2014/24/EU*). DCLG had earlier concluded that North East Finance (NEF), the delivery body for the current (JEREMIE 1) programme could not be the Implementing Body for JEREMIE 2 as it is not directly or 'substantially' under public sector control.
6. The investment phase of the JEREMIE 2 fund is intended to start early in the new year, providing access to an additional £120m of finance for business over the next five years until 2022/2023, with a further period of up to five years of portfolio activity (business support and repayment of the investment funds). The objective of the fund is to provide access to finance for businesses, to support business growth.
7. The new SPV (which will satisfy the European Commission's public control test for an Implementing Body for the Fund) will oversee the activities of the North East JEREMIE 2 Fund which is proposed to make £120m of investments, which will be financed by an ERDF grant of £58.5m and legacy funds of £1.5m from previous loan schemes matched by £60m of loans from the European Investment Bank (EIB), who also provided the loan finance for the current JEREMIE 1 fund. The

SPV would be the ultimate recipient of the ERDF grant, which would be passported from NECA and the borrower for the purposes of the EIB loan. The costs of the scheme over the next ten years are estimated to be up to £25m and are to be fully funded by legacy funds generated from previous loan schemes.

8. The SPV will be established as a company limited by guarantee and constituent local authorities of the NECA will be the members of the SPV. They, in effect, will be the owners of the company and will retain strategic decision making over the SPV through their reserved powers as members of the SPV. The SPV in turn will oversee the activities of individual fund managers (to be procured by the SPV) who operate specific funds and provide the access to finance to businesses with the operational funding decisions being taken by the SPV and their contracted fund managers.
9. The SPV will adopt the articles of association and will enter into a Members' Agreement with the Authority. This will set out how the SPV will function and will detail:
  - Voting rights;
  - Ability to direct the Board of Directors;
  - Reservation of matters for the Members;
  - Nomination of Directors (by the Leadership Board); and
  - Adopting a scheme of delegation for the SPV.
10. The SPV will have a board of directors and subject to no conflicts of interest being present, it is proposed that this is made up of a Chief Executive and Finance Officer, a member, a representative of the Leadership Board, together with some additional specialist non-executive directors. The Directors, who will require experience in relevant fields to undertake these roles, are to be appointed by the Leadership Board (on behalf of the constituent authorities). Further details of the governance structure are contained in the Leadership Board report at appendix 1.

### **Finance and Other Resources**

11. Over the life of the JEREMIE 2 Programme, it is envisaged that £120m will be provided as Financial Instrument support to businesses in the first five years. The cost of the fund managers over a longer 10 to 12 year period, will also provide important support and guidance to businesses and work with businesses to secure the return of the funding, is estimated to cost up to £20m, with a provision for the cost of operating the SPV over the 10 to 12 year period of up to £5m, an average of £0.5m a year.

The envisaged costs and funding for this is summarised below.

### **Estimated Costs and Funding**

	<b>ERDF Grant</b>	<b>EIB Loan</b>	<b>Legacy Funds</b>	<b>Total</b>
	£m	£m	£m	£m
Financial Instruments to Businesses (Loans/equity)	58.5	60.0	1.5	<b>120.0</b>
Fund Manager Costs over 10 years			20.0	<b>20.0</b>
IB / SPV costs over 10 years			5.0	<b>5.0</b>
<b>Total</b>	<b>58.5</b>	<b>60.0</b>	<b>26.5</b>	<b>145.0</b>

12. The estimated costs of the scheme have been based on the costs of JEREMIE 1 with some savings that have been identified in the operation of JEREMIE 2. The estimated costs have been scrutinised by the funders and approved in principle, with final approval being given when the ERDF grant and EIB Loan facility are agreed. The costs and performance of the Fund will be heavily scrutinised by the funders over the period, who have observers on the SPV Advisory Board; receive quarterly reports; and carry out audits on the fund over its life. The current JEREMIE 1 scheme has been subject to over 20 Audits so far, with positive outcomes.
13. The business model assumes that the payback from businesses over the 10 year period will recover the full cost of the Fund of £145m. The first receipts must be used to repay the EIB loan facility, with further payments creating a legacy fund in the SPV to fund future rounds of financial support to business. The EIB are making a purely commercial loan with repayment at their risk, with this decision being based upon their assessment of the track record of previous loan schemes and their confidence in the robust and experienced fund management arrangements that they require to be established. No guarantee for the loan facility will be given by the owners of the SPV and there is therefore no loan liability for the local councils.
14. Two legacy funds are being used, which requires the approval of Government Departments. Single programme Legacy Funds, with at least £6m and up to £8m expected to be available, where approval has been sought from the IDAB committee (responsible to DCLG and BEIS). The balance of the £26.5m will be funded from ERDF legacy funds from previous loan schemes, which has been conditionally approved by DCLG.
15. An application for ERDF funding of £58.5m has been submitted by NECA on behalf of the NELEP. The application is being considered by written procedure of the ESIF committee. The ESIF Committee will give advice to DCLG about the strategic use of regional funds. The final decision and application approval rests with the Managing Authority (DCLG).
16. The arrangements described above comply with the advice and guidance being received from DCLG. Equally important is that the arrangements are also EIB compliant, as they are the match funder, providing the loan at their risk. Once approved, ERDF funding will be awarded to the SPV, being drawn down over the life of the programme. ERDF match funding of £60m is to be achieved through a loan from the European Investment Bank direct to the SPV. Advice received and previous experience in JEREMIE 1 Funds nationally, is that no indemnity or guarantee is required from the EIB. Risks associated with ERDF clawback will be managed within the SPV and its contractual arrangements with fund managers, so there is not expected to be a clawback risk for the local authority owners of the SPV.
17. The liability of the Authority will be limited to their £1 membership guarantee of the SPV. The borrowing limits will not be affected and the involvement in the company should appear as a narrative note in their annual accounts.
18. The performance of the JEREMIE 1 fund is positive and it is on track to repay its EIB loan soon and to generate legacy funds broadly in line with projections. The main financial risk of the estimated £145m investment payback not being received in full is that it will reduce the level of legacy funds available to be used to fund future access to finance schemes in future periods.

19. Given the potential of volume of jobs to be created and protected and the impact on the growth in the region's economy, the scheme is considered to represent very good value for money.

### **Legal**

20. The creation of the SPV will comply with EU Procurement legislation and EU Commission Guidance.
21. The Authority has the necessary legal powers to participate in the SPV for the purposes set out in this report under Section 1 of the Localism Act 2011 (the general power of competence) and given that the extent of the proposed borrowing by the SPV is in accordance with the Authority's own borrowing powers under Part 1 of the Local Government Act 2003.
22. The Fund Managers will be appointed by the SPV in accordance with an EU compliant procurement process. Those bidders providing the most economically advantageous tender will be appointed.
23. In relation to State aid, the JEREMIE 2 programme will be structured so that it can operate in accordance with the risk finance provisions of the General Block Exemption Regulation (GBER 651/2014), and so individual investment proposals will not need to be notified to the European Commission. The JEREMIE 2 structure will be established to operate in accordance with Article 21 of GBER. In addition, where appropriate, investment will also be provided by the SPV on a no aid basis or de minimis.

### **Executive Decision**

24. The Council's decision to participate needed to be confirmed after the NECA Board meeting on 20 September 2016 (which met and confirmed NECA participation in the programme) but before a meeting of the DCLG European Structural Investment Funds on 7 October 2016. There was no Cabinet meeting during that period requiring the use of urgent powers to safeguard the Council's interests.

### **Consultation**

25. The proposals for the extension of Financial Instruments are the result of an independent assessment report, development of the Strategic Economic Plan and the ESIF Strategy, all of which included wide consultation and engagement processes.
26. Ongoing consultation is being undertaken with the NECA Leadership Board and Interim Chief Finance Officer for the NECA. The Cabinet Members for Economy have been consulted.

### **Alternative Options**

27. Initially 3 options were considered for the SPV. They included:
  - (i) NECA acting as the sole member of the SPV. NECA is currently unable to act as the sole owner of an SPV if it is to borrow, as NECA does not currently have borrowing powers for economic development activity (it can

only borrow for Transport schemes). Consequently, being the owner of an SPV which then sought to borrow could be deemed to be overreaching the vires of NECA;

- (ii) A constituent authority acting as sole member of the SPV. Legal advice was sought and whilst this is possible, the jurisdictional issues are considered too great for one constituent authority to proceed on its own; and
- (iii) The constituent authorities of NECA acting as members of the SPV, which, after careful consideration, is the recommended option.

### **Implications of Recommended Options**

#### **28. Resources**

- a) **Financial Implications** – The financial implications relating to this matter are set out above.
- b) **Human Resources Implications** – There are no implications arising from this report.
- c) **Property Implications** - There are no implications arising from this report.

29. **Risk Management Implications** – The risks in relation to this matter are set out above. Any risks identified regarding the Special Purpose Vehicle will be monitored and reported accordingly.

30. **Equality and Diversity Implications** – There are no specific equalities and diversity implications arising from this report.

31. **Crime and Disorder Implications** – There are no crime and disorder implications arising from this report.

32. **Health Implications** - There are no health implications arising from this report.

33. **Sustainability Implications** – There are no environmental and sustainability implications directly arising from this report.

34. **Human Rights Implications** – There are no specific human rights implications directly arising from this report.

35. **Area and Ward Implications** – The proposal covers all areas and wards.

#### **Background Information -**

North East Combined Authority Leadership Board 20 September 2016  
Agenda Pack, Item 9 North East JEREMIE 2 Fund

[http://www.northeastca.gov.uk/sites/default/files/minutes\\_document/Leadership%20Board%2020%20September%202016%2C%20Agenda%20Pack.pdf](http://www.northeastca.gov.uk/sites/default/files/minutes_document/Leadership%20Board%2020%20September%202016%2C%20Agenda%20Pack.pdf)

North East Combined Authority Leadership Board 20 September 2016, 4<sup>th</sup>  
Supplemental Agenda Pack, Item 9 North East JEREMIE 2 Fund

[http://www.northeastca.gov.uk/sites/default/files/minutes\\_document/Leadership%20Board%2020%20September%202016%2C%204th%20Supplemental%20Agenda%20Pack.pdf](http://www.northeastca.gov.uk/sites/default/files/minutes_document/Leadership%20Board%2020%20September%202016%2C%204th%20Supplemental%20Agenda%20Pack.pdf)