

Supporting the Formation of South West Mutual

Appendix B of this report contain exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act 1972

Report to: **Executive**

Date: **22 November 2018**

Title: **Supporting the formation of South West Mutual**

Portfolio Area: **Strategy & Commissioning, Cllr Wingate**

Wards Affected: **All**

Relevant Scrutiny Committee: **Overview & Scrutiny Committee**

Approval and clearance obtained: **Yes**

Urgent Decision: **No**

Date next steps can be taken: **After Full Council 6th December 2018**

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Recommendations: Executive **RECOMMEND** to Council to:

1. **APPROVE** the granting of £49,995 from the predicted 2018/19 business rate pilot gain in order to support the formation of South West Mutual as detailed in section 3 and Appendix 2 of this report.
2. *(If 1 approved)* **DELEGATE** authority to the Group Manager, Business Development, to conclude the ordinary share acquisition
3. **AGREE** that, where possible, officers support the formation of the mutual by promoting it to local authorities within the South West

1.0 **Executive Summary**

- 1.1 On 27th September, Tony Greenham of the South West Mutual, provided a presentation to South Hams District Council Members – regional banking for inclusive growth. A copy of the presentation can be found at Appendix A.
- 1.2 In order to progress, the new mutual is seeking £500,000 of initial funding, through the issuing of Founder Shares. These shares will receive a dividend of 7.5% once the new bank becomes profitable and this dividend will rise over time if South West Mutual is successful.
- 1.3 In view of the higher risk of investment at this early stage, if a banking licence is obtained and the bank starts trading, Founder Shareholders will also receive an additional 2 shares for every share held. The combination of these two returns generates an estimated 'internal rate of return' (being a measure of investment returns widely used within business and finance) of approximately 20% per annum.
- 1.4 However, it must be understood that there is a risk that there will be no financial return and the entire initial investment will be lost if the plan to launch the mutual is unsuccessful or a banking licence is not granted. Accordingly, officers do not recommend investing in the mutual with the

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primary purpose of deriving a financial return as that is deemed too much of a financial risk. Instead, it is proposed that the Council uses funds from the predicted business rate pilot gain to fund a grant to South West Mutual. This grant will equate to an initial investment of £49,995 in return for 3,333 ordinary shares.

- 1.5 The pilot gain resulted in one-off monies received in 2018/19 and the Council determined that these should be used to fund initiatives to support the local economy.
- 1.6 Appendix A explains how the new mutual would help support the local economy and promote inclusive growth. In particular, it will help make banking more local, provide branch facilities in rural locations, recycle the savings of local people and businesses back into the regional economy, promote financial inclusion and improve access to credit for small and medium sized business.
- 1.7 The ethos behind the new mutual is consistent with the Council's corporate strategy objectives of communities and enterprise.
- 1.8 Members are requested to support the recommendations and utilise business rate pilot gains to help support the formation of the new mutual. In doing so, it recognises that the funds utilised may not necessarily be returned to the Council.

2.0 Background

- 2.1. On 27th September, Tony Greenham of South West Mutual, provided a presentation to South Hams District Council Members about the proposal to form South West Mutual – regional banking for inclusive growth. A copy of the presentation can be found at Appendix A.
- 2.2. It is envisaged that this economic grant meets the Council's Enterprise (Creating places for enterprise to thrive and business to grow) and Communities (Council and Residents working together to create strong and empowered communities) objective.
- 2.3. It is anticipated that the new mutual will help derive the following benefits for the South West:

Economic	Supporting local enterprises, business rates and employment Boosting economic resilience during recessions, protecting jobs and incomes Inclusive growth: spreading opportunities for locally driven business and employment Recycling more spending and savings back into the Devon economy
Social & environmental	Tackling financial exclusion and problem debt Improving financial capability and wellbeing Restoring trust and building civic participation Improved environmental and social performance

3. Proposals

- 3.1. The mutual is seeking an initial investment of £500,000 in order to progress its banking licence application. It will then need to find an estimated £2.5m in 2019 to set up operations and complete the banking authorisation process, and finally secure a further investment of £17.5m in 2020 to capitalise the bank and enable it to commence trading.

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- 3.2. It is envisaged that local authorities within the South West, who believe in the ethos behind the mutual and the benefits this will bring to the local economy, may wish to participate in all stages of investment including capitalising the bank once a provisional banking licence has been granted and the investment carries a much lower risk.
- 3.3. South West Mutual is launching its initial fundraising on 19th November 2018 seeking investment from private and institutional investors within the region. It is considered that the commitment of local authorities to invest in the initial Founder Share Offer will reinforce the confidence of private sector investors, make a significant statement of support for the social and economic mission of South West Mutual, and potentially shorten the timetable to opening branches and commencing trading within South Hams and the wider South West region.
- 3.4. The Council has benefitted from being a business rates pilot area for 2018/19, which has allowed the Council to keep a higher share of business rates income in 2018/19 to fund its services. The Council is determined that this funding should be used to fund initiatives to support the local economy.
- 3.5. It is proposed that the 2018/19 business rate pilot gain is used to assist with the formation of the mutual, with the Council granting £49,995 to the mutual – this equates to approximately 10% of the amount of initial funding required by the mutual.
- 3.6. At this stage, officers **do not recommend investing** in the mutual in order to derive a financial return as that is deemed too much of a financial risk. Independent financial advice regarding a financial investment has not been sought.
- 3.7. It is proposed that the Council uses funds from the predicted business rate pilot gain to **grant fund** the mutual. In return for this grant of £49,995, the Council will receive 3,333 ordinary shares. Members recognise that the grant funds utilised may not necessarily be returned to the Council. This should not be viewed as a normal investment made for purely financial return but a grant to support the local economy.

These shares will receive a dividend of 7.5% IF the new bank becomes profitable and this dividend will rise over time if South West Mutual is successful. In view of the higher risk of investment at this early stage, IF a banking licence is obtained and the bank starts trading, Founder Shareholders will also receive an additional 2 shares for every share held. The combination of these two returns generates an estimated 'internal rate of return' (being a measure of investment returns widely used within business and finance) of approximately 20% per annum.
- 3.8. Members appreciate that this grant (investment) is risky, but without the grant funding, the proposed benefits to the local economy may never be realised.
- 3.9. It is envisaged that the Council would be one of the first to provide financial support to the mutual. It is anticipated that this will help the mutual obtain the remaining funding it requires from other South West authorities.

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3.10. A similar report and recommendation is to be considered by West Devon District Council in November.

4.0 Options available and consideration of risk

4.1. Members could opt to follow, amend or reject the recommendations.

4.2. There are risks that should not be discounted. Members will need to be satisfied that the granting of £49,995 to South West Mutual, in return for 3,333 ordinary founder shares is consistent with the Council's corporate strategy.

4.3. As the Council will receive ordinary shares, over the long term this initiative could be considered as an investment. However, this transaction should be viewed immediately as an economic grant.

4.4. Members recognise that this transaction is not without risk and therefore do not expect to re-coup the grant, nor a profit on any shares acquired. Exempt Appendix B contains the detailed Founder Share Offer document.

4.5. By making this "investment", the council will be forgoing an investment return on the business rate pilot gain monies. The current investment return achieved by the Council is circa. 0.8% per annum. This equates to forgoing £400 per annum, if interest rates and returns were to remain the same.

5.0 Proposed Way Forward

5.1 It is proposed that if Executive approve this report's recommendations, Council will be asked to ratify the decision in December. Assuming this is approved, delegated authority will be given to the Group Manager, Business Development to conclude the acquisition of 3,333 ordinary shares in South West Mutual – as per the offer document shown in Exempt Appendix B.

5.2 Support will also be given to the mutual in order to promote the council's decision to other South West local authorities – with the aim that other authorities provide the remaining funding required in order to progress the banking licence application (as described in Appendix A).

6.0 Implications

Implications	Relevant to proposals Y/N	Details and proposed measures to address
Legal/ Governance	Y	<p>Appendix 2 of this report is exempt from publication because it contains information about the Council's financial and proposed commercial affairs as defined in Paragraph 3 of Schedule 12A to the Local Government Act 1972. The information is the intellectual property of a third party and cannot be divulged further without their prior approval. In particular, South West Mutual is bound to comply with the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 which regulates the promotion of investments to the general public and hence places legal restrictions on the publication of Appendix 2 which the Council wishes to respect.</p> <p>The public interest test has been applied and it is considered that the public interest lies in not disclosing this report at this time because it contains financial and commercially sensitive</p>

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		<p>information which could prejudice the Council and the third party if such information was disclosed at this time.</p> <p>This proposal is consistent with the Council's powers to invest under the Local Government Act 2003 and section 1 Localism Act 2011 (the general power of competence).</p> <p>Investments made by local authorities can be classified into one of two main categories:</p> <ul style="list-style-type: none"> i) Investments held for treasury management purposes; and ii) Other investments <p>Local Authorities should disclose the contribution that all other investments make towards the service delivery objectives and/or place making role of that local authority.</p> <p>Officers are confident that the proposed economic grant will help establish and promote the success of South West Mutual. The formation of such an institution, as described in Appendix A is consistent with the Council's Enterprise (Creating places for enterprise to thrive and business to grow) and Communities (Council and Residents working together to create strong and empowered communities) objectives.</p> <p>There is an overriding duty toward prudent management of risk, and officers, including the Council's section 151 officer, owe a fiduciary duty in relation to given transactions.</p>
Financial	Y	<p>The Council has benefitted from being a business rates pilot area for 2018/19, which has allowed the Council to keep a higher share of business rates income in 2018/19 to fund its services.</p> <p>The Council is forecasting a business rates pilot gain of £575,000 for 2018/19, of which £475,000 has been transferred into an Economic Regeneration Projects Earmarked Reserve. This money was intended to support local economic initiatives and therefore this report's proposals are consistent with that aim. Officers do not recommend investing in the mutual in order to derive a financial return as that is deemed too much of a financial risk. However, it is proposed that the Council uses funds from the business rate pilot gain to fund a grant of £49,995 to the Mutual. In return, the Council will receive 3,333 ordinary shares.</p>
Risk	Y	<p>Members will need to be satisfied that the granting of £49,995 to South West Mutual, in return for 3,333 ordinary founder shares not only delivers best value but is also consistent with the Council's corporate strategy.</p> <p>Whilst the Council will receive ordinary shares as a result of its economic grant and the initiative could therefore be considered an investment, the Council views this transaction as an economic grant. In doing so, it recognises that this transaction is risky and therefore does not expect to re-coup any of the grant, nor profit from the shares acquired. Appendix B sets out the share offer.</p> <p>For the avoidance of doubt – there are several key differences between a grant contribution and a share purchase:</p>

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		<ul style="list-style-type: none"> • If the venture fails the investment by either method may be lost. • The financial liability as shareholders is limited to the value of the share-holding – The Council stands to lose 100% if the venture has debts equal to or greater than its investment. There should be some proportionality if the debts were less than the venture’s total share capital. • The only way that the Council could have additional liability (upward of its investment) would be if there has been some individual negligence. Officers of the Council have set out that funding is to be provided as a grant, not an investment and therefore the entire £49,995 is at risk. Independent financial advice has not been taken. The shares acquired will be shown in the Council’s accounts as a financial investment. • As a shareholder, the Council will have votes (= some control) but will not have that as a <i>pure</i> grant funder.
Comprehensive Impact Assessment Implications		
Equality and Diversity	N	Not Applicable
Safeguarding	N	Not Applicable
Community Safety, Crime and Disorder	N	Not Applicable
Health, Safety and Wellbeing	N	Not Applicable
Other implications	N	Not Applicable

Supporting Information

- Appendix 1: “South West Mutual – Regional banking for inclusive growth” A copy of the informal briefing made to South Hams District Council on 27th September 2018
- EXEMPT Appendix 2: DRAFT Founder Share Offer Document

Approval and clearance of report

Process checklist	Completed
Portfolio Holder briefed	Yes
Relevant SLT Rep / Exec Director sign off	Yes
Data protection issues considered	Yes
If exempt information, public (part 1) report also drafted	Yes