

## CABINET

13 JUNE 2023

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### Loan to Northumberland Community Bank

**Report of:** Councillor Richard Wearmouth – Deputy Leader and Portfolio Holder for Corporate Services

**Lead Officer:** Jan Willis, Executive Director - Transformation and Resources

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#### **Purpose of Report**

The report provides details of a potential loan facility to Northumberland Community Bank (NCB) of £50,000 towards the capital reserve.

#### **Recommendation**

It is recommended that Cabinet;

- Approve a loan facility of £50,000 to Northumberland Community Bank subject to the following:
  - NCB agreeing to the proposed terms and conditions;
  - NCC's Legal Team completing a legal agreement with NCB in advance of any loan drawdown by NCB, containing the terms and conditions set out within this report; and
  - Subsidy Control implications being investigated and satisfied.

#### **Link to Corporate Plan**

The report is aligned to the priorities outlined in the Corporate Plan 2021-24 “A Council that Works for Everyone”.

**Living & Learning:** *“We will care for our residents, supporting the most vulnerable in our society as well as encouraging active citizens. We will ensure the best education standards for our children and young people”*

#### **Key Issues**

1. The Council has been approached for a loan facility of up to £50,000 from Northumberland Community Bank.
2. The proposed loan facility would be subject to the terms and conditions identified within the main body of the report.
3. Any potential Subsidy Control issues will need to be addressed and resolved prior to any loan advance being made to Northumberland Community Bank.

4. The loan request was considered by NCC's Risk Appraisal Panel on 4 May 2023. The panel were supportive of the loan subject to the terms and conditions set out being agreed with Northumberland Community Bank.

### **Background**

Northumberland continues to face significant financial inclusion challenges that have a disproportionate impact on our most vulnerable and disadvantaged communities. Organisations such as community banks and credit unions offer a vital alternative to high cost loans and illegal lenders, particularly for the individuals within these communities.

With rising food and energy costs, and wage increases below inflation, many more people will be pushed into financial difficulties and will be tempted by payday lenders and loan sharks. NCB is playing an increasingly important part in defending Northumberland residents from these threats.

The NCB provides access to affordable loans, avoiding loan sharks and payday lenders. It aims to:

- Provide customers with access to sustainable, affordable finance;
- Provide basic financial advice and signpost applicants who have not been able to gain affordable credit to other organisations as appropriate;
- Support customers in building a credit history;
- Support customers who are currently unbanked;
- Promote savings accounts;
- Engage with local companies to offer savings and loan services for all with the aim to specifically help the "in work poor" through payroll deduction; and,
- Engage with schools to educate young people about the benefits of managing money better.

The NCB uses the deposits of savers to provide the affordable loans. Initially, loans were small amounts of up to £500 and typically repaid within 6 months. However, in recent years NCB increased its offering to higher value loans, between £1,000 and £5,000 as standard but as high as £15,000 in exceptional circumstances, as part of its plan to achieve financial sustainability within three years. The deposit amounts are also made up of private donations.

The level of deposits and loans outstanding at any one time is governed by the Financial Conduct Authority who specify minimum operational ratios that must be maintained in order to operate as a credit union. The ratio must be at least 3.00% capital to loan ratio and 10.00% of the loan book available in liquid assets.

In 2017, the team running the Tynedale Community Bank (TCB) were asked by NCC to consider taking over the Credit Union for South East Northumberland (CUSEN), a failing credit union based in Blyth and Ashington. The Council committed £20,000 to

CUSEN to recapitalise and bring it back within FCA rules on capital/asset ratios, and a further £30,000 to restructure staff, systems and facilitate a merger with TCB. The subsequent merged entity became NCB.

In 2018 the Council contributed a further £50,000 grant to aid in re-engineering the business following merger, allowing NCB to develop its IT systems and management processes to maximise efficiency and to ensure compliance with all appropriate regulations.

Whilst NCB has made excellent progress along the road to sustainability in the intervening years, further growth plans were hit particularly hard by the Covid pandemic. Credit Unions exist to support both savings and loans, however it is only the loan element which generates income. During lockdown people spent less, saved more and hence borrowed less, thus reducing NCB's income.

During the pandemic, the Council provided further support to NCB in the shape of a £40,000 grant, plus a £50,000 subordinated loan to prevent NCB falling below the capital to asset ratio of 3.00% in December 2020.

Despite the difficult last few years, NCB has continued its growth and clearly demonstrated a continuous trend towards long term viability, however it remains behind its original target and requires support for 2023 and 2024 to achieve sustainability. NCB has requested that NCC provide two years funding at £25,000 per year (2023 and 2024), either as a single lump sum or as two instalments.

NCB has requested a loan term of 10 years with repayment of the loan at the end of the term and interest paid annually. NCB has again requested a subordinate loan which will mean if the NCB ceases to trade, NCC would not be repaid the outstanding loan and interest amount as a priority creditor, and would rank behind other creditors.

### **Financial Appraisal**

Appendix 1 shows an indicative budget for the next 10 years for NCB. Income projections include loan interest receivable, which is calculated on the value of loans shown in the table within each financial year. It is assumed within the financial business plan that NCC loan support would be granted in 2023, with the full £50,000 paid as one lump sum.

The NCB only provided a 3-year financial forecast. This has been projected forward by the Council's Treasury Management Team over 10 years to cover the period of the loan. Inflation and loan interest have been included on an annual basis

The ratios for each year are also shown. This shows that if the forecast growth in loans is achieved over the period the FCA ratios would be more than within acceptable limits, with the lowest being 6.00% capital to asset in 2024 and 22.55% liquidity ratio also in 2024.

Appendix 2 shows a similar indicative budget for the next 10 years for NCB without the requested £50,000 loan support from NCC. This shows that the capital to asset ratio

could potentially drop to 4.00% in the current financial year, bringing it dangerously close to the FCA limit of 3.00%

### **Key Risks**

The following risks have been identified in relation to the provision of the loan to NCB:

#### **Loan levels not achieved**

There is a risk that the significant growth in the level of loans forecast in the business plan is not achieved and therefore there is a reduction in interest earned and the bottom line annual operating figure. This would affect NCB's ability to repay the loan from the Council within the set timeframe. The financial business plan provided by NCB for the three-year period to 2025 sets particularly ambitious targets for the value of loans granted, with the current year target being £1.076 million and forecast target in 2025 to hit £2.000 million.

#### **Bad Debt Management**

There is a risk that bad debts increase. This would increase the amount written off, and reduce the forecast capital reserve. This would ultimately adversely affect NCB's ability to repay the NCC loan.

The level of bad debt for NCB in 2023 is currently around 5.00% which is lower than the 6.00% that was built into the budget. There is a robust system that is in place to chase any default payments, however any increase over the 6.00% built into the business plan would affect the annual bottom line trading position which would lessen NCB's ability to repay the loan in the given timescale.

#### **Loan Security**

Normally the Council would include within the loan terms and conditions the requirement for security to be provided against the loan. This ensures that where there is a repayment default the Council has the option to recover its outstanding debts plus interest. This is normally achieved via a charge on an asset or a legal guarantee. NCB does not have any physical assets that a legal charge could be placed upon and there is no legal guarantee. This represents a risk to the Council in the event of loan default.

#### **Reserves**

NCB does have a usable capital reserve; however, without the £50,000 loan from NCC this could result in the FCA rules on capital to loan ratio being breached. A clause will be incorporated within the loan agreement which allows the Council to review NCB finances on an annual basis, and an option can be added to include that should it be possible to repay the loan early and not breach FCA ratios then NCB could repay the £50,000 loan and outstanding interest early.

#### **Subsidy Control**

The provision of a loan at less than market rate will constitute a Subsidy. The Subsidy Control Act 2022 came into force from 4 January 2023, with the rules applying to

awards of financial assistance made by public authorities to businesses and any other organisations engaged in economic activity.

There are two routes to subsidy control compliance:

- If the loan is offered at a rate that is the equivalent to that which a commercial inverter would offer then there will be no advantage to a specific enterprise, such that the definition of a subsidy is not met and therefore there would be no Subsidy if the loan is offered at this rate. Any rate lower than this will constitute a Subsidy.
- Under section 36 Subsidy Control Act 2022, an enterprise (NCB) can receive up to £315,000 by way of minimal financial assistance over the applicable period. The applicable period is the elapsed part of the current financial year together with the two immediately preceding financial years. In order to rely upon this NCB would need to sign a declaration and NCC and NCB comply with the requirements set out in section 37 Subsidy Control Act 2022. This is a process the Council is familiar with.

For this exemption the subsidy would be calculated with reference to the interest rate that could have been achieved on the market, compared to the interest charged, with the saving being the subsidy.

With a view to reflecting the cost of borrowing for the Council the proposed interest rate is 4.55%. A commercial rate of interest is anticipated to be 7.50% reflecting the increased risk of a subordinate loan, therefore the actual loan rate proposed reflects a saving of 2.95% interest (£15,506).

As a result, it is recommended that the second route is taken, with compliance with sections 36 & 37 Subsidy Control Act maintained.

### **Summary**

Without the proposed Council loan the NCB could very likely breach the FCA capital to asset ratio during 2023 based on up to date forecasts, and would therefore be unable to provide additional financial support within the County over and above existing levels.

There are some significant financial risks associated with this proposal. These are mainly due to the risk associated with the organisation's ability to accommodate unplanned expenditure and also the potential for a reduction in income, as a result of not achieving the ambitious growth forecast in loans granted. These areas will all impact on NCB ability to repay the loan to the Council. In addition to this there is no loan security.

In light of the anticipated cost of borrowing for the council and the Subsidy Control assessment it is suggested that an interest rate of 4.55% would be appropriate.

### **Loan Terms and Conditions**

The NCB has requested financial assistance of £50,000. As this request for financial assistance did not form part of the Council's Medium Term Financial Plan and the

Council faces its own financial challenges the Executive Director - Transformation and Resources suggested that a loan of up to £50,000 would be the best option.

The loan will have the following terms and conditions:

1. Subject to condition 2 below, NCB can commence drawdown of the loan once NCC's legal department are in receipt of the signed legal agreement between the Council and Northumberland Community Bank; and the other conditions of the loan agreement are met.
2. NCB to provide a 10 year cash flow forecast prior to commencement of loan drawdown.
3. Maximum loan value of £50,000.
4. Repayment of principal will be made by NCB at the end of the 10 years from the date of the loan drawdown or earlier as stated in 8 below. The Council will produce to the Borrower a repayment schedule. The Borrower will pay the Council the sum due on the date specified on the repayment schedule.
5. NCB may repay the Loan in whole or in part at any time prior to the end of the loan term. In doing so they will provide notification in writing to the Council no less than 5 working days' prior to the prepayment. Where necessary a revised payment schedule will be produced by the Council and issued to the Borrower.
6. The interest rate will be the 4.55% fixed rate for 10 years.
7. Interest shall be paid annually on 31 March, from the date of the loan drawdown in line with the repayment schedule.
8. NCB will supply NCC a copy of their annual accounts within one month of audit sign off. Upon review NCC can request repayment of the loan and outstanding interest in part or full provided that the repayment would not cause NCB to breach the FCA capital to loan ratio of 3% or loan book available in liquid assets ratio of 10%.
9. NCB must inform NCC if they expect to breach the FCA capital to loan ratio.
10. Note the loan will not be secured or guaranteed.
11. Should NCB fail to meet any of the scheduled loan repayments they will be charged a default interest charge of 7.50%.
12. Compliance with the Subsidy Control Act 2022, by the identification of a complaint solution.

### **Legal Power to Grant the loan**

The legal powers which enable the Council to enter into this Agreement and to make the loan available, are under the Localism Act 2011.

## **IMPLICATIONS**

<b>Policy</b>	We will care for our residents, supporting the most vulnerable in our society as well as encouraging active citizens. We will ensure the best education standards for our children and young people
<b>Finance and value for money</b>	NCB will repay the loan in line with the payment scheduled issued by the Council. Interest on the loan will be charged at the rate of interest of 4.55% for 10 years.  Provision of the loan will be funded from the Council's Capital Third Party Loan allocation within the 2023-24 Budget.
<b>Legal</b>	The proposal will be subject to a signed legal agreement.  A complaint subsidy control solution will be identified prior to the loan agreement being entered into (and therefore funding drawn down) to ensure ongoing compliance with the Subsidy Control Act 2022  All other legal implications have been addressed within the body of this report.
<b>Procurement</b>	None
<b>Human Resources</b>	None
<b>Property</b>	None
<b>Equalities</b> (Impact Assessment attached) Yes <input type="checkbox"/> No <input type="checkbox"/> N/A <input checked="" type="checkbox"/>	The loan will allow NCB to provide access to affordable finance.
<b>Risk Assessment</b>	The perceived risks of the project are outlined in the report.
<b>Carbon reduction</b>	None
<b>Crime &amp; Disorder</b>	None
<b>Customer Considerations</b>	None

<b>Consultation</b>	Leader of the Council
<b>Wards</b>	All



**Report sign off.**

***Authors must ensure that relevant officers and members have agreed the content of the report:***

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