Sheffield Hallam University | Centre for Regional Economic and Social Research

Evaluation of the Community Investment Enterprise Facility

Interim Report
(2019-2021)

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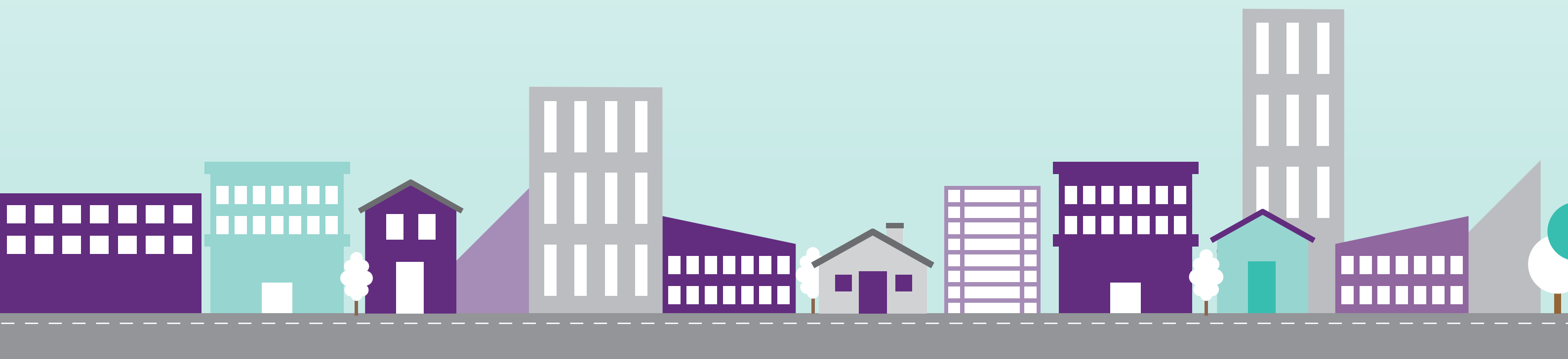
Community Investment | BIG SOCIETY CAPITAL | SIS Social Investment Scotland



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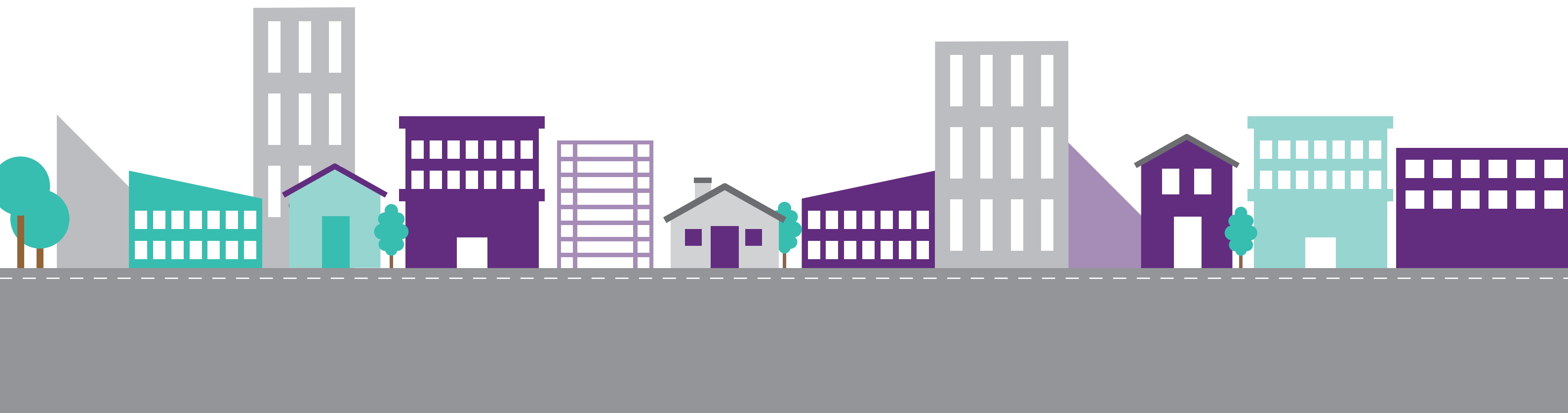


1. Introduction

This is the Interim Report of the Evaluation of the Community Investment Enterprise Facility (CIEF), undertaken by the Centre for Regional Economic and Social Research (CRESR) at Sheffield Hallam University. Previous reports from this evaluation include the 2019 and 2020 annual reports (Dayson and Damm, 2020, 2021), and a thematic report into the CDFIs' response to the COVID-19 pandemic (Damm, Dayson and Leather, 2021). The aim of this report is to provide a holistic stocktake of progress three years into the CIEF project.

What is CIEF?

CIEF is a £60 million investment facility, seeded by £30 million from Big Society Capital, and with £30 million in match funding from Triodos and Unity Trust Bank (as of December 2021). CIEF is managed by Social Investment Scotland (SIS), and aims to partially meet the capital needs of Community Development Finance Institutions (CDFIs), to build a better understanding of the financial and social impact of CDFI lending, and to test models of funding for CDFIs to attract other mission-driven investors.

CIEF has invested into four CDFIs across the UK since 2018, to help meet the needs of underserved micro, small and medium-sized enterprises (MSMEs) and the disadvantaged communities where they operate. These four CDFIs were identified as market leaders with sufficient scale, reach and lending track record to support the goals of CIEF.

What is a CDFI?

Small businesses can play an important role in society, by creating and sustaining jobs for local people and supporting local economic activity, especially in left-behind or disadvantaged communities. Yet many sustainable small businesses in these communities cannot access mainstream finance and credit markets, leaving them unable to maximise their social and economic benefit. CDFIs offer an alternative avenue for small businesses to access finance. They take a much more personalised, bespoke approach to loan decisions, rather than relying on algorithms or inflexible criteria. Their non-profit status and social mission also ensure that the maximum amount of resource possible stays serving the communities that need it most.

Who are the CDFIs?

Three CDFIs – Finance For Enterprise (FFE), BCRS Business Loans and Business Enterprise Fund (BEFUND) – were approved to deliver CIEF investments from the start of the programme. A fourth CDFI – First Enterprise (FE) – was approved in 2020. To give a sense of scale, collectively these CDFIs had a combined turnover of £8.2 million and current assets of £78.8 million for their financial year ending in 2021.

FINANCE FOR ENTERPRISE	BCRS BUSINESS LOANS	bef Business Enterprise Fund	First Enterprise Enterprise Loans
Finance For Enterprise (FFE) has operated for more than 30 years as a CDFI in the north of England, with offices in South Yorkshire and North-East Lincolnshire.	**BCRS Business Loans** was originally established in 2002 as a non-profit distributing co-operative lender. Initially covering social enterprises in the Black Country, BCRS now serves MSMEs across the West Midlands.	**The Business Enterprise Fund** (BEFUND) was founded over 15 years ago in Bradford, and has now spread across the North-East and North-West of England, as well as North and West Yorkshire, Humberside and North Lincolnshire.	**First Enterprise** (FE) was originally established in 1989 to help provide finance to the local BME community. By 1993, it had broadened to cover the entire business community. It now supports SMEs and social enterprises across the East Midlands and South-East Midlands. FE joined the CIEF programme in its second year.

Theory of change

The CIEF programme seeks to address several challenges for the UK CDFI market. First, that CDFIs are undercapitalised, limiting their ability to meet the scale of MSMEs' unmet demand for finance, especially within deprived communities (Henry and Craig, 2013[i]). Second, that there are data and evidence gaps, which hinder the ability of CDFIs to attract commercial capital by demonstrating their financial, social and economic impact (MacDonald and Prat, 2019).

By providing the upfront capital for CIEF, Big Society Capital hoped to both attract further co-investment, and provide large-scale and stable capital for the participating CDFIs over several years. In turn, this would provide positive outcomes to small businesses, their owners and staff, and the areas in which they operate. This would further help to bolster the CDFIs' reputation for delivering large-scale capital to underserved businesses, helping to attract future investment and improve the policy environment.

The evaluation

To assess the extent to which CIEF has met the goals of the theory of change over the course of its lifetime, the evaluation aims to:

A. Provide evidence on the financial performance of CDFI lending, especially outcomes for MSME loan recipients

B. Provide evidence about the social and economic impact of CDFI lending

C. Consider the change in the CDFI market over the lifetime of CIEF, including the impact of BSC's initiatives

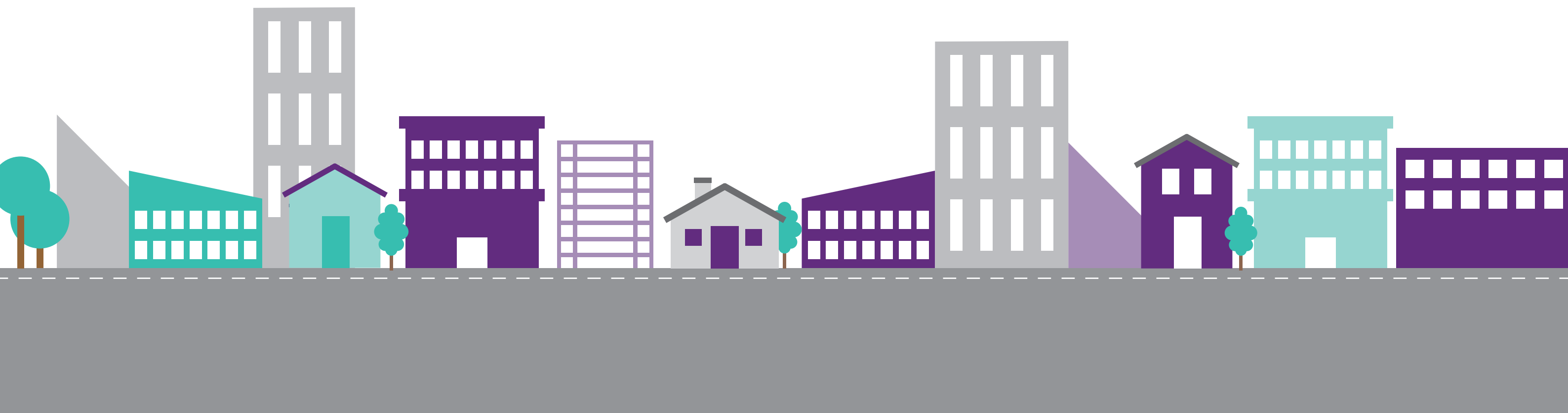
D. Develop and model good practice in approaches to measuring the social and economic impact of CDFI lending

Evaluation data

This report draws on several data sources. CDFIs submit baseline data on every loan made using CIEF funds every quarter, as well as information on the recipient MSME. Every quarter, the CDFIs also provide an update for their entire CIEF loan book, providing details such as repayments, defaults and restructures. Additional data on each MSME has been obtained by linking to its record in Companies House and the FAME database of company accounts data, as well as demographic data such as the Indices of Multiple Deprivation (IMD). Finally, a short survey of MSMEs was distributed a year on from the deployment of their initial loan.

In addition to the quantitative data, we conducted interviews individually and in small groups with eight stakeholders from the participating CDFIs and other relevant observers of the CDFI sector, which are referred to throughout the report.

An **interactive online dashboard** published alongside this report provides an opportunity to explore in more detail some of the data and findings discussed.



2. Headline figures

CIEF made its first loans in December 2018. Over the first three years of its operation, from January 2019 to December 2021, the four participating CDFIs have deployed **£48.4 million**, as part of **684 loans** to **626 MSMEs**. This constitutes **81 per cent** of the total capital allocated as part of CIEF.

The mean loan size for all CIEF loans is **£70,700** and the median is **£53,000**.

The mean loan term is **55 months** and the median is **60 months**. **81 per cent** of loans have a term of **60 months** (five years).

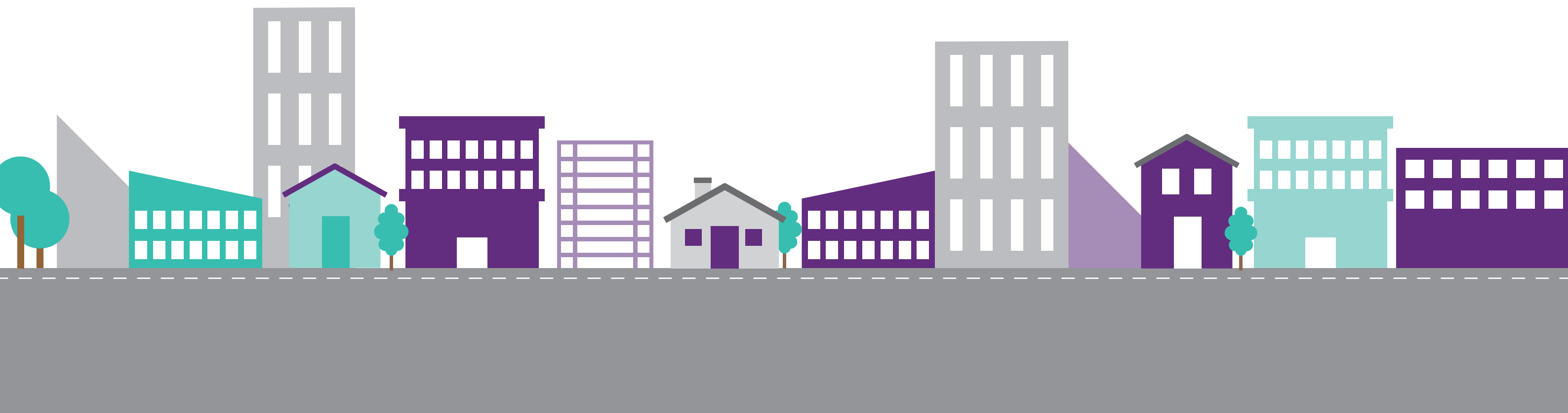
The mean interest rate is **14.5 per cent** and the median is **14.2 per cent**.

In addition to the £48.4 million of capital lent from CIEF, MSMEs have received a further **£15 million** from matched funding, using funds such as the Northern Powerhouse Investment Fund and the Midlands Engine Investment Fund (MEIF).

£14.4 million of capital had been repaid by the end of 2021, leaving **£34 million** outstanding.

By the end of 2021, **75** loans (**11 per cent**) had defaulted at some stage. **£3.5 million** was outstanding on these loans at time of default (**7.3 per cent** of all capital deployed).

This capital has not been written off, however, as CDFIs can still receive payments from MSMEs on defaulted loans, pursue recoveries, or claim on their government-backed guarantee, which covers 70-80 per cent of capital. The amount of capital eventually lost will be considerably lower. Future reports will explore the issues of recoveries in more depth.

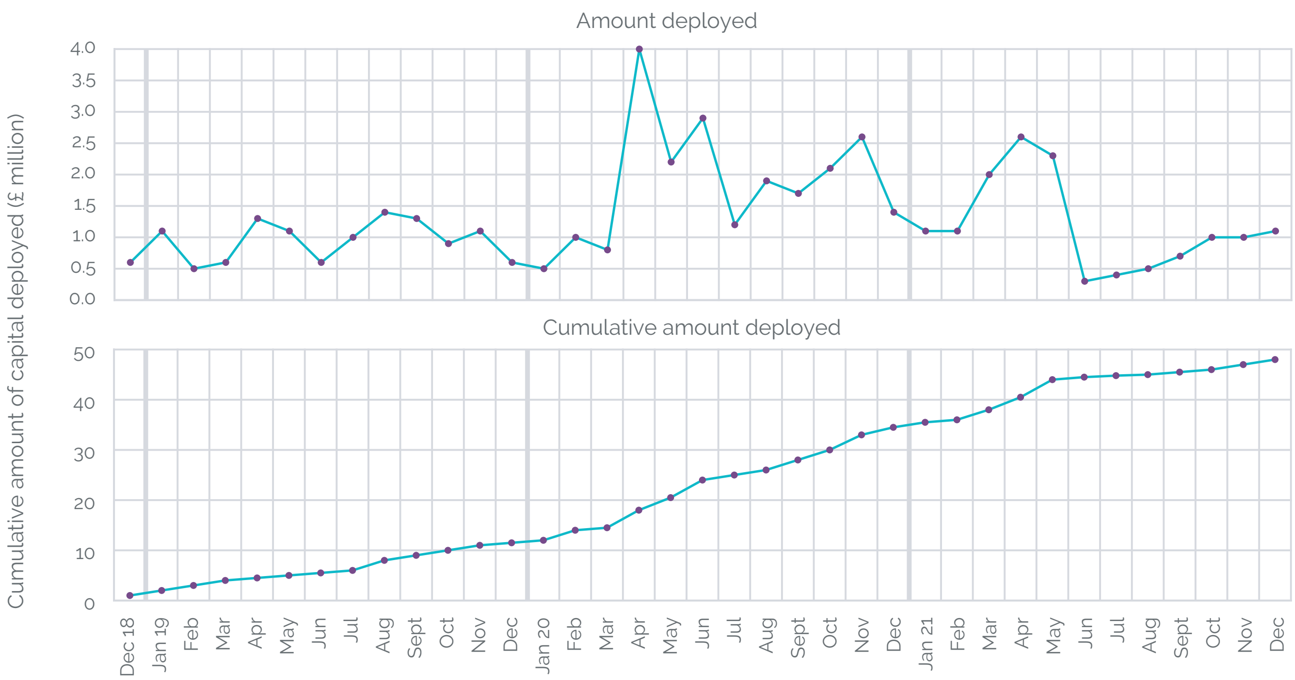


3. Development of the programme

Figure 1 shows the development of CIEF's deployment. Funds were initially deployed steadily, with additional matched capital provided by Triodos to FFE in July 2019 and BCRS in September 2019. Unity Bank also provided additional capital to BEFUND in April 2020 and FE in January 2022.

The amount deployed totalled £14.3 million by 23 March 2020. On this date, COVID-19-related lockdown restrictions were implemented for the first time across England, causing widespread disruption to economic and business activity. As discussed in the previous annual report (Dayson and Damm, 2021) and a stand-alone thematic report (Damm, Dayson and Leather, 2021), the pandemic and lockdown measures had a significant impact on the roll-out of CIEF. Demand increased significantly within a short period. Using CIEF funds, the CDFIs were able to start deploying a large number of loans to businesses very quickly as part of an emergency response, a fact which has arguably boosted the profile of CDFIs and increased support from policy-makers. These loans are likely to have had a high level of social impact, in line with the CDFIs' core mission, given the urgent need for support from many businesses. The acceleration in lending can also be seen by tracking the cumulative amount of capital deployed (Figure 1).

Figure 1: CIEF capital deployed per month[1]



Significantly, this surge in lending was conducted using guarantees from the Coronavirus Business Interruption Loan Scheme (CBILS), also implemented from 23 March 2020 by the UK Treasury, to support small businesses negatively impacted by the pandemic. CDFIs almost always use a Government-backed guarantee of this kind, administered by the British Business Bank (BBB), to compensate against the additional risks of lending to smaller, underserved businesses.

CDFIs and stakeholders were keen in interviews to stress how vital the government-backed guarantee schemes were for lending to these underserved MSMEs, especially in more deprived areas. Several interviewees stated outright that without the guarantees, there would be no CDFI lending market. It was also felt that following the CDFIs' role in successfully providing rapid loans during COVID, there was a greater awareness and understanding of the CDFI model among various Government departments and other policy-makers.

CBILS provided an 80 per cent guarantee against lenders' losses, with no upper cap on the amount claimed. Interest and lender-levied fees for CBILS-backed loans were also met by the Government for the first 12 months. In some respects, this offered more security than the previously available guarantee, the Enterprise Finance Guarantee (EFG), which covered 75 per cent of losses but had a claim cap of 15 per cent of annual lending. CDFIs pay a one per cent lender premium to the BBB to access the guarantee scheme, which is lower than the 1.5 per cent premium paid by for-profit lenders.

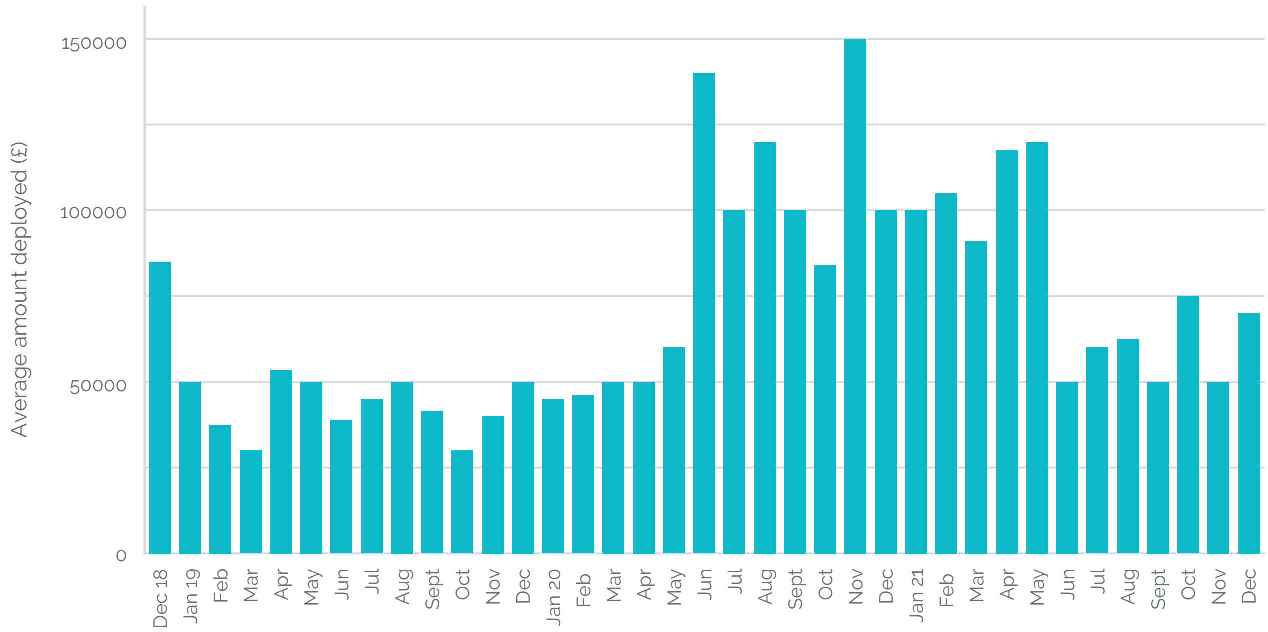
1 Source: Baseline data, 684 loans

CBILS also entailed some drawbacks for lenders, however, as no form of personal guarantee could be taken for facilities below £250,000, and a total price cap of 14.99 per cent was introduced around October 2020, which has remained at that level for subsequent guarantees. This cap was implemented to ensure that lenders were passing the economic benefit of the guarantees on to investees, as per state aid rules, and to reduce the risk of profiteering using the loan schemes. This includes the one per cent charge that the CDFIs have paid to use CBILS and subsequent guarantees. CDFIs need to service variable debt funding, so as market interest rates rise, this price cap will become more challenging, reducing CDFI sustainability.

In a stable, low interest rate environment, views on the cap were mixed, with some CDFIs and stakeholders arguing that the limit was not a major concern. They suggested that charging more than this level might indicate that operating costs were too high, or risk scaring off potential borrowers. On the other hand, some CDFIs suggested that an absolute cap prevented making higher interest loans to viable, yet riskier, propositions, balanced out by lower interest rate loans for other MSMEs.

The minimum size of a CBILS-backed loan was increased to £50,000 from the 4 May 2020, to coincide with the roll-out of the Bounce Back Loan Scheme (BBLS), an additional government scheme intended to encourage loans of up to £50,000 during the pandemic. This scheme offered a 100 per cent guarantee, as well as six-year terms, a fixed 2.5 per cent interest rate, with no fees, and with the first year of interest covered by the Government. While these loans were, therefore, very attractive to MSMEs, CDFIs were not accredited to deliver them. The terms specified were only realistically affordable for large mainstream lenders, operating at great scale. This severely disrupted the existing lending pipeline and forced them to shift their focus to loans over £50,000, backed by CBILS. The impact of this shift can be seen in Figure 2, which shows changes to the average size of CIEF loans by month. Since the end of BBLS in March 2021, the average loan size has reduced again. This may also be related to the lower minimum size threshold for the Recovery Loan Scheme (RLS) (£25,000) compared to CBILS.

Figure 2: Average size of CIEF loan[2]



2 Source: Baseline data, 684 loans

Figure 3 shows that the largest loans, over £100,000, have dominated since the transition to CBILS, until falling to a much lower level for the lattermost two quarters of 2021, after both CBILS and BBLS ended at the end of March 2021. Loans under CIEF are generally limited to £150,000 (or £200,000 for one CDFI). Medium-sized loans of between £50,000 and £100,000 have remained relatively steady over the same period, after an initial COVID-19-related spike, and may even now be on an upwards trajectory.

Figure 3: CIEF capital deployed per quarter, by size of loan[3]

The smallest loans, however, of less than £25,000, have not returned, as the minimum size of RLS, which was introduced after CBILS, is still £25,000. Arguably, this leaves a gap in the CDFI finance market, particularly as smaller loans may be among those with the highest social impact. However, it is also worth noting that Start Up Loans can be offered at up to this level, to MSMEs up to three years after starting trading, at a lower fixed interest rate. These may, therefore, provide an alternative option for MSMEs where possible.

CBILS closed for new loans on 31 March 2021 and was replaced by RLS on the 6 April 2021. RLS was set at the same 80 per cent guarantee level, again with a maximum cap on annualised interest and fees of 14.99 per cent. It was originally set to run until December, but was extended for a further six months until June 2022, at a lower 70 per cent guarantee level.

Due to the need for accreditation each time the guarantee changes, the CDFIs have experienced several interruptions to their lending. Because CBILS was introduced under the emergency conditions of the pandemic, existing EFG lenders were automatically given accreditation. This was not the case for the different stages of RLS. The end of a guarantee period can lead to a rush to finalise applications before the deadline, followed by a delay before a new scheme is announced and accreditation secured. In some cases, this has prevented CDFIs from lending CIEF funds completely for several months. The results of this can be seen clearly in Figure 1 around June 2021, though it is worth noting that there is a month lag between CBILS ending and the drop in deployment, as applications already signed before the deadline could still be finalised and deployed.

3 Source: Baseline data, 684 loans

Although this report focuses on data from 2021, it is worth noting that an additional phase of RLS was introduced in August 2022, scheduled to run for two years. This is longer than the other recent guarantees. It is also likely to be the longest that a guarantee can run, given limits on government spending commitments. The interviewed CDFIs and stakeholders hoped that as the guarantee became more established, future renewals would become quicker and less disruptive. Accreditation is important to protect the subsidy provided by taxpayers, alongside ongoing annual audits of CDFIs conducted by the BBB. It was noted, however, that stability and relative certainty for the guarantee arrangements are important requirements for attracting external investors into the CDFI market.

Notably, this third round of RLS has also reintroduced personal guarantees, absent since CBILS. This will be welcomed by CDFIs, as it prevents unethical behaviour by MSMEs, such as reopening a company under a new name to escape liability for old loans. It was noted by interviewees, however, that reclaiming under a private guarantee was not a particularly effective way to recoup funds, given the legal costs involved, further reinforcing the need for the government-backed guarantee.

MSME case study: Total Transparent Solutions

First Enterprise lent £150,000 to Total Transparent Solutions, a Staffordshire-based process outsourcing company, from both CIEF and MEIF. The company provides solutions to businesses, by outsourcing comprehensive management and technology related services to reduce administration and costs. Total Transparent Solutions has taken on significant new contracts from Hexagon Group, John Lewis and Thrifty, despite the impact of the pandemic. The funding will be used for equipment and IT development, to support existing roles and to create ten new jobs, to maintain quality of service for new and current clients. Andy John Rowe, Director, remarked, "The process with First Enterprise – Enterprise Loans has been straightforward and simple. We are delighted to have worked with Matthew and be considered as people and not just a number."

4. MSME investee characteristics

CIEF was designed to enable participating CDFIs to make loans to underserved small businesses, often located in disadvantaged areas, and led by individuals from disadvantaged groups. The following section explores the types of MSME that receive CIEF investments, focusing on the extent to which funds have reached underserved and disadvantaged communities of place and interest. Note that for MSMEs that have received more than one loan as part of CIEF, we have generally taken the information provided as part of their first loan application.

Lead applicants

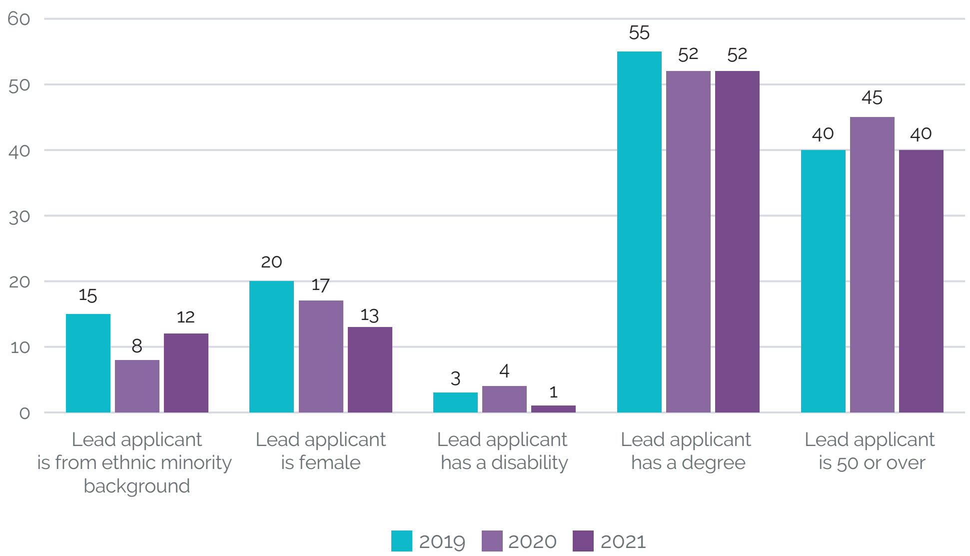
- 17 per cent (107) of lead applicants were female at the time of their MSME's first loan
- 12 per cent (74) were from an ethnic minority background
- 53 per cent (320) did not have a degree
- Seven per cent (43) were under 30
- 42 per cent (259) were over 50

According to a survey of small and medium-sized business (BEIS, 2021), 16% of SME businesses employing staff were women-led in 2020, very close to the CIEF figure. Five per cent of SME employers were minority ethnic group-led (MEG-led); the much higher figure for CIEF indicates CDFIs are effectively supporting business leaders from an ethnic minority background.

In its 2021 enterprise lending report, Responsible Finance (Russell, 2022) reports that 35 per cent of CDFI lending is to women-led SMEs and 13 per cent is to people from ethnic minority backgrounds-led SMEs. This may suggest that CIEF loans are reaching slightly fewer women-led business than CDFI lending more generally. It is possible, however, that the wider CDFI figures include some funds specifically targeted at women-led MSMEs.

Finally, it is worth noting that percentages of loans going to disadvantaged groups has fluctuated during the three years that CIEF has been operating. Whereas the proportion of ethnic minority-led applicants has recovered somewhat from a drop in 2020, the proportions of female and disabled lead applicants have both slightly dropped over time (see Figure 4).

Figure 4: Proportion of lead applicants in disadvantaged groups[4]



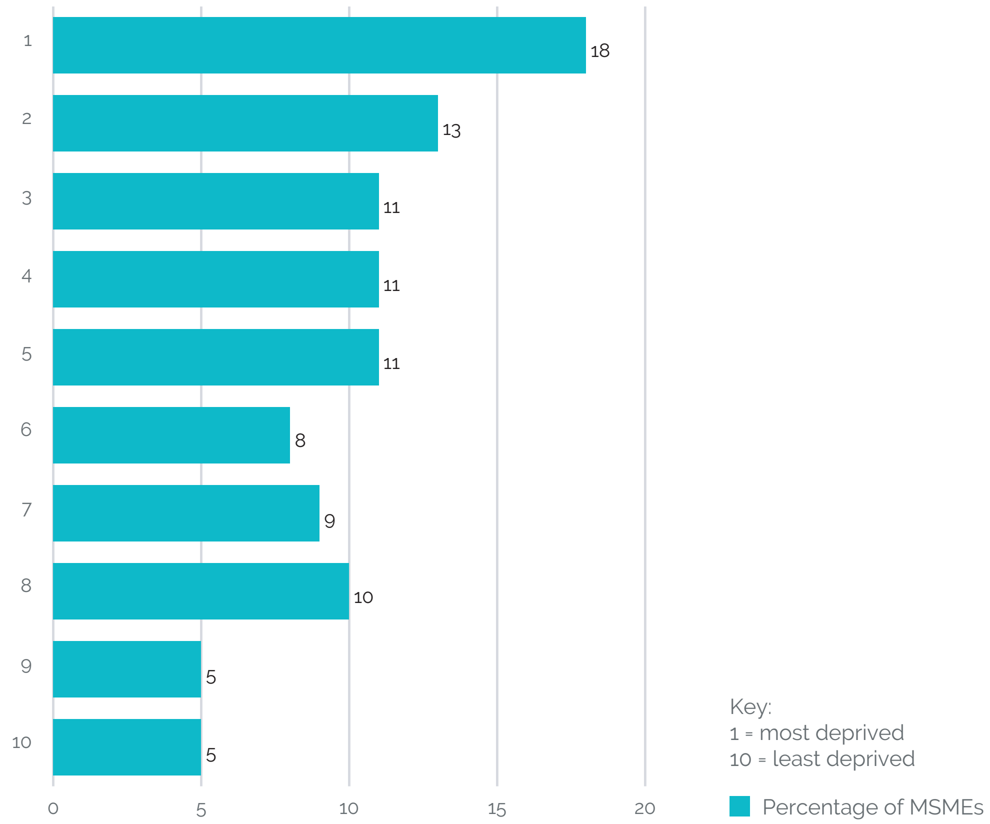
4 Source: Baseline data, MSMEs with valid data, left to right: people from ethnic minority backgrounds: 239, 145, 237; Female: 239, 238, 145; Disability: 238, 239, 145; Degree: 231, 226, 143; 50 or over: 145, 239, 238.

Indices of Multiple Deprivation (IMD)

CIEF is specifically targeted towards MSMEs operating in more deprived areas. All loans must qualify for **CITR tax relief**, which requires either that the lead applicant belongs to a disadvantaged group, or that the area in which it is registered falls into the bottom 35 per cent of neighbourhoods, according to at least one of the seven domains of deprivation which make up the overall IMD. This criterion is fairly inclusive, which is why we still see loans across the overall IMD distribution as part of CIEF, as shown in Figure 5.

There is a skew, however, towards the more deprived areas, as would be expected given the programme's aims. 18 per cent (133) of MSMEs are located in the bottom decile. This has shifted from 20 per cent in 2019, to 15 per cent in 2020, to 19 per cent in 2021. 42 per cent (260) of MSMEs are in the bottom three IMD deciles. This figure was 46 per cent in 2019, 36 per cent in 2020 and 40 per cent in 2021.

Figure 5: Indices of Multiple Deprivation deciles[5]



5 Source: Baseline data, 625 MSMEs with valid postcode data

Industry

The Standard Industrial Classification 2007 division of each MSME was recorded to explore which industry groupings were most common amongst investees. The three most common industries, accounting for half of all MSME loan recipients, were:

- Wholesale and retail trade – 20 per cent (119)
- Manufacturing – 16 per cent (97)
- Construction – 14 per cent (88)

According to the business population estimates produced by the Department for Business, Energy & Industrial Strategy (2022), ten per cent of tax-paying businesses operate in Wholesale and retail, five per cent in Manufacturing and 16 per cent in Construction.

Figures reported by the House of Commons Library (Hutton and Keep, 2022) suggest that of all CBILS and BBLS loans nation-wide, 20 per cent went to Wholesale and retail businesses, 12 per cent into Manufacturing and 15 per cent into Construction.

These figures suggest that the manufacturing sector is marginally more represented in CIEF compared to businesses nationally. CDFIs attributed this in interviews to the locations where they operate, which despite sometimes being characterised as 'post-industrial', often support a relatively high number of manufacturing companies.

MSME case study: Pit Putty

Nottinghamshire-based manufacturer and retailer of natural cosmetics, All Good Skincare Limited, trading as Pit Putty, received a £50,000 CIEF investment from First Enterprise. Pit Putty has formulated a natural deodorant made from 100% natural and plant-based ingredients. Despite the initial slump in orders during the pandemic, Pit Putty set its focus on generating more online sales within the UK market. It will use the funding to continue to regain the lost ground caused by COVID and grow to new heights, investing in staff onboarding, marketing, additional packaging and stock. Luke Baldwin, Director, noted that its account manager "was able to lead us through the application effectively and even provided valuable market insights from his own experience".

MSME investee size

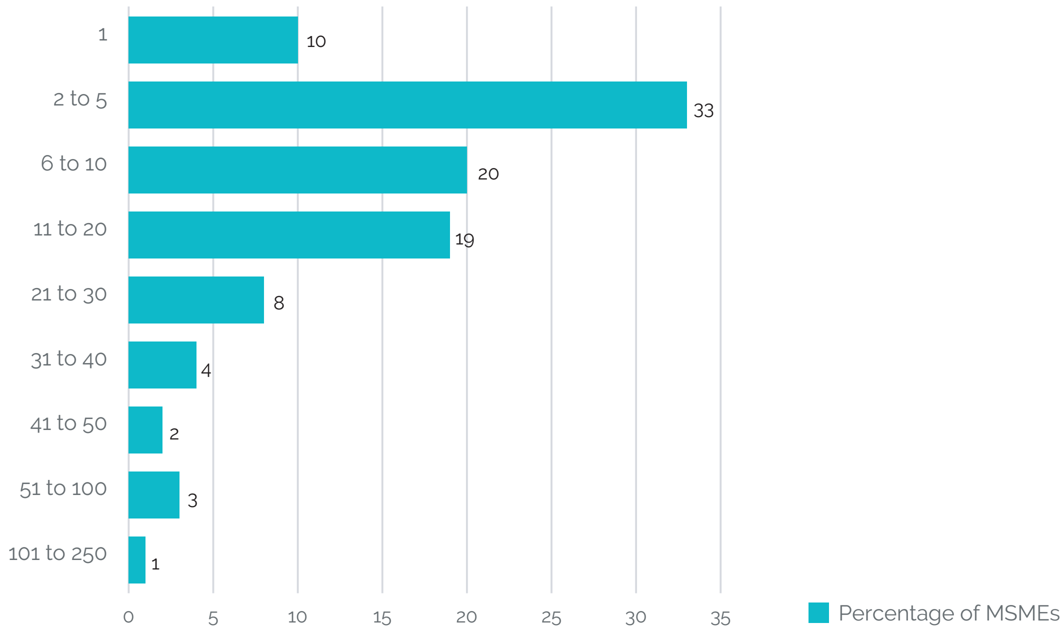
The theory of change for CIEF makes reference to 'underserved small businesses, often located in disadvantaged areas and/or led by an individual from a disadvantaged group'. Micro and small businesses account for the vast majority of the UK business population by number and 61 per cent of all employment (BEIS, 2021). This gives them substantial economic and social importance within communities across the UK.

Many CIEF investees are not just SMEs, but micro-sized enterprises. A full definition of a micro-sized enterprise from Companies House suggests that they have:

- an average number of employees no more than ten
- a balance sheet total of no more than £316,000
- a turnover of no more than £632,000

Starting with the number of employees, at the time of their first loan, CIEF loan recipients collectively employed 7,870 FTE full-time staff. The median number of FTE employees is seven and the mean is 13.4. Figure 6 gives a more detailed breakdown of the loan recipients according to employee counts. If we disregard assets and turnover, over half (63 per cent) of the MSMEs receiving their first CIEF loan are micro-businesses, based on having staff levels of ten or fewer.

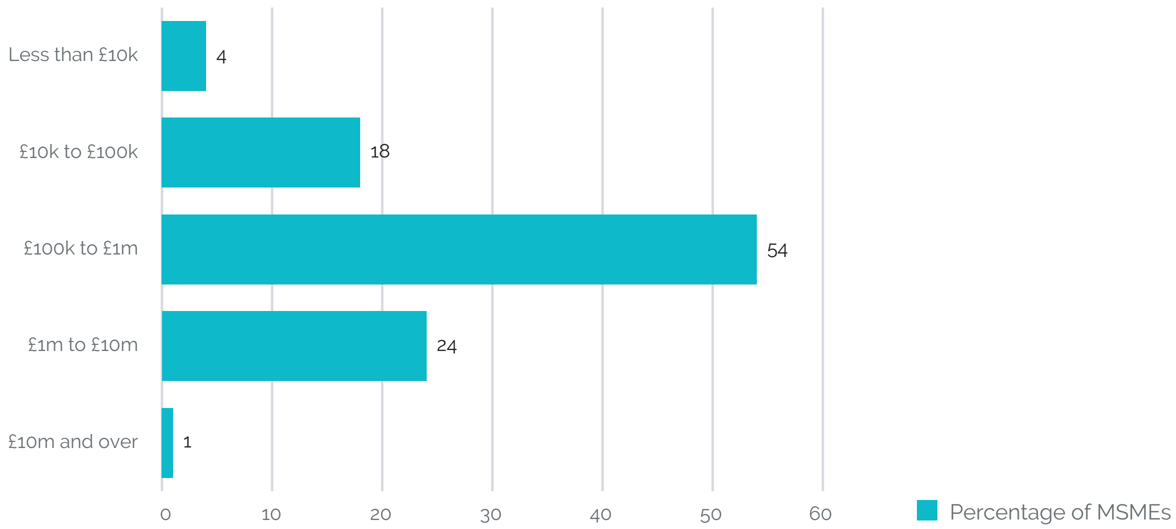
Figure 6: Number of employees at time of first loan[6]



A second measure of company size is provided by its total assets. Wherever possible, we matched the MSMEs in receipt of CIEF loans to the FAME database. This allowed us to determine companies' total assets, based on either the year they received the loan, or the year after if this was not available. This gives us another idea of the size of the MSMEs in receipt of CIEF loans. The mean amount of assets is £977,000 and the median amount is £348,000k.

If we disregard the number of employees and turnover, then 48 per cent of CIEF investees qualify as micro-businesses, based on their total asset levels.

Figure 7: Total assets at time of first loan[7]



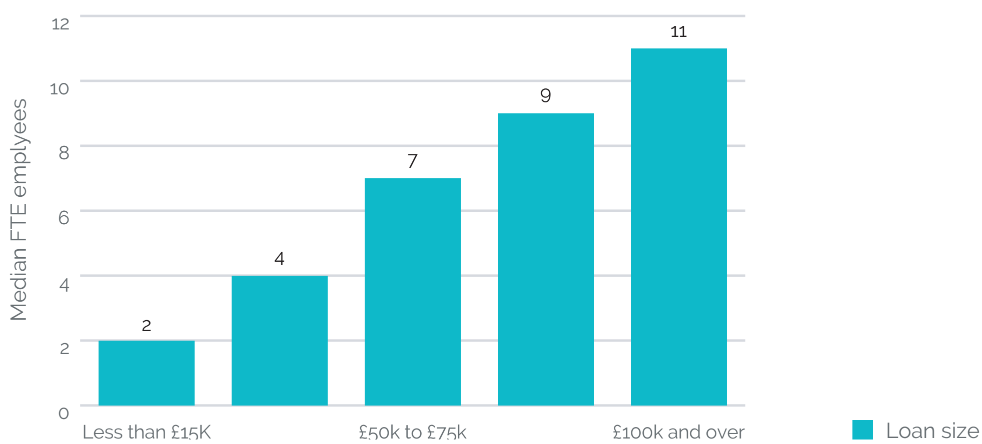
6 Source: Baseline data, 588 loans with valid employee data
7 Source: FAME data, 488 MSMEs with valid data on assets

Turnover data is not available for the investees, as it is not available from the FAME database. But taking together the criteria for both staff and total asset numbers, then 39 per cent of MSME investees are micro-organisations.

According to the FAME data, however, for those with valid data for their latest accounts, only 27 per cent of the MSMEs submitted micro-business accounts. The difference may potentially be explained by companies growing since receiving their loan, or the unknown influence of turnover data. A further 70 per cent submit accounts using options only available to small companies, suggesting that very few medium-sized companies have received CIEF loans.

In interviews, the CDFIs did not claim to specifically target small or micro-SMEs. Instead, they felt that they naturally attracted micro-organisations by virtue of the generally smaller loan size that they offered, as well as the additional business support available. Figure 8 shows that there is a very clear correlation between loan size and the size of the MSME in terms of their employees.

Figure 8: Median FTE employees by size of loan[8]



To what extent are CDFIs providing investment for MSMEs that is additional?

One of the goals of CIEF, is to make investments to MSMEs that are unable to access finance from other sources. If CIEF recipients could have received a loan from a high street bank instead, then the subsidy provided by the BBB guarantee may not have been necessary. Part of the reason for CDFIs' existence, is to provide finance to 'underserved' MSMEs, rejected by mainstream finance but still a viable prospect for a loan.

For example, 12 per cent of MSMEs with employees, in the Small Business Survey 2020, reported obtaining finance as a key obstacle to growth (BEIS, 2021). There is also evidence that ethnic minority and female-led businesses are more likely to be discouraged from applying for a loan (BBB, 2022). And there are also geographic barriers, with fewer lenders based outside London and lower property values with which to provide collateral (BBB, 2022).

In interviews, stakeholders contrasted the CDFIs to mainstream banks and other lenders, which lend large amounts of capital using automated models and algorithms. It was felt that because CDFIs offered a more bespoke, relational approach, they were able to assess applications on a more case-by-case basis, rather than ruling out MSMEs on the basis of set criteria. Their geographic proximity to MSMEs operating outside London was also seen as a vital part of this model.

8 Source: Baseline data, 588 loans with valid employee data

In some cases, CIEF applicants have been rejected outright by another lender. At the time of their first loan, 41 per cent (250) had been rejected by an external source of finance in the last year. The picture is complicated, however, in that MSMEs may choose themselves not to apply to a mainstream provider, or be ruled out by pre-qualifying criteria. In the past, CDFIs had been required to obtain 'hard decline' letters from banks for each application, but this was replaced with self-certification by MSME applicants. Because banks are monitored on how many loans to MSMEs they decline, it was acknowledged that they were likely to deter many MSMEs prior to this formal stage.

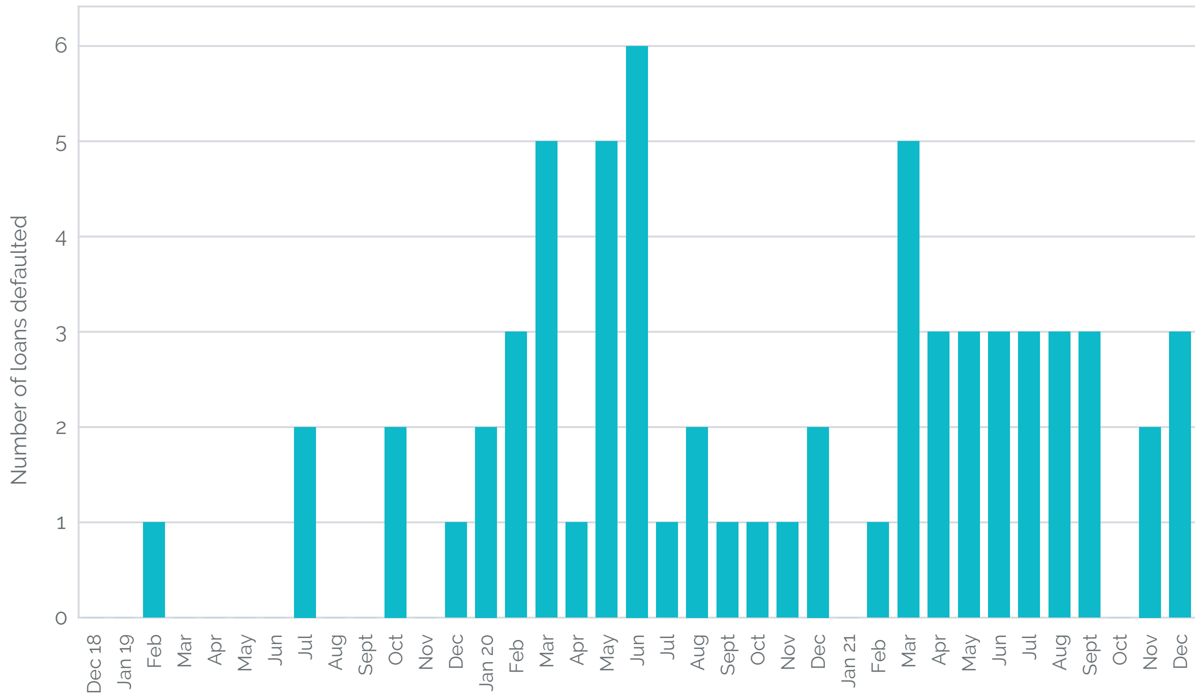
Self-certification was seen by the CDFIs and stakeholders as working well. They pointed out that given CDFI lending was inevitably more expensive than mainstream finance, it was unlikely that MSMEs would incorrectly self-certify in order to receive a CDFI loan.

5. Financial performance of CDFI loans

Of the £48.4 million of CIEF funds drawn down by MSMEs so far, £14.4 million has been repaid, leaving £34 million outstanding. CDFIs are asked to record defaults when a loan is 90 days or more in arrears, or when this outcome becomes inevitable, such as an MSME ceasing trading. By the end of 2021, 75 loans (of 684) had defaulted at some stage. This accounts for 11 per cent of all loans made under CIEF. The total amount outstanding on these defaulted loans, at time of default and therefore at risk of not being repaid, was £3.5 million. This is 7.3 per cent of all capital drawn down and 10.4 per cent of all outstanding capital.

Default rates have varied over time, as shown in Figure 9. Early defaults were unsurprisingly relatively low, as there were fewer loans and they remained relatively young. A relatively small, but noticeable, peak occurred following the outbreak of COVID-19, from February to June 2020, undoubtedly caused by the huge disruption to the economy. Some of these loans may have subsequently been restructured, and later returned to making payments, but despite support from both CDFIs and the Government, there will also be businesses that were unable to survive (see section 6).

Figure 9: Number of CIEF loans defaulting, by month[9]



After this initial period, however, existing customers will have been able to take advantage of the payment holidays and other forms of restructuring offered by the CDFIs, providing some relief. CDFIs have always offered a range of business support and advice to MSMEs as part of their relationship-based model. This ethos positioned them well to negotiate constructive outcomes for MSMEs in difficulty. As discussed further below, some potentially bad debt may also have been repaid using BBLS loans, and new customers will have benefited from the interest breaks offered through the CBILS guarantee. Default-rates remained relatively low for the subsequent year, before returning to a slightly higher level in March 2021. This uptick may be because various forms of government support came to an end, alongside the ongoing challenging conditions in the economy.

9 Source: Follow up data, 65 loans with valid data on default dates

The monthly breakdown of loan defaults shown in Figure 9, is complicated by the fact that older loans are generally more likely to have defaulted than younger loans, partly given that they have had more time in which to do so (see Figure 10). Loans deployed prior to the first national lockdown (23 March 2020) appear to be particularly more likely to have defaulted. By the end of 2021, 19.5 per cent (57) of the loans guaranteed by the EFG were in default, with £2.5 million capital outstanding on those loans (17.6 per cent of all the capital deployed under EFG). In contrast, 5.6 per cent (18) of loans guaranteed under CBILS were in default, with £990,000 outstanding on those loans (3.4 per cent of the total capital lent under CBILS.)

Figure 10: Percentage of loans (by number) defaulted, by month first deployed[10]

The impact of the pandemic itself is likely to be the most important explanatory factor, as well as the age of the loans, but it is also worth noting that earlier loans are on average smaller, given the later increase in minimum loan size to £50,000 under CBILS. Small loans are more likely to default than larger loans. 24 per cent of loans worth less than £25,000 have defaulted at some stage, compared to only eight per cent worth over £100,000. Relatedly, loans to smaller MSMEs are also more likely to have defaulted. 13 per cent of loans to MSMEs with five or fewer staff have defaulted, versus four per cent to MSMEs with 25 staff or over.

10 Source: Follow-up data, 75 defaulted loans

Table 1: Defaults by loan size[11]

Loan size	Number of loans deployed	Number of loans defaulted	Percentage of loans defaulted by number	Amount deployed (£'000)	Amount outstanding at time of default (£'000)	Percentage in default (amounts per size category)	Percentage contribution to total default amount
Less than £25k	62	15	24	1,019	195	19	0.4
£25k to £50k	133	16	12	4,213	461	11	1.0
£50k to £75k	183	17	9	9,548	729	8	1.5
£75k to £100k	86	10	12	6,380	653	10	1.3
£100k and over	220	17	8	27,227	1,479	5	3.1
All loans	684	75	11	48,386	3,516	7.3	7.3

Table 2: Defaults by number of employees[12]

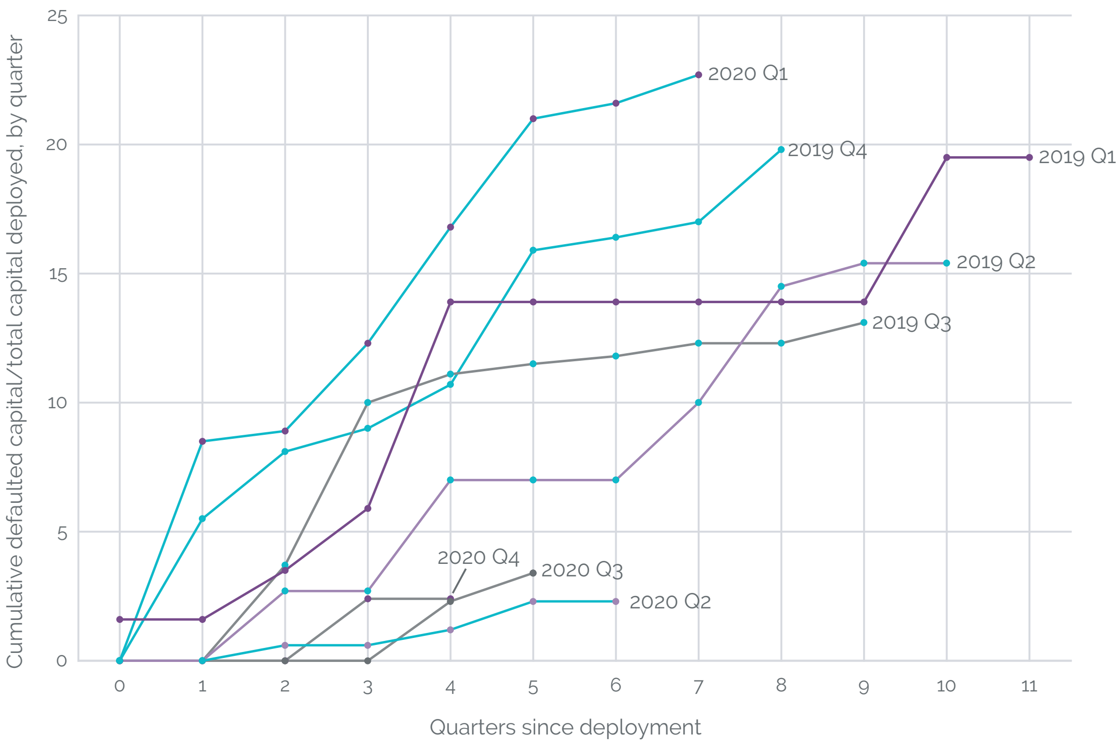
Number of employees	Number of loans deployed	Number of loans defaulted	Percentage of loans defaulted by number	Amount deployed (£'000)	Amount outstanding at time of default (£'000)	Percentage in default (amounts per employee category)	Percentage contribution to total default amount
1	65	7	11	3,202	174	5	0.4
2	65	11	17	4,032	408	10	0.9
3	52	8	15	2,606	318	12	0.7
4 to 5	94	9	10	6,601	523	8	1.1
6 to 8	93	6	6	6,696	235	4	0.5
9 to 11	53	9	17	3,989	500	13	1.1
12 to 15	63	8	13	4,364	395	9	0.9
16 to 24	66	5	8	5,510	295	5	0.6
25 or over	93	4	4	9,200	271	3	0.6
All loans*	684	75	11	48,386	3,516	7.3	7.3

Given the differences between cohorts of loans, as shown in Figure 10, it is sensible to explore the trends in defaults of loans broken down by the quarter in which they were first deployed. Figure 11 shows the cumulative amount of capital outstanding at the time of default, as a proportion of the total invested each quarter. Again, we can see that the loans made after first quarter of 2020, appear to be on a less steep curve of defaults than those made in 2019 and earlier in 2020. Perhaps unsurprisingly, the curve for loans made in the first quarter of 2020, just before the first COVID-19 lockdown, appears particularly steep.

11 Source: Baseline and follow-up data, 684 loans

12 Source: Baseline and follow-up data, 644 loans to MSMEs with non-missing employee data. *Totals are for all 684 loans - Vintage analysis

Figure 11: Cumulative proportion of capital in default, by quarter deployed[13]



Based on these results, it is difficult to predict where the overall default rate for the programme will eventually plateau. Given that CIEF loan recipients have already been declined or deterred from mainstream banks, it is generally believed that these MSMEs present higher default risk. However, this may not be true, given the alternative delivery process of loans by CDFIs. Relatively high default rates need to be seen in the context of the guarantee, which protects much of the capital, especially given CBILS and RLS do not have a cap on claims.

It is very difficult to benchmark the CIEF default rates against other programmes, as much depends upon both external circumstances and the characteristics of the investees. More mainstream programmes tend not to release detailed, transparent and comparable data, which would allow a fairer comparison. Even different CDFI funds have had different lending restrictions and took place at different points in the economic cycle. Default rates for the CDFI sector, therefore, appear to fluctuate significantly between funds (MacDonald and Prat, 2019).

An alternative approach may be to compare the CIEF results against all loans made using various BBB guarantees. An evaluation of the EFG guarantee scheme, by Durham University reported that the default rate for a cohort of EFG guaranteed loans, made between 2009 and 2012, was 27.4 per cent of loans, three years after drawdown (Allinson et al., 2013). For its predecessor scheme, the Small Firms Loan Guarantee, it reports that a cohort of loans made from 2006 to 2009 had a default rate of 33.3 per cent of loans after 11 quarters. Again, however, it is worth stressing that the relevant economic circumstances, target population and the characteristics of the MSME investees, will all have potentially differed significantly from CIEF.

The ultimate default rate for CIEF will, of course, partly depend on how economic circumstances develop over the next few years. At the time of writing, there is a huge level of uncertainty regarding the economic outlook. Relevant factors include high inflation, rising interest rates, a potential upcoming recession, supply chain challenges and sluggish recovery from COVID in some sectors. Given these economic headwinds, stakeholders and CDFIs interviewed felt that default rates were lower than might have been feared, particularly for pre-COVID loans. There was an acknowledgement, however, that despite being past the initial COVID-related shock, long-term viability could be a challenge for some investees.

13 Source: Follow up data - 65 loans with valid data on default dates

Restructures

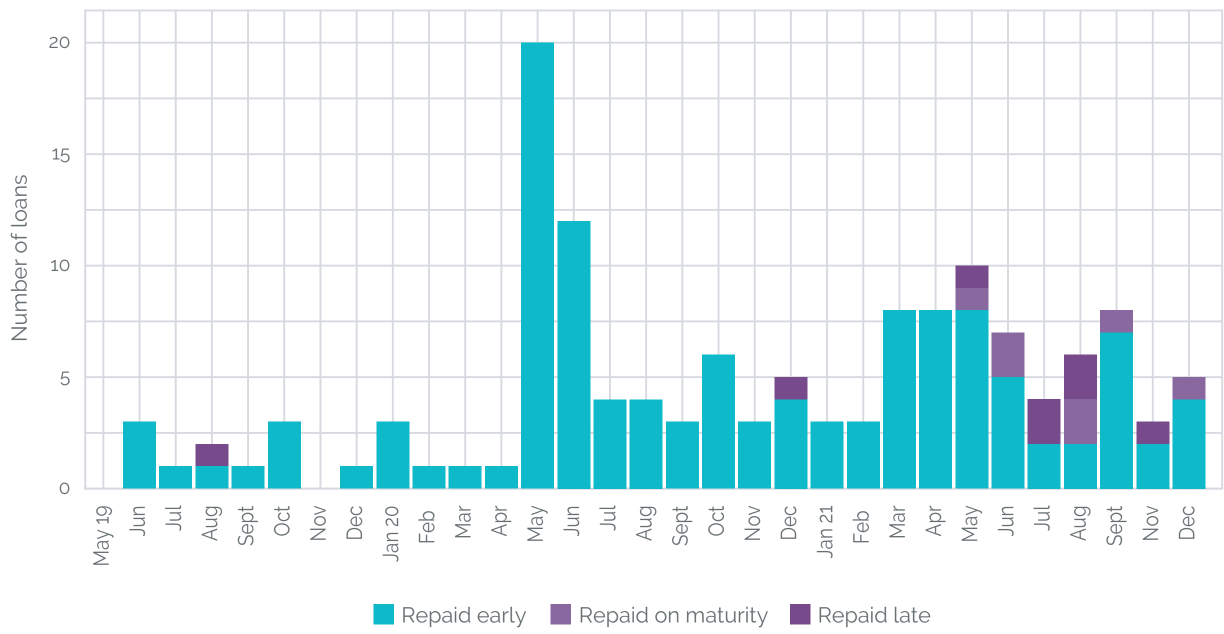
It should be noted that default does not, in all cases, mean that no further funds are received from the MSME. 155 loans (23 per cent) have been restructured as part of CIEF at some stage, largely in response to pandemic-related disruption. The total amount drawn down for these loans was £8.4 million, or 17.4 per cent of the total drawn down across the programme. The amount outstanding on these loans is £5.5 million, or 11.3 per cent of the total drawdown across the programme. We know that 119 of the restructured loans (76.8 per cent) returned to payments at some stage. We also know that 35 of the restructured loans (22.4 per cent) are recorded as having defaulted. Due to a lack of data on the dates of these events, however, we are not currently able to determine the exact sequencing for each loan. This gap should, we hope, be resolved in future waves of data collection. Perhaps the key point, however, is that without restructuring activities, it is likely that the overall default rate for the programme would have been much higher following the introduction of lockdown restrictions (see Damm, Dayson and Leather, 2021).

Early repayments

144 loans were reported as fully repaid by the end of 2021. Of these, 124 were repaid earlier than their maturity date, which means that they were early repayments. Most early repayments (86 per cent, 107 loans) were fully repaid at least a year early.

In many cases, MSMEs may have been able to secure cheaper funding to pay off their CDFI loan. As discussed in a previous report (Damm, Dayson and Leather, 2021), BBLS was offered by the Government from May 4 2020 to March 31 as a response to the COVID-19 pandemic. These loans were interest-free for the MSME in the first year and charged only 2.5 per cent interest thereafter. They were considerably cheaper than the CDFIs standard loans, which meant that MSMEs could save money by taking out a BBLS loan to pay off their existing CDFI loan. The CDFIs report numerous instances of this occurring. Consistent with this explanation, there was a large spike in early repayments over May and June in 2020 (Figure 12).

Figure 12: Full repayments, by month[14]



14 Source: Follow up data - 139 loans with valid data on repayment dates

Beyond BBLS, it is also possible that given the turmoil of the pandemic, some MSMEs took out CBILS loans from CDFIs that ultimately may not have been fully required. This may explain why early repayments increased in March 2021, as shown in Figure 12, as the interest-free period came to an end.

The long-term trend for early repayments will be worth monitoring over the course of the programme. While refinancing may be the best outcome for the MSME, there is also an opportunity cost, in terms of lost interest payments, that must be taken into account for the financial viability of the programme. Despite this cost, as mission-driven lenders, CDFIs do not charge early repayment fees, MSMEs are free to refinance with cheaper finance, if it becomes available.

6. MSME organisational outcomes

As part of the evaluation we have linked, where possible, the companies in receipt of CIEF loans to the FAME database of company accounts. Overall, 611 investees are registered companies and were successfully matched with the database.

Table 3 shows the latest status recorded against each of the companies. It shows that ten per cent are recorded on FAME as having some form of negative outcome. A further one per cent are dormant, which except for very early-stage start-ups, is also likely to indicate the company has ceased trading.

Table 3[15]

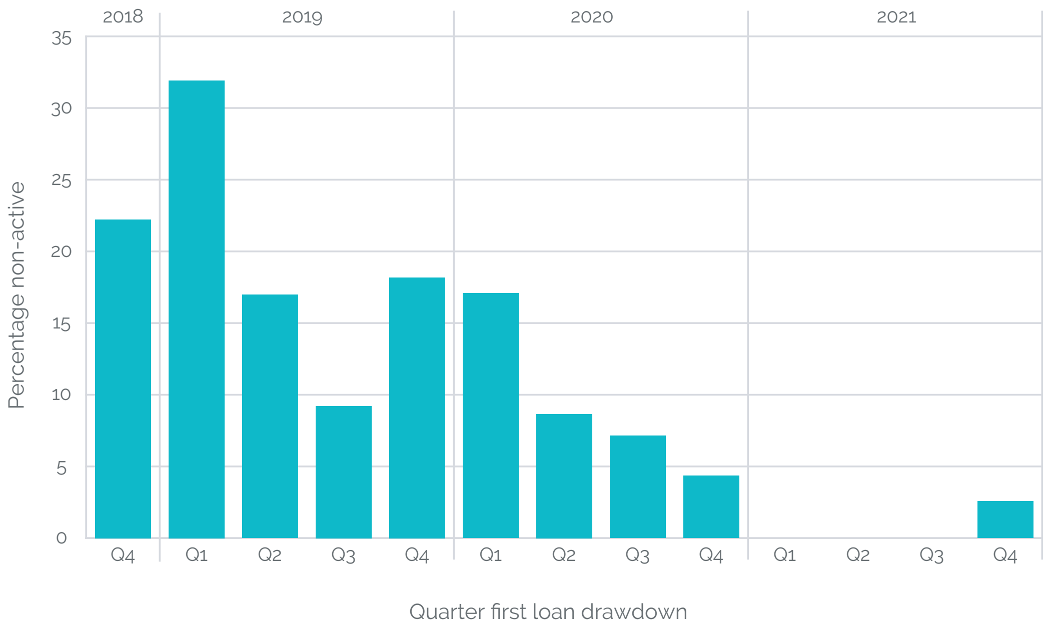
MSME status	Count	Percentage
Active	546	89%
Active (dormant)	7	1%
Active, appointment of liquidator	1	0%
Active, in administration	8	1%
Active, in default	1	0%
Active, with volume arrangement	3	0%
Dissolved	16	3%
In liquidation	29	5%

As with defaults, MSMEs who took out their first loan earlier in the programme, have had more time than more recent loans to experience a negative outcome, and for it to show up in their accounts and on the FAME database.

If we examine MSMEs that received their first loan in 2019, which have had sufficient time for any adverse outcomes to show up in the data, we find that only 3.7 per cent of MSMEs (nine) experienced a negative outcome in the first year after they drew down their first loan, and 9.5 per cent (25) within the first two years. Of MSMEs that received their first loan in 2020, 1.7 per cent (four) had experienced an adverse outcome in the first year after they drew down their first loan, and 7.1 per cent (17) in the first two years.

As with defaults, Figure 13 shows that MSMEs with their first loan in or prior to the first quarter of 2020, and hence also prior to lockdown regulations, are more likely to have recorded a negative outcome at any stage than more recent loans.

Figure 13: Percentage of MSMEs 'non-active', by quarter first loan deployed[16]



15 Source: FAME data, 611 MSMEs with valid status data
16 Source: Baseline and FAME data, 611 MSMEs with valid status data

Changes to MSME size

For the MSMEs whose first loan was in 2019 and whose assets and employees are recorded in their 2020 accounts, we can also explore how their size changed in the year following their loan. 71 per cent of these MSMEs increased their assets in the year following their first loan, two per cent recorded no change and 27 per cent recorded a reduction (Table 4).

Table 4: Assets change for MSMEs with first loan deployed in 2019[17]

Assets change in 2020	Number of MSMEs	Percentage
Over 50% reduction	10	3
11% to 50% reduction	64	17
1% to 10% reduction	26	7
No change	6	2
1% to 10% increase	38	10
11% to 50% increase	124	34
Over 50% increase	100	27

For MSMEs with their first loan in 2019 and valid data, 21 per cent had fewer employees recorded in their 2020 accounts. 42 per cent experienced no change and 36 per cent had gained employees (Table 5).

Table 5: Employees change for MSMEs with first loan deployed in 2019[18]

Employees change in 2020	Number of MSMEs	Percentage
Over 50% reduction	2	1
11% to 50% reduction	44	16
1% to 10% reduction	12	4
No change	116	42
1% to 10% increase	6	2
11% to 50% increase	50	18
Over 50% increase	44	16

MSME case study: Laystone Electronics

Sandiacre-based Laystone Electronics Limited is a family-run business, which provides cutting-edge LED lighting and LED control solutions that improve energy efficiency. It received funding to create two new jobs and safeguard 13 existing roles. The investment comes from First Enterprise, matching funds from CIEF and MEIF. The investment is for investing into stock, equipment, and research and development, as the company enters new markets. Having navigated its way through the challenges of the pandemic, it is now back on track to expand the business further. Steve Masidlover, Director, commented, "The support provided through both these funds has enabled the business to fast-track the final development stages of a new and exciting range of LED drivers that we have been working on".

17 Source: FAME, 368 MSMEs with their first loan in 2019, and valid assets data in 2019 and 2020
18 Source: FAME, 274 MSMEs with their first loan in 2019, and valid employee count data in 2019 and 2020

Subjective measures

Approximately a year after receiving their loan, CDFIs distributed a short online survey to investees, to explore what impact they felt the loan had had on their business. The response rate to the survey was relatively low at 44 responses, about nine per cent of the 481 MSMEs that received their first loan in 2019 or 2020. There is also a relatively high probability of response bias, in that dissatisfied or indifferent customers may be less likely to engage with a survey from the CDFIs, or may have gone out of business. Nevertheless, the results of the survey are very clear.

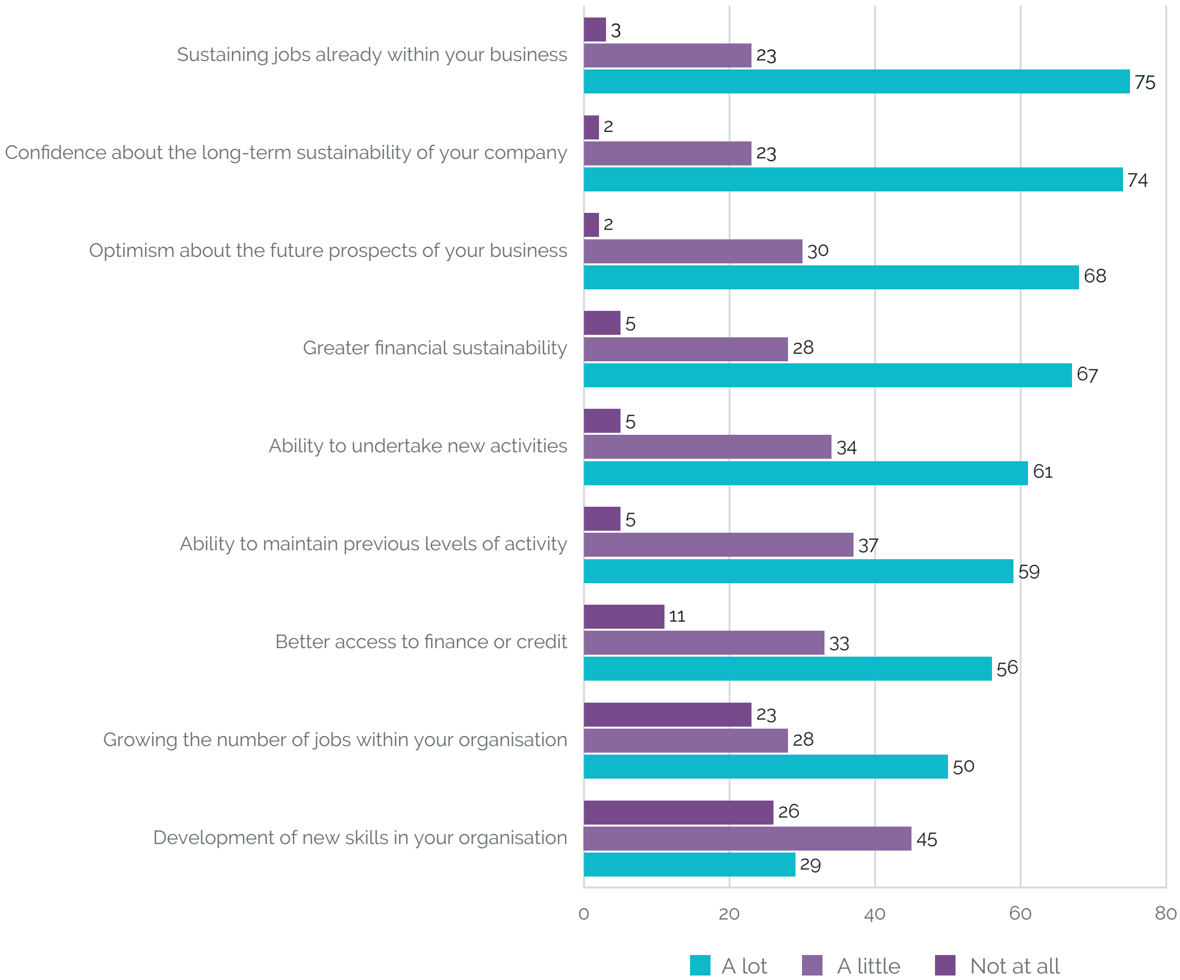
Overall, satisfaction with the CDFIs appears to be very high, with 85 per cent (35) very likely to recommend their CDFI to others and a further ten per cent (four) somewhat likely. Only five per cent (two) were not likely at all.

MSMEs were also asked about how much the loan had impacted various aspects of their business (Figure 14). The areas rated as the most impacted included sustaining existing jobs, confidence about long-term sustainability, optimism about figure prospects, and greater financial sustainability, with two thirds or more of respondents identifying 'a lot' of impact on these measures.

The ability to undertake new abilities, maintain previous levels of activity, gain better access to finance or credit and grow the number of employees, were all also rated relatively highly, with over half of respondents identifying 'a lot' of impact for each measure.

The only area where a slightly lower level of impact was identified, was the 'development of new skills', though 74 per cent of respondents still identified at least 'a little' improvement due to their loan.

Figure 14: Impact of loan on different areas of business[19]



19 Source: MSME web-survey: valid number of responses (top to bottom): 40, 43, 44, 43, 41, 41, 36, 40, 38

Notwithstanding the relatively low response rate, the results overall indicate a positive pattern. This is in keeping with the theory of change for CDFI lending generally, and particularly in the economic context of COVID-19 and lockdown restrictions, in that many recipients may have received loans necessary for their survival, that they were unable to access from elsewhere.

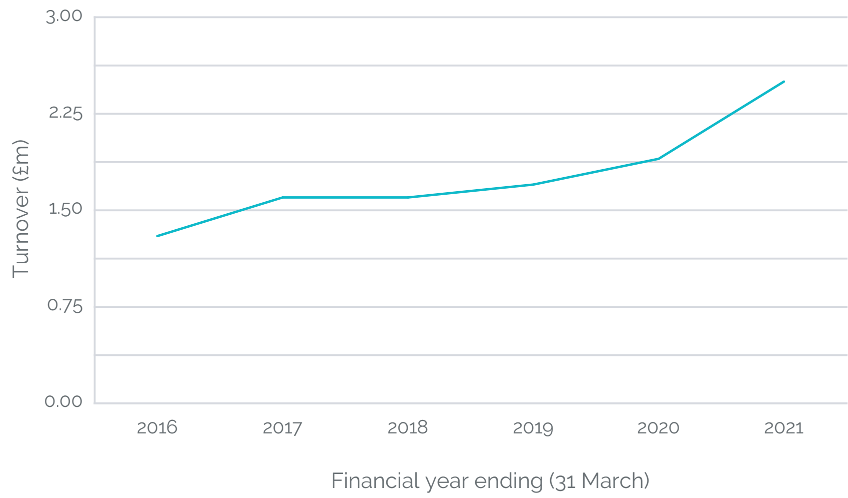
MSME case study: Clear Three

Clear Three, an award-winning laundry efficiency specialist based in Cannock, secured a £120,000 CIEF loan from BCRS Business Loans. The company helps businesses implement more eco-friendly washing systems, and will use the funding to strengthen and expand its consultancy services and diversify its technology into new markets. Clear Three CEO, Colin Oakley, reported that, "After securing funding from BCRS, we will be able to use the fund to recruit an additional two people and secure the future of six existing members of staff. The investment fund will not only allow us to recruit additional roles, but enable us to branch into new markets and continue to develop new products."

7. Impact on CDFI providers

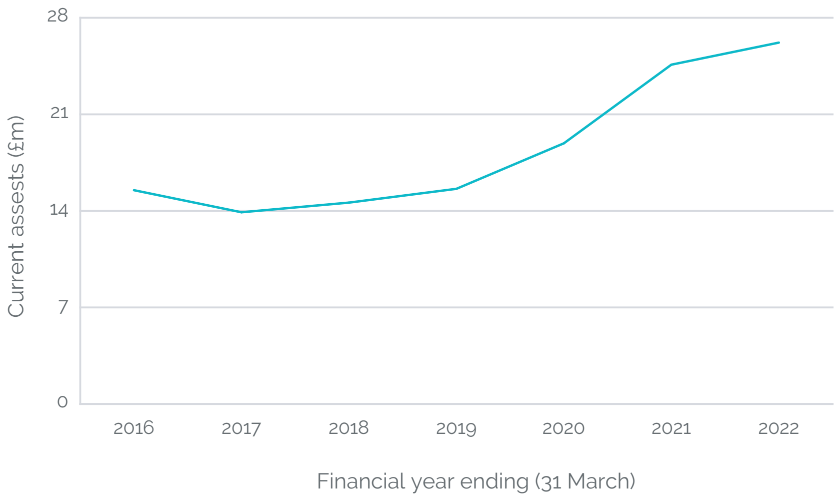
The participating CDFIs were generally positive about their financial trajectory, with several reporting their strongest ever financial year, peaks in lending, and new staff. Partly this continues a pre-existing trajectory, but Figure 15 below shows that turnover has notably increased since the launch of CIEF in 2019. Figure 15 shows an average of the three CDFIs that started lending from the start of the programme, though the trajectory is similar for each.

Figure 15: Turnover of participating CDFIs by financial year[20]



Likewise, we see a similar upwards trend for current assets in Figure 16, which includes debtors, in the form of loans to MSMEs. The availability of CIEF funds had enabled the CDFIs to lend in record amounts, especially over 2020 during the time of the first lockdowns.

Figure 16: Current assets of participating CDFIs by financial year[21]



It was also widely accepted, however, that the COVID-19 pandemic, while extremely challenging, had bolstered the CDFIs' loan books. In addition to the stronger COVID-related guarantees, early repayments from BBLS loans have cleared some bad debt from CDFIs' books. It is worth noting, however, that CIEF is delivered via special-purpose vehicles, and no profit derived from the CIEF lending can be removed from these, before BSC and the other lenders have been fully repaid for their investments. Combined with relatively low management fees, this means that CIEF has not yet provided much surplus finance for the CDFIs. Given that the CDFIs are non-profit, this means less surplus to reinvest in either further lending or the CDFI itself.

20 Source: Consolidated accounts data for FE, FFE and BCRS
21 Source: Consolidated accounts data for FE, FFE and BCRS

8. Changes to the CDFI market

Arguably, the four CDFIs providing loans using CIEF were already on very positive trajectories for professionalisation, resilience and growth. Obtaining CIEF funding may have accelerated this trend. There is a risk, therefore, that by 'picking winners', CIEF could unintentionally contribute to further bifurcation within the sector between larger, more professionalised CDFIs and their smaller counterparts.

Responsible Finance lists 24 lenders to small businesses on its website, many of which may remain relatively under-capitalised. Stakeholders were keen that ways were found to support these CDFIs, to grow the market further. One solution would, of course, be to include more CDFIs in any successor programme to CIEF.

There remains a need, therefore, for capacity building within the sector, to support CDFIs to develop their structures, processes and staff. It was noted by an interviewee, that a key part of the US model includes a large amount of grant support for capacity building. This fits within the wider 'blended finance' agenda in the UK, including the foundation of Access, which aims to provide a grant element alongside any loan finance.

It should also be borne in mind, that not all CDFIs may wish to expand. While this could be seen as a lack of ambition, there may also be legitimate concerns about the conditions attached to new capital and their fit with the social mission of the CDFI. For example, some CDFIs are more specialist than others, and only work within a geography, or in delivering very small micro-loans.

Nevertheless, stakeholders generally agreed that a lack of consistent coverage across the UK was a major problem for the CDFI market. If this is to be resolved, either existing CDFIs need to expand, or new CDFIs need to be established. Some interviewees felt that CDFIs were becoming more collaborative, and that this might in future enable shared back-office functions, cross-referrals or shared resources. Larger, more professionalised CDFIs might be able to work with their smaller counterparts to expand their reach. Mergers between CDFIs would be an extension of this logic, though positive and negative views were expressed by stakeholders on how this might impact the sector, given its reliance upon a localised, relational approach.

Policy environment

Interviewees widely agreed that the policy environment had become recently more favourable to CDFIs. In large part, this was attributed to the role that they had played in the COVID-19 pandemic. CDFIs were among the first to start making loans using CBILS, and were able to prominently demonstrate their social mission by helping businesses in need. This appears to have engendered goodwill from key policy-makers such as HM Treasury, BEIS and DCMS, and it was felt that there was now greater understanding of the CDFI model and its potential as a regional development tool. The role of Responsible Finance, the membership body for CDFIs and other social lenders, was praised as providing a joint voice, and the general tone of CDFIs' communications and lobbying efforts was seen by stakeholders as more professional than in the past.

It was acknowledged, however, that these improvements were largely a case of positive mood music, which had not yet resulted in a major policy shift or new capital. However, interviewees did notice some tangible results. They noted that CDFI stakeholders had been consulted about the new RLS guarantee, as well as potential changes to Community Investment Tax Relief, and felt that their voice was being heard. The renewal (in August 2022) of the third-wave RLS guarantee for two years was seen as a positive step, as well as the reintroduction of personal guarantees. It was also noted that CDFIs and other non-profit lenders paid a slightly lower premium (half a per cent) for using CBILS compared to for-profit providers. This provided tangible evidence that non-profit lenders are being explicitly taken into account by HM Treasury.

Remaining goals identified by stakeholders included a new, permanent capital base for the sector, perhaps set up by the Government from dormant assets; developmental grants for CDFIs to help build their capacity; and ongoing stability and certainty concerning guarantees. In addition, it was felt that legislation similar to the Community Reinvestment Act in the US, which rates banks on how well they're serving low-income communities, would help to further encourage investment from mainstream banks. This would ensure consistent support from the banks, even during economic downturns, when the risk of disinvestment would be higher.

9. Additional capital

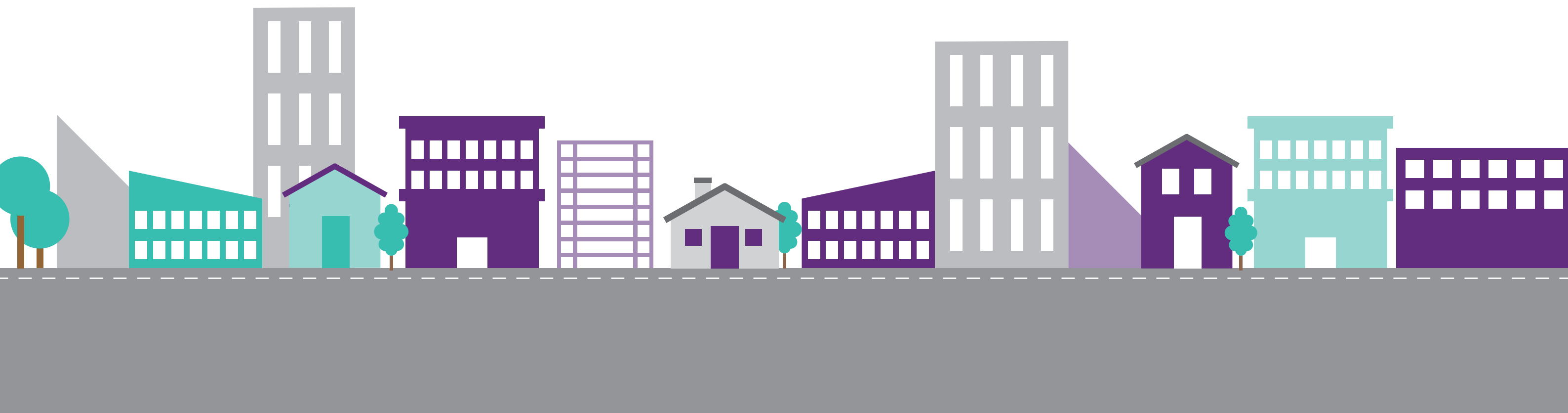
CDFIs reported that they had sufficient capital from CIEF and other sources, such as the Northern Powerhouse Investment Fund and the MEIF, to continue lending at roughly the same level over the short term. To expand the CDFI market further, however, and continue lending over subsequent years, additional capital investment is required.

One of the original goals of CIEF, was to use the initial investment from BSC to leverage in capital from additional sources. In this respect, the £30 million combined capital contributed by Triodos and Unity Trust Bank already marks a significant success, which was widely celebrated by interviewees.

Looking forwards, stakeholders were very keen to secure the involvement of mainstream banks within the CDFI sector. In the US, there is a much higher level of this kind of investment into the CDFI sector, which in turn is much more sizable and developed. This is partly due to legislation requiring lenders to meet the credit needs of all segments of their communities, which they fulfil in part through supporting CDFIs. But there is also an economic incentive, partly from a relatively safe return, given the government guarantee, but also because CDFI customers are likely to return to mainstream finance as they grow and develop further.

If any successor to CIEF were able to leverage funding from mainstream external lenders, in addition to the existing social lenders, then this would mark an even greater success. It could potentially provide a watershed moment for the CDFI investment market in the UK, and substantially increase the likelihood that other mainstream banks would follow suit. Although far from certain, the prospect of attracting this type of external finance was seen as better than at any time in the past, given that CIEF has been successfully deployed and the third wave of RLS provides two years of relative certainty. Another future possibility includes the establishment of a CDFI specific fund using assets released by the Government from dormant accounts. A source of relatively cheap, reliable capital for CDFIs would be a substantial help to enable expansion.

It is hoped that the successful deployment of CIEF will itself help to make the case regarding unmet demand. £60 million of CIEF funding has been largely deployed over three and a half years, seemingly without major difficulty. This is tangible proof of demand for CDFI loans, albeit in the context of the COVID-19 pandemic.



10. Conclusion

The results of the evaluation analysis, combined with stakeholder interviews, paint a cautiously optimistic picture for the CIEF programme, the participating CDFIs and the CDFI sector more generally, as well as the CDFI investees. The CDFIs and stakeholders were positive about CIEF and the role that it has played within the CDFI sector. CIEF was a major investment, and has helped the participating CDFIs to considerably expand their lending and elevate their profile. Although this could not have been anticipated at the start of the programme, it also provided a large amount of capital for these CDFIs throughout the COVID-19 pandemic, especially during the initial lockdowns. This showcased CDFIs' potential at a time of crisis, when loans to MSMEs were needed most.

The CIEF programme, in conjunction with COVID-19-related policy developments, has also had a largely positive impact upon the participating CDFIs. This is to be welcomed, firstly to help develop the CDFI market, but also because as non-profit lenders, their success results in further reinvestment. Some concerns remain, however, as to whether this success can be matched across the wider sector, which remains relatively undercapitalised.

Notwithstanding delays due to RLS accreditation, CDFIs do not appear to have struggled to deploy their CIEF capital. Although the pandemic may have boosted demand, it is promising that demand has so far remained steady throughout the COVID-19 recovery, despite a challenging economic outlook. As a result, close to £60 million of loans have been deployed across the UK at the time of writing. CIEF also appears to have done a reasonable job of targeting funds towards disadvantaged groups and areas.

While it is still relatively early in the programme, default rates appear on an acceptable trajectory. There is a marked distinction between loans made before the first COVID-19-related lockdown, and those made after using CBILS and RLS. In subsequent years, CDFIs will have had time to submit claims under the guarantees for the defaulted capital on these loans, which means that any losses on outstanding capital will be substantially lower than the headline default rates would suggest. A huge amount of economic uncertainty remains, however, especially relating to inflation and energy costs. It remains possible that this will impact on the CIEF default rates over the medium to long term. Future evaluations will focus on performance of CIEF loans, including default and recovery analysis, alongside outcomes for the CDFI providers.

CIEF has shown that a large-scale external investment, combined with the government guarantees and CITR, can be successfully deployed. This appears to have boosted the reputation of CDFIs among policy-makers. It is positive that stakeholders reported much closer engagement with CDFIs and Responsible Finance over the development of RLS. The formal recognition of non-profit status within the fee structure for these guarantees is also promising.

The main barrier to expansion of CDFI lending, remains sufficient capital. A warmer policy environment, and evidence from CIEF, have made the prospects of further external investment more likely than ever before.

Overall, CIEF has the potential to provide a compelling and positive story about the potential of the CDFI market to provide finance to underserved MSMEs, but much depends on developments over the next few years. Only once we know the long-run default rates, economic conditions and the prospects of further external investment, will the full legacy of the programme become clear.

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