Sheffield Hallam University | Centre for Regional Economic and Social Research

Evaluation of the Community Investment Enterprise Facility

Deep dive: CDFIs' response to the COVID-19 pandemic

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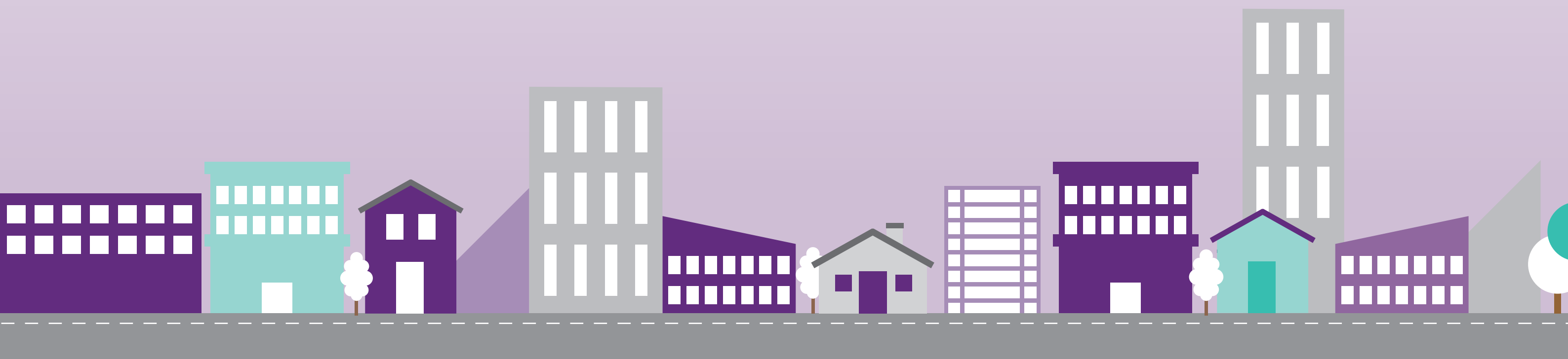
Community Investment | Big Society Capital | Social Investment Scotland



Abbreviations

BBB British Business Bank

BBLS Bounce Back Loan Scheme

BSC Big Society Capital

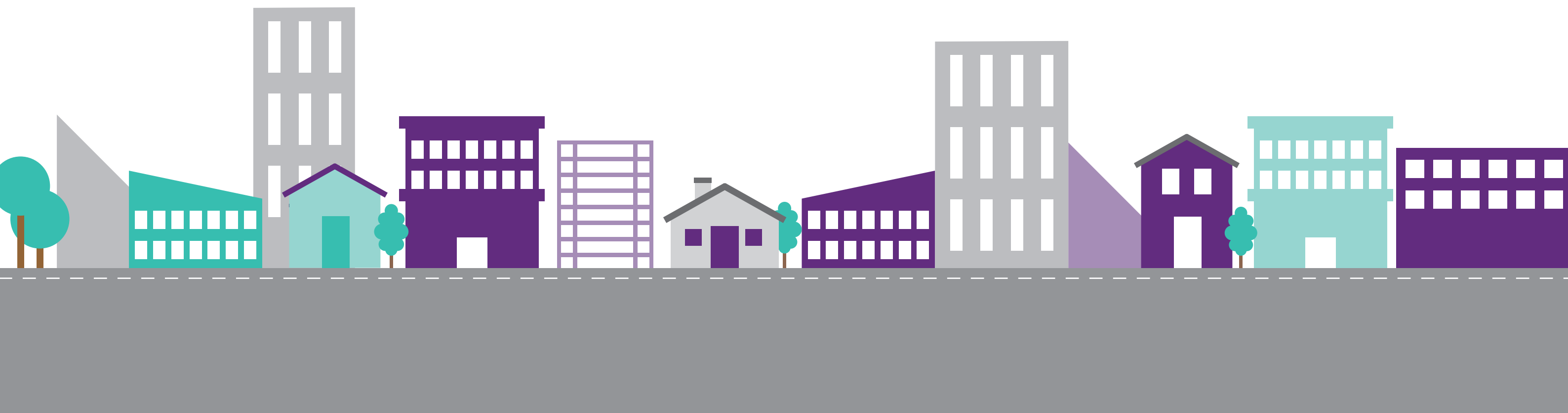
CBILS Coronavirus Business Interruption Loan Scheme

CIEF Community Investment Enterprise Facility

MSME Micro, Small or Medium Enterprise

RLS Recovery Loan Scheme

SIS Social Investment Scotland



1.Executive summary

The four Community Development Finance Institutions (CDFIs) involved in delivering the Community Investment Enterprise Facility (CIEF) responded rapidly to the COVID-19 pandemic and economic 'lockdown', driven by their social mission to provide finance to underserved MSMEs.

The CDFIs played a key role in delivering the Government's Coronavirus Business Interruption Loan Scheme (CBILS), and later the Recovery Loan Scheme (RLS), key public policy interventions to support small businesses during the pandemic.

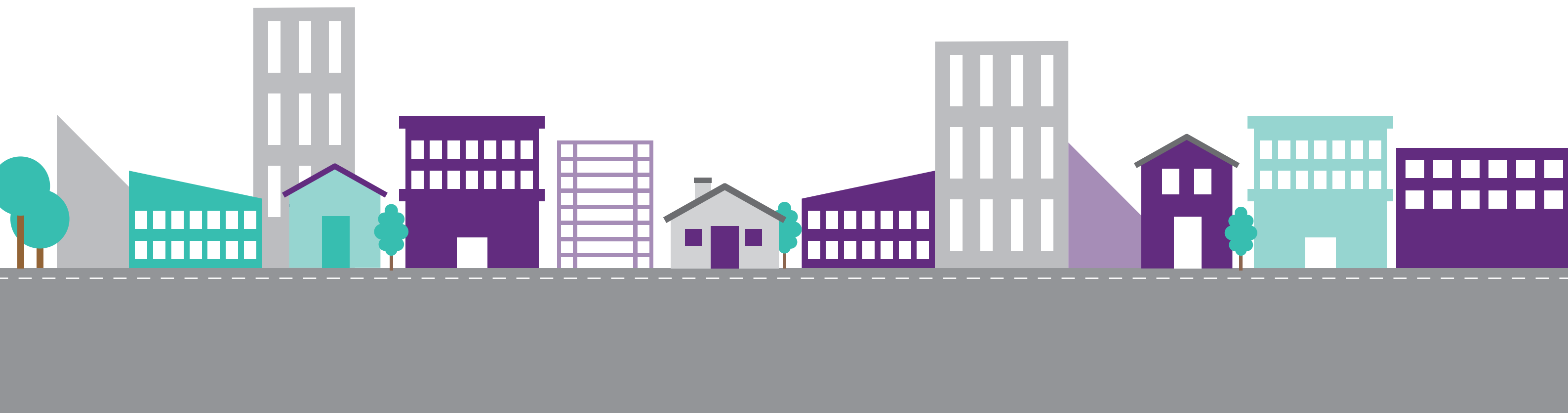
The CDFIs, with financing from CIEF and matched lenders, deployed 314 loans totalling £29 million using the CBILS guarantee up to the end of June 2021. These were made during a period of unprecedented crisis and many of these SMEs may have struggled to secure finance elsewhere, risking closure as a result. Thanks to their relationship-based approach to lending, the CDFIs were also able to support their borrowers with existing loans. CDFIs had deployed 291 loans to 281 MSMEs prior to the 23rd March 2020, the date of the first lockdown. Most of these recipient MSMEs were contacted and given individualised advice and support, ultimately resulting in some form of restructuring for 48 per cent of these the loans. 77 per cent of restructured loans returned to full repayments at some stage.

Although the later introduction of Bounce Back Loan Scheme (BBLS), another Government policy intervention, affected the CDFIs lending profile, they have still made a large proportion of loans to those in economically deprived areas since the first lockdown was announced. Amongst loans deployed on or after March 23rd 2020, 35 per cent were in the 30 per cent most economically deprived areas, and 58 per cent were in the 50 per cent most deprived areas.

The CDFIs' response to the COVID-19 pandemic has, therefore, provided further evidence of their distinctive role as effective, agile lenders to MSMEs that are underserved by mainstream finance. As such, CDFIs have the potential to play a key role in the development of economically deprived places, including in the 'levelling-up' agenda. CDFIs are a proven mechanism that enable private investment to flow into deprived areas. An increase in capital funding, including funds like CIEF; together with a long term, predictable guarantee scheme; and direct government support to promote the growth and development of the whole CDFI sector, would allow CDFIs to scale their impact in left-behind places.

5 key facts on CDFIs lending during the Covid pandemic.

1. 48 per cent of pre-covid loans were offered repayment holidays or changes to their terms to prevent defaults
2. 77 per cent of restructured loans returned to full repayments at some stage
3. Rapidly increased lending in the second quarter of 2020 to respond to demand from MSMEs, with CDFIs deploying nearly three times more loans and four times more capital, compared to the first quarter
4. Deployed £29 million, via 314 CIEF loans to 302 different MSME, made under the CBILS guarantee, until the end of June 2021
5. Post 23rd March 2020, £11.7 million (40 per cent of the amount lent) deployed to MSMEs registered in the 35 per cent most economically deprived neighbourhoods



2.Introduction

This report forms part of the Evaluation of the Community Investment Enterprise Facility (CIEF) being undertaken by the Centre for Regional Economic and Social Research (CRESR) at Sheffield Hallam University. Its purpose is to take a more in-depth look at the impact of the COVID-19 pandemic upon the CIEF fund and the four Community Development Finance Institutions (CDFIs) involved in its delivery.

CDFIs are non-profit lenders to Micro, Small and Medium Enterprises (MSMEs), who are unable to access suitable finance via mainstream lenders and are often based in disadvantaged communities. CIEF is a £60 million investment facility, seeded by Big Society Capital (BSC), with match funding from Triodos and Unity Trust Bank, and managed by Social Investment Scotland (SIS). It aims to support CDFIs in their social mission to provide finance to underserved MSMEs and to help build the wider CDFI sector. MSMEs started to drawdown CIEF funded loans in December 2018, initially from three CDFIs. A fourth CDFI joined the programme later, with its first loan drawn down in March 2020.

This report draws on reporting data submitted quarterly by the CDFIs, up to a cut-off date at the end of June 2021, as well as discussions with key staff members at the CDFIs, BSC and SIS. On the 23rd of March 2020, in response to the growing COVID-19 pandemic, the UK Prime Minster ordered the public to stay at home and introduced a swathe of restrictions upon their activities. The subsequent economic shock caused an unprecedented drop in UK GDP of 9.9 per cent from 2019 to 2020 (ONS, 2021), including an estimated 20 per cent fall in the second quarter compared to the first (ONS, 2020). These 'lockdown' restrictions meant huge numbers of businesses were unable to continue operating normally and there was a high risk that many otherwise viable businesses would fail, at great economic and human cost.

Prior to the 23rd of March, the CDFIs had collectively deployed 291 loans to 281 MSMEs, who had drawn down a total of £14.27 million of CIEF funding. 53 per cent of these loans were to MSMEs operating in the 35 per cent most deprived neighbourhoods in England. The CDFIs involved in CIEF were unanimous that helping MSMEs through this period, using the remaining funds, was essential to their social mission and reason for existing as organisations.

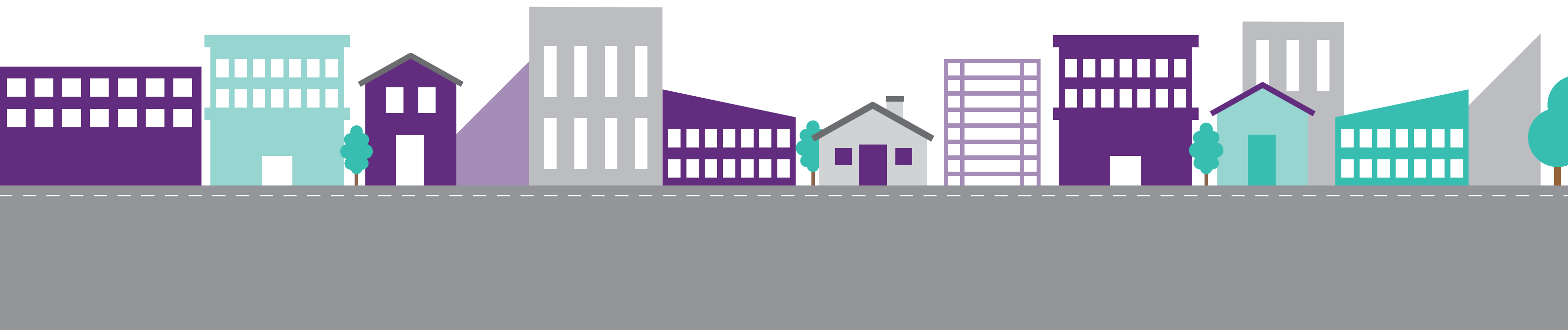
At the same time, the CDFIs clearly faced severe financial risks of their own, if they were unable to continue lending or if large sections of their existing loan book defaulted. Allowing their pipeline of loans from brokers and other sources to fall dormant would also have been risky, as it takes time to build back a pipeline of loans, and brokers may form relationships elsewhere. Their response, therefore, was directed towards both the 281 MSMEs who already had CIEF loans, as well as the huge numbers of businesses seeking new finance to help address the uncertainty created by the pandemic.

3.What happened to the existing CIEF portfolio?

Once the impact of the pandemic related restrictions became clear, the CDFIs conducted a rapid review of all their existing CIEF loans. In most cases MSMEs were contacted individually to discuss their situation and run through a standardized questionnaire. The CDFIs were often able to effectively offer free business advice, making the MSME aware of government support available, and ensuring they communicated with other key stakeholders such as landlords and HMRC.

In the quarterly follow up data, collected as part of the CIEF evaluation, CDFIs were also asked to record, for each loan, the way in which COVID-19 had impacted the MSME's business. 72 per cent of pre-covid loans reported a negative impact, a clear majority.

Where there was sufficient need, CDFIs agreed to restructure the loan, which means the original terms and conditions of repayment were changed. Of the loans deployed prior to the 23rd of March 2020, 48 per cent were recorded as being restructured in some way and 96 per cent of these involved a repayment holiday, either on interest, capital, or both and the remainder were extended terms.



Although restructuring might sometimes be seen as a negative outcome, in the unprecedented context of the pandemic it proved a vital tool, showcasing the CDFIs' flexibility and relatively personalised approach. The CDFIs were able to have conversations with each client and offer bespoke solutions when required. Repayment holidays varied in terms of their length; whether the holiday applied to interest, capital, or both; and whether repayments were reduced or stopped entirely. It is very unlikely that this sort of personalisation would have occurred within mainstream finance lenders given their very different business models, based around risk modelling and a large turnover of capital and loans.

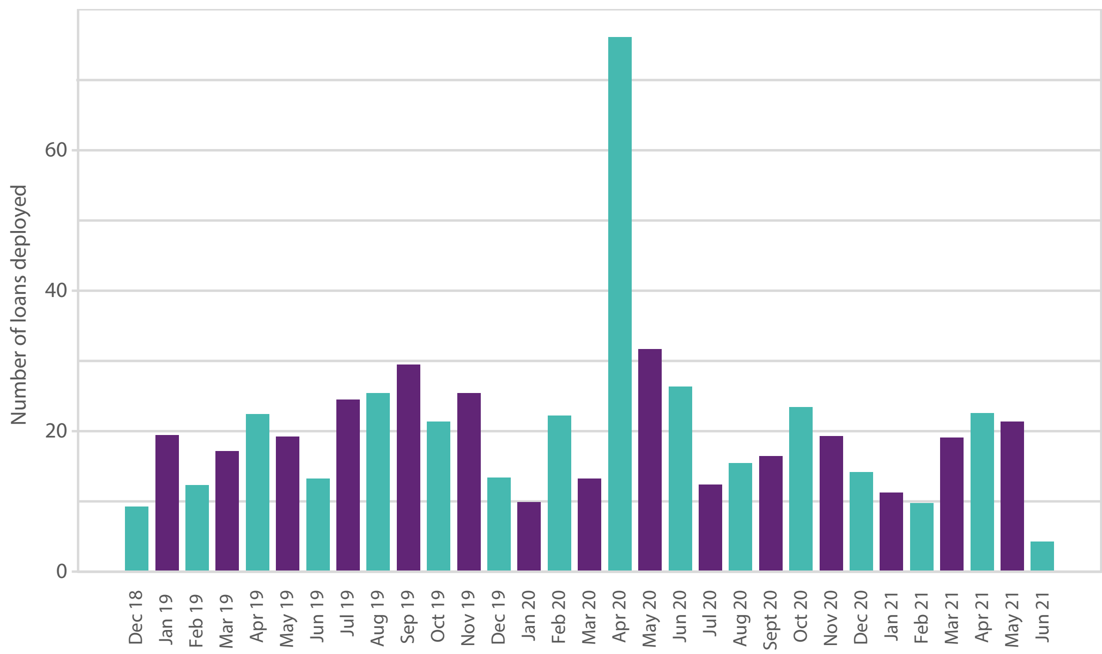
By the end of the second quarter of 2021, 21 per cent of the pre-covid loans which had been restructured had defaulted, whereas 77 per cent had returned to full repayments at some stage (even if later defaulted). The overall default rate for the programme, by the end of June 2021 was just 9.4 per cent of loans, accounting for 6.6 per cent of the total capital invested. The issue of MSME survival and loan repayments will be returned to in more depth throughout the remainder of the CIEF evaluation. It is certainly plausible, however, given the number of MSMEs unable to continue trading normally, that without restructuring the default rate may have been considerably higher.

4. What new loans did CDFIs provide?

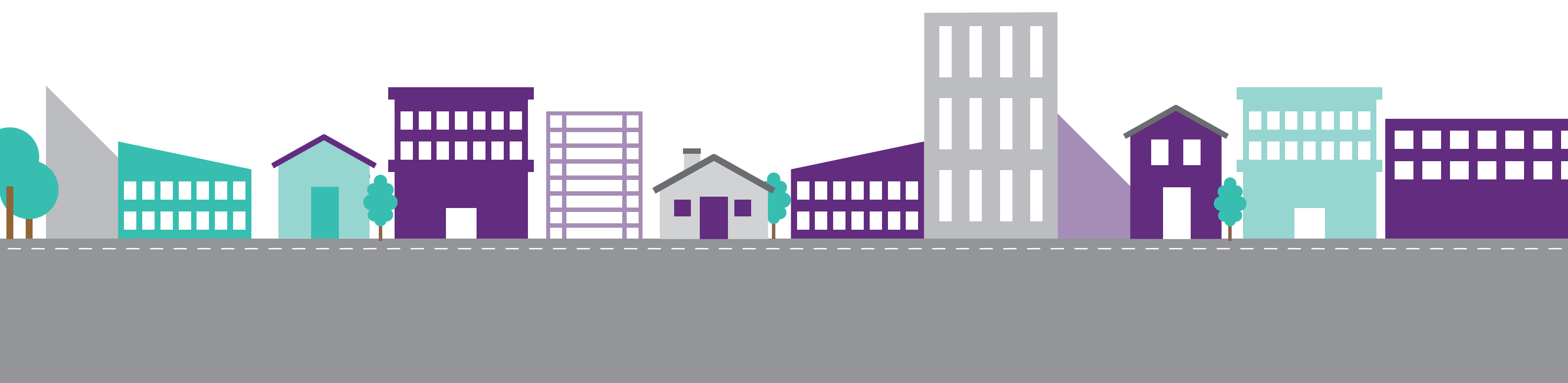
In addition to restructuring the existing portfolio of loans, the CDFIs also sought to offer new finance to MSMEs in the months that followed, by offering loans guaranteed under the new government scheme.

They reported large levels of demand in the immediate aftermath of the lockdown announcement, as seen from the prominent spike in the number of loans deployed in April 2020, in Figure 1. The CDFIs report that this period made large demands on their staff to manage the large numbers of applications and loans over a short period.

Figure 1: Number of loans deployed by month



The lending environment, however, was rapidly changing. To prevent a new credit crunch and a mass business failure, the Government introduced several schemes to encourage lending, in addition to other forms of support such as the Coronavirus Job Retention Scheme.



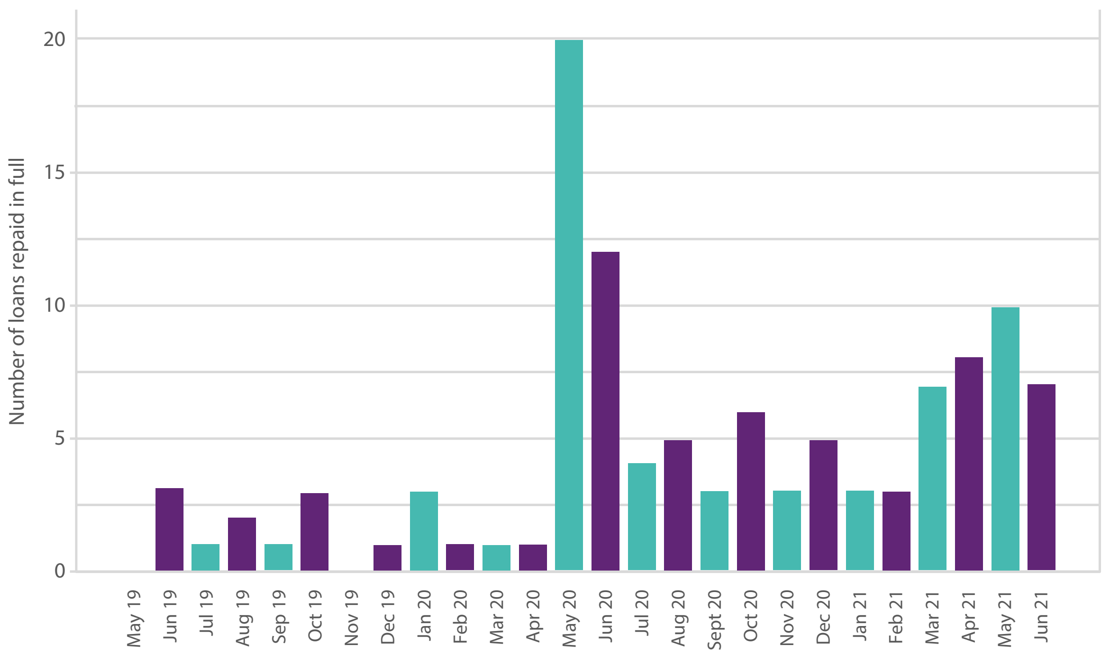
Capital lent out by CDFIs generally requires some form of government guarantee to protect lenders against the higher risk of default when providing lending to underserved MSMEs. Prior to the pandemic, lending from the CIEF fund had been under the Enterprise Finance Guarantee (EFG), which provided a guarantee of 75 per cent of capital for lenders (up to a 15% cap on the CDFIs' annual lending). The EFG was replaced by the Coronavirus Business Interruption Loan Scheme (CBILs) on the 23rd of March 2020, the same date that the first national lockdown was introduced, though it subsequently underwent further development. The lender's guarantee increased slightly to 80 per cent, compared to the EFG, with no cap on the portfolio of CDFIs and the Government paying all interest and lending fees on the loan for the first 12 months (H of C Library, 2021; BBB, 2021a). Loans could be made for up to six-year terms. All EFG lenders were automatically accredited for CBILs by the British Business Bank, though they were allocated a maximum total amount they could lend under the guarantee.

A major change occurred, however, with the introduction of the Bounce Back Loans Scheme (BBLS) on the 4th of May 2020. These loans were offered on a six-year term with a fixed interest rate of 2.5 per cent, with the first year of interest paid for by the Government (BBB, 2021b). Such low interest rates would have made them loss making for CDFIs after the costs of capital and administration, so none of the providers of CIEF were accredited as providers of BBLS. It was instead mainly provided at scale by large mainstream banks with access to large amounts of low-cost capital. Under BBLS, MSMEs were offered loans of £2,000 to £50,000, or 25 per cent of turnover, using a streamlined application procedure and a 100 per cent government backed guarantee (H of C library, 2021). From the point at which BBLS was launched, a minimum loan size of £50,000 was introduced on CBILS backed loans, to prevent overlap.

CDFIs have reported that CBILS backed loan applications at a relatively advanced stage of development subsequently did not go ahead, as MSMEs were instead able to secure loans via the BBLS scheme on more favourable terms than the CDFIs were able to offer. Indeed, CDFIs often felt compelled to actively encourage applicants to explore this option before considering a CBILS loan. Even if MSMEs required more than £50,000, in some circumstances it would make sense to explore BBLS first, before potentially refinancing using a CBILS loan at a later point, either with a CDFI or another provider.

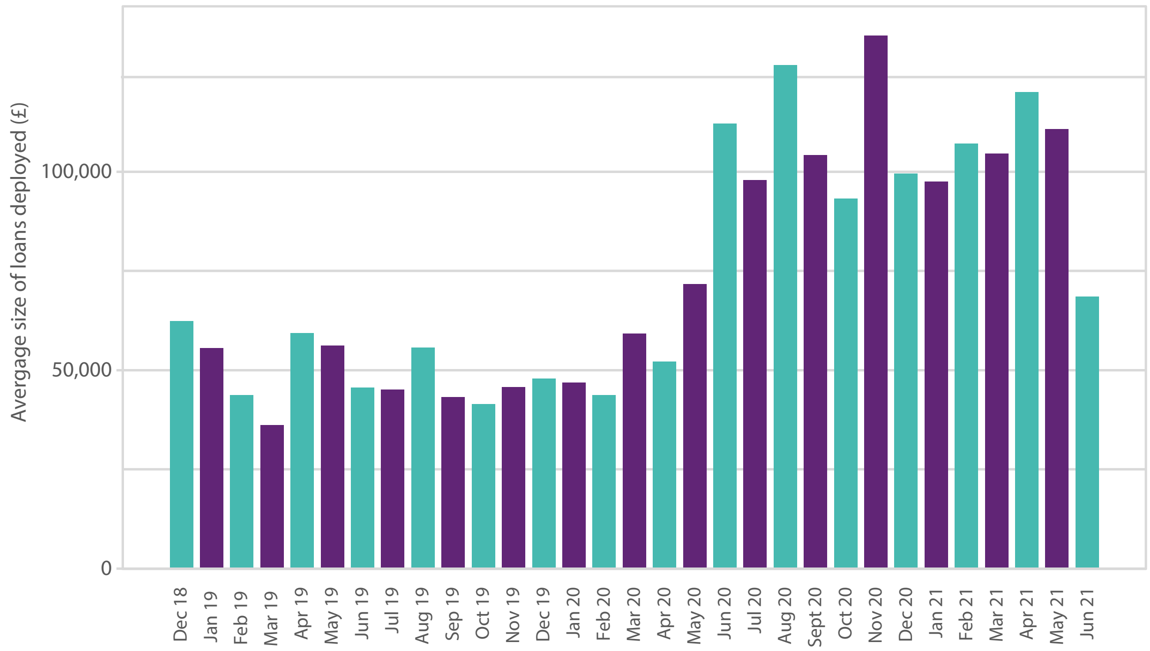
May and June subsequently also saw a record number of CIEF loans repaid, as shown in Figure 2. Most of these loans are less than £50,000 (81 per cent), which means it is most likely that MSMEs were refinancing using Bounce Back loans from other providers. In a few cases, larger EFG loans may also have been refinanced under CBILS to take advantage of the year of government funded interest payments, either with their existing CDFI or another provider with a lower interest rate provider. Where MSMEs refinanced elsewhere, the CDFIs will have lost out on further interest payments and had to relend that capital. On the other hand, CDFIs reported that across their loan funds there were cases of MSMEs in arrears using a bounce back loan to repay in full, which strengthened the CDFIs balance sheets overall.

Figure 2: Number of loans repaid by month



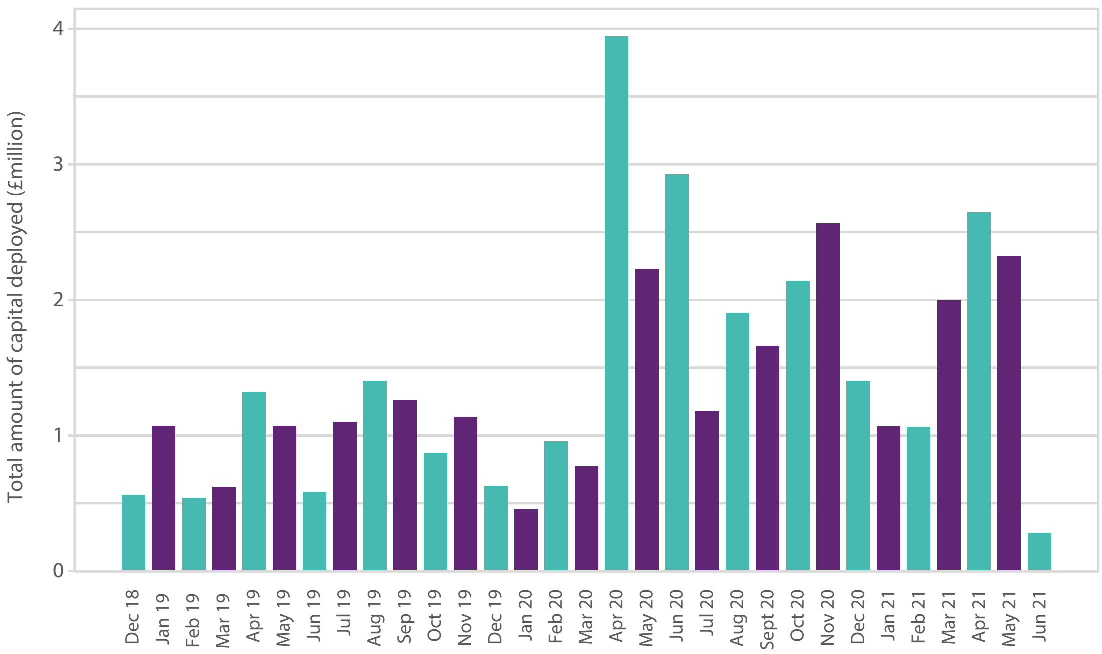
Of the 371 loans deployed prior to the launch of the BBLS scheme (4th May 2020), the average size of loan commitment agreed across CIEF was £52,591. Clearly, therefore, the BBLS occupied a core space in the CDFIs previous target market, and the minimum loan level on CBILS meant that CDFIs could no longer compete directly within this bracket. To adapt to this new environment, the CDFIs were, at different stages, able to negotiate a higher lending threshold than had previously been allowed under CIEF, to £150,000 for three of the CDFIs and £200,000 for a fourth. This largely explains the significant increase in the average loan size from May 2020 seen in Figure 3. The average size of loan deployed in the months following the introduction of BBLS more than doubled to £108,037.

Figure 3: Average (mean) size of loans deployed by month



This perhaps also explains why the sudden spike in the number of loans seen in Figure 1, during April 2020, was followed by a reduction back to more usual levels for subsequent months. The combined impact, in terms of the total amount of capital drawn down each month, can be seen in Figure 4, which shows the same spike in April 2020, followed by a lower, though still elevated average thereafter. Overall, several CDFIs reported that they had lent record amounts by their subsequent financial year end in 2021.

Figure 4: Total capital deployed by month



Further changes were introduced once the CDFIs had reached their allocated lending limit and had to apply for an increased lending limit from the BBB, generally around September or October 2020. A total price cap of 14.99 per cent was introduced, and lenders were expected to pass on the economic benefit of the guarantee to MSMEs in the form of 1 per cent overall reduction in the MSMEs' loan costs (BBB, 2021c). In some cases, this meant that the CDFIs had to reduce the interest rates that they had been charging prior to COVID-19 in order to stay under the threshold, despite the greater environmental risk and uncertainty. It also incentivised them to fix interest rates, as there remained no scope for raising rates further if the Bank of England base rate increased. Arguably, this creates a market distortion, as the CDFIs are not able to fully cost the different levels of risk posed by different loans.

CBILS, in turn, was replaced by the Recovery Loan Scheme (RLS) on the 6th of April 2021, with a smaller guarantee of 80 per cent and no interest or fee free period from the Government but retaining the same price cap (H of C library, 2021). In contrast to the original change to CBILS, CDFIs were not automatically transferred onto the new guarantee scheme. Some frustration was expressed amongst the CDFIs at the level of administration required for both re-accreditations and audits under the various guarantee schemes, especially where this delayed continuing to make loans or having to complete multiple audits in quick succession.

5.What types of new loans did CDFIs provide?

In addition to the change in average loan size, the characteristics of loan recipients changed after the first lockdown and CBILS were announced on the 23rd March 2020. For MSMEs whose first loan was deployed prior to the first lockdown, with valid data, 16 per cent were led by a Black, Asian or ethnically diverse individual. For loans deployed after this point, this dropped to nine per cent. For female led enterprises, the figures fell from 20 per cent to 15 per cent. There was also a shift in the size of the organisations applying. The percentage of MSMEs with five or fewer FTE employees fell from 52 per cent to 36 per cent, while the percentage with 25 staff or over increased from eight to 17 per cent (Table 1). Finally, there is some evidence that the Indices of Multiple Deprivation (IMD) for the neighbourhoods where MSMEs are registered became slightly less deprived. The proportion of MSMEs registered in one of the 10 per cent most deprived neighbourhoods fell from 21 per cent to 14 per cent, and the proportion in the 30 per cent most deprived fell from 47 per cent to 35 per cent (Table 2).

Table 1: FTE employees grouped before and after 23rd March

	Before 23rd March 2020		After 23rd March 2020	
FTE employees (grouped)	**Number**	**Percent**	**Number**	**Percent**
0 to 5	131	52%	96	36%
6 to 11	57	23%	65	24%
12 to 25	45	18%	62	23%
25 and over	20	8%	47	17%
Total	**253**	**100%**	**270**	**100%**

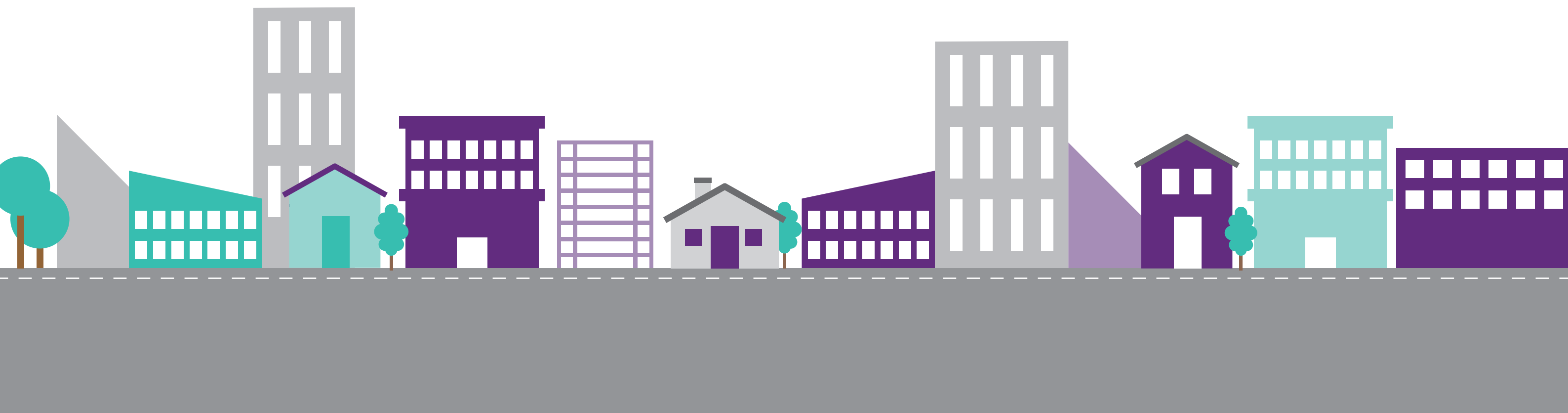


Table 2: IMD deciles before and after 23rd Mar

	Before 23rd March 2020		After 23rd March 2020	
Deprivation Decile	**Number**	**Percent**	**Number**	**Percent**
1 (Most deprived)	59	21	40	14
2	48	17	30	11
3	25	9	29	10
4	27	10	38	14
5	36	13	26	9
6	27	10	17	6
7	22	8	27	10
8	21	7	36	13
9	10	4	17	6
10 (Least deprived)	6	2	19	7
Total	**281**	**100%**	**279**	**100%**

There are several hypotheses for this shift. CDFIs do not report significantly changing their lending criteria, so it seems most likely that the factors originate in the demand side of the market. Most obviously, it is possible that entrepreneurs from relatively disadvantaged groups or communities, seeking smaller loans, were able to take advantage of BBLS loans from other providers, whereas previously they would have approached the CDFIs. Analysis or data has not yet been published on BBLS which would allow us to assess this possibility. This also presupposes that businesses from relatively disadvantaged groups or areas were less likely to pursue the larger CBILS backed loans, which may not necessarily be the case. The 2020 Small Business Survey (BEIS, 2020) does find some correlation between businesses size and whether they are women-led, but no such link for 'Minority Ethnic Group'-led enterprises. More concerningly, it is possible that the economic impact of the pandemic has disproportionately affected these groups and areas, which has suppressed their economic activity or opportunities for growth, perhaps over the longer term (e.g. Torres et al. 2021). This might include, for example, the greater impact of home schooling on women.

It is worth noting, however, that CDFIs are still making large numbers of loans to MSMEs in relatively deprived neighbourhoods, and that all CIEF loan recipients must meet one of the qualifying criteria for Community Investment Tax Relief. This means they must be based in a sufficiently deprived area (according to any IMD sub-measure) or be owned or operated by individuals disadvantaged due to one of several characteristics, such as ethnicity or age. The CDFIs also suggest that without their loan, many of the MSMEs who sought funding in the aftermath of the COVID-19 related lockdowns would not have survived. Given the difference in interest rates, MSMEs are only likely to have sought finance from CDFIs if unable to secure a cheaper BBLS or CBILS from mainstream banks. This lends some credence to the argument that CDFIs were offering a last resort lending option in many cases.

6.The future

The CDFIs have demonstrated throughout the COVID-19 crisis their capacity to adapt quickly to unprecedented circumstances and to lend large amounts of capital over a short period. As missionled social lenders, they were well placed at the outbreak of the pandemic to respond to the increased need for finance from MSMEs, many of whom would have struggled to acquire loans elsewhere. The CDFIs not only contacted almost all existing loan recipients, offering advice and restructuring where needed, but they were also able to dramatically scale up their lending to MSMEs.

This potential has been recognised by lenders, such as Triodos and UTB, who as of September 2021, had collectively provided £21.9m of the £45.5m deployed capital in the CIEF programme and invested a further £10m in the parent CDFIs as part of separate investments. The CDFIs participating in CIEF have arguably emerged from COVID-19 with stronger balance sheets and are optimistic about the potential to raise further funds. CIEF was praised for helping attract this further investment, by providing the CDFIs with a sustained and substantial source of capital over several years.

Based on their performance over the pandemic, CDFIs can play a significant role in the levelling up agenda, helping to support the economic recovery and providing loans to MSMEs in disadvantaged areas most affected by COVID-19. As the CDFIs themselves point out, investing in underserved or leftbehind areas has always been part of their reason to exist. For the CDFIs to operate at an even greater scale, however, significantly higher levels of long term and reliable capital, both commercial and concessionary, will be required, as well as a long term, predictable guarantee scheme.

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