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Annex A

E & SE Midlands LEPs Access to Finance Steering Group

Financial Instruments Options Analysis

1. Introduction

The LEPs in the E & SE Midlands have agreed to work together, with DCLG and the British Business Bank on a number of options designed to overcome SME obstacles to growth caused by lack of access to finance.

An Ex-Ante Market Assessment by European Investment Bank has demonstrated clear evidence of demand for small and larger business loans, early stage venture capital and funding for growth. Their findings were supported by a survey of businesses in 2014 and of professional intermediaries in 2015.

A steering group formed from representatives of each LEP has commissioned Blue Sky to:

- Consider key strategic drivers and imperatives that are common to the LEPs in the region and how they are developing a joint responses for access to finance;
- Clarify the major focal points of demand to help define what a fund might look like; and,
- Collate a summary of options to simplify communication with their Boards and respective ESIF Committees in order to secure commitment and facilitate decision making.

In identifying options that may be taken forward, the Steering Group has asked that those that have been determined to be unviable should be identified so that, for the time being, they may be eliminated from further consideration. By doing so, the Steering Group hopes to focus attention on only those viable options that can quickly be developed to a point that LEPs may consider them in detail.

GLLEP is working collaboratively with other Local Enterprise Partnerships (LEPs) in the East and South-East Midlands, as well as stakeholders such as the British Business Bank and DCLG, to develop a new fund-of-funds in the region. This recognises that access to finance remains a constraint to business formation, development and growth. The LEPs have already invested in research and analysis of market failure for SME finance in the region. However, the Block 1 ex-ante assessment indicated that further work was necessary to pinpoint the areas in which investment in Financial Instruments (FIs) was justified.

Blue Sky Corporate Finance has recently been commissioned to support the LEPs with this work, which is being funded by the British Business Bank through a £100k contribution from the former RDA legacy funds.

SME surveys provide useful data but given that just 25% of SMEs seek finance at any single point in time, it can be difficult to identify a sample that have had recent enough experience upon which to base any objective conclusions. Among those that do seek finance, they may be hampered by a lack of experience and the financial competence necessary to reassure funders. The objectivity of responses may also be affected by the outturn of any search for finance – those SMEs that were declined, may naturally become disaffected by the process, which in turn may indeed influence when and whether they re-enter the finance market in the future.

Therefore, the LEPs have undertaken a qualitative survey of business intermediaries that have both live contacts in regional SME markets and an oversight of prevailing business conditions and this survey will help to test and confirm the conclusions of the earlier research and analysis and the Block 1 ex-ante assessment. In turn, this will support the construction of a sound Investment Strategy. The approach of using such a survey in other regions has made a strong positive impact and is highly cost effective, as it has brought evidence to the table rather than just assertions from stakeholders.

The survey and earlier research and analysis will support an analysis of the options for implementation, range of products to be supported, including the type of investment intervention (debt, equity, mezzanine and / or loan guarantees), the case for and against sectorally focussed funds, optimum fund sizes, any geographical (LEP) focus and the evidence supporting the likely outcomes of these options. Outcomes will be considered in terms of both economic deliverables and likely financial returns. The various option approaches will also be tested with the European Investment Fund (EIF) informally and in real terms before an optimum approach, including possible operating models and structures, is recommended. The recommendation will also seek to deal with LEP specific priorities and how these are best served by the proposed model and structure, the scope for local partnership leadership to be involved in the development, management and monitoring of the performance of the proposed structure, and how LEP targets will be set, measured and monitored.

This recommendation will be incorporated into a market assessment report to be delivered by Blue Sky Corporate Finance by 31 October 2015.

The report itself will lead on to the development of an Investment Strategy which will not only match the Block 1 ex-ante assessment proposals against LEP investment priorities but also define a workable business plan (with assumptions), which can deliver the different needs identified by the LEPs and other stakeholders, such as the British Business Bank and DCLG. The Investment Strategy will be subject to consultation with these stakeholders before being submitted to the EIF as part of the Block 2 ex-ante assessment.

The Investment Strategy is due to be delivered by mid-November 2015.

In parallel with the Block 2 ex-ante assessment that will be carried out by the EIF, a detailed business plan and financial model will, then, be developed which satisfies LEP investment priorities and the objectives of the other stakeholders, as well as making a substantial impact on growing SMEs in the

East and South-East Midlands. The plan and model will also take into account the implications of compliance with State Aid, COCOF, the FCA and other regulations and regulatory bodies.

An agreed detailed business plan and financial model is due to be delivered by Blue Sky Corporate Finance by 31 January 2016, in order to enable any fund procurement process to commence by 31 March 2015

2. Conclusions

There are a number of implications that the LEPs should consider in taking this project forward:

1. There is clear and present need for interventions to support SME access to finance. National schemes such as those managed by the British Business Bank and grant schemes from Innovate UK present a partial solution but there is a weight of evidence that a substantial gap in the market remains for microloans, small business loans (including mezzanine), early stage venture capital and expansion finance for more established businesses;

2. A fund of funds requires scale in value, strategic scope and geographic coverage to be worthwhile;

3. The East and South-East Midlands LEPs cannot support a JEREMIE-type fund of funds on their own. A joint approach with the West Midlands LEPs does extend an opportunity to participate in a larger fund with sufficient scale to interest the EIB but early consideration must be given to how 'local' strategic and operational objectives may be recognised, delivered and integrated within a regional business support infrastructure.

4. The current ESIF allocations set aside are thought to be sufficient to enable engagement in a pan-Midlands fund of funds (this will be tested by detailed financial modelling), using ex-RDA legacies to support set-up and operating costs. Any material reduction in allocations may have a direct impact on viability and deliverability.

5. Other options to support local or limited 'single' funds may be viable but do not offer anything like the opportunity presented by a fund of funds.

3. Recommendation

It is recommended that:

1. Discussions should continue to work on options with the West Midlands LEPs to determine the basic principles of agreement by which a pan-Midlands JEREMIE-type fund of funds may operate;

2. Based upon local research of business needs, the East and South-East Midlands LEPs should proceed to draft and agree an Investment Strategy as a participant in a pan-Midlands fund of funds instrument that may be submitted to the EIB to complete the Block 2 Ex-Ante Assessment; and,

3. The current ESIF indicative allocations should be maintained. All other options should be placed on hold for the time being until the potential for a pan-Midlands fund is understood.

4. Strategic drivers and shared challenges

Each of the LEPs has agreed in principle to collaborate on the development of a region-wide fund of funds type programme.

The 'in-principle' budget allocations at each LEP are set out in the following table and are drawn from ESIF Strategies compiled in 2013.

	Indicative ESIF Allocation (£m)
Derby, Derbyshire, Nottingham & Nottinghamshire (D2N2)	£11.75
Greater Lincolnshire (GLLEP)	£5.00
Leicester & Leicestershire (LLEP)	£6.00
Northamptonshire (NEP)	£4.00
South East Midlands (SEMLEP)	£6.70
Total	**£33.45m**

This course of action is supported by successive reports that identify access to finance as a significant inhibitor of business start-up, development and growth. Research to support this view has been assembled from national, regional and local data, is summarised elsewhere in this paper.

The E and SE Midlands LEPs share many common strategic economic drivers and a number of strategic economic priorities.

Those drivers include:

- A strong and shared interest in stimulating enterprise, growth and innovation. The LEPs wish to support business growth especially in higher value-added businesses that may be at an early-stage of development or more established and able to respond quickly by creating new commercial opportunities and sustainable jobs;
- An interest in the delivery of a results-driven, comprehensive business development strategy, anchored on a network of Growth Hubs that will enlist contributions from partners at national, regional and local level and from public and private sectors;
- A joint response to an invitation from Government to take strategic leadership for the recycling of legacies that remain from ex-RDA investment funds; and,
- A desire to support sectors that are either important to current economies or have the potential to become so in the future. Many sector priorities are common to two or more of the five LEPs represented on the Steering Group which further supports a joint approach. The overlap of sector interests is represented in a diagram below.

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Matrix of E & SE Midland priority sectors.	D2N2	Leicester & Leics	Grtr Lincs	Northampton	SEMLEP
Manufacturing, technology and Innovation Engineering, transport equipment, aerospace, agri-tech, automotive, motor sport, food and drink, textiles, life sciences/health and care, renewables, low carbon goods & services	•	•	•	•	•
Creative and digital content	•	•	•	•	•
Visitor economy, rural economy, tourism & hospitality	•	•	•	•	•
Transport, ports and logistics	•	•	•	•	•
Professional and financial services		•			
Construction	•				

In summary, the E & SE Midlands LEPs share the same strategic drivers and economic priorities, have identified access to finance as a significant inhibitor of business start-up, development and growth, and agreed a joint, collaborative approach to access to finance.

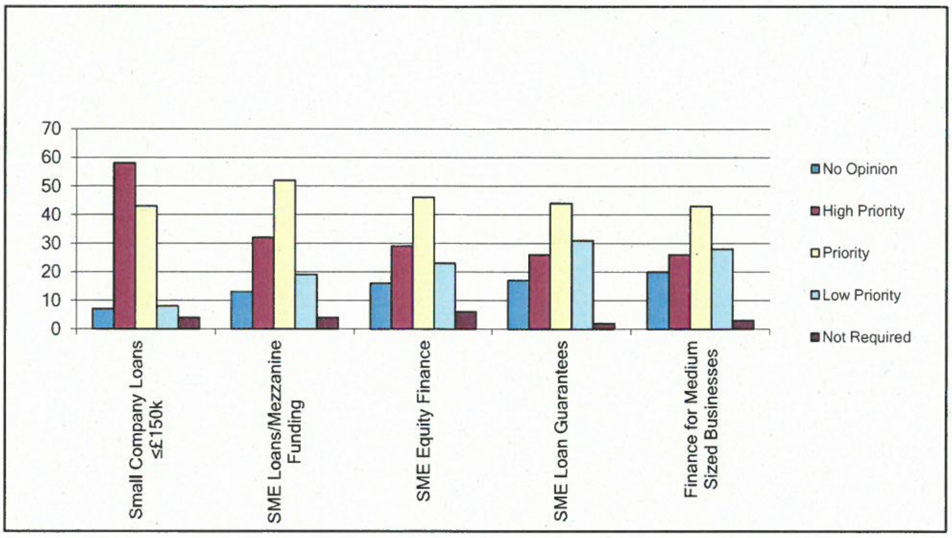
5. Demand

Access to finance remains a constraint to business formation, development and growth. Local reports commissioned by the LEPs in the East and South-East Midlands support this view.

The recent Mazars LLP business survey and report on SME access to finance (published in late 2013) concluded that around 26% of the region's SMEs considered the scarcity of funding to be a barrier to growth. This is equivalent to around 56,800 individual businesses in the region at any one time.

The Block 1 Ex-Ante Assessment (carried out by the European Investment Bank (EIB)/Regeneris and published in January 2015) on SME access to finance in the East and South-East Midlands concluded that there "*...was likely to be un-met demand for finance across the market...*", a view that was supported by a survey of intermediaries undertaken by Blue Sky Corporate Finance in September 2015.

As part of this survey, intermediaries were asked whether regional public sector interventions were required in a number of financial areas. The majority of intermediaries identified these areas as either a high priority or a priority.



6. Microloans

For microloans, the market gap is focussed on lending of between £20k and £100k. The Block 1 Ex-Ante Assessment estimates that an unmet demand exists in the region of *"...£4m and £70m per annum..."* respectively (based upon only 10% of demand being viable for support, if provision had been available).

The intermediary survey noted high prioritisation to be given to interventions to support lending up to £150k for start-up, growth and development.

There is evidence that this unmet need continues to persist and research notes that smaller businesses that are more likely to use finance at this level have been disproportionately affected by the departure of the banks from this market.

The region has also benefitted less than might be expected from the British Business Bank's (BBB) Start-Up Loan Scheme.

In terms of defining the potential of a new financial instrument, there has been comparatively little public sector provision, other than the on-going Enterprise Loans East Midlands initiative, but the report suggests that take-up might be comparable to that of funds serving similar areas in the West Midlands and Yorkshire and the Humber. The latter is known to have lent around £4m per annum in this category (and the former at least this amount).

7. Early Stage Venture Capital

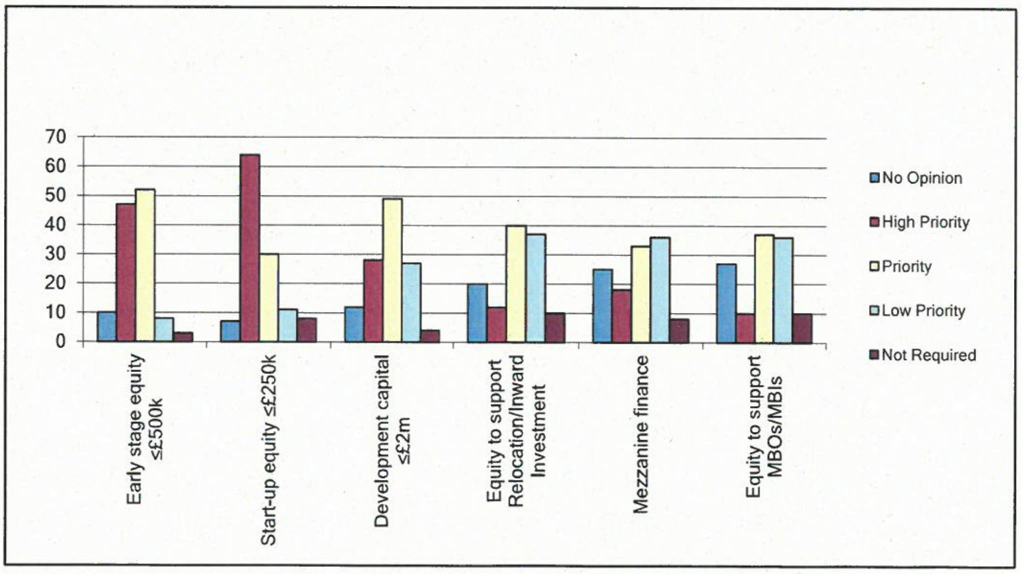
The Block 1 Ex-Ante Assessment struggled to isolate a quantified level of unmet demand for early stage venture capital but suggested that such demand was likely due to the lack of provision. This type of finance is well known to stimulate markets elsewhere and to be very effective in attracting mobile early-stage propositions. Put simply, demand for early stage venture capital tends to materialise only when there is finance on offer of the right type and at the right time but can be a powerful attractant and stimulant to value-added, high growth businesses.

Nationally, there is ample evidence of demand for pre-commercialisation and early stage venture capital for first round funding up to £500k. This range of equity investment continues to struggle to attract private equity investors and regional public sector backed funds that have offered finance in this category, in comparable areas in the North of England and elsewhere, have shown early signs of success in supporting indigenous businesses and attracting ventures from elsewhere. Schemes of this kind appear to benefit from coordinated efforts between providers of incubation space, university technology transfer offices, business angel networks and other forms of business support, including investment readiness.

Some national funds do operate in this space such as the Business Angel Co-Investment Fund and the Enterprise Capital Funds, both funded and managed by the British Business Bank. The extent to which these schemes deliver impact in the region in proportion to its share of the national SME headcount is anecdotally thought to be less than might be hoped. Previous research has noted that businesses in the southernmost part of the region may benefit from their proximity to finance markets and intermediaries in London and the 'Research Triangle' with Oxford and Cambridge.

A market consultation by EMB Group has suggested that there is a demand for proof-of-concept funding that would support university spin-outs and may co-invest alongside business angels and grant schemes such as those offered by Innovate UK.

In the Blue Sky Corporate Finance survey of intermediaries in September 2015, over 90% of those who expressed an opinion rated early-stage venture capital as a high priority or priority.

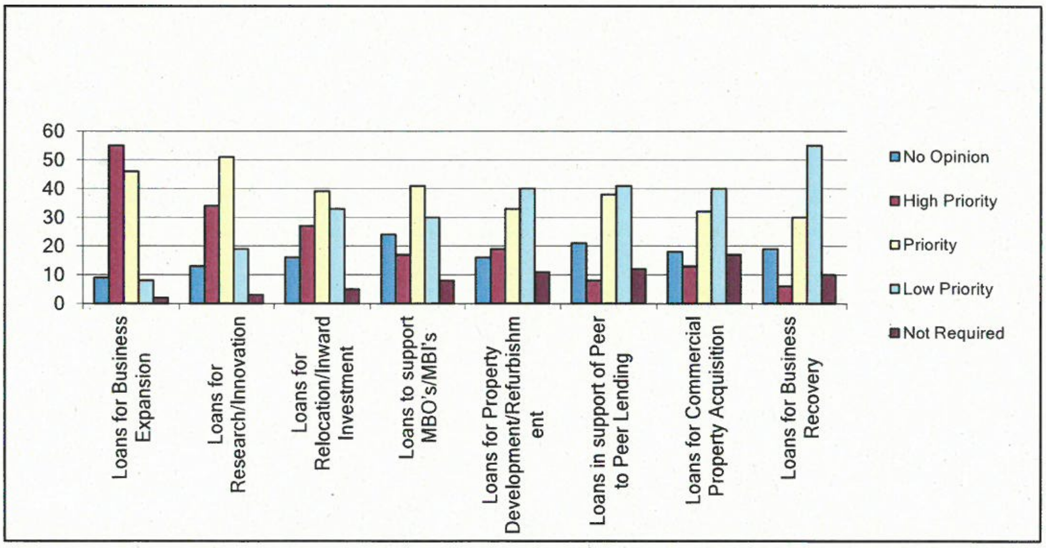


8. Debt for Growing, Established SMEs

The Block 1 Ex-Ante Assessment emphasised a particular opportunity for debt finance in the range between £80k and £300k with the most acute need around £200k. Assuming that around 10% of unmet demand was viable, the report suggested that demand is likely to be *"...in the region of £40m per year over and above any public sector provision from national and regional sources."*

This need is most acute in this category from manufacturing firms that are recovering business confidence after the impact of the banking sector's withdrawal from small business lending and credit facilities.

The Mazars LLP report suggested that around 26% of SMEs struggle to secure lending to support growth proposals. The regional survey of intermediaries indicated that over 78% of respondents prioritised the use of a new loan/mezzanine funding instruments for business growth. Encouragingly this survey outcome also suggests a high level of awareness of mezzanine finance among intermediaries and how it may be used to fund larger, riskier deals through a debt instrument. Chief among benefits for recipients are the retention by them of shareholdings, control and that funds operating mezzanine lending, generate returns from a combination of predictable loan repayments and redemption premiums rather than the need to realise uplifts on the sale of shares. In the same survey, 80% and 60% respectively of respondents supported its use for research and innovation and/or MBO/MBIs (both being purposes that may well be permissible under the current programme rules).



9. Expansion Equity for Established SMEs

The Block 1 Ex-Ante Assessment found little historic, publicly-funded regional activity in this part of the market. It was noted that there had been significantly lower levels of investment in this region than the English average with a further, acute drop between 2007 and 2013.

The widely reported equity gap of up to £5m was confirmed in the region with current unmet demand estimated to be in the region of *"...£10m per annum over and above that provided by private and public sector funded schemes."*

The Block 1 Ex-Ante Assessment also noted the same aversion to the use of equity finance amongst SMEs exists in the region as it does in comparable regions.

In summary, findings have identified a number of areas of un-met market demand for finance, most notably: microloans up to £150k; early stage venture capital; debt for growing, established SMEs; expansion equity for established SMEs.

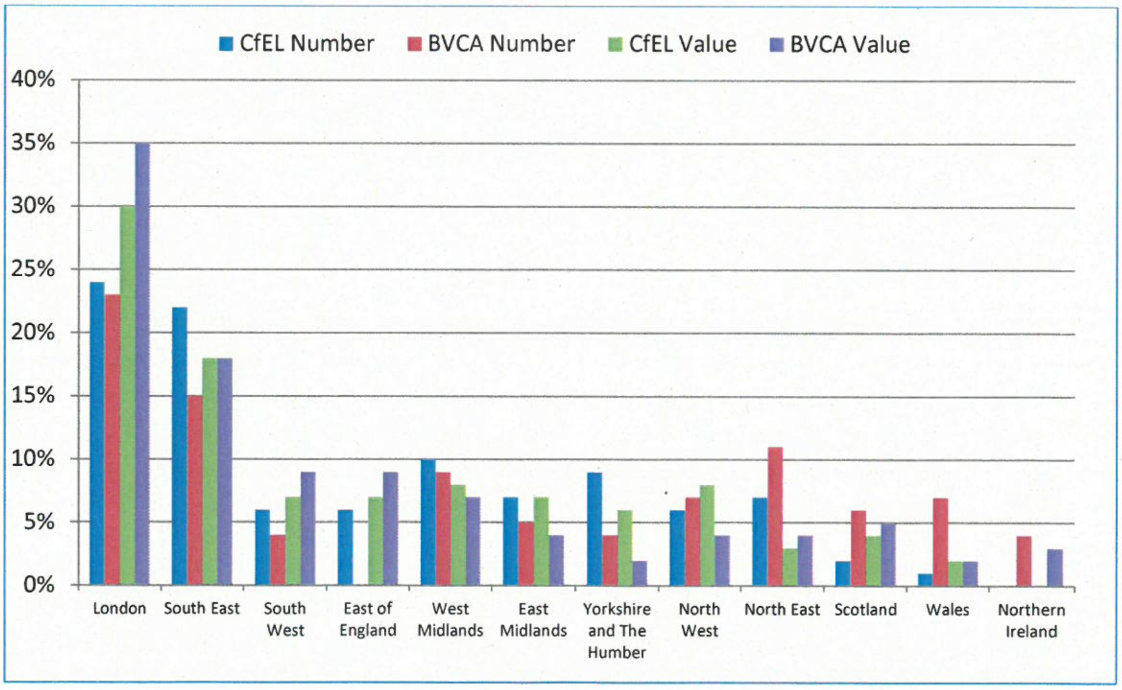
10. Additionality to National Schemes

There is a significant number of national access to finance initiatives and it is important that any regional strategy avoids duplicating/conflicting with these.

Most national schemes are managed or have the oversight of the British Business Bank (BBB) and include:

- Start-Up Loan Scheme
- Enterprise Finance Guarantee Scheme
- Angel Co-Investment Fund
- The Investment Programme
- Enterprise Capital Fund (and Catalyst Fund)

The diagram below provides a (2013) regional analysis across the range of British Business Bank activity (British Business Bank represented by its former name, Capital for Enterprise or CfEL).



The only UK public sector backed loan guarantee scheme is the Enterprise Finance Guarantee Scheme (EFGS) operated by providing a guarantee to debt providers against a proportion of their portfolio in order to increase the extent to which those providers may extend loans to businesses that lack collateral that may be otherwise applied as security. Recent reports suggest that take-up of EFGS has been comparatively strong in the region.

Against that however, performance of the British Business Bank's Investment Programme, which aims to attract new entrants to the debt finance market by providing matching capital for on-lending, is operating in the region at just 60% of the English average.

The Start-Up Loan Scheme, set up in 2012 to provide small loans to start-ups and very early stage businesses, has lent on average around £2.3m per year in the region which is equivalent to £28 per SME and just less than half of the English average.

In compiling the Block 1 Ex-Ante Assessment, consultants Regeneris took available national provision into account when it reported that there was significant and persistent market failure for finance across all categories of debt and equity.

11. Existing Local Provision

An exercise has also been undertaken to determine existing public sector provision across the East and South-East Midlands. With the exception of Enterprise Loans East Midlands, a small microloans fund, and Invest to Grow, a grant and loan fund supported by the Regional Growth Fund (RGF), there is limited provision across the region. A number of grant schemes supported either under the Growing Places Fund or RGF are coming to an end or will end by March 2017. Again, with the exception of the Derby Enterprise Growth Fund and Nottingham Investment Fund in the D2N2 LEP area, there are no other significant debt or equity instruments. Therefore, duplication of existing provision is not considered to be an issue.

In summary, the identified areas of un-met market demand for finance are not being met by national access to finance initiatives or existing local provision.

12. LEP ESIF Allocations

DCLG has asked LEPs to review ESIF Strategies and allocations for projects that have not yet been approved. This review, which must be presented back to DCLG in November 2015, will take into account ESIF grant awards that may already have been distributed elsewhere in programmes and where allowances need to be made for new priorities that have materialised since 2013. It will also take into account the need to reconcile a devaluation in programme values across the board of more than 20%, caused by a fluctuation of the Euro/Sterling exchange rate.

This is a critical issue for any LEP considering an investment in a fund of funds type programme. Firstly, any investment instrument must have sufficient scale in order to be financially viable and deliver strategic impact. It is generally considered, from experience, that any single instrument (excluding those for microloans) must have a starting value of c. £20m-£25m in order to satisfy these requirements.

The European Investment Bank's lending criteria (should this be the option for 'match' preferred by the LEPs) stipulates that they will only consider proposals for a total fund value of greater than £100m, assuming that £50m of ESIF grant (and legacies from previous funds where they exist) are used to leverage their support on a 1:1 matched basis.

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The EIB has also made clear that its loans may not be used to support development and running costs of these new funds. The British Business Bank has indicated that legacy funding from investments made by the former East Midlands Development Agency (*emda*) may be made available to support the set-up and/or running costs of a collaborative project covering the region. Legacy funding of between £3m and £9m has been estimated to be available, subject to investment performance.

It follows that LEPs wishing to deliver meaningful impact across a range of interventions, utilising support from the EIB within a fund of funds instrument are required to assemble at least £50m from their ESIF allocations. The present allocation is insufficient to allow the E & SE Midlands LEPs to present a case to EIB on their own. Further reductions will only serve to worsen the situation.

In summary, retention of the current ESIF allocations is crucial in ensuring a meaningful impact across a range of interventions.

13. Collaboration with the West Midlands LEPs

Early discussions have taken place with the six LEPs in the West Midlands which are proposing a fund of funds instrument in their region of £125m to be applied across six sub-funds designed to support debt, equity and mezzanine finance.

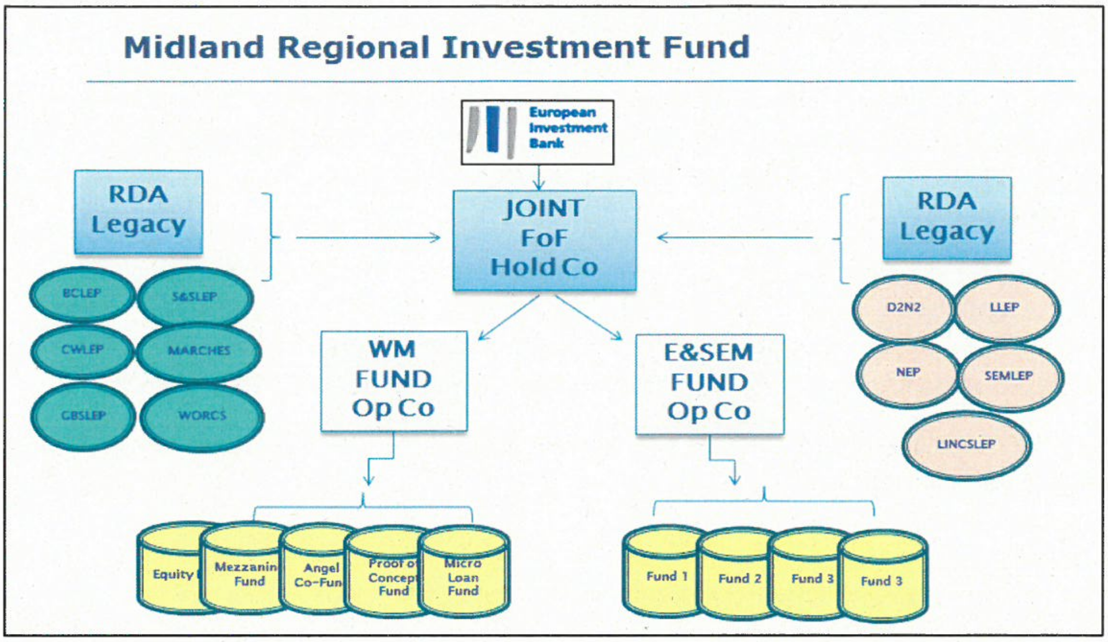
Such a potential collaboration has the added logic of fitting within the framework of the 'Midlands Engine' dialogue.

In-principle agreement has been reached between the two regions on an ongoing dialogue concerning the potential joint development of a pan-Midlands fund. This option presents many advantages. Chief among them is the potential for the E & SE Midlands LEPs to participate in a JEREMIE type fund-of-funds structure with the EIB matching the £33.45m funding on a 1:1 basis. This option would also help both regions save on establishment and management costs.

This option is one of five that are explored in this paper.

The details of a pan-Midlands fund are still to be defined but some potential defining principles have already been set out:

- A joint top-company structure would be established that would allow the engagement of both LEP regions with fund design, governance, management and delivery; and,
- There should be separately agreed investment strategies for each of the two regions and they should set the operating principles for activity based upon local market conditions, demand and the LEPs' strategic objectives.



14. Collaboration with the Yorkshire & Humber LEPs

Another sub-regional collaboration option might include the possibility of a joint fund-of-funds (along the lines of that proposed under the Midlands Engine discussions) with the 4 LEPs comprising the Yorkshire & Humber region.

It is known that the 4 LEPs concerned (Sheffield City Region, Leeds City Region, York, North Yorks & East Riding and Humber) are presently collaborating on a JEREMIE style fund-of-funds type programme. Indeed, the Steering Group that has been established to develop the Y&H programme has agreed to share its provisional investment strategy with its E & SE Midlands counterparts.

There is already some history of regional collaboration on economic development with South Sheffield and North East Derbyshire.

Most of the arguments 'on favour' of the option a potential collaboration with the West Midlands region would apply equally to this Y&H collaboration option.

The principle arguments 'against' this option could be summarised as follows:-

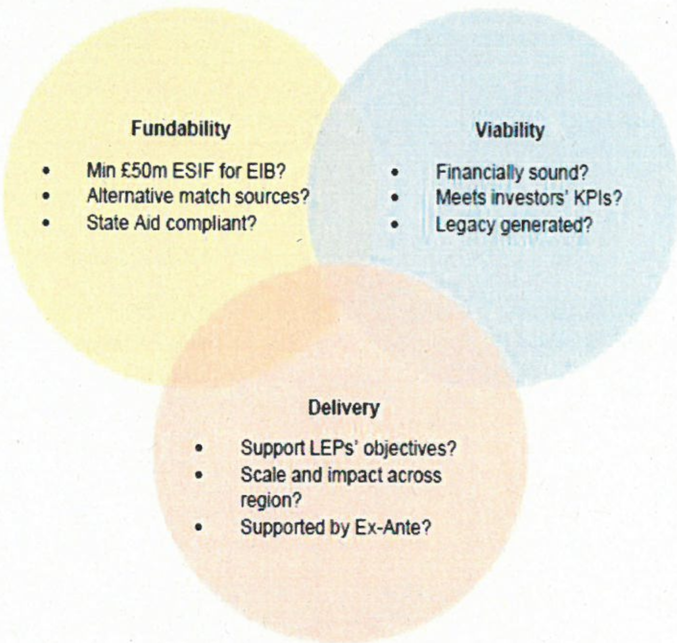
- There is no comparable 'political imperative' along the lines of the ongoing 'Midlands Engine' debate
- No meaningful discussions between the key stakeholders on this option have yet taken place. As a consequence this option is likely to take valuable time that is not readily available.
- The Y&H region has a pre-existing JEREMIE fund operational in the region and therefore the key stakeholders might seek to jealously preserve the legacy that this fund is expected to yield.

15. Options Review

Besides a 'do-nothing' option, six options have been identified:

- **Option 1**: A JEREMIE-type financial instrument for E & SE Midlands LEP areas only, using EIB loan as match;
- **Option 2**: A JEREMIE-type financial instrument in collaboration with West Midlands LEPs, using EIB loan as match;
- **Option 3**: A JEREMIE-type financial instrument in collaboration with the Yorkshire & Humber LEPs. Using EIB loan as match;
- **Option 4**: A JEREMIE-type financial instrument for E & SE Midlands LEP areas only, without EIB borrowing;
- **Option 5**: A Single Regional Loan Fund for E & SE Midlands LEP areas only; and,
- **Option 6**: One or more separate LEP-level financial instruments.

For this exercise, options have been set out in a matrix that compares each option against three key primary success factors that are believed to be fundamental to any new financial instrument. They are Fundability, Viability and Delivery represented by the following diagram.



<u>In summary, to be successful, any new financial instrument must be able to secure match funding not only at a sufficient level to enable it to be viable but also from a source that will enable delivery that meets the regions' objectives.</u>

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Option	Key features	Success factor	Assessment	Elimination status
Option 1: A JEREMIE-type financial instrument for E & SE Midlands LEP areas only, using EIB loan as match.	Conventional JEREMIE type fund focussed on E & SE Midlands, uses legacies and ERDF to match 1:1 co-financed investment from EIB.	**Fundability**	£33.45m ESIF allocation insufficient to attract EIB co-finance.	**ELIMINATE OPTION** EIB fundability is a terminally limiting factor.
		Viability		
		Delivery		
Option 2: A JEREMIE-type financial instrument in collaboration with West Midlands LEPs, using EIB loan as match.	JEREMIE type fund where some or all aspects of management and back-office is shared with West Midlands, operating under separate fund manager arrangements and E & SE Midlands level investment strategy.	**Fundability**	Combined EIB funding agreement would allow minimum EIB £50m to be reached.	PROCEED Requires agreement on representation/governance, geography/sectoral delivery targets. Consider in-area investment readiness and market making activity.
		Viability	Larger scale offers efficiency savings and market impact. RDA legacy useable to support costs.	
		Delivery	Investment strategies required to establish operating principles across fund - **targets, sectors, dealflow, etc... And EIB** loan repayments may dictate final delivery strategy. Also represents a substantial liability (a potential joint and several	
Option 3: A JEREMIE-type financial instrument in collaboration with Yorkshire & Humber LEPs, using EIB loan as match.	JEREMIE type fund where some or all aspects of management and back-office is shared with Yorkshire & Humber, operating under separate fund manager arrangements and E & SE Midlands level investment strategy.	**Fundability**	Combined EIB funding agreement would allow minimum EIB £50m to be reached.	**SECOND LEVEL OPTION** - could be made viable but will take valuable time to explore and properly assess. Might be an option that is held in reserve in case problems are encountered with the preferred option.
		Viability	Larger scale offers efficiency savings and market impact. RDA legacy useable to support costs.	
		Delivery	No meaningful discussions have yet taken place. We have no view of the Y&H appetite for this option. No work has yet been done on the alignment of interests. There is no 'political momentum' that is comparable to the 'Midlands Engine' discussion. This option is 'theoretically viable but will take valuable time to flesh out.	
Option 4a: A JEREMIE-type financial instrument for E&SE Midlands LEP areas only, without EIB borrowing.	Conventional JEREMIE type fund focussed on E & SE Midlands as option 1. With no EIB, match as a grant from another source	**Fundability**	Would require a grant of at least £47m-£50m. Presently, no grant schemes able to provide match.	**ELIMINATE OPTION** No grant schemes available presently - fundability is a terminally limiting factor.
		Viability		
		Delivery		
Option 4b: Conventional JEREMIE type fund focussed on E & SE Midlands as option 1. With no EIB, match must be sourced as a loan or investment from commercial provider.	Conventional JEREMIE type fund focussed on E & SE Midlands as option 1. With no EIB, match sourced as commercial loan/investment.	**Fundability**	Commercial loan must be pari-passu, procured/market tested. RDA legacies insufficient to meet match requirement.	**SECOND LEVEL OPTION** - could be made viable but only partially able to deliver LEPs strategic A2F objectives and does not support early stage or equity markets.
		Viability	Commercial investor if willing to support, may limit activity to 'safer' secured debt and away from early stage and longer term dealflow.	
		Delivery	Commercial provider may **influence/undermine LEPs' investment** policy. Does not deliver Block 1 market demand.	

Option 4c: A JEREMIE-type financial instrument for E & SE Midlands LEP areas only, without EIB borrowing.	Conventional JEREMIE type fund focussed on E & SE Midlands as option 1. With no EIB, match sourced as deal-level co-investment.	**Fundability**	Some types of funding are signifacntly more difficult to leverage than others, especially at pari passu terms - early stage lending, equity and early stage VC. RDA legacies insufficient to meet match requirement.	**SECOND LEVEL OPTION – could be** made viable but only partially able to deliver LEPs strategic A2F objectives and may not support early stage or equity markets.
		Viability	Co-investment funds are challenging and require fund managers that are adept at packaging and leveraging deals. If the fund manager provides leverage, may create difficulties in event that they are replaced.	
		Delivery	Commercial provider may **influence/undermine LEPs' investment** policy. Does not deliver full range Block 1 market demand.	
Option 5: A Single Regional Loan Fund for E & SE Midlands LEP areas only.	Fund likely to offer debt **only to a 'safer' portfolio** against which a commercial lender would co-invest or co-finance. Similar in effect to option 3b.	**Fundability**	Commercial loan must be pari-passu, procured/market tested.	**SECOND LEVEL OPTION – could be** made viable but only partially able to deliver LEPs strategic A2F objectives and does not support early stage or equity markets.
		Viability	Commercial investor if willing to support, may limit activity to 'safer' secured debt and away from early stage and longer term dealflow.	
		Delivery	Commercial provider may **influence/undermine LEPs' investment** policy. Does not deliver Block 1 market demand.	
Option 6: One or more separate LEP level financial instruments.	Could comprise a number of funds, each operating at a sub-regional level.	**Fundability**	Commercial funders for smaller funds may be difficult to find on pari-passu terms. No obvious grant schemes for match.	**SECOND LEVEL OPTION – could be** made viable but only partially able to deliver LEPs strategic A2F objectives and may not support early stage or equity markets.
		Viability	Viability is questionable for funds of less than £25m. Options may be limited to 'safer' secured debt only.	
		Delivery	Commercial provider may **influence/undermine LEPs' investment** policy. Does not deliver Block 1 market demand.	

<u>In summary, any new financial instrument for the East and South-East Midlands will have the greatest likelihood of success if it is part of a pan-regional arrangement.</u>

16. Conclusions

There are a number of implications that the LEPs should consider in taking this project forward:

6. There is clear and present need for interventions to support SME access to finance. National schemes such as those managed by the British Business Bank and grant schemes from Innovate UK present a partial solution but there is a weight of evidence that a substantial gap in the market remains for microloans, small business loans (including mezzanine), early stage venture capital and expansion finance for more established businesses;

7. A fund of funds requires scale in value, strategic scope and geographic coverage to be worthwhile;

8. The East and South-East Midlands LEPs cannot support a JEREMIE-type fund of funds on their own. A joint approach with the West Midlands LEPs does extend an opportunity to participate in a larger fund with sufficient scale to interest the EIB but early consideration must be given to how 'local' strategic and operational objectives may be recognised, delivered and integrated within a regional business support infrastructure.

9. The current ESIF allocations set aside are thought to be sufficient to enable engagement in a pan-Midlands fund of funds (this will be tested by detailed financial modelling), using ex-RDA legacies to support set-up and operating costs. Any material reduction in allocations may have a direct impact on viability and deliverability.

10. Other options to support local or limited 'single' funds may be viable but do not offer anything like the opportunity presented by a fund of funds.

17. Recommendation

It is recommended that:

4. Discussions should continue to work on options with the West Midlands LEPs to determine the basic principles of agreement by which a pan-Midlands JEREMIE-type fund of funds may operate;

5. Based upon local research of business needs, the East and South-East Midlands LEPs should proceed to draft and agree an Investment Strategy as a participant in a pan-Midlands fund of funds instrument that may be submitted to the EIB to complete the Block 2 Ex-Ante Assessment; and,

6. The current ESIF allocations should be maintained. All other options should be placed on hold for the time being until the potential for a pan-Midlands fund is understood.