

## ales SME Fund

KPI's Achieved to 28/02/14					
To: 28/02/14	No. of Investments	No. of Start Ups	Direct Investment (£'000)	PSL (£'000)	Jobs Created/Saved
<b>Actual:</b>					
Equity	4	0	1,547	1,970	33
Mezzanine	12	2	3,768	4,206	161
Loans	25	5	4,837	3,971	613
<b>Total</b>	<b>41</b>	<b>7</b>	<b>10,152</b>	<b>10,147</b>	<b>807</b>
<b>Baseline</b>	<b>62</b>	<b>n/a</b>	<b>10,500</b>	<b>10,500</b>	<b>525</b>
Achievement	66%	n/a	97%	97%	154%
<b>Variance</b>	<b>(21)</b>	<b>n/a</b>	<b>(348)</b>	<b>(353)</b>	<b>282</b>

## Wales Micro Loan Fund

KPI's Achieved to 28/02/14					
To: 28/02/14	No. of Investments	No. of Start Ups	Direct Investment (£'000)	PSL (£'000)	Jobs Created/Saved
<b>Actual</b>	<b>78</b>	<b>30</b>	<b>1,608</b>	<b>1,785</b>	<b>473</b>
<b>Baseline</b>	<b>87</b>	<b>n/a</b>	<b>867</b>	<b>433</b>	<b>87</b>
Achievement	90%	n/a	185%	412%	544%
<b>Variance</b>	<b>(9)</b>	<b>n/a</b>	<b>741</b>	<b>1,352</b>	<b>386</b>

Actuals and Baseline exclude WCVA.

## Wales Property Fund

KPI's achieved to 28/02/14						
To: 28/02/14	No. of Investments	No. of Start Ups	Direct Investment (£'000)	PSL (£'000)	Direct Jobs Created	Jobs Safeguarded
Actual	5	1	2,076	100	74	17
Baseline	6	n/a	4,125	1,238	87	106
Achievement	83%	n/a	50%	8%	85%	16%
Variance	(1)	n/a	(2,049)	(1,138)	(13)	(89)

## Wales Jeremie Fund

KPI's Achieved to 28/02/14								
To: 28/02/14	No. of Enterprises	Jobs Created	Jobs Safeguarded	Direct Investment (£'000)	PSL (£'000)	Collaborative R&D	Products, Processes or Services Registered	New or Improved Products, Processes or Services Launched
Equity	61	572	1,087	53,087	78,522	18	20	22
Mezzanine	28	135	564	17,898	26,126	2	0	3
Loans	425	1,909	4,730	51,719	34,512	9	2	18
<b>Total</b>	514	2,616	6,380	122,704	139,160	29	22	43
Baseline	556	4,315	n/a	126,672	156,473	15	19	22
<b>Variance</b>	<b>(42)</b>	<b>(1,699)</b>	<b>n/a</b>	<b>(3,968)</b>	<b>(17,313)</b>	<b>14</b>	<b>3</b>	<b>21</b>
<b>% Achieved</b>	<b>92%</b>	<b>61%</b>	<b>n/a</b>	<b>97%</b>	<b>89%</b>	<b>193%</b>	<b>116%</b>	<b>195%</b>

Baseline direct investment restated for a 30.09.15 investment period.

<b>JEREMIE LOAN RANGES</b>	<b>ENTERPRISE NO.</b>
£25,000 - £50,000	58
£50,001 - £100,000	71
£100,001 - £150,000	57
£150,001 - £200,000	17
£200,001 - £250,000	30
£250,001 - £300,000	10
£300,001 - £400,000	10
£400,001 - £500,000	10
>£500,000	7
TOTAL	270

# Finance Wales Interest Rate Review

## Background & Summary

1. Following Professor Jones-Evans' second stage review of access to finance in Wales a further review into the interest rates charged by Finance Wales was conducted.
2. The review focused on:
  - The comparability of FW's interest rate charges with those which may be charged by "the market";
  - The overall financial position of the Funds in which they are applied; and
  - Consideration, at a high level, of the implications of offering subsidised rates in the future.
3. To assist in the review an independent expert was commissioned to review a sample of loan cases from across funds operated by Finance Wales and to indicate the likely costs of the finance if "the market" were to have funded the deal. The detailed report is attached at Annex A.
4. In summary the review found that:
  - For 71% of cases Finance Wales were found to be charging below market rates. On average, setting aside the one large discrepancy case, they were around 5% lower than the market rate.
  - 6% were judged to be at market rate.
  - In 23% of cases Finance Wales were charging a rate that was deemed to be above the market rate. These tended to be in relation to lower risk deals. The rates averaged c2.5% higher than the market might charge but this differential would reduce when fees are taken into account.
  - The arrangement fees charged by Finance Wales are significantly lower than comparable market fees. The security and monitoring fees are at the lower end of the scale of those charged by "the market".
  - During the review the base case and latest forecasts for the Wales JEREMIE fund, the SME Investment fund and the Interim fund were examined. These funds are already subsidised using public funding (to cover the losses on the Funds) and were neither created, nor are they currently operated, with the expectation of delivering commercial rates of return.

## Interest Rate Review of Individual Deals

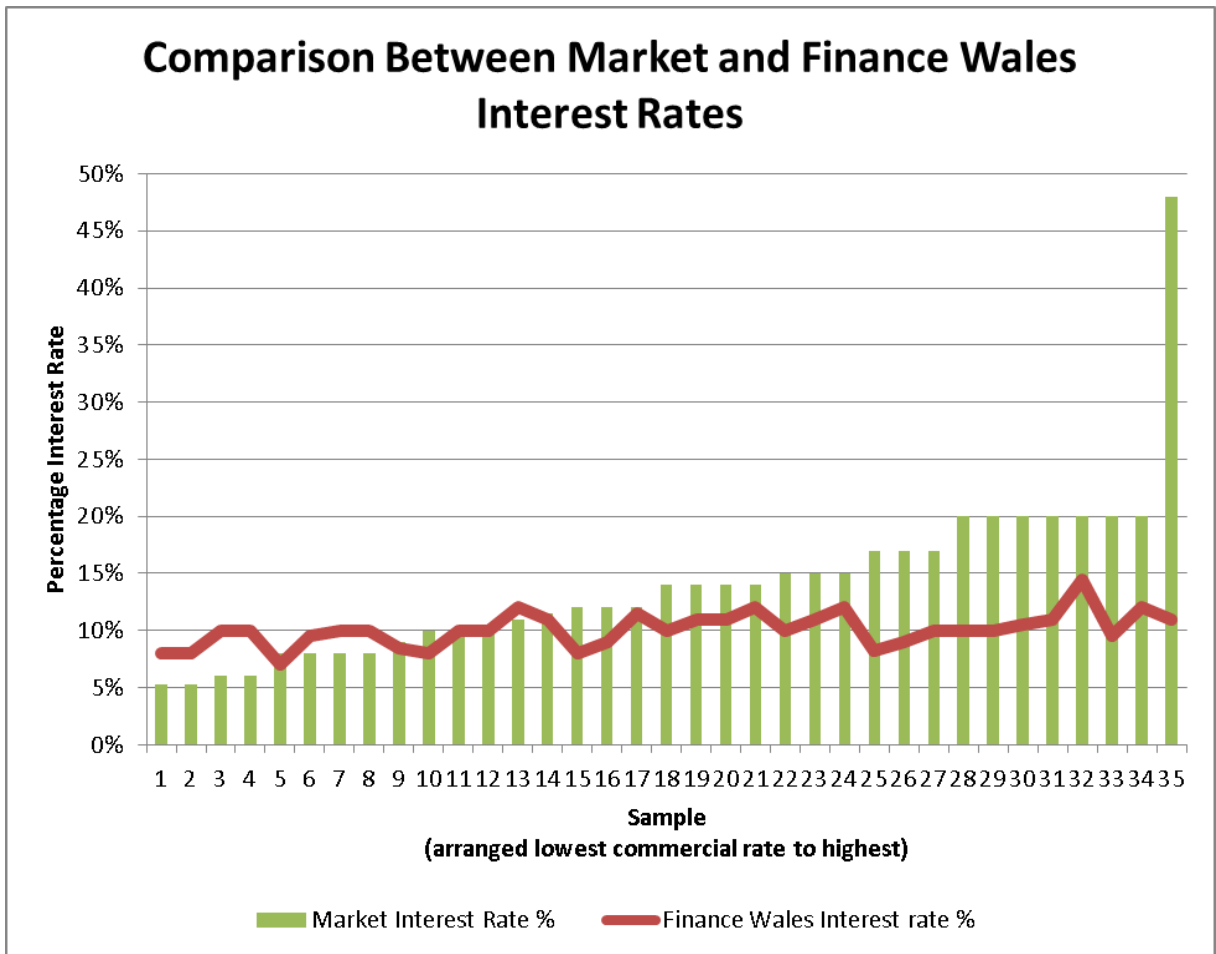
5. In order to establish the “reasonableness” of FW’s interest rates and charges compared to those a commercial organisation might charge, an independent, commercial finance broker was tasked with reviewing a random sample of deals from across FW’s funds. The following table shows the breakdown of the 35 cases that were reviewed:

**Table highlighting headline projects funded above, below or at the market interest rate**

Portfolio Fund	Sampled Number	Interest below market rate	Interest above market rate	Interest at market rate
JEREMIE Fund for Wales	25	19	5	1
Wales Micro Business Loan Fund	5	4	1	0
Wales SME Investment Fund	4	2	1	1
Wales Property Development Fund	1	0	1	0
<b>Total</b>	<b>35</b>	<b>25</b>	<b>8</b>	<b>2</b>

*Note – The Property Development Fund has only recently commenced investing. At the time of the sample, it had only made 2 investments.*

6. The analysis of each investment in the sample is shown below:

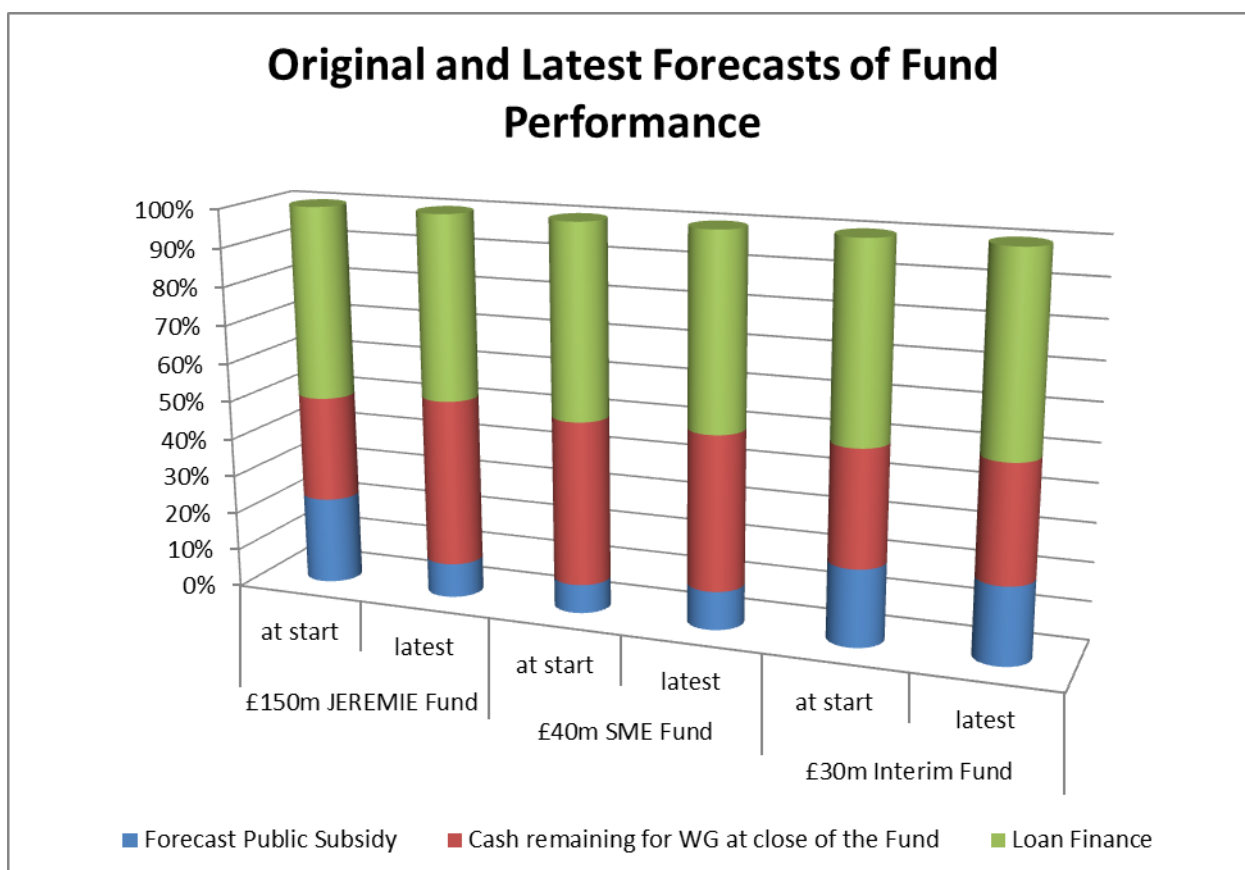


7. The above chart indicates that Finance Wales have determined a rate typically higher than the “market” where risk of the investment is low.

8. The chart also shows that the interest rates charged by the market would typically range from around 5% to 20% for the deals Finance Wales undertake. This compares to a typical range charged by Finance Wales of between 7% and 12%.

## Underlying Fund Dynamics

9. As part of the review the original business case projections and most recent forecasts for the three key funds managed by Finance Wales were examined. All of these funds were originally forecast to require a public subsidy (effectively a loss on the fund). This is still the case when the latest forecasts are taken into account. These subsidies are summarised in the chart below:



10. FW's investments are typically made in businesses which have little or no security to offer and/or which are beyond the traditional risk criteria of banks. As a result, FW experience default rates of over 10% on the loans they make. This is far higher than the default rates of the banks which are more in the region of 1-5%.
11. Overall, whilst the latest forecast subsidy is lower across the combined funds, the total subsidy of £24 million represents a best case estimate and still equates to just over 20% of the public funds invested. None of the funds were ever envisaged to produce a positive Return on Investment (ROI).

## Modelling the Potential Impact of Interest Rate Subsidies

12. It could be argued, based on the above analysis, that the Welsh Government is already offering a degree of interest rate subsidy in Finance Wales' existing funds. As part of the review Finance Wales was asked to model the impact of further reductions in interest rates.
13. By reducing interest rates charged on investments in Welsh businesses income from investments will fall and the levels of Government subsidy will need to increase. This could possibly be offset by steering the investment strategy towards lower risk investments which have less chance of default. However, the evidence from this review suggests that the market can offer equal or better deals particularly at the low risk end of the market.
14. Assuming a default rate of 20%, the estimated impact of interest rate reductions on a theoretical, pure loan fund of £60m would be:

<b>Example £60m Loan only fund</b>			
<b>Average Interest Rates</b>	5%	8%	10%
	£m	£m	£m
<b>Welsh Government Investment</b>	30	30	30
<b>Cash remaining at close of fund</b>	11	16	20
<b>Forecast Public Subsidy</b>	19	14	10

*Note – This Example Fund assumes £30m is sourced from a bank as match funding.*

15. The current subsidies are mainly driven by the costs of running the funds, the interest charges from the private sector contributors and the high default rates.
16. There is little doubt that by using existing state aid rules Finance Wales could offer further interest rate subsidies. There would however need to be consideration of the impact of any changes on applicant businesses, Finance Wales and any third party investors in their Funds.
17. This review has not examined the state aid implications of further subsidising the existing funds as this is better left to be conducted when reviewing the specific proposals that will come from the next stage of the strategic work in to Access to Finance.



## Annex A

## **Finance Wales – Interest Rate Review**

### **Scope of the project:-**

Provide the Welsh Government with an impartial view on the “reasonableness” or otherwise of the interest rates charged by Finance Wales on a number of their investments across their funds, over the last few years.

### **Project Sample:-**

I was asked to review a sample from a number of Finance Wales’ funds. This sample was chosen for me by Welsh Government [Appendix 1]. For reference I have listed the funds, overall number of projects from which the sample was chosen and the sample size I reviewed from each.

<b>Portfolio Fund</b>	<b>Total Number of Projects in the Fund</b>	<b>Number Sampled</b>
JEREMIE Fund for Wales	537	25
Wales Micro Business Loan Fund	61	5
Wales SME Fund	23	4
Wales SME Property Fund	2	1
<b>Total</b>	<b>623</b>	<b>35</b>

### **Methodology: -**

For the whole of this review I adopted the following approach.

I spent between 20 to 30 minutes reviewing each file across the whole of the sample selection. This involved reading each Investment Sanction Paper, together with the accounts and full supporting due diligence.

On each file I made a note of the key areas of risk, level and type of security that was available [if any], together with all fees and interest rates associated with the lend.

I then made a brief summary note with regards to whether the deal could have been funded by a more traditional / mainstream funding option and the comparable likely costs of such finance.

### **Findings:-**

The overall quality of the files under review was excellent. The sample of 35 files was written by a number of different advisors, but their individual approach was consistent throughout all of the files. The reports and files were certainly of a high enough quality to be submitted straight into the credit teams of most of our panel of funders.

**Table highlighting headline projects funded above, below or at the market interest rate**

<b>Portfolio Fund</b>	<b>Sampled Number</b>	<b>Interest below market rate</b>	<b>Interest above market rate</b>	<b>Interest at market rate</b>
JEREMIE FUND for Wales	25	19	5	1
Wales Micro Business Loan Fund	5	4	1	0
Wales SME Fund	4	2	1	1
Wales SME Property Fund	1	0	1	0
<b>Total</b>	<b>35</b>	<b>25</b>	<b>8</b>	<b>2</b>

**Table providing the average Finance Wales interest rate against the average market rate of interest.**

<b>Portfolio Fund</b>	<b>Sampled Number</b>	<b>Finance Wales average interest rate</b>	<b>Market average interest rate</b>
JEREMIE FUND for Wales	25	10.03%	13.42%
Wales Micro Business Loan Fund	5	11.00%	19.20%
Wales SME Fund	4	9.88%	13.81%
Wales SME Property Fund	1	8.00%	5.25%

**Table providing the average Finance Wales arrangement fee against the average market arrangement fee.**

<b>Portfolio Fund</b>	<b>Sampled Number</b>	<b>Finance Wales average arrangement fee</b>	<b>Market average arrangement fee</b>
JEREMIE FUND for Wales	25	1.56%	3.84%
Wales Micro Business Loan Fund	5	1.30%	3.80%
Wales SME Fund	4	1.56%	3.50%
Wales SME Property Fund	1	1.00%	2.00%

It should also be noted that Finance Wales charge an average annual monitoring fee of 0.5%. In the current financial market, I am finding lenders charging in the region of 0.5% to 1% on an annual basis. Finance Wales also charge a "security fee" of circa £275 per case, whereas the UK banks and lenders charge from £250 to £450 per legal charge registered.

Of the 35 files reviewed, the market comparisons were derived from a mixture of High Street lenders, Asset Based lenders, Peer to Peer funders and a number of specialist funders as were relevant to each individual case.

**Summary:-**

As you can derive from the above tables, in the main [77.14%] of projects were funded at or below the market interest rate.

The 8 projects that were considered to have an interest rate charged above that of the market rate can be analysed as follows: -

- 3 were property related projects
- 1 was a Peer to Peer type project
- 1 was an invoice financing project
- 3 were asset finance proposals

All of these were considered to be able to be funded by mainstream lenders at below the interest rate charged by that of Finance Wales.

In all of the cases, the arrangement fees charged by Finance Wales were significantly below that as would be charged the by market.

Finally, of the 35 sampled projects, assuming that the businesses had continued to achieve or exceed their forecasts, then a fair proportion of these deals could now be refinanced back to more mainstream funders. Certainly for the projects that were funded back in 2010/11, there are many more innovative entrants into the UK funding market that would provide viable funding options for them, however not necessarily at a lower interest rate.

**Report compiled by: -**

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