

Decision Pathway – Report Template



PURPOSE: Key decision

MEETING: Cabinet

DATE: 01 December 2020

TITLE	Avon Mutual Regional Community Bank		
Ward(s)	City Wide		
Author: Denise Murray	Job title: Director of Finance		
Cabinet lead: Councillor Craig Cheney	Executive Director lead: Mike Jackson		
Proposal origin: <i>Other</i>			
Decision maker: Cabinet Member Decision forum: <i>Cabinet</i>			
Purpose of Report: The report provides a progress update on the establishment of Avon Mutual a Community Bank for the region with an inclusive ethos that supports the local community and economy and seeks approval for Bristol City Council (the Council) to make a further investment in development shares that will support the proposition through the next stage of its development.			
Evidence Base: <u>Background</u> Access to financial services and financial inclusion are of fundamental importance to achieving an inclusive economy where no one is left behind and cash-flow and business investment is even more paramount post the presence and impact of Covid-19 regionally, nationally and globally. The UK's investment institutions currently do not provide a diverse and resilient financial system that has enough variety and choice to serve the needs of all our community. Groups of individuals and businesses are excluded from obtaining a basic level of service from financial services providers. <u>SME Lending</u> For many micro, small and medium size enterprises access to cash can be a critical success factor to the survival of the business. SME loans have been decreasing nationally since 2013; SME loans in the BS postcode area in Q1 2020 had fallen by 15% (over 7 years); recovering marginally from 19% decrease in lending - year 5 low in Q4 2017. This trend is materially different to the average decrease in lending across the wider southwest region; 11% (Q1 2020) and almost 3 times worse than the 7% at the year 5 low in 2017. National comparator 15% (2020) and 11% (2017). The Big Four banks only allocated 1%-4% of assets to SME lending (Source: UK Finance Post Code Lending Data). <u>Bank Branches / ATM Closure</u> Bank branch closures nationally, and Bristol specifically, is significant. Since January 2015 almost 50% of branches have closed across Bristol with Bristol East the worst impacted with 63% decrease (8 to 3). Free ATMs have been removed and ATM charges of up to £2 per withdrawal are becoming the norm. The national analysis showed Bristol West is the second worst area in the country for the decline with the loss of 40 free machines (Birmingham Ladywood is first with 47). <u>Poverty Premium</u> The poverty premium which is integral to many financial service products means that those who are most vulnerable pay more for financial services. Research by the University of Bristol indicates that the impact of this 'poverty premium' can be severe - for 10% of low income households an additional cost of £780 p.a. can be expected and for those in severe hardship this premium rises to as much as £2,250 p.a. These costs are attributed to a lack of access to a full current account, a necessity to use high-cost credit, living in perpetual overdraft debt, and households using high cost "rent-to-own" for essential household goods.			

There is a strong view that these factors disproportionately affect communities and businesses in areas of deprivation or rurality and have a significant impact on the most vulnerable that need easy, inexpensive access to banking / cash facilities. It is important that consumers continue to have the freedom to pay for goods and services however they choose and access to cash must be maintained for those who need it. We recognise that as cash usage falls, it is important to consider how this infrastructure can be redesigned to better reflect cash's declining popularity but this needs to be considered from both a social, economic and financial ethos.

The impacts of exclusion in Bristol are not just financial but also affect education, employment, health, housing and overall well-being.

The Avon Mutual Community Bank

Regional community banks, in touch with and supporting their local economies, are commonplace in continental Europe and the USA with community banking models that aim to deliver better economic and social outcomes for the regions in which they operate. A network of community banks are being considered with the aim of replicating the successes and best practices of values based banking models across the UK.

The Avon Mutual was established to create a regional community bank for the West of England covering Bristol, South Gloucestershire, Bath and North East Somerset, Gloucestershire, Wiltshire and North Somerset, with an economic and social mission that includes the following:

1. the creation of a bank to serve the everyday financial needs of ordinary people, local community groups and micro, small and medium sized companies;
2. to help redress regional inequalities, make financial inclusion the norm, build and store community wealth;
3. to significantly increase the proportion of bank lending going to the 'real' (non-financialised) economy, micro and SME's instead of the financial economy;
4. to rebuild the regional economy and economic resilience; and
5. to bring about a renaissance of customer service, relationship banking and mutual trust.

The ambition is to obtain a licence and commence operational trading in late 2021 or early 2022.

Cabinet July 2019

Cabinet July 2019 approved an initial investment of £100,005 (at risk) to support the first round formation of Avon Mutual and up to £50,000 to be used by the Council to undertake further independent due diligence for this proposition and to support any further investment from the Council.

Due Diligence - Community Bank

A National Framework was established which can be accessed by all UK authorities and the provider on the framework is RSM Corporate Finance LLP ("RSM"); with a two phase approach to the due diligence work proposed:

- Phase 1 – Regional diligence - comprehensive financial review of the regional 'community bank' model for the area and examination of the viability of supporting local citizens who may be deemed high risk financially, and micro, small and medium sized enterprises.
- Phase 2 – Local diligence to consider the strategic case for the investing authority and the ability to have a positive impact on social, environmental and economic outcomes in the defined local area.

The Council in conjunction with other authorities in the region with an initial interest in the proposition commissioned Phase 1 due diligence and two reports (exempt) were produced and are attached at appendix I(i) and I(ii). The reports were positive in terms of progress of the regulatory process to the operating licence (which is where the promoters have focused much of their attention to date) and the underpinning assumptions are considered prudent. Circa £23 million is the expected investment required (Covid permitting) to launch the bank and by year 10 the bank aims to have 24 staffed branches, 200 staff, 97,000 personal and small business members and a c£570 million loan book lending of local money within the local economy.

The risk in the proposition remains and investment should be perceived as long term as annual dividends may not be achieved until year 6 requiring Social or Patient capital that reflects the delay in dividends whilst the bank grows. Growth could be accelerated with a further capital investment primarily to fund working capital / loan book growth, and this is currently modelled within the 5 year forecast, however this will need greater consideration by investors. The reports make a number of recommendations such as compound stress testing of the sensitivities, differential pricing model for current account fees (currently £5 per month for individuals and self-employed) to both effectively support and

incentivize take up of the accounts by the most vulnerable, and accelerated research to facilitate a co design with investors of the impact framework.

Avon Mutual is seeking investment in 3 rounds:

- Round 1 (Founder Share) - initial investment of £1 million has already been raised from a range of stakeholders including £100,005 from the Council. This enabled the promoters to build the initial team and start the licensing process – the Council’s investment in this round resulted in two free shares for every share purchased (reflecting the risk profile of this investment) which Avon Mutual estimates equates to an indicative 18 - 20% IRR on expected dividend payments.
- **Round 2 (Development Share)** – the second round of funding is seeking to secure up to £2.4million (the “Development Share Offer”) autumn 2020 – summer 2021, to further develop its business plan and to continue the regulatory process of becoming authorised as a bank. This element is disaggregated into two phases:
 - **Development Share Offer (Phase 1)** - In this first phase, the bank is aiming to raise £500,000 by issuing 333,334, non-withdrawable, non-redeemable shares of £1.50 each (nominal value of £1.00 per share and premium of £0.50). Avon Mutual’s estimate equates to an indicative 9 - 10% IRR.
 - **Development Share Offer (Phase 2)** - a further £1.9 million investment to finalise licensing, test systems, build bank team and first branches and HQ – with terms as outlined above.
- Round 3 (Capital Share) – investment of approximately £20million drawn down day after licence gained to capitalise the bank after obtaining a banking licence. Operations would go live with branches fitted out, systems integrated and trading commenced. The current rules of Avon Mutual state that investors in the final share issue prior to launch will pay a subscription price of at least £3.00 per share and the investment in this round would equate to circa 5 - 6% IRR.

Proposal

Avon Mutual has been successful in attracting investors such as high net worth individuals, councils and a range of grant providers to complete round 1 and part of round 2. Having given consideration to the reports the Council is proposing to invest up to a further £200,001 in Round 2 development shares; however this is in two tranches.

1. £100,001 phase 1 - to provide the resources required to undertake the detailed market research and draft Impact Framework (as outlined in the Avon Mutual update provided at Appendix A), and following our local due diligence investor recommendations can be made to ensure alignment with the Council’s strategic direction.
2. £100,000 phase 2 - which will be subject to the Council’s endorsement of the Impact Framework, to finalise the regulatory business plan, test the approach, and to seek authorisation from the Bank of England and Financial Conduct Authority to become a bank and commence trading.

£50,000 is earmarked to undertake local diligence, consider the strategic case and ability to have a positive impact on social, environmental and economic outcomes in the local area and deliver the benefits outlined for Bristol citizens.

The benefits for the customer remain unchanged:

Achieving financial inclusion, the same service for all regardless of income, charging a simple and transparent upfront membership fee of £5/month for personal accounts (differential pricing to be considered) and £10/month for business accounts. In return for this fee, there are a range of benefits that all current account providers will receive such as:

- The provision of staffed branch services, which many SMEs rely on for cash banking facilities.
- “Softer” analogue human factors and local knowledge.
- A current account without requiring a minimum income or a credit check, which means that customers currently excluded and seen as a greater risk can bank, improve financial management and receive the wider benefits from direct debit discounts.
- Interest will be paid on whole combined balance across accounts including current account balances.
- No complex additional charges (for example SME’s paying in cash).
- Access to cash via ATM’s will be free - bank branches are closing and independently operated machines usually charge around £1.50 to £2 per transaction.
- The main credit product for individuals and SME’s is an overdraft, which can only be provided directly by banks (and not by credit unions or post office accounts).
- Access to residential mortgages as well as business and personal loans at reasonable rates.

The membership fee is considered to be outweighed by these benefits and the significantly reduced ‘poverty premium’

for low income families. Whilst the Council understands the benefits we are asking for further consideration to be given to a differential pricing model for current account fees for the most vulnerable to both effectively support and incentivize take up.

In taking this decision members of the Council should recognise that the investment may not necessarily be returned to the Council as there is a risk there will be no financial return and the entire investment could be lost if the plan to launch the mutual is unsuccessful, a banking license is not granted, or if the mutual turns out not to be profitable. Hence, at this stage, officers do not recommend investing in the mutual explicitly to derive a financial return as this is deemed too much of a financial risk but that investment is considered for the wider social, economic and environment impact.

It is envisaged that other authorities within the region who support inclusive financial and economic growth would also consider investment to make this proposition a reality and potentially shorten the timetable to opening branches and commencing trading within the wider West of England region. The Council would seek to promote the wider benefits of financial inclusion to other local authorities, Combined Authority and anchor organisations within the region.

Cabinet Member / Officer Recommendations:

1. To approve an investment of up to £200,001 (at risk) in round 2 (development shares) to support the formation of Avon Mutual; a Regional Community Bank for inclusive growth, funded from the capital investment reserve and redirection of associated returns from previous investments.
2. To approve £50,000 to be used by the Council to undertake the phase 2 local due diligence to inform the Impact Framework and wider business model for this proposition and any further investment from the Council.
3. Delegate authority to the Director of Finance in consultation with the Director Legal and Democratic Services and Deputy Mayor and Cabinet Member for Finance, Governance and Performance to agree the investment tranches and conclude the subscription by the Council for 133,334 shares for a sum of up to £200,001 in Avon Mutual, and all matters and documentation required in connection with the Council's investment.

Corporate Strategy Alignment:

The proposal supports the goal outlined in the Council's Corporate Strategy and the One City Plan of "building a city of hope and aspiration, where everyone can share in its success" and in working towards this goal, the following Corporate Strategy priorities apply:

- **Empowering and Caring** - empowering communities and individuals, increase independence and support those who need it.
- **Fair and Inclusive** - improve economic and social equality, pursuing economic growth which includes everyone and making sure people have access to homes they can afford.

Our principles:

- Build city resilience, improving ability to cope with environmental, economic or social 'shocks and stresses'.
- Use our assets wisely, generating a social and/or financial return.

City Benefits:

A regional community bank with a social ethos can assist in developing balanced communities which are inclusive. They can play a key role in establishing a resilient city financing structure, with investment strategies that recognise the long-term challenges and vision for the region and the long-term resilience value shaped by investments, rather than just short-term financial returns. This proposition could assist the Council to deliver target outcomes around a prosperous and inclusive economy, as well as helping the city to be innovative, prosperous, resilient and attractive to business.

Consultation Details:

1. In conjunction with key stakeholders, Avon Mutual has run a series of public events across the region to engage stakeholders, explain the plans and to hear what investors would want from the region's bank;
2. They have also had hundreds of one-to-one meetings with people and organisations and spoken at a number of events;
3. Movement building is ongoing and will involve further stakeholder engagement as the proposition is shaped to reflect the region and the key milestones are delivered.

Background Documents:
Cabinet July 2019

Revenue Cost	£250,001	Source of Revenue Funding	Capital Investment Reserve – Recycled Interest
Capital Cost	£0	Source of Capital Funding	Not Applicable
One off cost <input checked="" type="checkbox"/>	Ongoing cost	Saving Proposal <input type="checkbox"/>	Income generation proposal <input checked="" type="checkbox"/>
<input type="checkbox"/>			

Required information to be completed by Financial/Legal/ICT/ HR partners:

Finance Advice:

To date from the £150,000 previously earmarked the Council has invested £143,005 in the setting up of the Avon Mutual Regional Community Bank as outlined below:

1. £100,005 (at risk), direct investment into the Community Bank and hold 6,667 Founder shares (£15 each) which will subsequently be converted into 20,000 ordinary shares.
2. £43,000 on the procurement and establishment of a national framework and commissioning Phase 1 due diligence.

This proposition seeks a further investment of up to £250,001 into the development round. £200,001 to inform the development of the impact framework and the next stage in the application process and further phase 2 due diligence (£50,000) to ensure local strategic alignment and to support any decisions for future investment into Round 3 – Capital Share (operation).

If approved, this investment will be made in 2020 (£100,000.5) and 2021 (up to £100,000.5); purchasing 133,334 (non-withdrawable, non-redeemable shares) at a price of £1.50 each share (nominal value of £1.00 per share and premium of £0.50). Avon Mutual estimates that this will equate to an indicative 9 - 10% IRR if the new bank becomes profitable as modelled in Year 6. It should be noted that any dividend would be subject to Avon Mutual receiving the relevant approvals and future funding to enable it to operate and, once it commences operation, being profitable. Similarly dividend return may rise over time if the bank is successful and the surplus returned is greater than initially modelled.

Risks

While community banks would tap into localism, they would still have a challenge in attracting customers as bank switching is not a common occurrence and the competition could perceive a threat and respond accordingly. Some depositors would act out of philanthropic motives, however community banks would still have to offer an attractive commercial proposition to lenders and borrowers if they are to be viable and remain sustainable in the long term.

The investment has limited liability, if the bank is wound up investors and/or members have no liability to contribute to its assets and no personal responsibility for settling its debts and liabilities. Distribution on dissolution is limited to the amount invested, comprising nominal value plus any share premium, thus if the bank is wound up, no more than the subscription price (e.g. £1.50 per share) will be received by shareholders.

Given the risks that a license or operational profits may not be achieved this should not be viewed as an investment made for purely financial return but one which focuses on social and environmental impact and supports the local economy and at least in the short term akin to an economic grant.

Source of Funding

It is proposed that the Council recycles the returns from previous loan investments from the capital investment reserve, such as Bristol Waste Company and the Bristol Credit Union currently estimated to be c. £296,000 in 2020/21. By making this “investment”, the Council will be forgoing potential interest / return on the funds held in this fund. The current investment return achieved by the Council is c.0.35% per annum. This equates to forgoing £700 per annum, if interest rates and returns were to remain the same. Interest rates are expected to remain low during the medium term and therefore the opportunity cost of investing these balances during this period is minimal.

The purchase of share capital is treated as capital expenditure and will be reported within the capital programme accordingly.

Finance Business Partner: Jon Clayton – Capital & Investments Manager

2. Legal Advice:

The July 2019 report identified the legal basis for supporting the Community Bank and this has not changed. Similarly that report set out the potential risks for the Council as an investor/shareholder, primarily the loss of its investment should the project fail; the absence of any guarantee of a return (and these remains the case albeit now with an increased investment); and its limited liability in the event of bank failure – all detailed elsewhere in the report. The due diligence report makes it clear that there are risks with the investment of further funds in Avon Mutual, as there are only the projections provided by the bank to base the report on. Unless the Council becomes a member, (as distinct from a shareholder) it will have no say in the direction of the bank, as this is a function exclusive to members. (This is not the same situation as would apply to a normal limited company). That said, membership would still only entitle the Council to one vote at a general meeting and not a number equal to the number of shares, as in the case of a company limited by shares. Accordingly the major risk remains that if the bank does not succeed and has to be liquidated the Council may not get back its investment. Cabinet needs to balance these risks against the perceived advantages and benefits detailed elsewhere in the report.

Legal Team Leader: Eric Andrews - Legal Services, 20 November 2020

3. Implications on IT: As a funding only initiative, there are no identifiable IT implications in this proposal.

IT Team Leader: Simon Oliver – Director, Digital Transformation, 17/11/2020

4. HR Advice: No HR implications evident because Avon Mutual is a separately constituted organisation.

HR Partner: James Brereton - People & Culture Manager, 19/11/2020

EDM Sign-off	Mike Jackson	18/11/2020
Cabinet Member sign-off	Cllr Cheney	21/09/2020
For Key Decisions - Mayor's Office sign-off	Mayor's Office	29/10/2020

Appendix A – Further essential background / detail on the proposal Appendix A - Avon Mutual Regional Community Bank – Update	YES
Appendix B – Details of consultation carried out - internal and external	NO
Appendix C – Summary of any engagement with scrutiny	NO
Appendix D – Risk assessment	NO
Appendix E – Equalities screening / impact assessment of proposal	YES
Appendix F – Eco-impact screening/ impact assessment of proposal	NO
Appendix G – Financial Advice	NO
Appendix H – Legal Advice	NO
Appendix I – Exempt Information Appendix I(i) – Due diligence report Financial Appendix I(ii) – Due diligence report Social Appendix I(iii) - Application to Purchase Shares	YES
Appendix J – HR advice	NO

