

Investment for Growth and Jobs Programme 2014-2020

Financial Instruments

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Content of Presentation

- **What are Financial Instruments?**
- **Why use Financial Instruments?**
- **Financial Instruments in the ERDF Growth and Jobs Programme**
- **Decision process for interventions through Financial Instruments**
- **Monitoring of Financial Instruments – Funds and Projects**
- **Recording of ERDF support through Financial Instruments**
- **ESIF Reporting requirements for Financial Instruments**
- **Progress and examples of projects supported by Financial Instruments**

What are Financial Instruments?

- **Financial instruments provide non-grant support for business investments**
- **This can be through:**
 - Loans**
 - Guarantees**
 - Equity**
- **Possibly combined in the same operation with other risk-bearing mechanisms:**
 - Technical support**
 - Interest rate subsidies**
 - Guarantee fee subsidies**

Loans

A capital sum lent to a business:

The capital value is repayable by the business over a defined period of time

Interest is paid on the capital value at an agreed interest rate

Loan can be secured (e.g. against property) or unsecured (higher interest rate)

Guarantees

A promise by one party (the guarantor) to assume the debt obligation of a borrower if that borrower defaults.

A guarantee can be limited or unlimited, making the guarantor liable for only a portion or for all of the debt.

An assurance is therefore given to a lender that their capital will be repaid if a borrower defaults on a loan

Equity

Capital is invested in return for total or part ownership of a business (shares), includes venture capital for SME growth or early-stage seed capital for start-up

An Equity investor *may* assume some management control of the business, the investor *may* also share the profits of the business

The investment return depends on the growth and profitability of the business, it is earned when the investor sells its share in the business to another investor (“exits”) or through an initial public offering (IPO) of public ownership

Why use Financial Instruments?

At a strategic level

Financial instruments represent a resource-efficient way of deploying ESIF / cohesion policy resources in pursuit of Europe 2020 Strategy objectives

Financial instruments help to mobilise additional public or private co-investments in addition to ESIF support in addressing market failures

Financial instruments provide incentives for a business to improve performance, including greater financial discipline by supported projects

Delivery of Financial Instruments requires additional expertise and know-how, which helps increase the efficiency and effectiveness of public resource allocation

Financial Instruments have been used for delivering project investments through Structural Funds since the 1994-1999 programming period

Their relative importance has increased over time, during the programming period 2007-2013 they accounted for around 5 % of total ERDF resources

In light of current economic conditions and increasing scarcity of public resources, the European Commission expects Financial Instruments to play an even stronger role in delivery of cohesion policy in the 2014-2020 programming period

As ERDF support is focused on thematic objectives, Financial Instruments can fund a wide range of projects from public infrastructure or productive investments to support for households to improve energy efficiency performance of their homes.

At an operational level

Financial instruments:

- are expected to be repaid;
- are revolving i.e. with funds repaid being used again in the same area;
- are suitable for financially viable projects, i.e. those which are expected to generate enough income or savings to pay back the support received;
- are designed to attract co-investment from other sources, including private investment, to increase the amount of funds available in particular in sectors/areas where there are problems with access to finance;

Financial instruments:

- can take the form of loans, guarantees or equity;
- can support supply-side development, by contributing to market development;
- may be used in a complementary way with ESIF grant supported interventions (but only for different project costs!);
- may be managed by national or regional banks, international organisations such as the European Investment Bank, European Investment Fund, by Financial Intermediaries, and (for loans and guarantees only) by Managing Authorities.

Financial Instruments in the ERDF Investment for Growth and Jobs Programme

Northern Ireland Context

The ERDF element of Northern Ireland's Operational Programme 'Investment for Growth and Jobs 2014 to 2020' (EUIGJ) is focused on 3 Thematic Objectives

1. Strengthening research, technological development and innovation
2. Enhancing the competitiveness of SMEs
3. Supporting the shift towards a low-carbon economy

Investment for Growth and Jobs Programme 2014 - 2020



Invest NI Activity

- €415M allocation of ERDF and Match Funding for 2014-2020, to support projects under the following schemes:

Priority 1: Strengthening Research, Technological Development and Innovation

- Grant for Research and Development (to Business)
- Design Development

Priority 2: Enhancing the Competitiveness of SMEs

- *Access to Finance [Financial Instruments] – €152M ERDF and Match*
£70M approximately of ERDF support
37% of Invest NI's ERDF activity
30% of overall N Ireland ERDF Programme
- SME support
- Local Economic Development

ERDF ex ante assessment

RSM McClure Watters were engaged by the ERDF Managing Authority in December 2013 to undertake an Ex-Ante Assessment of Financial Instruments that would be required for N Ireland

The external Consultants delivered their Ex-Ante assessment in March 2014

The Ex-Ante concluded that Invest NI's Financial Instruments offering, via its Access to Finance continuum of support for equity and loans, was in line with the areas of market failure identified by the Consultants for NI SMEs that have growth and export potential

The ex ante report also endorsed the scope of the Invest NI funds as they:

- provide value add being additional to baseline support;**
- provide the mechanism for leveraging and accessing private sector investment and sharing risks with the private sector;**
- provide the opportunity to build awareness and capacity of local companies to access alternative forms of finance;**
- complement existing grants for research and development, particularly at a seed / early stage of business life**

The report recommended that ERDF funding should be used to support all these initiatives and at a level of up to £154m ERDF for the period 2014-2023.

ERDF support for Financial Instruments

- With competing priorities for ERDF support, and concentration of NI Operational Programme on only 3 thematic objectives, it was clear that ERDF funds would not be available to meet in full the identified funding requirement for Financial Instruments from the ex ante assessment
- Anticipated ERDF funding from IGJ Programme for Financial Instruments will be circa £70m in the period to end December 2023
- Decision was therefore made by Invest NI to use ERDF to support Equity Funds only, with loans being funded from other 'bid for' public resources

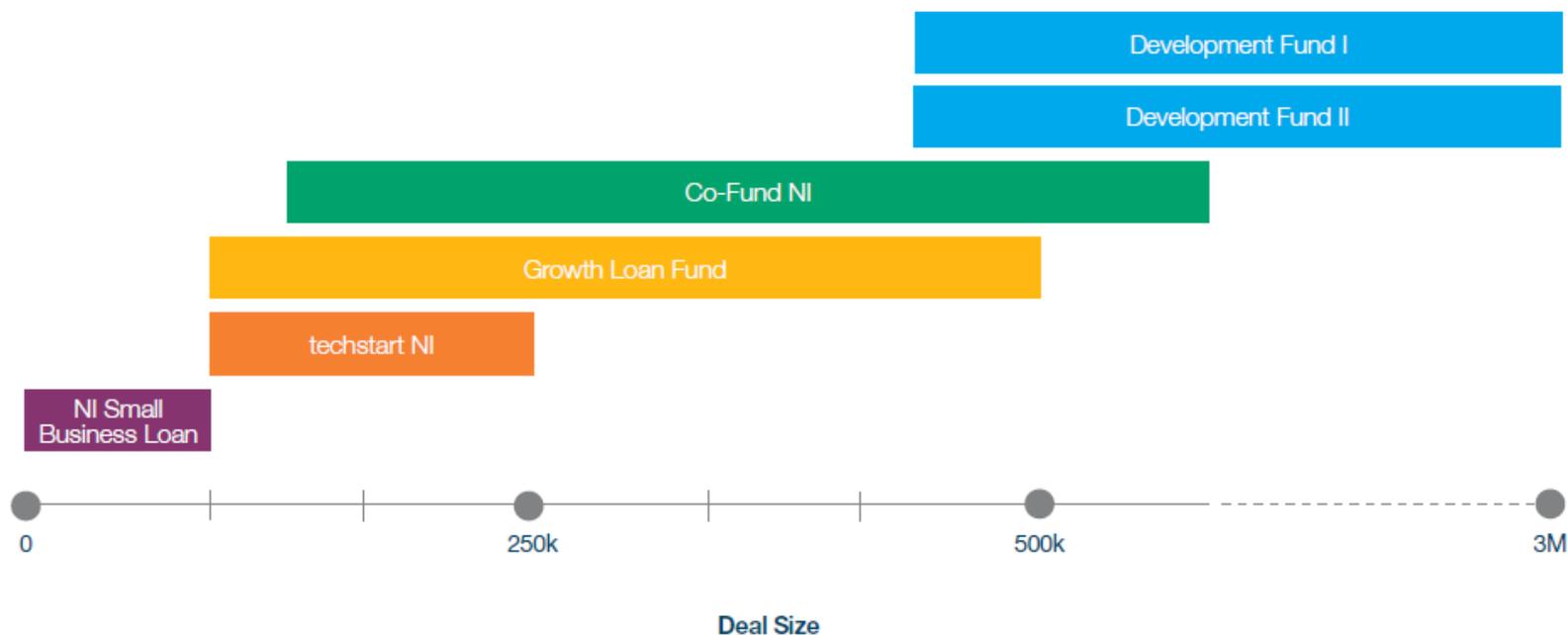
- The ex ante Assessment recommended the following ERDF (Public) and Private sector match for the period 2014-2023 for the Equity Funds.

	ERDF		Other Public		Private		Total
techstart University Fund I	£2.2m	60%	£1.4m	40%	£0.0m	-	£3.6m
techstart University Fund II	£1.4m	60%	£1.0m	40%	£0.0m	-	£2.4m
techstart Equity Fund I	£13.8m	60%	£2.3m	10%	£6.9m	30%	£23.1m
techstart Equity Fund II	£9.2m	60%	£1.5m	10%	£4.6m	30%	£15.3m
Co-Fund I	£8.0m	47%	£0.0m	-	£9.0m	53%	£17.0m
Co-Fund II	£15.9m	46%	£0.0m	-	£18.3m	54%	£34.2m
Development Funds I	£26.0m	50%	£0.0m	-	£26.0m	50%	£52.0m
Development Funds II	£20.0m	50%	£0.0m	-	£20.0m	50%	£40.0m
	£96.5m	51%	£6.2m	3%	£84.8m	45%	£187.6m

- Any shortfall in funding requirement for equity Funds to come from recycled ERDF, other public contribution, enhanced private leverage

Access to Finance Solutions

A Risk Capital funding continuum – from £1k start up capital to £3m development capital.
CURRENT FUNDS.



- NI Small Business Loan Fund (£5m) (Debt)
- techstart NI (£29m) (Equity & Grant)
- Growth Loan Fund (£50m) (Debt)
- Co-Fund NI (£28m) (Equity)
- Development Funds (£60m) (Equity)



Management of Funds

**Each Fund is separately managed by an appointed Fund Manager –
Financial Conduct Authority regulated**

**No Holding Fund structure (sometimes called a Fund of Funds)
in Invest NI's Access to Finance strategy**

**Each Fund Manager has been procured and appointed through CPD processes
to ensure compliance with procurement regulations**

For the ERDF supported Equity Funds the Fund Managers are:

Co-Fund – Clarendon Fund Managers

Development Funds – Crescent Capital

Kernel Capital

techstart NI – Pentech Ventures LLP

**Responsibility for the strategic oversight and direction of our
Access to Finance strategy lies with Invest NI's Board**

**A Board sub-committee has delegated responsibility for this
strategic oversight (Access to Finance Working Group)**

**Day to day management of delivering the Access to Finance
strategy lies with Invest NI's Corporate Finance Division**

**An individual manager within Corporate Finance has lead
responsibility for Invest NI's management of each Fund**

No member of Invest NI's Board, Executive Leadership Team, Senior Management, or Invest NI staff from any Division has input to the individual investment decisions made by each Fund

Investment decisions are the sole responsibility of the appointed Fund Manager

Summary Position for ERDF supported Financial Instruments

None of Invest NI's Loan funds receive ERDF funding

- these are funded through other public resources matched by private investment

Invest NI does not operate any Guarantee funds

- such funds are covered adequately in the UK by the British Business Bank

Only Equity funds have been included in the EUIGJ for ERDF investment support:

Co-Investment Fund (Co-Fund NI)

Crescent Capital Development Fund

Kernel Capital Development Fund

techstart NI SME Fund

techstart NI QUB Fund

techstart NI UU Fund

Decision process for supported interventions through Financial Instruments

- **Fund managers promote the fund that they are responsible for**
- **Make a decision as to whether to invest in companies**
- **Where appropriate, recruit other investors**
- **Investment is made by the Fund Manager**
- **Share certificate is issued**
- **Invest NI is informed of any potential investments before they are finalised**

Monitoring of Financial Instruments Funds and Projects

- **Invest NI has a Management Service Agreement (MSA) with each Fund Manager**
- **The MSA details the monitoring requirements, targets, etc for each fund**
- **The MSA also details management fees, these are paid separately to investments made and are also ERDF supported**
- **Fund Managers provide a monthly activity update**
- **Quarterly monitoring meetings are held with each Fund Manager**
- **Annual returns must be submitted by the Fund Managers detailing turnover, jobs created etc**

Access to Finance Working Group



Advisory Board for each Fund includes Invest NI Board member



Fund Manager Roundtable



Monthly written update



Quarterly monitoring meeting

Recording of ERDF support through Financial Instruments

All support provided by ERDF for investments made by the individual Fund Managers is recorded by Corporate Finance using information received from each Fund Manager

The total investment value of each project is split across (i) ERDF investment amount, (ii) match funding (from private and / or public sources), (iii) private leverage

As the investment ratio for the EUIGJ is 60% ERDF and 40% match funding, the Administration Manager in Corporate Finance calculates the match funding required to ensure the full amount of ERDF investment can be drawn down from the Commission, with any investment balance from the total invested deemed as private leverage

For Co-Fund and the two Development Funds all match funding comes from private sources

For the three techstart NI funds, match funding can be from wholly private sources, or from a combination of public and private sources

In each of the funds, private leverage is the value of total investments made in a project that exceeds the 60/40 ERDF and match funding required to draw down the ERDF element from the European Commission

Corporate Finance inform Invest NI's FMT of the investment amount made in each project by each Fund

FMT provides Invest NI's EU Programmes team with details of each investment that Invest NI has paid to the Fund Manager

EU Programmes team (will) record each individual investment including ERDF, match and leverage on Database 2014 for the EUIGJ programme

This will then be used to draw down ERDF support from the Commission through Managing Authority

ESIF Reporting requirements for Financial Instruments

The European Commission has established through Regulations a set of defined reporting processes for Financial Instruments supported through the European Structural and Investment Fund (ESIF)

Separate reporting templates must be completed for each Fund that is in receipt of ESIF support

These are required annually as part of the submission by Managing Authority of its Annual Implementation Report (AIR) to the Commission

An individual template is completed by Invest NI for each ERDF supported Fund

In addition to the information provided in the AIR , reporting on Financial Instruments that are in receipt of ESIF funds is required by the Programme Monitoring Committee (PMC) at each 6 monthly PMC meeting

Invest NI has developed a spreadsheet which gives a summary position of each Fund against key indicators of the Operational Programme

This is produced on a 6 monthly basis, for inclusion in the papers for PMC meetings that are co-ordinated by DFP's European Union Division

Progress and examples of projects supported by Financial Instruments

The 2014/15 results for Invest NI's Access to Finance Solutions are summarized below – this includes ERDF and non-ERDF supported Funds.

This is first full year that all elements of our Access to Finance initiatives including the ERDF supported elements have been available to the investment market





£28m fund was launched in June 2011 and is administered by **Clarendon Fund Managers**

Fund **co-invests alongside business angels** and other private investors with view to encouraging angel development and accelerating syndication.

The angels / private investors lead the deal and set the terms with typical deal size between £150k and £1m

Performance for FY 2014/15
£9.2m across 24 deals



Selection of Investee Companies



Development Funds

£60m fund was launched in October 2013 and is administered by **Kernel Capital (£30m)** and **Crescent Capital (£30m)**.

Completes the deal flow chain given the equity gap in venture capital in N Ireland.

Performance for FY 2014/15
£4.2m across 6 deals

Selection of Investee Companies



techstart^{NI}

Fund was launched in July 2014 and is administered by **Pentech Ventures LLP**.

It represents an integrated suite of funds and support for entrepreneurs, seed and early stage SMEs and university spin-outs:

- a) **£17m SME Equity Fund** which provides seed capital investments of **£50k-£250k**.
- b) **Two £1.5m university funds** (£3m) each providing capital to university spin-outs via investments of **£50k-£250k**.
- c) **£3.6m Proof of Concept Grant Fund** provides **grants of up to £25k** to help commercialise technology innovation.

Selection of Investee Companies



- d) **Investment Awareness Programme** which provides mentoring/workshop support to help prepare entrepreneurs for the issues that will face them in establishing a high growth business.

Performance for FY 2014/15

£3.3m across 79 deals

Conclusion

In 2010 Invest NI embarked on creating a suite of funds which now totals more than £170 million of public and private funding, helping SMEs with high growth potential to forge ahead and drive rapid growth within their business.

These funds are a mix of loans and equity finance and are helping to fill the funding gap created by an immature market in N Ireland for venture capital and early stage seed funding to businesses, and a tightening of bank lending

In N Ireland we have only been able to do this with part financing from the European Regional Development Fund (ERDF) in supporting our Equity Funds.

THANK YOU FOR YOUR ATTENTION

TIME FOR Q&A