Community Investment Services Ltd

Supporting responsible finance

Community Investment Tax Relief (CITR) and the Responsible Finance Sector

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Responsible Finance

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Executive Summary

This aim of this research is to provide evidence on the progress and impact of the Community Investment Tax Relief (CITR) scheme. It is the first piece of research into CITR since the scheme was launched in 2002, following the recommendation of the Social Investment Task Force.

CITR provides a tax relief to individuals and companies that invest in accredited Community Development Finance Institutions (CDFIs)[1]. The investment is then onward lent by the accredited body into enterprises that meet the scheme criteria.

The aims of CITR are:

- *to stimulate private investment in disadvantaged communities; and,*
- *to support a thriving community development finance sector*.

Since 2002 CITR has raised around £145m in private investment (well below the £100m per annum envisaged). The community development finance sector continues to seek to achieve sustainability and remains substantially under-capitalised.

This research takes stock of the impact of CITR, its usage, achievements, lessons to date and its future role in the *access to finance* and *enterprise in disadvantaged communities* landscape. It has been funded by Power to Change and a consortium of responsible finance providers.

Focusing on enterprise lending (including social enterprise lending), the research utilised a full review of the existing material available on CITR; in addition, interviews and a workshop were conducted with key stakeholders, CDFIs and investors with an interest in the scheme.

Overall Conclusion

Our research shows that, despite not achieving the levels of investment expected, CITR has been successful in stimulating significant levels of private investment into disadvantaged communities. It has also found a number of CDFIs are utilising CITR as an integral part of their capital raising strategy, with others seriously considering using it in the future. We found there was a strong desire within the sector to increase CITR usage and address the current barriers to take up.

Conclusion One: Investment raised under CITR

Over the period 2003 – 2017, we estimate that there has been £145m of CITR investment generated, facilitating around £217 million of SME lending into enterprises in disadvantaged communities. Averaging around £10 million per annum, it is believed around £16m was raised in 2016.

This investment has created over £1.5 billion of value to local economies, with a cost to the taxpayer of around £36 million.

Since its launch, CITR has not achieved the per annum investment levels originally expected, with limited evidence of sustained growth. However, where capital has been raised, using sector benchmarks and the CITR legislative rules, we can gauge that it is having a significant impact in terms of lending volumes and economic benefit.

1 The Community Development Finance sector is now branded as the Responsible Finance sector. However, in

Raising Investment has been most successful through bank-based deposit schemes. This accounts for around two-thirds of all investment funds generated. Two social banks are core to this success, and CITR remains a key element of their business models. With individual investments guaranteed by the Financial Services Compensation Scheme (FSCS)[2], social banks suggest that demand to invest from individuals cannot be met given the limitations inherent in the CITR rules for meeting the onward lending requirements.

Of the remaining CITR investments made within the sector, the majority has been generated by around half a dozen SME enterprise lenders utilising CITR to raise bank borrowing. Critical to the growth of this model has been the sectors' ability to raise bank borrowing in combination with the (temporary) Regional Growth Fund. This approach, backed with CITR, creates a 'first loss' guarantee, attractive to some banks and financial institutions. Findings suggest that more organisations are considering ways this could work at greater scale in the future.

Less used has been utilising CITR to issue shares in CDFIs[3] and raising capital from individuals in the form of small loans. To date, less than 5% of investment raised has been through these approaches, generally supported by individual local social investors. That said they are important routes to raising capital for some smaller CDFIs.

Conclusion Two: Contribution to access to finance markets and underserved enterprises

Originally, CITR was developed to meet the (continued) funding gap for viable enterprises in disadvantaged communities, recognising CDFIs as the key delivery vehicle to meet this demand.

Between 2008 and 2016, the gross flow of SME lending by the sector increased by 260% representing an average of £70 million of lending per year. However, the bulk of this growth is strongly linked to the success of the £60m Regional Growth Fund programme (which began in 2011/12). Comprised of £30 million of new capital on a first loss basis from government, this was matched by two banks to create a £60 million fund, and effectively utilised CITR in some investments. RGF is coming to an end and, in 2017, enterprise lending by CDFIs dropped as CDFIs reported restrictions on loan capital funds.

However, feedback from CDFIs suggests that using CITR to attract private sector capital was less of a priority when there were other sources of funding available. Now that many of these sources are no longer an option, CITR may become a far more important tool for the sector in raising investment. This research has found evidence from a number of bodies that CITR is now forming part of their strategy going forward, with a particular focus on exploring innovative ways to use the scheme more effectively. It also provides an important revenue stream to some smaller community-based lenders.

The contribution of CITR in supporting 'not for profit' enterprises in disadvantaged communities has been the greatest success, spearheaded by the social banks. Nevertheless, in a decade when social enterprise growth has consistently outperformed SME growth (as has the use of external finance by social enterprises), the social enterprise sector, which has a particular concentration in disadvantaged

[2] Or EU Deposit Guarantee Scheme which is the EU equivalent to FSCS.
[3] In the form of withdrawable share capital using the Cooperative and Community Benefit Societies Act model.

communities, continues to report access to finance as a major barrier to sustainability and growth[4]. Whilst performing well in this area, the suggestion is that CITR could be even more effective in supporting social enterprise through changes to elements of the scheme criteria.

Conclusion Three: Supporting CDFI sustainability

CITR was designed to support investment into CDFIs and, thus, aid their ability to achieve sustainability. By 2010, the number of CDFIs was in decline and the Department for Business Innovation and Skills (BIS) reported in 2010[5] 'the sector remains a long way from achieving operational sustainability and even further from achieving financial sustainability'.

CITR can be seen to be effectively supporting the sustainability of the social banks, and even the main social enterprise lenders to some extent. In contrast, its impact on supporting the sustainability of SME lenders has been much less successful in the majority of cases (particularly those cases that have not benefited from RGF funds). Some smaller organisations have reported that CITR has been key in their success in attracting investment from individual investors with a strong local and social purpose. In 2015, PricewaterhouseCoopers (PWC) reported little progress on, and the continued challenges to, the sector's sustainability. In both reviewing the state of the sector and future sustainability scenarios, CITR was barely mentioned in the report.

In contrast, the sector is actively bringing forward new initiatives to support investment, lending and sustainability, especially through engagement with devolution and institutional investors. Feedback suggests that CITR could form a key tool to unlock these funding streams. As such, with further support, it could be a very important mechanism for the future of the sector.

Conclusion Four: A Continued desire to make the scheme meet its original ambitions

Both the sector and government believe that CITR's original policy objectives continue to remain highly relevant, especially as a targeted intervention at enterprises in disadvantaged communities. Evidence suggests that there is a strong will within the sector to build on those areas where CITR has been successful in raising capital, while also exploring new and innovative ways the scheme may begin to approach the level of impact as originally envisaged in 2002. It should be noted that an increase in the use of the CITR could see considerable additional impact in disadvantaged communities. If the scheme had raised in the region of what government had originally expected, we might have seen around £2.3 billion of enterprise loans facilitated in disadvantaged communities at a maximum cost of £375 million in terms of foregone tax receipts.

In addition, CITR does have some unique advantages, not least its ability to bring together corporate and individual investors, as it is available against both income and corporation tax liabilities.

Recommendations

Key to the success of the scheme going forward will be finding new ways to make CITR work with other mechanisms that provide first loss cover. Now that EFG and CITR can be used together, priority

[4] SEUK (2017) The Future of Business – The State of the Social Enterprise Survey 2017; DCMS/BEIS (2017) Social Enterprise: Market Trends 2017.
[5] BIS Evaluation of Community Development Finance Institutions (CDFIs) - March 2010.

should be given to CDFIs ***modelling the impact of using EFG together with CITR as part of their business model (Recommendation 1).***

CITR mechanism for wholesale funds (as well as raising capital through securities) has also not been used to any great extent (despite a number of CDFIs having been accredited as wholesale bodies). ***The sector should ascertain if a wholesale model is a viable option under CITR or if the other available mechanisms for raising capital could be used more effectively (Recommendation 2).***

The CITR scheme has not changed a great deal since its introduction, despite calls to amend certain rules to increase its impact. Some stakeholders believe CITR should be brought in line with other similar programmes (for example Social Investment Tax Relief, SITR), others are concerned that the relief does not lose its appeal to investors in light of changes to interest rates. There were also views that the investment period should be reduced as many banks were unwilling to lend for a five-year term. Permitted accreditation limits and 'relevant investment' loan sizes have not been reviewed since 2002. The definitions surrounding what is a disadvantaged business and what is and is not residential property are complex as are the calculations for the number of different types of non-residential property that can be counted as CITR relevant investments. All of this makes it difficult to ensure that accredited bodies are meeting the requirements of the scheme. ***The sector should make its case to government to:***

- ***bring the CITR relief in line with SITR or to set it at a certain level over the Bank of England base rate or to consider the amount of time that the investment must be held (Recommendation 3).***
- ***increase the current CITR accreditation levels of £10m and £20m, as well as the maximum loan size of 'relevant investments' either in line with inflation or to reflect the current market that the sector is now serving (Recommendation 4).***
- ***simplify the method for determining disadvantage (without losing some of the current flexibility detailed under the definition of Case 3 and without losing the defining characteristic of CITR in supporting disadvantaged communities (Recommendation 9)).***[6]
- ***simplify the rules on property restrictions and/or agree further guidance on how residential property is defined (Recommendation 8).***

In reviewing the available literature on CITR, it is apparent that there is very little in the way of research into the operation or effectiveness of the scheme. ***The sector should work with government to publish a range of figures on the use of CITR to allow the sector to demonstrate progress and impact (Recommendation 5).***

No organisation has been tasked to support and champion CITR use. This is in contrast to Social Investment Tax Relief (a comparable tax relief) where Big Society Capital has been undertaking work to highlight the relief and encourage its use. ***The sector should petition Responsible Finance, Government and Big Society Capital (and/or another body strongly positioned to champion***

[6] The recommendations are numbered as they appear in the report but appear in a different order in the executive summary.

CITR to investors) to take a leadership role in highlighting CITR opportunities to investors. This includes raising awareness among the adviser community and supporting the sector to develop new models to utilise CITR (Recommendation 6).

There is also little material highlighting CITR's impact or its advantages to the investor network. ***The sector should jointly produce promotional material to highlight CITR to investors (Recommendation 7).***

Feedback from a range of accredited bodies (including some who are regulated banks) suggests that the risk of falling foul of state aid rules has been one of the issues which have hampered growth in expanding the use of CITR investment. ***The sector (with support from government) should work together to clarify the state aid rules for investors, in such a way that it is less of a barrier to larger CITR investments (Recommendation 10).***

An issue raised by many in the sector during this research relates to the rules regarding CITR onward lending requirements; in particular, the ability of a CDFI to maintain an average of 75% lent, while still being in a position to repay investment. ***The sector should review (and feedback to government) the practicalities of the onward lending rules to ensure that they are not a barrier to the success of the scheme (Recommendation 11).***

1. Introduction

1.1. This research

The aim of this research is to provide evidence on the progress and impact of the Community Investment Tax Relief (CITR) scheme. In 2000, through the Social Investment Task Force, HM Treasury sought ways in which it could achieve a radical improvement in wealth creation, economic growth, employment and the overall social fabric within the poorest communities in the UK. The introduction of Community Investment Tax Relief was one of five key recommendations provided to government[7].

The aims of CITR were twofold:

- ***to stimulate private investment in disadvantaged communities*** by providing a tax relief to individuals and companies; and,
- ***to support a thriving community development finance sector*** whereby CITR investment takes place through accredited Community Development Finance Institutions (CDFIs). The investment is then onward lent into profit-seeking and not-for-profit enterprises in disadvantaged communities.

Since 2002:

- ***CITR has raised around £145m in private investment,*** significantly less than the £100m per annum envisaged when launched; and,
- ***the community development finance sector is struggling to achieve sustainability*** and remains substantially under-capitalised.

No formal evaluation of the impact of the programme has been undertaken since its introduction. This research takes stock of the impact of CITR, its usage, achievements and lessons to date, and its future role as a key mechanism for supporting access to finance for enterprises in disadvantaged communities.

The research has been funded by Power to Change and a consortium of community development finance institutions (CDFIs), part of the responsible finance sector. CDFIs are lenders with a social and economic mission who provide a range of loan products across the full range of access to finance markets (personal, SMEs, social ventures and home improvement lending) to individuals and businesses underserved by mainstream lenders. This Report is focused on enterprise lenders and their provision of finance through CITR.

[7] Social Investment Task Force, 2000, Enterprising Communities: Wealth Beyond Welfare.

1.2. Research methodology

The research has utilised several methods:

- ***Review of existing CITR-related material:*** drawing on government websites and their online archives (GOV.UK), grey literature searches, sector and technical documentation. Overall, very little material exists on the scheme;
- ***CDFI Interviews, Workshop and Case Studies:*** Over the period August 2017 - January 2018, CDFI enterprise lenders undertook a series of semi-structured interviews and consultations, including a Workshop in November 2017 on CITR convened by Responsible Finance. Engagement with CDFIs has included those accredited under CITR (7) and non-accredited CDFIs (2). A list of participants is provided in Annex 1.
- ***Stakeholder Interviews:*** Interviews have taken place with sector stakeholders, including Responsible Finance, HM Treasury, HM Revenue and Customs and the Department for Business, Energy and Industrial Strategy (BEIS) to understand how they see CITR in relation to the original policy objectives along with the potential future opportunities for the scheme. A list of participants is provided in Annex 1.
- ***Investor interviews:*** 3 investors with an interest in CDFI activity were interviewed to garner their understanding of CITR and why it does, or does not, fit with their investment strategies and activities.

1.3. Report structure

Following this Introduction, the Report is structured as follows:

- Section 2 reviews the CITR scheme, the rationale for the intervention and how it is expected to work for investors and CDFIs;
- Section 3 considers how the Scheme has performed, how it is being used and the views of stakeholders in the sector;
- Section 4 considers how the Scheme has contributed to enterprise in disadvantaged communities and its role in supporting a thriving community development finance sector; and,
- Section 5 draws together Conclusions and Recommendations based on the evidence and findings of the research.

2. The Community Investment Tax Relief Scheme

2.1. The rationale for intervention

CITR provides a tax relief to individuals and companies that invest in accredited CDFIs. The investment is then onward lent by the accredited body into enterprises that meet the scheme criteria. This includes the condition that they are based within a disadvantaged community. Under the rules, enterprises supported may be profit distributing or non-profit enterprises.

An intervention logic describes the expected 'theory of change' implicit in any proposed policy and investment intervention, linking the use of policy resources with expected real-world changes in behaviour to achieve stated objectives. An intervention logic provides a series of steps in any project or scheme that can be monitored to assess project progress and achievements. Figure 2.1 provides an intervention logic for CITR.

In the case of CITR, the intention has been to use the government resource of tax regulation ('inputs') to develop an investment scheme to attract new private investors to invest through CDFIs into enterprise lending. Creating returns for investors and income for CDFIs, lending is targeted to support enterprises in disadvantaged communities ('outcomes'). New private sector investment in underserved communities is achieved (with associated economic and social benefits) alongside a stronger community development finance sector ('impacts').

HM Treasury has overall policy responsibility for CITR (as it falls within the tax system); they set the level of incentive and are responsible for the legislation that governs the scheme. In practice, a great deal of the technical expertise that HMT relies on is based within HMRC.

Accreditation is managed by the **Office of the CIC Regulator** (within the Department for Business, Environment and Industrial Strategy (BEIS)). The process involves an application form being submitted, in which the applicant must demonstrate two main criteria. The first is that the body has aims and activities in line with the requirements set out in the Material Concerning the Accreditation (The Material) of CDFIs[8]. The second is that they must demonstrate that the organisation will run its operations, and in particular its CITR loan book, in a way that is compliant with the legislation. The CIC Regulator's Office needs to actively consider the evidence provided by the applicant and determine that the proposed approach is in line with the regulations and legislation governing the programme. As part of the accreditation process, they will also take a view on the sustainability of the operations of the body. They are also responsible for the maintenance of the Material Concerning the Accreditation of CDFIs and for monitoring all the CDFIs accredited under the scheme (to ensure that they continue to operate within the rules).

The Department for Business, Energy and Industrial Strategy (BEIS) also have an interest in the programme in so far as they are responsible for SME access to finance policy. The **British Business** Bank also has an interest in CITR, as they have responsibility for a number of programmes that may be utilised by the sector. In particular, the Enterprise Finance Guarantee (EFG) programme which can be used in conjunction with CITR.

In addition, the **Department for Culture, Media and Sport** (DCMS) Inclusive Economy Unit has an interest in CITR in terms of its objective to encourage responsible business. These range from social enterprise start-ups to companies with a focus on 'profit with purpose'. An element of CITR specifically encourages investment in non-profit enterprises.

Big Society Capital also has an interest in CITR as part of their mission to encourage social investment.

[8] BEIS Material concerning the accreditation of CDFIs.

Figure 2.1 CITR: Intervention logic

<u>Context to the intervention</u>

After a period of sustained economic growth, poverty has become more concentrated and inequality more marked. The Social Investment Task Force identifies a need to increase investment, enterprise and wealth creation in communities shunned by investors. Their report identifies mechanisms to unleash new and sustainable sources of private investment in under-invested communities.

<u>Rationale for the intervention</u>

1) Provide a tax incentive to increase private investment in disadvantaged communities to generate enterprise, wealth creation and sustainable communities

2) Given a thriving community development finance sector is vital to boosting enterprise and wealth creation in under-invested communities, channelling private investment through CDFIs will increase the scale, capacity and robustness of CDFIs

Inputs	Activities	Outcomes	Impacts
<u>Government</u> Tax incentive for investments Accreditation and monitoring systems <u>CDFIs</u> Compliant investment vehicle and structures	Develop new relationships with private investors Educate investors as to the benefits of CITR Develop investment strategies which are compliant with the legislation Investment amounts raised on CITR compliant terms CDFIs on-lend to enterprises in disadvantaged communities Reporting systems	Business and social venture start-ups SME and social venture growth (turnover, jobs) Expanded services in the community Return for investors Return (income stream) for CDFIs Greater understanding of the role and impact of CITR across key government stakeholders	Viable enterprises in disadvantaged communities able to access finance Expansion of enterprise and investment in disadvantaged communities Sustainable CDFIs serving business and social ventures with appropriate and fair finance. Private sector funding model for CDFIs supported by government

2.2. CITR: how it works for CDFIs

The CITR rules allow for an organisation to be accredited as a **wholesale or retail CDFI**. A wholesale CDFI predominantly onward lends to other CDFIs. An organisation with a retail accreditation lends mainly directly to businesses (that meet the CITR criteria). CITR accredited bodies are allowed to raise up to £20m for a wholesale accreditation. The limit for retail accredited CDFIs is lower at £10m. For a body to meet the requirements to be accredited, the activities of the organisation must be directed at the provision of finance, or the provision of finance and business advice, for enterprises in disadvantaged communities. It is also a requirement that organisations will only provide finance to SMEs that have been unable to obtain funding from other sources, primarily mainstream providers of finance, such as banks.

In order to make use of CITR, an organisation needs to undertake a significant amount of preparatory work to assess their eligibility, against the key criteria and to meet the government rules regarding the programme. Following this, the next step is to provide a detailed application to the Office for the CIC Regulator. An accredited body must have appropriate systems in place to ensure that they can demonstrate they continue to meet the criteria for accreditation and that they are continuing to operate within the rules for the programme. In practice, this involves providing a yearly report containing high-level data[9] on scheme usage. The yearly report also contains a signed declaration confirming that all of the scheme rules have been adhered to. This is then submitted to government for formal sign-off.

The CDFI then needs to develop investment strategies that are compliant with the legislation. The aim being, to raise investment from corporate and individual investors on terms that allow sufficient return, including covering lending costs to those enterprises that meet the scheme criteria.

CDFIs are required to onward lend the investment raised into businesses in disadvantaged communities. The maximum loan size they can make is £250k (for non-profit enterprises) and £100k (for profit distributing enterprises). **Non-profit enterprises** are defined for CITR purposes as:

- public sector projects, or
- projects benefiting charities and other non-profit-distributing bodies which are engaged in public function, or
- small-scale projects of a purely local nature (even though the service provider may receive remuneration and competition for their supply).

Companies registered as Community Interest Companies (CICs) are also regarded as non-profit-distributing enterprises for the purposes of CITR. **Profit distributing enterprises** are not specifically defined in the regulations, however, it is reasonable to assume that they include businesses that do not fall into the above definition and are intended to generate a profit (whose purpose is not to be reinvested into the community or project).

An enterprise in a disadvantaged community is defined as an enterprise located in the:

- top 35% deprived Local Super Output Areas overall; or
- top 35% deprived Local Super Output Areas based on income, employment, health, education, access to services, housing and crime or top 50 Local Authorities in any of

[9] Including the number and overall value of investments raised using CITR and the number and overall value of loans disbursed.

the measures based on income, employment, health, education, access to services, housing and crime (England only); or an enterprise; or

- owned and operated by, or intended to serve, individuals recognised as being disadvantaged on account of their ethnicity, gender, age, disability or other similar defining characteristics.

In using CITR there is the need to onward lend an average of 75% of the investment fund in 'relevant investments'.[10] Given this, repayments against the CDFI loan book need to be matched with new lending in order to maintain the 75% average. In addition, the CDFI also needs to repay the CITR investments at the end of the five-year period. Any new CITR investments coming into the fund also need to be deployed quickly to ensure the 75% average onward lending requirement is maintained.

2.3. CITR: how it works for investors

The CITR tax relief enables an investor in an accredited CDFI to reduce their income or corporation tax liability. The relief is worth 25% of the money invested and is spread over five years. CITR investors fall into two main categories, individual and corporate investors**.** This is in line with the relief being available to either individuals through income tax relief or to companies via corporation tax relief.

Investors either invest in i) accredited bodies that are also banks by making a deposit or ii) through share issues or iii) via a loan[11.] Concerning banks, they provide accounts in which deposits can be made. There are two banks that are accredited under CITR, Charity Bank and Triodos Bank. These are known as social banks. Deposits are then invested into CITR 'relevant investments'. The fact that these deposits are made into a bank means the investment is covered by the Finance Service Compensation Scheme (FSCS)[12.] This protects the first £85,000[13] of investment if the bank was to fold.

Direct investment into CDFIs takes place via the purchase of shares or loans. Where issuing equity, in practice, CDFIs have raised share capital using the Co-operative and Community Benefit Societies Act 2014. CDFIs have used this model, as there is significantly less regulation associated with it compared to other share issues. There is little or no protection against risk (beyond that which the organisation is able to offer from the strength of their own balance sheet).

For both the individual and corporate investor, claiming tax relief is a straightforward process. There is a specific box on the Company Tax Return and Income Tax Return into which the amount of relief can be added. However, as the relief is based on the average of the invested amount, this can vary in each of the 5 years of the investment period (if the investment takes

[10] There are rules defining what counts as a 'relevant investment' and therefore counts towards the onward lending target of a CDFI.
[11] Investments can also be structured by issuing securities but this has not been used on a CITR investment.
[12] Or EU Deposit Guarantee Scheme.
[13] Or first €100,000 in EU deposit guarantee scheme.

the form of a loan). As such, establishing the amount of relief to be claimed in each accounting period can be more complex[14].

The expected outcomes of CITR are to drive private sector investment into underinvested areas, supporting wealth generation and prosperous communities. Channelled through the CDFI (Responsible Finance) sector, the scheme has been expected to create new capital and income streams to support sustainable business lending models.

3. The Performance of CITR

3.1. Overall performance

Overall, a number of simple metrics can be developed to gauge the use and impact of CITR:

- Since its introduction in 2002, we estimated that £145m[15] has been invested through CITR. The highest amount invested in a single year was around £26.5m in 2010.[16] In comparison, total lending to businesses and social enterprises by CDFIs in the latest year has totalled £206.7m. We estimate that CITR comprises less than 10%[17] of total CDFI enterprise lending;
- BEIS reported that between the years of 2004 and 2014 an average of £9.5m was raised each year. We understand that around £16m was raised last year (2017), however, no formal figures have been reported by BEIS;
- We estimate that CITR has facilitated £217m of loans. Applying the Responsible Finance figure of £7[18] of economic value created by each £1 of CDFI lending, means CITR has generated more than £1.52bn of value to the economy;
- If CITR had raised in the region of what government had originally expected, and we apply the same assumptions, we might have seen around £2.3 billion of loans facilitated and over £15 billion of value added to the economy;
- Around two-thirds of all the total investment raised under CITR has been achieved by two accredited social banks;
- In total there are currently 34 accredited CDFIs that can use CITR[19]. This is the largest number since the scheme began;

[14] HMRC manual
[15] This is an estimate based on the total that BEIS reported to Responsible Finance up to 2014, of £113,676,088 and an estimate of £10m a year for the last three years (we believe that £16m was raised last year).
[16] BEIS used to provide data to Responsible Finance but have not done so since 2015 and were unable to provide up to date figures for this report.
[17] This figure is approximate based on figure reported on CITR raised from 2003-2014.
[18] Responsible Finance collects aggregate lending and impact data on an annual basis, dating back to 2002. In 2014 they developed an Economic Impact Tool for the Community Finance Industry, which uses Green Book evaluations to quantify the value of the impact of responsible finance lending. This tool suggests by lending to underserved businesses the sector contributes £0.6 billion to GDP annually, through jobs created and saved, and new business starts. For every £1 lent by responsible finance providers, £7 in economic value is created.
[19] A total of 31 are listed on the BEIS website as of 1 March 2017. We are aware of three others who have since been accredited. However, a number of accredited CDFIs are dormant.

- Around one-third of the Responsible Finance members who undertake enterprise or social enterprise lending are accredited to use CITR[20];
- Since its introduction, it is not known how many individual private investments have been made through CITR;
- Since its introduction we cannot say how many enterprises have benefitted from investment facilitated by CITR;
- Whilst scheme data is collected and reported to government by accredited bodies very little has been released on the usage and impact of the programme. Currently, BEIS choose to not publish any data on CITR. Whilst CDFIs do report on their overall activity (and Responsible Finance publish a yearly report) they do not separate out the CITR lending.

These outcomes have been generated differentially through the three investment approaches adopted under CITR (reviewed below). In practice, individual investors have been offered a mainstream financial product (a bank account), with the protection against the risk offered by schemes that protect deposits. Deposit driven investment through social banks has been the main CITR activity, with the second avenue, where accredited bodies raise significant capital via individual and corporate investors (including from banks), much less successful in terms of capital raised.

3.2. The use of CITR: paid on bank deposit

As outlined, the most successful method of raising finance under CITR has been by the two CDFIs who are also social banks. These are banks whose lending activity is undertaken with a specific social purpose. As of 2015[21] these organisations account for around two-thirds of all the total investment raised under CITR. Having a 'social mission' is key to these organisations ability to gain CITR accreditation. Whilst there is no specific requirement for an accredited body to have a social purpose, there is a requirement for the aims of the organisation to be in line with the criteria in the CITR rules.

This form of investment has been so popular that demand to invest can outstrip the bank's ability to onward lend the funds in 'relevant investments'. This is not simply a matter of the body not having a strong pipeline. It can be driven by the time between raising the CITR capital and deploying it. Or the fact that not all the lending a body undertakes is a 'relevant investment' (due, for example, to the size of the loan or the fact it does not meet the definition of disadvantaged). In order to manage this issue, one of the social banks only lets investors place CITR funds with them when they invest in an account that does not attract a tax relief (with an equal amount of investment).

Alongside the attraction of the social mission incorporated in the bank's enterprise lending policies, these organisations have a major advantage over their non-bank CDFI compatriots

[20] The BEIS list of accredited members covers those accredited up to March 2017. However, we are aware of a number of bodies that have subsequently been accredited.
[21] This is the last time data on performance of the programme was provided to Responsible Finance.

due to any individual investments received being protected by FSCS[22] or EU deposit guarantee schemes.

For the social banks, the success of this approach is that the risk of the investment is covered (by the deposits being guaranteed) and the return to investors is predominantly covered by CITR, thus this has allowed the banks to raise investment at a lower cost than would otherwise be the case. In turn, this allows attractively costed lending products to be offered to social ventures which are critical; the cost of loans is a significant factor given that many organisations have historically relied on grants and are unlikely to be able or prepared to pay a full commercial rate.

Case Study 1: Charity Bank

Charity Bank is a regulated bank and ethical lender who was founded to support charities with funding they would be unable to secure elsewhere. It is a savings and loans bank with a mission to use money for good. The money deposited by savers is used to make loans to charities, social enterprises and organisations with charitable purposes.

Charity Bank offers loans to small and large organisations from £50,000 to £3.5 million, and more in partnership with other lenders. Key to their business model is to attract deposits from savers who wish to invest in an organisation that shares their ethical beliefs.

Charity Bank was accredited to use CITR in 2003.

Investors are mostly made up of individuals and a small number of for-profit organisations. Key to this ability to raise investment using CITR is that, as a bank, any investment made in the organisation is protected under the Financial Services Compensation Scheme (FSCS). This covers any deposit up to £85,000.

A quarter of all deposits received are CITR based. As such, it is a critical part of Charity Bank's strategy. Charity Bank lends to a number of charity and social enterprises both in and outside disadvantaged areas. They also make loans outside of the CITR criteria (loans larger than £250k). This means they need to raise a range of funds, both CITR and non-CITR, to ensure they meet their investor needs.

For those accredited CDFIs using the 'paid as a bank deposit' approach, CITR has been extremely successful in bringing private investment into the organisation. The research has highlighted that CITR is critical to their ability to attract investment and support their business model, with at least one organisation stating that they simply would not be in business without it.

3.3. The use of CITR: as a tool for bank borrowing

A number[23] of CDFIs have raised capital from banks using CITR. The bank is attracted to the deal by having access to a 5% tax relief. This, in turn, allows the CDFI to attract investment at

[22] This offers protection on deposits of up to £85k to those banks participating in the scheme.
[23] We believe around 12 CDFIs used this mechanism between 2003-2014.

a lower cost than would otherwise be the case. Some of this benefit can be passed on within the lending product offered to enterprises, namely through a more attractive interest rate.[24]

This approach has been commonly used since the introduction of CITR back in 2002. More recently it has been applied in conjunction with Regional Growth Fund (RGF) capital. Whilst detailed figures are not available, interviews suggest that the combination of RGF and CITR has seen a significant increase in bank lending to CDFIs.

The Regional Growth Fund (RGF) was created in June 2010 with the intention of promoting the private sector in areas within England most at risk to public sector cuts, by providing financial support for private enterprises to leverage additional funding and create sustainable jobs. The Responsible Finance sector was successful in bidding to run a £60m RGF wholesale fund, where government contributed £30m that was match-funded from participating banks. The contractual obligation associated with the government grant is that it must be used to cover the default in the programme and then to repay the bank loan. Default ceiling rate has been set at 30% and, in practice, this has meant that there is 'first loss cover' in place to protect the investment (given that default rates have been substantially lower). It is this ability to provide the first loss cover of the bank funding via grants that has been a major factor on why this approach to using CITR has been so successful in raising investment.

However, this model has seen CDFIs providing part of their loan book as security to the bank. In practice, this has amounted to the CDFI giving the investor recourse to an amount of their loan book equal to two times the amount borrowed. The CDFI must then collect repayments on the onward lending in order to repay the bank loan. Therefore, whilst this approach has seen a significant increase in the amount of bank investment into CDFIs, it is not without its issues.

First, the amount of security that a CDFI must offer to the bank means that the level of growth it can undertake is limited.

Second, the fact that it has to collect repayments and hold them before repaying the bank loan means that the advantage of CITR in terms of reducing the cost of capital is lessened. This is due to the fact the CDFI will have CITR capital sitting in a bank account which pays little or no interest, while still paying interest on the loan back to the investor.

Thirdly, because the CDFI must hold loan repayments it makes it difficult to meet the onward lending requirement on the CDFI capital. While an average of 75% of the investment must be onward lent, the CDFI must collect loan repayments to enable repayment of the capital at the end of the investment period.

A fourth issue is that a number of banks are simply not making a profit, and therefore do not have a tax liability that enables them to take advantage of the relief. This reduces the number of banks who would benefit from investing through CITR.

[24] This is sometimes paid to the CDFI as a rebate.

CDFIs have also reported that adopting this approach beyond the Regional Growth Fund is difficult due to the general lack of awareness and understanding of CITR within the banks. Concerns were raised during this research that many of the banks are not prepared to lend into this sector due to an overarching strategic decision not to expose themselves to the associated risks (of the underlying SME lending). Therefore it almost goes without saying that if they have made a decision not to lend to the small business sector directly, why would they provide funds to another lender where decisions and processes are outside their control?

As an example, one recent large wholesale deal ultimately ran into difficulty because the calculations for EU State Aid (as provided in the HMRC guidance) was not sufficiently clear and therefore did not provide the levels of certainty required for sign-off within the bank.

As a result of this lack of understanding, only those few banks that have built up some experience of the scheme over time have used CITR to any great extent. Interviews suggest that this is part of the reason CITR has not had the impact and support from the banking sector government originally expected. For greater scale and usage of CITR, the scheme needs to be embraced by a broader banking community.

Case Study 2: ART Business Loans (ART)

Originally set up in Aston, ART was established in 1997 to help ‘alleviate poverty through enterprise’ by lending to businesses unable to access any or all of the finance they needed from the banks and so enable them to create or preserve jobs. ART was created as one of the recommendations from the Aston Commission, led by Sir Adrian Cadbury, which was investigating issues around access to finance in the West Midlands area.

ART raises finance from the banks and from private and public sector investment. These funds are onward lent to businesses in a specific area.

ART Business Loans’ current mission is “to ensure that viable business in the West Midlands can access the finance they need.” They lend where the banks either refuse to or cannot provide finance.

ART has been a CITR-accredited CDFI since 2003. In that time they have raised over £4m through the programme. Their original strategy for CITR was as a tool to raise money through shares using the Community Benefit Society model. However, by far the most CITR capital ART has raised has been through bank loans.

ART has used CITR in conjunction with the Regional Growth Fund grant to lower the cost of the private sector matched bank loan. The tax relief lowers the amount that ART must pay. In practice, this is provided to ART as a rebate at the end of each year thus enabling ART to borrow at a lower rate.

However because of structure of the Regional Growth Fund, with the returns from ART's loans being held in order to be repaid to the bank, the investment is not as cost-effective to ART as it could be (as the amount deployed reduces over time but ART must still service the interest). ART must also offer security in order to secure the lending. This limits the growth that they have been able to achieve under the Scheme.

ART has attempted to raise capital via other routes using CITR (most recently through a peer-to-peer platform) but has found that the offer of the relief alone is not enough without some protection against the risk.

To address this issue, ART has recently applied for EFG accreditation. They believe that the ability to use this with CITR, and therefore covering the first loss risk, will make borrowing at scale a more realistic proposition.

This approach will be key to ART's investment strategy going forward.

The use of CITR as a tool for bank borrowing has been the second most widely used model by the CDFI sector (beyond the deposits taken by social banks), although accounting for only around 25%[25] of funds lent (circa £36m). There remains a general lack of understanding among a broader set of institutional investors and banks on how this works in practice. In particular, there are perceived complexities around claiming the tax relief and that this form of subsidy may impact on other 'subsidised' schemes being used by banks (and therefore how this will work within EU State Aid rules). Nevertheless, such complexities have been shown to be overcome when first loss is covered (for example, Regional Growth Fund), and banks have shown on-going interest in developing the approach, especially with Enterprise Finance Guarantee (EFG) as a tool to provide first loss cover.

3.4. The use of CITR: as a tool for issuing shares

Whilst CITR can be paid on an investment of share capital, in general, the first (and seemingly only) approach to be used to raise capital under the CITR scheme has been through the use of the (then) Industrial and Provident Society model. This allowed shares to be issued by an organisation to fund community projects and was subsequently replaced by the Cooperative and Community Benefit Societies Act when it came into force in 2014. We estimate that this approach has only been used for under 5% of the total CITR funds raised.

This model involves registering as a society for the benefit of the community. This then allows an organisation to issue share capital in line with the Act. In practice this means shares:

- that are non-transferable (cannot be transferred between people);
- have a fixed value and not be subject to speculation; and

[25] The figure is an estimate based on 2003 - 2014 data.

- have a limit on the interest paid on share capital (so that the interest is not above a level which will attract investment).

Societies operating under this legislation are subject to an asset lock, which prevents the society being sold and the proceeds of the sale being distributed amongst shareholders. This removes the possibility of capital appreciation and the scope for investor speculation.

The advantage of this approach for CDFIs is that whilst the public offer of shares in companies is regulated (by the Financial Conduct Authority), community shares are not. As such they are more likely to be appropriate for CDFIs, where the size of organisation and investment may make the regulatory barriers hard to overcome. The objectives of CDFIs are also likely to be in more in line with those of the Cooperative and Community Benefit Societies Act.

It should be noted that in order to use this approach to raising share capital, the CDFI needs to be legally structured as a Cooperative and Community Benefit Society and operate within that legal structure (which involves being registered with the Financial Conduct Authority). For existing bodies (not incorporated in this way) this is likely to mean establishing a new entity.

However, the ‘CITR equity model’ is of limited attraction to those who normally seek equity approaches to investment. Equity investments (outside of the Cooperative and Community Benefit Society model) are generally used to allow investors to benefit from the upside of a business doing well, whilst sharing the risk of failure (or of the business performing below expectations). The activities and objectives of the responsible finance sector and the fact that they concentrate on the social return means that high profits are very unlikely. It, therefore, seems that CITR equity investments will not be used to any great extent in the sector, bar through the ‘traditional’ Cooperative and Community Society model. Neither, for example, have we found examples of this approach being used for community asset purchase (although we know of one CDFI who has explored the CITR route for local community energy projects).

Case Study 3: Foundation East

Foundation East is a Responsible Finance Provider covering the East of England. They are a membership organisation that is democratically run and controlled by its members; who share and support its values and mission. Foundation East is a Registered Community Benefit Society, authorised and regulated by the Financial Conduct Authority and recognised by HMRC as an exempt charity.

As a Community Benefit Society, Foundation East can raise capital to lend to their customers by selling shares in the Society. Both ordinary and Community Investment Tax Relief, or "CITR" shares are available to purchase. These 'community shares' are withdrawable share capital; a form of share capital unique to co-operative and community benefit society legislation. This type of share capital can only be issued by co-operative societies, community benefit societies and charitable community benefit societies[26].

Foundation East is currently accredited to raise £100,000 of CITR investment. This has actually been lowered by request over the years due to lack of activity. However, this cap is in line with the current restrictions on Community Benefit Societies, which state that no equity investment above £100k can be accessed from a single investor.

Investment has been achieved through a spread of investors. Initially, it was anticipated that the focus would be on corporate investment. However, this has not been as productive as they would have hoped. Therefore the focus has moved to individuals looking to invest. Despite the current low interest rates making CITR an attractive proposition in the market, gaining access to this investor network has remained problematic. Foundation East has raised £71,000 using CITR since they became accredited in 2005.

Foundation East's inability to raise significant funds through CITR is due to a number of issues:

- Ability to meet the onward lending requirements as regards supporting disadvantaged businesses. Due to the geography of the client base, much of Foundation East's client base falls within areas not deemed to be the most disadvantaged. Therefore meeting the CITR rules remains a problem. Although it should be noted that this is a general issue with the region in which FE operates. For those CDFIs with a customer base in an area with mainly eligible investments, taking a higher number of small investments over time makes the onward lending rules easier to achieve.
- Lack of understanding within their investor network on what CITR actually is and how it can be an effective tool for investment. This has led to attracting private sector investment as a resource-intensive, time-consuming process.
- Other tax reliefs being more attractive and better promoted. Enterprise Investment Scheme (EIS)[27] offers a 30% relief up front to investors. The recent Social Investment Tax Relief (SITR)[28] also offers a relief of 30%, and the investment only has to be held for three years (rather than five for CITR).
- The rules restricting early repayment of the investment and the subsequent impact that may have on their balance sheet.

Despite these challenges, Foundation East does see a future for CITR. In particular, now it can be used with the Enterprise Finance Guarantee (EFG).

[26] Further information on 'Community Shares' can be found here.
[27] Guidance on Enterprise Investment Scheme.
[28] Guidance on Social Investment Tax Relief (SITR).

Currently Foundation East is looking at the possibilities of working within a large wholesale fund, where CITR can be used as part of a larger offer for investors. EFG will be key in this model to manage the risk portion of the fund and give extra incentive for private-sector investment.

3.5. The use of CITR: raising loan capital directly from individual investors

In addition to raising loan capital from banks, there are a small number of CDFIs that have used CITR to attract funds from individual investors. In many ways, this is a similar approach to that of CDFIs who have raised share capital from individuals. We estimate that together these approaches have been used for under 5% of total CITR funds raised. However, interviews suggest that they are a key strategy for some CDFIs in attracting investment. Loans are unsecured and attract interest as well as the 5% tax relief to provide a more attractive return.

The advantage of this approach is that whilst in order to offer shares through the Cooperative and Community Benefit Societies Act a specific legal form must be taken, this is not the case for a body looking to raise loan capital. This means that the CDFI can take a normal company form.

It should be noted that some CDFIs we spoke to said they had avoided this approach due to the complexity of regulation in this area (relating to deposit-taking). Nevertheless, CDFIs using this innovative approach have notified the regulator and have been advised that using this model is not in breach of the regulations. Therefore this is a viable option for other CDFIs to consider.

3.6. Alterations to the CITR scheme since its launch

Since its introduction in 2002, there have been only minor changes introduced to CITR:

- BEIS[29] (BIS at the time) undertook some work to simplify the reporting and re-accreditation process of CITR in 2011. This resulted in the requirement for CDFIs to re-apply for formal reaccreditation every three years. Under the current rules, providing a CDFI fulfils their annual reporting requirements, the accreditation automatically rolls forward for another twelve months. This change has been positive as it provides greater certainty for the investor as it eliminates the risk that a CDFI may lose CITR accreditation after three years, and therefore the loss of any potential relief to the investor during the five-year investment period.

- The CITR annual reporting requirement moved to a self-declaration approach, rather than all the investment data having to be submitted and reviewed by government for formal approval. As a result, there is now the possibility that CDFIs may be subject to audit by BEIS on their CITR activity.

[29] The Department for Business, Energy and Industrial Strategy.

- The onward lending requirements were relaxed in 2008 so that the amount of the investment needed to be lent was based on an average of 75%, rather than having to meet that figure at all times. This allowed CDFIs to adopt a more strategic approach to the management of their CITR portfolio.

3.7. Complexity of CITR

Undertaking this research has highlighted several areas of complexity within the CITR regulations:

- Property lending is allowed within CITR but not in the case of residential property investments. The definition of residential property often hinges on whether or not a care function is being provided. Feedback from social enterprise lenders, in particular, has highlighted that this adds confusion when determining whether or not they can support particular projects. In addition, there are also rules around different types of non-residential property with stated ratios of how an investment can be spread across different categories. From interviews with stakeholders, it is clear that these rules simply add extra complexity and are a barrier to lending.
- The definition of what is a disadvantaged enterprise also has a high level of complexity. These are also split into different cases (Case 1, 2 and 3), with a rule that the value of Case 2 investments must not exceed the total value of Case 1 and 3. This adds further confusion for a CDFI when it comes to determining its lending decision and if they can count the organisation supported towards their CITR onward lending target.

In addition to the above, further complexity has been highlighted by CDFIs regarding their ability to meet the onward lending requirements. An organisation must be able to demonstrate that it has lent an average of 75% of its investment fund in 'relevant investments' in 'qualifying enterprises'[30]. Calculating the investment fund on any day is complex (with CITR investments forming part of the fund three months after they have been raised and ceasing to be part of the fund three months before they are due to be repaid). Also, any loans made by the CDFI and subsequently written off are also subtracted. The 75% average must be calculated either on four quarterly dates or at the end of each day throughout the reporting year. This approach was introduced by government to allow more flexibility. However, CDFIs have highlighted that the calculation is confusing and causes uncertainty that they have successfully onward lent the required funds as stated in the CITR rules. An added complication is that the CDFI also needs to repay the CITR investments at the end of the five-year period. Also, any new CITR investments coming into the fund need to be deployed quickly to ensure the 75% average onward lending requirement is maintained. For example, one social bank raised over £22m during one year. In practice, this would mean deploying at least £15.5m in loans in order to meet the rules. At the end of the five-year investment period, the £22m initial investment will then need to be repaid. This issue has hampered the growth of CITR investment.

[30] The legislation governs those enterprises that qualify as a 'relevant investment'. The main criteria being the fact that they are situated within being in a disadvantaged area.

3.8. The use of CITR: new developments

3.8.1. CITR and EFG

In the past twelve months, there have been some new developments on how CITR can be used. The sector has been lobbying for some time to allow CITR to be used alongside the Enterprise Finance Guarantee (EFG) scheme. This will enable some of the lending risk to be covered by the guarantee mechanism, therefore making any investment into the sector a much more attractive proposition. This change was finally agreed in October 2017 and, as highlighted in this research, has been met positively by stakeholders from across the sector as a potential game-changer in driving up usage of the scheme. While it is too early to determine the full impact of this change, an example of how this may be applied in practice is set out in Box 1.

Box 1: The Combination of the Enterprise Finance Guarantee (EFG) and Community Investment Tax Relief (CITR)

Government has now confirmed that CITR and EFG can be used together. Critically, this provides the responsible finance sector with a mechanism to provide first loss cover on their loan book. This is a significant policy change championed by the sector and a helpful change to the CITR rules.

Private sector capital can be raised using CITR. If the CDFI is also accredited for EFG, this can then be used to guarantee the onward lending to SMEs. The borrower (SME) pays a premium on the loan for the benefit of the guarantee, with the CDFI having protection against a portion of the loss if the loan defaults.

EFG pays out 75% of each loan guaranteed (in the event of default) up to a cap of 20% on the loan portfolio. In practice, this means that there is potentially 15% cover for the CDFI.

Key to making this work will be the CDFI having an understanding of what the impact will be on their business model and cash flow. This will allow them to approach investors with a clear proposition.

3.8.2. New entrants

Whilst CITR was developed alongside a number of different interventions to support the development of the sector, more recently a number of bodies have become accredited which do not necessarily fit in the traditional definition and mould of a ‘Responsible Finance Provider’ (RFP). For example, they may have a focus on green energy or the training of ex-offenders.

Whilst they may not identify as RFPs,[31] they do support enterprises in line with the CITR regulations[32] (including having a social purpose) and therefore successfully gained CITR accreditation.

This expansion of the sector can only be good for CITR, as it both increases the usage and reach of the scheme while demonstrating the benefits to a wider community that may not be familiar with RFPs and the sector as a whole. However, as many of these organisations are newly accredited the full impact of what they will bring to the scheme is not possible to determine at this time.

CDFIs have highlighted the risk that a greater breadth of accredited CITR providers could prove problematic to any overarching promotion undertaken by the responsible finance membership. However further work will have to be undertaken to determine the full scale of this issue.

3.8.3. CITR and peer-to-peer lenders

One CDFI has attempted to raise CITR investment via a peer-to-peer platform. This was only partially successful. Since the proposal was put in place, the regulator has subsequently written out to all the peer-to-peer platforms to warn them that raising investment for businesses, which is then onward lent, is in contravention of banking legislation.

It is argued that this seems to be at odds with the messages that government has been giving to the sector, where the line has been the need to embrace innovation and seek more private sector capital.

It is also out of step with one government source that, during the interviews for this research, suggested that the sector should consider raising capital through just such a peer-to-peer route.

3.8.4. Summary: The impact of CITR

While CITR has not raised investment at the levels originally envisaged in 2002, it is clear that it has still had a significant impact on both the organisations using the scheme and on those businesses and social enterprises that have accessed finance as a result. It also appears to generate a high level of impact for the public subsidy (in the form of foregone tax receipts) that supports the scheme.

Between 2003-2014, 8 organisations raised over £2m each under CITR. The largest user of CITR, when interviewed for this project, was clear that without CITR they simply would not be able to operate anywhere near the level they currently do.

In recent years there has been a steady increase in organisations seeking accreditation for the scheme. BEIS data reports 18[33] bodies were accredited to use CITR in 2014. The most recent figures show that number has now increased to 34 organisations.

[31] A number of accredited bodies are not members of Responsible Finance.
[32] In order to gain accreditation 75% of their operations need to be directed towards access to finance and/or the provision of business support to SMEs in disadvantaged communities.

It remains the case that the overall impact of CITR is much less than government originally envisaged back in 2002; with the £145m raised to date much less than the expected £100m per annum. That said more CDFIs seem to be actively considering how they might utilise CITR than any time in the history of the scheme.

Since 2002 there has been significant variation in the amount raised year-by-year using CITR. Data is incomplete due to BEIS/HMRC not routinely publishing the figures (although information has periodically been provided to Responsible Finance). From the information available the most CITR raised in any given year was just over £26.5m in 2010.

The least was in 2004 when only around £300k was raised. Therefore to date, the average works out at around £9.5m per annum. Evidence suggests that the amount raised in 2016 was around £16m.

Due to the lack of data, it is not possible to determine how CITR is spread across different investment types. However through interviews and reviewing the available data, it is clear that the majority (around two thirds) is being invested through those accredited bodies that are also (social) banks (for the reasons outlined in Section 2.3).

Beyond that, there is no data on the split between the level of investment raised as loan and share capital. However, our research suggests that bank deposits are the most frequent investment in both number and total value. The second most common type of investment (in number) are equity investments and small (non-bank) loans, however, the total value invested via this approach is less than has been invested via bank funding.

It became clear during this research that there is also very little data available on the onward lending into SMEs. We know that BEIS collect this information, as it is required as part of the annual reporting for accredited bodies. If we assume that of the £145m raised using CITR, loans of £217m [34] have been made. At a basic level, this demonstrates that a high level of lending is facilitated by the programme (further extrapolation as to the number of loans given the level of data available is likely to be inaccurate).

If we apply the Responsible Finance figure of £7 of economic value created by each £1 of CDFI lending, then we can estimate that CITR has generated over £1.5bn of value to the economy. This is based on a maximum government contribution of £36.6m in terms of the maximum tax relief payable by HMRC. If CITR had raised in the region of what government had originally expected and we apply the same assumptions, we might have seen around £2.3 billion of loans facilitate over £15 billion of value added to the economy (at a maximum cost of £375 million in terms of foregone tax receipts).

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[33] There may have been others accredited who had not used the programme or who had previously been accredited but were not accredited at that time.

[34] This assumes that an average of 75% of the £145m has been onward lent over the 5 years of investment and that repayments have been made of 20% each year and these have been reinvested to maintain that rate. We have used a 5-year loan repayment figure for this illustration. RF 2017 Industry report (rather than individual lenders figures) which has loan lengths of 4, 3.5, 3.5 and 4.8 years for start-up, micro, SME and social enterprise respectively (not that they do not include Social Banks figures). We have increased this to 5 years for this illustration (and thus reduced our estimation of the total amount lent) as some CITR is repaid before the 5 year investment period is complete and will therefore not be made in further loans.

The lack of available data also makes it impossible to break down any geographical and demographic trends regarding SME lending to enterprise in disadvantaged communities under CITR. As this is a key objective of the scheme it is extremely frustrating that the impact cannot be fully explored.

The above also applies to undertaking any analysis on cost per loan or average loan size.

3.9. CITR: A view from investors

To use CITR as a successful tool for engaging with potential investors, CDFIs first need to develop investment strategies, which are compliant with the legislation governing the scheme. They, in turn, raise investment from corporate and individual investors on terms that allow them to provide a sufficient return as well as ensuring they cover their lending costs. This issue has been a key barrier to the sector being able to effectively make the most use of CITR. The costs of a CDFI's lending includes both its operational cost and the defaulting loans in the loan book. Both the investors and CDFIs interviewed cited the ability of the CDFI to cover defaults and operating costs as a key concern. Most accredited organisations do not have a balance sheet of sufficient scale in order to provide investors with enough security to convince them to invest on purely commercial, rather than philanthropic, grounds.

We have therefore seen the vast majority of individual investors choose the safer option of investing in those accredited bodies that are also banks. Evidence suggests that this approach to lending is very popular and that investor demand for these opportunities has outstripped supply. There is also clear evidence (from, for example, forums on Money Saving Expert) that these opportunities are viewed and promoted as good, almost no-risk, value investments. Around £100m of all the CITR that has been raised has been invested through this avenue. It is clear, as highlighted elsewhere, that the key reason for this is the protection offered to bank deposits.

The interviews with CDFIs targeting individual investors have suggested that those that have invested through share issues or loans have done so for very different reasons. These investments are often made at a local level, mainly by those investors wishing to 'give something back' to the local community rather than simply make a financial return.

Those who have invested into CDFIs in this way have done so with little or no protection against risk (beyond that which the organisation is able to offer from the strength of their own balance sheet). It is therefore not surprising that the sector has seen a much greater quantum of investment in the form of deposits. We estimate that around 5% has been invested in small loans or via shares in non-bank CDFIs.

Where banks are investing in CDFIs and claiming CITR, a number of issues have been raised as being a barrier to investment. The first and possibly most important (which was raised by all of the investors that we spoke to as well as most CDFIs, and non-accredited bodies) was the availability of cover for first loss. Investors were clear that without additional funding to cover the default on the loan portfolio they were unable to lend into the sector. Investors (and again most CDFIs) highlighted the importance of match funding, which was used successfully through the RGF programme as a recent mechanism that has overcome this issue (at least temporarily).

In discussions, the change to allow EFG to be used alongside CITR was highlighted as a positive move, but there was no clear view about the real world impact that this would have and any changes it may make on the banking models (which define the amount of lending that they will offer a CDFI). It is clear that more work will need to be undertaken by the sector to fully realise the potential impact of this development and how it can encourage new investors.

The level of relief offered by CITR was also highlighted as an issue in attracting investors. In particular, that the 25% return over a 5 year period is less generous than similar schemes operating in this space. Social Investment Tax Relief (SITR) offers a 30% relief which is paid upfront to the investor and the investment must only be held for 3 years. The Enterprise Investment Scheme (EIS) also offers the same 30% relief over 3 years. The view that CITR does not compare favourably to other reliefs was widely held among those interviewed for this research. It was also noted in the interviews that a change in interest rates could reduce CITR's competitiveness in terms of attracting investment. The length of time that CITR needed to be held was also highlighted as an issue. Many banks will only lend for a five-year term to lower risk investments. The fact that CITR investment needs to be for five years could put banks off from investing.

The complexity of the rules surrounding CITR was also raised at a general level by investors. Investors pointed to particular issues where there had been a need to spend a great deal of time understanding an issue and seeking clarification with HMRC. The time and resources associated with reaching a high level of certainty before an investment can be made add to the costs of any potential deal, a critical point particularly amongst smaller investors into the sector.

Another key issue highlighted by investors was the general lack of certainty that they will ultimately be able to benefit from the tax relief. There are a number of reasons for this:

- the investor's tax liability during the investment period may not allow for the full relief to be claimed;
- the CDFI may lose their accreditation during the period of investment meaning that the investor is unable to claim some or all of the relief associated with the investment.

The process of claiming CITR for the investor is actually viewed as relatively straightforward, as there is a specific box in the Company Tax Return form. However, as the relief is based on the average of the invested amount which can vary in each of the 5 years of the investment period (if the investment takes the form of a loan) establishing the amount of relief to be claimed in each accounting period can be much more complex[35]. In addition, even more complicated for the individual investor is understanding the investment proposition in general (and how it will work based on the CITR rules) along with the associated risks.

[35] HMRC Community Investment Tax Relief Manual - Determining 'The Invested Amount'.

Seeking a level of understanding among investors around the practicalities of the relief and the business model of lenders within the Responsible Finance sector remains a major barrier to attracting new investment into this space.

The level of understanding among the adviser community that supports the investor network has also been highlighted as a major issue. This, combined with the lack of general publicity and awareness of CITR, makes ‘selling’ the scheme to investors extremely difficult. As such, any organisation wishing to raise CITR investment is often starting from a point of needing to explain the positives of the relief, and the potential impact it can have on the sector, to investors. This is also hindered by the lack of information on government websites, particularly around highlighting the positive impact and usage of the scheme.

3.10. CITR: Stakeholder views

Responsibility for CITR is split between HMT, HMRC and BEIS. All three departments were interviewed as part of this research. This section provides an overview of these discussions along with the views of Responsible Finance.

All parties accept that CITR has not had the impact, at least financially, as originally envisioned in 2002. However, as the only relief with a clear policy outcome to provide finance into disadvantaged communities, it was suggested that it was well targeted and that, from this perspective at least, the key objectives have been met. In this regard, it is viewed positively and remains a valid component of Access to Finance policy.

From discussions, it became apparent that the intervention is viewed by policy officials mainly from the perspective of being part of the suite of measures that ensure SMEs can access the finance that they need. This seems to understate the original purpose of the scheme, including the fact that social banks have raised the most capital using CITR. It was not viewed (by the people interviewed at least) as part of the new "inclusive economy" agenda. That said, the additional social and economic value of supporting disadvantaged communities was noted (for example, in terms of moving people off benefits and into work). Overall it was viewed as a relatively cost-effective and easy scheme to operate. Although this was the view from HMT, HMRC and BEIS it should be noted that the Office of the CIC regulator declined to talk to us as part of the research.

In addition, while acknowledging CITR may not have been as attractive to investors initially (due to only offering a 5% return), the low-interest rates since the recession in 2007/08 do make it a competitive investment opportunity in the current market. It is believed from some stakeholders that CDFIs could do more to take advantage of this situation. Clearly, the attractiveness of CITR may change if the interest rate were to rise.

The recent change to allow EFG to be used alongside CITR has also been viewed as a positive step forward for CITR from a policy perspective, and, as EFG usage increases, it is expected that CITR will also be used more widely.

In addition, it is accepted that the CDFI sector remains a diverse landscape, making a 'one-size fits all' approach to implementing new policy initiatives difficult.

In terms of the complexity of the scheme, it was noted that any change to simplify certain elements has an associated risk that the scheme may be open to abuse (as seen with other tax incentives).

The trade body for the sector, Responsible Finance, did acknowledge that CITR is the only policy tool targeted to its members. However, they are concerned at its lack of innovation over time and its ability to successfully meet its original aims and ambitions in the current market.

They also see the ability for EFG to work alongside CITR as a positive move, that should help drive up demand across the sector. But the key to this success is a greater awareness from the investor community on the positives of the scheme. In addition, some simplification and clarification on certain rules, such as State Aid and the definitions around disadvantaged communities, would also be beneficial.

3.11. CITR: The CDFI view

3.11.1. Lack of awareness and understanding of CITR and promotion by government

Based on interviews with CDFIs, a key barrier to greater CITR investment is the lack of awareness of the scheme among the financial advisor and investor networks. Evidence from the sector suggests that there simply is not enough understanding of what CITR is, and the positive impact it can have on disadvantaged communities, from those with access to high net worth individuals and other potential investors.

CDFIs have stated that government websites lack any promotion highlighting the positives of the scheme to attract investors. All the online content is very technical, highlighting the risks rather than the benefits.

It was suggested that there needs to be a promotional campaign with a greater focus on the positives of CITR, run either by individual CDFIs or collectively via Responsible Finance. Nevertheless, it was noted also that there remains an issue of ownership and responsibility across government concerning CITR with tax policy, tax implementation, access to finance policy, administration of CITR and the inclusive economy agenda owned by different policy teams within several different departments. This feeds into the lack of promotion of the scheme and does not support awareness or understanding across key investment and advisor channels.

This is compounded by the availability of government data on CITR usage. This reinforces the issues as to why many in the investor community are unaware of the programme and the impact it is having on those businesses in disadvantaged communities. In addition, it is difficult for the sector to be held to account as to how they can use the programme effectively, or to seek to do so when no headline numbers on usage and impact are available.

Several CDFIs have stated that with the advent of EFG being used alongside CITR, they plan on producing promotional material. This will have the specific aim of highlighting the positives of the scheme and the impact it can have on local communities. However other parties have stated they prefer a more collegiate approach, with all the CDFIs working together to produce standardised material that all organisations can use as part of a sector-wide promotional campaign. Further work on driving this issue forward is being taken by Responsible Finance.

3.11.2. Other competitor schemes

In addition to CITR, other reliefs are also available, such as the Social Investment Tax Relief (SITR) and the Enterprise Investment Scheme (EIS). Evidence suggests that these have a much higher profile than CITR, with a greater awareness level and promotion online, however, take up of these schemes has also been limited.

By definition lending to start-ups, micro businesses and SMEs who are unable to access mainstream lending is going to be a high-risk proposition. While CITR offers investors a return of 5% per annum (25% over the five-year period) this remains a less generous return than other government tax relief initiatives. For example, EIS and Seed Enterprise Investment Scheme (SEIS) offer 30% and 50% respectively. In addition, SITR, which operates in a similar space and is also designed to support Social Enterprises, also offers a 30% relief.

It is this less generous return against a high-risk investment proposition that has been highlighted consistently during this research as a key hurdle as to why CITR continues to underperform and fails in attracting a significant number of investors. It was also highlighted that if interest rates were to go up, CITR would become comparatively less attractive when compared with other investment opportunities.

3.11.3. Restriction of CITR investment limits

CDFIs highlighted the fact that all the investment limits within the CITR regulations had been set in 2002/3, at the time the scheme was introduced. Interviewees also suggested that if the sector is to be able to use CITR at scale these might need to be reviewed. While it was noted that the £20m limit on wholesale accreditation might be increased by simply applying for a new accreditation, this still creates added work and uncertainty for both the CDFI and any potential investor(s).

In reality, for CITR to work at scale, and therefore have the impact as originally conceived by government, both the £20m wholesale and £10m non-wholesale limits should be reviewed. In reality, a wholesale fund is unlikely to work capped at a £20m limit.

3.11.4. Complexity

The sector has historically viewed CITR as a complex and bureaucratic scheme to administer. In the last few years, BEIS have worked with CDFIs to simplify the areas that fall under its remit, primarily the reporting and re-accreditation requirements. However, there remain elements of CITR that continue to cause confusion and uncertainty. The key areas of concern highlighted during our research are laid out in section 3.7.

As these rules were created based on the scheme aims and economic factors at the time of creation (2002), it is the strong view of the sector that they should be reviewed to ensure they reflect the current state of the market.

3.11.5. State Aid clarification

Evidence also highlighted State Aid as an area of concern for many CDFIs. In particular, the lack of certainty regarding the calculation for investors as provided by government. This may become a non-issue post Brexit negotiations, however, in the short-term clarity was sought by those interviewed. Feedback from a range of accredited bodies (including those who are regulated banks) suggests that the risk of falling foul of state aid rules has been one of the issues that have hampered growth in expanding the use of CITR investment.

4. CITR, underserved enterprises and CDFI sustainability

The second stated aim of CITR is to support a thriving community development finance sector through the onward lending of investment to profit-seeking and not-for-profit enterprises in disadvantaged communities.

4.1. CITR and its contribution to enterprise in disadvantaged communities

Notwithstanding changes in macro-economic context, commercial bank appetite and the rise of new forms of provision, there remains a long-running issue of access to finance, and a funding gap, for **for-profit** businesses that have been declined commercial finance despite a viable business plan. This position has been documented through a diverse set of reports, for at least two decades, stretching back to the birth of CDFIs. This can be down to an array of reasons, such as limited collateral, adequate track record, or the risks and level of finance sought simply make supporting this enterprise demographic unattractive to mainstream lenders. In the most recent statement on the funding gap, Roberts and Walker (forthcoming) suggest that the number of SMEs falling into this gap may, if anything, be growing again.

In its origination, CITR was developed to meet this funding gap for those enterprises in disadvantaged communities, recognising CDFIs as the key delivery vehicle to do so. And, between 2008 and 2016, the gross flow of SME lending by the sector increased by 260% although, in total, this implies an average of only £70 million of lending per year. Nevertheless, on the face of it, CITR has supported substantial growth in lending to for-profit enterprises in disadvantaged communities.

However, the bulk of this growth in lending is strongly linked to the success of the £60m Regional Growth Fund programme, which began in 2011/12. Comprised of £30m of new capital on a first loss basis from government, this was matched by two banks to create a £60 million fund, with CITR being a key element of their investment (see Case Study 2).

The RGF programme has been very successful in terms of delivery outcomes and cost per job, but the volume boost it provided is now reducing. Indeed, enterprise lending by CDFIs went down in 2017[36], despite recognition of a continued or even growing access to finance

[36] Responsible Finance Annual Industry Report - December 2017.

gap (and all other market provision growing), and as CDFIs reported running out of loan capital. Or put another way, in the words of government, CITR may well be ‘the only relief with a clear policy outcome to provide finance into disadvantaged communities’ and it may be ‘well targeted’ but i) its impact has fallen significantly short in meeting the scale of access to finance needs of enterprises in disadvantaged communities and ii) the impact it has achieved has been heavily reliant on a (temporary) linked scheme, the Regional Growth Fund.

As of today, other publicly funded schemes that may support enterprise in disadvantaged communities include:

- **Start Up Loans**[37] is a government-backed programme to provide microfinance to anybody in the UK wishing to start their own business. The programme has supported over 51,000 businesses, lending over £360m. Responsible Finance Providers have been key partners in the delivery of the scheme since its launch in 2012;
- Winding down **Regional Growth Fund**[38] (RGF), is an innovative funding partnership aimed at delivering funding to small and micro-businesses that are unable to access mainstream finance. The programme matched £30m of public-sector funds with £30m of bank funding (from The Co-operative Bank and Unity Trust Bank). It is delivered by seventeen responsible finance providers spread across England;
- **Northern Powerhouse Investment Fund**[39] (NPIF) whose aim is to provide investment into Microfinance, Business Loans and Equity Finance sub-funds, such as Responsible Finance Providers. These organisations will then onward the funds to small and medium-sized businesses across Yorkshire and the Humber, the North-West and Tees Valley;
- Covering Shropshire to Lincolnshire, the **Midlands Engine** was created to support multiple projects to improve industry, infrastructure and transport across the Midlands. The aim is to attract high-value, outside investment into the region. The project also has around £250m to support small businesses;
- **Enterprise Finance Guarantee** (EFG)[40] used by the Responsible Finance sector to support start-up and established SMEs. It enables accredited organisations to lend to viable small businesses that lack sufficient security with which to borrow. In these cases, the EFG guarantee will allow government to cover 75% of the risk. The scheme is particularly advantageous for the Responsible Finance sector, as their client base often comes from under-representative demographics that are less likely to have the security and collateral to support mainstream borrowing.

As has been noted in Box 1, the combination of EFG with CITR may prove critical in CITR achieving its on-going objective of support to enterprise in disadvantaged communities.

[37] Start Up loans website.
[38] Regional Growth Fund Guidance - Gov.uk.
[39] NPIF Website.
[40] Enterprise Finance Guarantee - British Business Bank website.

In contrast, the contribution of CITR in supporting **'not for profit'** enterprise in disadvantaged communities has been a much greater success; and run in parallel with the growth of social investment in the UK[41] more broadly and the rise of social enterprises, mutuals, community businesses[42], social ventures, charity trading arms, etc.

Spearheaded by the social banks, such lending has represented the substantial majority of enterprise lending made under CITR. Indeed, it is reported by the social banks that the issue has not been raising investment but finding 'relevant investments'. Nevertheless, in a decade when social enterprise growth has consistently outperformed SME growth, as has the use of external finance by social enterprises (a sector which has a particular concentration in disadvantaged communities), access to finance continues to be reported as a major barrier to sustainability and growth[43],

4.2. CITR and its contribution to CDFI sustainability

CITR was deliberately designed to support an income stream to CDFIs and, thus, their sustainability. Indeed it was developed alongside the **Phoenix Challenge Fund** launched in 2000. It's aim, like CITR, was to tackle the market failure of access to finance for those enterprises in disadvantaged areas by supporting the expansion and sustainability of the supply infrastructure such as CDFIs. The Phoenix Fund ran from 2000 to 2006, in which time around £42m of funding was distributed across some 60 RF providers[44].

Nevertheless, by 2010, the number of CDFIs was beginning to shrink and BIS (2010) reported 'the sector remains a long way from achieving operational sustainability and even further from achieving financial sustainability'. Furthermore whilst financial modelling suggested that large social enterprise lenders could achieve at least operational sustainability, the challenges of sustainability for SME lenders remained considerable.

Replicating the earlier message regarding the impact on enterprise lending, CITR could be seen to be supporting the sustainability of the main social enterprise lenders to some extent, and the social banks in particular. Its impact in supporting SME lenders has been less consistent. Whilst CITR contributes to some CDFI's capital raising and is a key component in others, it is still to reach widespread use across the sector.

In similar vein, five years later, PWC (2015)[45] reported little progress on sector sustainability and the continued challenge to the sector. Possibly more telling, in both reviewing the state of the sector and its sustainability, CITR was barely mentioned (other than tax relief being a potential source of other funding), either as part of the analysis of the then state of play or in the scenarios for future sustainability put forward in the report.

[41] Social Investment Insights Series - Big Society Capital - March 2016.
[42] The Community Business Market in 2016 - Power to Change - November 2016.
[43] SEUK (2017) The Future of Business – The State of the Social Enterprise Survey 2017; DCMS/BEIS (2017) Social Enterprise: Market Trends 2017.
[44] BIS Evaluation of Community Development Finance Institutions (CDFIs) - March 2010.
[45] PWC - The Sustainability of Community Development Finance Institutions - Dec 2015.

In summary, for the community development finance sector, for social enterprise lenders, and the social banks in particular, CITR has contributed in a significant manner to the sustainability of the sector. The combination with Regional Growth Fund (a temporary programme) has seen more use of CITR across the enterprise lenders and it remains an important tool for others. But there is scope for much greater use of CITR to drive sustainability in the sector.

In addition, there are other innovative actions (see Case Study 4 and 5) where CITR could be a critical tool in driving forward sustainability within the sector.

Case Study 4 - AskIf

AskIf is a commercial social enterprise whose mission is to transform the scale of funding available to small businesses unable to secure a loan from mainstream lenders. AskIf has been working with Responsible Finance and several Responsible Finance Providers for several years, first undertaking market research before designing and then implementing their platform model in partnership with four Responsible Finance Providers. The model breaks down the key barriers identified as preventing scale across the Responsible Finance industry – namely poor systems/data and lack of loan capital for deployment to SMEs. AskIf has delivered the platform infrastructure to enable the network of lenders to scale – to lend more and lend more efficiently. AskIf is now focussed upon delivering new and scaled loan capital into the sector. AskIf's model provides a single, straightforward channel through which institutional investors can deploy capital at scale across this multi-lender origination network.

AskIf is keen to support use of CITR within the investment structures that it's building for institutional investors, so that investors can benefit from the tax relief that CITR offers and borrowers can benefit from lower interest rates. AskIf will use CITR alongside EFG and other applicable government incentives and subsidies. Acknowledging that CITR will not benefit certain institutional investors (non-tax payers such as pension funds and offshore investors), and that commercial investment in this sector of SME loans may not be suitable for retail investors, AskIf is actively focussed upon opportunities to use CITR with other corporate investors.

Case Study 5 - Business Finance Solutions

Business Finance Solutions (BFS) has procured and invested in the latest digital bank technology, creating a fully automated software platform that is a compliant front to back digital banking platform configured for the Responsible Finance (RF) market. Offering this service to RF Partners brings economies to BFS that allow the sector affordable access to top class, fully white labelled technology. This innovation brings the level of speed; digital access and self-enablement currently only provided by mainstream finance providers or intermediary 'fintech' finance providers operating at scale. Hopefully unlocking keys to the continued sustainability of the sector it can offer compliant, consistent delivery and the potential to aggregate data and demonstrate risk management in raising stakeholder capital.

As a Social Enterprise the BFS mission focuses on working with other 3rd sector partners by sharing infrastructure and enabling better sustainability, improved service, self-service and cost efficiencies for partners across the UK.

BFS are currently implementing the system across their self-managed ERDF, RGF and CA backed funds, the Start Up Loans process across the UK and the Northern Powerhouse Investment Micro Fund. In 2018 BFS is initiating feasibility under NDA with a major personal lender and a large consortium of credit unions.

5. Conclusions and Recommendations

In 2000, through the Social Investment Task Force, HM Treasury sought ways in which it could achieve a radical improvement in wealth creation, economic growth, employment and the overall social fabric within the poorest communities in the UK. The introduction of Community Investment Tax Relief (CITR) was one of five key recommendations subsequently made to government. The aims of CITR were:

- *to stimulate private investment in disadvantaged communities* by providing a tax relief to individuals and companies; and,
- *to support a thriving community development finance sector* whereby CITR investment takes place through accredited Community Development Finance Institutions (CDFI). The investment is then onward lent into profit-seeking and not-for-profit enterprises in disadvantaged communities.

Our research shows that, despite not achieving the levels of investment expected, CITR has been successful in stimulating significant levels of private investment into disadvantaged communities. It has also found a number of CDFIs using CITR as an integral part of their capital raising strategy, with others seriously considering using it in the future.

5.1. Conclusion One: Investment raised under CITR

Over the period 2003 – 2017, we estimate that there has been £145m of CITR investment generated, facilitating around £217 million of SME lending into enterprises in disadvantaged communities. Averaging around £10 million per annum, it is believed around £16m was raised in 2016.

This investment has created over £1.5bn of value to local economies, with a cost to the taxpayer of around £36 million.

Over fifteen years CITR has not achieved the per annum investment levels originally expected, with limited evidence of sustained growth. However, where capital has been raised, using sector benchmarks and the CITR legislative rules, we can gauge that it is having significant impact in terms of lending volumes and economic benefit.

Raising Investment has been most successful through bank-based deposit schemes. This accounts for around two-thirds of all investment funds generated. Two social banks are core to this success, and CITR remains a key element of their business models. With individual investments guaranteed by the FSCS[46], social banks suggest that demand to invest from individuals cannot be met given the limitations inherent in the CITR rules for meeting the onward lending requirements.

Of the remaining CITR investments generated within the sector, the majority has been generated by around half a dozen SME enterprise lenders utilising CITR to raise bank borrowing. There are currently 34 lenders registered for CITR. Critical to the growth of the use of CITR in this way has been a CDFIs ability to raise this bank borrowing in combination with the (temporary) Regional Growth Fund. This approach, backed with CITR, creates a 'first loss' guarantee, attractive to some banks and financial institutions. Findings suggest that more organisations are considering ways this could work at greater scale in the future.

Less used has been utilising CITR to issue shares in CDFIs and raising capital from individuals in the form of small loans. To date, less than 5% of investment raised has been through these approaches, generally supported by individual local social investors. That said they are certainly important routes to raising capital for some smaller CDFIs.

5.2. Conclusion Two: Contribution to access to finance markets and underserved enterprises

Originally, CITR was developed to meet the (continued) funding gap for viable enterprises in disadvantaged communities, recognising CDFIs as the key delivery vehicle to meet this demand.

Between 2008 and 2016, the gross flow of SME lending by the sector increased by 260% representing an average of £70 million of lending per year. However, the bulk of this growth is strongly linked to the success of the £60m Regional Growth Fund programme (which began in 2011/12). Comprised of £30m of new capital on a first loss basis from government, this was

46 Or other EU deposit protection scheme.

matched by two banks to create a £60 million fund, and effectively utilised CITR in some investments. RGF is coming to an end and, in 2017, enterprise lending by CDFIs dropped as CDFIs reported restrictions on loan capital funds.

It is not currently reported how many enterprises have been supported through CITR investment. As a stand-alone scheme, CITR has provided only a small contribution (in terms of overall investment in the sector) to supporting ‘for profit' SME enterprise in disadvantaged communities, although the extent of this cannot be fully assessed given the lack of release of reported data by government. However, feedback from CDFIs suggests that using CITR to attract private sector capital was less of a priority when there were other sources of a capital available. Now that many of these sources are no longer an option, CITR may become a far more important tool for the sector in raising investment. This research has found evidence from a number of bodies that CITR is now forming part of their strategy going forward, with a particular focus on exploring innovative ways to use the scheme more effectively. It also provides an important revenue stream to some smaller community-based lenders.

The contribution of CITR in supporting ‘not for profit' enterprises in disadvantaged communities has seen greater success. Spearheaded by the social banks, they reported that the issue has been not raising investment but finding a significant number of ‘relevant investments' in which to onward lend. This issue is driven not by the lack of a pipeline, but by the number of propositions that fit the scheme rules. Nevertheless, in a decade when social enterprise growth has consistently outperformed SME growth, as has the use of external finance by social enterprises (a sector that has a particular concentration in disadvantaged communities), access to finance continues to be reported as a major barrier to sustainability and growth. Whilst performing well in this area, the suggestion is that CITR could be even more effective in supporting this sector, with some further changes to elements of the scheme criteria.

5.3. Conclusion Three: Supporting CDFI sustainability

CITR was designed to support investment into CDFIs and, thus, aid their ability to achieve sustainability. By 2010, the number of CDFIs was in decline and BIS/GHK (2010) reported ‘the sector remains a long way from achieving operational sustainability and even further from achieving financial sustainability’.

CITR can be seen to be effectively supporting the sustainability of the social banks, and even the main social enterprise lenders to some extent. In contrast, its impact on supporting the sustainability of SME lenders has been much less successful in the majority of cases (particularly those cases that have not benefited from RGF funds). However, some smaller organisations have reported that CITR has been key in their success in attracting investment from individual investors with a strong local and social purpose. In 2015, PWC (2015) reported little progress on, and the continued challenges to, the sector’s sustainability. In both reviewing the state of the sector and future sustainability scenarios, CITR was barely mentioned in the report.

In contrast, the sector is actively bringing forward new initiatives to support investment, lending and sustainability, especially through engagement with devolution and institutional investors. Feedback suggests that CITR could form a key tool to unlock these funding streams. As such it could be a very important mechanism for the future of the sector.

5.4. Conclusion Four: A continued desire to make the scheme meet its original ambitions

Both the sector and government believe that CITR's original policy objectives continue to remain highly relevant, especially as a targeted intervention for enterprises in disadvantaged communities. Evidence suggests that there is a strong will within the sector to build on those areas where CITR has been successful in raising capital while exploring new and innovative ways the scheme may begin to approach the level of impact as originally envisaged in 2002. It should be noted that an increase in the use of the CITR could see considerable additional impact in disadvantaged communities. If the scheme had raised in the region of what government had originally expected, we might have seen around £2.3 billion of loans facilitated at a maximum cost of £375 million in terms of foregone tax receipts.

In addition, CITR does have some unique advantages, not least its ability to bring together corporate and individual investors, as it is available against both income and corporation tax.

The responsible finance sector is keen to work with government, investors and broader stakeholders to overcome the barriers to full utilisation of CITR.

The report identifies a number of barriers: awareness and understanding of CITR; lack of data on the scheme and its performance; the introduction of related competitor schemes such as Social Investment Tax Relief; operational limitations and complexities which have substantial impact on investor positions, and the role of first loss cover in conjunction with CITR.

Regional Growth Fund and the protection on bank deposits have demonstrated the substantially enhanced potential of CITR investment where it is combined with some form of first loss cover protection against investment or lending risk.

The fact that government has now clarified the scheme rules to allow EFG and CITR to be used together (and thus provide some risk protection) will go some way to addressing at least some of this issue (whilst noting that the major previous direct facility for such a position – Regional Growth Fund – is ending and that the clarification is in its early days).

5.5. Recommendations

5.5.1. New investment avenues

The research found that key to the success of the scheme going forward will be finding new ways to make CITR work with other mechanisms that provide first loss cover. Now that EFG and CITR can be used together priority should be given to making this model work going forward. ***Therefore CDFIs should undertake detailed modelling on the impact of using EFG together with CITR as part of their business model (Recommendation 1).***

In our interviews, it became apparent that not all of the opportunities that CITR affords the sector have been explored fully by CDFIs. Particularly in the case of equity investments (outside of the Cooperative and Community Benefits Societies model) or via securities. While interviews with the sector highlighted there may be good reasons why these are not appropriate in all cases, there remains scope for innovative use in this area.

In addition, the CITR mechanism for wholesale funds has also not been used to any great extent (despite a number of CDFIs having been accredited as wholesale bodies). This approach could potentially prove a useful mechanism to aggregate demand from a number of organisations and support CITR to operate at a scale where it can have a much greater impact and profile for the sector. ***We, therefore, recommend that the sector works to ascertain if a wholesale model is a viable option under CITR or if the other available mechanisms for raising capital could be used more effectively (Recommendation 2).***

There was feedback from some stakeholders that in order to support the sector to make the most of the opportunities offered by CITR, it should be brought in line with other similar programmes (for example SITR). This related to both the level of relief, and the amount of time that the investment needs to be left in place. Other stakeholders were concerned that the relief did not lose its appeal to investors in light of changes to interest rates. ***Therefore we recommend the sector should make its case to government to bring the CITR relief in line with SITR or to set it at a certain level over the BoE base rate or that the length of time that CITR investment needs to be held is reduced (Recommendation 3***). However, we note that government is resistant to any increase in the level of relief. This recommendation should, therefore, be carefully considered before being pursued by the sector.

In addition accreditation limits, along with the permitted 'relevant investment' loan sizes, have not been reviewed since 2002. These limits have also not risen in line with inflation since 2002. ***In light of this, we recommend that the sector should make the case to government to increase the maximum CITR accreditation levels of £10m and £20m, as well as the maximum loan size of 'relevant investments' either in line with inflation or to reflect the current market that the sector is now serving (Recommendation 4).***

5.5.2. Government monitoring and reporting and Scheme promotion

In reviewing the available literature on CITR, it quickly became apparent that there was very little in the way of research into the operation or effectiveness of the scheme. It has also proved difficult to assess its impact in detail, as government does not release headline figures on the amount of CITR raised or the number of businesses supported. This is despite the range of metrics that are required to be reported (under CITR regulatory requirements) by accredited organisations. Despite operating for 14 years, no formal government evaluation has been conducted.

This is in stark contrast to other SME access to finance interventions (the Enterprise Finance Guarantee or Start Up Loans scheme for example) where they form a regular part of the British Business Bank's reporting. ***The sector should work with government to publish a***

range of figures on the use of CITR to allow the sector to demonstrate progress and impact (Recommendation 5). This would support the sector in demonstrating that the programme is striving to meet its initial ambitions. Relatedly, formal evaluation of CITR is long overdue.

As well as no information released on the performance of CITR, no organisation has been tasked to support and champion its use. This is in contrast to Social Investment Tax Relief (a comparable tax relief) where Big Society Capital has been doing much work to highlight the relief and encourage its use. ***We recommend that the sector should petition Responsible Finance, Government and Big Society Capital (and/or another body strongly positioned to champion CITR to investors) to take a leadership role in highlighting CITR opportunities to investors. This includes raising awareness among the adviser community and supporting the sector to develop new models to utilise CITR (Recommendation 6).***

There is also little material highlighting CITR's impact or its advantages to the investor network that may be interested in exploring it further. ***The sector should jointly produce promotional material to highlight CITR to investors (Recommendation 7).***

5.5.3. Clarification and simplification

The research has highlighted a number of areas where CITR is overly complex (for little reason) and some other areas where clarification of the rules would be helpful.

Investors have suggested that the scope of the CITR rules and regulations is a barrier to them choosing to use the scheme. In particular, the level of internal resources and upfront work required to ensure they are comfortable before taking a CITR investment forward is proportionately high.

CDFIs have suggested a more cautionary approach to lending through the scheme, not due to risk, but to ensure they do not fall foul of ambiguous scheme rules.

For example, property lending is allowed within CITR rules but not in the case of those investments deemed 'residential'. The definition of residential property is complex as is the calculation that an accredited body must do in other 'case 1' and 'case 2' property investments. ***Therefore we recommend that the sector should make the case to government for simplifying the rules on property restrictions and/or agree further guidance on how residential property is defined (Recommendation 8).***

The definition of what is a disadvantaged enterprise also has a high level of complexity. These are also split into different cases (Case 1, 2 and 3), with a rule that the value of Case 2 investments must not exceed the total value of Case 1 and 3. This adds further confusion for a CDFI when it comes to determining its lending decision and if they can count the supported organisation towards their CITR onward lending target. ***We, therefore, recommend that the sector should make the case for simplifying the method for determining disadvantage (without losing some of the flexibility currently detailed under the definition of Case 3***

and without losing the defining characteristic of CITR in supporting disadvantaged communities) (Recommendation 9).

Feedback from a range of accredited bodies (including some who are regulated banks) suggests that the risk of falling foul of state aid rules has been one of the issues which have hampered growth in expanding the use of CITR investment. In particular, the need to determine a commercial rate to use when calculating the level of aid (if any) to investors. ***Therefore the sector (with support from government) should work together to clarify the state aid rules for investors, in such a way that it is less of a barrier to larger CITR investments (Recommendation 10).***

5.5.4. Onward lending requirements

An issue raised by many in the sector during this research relates to the rules regarding CITR onward lending requirements; in particular, the ability of a CDFI to maintain an average onward lend of 75%, while still being in a position to repay the banks investment. This is mainly a problem in cases where a significant investment is being made by a single investor.

CDFIs have stated in interviews that investors prefer a single repayment at the end of the five-year term. However, in practice, coordinating the repayments from end beneficiary businesses in a way that allows the accredited body to not only repay the investor after five years but also meet the onward lending requirements is impractical at best.

CDFIs have previously raised the potential of the rule being changed, so an accredited body is only required to onward lend a certain proportion of each CITR ‘qualifying investment’ at some point in the investment period. ***Therefore we recommend that the sector review (and feeds back to government) the practicalities of the onward lending rules to ensure that they are not a barrier to the success of the program (Recommendation 11).***

Annex 1

Participants

ART Business Loans

Ask If

BCRS Business Loans

Business Enterprise Fund

Business Finance Solutions

Big Issue Invest

British Business Bank

Capitalise

Charity Bank

DSL Business Finance

ELEM

Finance For Enterprise

Five Lamps

Foundation East

Funding for Enterprise

HM Revenue and Customs

HM Treasury

Impetus

Key Fund

Let's Do Business Group

Newable

Power to Change

Purple Shoots

Responsible Finance

The FSE Group

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Annex 2

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