

CAPITAL FOR ENTERPRISE LIMITED

ENTERPRISE FINANCE GUARANTEE

**Q&A ON EXPANSION OF EFG TO INCLUDE BANK LENDING TO
COMMUNITY DEVELOPMENT FINANCE INSTITUTIONS**

ISSUE 3

20th DECEMBER 2010

What is the “Bank to CDFI” Variant of EFG?

CDFIs (which, as financial intermediaries, were originally excluded from receiving EFG-backed loans) have from May 2009 been eligible to receive EFG-backed loans from banks for the purpose of providing capital for on-lending.

Is there a limit on the amount of money that can be lent to CDFIs in this way?

There is no limit at present. The intention is to respond to appropriate demand arising from “wholesale” transactions between banks and CDFIs for the purpose of providing capital for on-lending.

Does a CDFI need to be an EFG accredited lender to receive a bank loan guaranteed under EFG?

No. Banks may lend to CDFIs whether or not they are accredited EFG lenders. However, in all cases CDFIs will need to demonstrate to the bank that they will be able to repay the loan.

How will this work where a CDFI is also an accredited EFG lender?

There will be no change as EFG operates independently at each level (Bank to CDFI and CDFI to SME). However, the fact that the CDFI may use EFG when on-lending at least some of the capital borrowed is likely to be considered by the bank as providing additional security which could in turn influence the cost of funds and/or other terms of the transaction between the bank and CDFI.

Won't this mean that banks will make inappropriate (high risk) loans to CDFIs?

No. This provides an additional guarantee for banks but the CDFI will still need to demonstrate that the loan is viable. Banks will still carry a significant proportion of the risk so it will not be in their interests to make inappropriate loans. Equally it is in each borrowing CDFI's interest to ensure that they are able to repay the bank as otherwise the bank is unlikely to wish to have a long term relationship with the CDFI.

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Will there be a cap on what the banks can claim on the loans they make to CDFIs under the scheme?

Yes. The normal EFG scheme-level cap rate will apply. However, as each bank loan to a CDFI is a distinct and individually-negotiated transaction, the cap will operate at the level of each individual loan from a bank to a CDFI rather than across a portfolio of loans (in contrast with other EFG lending), thus ensuring that there is no “cross-subsidy” between individual bank-CDFI relationships. The claim limit for the bank is set at 13% and the guarantee rate remains at 75%, i.e. a net limit of 9.75%. Therefore, for example:

A fully drawn £1m facility provided by a bank to a CDFI will have a net Claim Limit of £97,500.

If the CDFI has net losses of £100,000 on the £1m facility, then the bank is entitled to claim the full 75% of £100,000, or £75,000.

If losses are £200,000 then the CDFI’s claim will be capped at £97,500, rather than £150,000 (75% of £200,000).

Is there a limit on the size of the loan banks can make to CDFIs under the scheme?

Yes. It is £1million as for all other EFG loans.

How will the Bank claim against the EFG for these loans, won’t it mean CDFIs going into administration?

No. Banks will be able to claim if a proportion of the CDFI’s portfolio of loans made from the capital provided from the bank default. They will not have to seek the liquidation of the CDFI prior to claiming but they must pursue any security held specifically in respect of the EFG-backed transaction.

Can a bank benefit from CITR on an EFG loan to a CDFI?

Yes, subject to the CITR rules being satisfied. In practice the principal restriction to be taken into account is that any on-lending of these funds by the CDFI as an EFG-backed loan cannot be treated as a relevant investment (i.e. contributing towards meeting the minimum qualification thresholds) for CITR purposes.

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Won't the premium charged for EFG make the loans too expensive for the CDFIs and thus the disadvantaged communities that they are meant to serve?

No. Given the particular issues that CDFIs face in raising capital and the need to ensure that CDFI customers are able to access the finance they need, CDFIs are not required to pay any premium to BIS in respect of the loan.

If the CDFIs are lent funds with an EFG loan can they make a loan which is part funded with other public funding? For example a loan of £50k which could be funded £25k Bank (EFG), £12.5k RDA and £12.5k ERDF?

In the case where a CDFI blends capital from a number of sources in one loan then for the purposes of EFG applied to bank lending to CDFIs the calculations done in the event of default would simply need to be done on a pro-rata basis. The benefit to the bank under the guarantee is only accrued in relation to that proportion of the defaulting loan that was made using capital the bank had loaned to the CDFI.

Can a CDFI draw down the loan over time so they can use it to meet ongoing need for capital?

Yes. As with any EFG loan the drawdown profile and any other conditions are a matter for negotiation between the bank and the CDFI, provided that the loan remains within the overall eligibility criteria.

What if I have any further questions?

Please contact Mark Hambly or another member of the Debt Markets Team at CfEL on 0114 206 2136 or mark.hambly@capitalforenterprise.gov.uk

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