

Agenda item:

Title of meeting: CABINET AND CITY COUNCIL

Date of meeting: 10th July 2014 (Cabinet)
15th July 2014 (Council)

Subject: Hampshire Community Bank

Report by: Head of Financial Services and Section 151 Officer

Wards affected: All

Key decision: Yes

Full Council decision: Yes

1. Purpose of report

- 1.1 To describe what a "Community Bank" is and the advantages one could bring to the local economy and to set out details of an opportunity to help create a new "Hampshire Community Bank" (HCB).
- 1.2 To seek endorsement to the key aims of HCB and, if agreed, give delegated authority to the Head of Finance and Section 151 Officer (HFS) to invest up to £5 million in creating the HCB in consultation with the Strategic Director Regeneration but subject to the HFS being satisfied with the outcome of the Due Diligence process.

2. Recommendations

Recommended that:

- 1) The key aims for the Hampshire Community Bank Limited as set out in this report are endorsed.
- 2) The Governance arrangements set out in Section 10 are approved.
- 3) Authority to approve a Capital Investment of up to £5 million in in the creation of Hampshire Community Bank and incur any necessary costs relating to the Due Diligence process is delegated to the Head of Financial Services and Section 151 Officer in consultation with the Strategic Director Regeneration.
- 4) The £5m Capital Investment costs to be funded by unsupported Prudential Borrowing and Due Diligence costs up to £25,000 are financed from the MTRS Reserve.
- 5) The attached financial appraisal is approved and the Corporate Capital Programme is amended to reflect the addition of this new Capital Investment.

3. Reasons for recommendations

3.1 To provide authority to invest in the creation of the Hampshire Community Bank to help generate the benefits set out in section 5.

4. Background

4.1 The initiative for this process came from Professor Richard Werner who is Director of the Centre for Banking, Finance and Sustainable Development at Southampton University. Professor Werner is an internationally renowned expert on banking who correctly predicted the "Credit Crunch" collapse of the UK banking system and property market, highlighted the problem of 'recurring banking crises' and suggested workable solutions. See details of his career on the [University of Southampton website](#) .

4.2 The House of Commons' "[Competition and Choice in Retail Banking](#)" 2011 report, clearly showed that dissatisfaction with UK banks runs high. It also quoted the Governor of the Bank of England (Para 143) as follows " ... *make sure that we find ways of encouraging new banks that will pose a competitive threat to [existing] banks*" In July 2013 the [Government's response to the Parliamentary Commission on Banking Standards](#) stated in Chapter 4, para 4.2 "*The Government is determined to see a step change in competition in the UK banking market in order to achieve better outcomes for consumers*". Community Banks could be a very positive way for local councils to respond to the Government challenge to banking.

4.3 Professor Werner has highlighted creation of Community Banks as a way of greatly strengthening and improving the banking system. He has gathered together a group of people with the necessary skills and has started up a Community Interest Company called "Local First Community Interest Company" with the express purpose of creating a Community Bank here in Hampshire. He has secured a £250,000 grant and £950,000 loan approved by the Secretary of State for Business, Innovation and Skills to cover set up costs including getting a banking permission. He has also persuaded one of the world's top 10 law firms to help secure the banking licence without payment on a "pro bono" basis.

4.4 Local First CIC has produced a document entitled "Hampshire Community Bank - Information Memorandum for Investors" which is specifically aimed at local government institutions such as Councils, Universities etc. It sets out the arguments for creating a Community bank together with an outline implementation plan and timetable. Copies of the document have been placed in the group rooms.

4.5 The main characteristics of a Community Bank are set out below:

- Not for profit with any surpluses distributed between the founding investors and grants to the local area on a 50/50 basis
- Run by local bodies for local people
- Main purpose is to create a strong and sustainable local economy
- Cannot ever be taken over or sold
- No "Bankers Bonuses"

4.6 The case for a Community Bank centres around the following:

- A lack of competition and concentration of larger corporate banks creates an environment susceptible to a "credit crunch" and its associated affects. Large banks prefer to lend large amounts to large companies creating barriers for Small and Medium Sized Enterprises (SME) access to finance and therefore growth arising from their formulaic non local approach. See Government's response to the Parliamentary Commission on Banking Standards referred to above.
- The German Sparkassen group of local, legally independent, not-for-profit savings banks have been a continuing success story over the last 200 years, including during the current recession, which demonstrates that this business model is both beneficial and commercially viable. In Germany, local, not-for-profit banks and credit unions account for 70% of all retail bank deposits and an even higher percentage of lending to Small and Medium Sized Enterprises (SMEs), but in the UK this figure is less than 1%. It is their virtual absence in the UK that accounts for many of the funding problems SMEs are facing.
- HCB could be an exciting opportunity for Portsmouth and Hampshire to help improve economic prosperity generally, particularly in the marine and maritime sector.

5. Hampshire Community Bank Key Aims and Outputs

5.1 The HCB process would create a new "not for profit" bank which cannot ever be taken over or sold and which will exist in perpetuity to benefit the County of Hampshire.

5.2 Half of the surpluses made by the Bank will be distributed via a Grants Board towards innovation, social enterprise and business start-up's. Investors will be given representation on that Grants Board

5.3 If successful, the bank will be a powerful force in achieving the following :

- Securing a strong and sustainable local economy in Hampshire
- Working with businesses, councils and charities to deliver sustainable economic growth
- Retaining wealth in the local area

5.4 Over a five year period it is estimated that the HCB could deliver the following outputs:

- Distribution of half of the surpluses generated by the bank by a Grants Board including the investor's representatives to support charitable or other deserving causes in Hampshire. Over five years that is estimated to yield over £6.5 million. Over 10 years the sum distributed could be over £20 million.

- Support around 480 small and medium enterprises to grow through provision of key investment capital.
- Provide funding to support £375m of investment in the Hampshire economy.
- Creation of between 7 and 11 additional jobs for each £1m of locally focused lending giving between 2,600 and 4,100 new jobs over the first five years.
- Leverage additional private sector investment into the Hampshire economy.
- Generate increased local tax revenues from business rates.
- Increased rate of business survival and job retention in the event of a future recession.
- Improved access to financial services for those who are disenfranchised by the current banking systems
- 6% return on investment for founding investors, although no dividend is planned during the first 2 years of operation (see Financial Appraisal at Appendix 2 for estimated effects on PCC).
- Creation of a new local institution that can support council plans and act as a partner in the delivery of a range of strategies such as local economic development; sustainability [waste, energy]; housing; education; apprenticeships; cultural offerings, etc.

5.5 Creation of the HCB would be in line with the following strategies: the LEP Strategy for Growth, PCC's Regeneration Strategy and the Medium Term Financial Strategy that aims to drive regeneration, reduce the demand for council services and reduce the council's reliance on central government grant.

5.6 It is therefore recommended that, subject to the Governance arrangements set out below, authority to implement the Hampshire Community Bank proposals as set out in this report is delegated to the Head of Financial Services and Section 151 Officer in consultation with the Strategic Director Regeneration.

6. Business Model & Business Plan

6.1 How would HCB operate, what services would it provide?

- At launch Hampshire Community Bank will offer as a minimum savings facilities, business loans and mortgages.
- In the first year, the bank aims to provide a full range of banking services to both businesses and individuals in Hampshire, enabling customers to switch to HCB without loss of service.

- Services for Individuals will include:
 - Current accounts (debit cards, standing orders/direct debits, faster payments/CHAPS/BACS/SWIFT International)
 - Savings accounts
 - Cash ISAs
 - Stock and share ISA accounts with free investment advice via partners
 - Accounts for CICs, charities, local authorities, local clubs and societies
 - Cash /pre-paid cards
 - Credit cards
 - Mortgages, especially for new-build (green, local)

- Services for Businesses will include:
 - Current accounts (with overdraft facilities)
 - Loans
 - Mortgages
 - Business credit cards
 - Asset finance
 - Trade finance
 - Support for businesses and mutuals during transition to employee ownership

6.2 How will the HCB differ from other banks? The bank's primary goal is to help create a strong, sustainable economy in Hampshire. To achieve this the intention is that the bank will:

- Lend in a way that benefits and focuses on Hampshire;
- Prioritise 'productive' lending, that is lending that creates jobs, sustainable economic growth, delivers a low carbon economy and enhances local economic 'resilience'.
- Create an organisational culture that values strong relationships with the community
- Recruit and train staff from the local community;
- Operate an apprenticeship system and support businesses in offering apprenticeship systems
- Operate as a 'not for profit' social enterprise, reinvesting all surplus profits in the local community
- Grow organically to meet the needs of individuals and business, not to meet targets
- Offer innovative services that support local saving and lending;

- Offer expertise in financing employee-ownership and mutualisation schemes
- Be transparent and focus on the ‘triple bottom line’ i.e. the commercial, social and environmental impact of the bank’s lending decisions
- Create a culture in which staff are motivated not by bonuses, but by contributing to the local community. There will be low differentials between the highest paid and lowest paid staff.
- Become a true financial partner to Hampshire stakeholders from all walks of life.

6.3 How will HCB customers access services? A HCB office presence will be required and is planned for rented accommodation, but in the main HCB would conduct business in a way similar to that of, say, First Direct Bank whereby there are no bank branches as such and individual clients access services via the phone, online and other bank branches/ATM Cash Machines. Business customers would receive all of the above together with a personalised service through which HCB staff would look to understand local business needs and tailor appropriate lending offers.

6.4 How will HCB attract money from depositors? The HCB plans show that depositors would be offered a savings interest rate of 1% above the London Inter-Bank Offer rate. This is assumed to be more than sufficient to generate the level of deposits shown in the Business Plan.

6.5 Who will borrow from HCB? The planned loan book for HCB is as shown in the table below:

Planned loan book of Hampshire Community Bank	Year	Year	Year	Year	Year
	1	2	3	4	5
	£ Million	£ Million	£ Million	£ Million	£ Million
SME lending	46	90	110	133	150
Residential property	35	67	83	100	112
Student loans	5	11	14	17	19
Sovereign/sub-sovereign	12	23	28	33	38
Commercial property	17	34	41	50	56
Total lending	115	225	276	333	375

6.6 How much money will the bank distribute to worthy causes? Distribution of half of the surpluses generated by HCB to support charitable or other deserving projects or causes in Hampshire is estimated to yield over £6.5 million in the first five years and over 10 years the sum distributed could be over £20 million.

6.7 When will HCB start operating at a profit? A summary of the preliminary HCB Financial Plan over 5 years is shown below:

Profit and Loss Summary from preliminary Financial Model	Year 1 £'000	Year 2 £'000	Year 3 £'000	Year 4 £'000	Year 5 £'000
Operating income	1,819	4,421	6,512	7,859	8,933
Net profit / (loss) before tax	-402	2,153	4,308	5,607	6,526

7. Creation and Operation of HCB

7.1 At this stage, it is anticipated that the following organisations will pledge their support subject to due diligence:

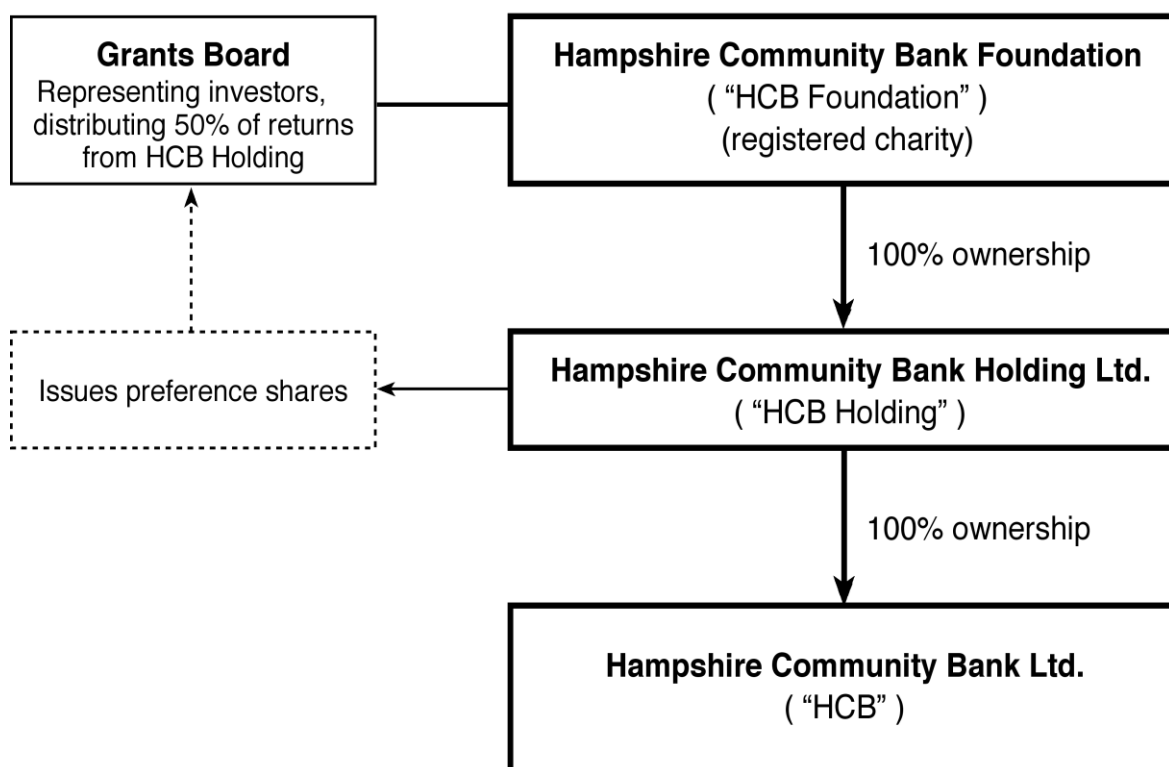
- Eastleigh Borough Council
- Test Valley Borough Council
- Winchester City Council
- New Forest District Council
- University of Portsmouth
- University of Southampton

7.2 The exact amount of the investment by each organisation has yet to be determined however it is anticipated that the Bank will need to raise £7 million locally which it is planned will be matched by the Department for Business Innovation & Skills (BIS) making a total investment of £14 million to launch the Bank. This is estimated to be of sufficient scale to provide for a sustainable and conservatively run bank with a loan book after 3 years of £276 million.

7.3 HCB would operate only in Hampshire and the launch is planned for Spring/Summer 2015.

8. Legal Structure

8.1 The "Hampshire Community Bank - Information Memorandum for Investors" described at Para 4.4 above confirms that once a banking licence is obtained Local First CIC Company would change to become Hampshire Community Bank Ltd. Hampshire Community Bank Ltd. would be fully owned by a bank holding company, Hampshire Community Bank Holding Ltd. ("HCB Holding"), which in turn would be fully owned and controlled by a charitable foundation (the Hampshire Community Bank Foundation, "HCB Foundation") whose charter enshrines its goal to own the bank in perpetuity, offer appropriate corporate governance and receive and allocate the dividends from the bank in order to support social, environmental, educational, research and cultural projects. As the charity and holding company cannot sell the bank shares, this structure ensures the continuation of the bank and its not-for-profit character. The figure below shows the structure in diagram format:



8.2 Details of the Local First CIC Company team, associates and partners who are involved in the project are set out in Appendix 1.

9. Risks, Due Diligence & Financial Appraisal

9.1 The Due Diligence process includes (inter alia):

- Legal structure and governance arrangements
- Organisational structure and operations
- Licensing and regulation
- Investment and funding
- Business Plan (including the marketing strategy, loan book strategy, competitor analysis, financing strategy and financial forecasts)
- Distributions to Shareholders
- Services (including lending criteria)

9.2 The Banking Authorisation process is extremely rigorous and will address most of our due diligence requirements however, particular attention will be paid to the control and distribution of profits:

- 1) Initially between the founding investors and the Grants Board and then subsequently;
- 2) The relationship between the relative shares of the amounts invested compared to the relative voting rights for the distribution of profits via the Grants Board.

9.3 The main risks at this stage are as follows:

- Approval of the Banking License and therefore the extent to which costs are incurred (funded by the founding investors at risk) up to that point. To mitigate this risk only £2m of the £14 million capital will be accessible to directors. The remainder will be held in an escrow account and only released either upon receiving the informal approval of the banking license by the regulators or agreement of the majority of shareholders. On a £5 million investment by PCC that would equate to around £700,000.
- The robustness of the Business Plan, the success of which will drive the return to the founding shareholders. An initial internal review of the Business Plan has not raised any concerns. The Business Plan itself however, will be scrutinised through the regulatory process and it is the intention of the founding investors to also take some external professional advice on the plan.

9.4 At this relatively early stage, a significant amount of due diligence is still to be performed. However, to enable the banking regulatory process to proceed, it is necessary for the Bank to be able to demonstrate that it has raised sufficient capital to make its application. It is recommended therefore that authority to make an investment of up to £5 million in the creation of the Hampshire Community Bank, including costs relating to the due diligence process, is delegated to the Head of Financial and Section 151 Officer in consultation with the Strategic Director Regeneration but is subject to the Head of Financial and Section 151 Officer being satisfied with the outcome of the Due Diligence process. It is further recommended that the £5m be funded from Prudential Borrowing as an Invest to Save scheme as demonstrated by the financial appraisal set out in Appendix 2 and summarised below.

9.5 A Financial Appraisal is attached as Appendix 2 and includes a summary as shown in the table below. Please see Financial Appraisal summary for notes explaining the amounts shown:

Description	£ Million
Total amount invested by PCC over ten years	5.00
Cash amount paid to PCC by the Hampshire Community Bank (HCB) over 10 years	
- 6% as HCB initial Business Plan and Financial Model	3.45
- 4% assuming a reduced performance by HCB	2.07
Net Present Value of Capital and Revenue Cash Flows over 10 years	
- 6% as HCB initial Business Plan and Financial Model	1.16
- 4% assuming a reduced performance by HCB	0.19

9.6 It is also recommended that the Head of Finance & S151 Officer make regular progress reports on the project and due diligence process to the Corporate Projects Board as set out in Section 10 below.

10. Project Governance

10.1 If approved the HCB proposal would be set up as a Corporate Project and run accordingly.

10.2 It is likely that a "non- legal entity" group comprising representatives of the founding investors would need to be created to govern the HCB project, although any decisions relating to statutory services will revert back to the relevant local authority or statutory body.

10.3 Governance for the project would be managed in accordance with the City Council's process for all major projects as follows:

- Reported through Corporate Projects Board
- Regular briefings to Leader and Portfolio holder for PRED
- Monitoring from Government via BIS

10.4 Consultation arrangements would include Member engagement as necessary.

10.5 Subject to a satisfactory review of the legal structure (see Legal Services comments in section 12 below) any appointment of City Council representative(s) will be made in accordance with the City Council Constitution.

11. Equality impact assessment (EIA)

11.1 A preliminary EIA has been carried out which indicates that the requirement for a full EIA is low.

12. Legal Services comments

12.1 There is a power to invest in the manner herein envisaged, provided the investment is sound, and that it promotes benefits to the PCC area. A thorough review of the legal structure by the legal services team will be necessary before execution of any documentation in relation to the proposed investment.

13. Head of Financial Services and Section 151 Officer comments

13.1 A Financial Appraisal is attached at Appendix 2 and an extract from the summary is shown in Para 9.5 above. The appraisal shows the effects of the HCB's planned 6% returns over ten years on a £5 million investment and the effects of a reduced level of return of 4%. It also shows that at both 6% and 4% levels of return the investment yield would be better than that PCC could obtain from lending to "risk free" borrowers. This proposal however is not risk free as yet and therefore it is recommended that investment is subject to the Head of Financial

Services and Section 151 Officer being satisfied with the results of a Due Diligence investigation.

13.2 The scheme is considered a "Spend to Save" project and it is recommended that Due Diligence and other associated revenue costs up to £25,000 are financed by a transfer from the Medium Term Resource Strategy Reserve.

13.3 It is recommended that the Financial Appraisal is approved

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Signed by: **Chris Ward, Head of Financial Services and Section 151 Officer**

Appendices:

- Appendix 1 - Local First Community Interest Company Team, Associates & Partners**
- Appendix 2 - Financial Appraisal**

Background list of documents: Section 100D of the Local Government Act 1972

The following documents disclose facts or matters, which have been relied upon to a material extent by the author in preparing this report:

Title of document	Location

The recommendation(s) set out above were approved/ approved as amended/ deferred/
rejected by on

.....
Signed by:

APPENDIX 1

LOCAL FIRST COMMUNITY INTEREST COMPANY TEAM, ASSOCIATES & PARTNERS

Local First CIC has produced a document entitled "Hampshire Community Bank - Information Memorandum for Investors" (IMI), see Para 4.4 of main report for more details. The IMI confirms that once a banking licence is obtained Local First CIC Company would change to become Hampshire Community Bank Ltd (see proposed legal structure in Para 8.1 of main report). The IMI also describes the team, associates and partners who are involved in the project as set out below.

Richard Werner (Chairman and Chief Executive)

Professor Werner is chair of Local First CIC. He is also Chair in International Banking at the University of Southampton, founding director of its Centre for Banking, Finance and Sustainable Development and programme director of the MSc in International Banking.

Richard has worked in director roles at Bear Stearns and Jardine Fleming, is an FCA approved person and runs the global funds of Providence Asset Management Ltd. Having popularised the expression 'Quantitative Easing' in the 1990s, he is well known as a central bank watcher and expert on banking systems, bank regulation and the recurring banking crises. His books include 'New Paradigm in Macroeconomics' (Palgrave Macmillan, 2005) and 'Where does money come from?' (with Josh Ryan-Collins, Tony Greenham, Andrew Jackson; new economics foundation, 2nd ed. 2012). Since 2011 he has been a member of the European Central Bank (ECB) Shadow Council.

Roy Ruffler

Roy founded Ruffler Bank in 1969 and was the Chairman and owner of the bank until 2009, when he sold his shareholding to AnaCap Financial Partners LLP. The bank is now known under the name Aldermore Bank. Ruffler Bank built its business by marketing a range of savings schemes to consumers and providing business finance facilities to SMEs. Roy will provide nonexecutive oversight to the bank.

Colin Fisher

Colin is a non-executive director of Morgan Stanley Bank International Limited, where he was also chairman of the audit committee for 6 years. In addition, he is a nonexecutive director and chairman of the audit committee of BMCE Bank International. He has been a director of Lloyds TSB Financial Services Holdings Limited (where he was Head of Retail Banking) and Lloyds TSB Scotland plc. He has also been chairman of ActivCard UK Limited, Goldfish Bank Limited, United Dominions Trust, and Mortgage Express.

Reiner Faust

Reiner has been executive director of several German co-operative local banks. Moreover, he has experience in setting up local banks from scratch, from the time of German unification, when the German co-operative banks and Sparkassen established new, independent local banks in former East Germany. Reiner is currently head of Raiffeisenbank Gotha, a city with a historic link to England.

Mike Battersby

Mike has 25 years of marketing and corporate financing experience from Lloyds Banking Group and at Royal Bank of Scotland, where he was Regional Director for Solent and the South West. Mike has worked at a high level to formulate policy in the Employee Ownership Association as part of a working group formed to advise the government, and has worked locally to promote the sector via his own advisory business.

Fiona Brownsell

Fiona is a financial transformation specialist and CEO of new bank incubator, Tusmor. Fiona was a core launch team member of Metro Bank, where she was designer and developer of their IT system. She has particular expertise in banking IT and recently advised the Treasury Select Committee on this matter. Fiona was formerly a Vice President of American Express, where she was responsible for their Technologies Division.

Key members of the team:

- **Martin Read** who is a Director of Local First CIC and former KPMG accountant and has worked on a previous successful banking license submission to the FSA.
- **Charles Bazlinton**, who is a Director of Local First CIC, works to promote the understanding of economics and banking matters and is author of 'The Free Lunch - Fairness with Freedom'.
- **Andrew Rigg**, who is a Director of Local First CIC, farms in Hampshire and co-founded and chaired an innovative environmental charity in the early 1990s. Andrew is also a director of a renewable energy company.
- **Alex Templeton**, an energy sector specialist, NESTA award-winning innovator and author of a report on low carbon finance options for local authorities.
- **Kostas Voutsinas**, PhD, a financial sector and asset management analyst and fund manager, who is also an FCA approved person.

Partners

Sparkassen DSGV

Sparkassen DSGV (German Savings Banks and Giro Association) is the umbrella group for the 426 German community savings banks and associated financial organisations. DSGV has extensive experience in the launch and development of new banks and is currently launching two new community banks in Greece. It should be noted that the Sparkassen network is distinct both legally and strategically to the German 'Landesbanks' that encountered problems during the financial crisis.

Deloitte

Deloitte's New Banking Team helps organisations acquire banking licences in the UK and have offered an element of pro bono work to Local First.

Blake Laphorn (from 1 July Blake Morgan)

Blake Laphorn is one of the UK's leading full service law firms and is well established in Hampshire. Their Banking Team is operating in support of Local First.

International law firm

A "top ten" international law firm is working without payment on a "pro bono" basis with Professor Werner and the Local First CIC team to help secure a banking licence.

Parity Trust

Parity Trust is a Hampshire-based Industrial and Provident Society that provides affordable finance for individuals, social enterprises and SMEs. It is supporting the creation of a local bank.

Association of Cooperatives in Bavaria

This is the largest of the federally organised cooperative bank organisations in Germany, whose deputy head of legal has experience in establishing banks in the EU and is offering assistance.