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FINANCING FOR SOCIETY
Assessing the Suitability of Crowdfunding for the Public Sector

MARK DAVIS + LAURA CARTWRIGHT  MAY 2019
DISCLAIMER: This independent report has been produced as the main output from the Financing for Society research project led by Dr Mark Davis of the School of Sociology and Social Policy at the University of Leeds, UK. The project was funded by a research grant from the UK Government’s Department for Digital, Culture, Media and Sport (DCMS) and conducted in partnership with Abundance Investment and Local Partnerships.

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This report is intended to inform decision-makers in the public, private and third sectors. It has been peer-reviewed by two colleagues from a different Faculty at the University of Leeds, as well as by nominated external reviewers, before its publication.

The views expressed in this report represent those of the authors alone and do not necessarily represent those of the Government department that funded the work, the research partners, academic institution of the authors, external organisations commissioned through the project, or our case studies.
# Contents

## Part One: Why Consider Crowdfunding for the Public Sector?

1. Executive Summary  
2. Introduction  
3. What is Crowdfunding?  
   - Crowdfunding Business Models  
   - Public Sector Crowdfunding  
   - Regulation of Crowdfunding in the UK  
   - IFISA Eligibility  
   - Crowdfunding Example: The Swindon Case  
   - Who invests in Crowdfunding and Why?  
   - Public Perceptions of Local Authority Crowdfunding

## Part Two: Assessing the Suitability of Crowdfunding for the Public Sector

4. Case Study Findings  
5. Output 1: Decision-Making Tool  
6. Output 2: Community Municipal Bond  
7. Output 3: Crowdfunding to Replace Private Capital in PPP Projects

## Part Three: Growing Crowdfunding for the Public Sector

8. Analysis  
   - Understanding the Public Perception of Crowdfunding  
   - Additional Support for the Public Sector  
   - Impact on Current Models of Funding  
   - Attitudes to ‘Place-Based’ Investing  
9. Recommendations

## Appendix A: Case Studies

A1: Bristol City Council  
A2: Isle of Wight Council  
A3: Leeds City Council  
A4: NHS Dudley Clinical Commissioning Group  
A5: King’s College Hospital NHS Foundation Trust  
A6: Royal Devon & Exeter NHS Foundation Trust

## Appendix B: Extended Summary

ABOUT THIS REPORT  
THE AUTHORS  
THE PARTNERS  
USING THIS REPORT  
BUILDING CASE STUDY EVIDENCE  
REFERENCES
Do you know where your money is? If you immediately think of cash, then there's a good chance you've just pictured a purse or imagined a bank vault in order to reassure yourself. But if you thought of your savings and investments, then there's a good chance you don't know exactly where your money is.

And this suggests a far more fundamental question. Do you know what your money is doing? I lead a programme of research at the University of Leeds that starts from the principle that how and where we decide to spend, borrow, save, and invest makes a material difference to the type of social world that we are creating for ourselves and for future generations. What we do with our money really matters.

If we want a radically different world to the one we now see around us – if we want that world to be fairer, more equitable, and more sustainable – then we are going to have to do radically different things with our money. We are going to have to allocate capital to those enterprises and organisations that can unambiguously demonstrate the positive social and environmental outcomes they are delivering.

At a time when public sector finances are under increasing pressure, crowdfunding – still mistakenly seen as being just another form of charitable giving – has the potential to offer this radical alternative via an investment-based business model that generates social, environmental and economic returns. But does it work? For whom? And in which contexts?

In the following report, we provide a landmark assessment of the suitability of crowdfunding as a new model of finance that could offer better value to the public sector. Through our research with six case studies – three UK local authorities and three NHS bodies – the report: helps to overcome existing knowledge barriers with respect to crowdfunding; provides a decision-making tool to demystify the process of utilising crowdfunding as a public body; shows how crowdfunding can be utilised to create new forms of civic engagement with local residents and service users; presents a new Community Municipal Bond structure co-created as an output of the project; and, offers a series of recommendations for what should happen next for public sector crowdfunding. The report concludes that the public sector is yet to make the most of crowdfunding and to realise the financial and non-financial benefits it has been shown to generate.

I hope this report will be a helpful guide to encourage public sector bodies to unlock the potential of crowdfunding, and in turn start to create a better, more sustainable world by disrupting habitual uses of money.
1 EXECUTIVE SUMMARY

WHAT IS INVESTMENT-BASED CROWDFUNDING?

1.01 Crowdfunding is a way of financing projects, businesses and loans through small contributions from a large number of sources, rather than large contributions from just a few.

1.02 While the general public is most familiar with ‘donation-based’ crowdfunding, ‘investment-based’ crowdfunding (i.e. debt, equity) is the largest UK alternative finance sector by volume and is regulated by the Financial Conduct Authority (FCA). Investment-based crowdfunding is where people provide capital on the basis of receiving a financial return (see Section 3).

1.03 This type of crowdfunding is rarely utilised by the public sector. Our research identified two main reasons for this: a lack of knowledge and expertise on investment-based crowdfunding within public bodies; and, a concern that current crowdfunding business models could not better the capital costs and/or administrative costs of existing forms of public sector borrowing.

1.04 One notable exception to this is the crowdfunding campaign led by Swindon Borough Council, which raised £1.8m in five months for a new solar park in 2015 (and again in 2016) by offering investors a tax-free interest return (see Paragraph 3.52).

1.05 At a time when financial returns from traditional products are relatively low for retail investors, the option to use investment-based crowdfunding as a way of engaging local authority residents and/or NHS service users in finding ‘place-based’ solutions to community needs is attractive.

THE FINANCING FOR SOCIETY PROJECT

1.06 Led by the University of Leeds, Financing for Society was an independent project funded by a research grant from the UK Government’s Department for Digital, Culture, Media, and Sport (DCMS).

1.07 The grant enabled the project team – comprising the University of Leeds; Local Partnerships; and the crowdfunding platform, Abundance Investment – to work with public sector bodies to assess the suitability of investment-based crowdfunding to finance socially-beneficial public infrastructure projects (see section 2).

1.08 The research sought to test whether or not:

- investment-based crowdfunding could offer better value to the public sector;
- the process as a whole could mirror that for the Public Works Loan Board (PWLB) or via Public Private Partnership (PPP) project finance, as common sources of public sector funding; and if
- it could provide material opportunities for people to realise a more ‘blended return’ of positive social, environmental and economic outcomes from investing directly in their community.

1.09 Through the competitive allocation of ‘pilot funding’, the project team worked with six case studies – three UK local authorities and three NHS bodies – to help them conduct feasibility studies on using investment-based crowdfunding to finance specific infrastructure projects in their area. These projects included green energy initiatives, community regeneration schemes, and new health hubs.

1.10 Our research found that investment-based crowdfunding provides a viable and significant opportunity for public bodies seeking additional models of finance for public infrastructure projects, whilst also growing local engagement between the public sector and their community. This opportunity is not without its challenges (both real and perceived), which appear to affect projects within NHS bodies more adversely than local authorities.

1.11 Of the six case studies: two (both local authorities) are taking crowdfunding forward; two are further considering their options; and two (both NHS bodies) have determined it was not presently feasible due to the scale of project for which they are seeking finance (see Section 4 and Appendix A).
1 EXECUTIVE SUMMARY

KEY OUTPUTS

1.12 The research team worked closely with the case studies to develop three key outputs:

1. We designed a Decision Tool for free public sector use. The tool shows how investment-based crowdfunding could be considered as part of the normal stages of a project development process. This demonstrates how project and investment risk can be transferred according to considerations of ownership, control and borrowing limits (see Section 5).

2. We co-created a new Community Municipal Bond structure for the public sector. It was designed specifically to allow local authorities to raise capital efficiently and cost effectively, whilst also increasing civic engagement by connecting local residents directly to the activities of the issuing authority (see Section 6).
   - This bond structure has the potential to command a lower cost of capital because project risk is managed by the local authority within its balance sheet and is not transferred to investors;
   - One of the principal benefits of this new model of finance, therefore, is that it allows greater transparency and hypothecation of investment capital inflows into the local authority, while holding the risk separately and having this risk managed via the local authority’s standard operating practice;

3. We also found that investment-based crowdfunding can provide an alternative to private capital for small-scale PPP projects in the NHS, especially as a competitive source of senior and ‘mezzanine’ debt with respect to price and investment terms (see Section 7).
   - Our research indicates that this is easier to manage on smaller scale projects, as experiences with the NHS case studies suggest that concerns over the risk of not raising the required volume of funding are critical as to whether or not an NHS body pursues crowdfunding;
   - We also found that it is vital to ensure that the additional benefits of utilising community investment are demonstrably seen to accrue to society and not to the private sector.

RECOMMENDATIONS

1.13 We have determined that investment-based crowdfunding is a viable and significant opportunity for public bodies seeking additional models of finance. Alongside the possibility to finance projects successfully at competitive rates, crowdfunding public infrastructure provides tangible ways in which to build new networks of trust with the local community.

1.14 In order to encourage more public sector bodies to consider using investment-based crowdfunding, we have six key recommendations. These are primarily addressed to the UK Government as the most efficient vehicle by which to mainstream the concept and secure further support for the public sector.

R.01 IMPLEMENT A COHERENT POLICY FRAMEWORK FOR PUBLIC SECTOR CROWDFUNDING

The UK Government should use this report’s findings as part of a wider evidence base for the development and implementation of a new national policy framework for public sector engagement with investment-based crowdfunding.

This should seek to ensure that the cycle of project management and procurement includes crowdfunding as part of the respected mix of financing options.

R.02 CHANGES TO STATUTORY LEGISLATION FOR COMMUNITY MUNICIPAL BONDS

In order to reduce the overall cost of capital for the public sector, the UK Government should open up the Community Municipal Bond product developed through our research for Innovative Finance ISA investors so that the product can become more accessible to community investors.
1 EXECUTIVE SUMMARY

R.03 DEVELOP AND DELIVER A STRATEGIC COMMUNICATIONS CAMPAIGN
The UK Government should work with all relevant stakeholders to develop clear and meaningful marketing and communications strategies, at both the national and local level, to signal investment-based crowdfunding as a normal and legitimate model of finance for the public sector.

R.04 CREATE AND SUSTAIN A CENTRAL REPOSITORY OF PUBLIC SECTOR CASE STUDIES
The University of Leeds invites DCMS to collaborate in the creation of a free, open access database to provide a central repository of case studies for public sector bodies to draw upon in order to assess the suitability of investment-based crowdfunding in their own local context.

This collaboration should also produce and deliver tool kits, guides, professional development training, and knowledge exchange events to ensure expertise is shared across the public sector, e.g. making the concept of Community Municipal Bonds better understood and more accessible.

R.05 INVEST IN WIDENING THE EVIDENCE BASE
The UK Government should provide additional funding for a second stage of the Financing for Society project. Open to tender, this should include 18-24 case studies from across the UK at either the feasibility stage or as a real world trial of the Community Municipal Bond product. This second stage should also assess the extent to which measurable social and/or environmental benefits are realised through public sector crowdfunding.

R.06 CREATE AN UNDERWRITING OR BRIDGING FUND FACILITY FOR PPP PROJECTS
The UK Government should draw upon existing precedents to create an underwriting or bridging fund facility for PPP projects. The model of PPP finance and the wider ecosystem that exists around this market has been developed to focus upon the needs of the institutional investment market, not the needs of investment-based crowdfunding as a new model of public sector finance, and therefore needs addressing.
“What started out as a relatively straightforward project to see whether crowdfunding could be used to finance energy efficiency projects, ended up delving deep into the legal and financial mechanisms to best deliver a crowdfunding offer via a municipal bond.”

RICHARD LOWE
Bristol City Council
2 INTRODUCTION

2.01 In what follows, we offer the first systematic study to assess the suitability of investment-based crowdfunding for the public sector.

2.02 Our research engaged six public sector case studies along with external partners to evaluate the economic, legal, political, and technical potential of crowdfunding as an additional form of finance for public sector infrastructure projects.

2.03 The UK has a long tradition of using private sector finance to fund public sector infrastructure projects such as: bridges and tunnels, hospitals, housing, prisons, rail, roads, and schools. The NHS has a long tradition of using private finance and, as it is unable to borrow money in the same way as other public bodies, this trend appears set to remain.

2.04 So, as the UK crowdfunding sector continues to grow and to mature, we wanted to use our research to:

• help overcome existing knowledge barriers;

• test whether or not crowdfunding could offer better value to the public sector; and to

• assess if the internal capacity required to develop crowdfunding for the public sector could be minimised so that it mirrored that for the PWLB, or via PPP project finance, as common sources of public sector funding.

2.05 To achieve this, it was vital that our research to assess the suitability of crowdfunding directly engaged and collaborated with public sector bodies in order to generate a robust evidence base of case studies for others to draw upon.

CONTEXT

2.06 A national programme of austerity measures has drastically altered the landscape of public finance. Local authorities face not only continued budget cuts but also a variety of administrative constraints in accessing finance to fund long-term projects.

2.07 The UK must adopt a more mission-oriented approach to innovation if it is to create the smart and sustainable infrastructure ready to meet 21st-century challenges, as outlined in the UK Government’s Industrial Strategy and Clean Growth Strategy.

2.08 The UK will otherwise likely struggle to compete with those countries that pursue more ambitious visions and long-term strategies for investing in their cities and regions.

2.09 Ultimately, failing to invest in public infrastructure over the longer-term can be more costly due to the rapid deterioration that can occur if it is not adequately maintained or replaced with more sustainable alternatives at the end of life.

2.10 Crowdfunding could offer a way of financing public infrastructure projects that offers better value not simply by providing competitive capital, but also by allowing citizens to become more directly involved in the improvement of local facilities and services.

2.11 At a time when trust in both ‘big finance’ and ‘big politics’ appears low, crowdfunding may have the potential to reignite civic engagement in a way that is independent of traditional party politics and not especially time consuming.

2.12 The appeal of finding new ways for the public sector to (re)connect with their residents and service users appears to be attractive in the context of increasing communication touchpoints, which in turn leads to greater understanding and building new networks of trust.

2.13 The option to use crowdfunding as way of engaging local citizens by responding to needs and concerns within the community, as well as increasing the retention of local capital for investing in regional solutions to those concerns, would appear to be attractive.

2.14 Recent reports show that people want ‘public services run as public services, but with all the dynamism and autonomy of being in the private sector, not least being able to borrow for vital investment’.

2.15 Might crowdfunding offer a potential middle ground in which citizens can engage with local democratic processes by investing in line with their social values?

2.16 And, might this reinvigorate levels of civic participation in local politics by facilitating a new dialogue between public sector bodies and those that live within the community?

1 https://www.gov.uk/government/topical-events/the-uks-industrial-strategy
3 Plimmer and Tetlow, 2017.
4 Rioja, 2013.
5 Hutton, 2018.
6 https://www.gov.uk/government/publications/civil-society-strategy-building-a-future-that-works-for-everyone
2 INTRODUCTION

2.17 The UK Government’s Civil Society Strategy recognises that social value flows from thriving communities with strong financial, physical and natural resources, and strong connections between people⁶.

2.18 In a reimagining of the Big Society agenda⁷, the Government’s vision now is that the public sector should focus more on the needs of ‘place’ and take a more collaborative approach with local communities to achieve better social, environmental and economic results. This would involve local stakeholders in an equal and meaningful way in how services are created and delivered⁸.

2.19 Indeed, through such instruments as the 2012 Public Services (Social Value) Act, the current policy landscape encourages the public sector to factor in to their decision making the wider social and environmental considerations of all procurement activity and public sector borrowing⁹.

2.20 Whilst examining the role of financing is not currently part of the government programme of activity relating to that 2012 Act, we suggest that knowing the social value of different types of money matters. Assuming the overall cost of capital to be equivalent, if there is a higher social value in one form of capital than another, we would prefer to see this option selected.

2.21 This means that all the resources of a community, including public funding, could be deployed to tackle a community’s key challenges. Might crowdfunding as a new model of finance have a role to play in helping to deliver on these wider civil society ambitions?

AMBITION AND SCOPE

2.22 Within this context, the Financing for Society research project tested investment-based crowdfunding via six case studies to evaluate whether or not it could provide flexible and competitive capital to the public sector for infrastructure projects.

2.23 At the same time, we assessed the extent to which this form of capital also enabled the wider generation of social value, understood in the context of our case studies as:

- Residents or service users accepting an equivalent or below market return if they perceive the investment as helping their community and/or if they are directly benefiting from the end service;
- Investing direct into an NHS or local authority service to create new points of contact for citizens with the state, increasing understanding and transparency and helping to build new networks of trust through greater civic engagement.

2.24 Our research had three priority objectives:

01 To overcome existing knowledge barriers by elaborating different crowdfunding business models, explaining how they are regulated, why people choose to invest and, so far as possible, what the public thinks about crowdfunding;

02 To assess the suitability of crowdfunding for public sector bodies, including technical questions of how to decide if crowdfunding does or does not work for certain types of public infrastructure projects;

03 To make evidence-based recommendations for growing crowdfunding as an option for public sector bodies in a way that delivers greater social and/or environmental benefits to investors, residents, a local community, and/or the public sector body itself. To achieve this, we considered:

- equivalent capital costs for local authority financing;
- increases in citizen participation and community cohesion, and how that might be measured;
- an increased level of ‘perceived’ ownership over local assets;
- increased engagement with alternative means of saving / investment; and
- the opportunities and limitations to place-based investing¹⁰.

METHOD

2.25 At the University of Leeds¹¹, Dr Mark Davis was the Principal Investigator and Dr Laura Cartwright the project’s Research Fellow. The project was co-created with our principal research partners: crowdfunding platform Abundance Investment¹² and Local Partnerships, a joint venture between the Local Government Association, HM Treasury and the Welsh Government¹³.

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⁷ Although beyond the scope of this study, we note the connection here to Social Investment Tax Relief (SITR) funds, which have also stimulated place-based investing from local investors. As an example, see the Resonance Bristol SITR Fund report: https://resonance.ltd.uk/wp-content/uploads/2017/06/Bristol-SITR-Fund-SIR-2017.pdf
⁹ For another approach to this challenge in the context of climate action, see the excellent work by Nick Robins, Andy Gouldson and their team: http://www.lse.ac.uk/GranthamInstitute/publication/investing-in-a-just-transition-in-the-uk/
¹⁰ https://essl.leeds.ac.uk/sociology-research-expertise
¹¹ https://www.abundanceinvestment.com
¹² http://localpartnerships.org.uk
2 INTRODUCTION

2.26 We wanted to work closely with public sector bodies in delivering the above assessment. To facilitate this work, the Financing for Society project tendered a total Pilot Fund of £300,000 that opened on 15th January 2018 and closed on 30th March 2018. Local authorities and public bodies were eligible to apply for up to a maximum value of £75,000.

2.27 This Pilot Funding was to be spent on a range of feasibility activities, including the development of original business cases (e.g. including financial, legal, and technical advice), knowledge transfer activities, and/or to help implement a crowdfunding event via a platform (e.g. an actual finance raise).

2.28 Applications to the Pilot Fund were assessed independently by the University of Leeds and Local Partnerships in three rounds held on 24th January, 15th February, and 1st March 2018. As a result, Pilot Funding was allocated to six public sector projects that became the comparative case studies for this report.

2.29 The criteria applied to the applications included a stated requirement that preference would be given to those projects that established a clear vision for the social impact of the work undertaken. As well as the feasibility of crowdfunding, we wanted to know how public bodies understood social benefits and how, if at all, they intended to measure this.

2.30 The comparative case study approach enabled us to understand better what worked for whom in which circumstances, so as to assess the generalisability of our findings across the wider diversity of public sector bodies.

2.31 On these criteria, we provided Pilot Funding to three UK local authorities (Bristol City Council, the Isle of Wight Council, and Leeds City Council) and three NHS bodies (both King’s College Hospital and Royal Devon and Exeter Trusts, and the Dudley Clinical Commissioning Group).

2.32 We conducted two phases of fieldwork, incorporating both desk-based research and extended semi-structured interviews with all relevant stakeholders and external partners. The principal project team also engaged directly and collaborated with each of the case studies throughout the process to provide support as their thinking developed during the research.

2.33 Further details on each of the six case studies, including what they learned with respect to the suitability of crowdfunding, is included as Appendix A to this report. The information provided there is drawn from project reports submitted by the Senior Responsible Officer appointed by each case study as a requirement of receiving the Pilot Funding.

2.34 They are included in an Appendix because they do not carry the voice of the report authors. The analysis and report findings that we present in Section 4 and which appears throughout the main body of our report draw upon data from all six case studies.

2.35 The Financing for Society project closed on 31st January 2019. All details are correct at the time of publication.
“If the outcome of this project is to identify a range of secure investments that are open to a lot more local people to invest small amounts of money, and give them a better return than they’re getting from their savings accounts, and that led to some social good, then I think that’s a great outcome for everybody.”

JIM FAWCETT
Isle of Wight Council
PART ONE:
WHY CONSIDER CROWDFUNDING FOR THE PUBLIC SECTOR?
3 WHAT IS CROWDFUNDING?

3.01 In its simplest expression, crowdfunding is ‘a way of financing projects, businesses and loans through small contributions from a large number of sources, rather than large amounts from a few’.15

3.02 In practice, individuals deposit money on an online platform, committing that money to a specific project, business or loan and have that relationship mediated by the platform. Depending on the business model, the individual investor may or may not receive a financial return.

3.03 Crowdfunding is still most frequently associated with ‘donation-based’ contributions to more socially-minded initiatives, such as fundraising by amateur musicians and film-makers, ethical ‘start-up’ ventures, or for countless charitable activities, with the expectation of zero financial return or sometimes a tangible, but non-financial, reward.16

3.04 Operating akin to an economy of gift exchange, typically the promoter is a friend, a relative, or socially connected in some way (either physically or virtually, e.g. through social media). For many, crowdfunding continues to be thought of as just another form of charitable giving.17

3.05 Contrary to this popular perception, however, ‘investment-based’ crowdfunding is now the largest UK alternative finance sector by volume. This model enables people to allocate capital on the basis of receiving a financial return.

3.06 This reflects a growing motivation amongst individuals to pursue a ‘blended return’ of both personal wealth creation and the generation of positive social and/or environmental outcomes, as compared to philanthropy and charitable giving.

3.07 Investment-based crowdfunding has evolved into a serious and powerful new sector, providing capital for private, public and cross-sector actors by successfully helping individuals, companies and projects bypass traditional finance institutions.

3.08 Crowdfunding has been successful in the UK because it harnesses the power of technology to remove layers of the traditional financial system. In so doing, it has created a better deal for investors and finance receiving companies.

3.09 The challenge for us was to test whether or not similar benefits could be realised in the emerging public sector crowdfunding market.

3.10 The UK state is primarily financed by private capital, with institutional investors such as pension funds or life companies purchasing Gilts (which flow through to PWLB loans, amongst other things) or in providing finance direct to PPP projects.

3.11 One important test that our research considered, therefore, was the extent to which the competitive benefits found in crowdfunding markets for business can be replicated in the public sector by directly engaging resident investors and taxpayers.

3.12 The emergence of crowdfunding in the SME business sector has also introduced greater competition into UK finance markets, helping to create more resilient and competitive finance markets for business.

3.13 One of the primary reasons that UK Government has supported the growth of crowdfunding over the past decade is as a reaction to the global crisis of 2007/8. Prior to the crash, it is estimated that 90% of the debt flowing into the UK economy came from banks.19

3.14 With such dependency on the banks, UK recovery was slower than those global economies with debt markets that were far less reliant on a single source of finance, such as the USA where only 40% of the debt prior to 2008 came from banks.20

3.15 Scaling loan-based SME crowdfunding has helped the UK to build a far more competitive and resilient debt market, and so the questions are:

- Can the same be done for public sector finance and, if so, by utilising which crowdfunding model?
- More broadly, can public sector crowdfunding challenge this dependency upon the banks by enabling people to invest locally to create better social and/or environmental outcomes for their communities?

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15 Baeck, et al., 2012.
16 Baeck and Bone, 2016.
17 Mauss, 1954.
19 See footnote 19 above.
20 See footnote 19 above.
3 WHAT IS CROWDFUNDING?

CROWDFUNDING BUSINESS MODELS

3.16 A highly diverse ecosystem of platforms now operates in the UK. Together, they provide capital to virtually every sector of the economy and life stage of a company or project.

3.17 Investment via platforms typically occurs in five sectors in the UK:
• Renewable Energy;
• Construction;
• Community and Social Enterprise;
• Technology; and
• Environment and Clean Tech.

3.18 The Community and Social Enterprise sector was the highest funded for both donation-based and reward-based crowdfunding in 2016, which points to the appeal of supporting socially beneficial projects through giving.

3.19 Platforms tend to develop a focus on a specific type of finance (e.g. donation, debt or equity), but then diversify via their focus on a specific sector of the economy, such as charity, real estate, or infrastructure funding.

3.20 Platforms also diversify via the type of debt or equity finance they provide, for instance corporate working capital, bridging finance or project finance.

3.21 This means that there is no single type of crowdfunding investor. Rather, the diversity of the crowdfunding sector reflects the broad set of motivations that individuals have for their money, ranging from the philanthropic to the self-interested, and from the constructive to the speculative.

3.22 Broadly speaking then, UK crowdfunding platforms can be categorised as follows:

3.23 DONATION/REWARDS-BASED CROWDFUNDING PLATFORMS
• These platforms facilitate the financing of individuals, charities or other smaller non-profit organisations;
• Donors participate principally because they believe in the cause;
• They do not receive a financial return on their money, but may receive alternative non-financial rewards.

EXAMPLE: Crowdfunder specialises in enabling individuals to back socially-useful projects or activities.

3.24 DEBT SECURITY OR LOANS-BASED CROWDFUNDING PLATFORMS
• These platforms facilitate the provision of debt finance to organisations and companies bypassing the need for traditional banks;
• Depending on the specific model of the platform, investors lend money via a loan or debt security (i.e. bond / debenture);
• Lenders receive interest on the money lent and, if all goes well, their capital is returned as either a single payment or over the life of the investment;
• Platforms that deal in loans or debt securities are regulated under two related but fundamentally separate regimes;
• Debt securities sit within the EU-derived Markets in Financial Instruments Directive (MiFID) regime, whereas loans are governed by UK specific legislation introduced in 2014;
• It is generally understood that debt security platforms face higher regulatory standards;
• The debt category of crowdfunding is the most populated and diverse, which reflects the wide variety of use cases for debt financing within the economy.

EXAMPLE: Abundance Investment is a debt security platform focused on providing short and long term debt to infrastructure companies and public sector organisations. Funding Circle is a loan-based platform focussed on providing working capital and growth capital to the UK SME sector.

23 www.crowdfunder.com
25 For more on the UK regulatory framework, see paragraph 3.38 of this report.
26 www.abundanceinvestment.com
27 www.fundingcircle.com
3 WHAT IS CROWDFUNDING?

3.25 EQUITY-BASED CROWDFUNDING PLATFORMS
• These platforms support equity-based capital raising by new or established businesses;
• Investors allocate capital to a given opportunity of their choice in exchange for transferable shares;
• Currently, the sector is focussed primarily on the early stage or start-up phase of company growth, so investors are typically hoping that the shares they purchase will increase in value.

EXAMPLE: Crowdcube is a leading equity crowdfunding platform for entrepreneurs of start-ups and growing businesses to connect with potential investors.

28 www.crowdcube.com
29 www.seedrs.com
30 www.ethex.org.uk
32 Zhang, et al., 2018.
33 Davis and Braunholtz-Speight, 2016.
34 See especially: Ahlers, et al., 2015; Cholakova and Clarysse, 2015; Davies, 2015.
35 Zhang, et al., 2018
36 Zhang, et al., 2018
37 See Section 8.
39 www.crowdfunder.com
40 www.spacehive.com

3.26 CO-OPERATIVES AND SOCIETIES FOR THE BENEFIT OF COMMUNITIES
• A smaller market exists for both cooperative (Co-ops) and community benefit society (Ben Comm) business models.
• Although there are differences between the two, in practice they are extremely similar. Technically, a Co-operative is run for the benefit of its members, whereas a Ben Comm is run for the benefit of the community;
• Co-ops and Ben Comms use withdrawable shares, commonly known as ‘community shares’. This model is distinct from traditional equity investing as the share offers are exempt from FCA rules;
• The model is underpinned by the idea of equality in terms of governance with one person getting one vote regardless of investment level, rather than a vote per share as with traditional equity models.

EXAMPLE: Ethex are the UK’s leading platform in this sector, having pioneered the concept of ‘positive investing’.

3.27 As the alternative finance sector as a whole matures, crowdfunding platforms are frequently raising multi-millions worth of investment for the UK economy. To give a sense of scale, the total value of the overall alternative finance market in the UK grew 35% to £6.2bn during 2017, up from £4.6bn in 2016 and from £3.2bn in 2015.

3.28 This growth and maturation of the sector is driven by sophisticated peer-to-peer (P2P) crowdfunding models, which facilitate loans to either retail borrowers (known as peer-to-consumer, or P2C) or to businesses (known as P2B).

3.29 As we saw above, there are also equity-based schemes that make an initial public offer (IPO) to potential investors to fund real estate and civic infrastructure projects.

3.30 In 2016/17, equity-based crowdfunding grew by 22% year-on-year to reach £333m, whilst real estate crowdfunding increased by more than 200% to grow to £211m.

3.31 In the same period, donation-based crowdfunding only grew by 2.5% and reward-based crowdfunding decreased by £44m for 2017.

3.32 This data suggests that the market trend is moving away from donations and into investment-based crowdfunding (i.e. loan and equity/debt).

3.33 Currently, this funding is not evenly distributed throughout the UK, however. There is a significant concentration of investment in London and the South-East. This raises important questions that we shall address later on about the feasibility of crowdfunding as a form of ‘place-based’ investing for those regions already struggling with social and economic inequalities.

3.34 It also raises interesting questions, beyond the scope of this report, about the role of regional building societies and/or community banks in provisioning regional bonds to support local investment.

3.35 In relation to public sector crowdfunding, the market is still very new. There are platforms and products operating in and around the space, however.

3.36 CIVIC CROWDFUNDING
• There is a growing sector of donation-based civic crowdfunding that is led by platforms such as Crowdfunder and Space Hive.
Assessing the suitability of crowdfunding for the public sector

FIGURE 1: TOP FIVE SECTORS BY CROWDFUNDING MODEL (2016)
FIGURE 2: LEVEL OF FUNDING RECEIVED BY UK REGION (2016)
3 WHAT IS CROWDFUNDING?

- Civic crowdfunding uses the donation-based crowdfunding model to bring together people to donate money to do good things within their community, such as bringing a community asset back into use. It can be a powerful tool for building community activism;
- Local authorities sometimes support the activities of these platforms by providing matched funding to projects initiated by the community;
- The critique sometimes levelled at the sector, however, is that it favours more affluent regions as it is these communities that can mobilise both donations and time.

3.37 LOCAL AUTHORITY INFRASTRUCTURE CROWDFUNDING

- As elaborated more fully below, the pathfinder case here is Swindon Borough Council (SBC) working with Abundance Investment to issue the first and currently only public sector crowdfunding investment;\(^{41}\)
- SBC raised just under £5m of 20-year project finance from their residents and the wider public for the development of two solar parks. The approach proved a powerful way of engaging residents with the Council’s low carbon ambitions;
- Although the approach worked on the Swindon projects due to specific local conditions at the time, the cost and complexity of the project finance approach when compared against PWLB borrowing terms and rates meant the model at that time was not easily scalable;
- This finding motivated our research to assess the suitability of crowdfunding in terms of equivalent capital and administrative costs for public sector financing.

REGULATION OF CROWDFUNDING IN THE UK

3.38 Investment-based crowdfunding is regulated by the FCA, while donation- and reward-based crowdfunding is unregulated as these models do not facilitate investments.

3.39 The UK Government has been supportive of the crowdfunding sector as a whole, seeing it as helping to build a more resilient and competitive financial market. As a result, it has pioneered the development of crowdfunding financial services rules and regulation since 2014.

3.40 Prior to 2014, loan-based crowdfunding was outside of regulation with credit agreements governed by the now closed Office for Fair Trading, while equity or debt security crowdfunding was regulated under existing financial services law.

3.41 In 2014, however, the Government introduced the first comprehensive set of rules to cover all aspects of investment-based crowdfunding. It introduced new specific investor protection rules for equity and debt security crowdfunding building on the existing body of rules.

3.42 With equity and debt security crowdfunding operating under a similar set of rules, the FCA grouped them together under the title ‘Investment-based Crowdfunding’. Separately, a new category of rules was introduced for ‘Loan-based Crowdfunding’, resulting in the sector becoming regulated for the first time.

3.43 The reason for the distinction is because debt security and equity investment rules are derived from EU law, while loan-based crowdfunding is not covered by EU law meaning that rules in this category have been developed at the national level.

3.44 As a result, a strong regulatory framework for the industry now provides a solid foundation for the growth of crowdfunding over the coming decades.

3.45 In 2018, the FCA published a review of the crowdfunding rules to assess the effectiveness of the new rules. In the review, the FCA proposed a number of potential changes specifically in the loan-based crowdfunding sector, which it will consult on over the course of 2019.\(^{42}\)

3.46 If implemented, these changes will bring the loan-based market more into line with investment-based crowdfunding rules, which are widely accepted to provide a higher regulatory standard.

IFISA ELIGIBILITY

3.47 In 2016, HM Treasury and HM Revenue and Customs (HMRC) introduced a new type of ISA, the Innovative Finance ISA (IFISA), which enabled debt-based crowdfunding investments (debt securities and loans) to become ISA eligible.

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\(^{41}\) For more on the Swindon example, see paragraph 3.52 of this report.

3 WHAT IS CROWDFUNDING?

3.48 For investors, this means that they can purchase their crowdfunding loans and debt securities from within an ‘ISA wrapper’ and receive their returns tax free.

3.49 For borrowers, this means that they can access the large pools of capital held within the UK’s 10.8m Adult ISAs. In 2017-18, that pool amounted to £69 billion subscribed to Adult ISAs. The ambition of UK Government is that this will ultimately make the debt market more competitive and reduce the cost of capital for borrowers, thus helping the UK economy overall.

3.50 While Crowdstacker provided the first ISA eligible loan, which was to a business, Abundance Investment launched the UK’s first ISA-eligible crowdfunding bond during their work in Swindon, a process that raised £4.24m to finance the construction of a solar farm owned by SBC.

CROWDFUNDING EXAMPLE: THE SWINDON CASE

3.51 In 2016, SBC offered the UK’s first council-owned ISA-eligible bond. The original proposal was for SBC to invest £3m in a solar scheme on council-owned land, at Chapel Farm, Blunsdon.

3.52 SBC’s £3m was joined by a community investment, in the form of a project finance Debenture (Bond) at a minimum investment level of £5. Public Power Solutions developed the scheme with Saliis Energy as the construction partner and Abundance Investment as the crowdfunding partner.

3.53 The council procured Abundance Investment via an Official Journal of the European Union (OJEU) compliant procurement framework. SBC trialled two slightly different models: one where Abundance Investment was procured on a stand-alone basis; and one where the contractor tendering for a Design Build Finance Maintain (DBFM) contract was directed to include crowdfunding in their bid.

3.54 Abundance Investment administered the offer, led the marketing, provided advice on compliance with FCA regulations, and now administers the investors as well as providing a secondary market for investors looking to sell.

3.55 The council also set in the procurement process their explicit objectives for using crowdfunding to raise the finance (which is an approach that has raised possibilities also for PPP procurement exercises within the NHS, as explored in three of our case studies). Abundance Investment achieves this low cost of capital for borrowers, thus helping the UK economy overall.

3.56 The council procured a Design Build Finance Maintain (DBFM) contract was directed to include crowdfunding in their bid.

3.57 SBC’s vision is to develop a low carbon economy by 2030 and this project is now helping them to achieve that. In spring 2016, investors that included many Swindon residents co-funded a 4.8MW solar farm, investing £1.783m alongside SBC’s £3m.

3.58 The solar farm is now generating clean energy electricity that continues to earn revenues from the Feed-in Tariff and Export Tariff operational at the start of the project, creating a long-term income for SBC, investors and defined community initiatives.

3.59 The scheme will contribute to SBC’s target of 200MW of renewable energy generation by 2020. It will also give residents of Swindon and beyond the opportunity to make any sized financial investment in a community project, at a predicted return of 6% over 20 years, while benefiting from the cleaner energy produced as part of Swindon’s low carbon economy.

3.60 The offer was available to all socio-economic groups in the region that could afford to invest £5 or more, since the crowdfunding platform Abundance Investment operates this as the point of entry for investors as part of a commitment to increase financial inclusion and long-term saving rates.

3.61 Abundance Investment achieves this low minimum investment level by operating entirely online, which means that people investing via the platform nevertheless must be able to access a computer to open and to manage their account over the term of the investment, although the company does provide a customer service phone line for anyone less confident operating online.

3.62 Work with marketing experts ensured that the SBC offer was in as plain English as possible in order to mitigate any language impact and to comply with financial services regulation requirements that offers be “fair, clear and not misleading”.

3.63 To optimise take-up rates, SBC sent out the crowdfunding investment offer with copies of the annual council tax statements that reached every resident.
WHAT IS CROWDFUNDING?

3.64 The benefits are clear to residents of Swindon and beyond. They get a rate of interest preferential to a bank, invest in a scheme that has 65% of its profits going back into community benefit, and they join and participate in a community scheme.

3.65 The solar farm gained investment from all the main demographic groups in the Swindon area, with the youngest investor being 22 and the oldest over 80.

3.66 Although more affluent sectors were key contributors to the project, there was over £70k of investment from ‘young urban’ and £60k from ‘older suburban’ categories of residents, both of whom do not traditionally invest in renewable energy projects via the Abundance Investment platform.

3.67 Across both funding rounds, in the end 1,220 people invested a total of £4.24m. 15% of the investors came from postcodes within the borough, with a higher percentage of people investing who had an association with the borough via work, family or place of birth.

3.68 Notably, 18% of investors allocated £100 or less to the project, with 2% of investors investing the minimum of £5, further demonstrating the model’s accessibility.

3.69 The project suggests that it was SBC’s involvement that broadened access to the investment offer and provided a further level of credibility and security to the venture. The ability and willingness of the council to work with the community to build trust was seen to be crucial to enhancing the chances of success with a crowdfunding raise.

WHO INVESTS IN CROWDFUNDING AND WHY?

3.70 The size of the UK crowdfunding market demonstrates that many people trust crowdfunding and are motivated to invest this way. But who are the ‘typical’ investors in these markets and why do they choose to use crowdfunding?

3.71 One explanation is a perceived loss of trust in mainstream financial markets. A 2018 poll conducted by YouGov on behalf of the think-tank Positive Money found that a decade on from the start of the global financial crisis, two-thirds of people still do not trust banks to work in the best interests of society.

3.72 Crowdfunding is often deliberately marketed as ‘alternative, disruptive, or democratising’ so as to compare more favourably to traditional finance. This is typically expressed through appeals to relationality and the promise of heightened levels of transparency and agency as the basis for trusting these markets.

3.73 And yet, in spite of key marketing signals suggesting this is their core business, few crowdfunding platforms have the capacity actively to measure the social impact of their activities.

3.74 Whilst each platform has an accurate grasp of its own investment performance, to date there is limited data on the long-term impact of crowdfunding investments because the sector is relatively new.

3.75 There is only partial visibility of the types of social outcomes crowdfunding investments are generating, who is benefitting, and whether the projects funded remain viable enterprises in the medium- or longer-term.

3.76 Data on the expectations and practices of crowdfunding investors is also limited. As it typically relies upon data from sector entrepreneurs and crowdfunding companies, existing academic studies have tended to emphasise those factors that help to make a crowdfunding project financially, rather than socially, successful.

3.77 That being said, whilst motivating factors do include the appeal of the interest rate on capital invested, and any equity stakes or financial reward as part of the offer, studies have also found that important motivations for investors include:

• a commitment to communities of interest;
• the exciting challenge of an innovative venture;
• the opportunity to advance social status amongst peers; as well as
• a desire to make money.

3.78 Crowdfunding enables active choices that reflect primarily moral incentives, with ‘social projects’ more likely to succeed than others, especially in donation- and reward-based crowdfunding markets.
3 WHAT IS CROWDFUNDING?

3.79 In equity-based crowdfunding, ‘being excited about a specific company or project’ has been ranked as more important than high financial returns for investors and signals the importance of generating excitement for a given project through a coordinated marketing and promotions strategy as part of any crowdfunding campaign56.

3.80 In the context of public sector crowdfunding, getting investors ‘excited’ about helping their local authority to deliver a better community service and/or helping an NHS body to provide better care locally, suggests that people might be prepared to take an equivalent or marginally lower financial return from their investment.

3.81 In other words, crowdfunding can create higher social value for the capital input and thus complement wider forms of social value creation57.

3.82 Data also suggests that engaging with relevant community stakeholders at the earliest stage of the process is vital to secure community ‘buy-in’ (both in terms of support from local ‘champions’ and to encourage early-stage investors), as well as to ensure key messages are clearly communicated to diverse groups of residents.

3.83 This means that understanding the public perception of crowdfunding, covered in the next section of this report, is crucial if it is to become a viable form of finance for local authorities.

3.84 Residents with no prior experience of crowdfunding, and who are not part of social networks where this is practiced as a legitimate form of financial behaviour, will require additional support if they are to participate.

3.85 In shifting perceptions away from the idea that crowdfunding simply enables donations to worthy projects, it is important to emphasise both the real financial return to individuals with investment-based crowdfunding as well as the wider community-benefit of the given project as part of a blended return.

3.86 Resident investors will require additional help and reassurance from both the public body and the sponsoring crowdfunding platform to understand better the risks that are being assumed with investment-based crowdfunding. This is to ensure that the public’s lack of familiarity with the process is not exploited and could, for example, include advice on how to access their investment and the financial returns it generates in a given timeframe.

3.87 Without this, crowdfunding investments run the risk of appearing unduly to capitalise on the naivety of the public and may be experienced as not so very different in practice to donation-based giving, as money appears simply to be ‘handed over’ to a platform without any tangible or immediately realisable economic or social benefit to the resident investor.

3.88 If crowdfunding can provide a more transparent way of aligning investment choices and social values, then those projects that are funded – and consequently the type of society slowly being created by those investments – is likely to be one that reflects the specific values of a narrow demographic of already moneyed individuals, unless more community investors can be motivated to participate.

3.89 How to encourage and to enable residents to invest any available resources locally for the good of their community, rather than allowing this resource to flow out of their local economy through traditional financial products, is one of the principal opportunities represented by the emerging collaboration between the public sector and crowdfunding platforms58.

3.90 Evidently, there will be power relations at play and not everyone in a community will be willing or able to participate in a new form of civic engagement. But local authorities and crowdfunding platforms will need to consider how to engage diverse groups of residents and stakeholders in order to avoid exaggerating existing inequalities by listening only to the ‘usual suspects’ of relatively wealthy, educated and motivated local groups59.

3.91 After all, who is participating in a local crowdfunding event is likely to be just as important as why they are doing so. Ensuring that the whole community is able to participate is important in establishing the credibility of crowdfunding as a new mechanism for raising finance from and for that same community.

57. Working with Cambridge Centre for Alternative Finance (CCAF), Mark Davis was commissioned by the FCA to interview 52 crowdfunding investors, some of whom reported being motivated to invest precisely by this offer of a ‘blended return’. This evidence informed the FCA’s “post-implementation review” of investment-based crowdfunding platforms, accessed at: https://www.fca.org.uk/publication/consultation/cp18-20.pdf.
58. See the Appendix to this report for case study evidence of this emerging collaboration.
59. Davis and Wright, 2017.
3 WHAT IS CROWDFUNDING?

3.92 Low levels of entry for investors, such as the £5 minimum offered by Abundance Investment, goes a long way towards including residents from economically disadvantaged areas, but still assumes these groups have something available to invest.

3.93 Inevitably, not everyone in a community will be able to invest, so it is essential that any investment from local residents is for projects that can demonstrate wider benefits for everyone in the community.

3.94 Even if they are able to participate at that level, residents are unlikely to feel as if they have an equal say in deciding which projects are developed for crowdfunding. This raises important questions about governance, ownership and control of community assets, and local authority decision-making that were beyond the scope of this report, but which we signal as important for future research.

PUBLIC PERCEPTIONS OF LOCAL AUTHORITY CROWDFUNDING

3.95 With the market for public sector crowdfunding still nascent, there is limited data regarding public perceptions of crowdfunding as a form of investment making.

3.96 Facilitated by the Financing for Society project, Social Finance conducted research for the Isle of Wight Council to test people’s perception of crowdfunding and the idea of investing into local authority developments.

3.97 The results presented in their report show that a significant proportion of people simply did not associate the term ‘crowdfunding’ with investment making. Indeed, Social Finance concluded that positioning their research under the title ‘crowdfunding’ had potentially skewed their results60.

3.98 On this point, it is interesting to note that when Abundance Investment worked with SBC they did not use the term ‘crowdfunding’ in any communication material for the bond raise.

3.99 Whilst crowdfunding relates to the regulatory definition of the activity, the FCA leaves it to individual platforms to decide how best to communicate a given product and its benefits to the public, providing this is done within the constraints of ensuring all communications are ‘fair, clear and not misleading’.

3.100 As noted earlier, mainstream attitudes to crowdfunding are still tempered by its perceived novelty as an idea. Crowdfunding in its ideal form, however, challenges our habitual uses of money and encourages us all to think in radically different ways about how we understand and use money within society61.

3.101 That being said, there is a long-held tradition of retail investors purchasing UK Government Gilts. In 2017-18, £46bn of UK Gilts were owned by individual investors, while National Savings and Investments (NS&I) savings and premium bonds continue to be so successful that limits are now in place to restrict how much an individual can purchase62.

3.102 Public sector crowdfunding could be seen as a novel extension of this existing process, but there is also the potential for this to be done in a more transparent and meaningful way for investors as crowdfunding allows them to see exactly where their money is and what change it is making happen.

3.103 The growth of local and hypothecated savings offers from Building Societies and other mutuals provide another useful proxy for understanding consumer attitudes to crowdfunding. The success of brands like Ecology Building Society within their target audience of ethically-minded consumers shows that investors are open to holding their money in products with a social purpose or local connection63.

3.104 Crowdfunding structures allow that social purpose and local connection to be more tightly defined through the use of a specific bond or loan (rather than intermediated savings or bonds), with the appetite for such investments already well established.

3.105 For example, a 2016 customer survey by Abundance Investment found that 89% of the investors on their platform would be interested in investing in low carbon projects being developed by local authorities. This survey was conducted after the SBC projects were financed and so demonstrates a high level of support on the platform for local authority projects.

60 Social Finance, 2018.
63 https://www.ecology.co.uk
3 WHAT IS CROWDFUNDING?

3.106 This data does not capture the broader public sentiment, however, as it only refers to investors on a single platform and with direct experience of public sector investing. It does demonstrate the strength of ‘learning by doing’ and that the uplift in both knowledge and interest can be immediate following a first experience of investment-based crowdfunding.

3.107 The Social Finance report mentioned above sought also to examine people’s preference for different local authority investment ‘risk/return’ profiles. Preference was tested by asking respondents to signal how much they would be prepared to invest against each option. Separately, respondents were asked for the average amount that they saved each year.

3.108 The findings in Table 1 (see right) indicate that, assuming there is a return on offer, investors will consider putting a significant proportion of their annual savings into local authority-backed investments.

3.109 The Social Finance report also reinforces anecdotal evidence from Abundance Investment by indicating that some resident investors do not trust their local authority to deliver projects effectively, as well as suggestions that council tax revenue should be used to provide central funding in public services rather than investment capital for funding local projects.

3.110 More research is required to unpick these points, but these concerns suggest that:

- there is a general misunderstanding of how public sector bodies, including local authorities, actually operate.

3.111 This latter point is supported by Local Government Association (LGA) research indicating that there is a significant lack of public awareness regarding what local authorities do.

3.112 Councils regularly borrow money (e.g. PWLB) to invest in the development of their community, as well as to invest in money saving and revenue generating assets. It is likely that residents do not have the time or inclination to understand the intricacies of this process, but it is also incorrect to assume that local infrastructure projects are somehow funded only through council tax collection.

3.113 In addition, varying levels of trust in local authorities are a factor in the level of faith amongst residents that local authorities will operate in the community’s best interest. The LGA research is again useful here, noting that “people who feel well informed about what their council does are much more likely to think it provides high quality services and that it offers residents good value for money”.

3.114 Put another way, we can state that people who are better informed about local authorities tend to have higher levels of trust in their activities and the people making decisions. The LGA research concludes by pointing out that “it is notable that councils which communicate most effectively with residents tend to be the most successful”.

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**TABLE 1: INVESTOR APPETITE FOR LOCAL AUTHORITY BACKED INVESTMENTS**

<table>
<thead>
<tr>
<th>RISK PROFILE</th>
<th>AMOUNT WILLING TO INVEST</th>
<th>AS A PERCENTAGE OF DECLARED ANNUAL SAVINGS</th>
</tr>
</thead>
<tbody>
<tr>
<td>No risk of losing money, no return</td>
<td>£190</td>
<td>7%</td>
</tr>
<tr>
<td>No risk of losing money, very low return (e.g. 2% p.a.)</td>
<td>£637</td>
<td>26%</td>
</tr>
<tr>
<td>Low risk of losing money, low return (e.g. 6-8% p.a.)</td>
<td>£971</td>
<td>38%</td>
</tr>
<tr>
<td>Moderate risk of losing money, moderate return (e.g. 8-12% p.a.)</td>
<td>£898</td>
<td>35%</td>
</tr>
<tr>
<td>High risk of losing money, high return (e.g. 15-20% p.a.)</td>
<td>£459</td>
<td>18%</td>
</tr>
</tbody>
</table>

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3 WHAT IS CROWDFUNDING?

3.115 Does the act of investing via local authority crowdfunding projects provide a new way for residents to see the workings of a council and so help to create new forms of active citizenship? Evidence from our six case studies indicates that:

- investment-based crowdfunding has the potential to deliver a new platform through which local authorities can communicate with their residents and (re)build trust; and
- there is appetite for resident investors to back local authority led projects.

3.116 We wanted to know if crowdfunding can become a tool for building greater trust between residents and authorities and provide the basis for stronger working relationships that better enable public sector bodies to meet local challenges efficiently and effectively.

3.117 In Part One of this report, we have helped to build knowledge of different crowdfunding business models; explained how they are regulated; demonstrated why people invest; and, so far as available evidence allows, established what the public thinks about crowdfunding.

3.118 In Part Two, we present an overview of the findings from our six case studies, before presenting three key outputs from the research that we have produced in order to assist public sector organisations in assessing the suitability of crowdfunding.

66 See paragraph 3.52 and the Appendix to this report.
“So I think what we felt through wanting to explore crowdfunding was, although it’s not going to be the way we’re going to fund everything, it’s an extra tool and in some circumstances it may be appropriate for us to deploy it. Particularly when there might be a community element to what we’re trying to achieve, or we want to ensure there is great buy-in to the scheme that we’re funding for.”

TOM KNOWLAND
Leeds City Council
PART TWO: ASSESSING THE SUITABILITY OF CROWDFUNDING FOR THE PUBLIC SECTOR
4 CASE STUDY FINDINGS

4.01 Our research with six case studies allowed us to assess the suitability of crowdfunding in a variety of different contexts and project types across both UK local authority and NHS sectors.

4.02 This variety ensured that the research covered different public sector organisations with varied borrowing powers and constraints, in turn creating opportunities for the research team to co-develop and to test different concepts for using crowdfunding to finance public sector infrastructure.

4.03 All six case studies were at the outline business case stage of the project development cycle, which provided scope to assess a wide range of approaches for delivering each individual project. It also allowed us to reflect upon the need for crowdfunding to be equivalent to existing, more familiar forms of borrowing in terms of capital and administrative costs.

4.04 This means that our analysis is primarily focused upon the technical and cost competitiveness of capital considerations (i.e. both price and terms) of pursuing crowdfunding as a new model of finance for the public sector.

4.05 Each case study worked with the research team, as well as with external organisations (Archus Ltd., BDO, Grant Thornton, Keystone Law, KPMG, Michelmores, Social Finance, and Walker Morris) commissioned through the awarded Pilot Funding, to explore a variety of models for introducing crowdfunding as a new model of finance for their chosen project.

4.06 In both the NHS and local authority case studies, there was evidence that crowdfunding can play a useful role as a new model of flexible and competitive finance, which also has the potential to deliver material social, environmental and economic benefits to a local community.

LOCAL AUTHORITY CASE STUDIES

SECTOR BACKGROUND

4.07 Local authorities are funded through revenue from business rates, council tax, and investment income, as well as borrowing and a central Government grant.

4.08 As has been widely reported, the grant from central Government has been reduced significantly since 2010. By 2020, UK councils will have lost 60p out of every £1 that the Government had formerly provided for public services.

4.09 As a result, local authorities are increasingly focused on the efficiency of their service provision, as well as on the redesign and rationalisation of service provision.

4.10 Local authorities are able to borrow money to finance capital investments in new public infrastructure that demonstrably improves the economic and social life of their community. They are also able to borrow money to buy and/or to develop revenue generating assets.

4.11 Local authority borrowing is strictly controlled by the Prudential Code established by the Chartered Institute of Public Finance & Accountancy (CIPFA). These guidelines are used by councils to set internal borrowing limits and to drive decision making.

4.12 In 2015, PWLB provided 75% of local authority borrowing. The total size of the PWLB loan book at the end of the 2017 financial year was £71bn, with 780 loans during that year totalling £5,162m. This equates to an average loan size of £6.6m.

4.13 This average loan figure is significant because it is in line with amounts that are regularly raised successfully on crowdfunding platforms for single issuers. Moreover, the majority of environmental or social infrastructure projects envisaged by local authorities are likewise comparatively small in scale (<£20m).

4.14 It is important to be clear that investment-based crowdfunding is not treated as a distinct form of local authority finance. Decisions to use investment-based crowdfunding would still have to meet the Prudential Code and any borrowing from residents as investors would have to be demonstrated to be affordable, prudent and sustainable.

4.15 The potential of investment-based crowdfunding is to provide an equivalent or lower cost of capital at the same time as being capable of delivering greater material social and/or environmental benefits than traditional finance. Looked at another way, crowdfunding can create higher social value for the capital input and complement other forms of social value creation.
4 CASE STUDY FINDINGS

SUMMARY OF CASE STUDIES

4.16 Both the Bristol City Council and Leeds City Council case studies focused on low carbon infrastructure.

4.17 In Bristol, the project sought finance for the installation of energy efficiency measures in council owned commercial property, with these measures being paid for by tenants on a “pay-as-you-save” basis.

4.18 In Leeds, the project sought finance for the installation of solar PV panels on the council’s estate, with the power being consumed onsite by the council buildings.

4.19 The Isle of Wight Council case study was distinct as it is focused on the built environment, specifically new build developments and redevelopments of existing sites that play a role in the ‘Isle of Opportunities’ regeneration programme established by the council\(^2\).

4.20 The Isle of Wight Council is considering a range of finance models for delivering this sustainable investment programme with the intention being that some projects are developed by the council while others are taken forward by the private sector or through existing partnership models.

4.21 This spread of live local authority projects provided a useful ‘living lab’ for the research team to assess the suitability of crowdfunding across a range of public sector infrastructure development models\(^3\).

KEY FINDINGS

4.22 As we saw earlier, a starting point for each local authority case study was the Swindon example of delivering community investment, but there was an awareness that the model of public sector crowdfunding developed in that particular context may not be easily replicable\(^4\).

4.23 The feedback from both Bristol’s and Leeds’s legal and treasury teams was that borrowing external money at project company level went against standard treasury management practice of borrowing at the corporate level for downward distribution to projects, or project companies if relevant.

4.24 It was also made clear by both local authorities that community investment into either the council or into council owned projects, regardless of any anticipated social benefits, would still have to compete favourably with PWLB in terms of cost of capital and its ease of use.

4.25 As detailed in the Isle of Wight Council case study, crowdfunding could be regressive if the investment is offered at a higher interest rate than the council’s existing cost of capital.

4.26 Two distinct approaches to project delivery were explored, therefore, which in simple terms can be described as ‘off balance sheet’ and ‘on balance sheet’ development.

4.27 Local authorities may choose to deliver a project off balance sheet if they want to transfer risk, manage the use of their borrowing budget, or feel that the private or community sector is better placed to deliver and operate a specific project.

OFF BALANCE SHEET PROJECT DELIVERY

4.28 Delivering low carbon infrastructure via off balance sheet community owned or not-for-profit vehicles was examined as an alternative route to council ownership.

4.29 Consideration was given to the local authority using its procurement function to procure a specific business model type and structure that utilised crowdfunding in the project financing.

4.30 In the context of energy services for the local authority, however, this approach was discarded as financial modelling indicated that this route would increase the costs of the energy service when compared to local authority ownership and mean the council lost direct control of the project.

4.31 There was also concern that if the project provided energy services primarily to the procuring local authority, there was a significant risk that the project would be considered on balance sheet from an accounting perspective. This would mean that any potential benefit from not having the project borrowing costs on the council balance sheet would be lost.

\(^2\)See paragraph 3.52 of this report.

\(^3\)https://iwightinvest.com

\(^4\)For an example of a living lab approach, see http://sustainability.leeds.ac.uk/the-living-lab/
4 CASE STUDY FINDINGS

4.32 After all, local authorities are still dealing with the consequences of those changes to accounting rules that brought many millions of pounds of old Private Finance Initiative (PFI) contracts back on to state balance sheets.

4.33 Social Finance’s work with the Isle of Wight Council project gave further consideration to finance models where ownership, and therefore risk, was transferred away from the council to either private companies, community groups, or not-for-profit companies to operate and finance the projects.

4.34 Where there is sufficient risk transfer from the state to a non-state owner of the project, the council could opt to have projects delivered by a third party. In that context, the council could use the procurement or planning system to incentivise those bidding to be project owners to use crowdfunding.

4.35 Another model was explored through the research whereby the council might deliver the project, but both investment and risk would be transferred to community investors. This was explored in relation to individual projects, or aspects of a development, that carried higher risk but that also had the potential to deliver social and/or environmental benefits.

4.36 Our research collaborated closely with the case studies to explore this new concept for public sector crowdfunding, which would see resident investors brought together both to finance and to carry the risk for the delivery of high value, non-core services.

4.37 Whilst it was felt that this model might be appropriate in certain contexts, however, the concept clearly entailed significant moral hazard for a council should they be faced with having to take a decision to intervene in order to stop residents losing money if the project or service started to fail.

4.38 Additionally, whilst investors assuming risk is nothing new, with resident-led investment driving the development of public sector infrastructure, vital questions were raised over governance, ownership and control of community assets, equality and the possible erosion of democratic control over council developments.

4.39 We also explored scenarios where non-economic aspects of projects, which may carry high social benefits, could instead be funded via donation-based crowdfunding rather than an investment model.

4.40 Beyond acknowledging that such models fit with the current public perception of crowdfunding as a form of giving akin to philanthropy, given our focus upon investment-based crowdfunding, a fuller examination of these scenarios fell beyond the scope of this project.

COUNCIL OWNED PROJECTS

4.41 After exploring the Swindon example as well as off-balance sheet models in greater detail, the Bristol and Leeds case studies settled on creating a model for community investment that fitted within a local authority’s normal treasury management and borrowing frameworks, but which also provided a competitive source of capital for local authorities.

4.42 The product design process was supported by the fact that Leeds City Council had historically issued investment bonds to resident investors. Members of the current treasury management team had worked at the council during this time. Leeds’s original bond programme was closed in 1990 due to the high costs of administering the bond pre-internet via a paper-based process.

4.43 This experience and the ‘institutional memory’ within the council helped to focus the research on the potential for creating an internet-enabled crowdfunding structure, or Community Municipal Bond as the concept became known during our research.

4.44 We worked with both Bristol City Council and Leeds City Council to develop this concept in detail as a means of addressing the challenges they found in replicating the SBC model.

4.45 These included:

- the high cost of the project finance model used in the Swindon approach;
- broader challenges posed by off balance sheet approaches to developments; and
- approaches that transferred only high risk development to community investors.

4 CASE STUDY FINDINGS

4.46 Both local authorities have since signalled that they consider the Community Municipal Bond structure co-developed through the Financing for Society research project as holding significant potential to deliver both economic value for the council, as well as wider social and environmental benefits for their local communities.

WHAT SORT OF PROJECTS WOULD BE APPLICABLE FOR FUNDING?

4.47 Our research suggests that any project that is to be funded by a local authority in principle could be considered for financing through a Community Municipal Bond.

4.48 This is because the model developed through our research is inherently flexible, so that a Community Municipal Bond could be run alongside a traditional borrowing process. In this instance, standard PWLB borrowing could be used only for taking up any shortfall in the bond raise.

4.49 As the experience from Swindon and the Isle of Wight Council case study indicates, however, linking community investment to projects considered to have high social and/or environmental benefits, as well as being tangible and easy to understand, will help to make any bond raise more attractive to local resident investors.

CURRENT STATUS

4.50 Building upon the findings from our three UK local authority case studies, as an outcome of the research project Abundance Investment is now drafting legal documentation and finalising the issuance process in anticipation of a pilot phase for the Community Municipal Bond concept.

4.51 At the time of writing, Leeds City Council are planning to run a pilot to explore the viability of the Community Municipal Bond concept in 2019.

NHS CASE STUDIES

SECTOR BACKGROUND

4.52 The NHS is funded mainly from general taxation and National Insurance contributions. The level of NHS funding in any given year is set by central Government through the Spending Review process. This process estimates how much income the NHS will receive from the above sources, as well as via service user charges.

4.53 If National Insurance or service user charges raise less funding for the NHS than originally estimated, funds from general taxation are used to ensure the NHS receives the level of funding it was originally allocated.

4.54 NHS bodies are able to borrow money for capital investment, but borrowing is severely constrained. These constraints do not relate to the availability or cost of finance, since the NHS is viewed as a very strong covenant that could access financing at competitive rates from a wide range of sources.

4.55 Rather, the constraints relate to limitations imposed on the ability of NHS organisations to borrow that are linked to the international definition of national debt. There is a clear objective in Government policy to control levels of public sector borrowing and ipso facto total national debt.

4.56 Our research with three NHS bodies found that the relevant guidance on borrowing currently drives NHS project development toward the use of ‘project finance’ via PPP structures.

4.57 PPP structures mean that a project tends to be delivered on a DBFM basis by a non-public sector partner, which then makes a facility available to the NHS client. This PPP approach is increasingly seen as politically controversial, but currently remains the dominant approach to NHS project delivery.

4.58 Our research found that the political risk associated with any new model of finance for the NHS can potentially be mitigated by ensuring that the investment returns accrue clearly and demonstrably to the UK taxpayers who ultimately pay for the service.

4.59 Questions were also raised as to whether investors who are also beneficiaries of the service would take a more holistic view of their investment and accept a more blended return, thereby providing capital at better value than the global institutional investors who currently fund these NHS projects and are focused solely on a targeted financial return.

76 For further details of the Community Municipal Bond structure and its potential social benefits, see Section 6 of this report.
4 CASE STUDY FINDINGS

SUMMARY OF CASE STUDIES

4.60 Our three NHS case studies considered replacing the traditional private finance used in PPP models with community investment.

4.61 This process is distinct to the local authority model outlined above and, as a consequence, a different set of considerations were factored in to the research.

4.62 The NHS projects seeking finance represented a range of project scales and complexities. The largest project was put forward by King’s College Hospital NHS Foundation Trust (King’s College Trust), specifically the development of a new Institute of Haematology requiring an estimated £200m of capital. The external organisation engaged for this aspect of the research was KPMG77.

4.63 The other two case studies considered relatively smaller projects. Royal Devon and Exeter NHS Foundation Trust (Royal Devon and Exeter Trust) was seeking finance for an elderly care residential development, which required around £20m of investment. The external organisation engaged for this aspect of the research was BDO78.

4.64 NHS Dudley Clinical Commissioning Group (Dudley CCG), through the relationship with Community Health Partnerships which is wholly owned by the Department of Health and Social Care (DHSC) and the NHS Local Improvement Finance Trust (LIFT) framework, considered the use of crowdfunding in the delivery of their Kingswinford community care centre. The external organisation engaged for this aspect of the research was Archus Ltd79.

4.65 As with our local authority case studies, the NHS projects were all at the outline business case stage. This meant that the use of crowdfunding was being considered against a variety of approaches to developing the projects, including whether all or only part of the financing was to be provided through crowdfunding given the scale of investment being sought.

4.66 Our findings from these three case studies established that in some ways replacing private capital with community investment is relatively simple, as the issue very quickly focused upon the cost competitiveness of the crowdfunded capital and the nature of investment terms. Our research also found some very significant challenges, however, which raised both technical and social concerns.

KEY FINDINGS

4.67 Our evidence suggests that crowdfunding may potentially offer a competitive source of funding with respect to price and investment terms. As with the local authority context, by enabling retail investors to allocate capital directly to a project, some of the layers of the traditional financial system are removed creating efficiencies in the process.

4.68 The decision to create a PPP involves the transfer and/or sharing of project risk with investors. This is a familiar approach for existing crowdfunding investors and the communication of risk (and checking on the understanding of those risks) is already an important part of the role of an authorised crowdfunding platform. This would still hold for the process of issuing a bond within a PPP.

4.69 A significant point regarding the value of crowdfunding was stressed in the research. As the current model of PPP tends to rely on institutional global capital, the needs of the service provider and the needs of the capital often come into conflict.

4.70 Capital looks to prioritise the protection of targeted investment returns, whereas service providers will focus upon optimising service delivery. Crowdfunding would appear to have the potential to align these interests far better by enabling service beneficiaries also to become investors.

4.71 In this case, when difficult decisions are required, crowdfunding investors motivated by more blended returns may consider their return far more holistically than an institutional investor who is more likely to be solely focused upon protecting their target financial return number.

4.72 Wider evidence shows that crowdfunding investors, because they invest their own money with a broader set of social values than institutional finance, tend to pursue ‘good causes’ and be more supportive of companies in challenging times80.

4.73 We also identified further challenges to the use of crowdfunding, however, including the need for PPP projects to align a number of different investors, institutions and stakeholders around a financial close date. Indeed, there may be a need to align investors before this (e.g. when the PPP provider submits a bid, since financing often needs to be committed in advance)81.

77 https://www.kpmg/uk/en/home.html
78 https://www.bdo.co.uk/en-gb/home
79 http://www.archus.uk.com
80 Baeck and Bone, 2016.
81 The financial close is the date when all funding needs to be contractually committed though not yet drawn.
4.74 As crowdfunding platforms do not have their own capital to deploy, but are required to raise capital against a specific project, it is challenging for them to be incorporated in this standard process.

4.75 Our research indicates that this might be easier to manage on smaller scale projects, as the risk of not raising the required funding decreases. On very large and ambitious projects, such as the one represented by the King’s College Trust’s Institute of Haematology, the risk of a crowdfunding platform not raising sufficient capital to fill its allocation increases the risk for the entire project.

4.76 The current system of PPP project finance within the NHS has been designed around the needs of traditional capital, rather than the requirements of crowdfunding.

4.77 As KPMG point out in their report on the King’s College Trust case study, there is a role for Government in levelling the playing field to enable crowdfunding to compete effectively. This could be achieved through the provision of underwriting and/or bridging finance, for example, which we cite as a formal recommendation (R.06) in Section 9 of this report.

4.78 A second challenge raised by all three NHS case studies is that of determining precisely who benefits from the introduction of crowdfunding. For the NHS cases, the project equity was intended to be either entirely or partially owned by for-profit companies, which may undermine the appeal to community investors motivated by the public good.

4.79 In this scenario, crowdfunding may help only to reduce the overall cost of the project to the NHS and thus help to secure greater profits to the private owner.

4.80 In our assessment, if crowdfunding enables community investors to provide a lower cost capital for such projects, then ensuring that the additional benefit of their investment accrues entirely and demonstrably to society and not to the private sector is critical.

4.81 To be able to manage this, all stakeholders in a project must be aligned on the reasons for involving community investors so that the benefit of their participation can be demonstrated to accrue to the intended community stakeholders.

4.82 As authors, we stress this point in the strongest terms and identify this as a clear risk to the use of crowdfunding in the public sector’s delivery of PPP projects.

4.83 This risk could be mitigated, however, by effective design of the procurement process of crowdfunding within a project, as the Swindon example above demonstrates.

4.84 As a further response to this challenge, we pose the question as to whether the ownership structures of PPP projects need to evolve, and/or whether civic minded community investors could help to drive the emergence of a new and ‘not-for-profit’ PPP sector (e.g. non-profit distributing schemes in Scotland)\(^2\).

4.85 KPMG’s report on the King’s College Trust for the Financing for Society project makes a clear recommendation that crowdfunding is not currently deemed suitable for a project of the size and complexity of the Institute of Haematology.

4.86 Their report does caveat this assessment by also pointing out that, as crowdfunding scales, this assessment could change. They also suggest that crowdfunding could be suitable for smaller scale PPP projects, but that £200m is currently beyond what crowdfunding can demonstrably raise.

4.87 Analysis submitted on both the Dudley CCG (by Archus Ltd.) and the Royal Devon and Exeter Trust (by BDO) projects, which are both below £20m, offer a more positive assessment of the use crowdfunding at this scale. Both make recommendations that crowdfunding should be considered as an option for providing competitive senior debt for the respective projects.

4.88 The challenge posed by the provision of senior debt is the scale of investment required with the projects estimated at £10m to £18m respectively.

4.89 Abundance Investment have raised amounts up to £7m for individual projects within weeks and have plans for raises in the region of £20m by 2020, so the issue of scale might not be a challenge for too long. In some ways the size of raise is not where the risk is, however, since it is also the time period within which the finance needs to be raised for a given project that creates challenges.
4 CASE STUDY FINDINGS

4.90 Our research with the Dudley CCG case study also reached an interesting conclusion with regard to community investment, which came to be regarded as an option for the provision of ‘mezzanine debt’.

4.91 Mezzanine debt is the middle layer of capital that falls between secured senior debt and equity. This type of capital is usually not secured by assets and is lent strictly based on a company’s ability to repay the debt from free cash flow. It is a form of debt often used in complex private financing models.

4.92 Archus Ltd. conducted financial modelling of the Kingswinford project and tested senior debt market rates, which was then combined with an assessment of crowdfunding market rates led by Abundance Investment.

4.93 Taken together, these assessments indicate that an attractive rate of interest can be provided to community investors on a layer of mezzanine debt and that in turn this would reduce the senior debt price, resulting in a lower overall cost of capital for the project.

4.94 The other attraction of using crowdfunding to provide mezzanine debt finance is that it would limit the level of community investment to perhaps no more than 10% of the total capital requirement, which for the Kingswinford project would equate to circa £1.3m.

4.95 This is a highly achievable target for any mature crowdfunding platform, making it a useful starting point for piloting the use of crowdfunding within the PPP infrastructure space.

4.101 The Act is intended to encourage commissioners to talk to their local provider market or community to design better services, often finding new and innovative solutions to difficult problems. As a formal recommendation we suggest that the nature of the finance – i.e. where the funding comes from – should become a key part of social value procurement.

4.102 The opportunity of using the procurement process to stimulate the market throws the challenge of innovating finance models over to the bidders, so that they compete to develop the optimum structure for involving community investments in the business models for their projects. On a stand-alone basis, bidders could respond to tenders by making a point to include community investment as a point of differentiation in the market.

4.103 In addition, by not making it mandatory but simply introducing a level of incentive, the KPMG report also indicates that the market would quickly clarify whether there was demonstrable value to including crowdfunding or not.

4.104 In the following Sections of the report, we intend to meet the above challenges facing the use of investment-based crowdfunding as a new model of finance for public sector organisations by presenting three key outputs from the research.
“I think it’s going to be quite hard work to get the first couple of projects done. But I do believe that they will be market-making and, once the general public can see that, and you can then present something in a different area and say ‘… here’s an image of what you will end up with. This will be a local health facility and you’ll also be investing in your local health facility’. So I think it’s about giving some tangible examples.”

RICHARD DARCH
Archus Ltd.
5 OUTPUT 1: DECISION-MAKING TOOL

5.01 One of the main barriers preventing the public sector from unlocking the potential of crowdfunding as a new model of finance is a lack of knowledge and expertise within public bodies with respect to crowdfunding as an investment-based business model.

5.02 It was clear during the course of our research that public bodies would welcome assistance with understanding more about crowdfunding as an investment option, especially how it could be considered as part of the normal stages of a local authority’s project development process.

5.03 To assist with the assessment of the suitability of crowdfunding for public sector projects, the research team worked closely with both Bristol City Council and Leeds City Council to co-create a decision-making tool.

5.04 The tool builds upon insight from the excellent work undertaken by Social Finance for the Isle of Wight Council case study, but we have extended the scope to encompass a broader range of public sector organisations.

5.05 Our intention in co-creating this tool is to provide guidelines to public bodies on the processes and considerations that ought to be made before pursuing crowdfunding as a finance option for a given project type.

5.06 In particular, as well as a step-by-step ‘decision pathway’ for public bodies to follow in their exploration of crowdfunding as a suitable finance option, the tool highlights how project and investment risk can be transferred according to considerations of ownership, control and borrowing limits.

5.07 This ranges from full transfer of risk to the private sector through to full control and assumption of project risk by the local authority, despite the funds being raised for a specific purpose.

5.08 This tool is intended as a guide only. The specific costs, benefits, and risks of using crowdfunding will need to be weighed on their own merits by each organisation within its own local context, with external advice sought from appropriate sources as needed.

USING THE DECISION TOOL

STEP 1: HAS INITIAL FEASIBILITY IDENTIFIED A PROJECT THAT REQUIRES CAPITAL INVESTMENT?

- Initial feasibility is the starting point for any project, as this identifies that there is a need for something to be done;
- This need could be anything from building a new school to replacing internal IT systems, but in the context of considering crowdfunding the project has to have a capital investment requirement.

STEP 2: DOES THAT PROJECT GENERATE SOCIAL, ENVIRONMENTAL OR ECONOMIC VALUE FOR THE COMMUNITY?

- Our research indicates that there is a potential crowdfunding solution for almost any project type that requires capital investment;
- Our research also makes clear, however, that certain projects are far more suitable to crowdfunding than others;
- This includes ‘good causes’ projects that deliver clear and demonstrable social, environmental, and economic benefits such social housing, district heating and renewable energy infrastructure, as well as regeneration schemes;
- Throughout this report, we have made the case that crowdfunding should be seen as a new model of finance for delivering positive social and/or environmental outcomes as part of a ‘blended return’ to investors.

STEP 3: IS THAT PROJECT, OR ARE SECTIONS OF THAT PROJECT, CLEARLY DESIGNATED FOR BROAD COMMUNITY USE?

- Though all projects developed by a local authority should offer value to the community, certain projects offer more targeted benefits to the community or to specific sections of the community;

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84 For further details on the work undertaken to develop this tool initially for the Isle of Wight Council, see Social Finance, 2018.
85 For a wider discussion on the importance of socially and environmentally just outcomes for alternative models of finance, see Hall, et al., 2018.
FIGURE 3: CROWDFUNDING DECISION-MAKING TOOL

1. Initial Feasibility identifies a project requiring capital investment
   - NO
   - YES

2. Does the project generate a social environmental or economic benefit for the community?
   - NO
   - YES

3. Are sections of the project earmarked for community use or designated as a community asset?
   - YES
   - NO

4. Is the council looking to retain ownership and control of the project?
   - NO
   - YES

5. Is the council looking to transfer some risk?
   - NO
   - YES

6. Does the project meet the council’s investment hurdle rate (internal cost of capital)?
   - YES
   - NO

7. Is the council able and willing to finance the entire project?
   - NO
   - YES

8. Will the council borrow money for the project?
   - NO
   - YES

- Use reserves
- Use PWLB or other borrowing
- Use Community Municipal Bond or split funding between PWLB and CMB

Consider implementing a Community Asset Transfer

Consider using Procurement to encourage private and/or social enterprise sector to incorporate crowdfunding into their bids

Consider using Procurement to encourage private and/or social enterprise sector to incorporate crowdfunding into their bids

CONSIDER DEBT CROWDFUNDING
CONSIDER EQUITY CROWDFUNDING OR COMMUNITY SHARES
CONSIDER DONATION-BASED CROWDFUNDING
DO NOT CONSIDER CROWDFUNDING AT THIS STAGE

COMMUNITY MUNICIPAL BOND
5 OUTPUT 1: DECISION-MAKING TOOL

• In this case, consideration can be given as to whether or not there is an opportunity to engage that project’s community of interest to raise capital to maximise the community benefit of the project (i.e. resident investors from the local community);

• The first point of consideration is whether or not the project has certain aspects or ‘add-ons’ that are beyond the budget of the local authority, or that do not have a strong business case. In such cases, perhaps the project could be funded philanthropically via donation-based crowdfunding;

• An example of this could be the redevelopment of a park, where budget restrictions may limit the ability of the local authority to provide all the additional park services that they and the community would like (e.g. skate parks or tennis courts);

• Donation-based crowdfunding could be used to raise money to deliver those additional services via gifts from the benefiting section of the community.

STEP 4: IS THE LOCAL AUTHORITY LOOKING TO RETAIN OWNERSHIP AND CONTROL OF THE PROJECT?

• The local authority may decide that they do not want to retain ownership or control of a given project over the long term;

• This decision could be taken on the basis that the project risk is higher than the local authority’s risk appetite, or because the local authority faces constraint on its prudential borrowing and so has a freeze on any new capital projects;

• In this case, the local authority has a number of options for delivering the project and could use the local authority procurement processes to direct those partners bidding to deliver the project to consider crowdfunding;

• There are also several other options at this point:

TRANSFER TO COMMUNITY OWNERSHIP

• If the project has a high potential to deliver social value, the local authority can utilise the Community Asset Transfer model where local authorities transfer assets to the community to operate;

• An example could be the transfer of a library to community ownership, so that the community take on the risk of running and developing the site;

• In this case, a variety of crowdfunding models may be suitable, such as community shares and/or debt-based crowdfunding, depending upon the legal structure of the organisation taking over the asset;

PRIVATE SECTOR PROJECT DELIVERY (FOR PROFIT OR SOCIAL ENTERPRISE)

• Another option is to hand over the total delivery of the new public service or public infrastructure to the private sector;

• In this case, as noted above, the local authority might use their procurement process to direct those bidding to be the contractor to ensure a social purpose target is met and/or to consider the use of crowdfunding;

• A good example is a complex energy service contract, or the development and operation of leisure centres;

• While the ownership (equity) of the project is likely to remain with the private sector, debt-based crowdfunding could be used to connect residents with the project to ensure that more of the economic value generated by the project is nevertheless retained locally;

PUBLIC PRIVATE PARTNERSHIP (PPP)

• This category includes a variety of different business models;

• For instance the project could be delivered entirely by an entity owned by the private sector (i.e. as above, for profit or social enterprise) through DBFM contracts;

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[38] FINANCING FOR SOCIETY Assessing the suitability of crowdfunding for the public sector
5 OUTPUT 1: DECISION-MAKING TOOL

• Local authorities could also form joint ventures with private sector partners with the local authority perhaps investing land into the project company. This approach is often used in complex infrastructure projects as well as large scale regeneration programmes or housing developments;

• In these cases, it is unlikely that equity-based crowdfunding will be suitable, as control will be maintained by the corporate entity and/or local authority;

• Again, however, the procurement process could be utilised more effectively to encourage bidders to demonstrate that positive social and/or environmental outcomes will be realised through crowdfunding.

STEP 5: IS THE LOCAL AUTHORITY LOOKING TO TRANSFER RISK?

• The local authority may decide to retain ownership and control of the project, but still look to transfer some risk to the private sector;

• In this case, once again the procurement system could be used to direct partners to deliver social aspects of the project and/or to encourage resident investment via an appropriate model of crowdfunding;

• We suggest that two main risks are relevant here:

FINANCING RISK

• In their work with the Isle of Wight Council, Social Finance state that some projects carry a higher risk than perhaps the local authority has an appetite for;

• In these cases, the project could still be delivered by the local authority within any construction framework, but would be funded by resident investors who want to ensure the delivery of a certain project;

• An example could be the setting-up of a café within a community centre, whereby the community finances the build of the café through investment-based crowdfunding and themselves carry the risk of the café not being successful;

CONSTRUCTION AND OPERATIONAL RISK

• A local authority can transfer the construction, operations and maintenance (i.e. performance) risk of projects to contractors through well negotiated contracts;

• This model is increasingly used in renewable energy infrastructure. An example would be where the public sector owns and finances the development of a solar farm, but relies upon private sector partners to design, construct and operate the project.

STEP 6: DOES THE PROJECT HAVE A BUSINESS CASE AND MEET THE LOCAL AUTHORITY INTERNAL HURDLE RATE?

• If the local authority intends to retain ownership, a full business case would need to be developed to demonstrate that the project meets the local authority’s hurdle rate and aligns with its overall strategy;

• The Finance team within the local authority will then become key decision makers in the project delivery.

STEP 7: DOES THE LOCAL AUTHORITY WANT TO PROGRESS TO FINANCE THE PROJECT AND IF SO HOW?

• A viable business case does not necessarily mean a project will progress. The local authority will have capital investment budgets, as well as prudential borrowing budgets, which projects will need to compete with for funding;

• At this point, the local authority will also give consideration to how the project is delivered. This could be via a wholly owned company, for example, or instead delivered within the corporate balance sheet;

• If the local authority decides not to progress the project due to borrowing constraints, the project team could revert to looking at methods of developing the project through transfer of ownership.
STEP 8: WILL THE COUNCIL BORROW MONEY OR USE RESERVES?

- Once the business case is signed off and the budget has been agreed for the project, the Treasury team will likely decide on whether to use existing reserves or further borrowing;

- If the Council decides to borrow money, the Community Municipal Bonds option developed through our research could be considered alongside traditional borrowing solutions (e.g. PWLB);

- As our research suggests, finance from Community Municipal Bonds and PWLB could be mixed, providing the opportunity for residents to invest along with the local authority in the project;

- As the next section of this report outlines in greater detail, investors would be lending money to the local authority, rather than to the project specifically;

- The difference with the Community Municipal Bond option is that strategic communications would make it clear precisely what the funds are being used for and how this translates into tangible benefits to the community, as a core part of regular updates on the delivery of the overall project and its stated outcomes.
6.01 The second main barrier preventing the public sector from unlocking the potential suitability of crowdfunding as a new model of finance is a concern that current crowdfunding models could not better the capital and administrative costs of existing forms of public sector borrowing.

6.02 One of the most significant outcomes from our research, therefore, has been the co-creation of a new Community Municipal Bond structure. Particular thanks are due to Abundance Investment who led this aspect of the research, along with Bristol City Council, Leeds City Council and Walker Morris who assisted the research team’s evaluation of the concept.

6.03 The Community Municipal Bond has the potential to be an attractive means for local authorities to raise capital efficiently and cost-effectively, whilst also directly increasing engagement with local residents.

6.04 Community Municipal Bonds could command a lower cost of capital because project risk is managed by the local authority within its balance sheet and is not transferred to investors.

6.05 As the research with our case studies indicates, the risk of a local authority defaulting on its debt is very low. One of the principal benefits of this new model of finance, therefore, is that it allows greater transparency and hypothecation of investment capital inflows into the local authority, while holding the risk separately and having this risk managed via the local authority’s standard operating practice.

6.06 In principle, a local authority would issue a Community Municipal Bond directly to the public via a crowdfunding platform engaged for the purpose, with the finance raised at the corporate level. This could be used to replace existing sources of borrowing (e.g. PWLB) to fund specific public infrastructure projects, or to refinance existing loans.

6.07 The risk assumed by the investor is that the council will continue to operate, rather than assuming the risk linked to a specific project, although the capital raised could be earmarked by the council for a meaningful local project of defined social and/or environmental value.

6.08 By being issued directly by a local authority and administered online by a crowdfunding platform, a new standardised, low-cost process would be created without being an additional bureaucratic burden for already pressed local authorities. The council would only need to make a single interest payment and does not have to deal with the costly day-to-day administration of investors.

6.09 The local authority would have a choice regarding the level of communication and engagement that it has with its investors across the term of the investment as part of its attempts to increase local participation in civic life.

6.10 UK local authorities have, historically, issued bonds to retail investors. Leeds City Council and Hackney London Borough Council have both issued bonds in the past. Leeds City Council closed their retail bond programme in the 1990s because the cost of its administration pre-internet was prohibitive in comparison with other sources of funding.

6.11 Designing the Community Municipal Bond product also poses some challenges to the crowdfunding sector as it requires modifications to the standard crowdfunding business model to deliver a low-cost, easy-to-use process for issuing bonds in such a way that also fits within a local authority’s standard treasury management processes.

6.12 Working with financial services and public sector legal advisers through the Financing for Society project, a structure was developed that as far as possible emulates the PWLB borrowing process, at the same time as delivering an interest rate that matches or betters PWLB borrowing costs.

6.13 The resulting Community Municipal Bond product co-created through our research would be attractive to retail investors seeking a blended return, as the overall proposition delivers both financial as well as social and/or environmental benefits.

6.14 Indeed, if the product were also to provide an option for giving up interest on the investment (see paragraph 6.26), then it would offer resident investors a further opportunity to create additional social impact.
6 OUTPUT 2: COMMUNITY MUNICIPAL BOND

6.15 The design of the Community Municipal Bond product draws on the lessons learned from successful institutional municipal bond raises in other parts of the UK, such as Aberdeen85, Birmingham and Warrington86.

6.16 The Community Municipal Bond is also designed to be complementary to the Municipal Bond Agency (MBA) initiative, which brings together local authorities to raise capital from the institutional capital markets87.

6.17 The Community Municipal Bond approach is a flexible, easy-to-use model for authorities looking to raise smaller amounts than they might potentially seek to raise through the MBA, however, with anticipated raise amounts in the region of £0.25m – £10m in a single issue or via a programme of bond raises.

6.18 Our research has also identified Community Municipal Bonds as having the potential to fill a gap in the retail investment market for low risk income-generating financial products. Current established products that offer ‘risk/return’ profiles comparable to Community Municipal Bonds are UK Gilts and Annuities.

6.19 With the UK household market for Gilts currently valued at £46bn90 and an Annuity market of £4bn per year with a drawdown market of £22bn per year91, there is potential for Community Municipal Bonds to become a viable and substantial source of funding for local authorities over time. The ISA market is currently £600bn (with £280bn held in low returning cash ISAs92), while the total UK pension market is 3-4 times this size93.

6.20 Our initial analysis of current rates on UK Gilts and Annuities of comparable lengths show that Community Municipal Bonds could provide investors with better risk-adjusted returns while remaining cheaper for local authorities than PWLB loans.

6.21 The design of the Community Municipal Bond also builds upon the original insight of investment-based crowdfunding, which is that value is created for both borrowers and investors when technology is used to cut out the multiple layers of intermediation incumbent in traditional financial services.

6.22 The buyers of local authority bonds and UK Gilts are in effect UK residents, via life and pension companies. The Community Municipal Bond provides local pensioners, savers and investors with the opportunity to bypass these intermediaries and “go direct”, potentially providing both the investor and local authority with a better deal whilst also aligning investment practice with more positive social and/or environmental objectives.

6.23 When compared to existing sources of local authority financing (e.g. PWLB, Municipal Bond Agency, Direct Bond Issuance, Inter-Authority Lending), Community Municipal Bonds also offer significant scope for creating social, environmental and economic value.

6.24 Through our research, we have identified four potential social benefits that may be generated by Community Municipal Bonds over time as the product becomes better understood in the market.

6.25 CREATING ENGAGED AND ACTIVE CITIZENSHIP
• Community Municipal Bonds create an efficient communication and engagement platform for local authorities to build new relationships with their residents;
• Local authorities would send digital communications direct to investors to explain precisely how their funds are being used as a regular feature of the published overview of their financial position;
• In building new relationships with citizens to show how the council is working to improve their community, new networks of trust can be built so that residents may be more likely to support the local authority in ambitious new initiatives and projects, which in turn can lead to more active citizenship.

6.26 CREATING NEW DONATION-BASED INCOME STREAMS
• Community Municipal Bonds could evolve into new opportunities for local authorities also to use donation-based crowdfunding models for engaging residents with the idea of giving money to provide non-core services;
• Westminster City Council recently created a mechanism for residents to donate money alongside their council tax payment on the basis that extra funds would be used to tackle homelessness in the borough. In three months, the Council received an extra £324,000 from 300 households94;

6.27 https://www.aberdeencity.gov.uk/services/council-and-democracy/aberdeencity-council-bonds
6.29 https://www.ukmba.org
6.34 https://www.thetimes.co.uk/article/300-households-in-westminster-heed-call-to-pay-homeless-tax-d00qj0h
6 OUTPUT 2: COMMUNITY MUNICIPAL BOND

- There is also anecdotal evidence from the Charity Bond sector that some retail investors are willing to give up a portion of their interest on the basis it is retained by the charity to fund frontline services.

6.27 CREATING LOCAL ECONOMIC BENEFITS
- Community Municipal Bonds offer a competitive financial return against other long-term low risk investments for local residents and therefore can provide a local economic benefit;
- Community Municipal Bonds are likely to be attractive as an alternative retirement income product. Pensioners are more likely to spend money in their local community, so if they can access higher and/or more stable returns via Community Municipal Bonds then that additional money and security of income flow can be expected to benefit the local economy.

6.28 REDUCING COST OF CAPITAL FOR LOCAL AUTHORITIES
- Community Municipal Bonds offer an attractive ‘risk/return’ trade off against UK Gilts;
- If the traditional UK household Gilt investor can be attracted to purchase Community Municipal Bonds, there is potential to reduce the cost of capital for local authorities below PWLB rates;
- Community Municipal Bonds can also create higher social value for the capital input and thus complement other forms of social value creation locally;
- This could mean that a wider range of projects become viable for local authorities to finance through crowdfunding.

CHALLENGES TO SCALING THE COMMUNITY MUNICIPAL BOND
6.29 Since 2014, the UK Government and FCA have put in a strong regulatory framework for investment-based crowdfunding, which provides a good foundation for growing a market for Community Municipal Bonds95.

6.30 One major challenge to scaling Community Municipal Bonds, however, is that the current rules relating to the IFISA were created before the concept of Community Municipal Bonds was developed and therefore bonds issued by local authorities are not currently eligible to sit within an ISA.

6.31 Despite their attractiveness as an alternative to UK Gilts and Annuities, not being ISA-eligible will limit the ability of Community Municipal Bonds to achieve their full potential for creating social and financial value for local authorities.

6.32 Most people invest exclusively through their ISA, as only a fraction of the population has sufficient money in excess of their annual allowance to invest elsewhere. At the end of the 2017-18 financial year, the market value of Adult ISA holdings stood at £608 billion, with roughly £280bn held in low returning Cash ISAs96.

6.33 Community Municipal Bonds could compete with these on an equivalent ‘risk/return’ profile, but at present they would miss out on that very large pool of capital and so the opportunity to redirect those funds transparently to serve the public good via local projects.

6.34 The IFISA was created to increase diversity and competitiveness of SME and personal borrowing debt markets. Changes to statutory legislation could open up Community Municipal Bonds to ISA investors by ensuring that they are more accessible to resident investors.

6.35 Whilst the ‘unwrapped’ return would still be competitive with traditional investment products in the event of non-eligibility, having the capacity to wrap the product within an IFISA would be revenue neutral for Government and could put a downward pressure on future Community Municipal Bond interest rates, in turn reducing the overall cost of capital for the public sector.

6.36 We hope that the evidence presented throughout this report will encourage HM Treasury to consider amendments to statutory legislation in order to extend the IFISA to include bonds issued by local authorities. In our view, this would help to obtain a clear sense of the volume of investment that this change would unlock and demonstrate appeal to the target group of investors.

6.37 With £46bn of UK Gilts owned by households, competition in an ISA-driven Community Municipal Bond market could help bring down the cost of local authority debt closer to Gilts prices.

6 OUTPUT 2: COMMUNITY MUNICIPAL BOND

6.38 Having developed Community Municipal Bonds as a potential solution for local authorities to access a low-cost source of capital with a ready market among retail investors, the next step is to pilot the Community Municipal Bond structure in a real world context.

6.39 As noted earlier, Leeds City Council will run a pilot to explore the viability of the Community Municipal Bond concept in 2019. This will be done alongside local market testing to assess the public perception of this form of crowdfunding by a local authority.

6.40 Results from this pilot will be published in due course on the Financing for Society research page at the University of Leeds.\(^7\)

\(^7\) The report on Leeds City Council’s pilot of the Community Municipal Bond in 2019 will be published at: https://baumaninstitute.leeds.ac.uk/research/financing-for-society/
7 OUTPUT 3: CROWDFUNDING TO REPLACE PRIVATE CAPITAL IN PPP PROJECTS

7.01 As a third output from the Financing for Society project, our research has also provided clarity over the suitability of crowdfunding as new model of finance for PPP projects.

7.02 At the start of our research, it was not clear whether any model of crowdfunding could integrate into traditional PPP projects. The insights generated through our work with the three NHS case studies indicates that there is scope for crowdfunding to provide flexible and competitive capital to these projects.

7.03 Our research also identifies the potential for crowdfunded capital to offer additional value to project procurers through the greater alignment of interests between the social purpose of a project and the crowdfunding investors.

7.04 Concerns were raised by our NHS case studies regarding the conflicts that could arise in traditional PPP models between the interests of capital, project owners and procurers during the life of the project. This tension arises typically due to the providers of capital (i.e. institutional investors) prioritising the protection of their targeted financial return over long term public service outcomes.

7.05 Our research raises the possibility that, by sourcing capital direct from the service users themselves, a better alignment could be achieved between the needs of the service procurer and capital.

7.06 To be clear, this is something that would need further research to validate fully. But, as Section 3 of this report testifies, people are increasingly looking to invest in products that provide a ‘blended return’ of positive social, environmental and financial outcomes.

7.07 Projects that can solicit greater engagement to realise these positive outcomes through investment will find that these investors take a far more holistic view of their return than traditional institutional money.

7.08 These investors are the decision-makers for their own capital in contrast to institutional money, which must refer to its mandate that more often than not is rigid in its direction solely to optimise a targeted financial return. A mix of motivations and outcomes is likely to emerge, however, since capital is unlikely to benefit directly from service use, and service beneficiaries may not achieve optimal financial returns from their investment.

7.09 It was also suggested that by supporting the growth of crowdfunding in PPP markets, the Government would encourage the growth of a more competitive and resilient project finance debt market, generating similar benefits to that which occurred in the SME lending market with the growth of loan-based crowdfunding.

7.10 By developing new models of finance and disrupting the over-reliance of projects on finance from traditional lenders, the UK economy would become far more resilient against any future banking crisis.

7.11 The use of crowdfunding is not without its challenges, however. Our research highlighted a key obstacle which is co-ordinating the crowdfunded capital around a project financial close date, where legally binding commitments from multiple funders might be required at the same time to ensure that a deal progresses.

7.12 Indeed, there may be a need to align investors before this date, for example, at the point when the PPP provider submits a bid, since financing often needs to be committed in advance.

7.13 The challenge for crowdfunding is that, because funding is raised against a specific project, it is not possible to guarantee the time it will take or even the amount of capital that will be raised. For larger and more complex projects, therefore, including crowdfunding can materially increase risk and make this financing option less attractive.

7.14 It is for this reason that our research assesses crowdfunding as suitable for smaller PPP projects in the region of £1m-£15m, where crowdfunding can provide an attractive source of senior debt and raise funding in a way that aligns with a project’s timetable.

7.15 For those larger and more complex projects, crowdfunding is better considered as an option to provide a competitive mezzanine level of finance, which is far likelier to be within the funding range of mature crowdfunding platforms.

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98 For further details, see the text linked to Recommendation R.06 in Section 9 of this report.

99 The financial close is the date when all funding needs to be contractually committed though not yet drawn.
7.16 As a way forward, our research recommends that Government explores how best to support the uptake of crowdfunding within the PPP project sector. One suggestion emerging from our research is to create guidance for public sector bodies procuring PPP projects on how to encourage bidders to consider using crowdfunding at the tendering stage.

7.17 Finally, though we do not envisage that Government will consider making crowdfunding mandatory, using the procurement process to incentivize private sector bidders to demonstrate positive social and/or environmental impact and to find ways of including crowdfunding in their bids is recommended.
“There is a need to develop funding opportunities and financing options for the public sector. There has to be an understanding that funding from central Government and local Government is going to be limited for the foreseeable future, but that investment is desperately needed in many parts of the country for different things. My message is to ask Ministers to be open to the opportunity that crowdfunding will provide, leaving aside the politics of whether or not things ‘should’ be funded in that way, to allow local individuals to help shape their local communities.”

JANE FRANCIS
formerly NHS King’s College Hospital
8 ANALYSIS

8.01 In this section of the report, we draw upon data generated through research with our six case studies in order to assess the suitability of crowdfunding for the public sector.

8.02 We highlight the major challenges (real and perceived) still facing public bodies, policymakers, and the crowdfunding sector ahead of making our series of recommendations in the next section of the report.

UNDERSTANDING THE PUBLIC PERCEPTION OF CROWDFUNDING

INCREASING PUBLIC AWARENESS OF CROWDFUNDING

8.03 There is a high level of public awareness about the financial challenges faced by the public sector as spending cuts become increasingly visible in towns and cities, from libraries and community centres closing through to pressures on social care, housing, and mental health support.

8.04 The public are rightly concerned about the implications of further spending cuts to local services and many will likely seek to get involved if they are provided with the opportunities and the available resources (both time and money) to help their community to meet these challenges.

8.05 Each of the case studies included in our research agreed that the popular perception of crowdfunding is still locked into ‘donation’ and ‘reward’ based business models that will not provide them with a financial return.

8.06 The approach adopted by Swindon Borough Council can be seen to mitigate this risk. They worked with crowdfunding platform Abundance Investment to use crowdfunding to generate efficiencies in finance delivery, but opted not to use the term ‘crowdfunding’ in their communications with resident investors because of that popular perception.

8.07 Further work is needed to improve public understanding of crowdfunding as a legitimate investment-based business model, something that this report has started to correct.

WHO INVESTS IS JUST AS IMPORTANT AS WHY THEY DO SO

8.08 It is far from certain how many members of a given local community would be willing or able to participate in a local authority crowdfunding campaign, especially in those cities and regions that suffer the highest levels of social and economic deprivation.

8.09 The Swindon example that we presented in Section 3 of this report shows the potential scale of resident involvement, providing that levels of accessibility are attended to and community benefit is clearly demonstrated.

8.10 In all six case studies, proposed projects were required to go through a public sector business case development process, with investors only to be invited to participate once the project has been approved and signed-off internally.

8.11 Our research did not test the idea of using ‘the crowd’ to determine which public sector projects ought to be considered for crowdfunding. We simply signal that this could be an option worth testing since one of the anticipated benefits of this form of finance is to create new forms of active citizenship and civic engagement.

8.12 Working in partnership with local people to identify projects that meet community need could be vital to mitigating the risk that larger public infrastructure projects may struggle to convey a clear sense of local or community ‘feel’.

8.13 Increasing resident (local authority) or service user (NHS) involvement in project ideation, for example, is something that the public sector could explore given the potential to enhance community engagement through crowdfunding activities.

8.14 Utilising crowdfunding for investment represents a new way to engage citizens, potentially to save the public sector money by attracting civic-minded investors that are prepared to take a ‘blended return’ of positive social, environmental and economic outcomes, and to build understanding of public sector activities through new networks of trust.

8.15 Enabling investment in line with social values to generate beneficial outcomes is a noble ambition of crowdfunding and more transparent than traditional savings and investment models.
8 ANALYSIS

8.16 Not all investors will share the same values, of course. Who determines what counts as ‘socially beneficial’ and, more fundamentally, who is proven to benefit materially from those projects selected for crowdfunding will be vital to the success of any campaign.

8.17 Involving local citizens in reaching answers to these questions will help to mitigate the risk that projects are perceived as ‘vanity missions’ by public sector bodies and/or the wealthier members of a community.

8.18 As a way forward for UK councils, we recommend that projects are developed via the existing democratic framework operated by local authorities to ensure that there is effective community consultation with residents having ultimate control via the ballot box.

8.19 Crowdfunding should be an additional financing option that is considered both legitimate and normal when a project is being passed through the public sector body’s decision making processes.

8.20 Unlike other financing tools, however, crowdfunding is an option that can help to build greater resident engagement over time as new civic relationships are forged through the investment process with the community.

8.21 Any successful crowdfunding project has to balance the need for accessibility and involvement (e.g. via low minimum investment amounts of £5-£10) with the need to provide volume of capital where it is needed (and where local investment capital may be limited and constrained).

8.22 Our research indicates that, by ensuring both large and small investors are treated equally in terms of their investment rights and the levels of communication and engagement with them as individuals, crowdfunding does offer a new way of building civic relationships between the public sector and local communities of residents and/or service users.

ADDITIONAL SUPPORT FOR THE PUBLIC SECTOR

OVERCOMING A CULTURE OF RISK-AVERSION

8.23 Whilst our six case studies each demonstrated truly creative and ambitious thinking, it was noted that there still remains a culture of risk-aversion within public sector bodies.

8.24 Whilst entirely sensible given cuts to public funding, this confirmed that substantial support – including a coherent and consistent policy framework from UK Government; additional financial resource; knowledge exchange events; and changes to current procurement processes – will be needed if the uptake of crowdfunding as a new model of public sector finance is to scale rapidly and have the chance to realise identified benefits.

8.25 A crucial first step in this process will be getting relevant senior teams on board. A key finding from our research was the challenge faced by public bodies when a high turnover of senior staff causes a loss of momentum in trying to shift thinking amongst internal teams in a more innovative and entrepreneurial direction.

8.26 This was true both for the King’s College Trust case study, when the Senior Responsible Officer for the project changed during the research process, but also for a possible seventh case study that struggled to gain support from relevant senior teams following an internal spending review. Despite a successful application, this seventh case study was forced to withdraw from our research early on and to decline the offer of pilot funding as a consequence.

8.27 At a time of acute economic uncertainty, it is not just the public sector that requires support and reassurance. The UK public are also likely to be risk-averse, and so require clear and material incentives, if they are to consider changing the way they habitually use or invest their money.

8.28 One way of overcoming this for the public could be the appointment of crowdfunding ‘champions’. This could be achieved through the appointment of new Citizen Commissioners with a remit to work collaboratively with public bodies and community stakeholders to ensure that crowdfunding projects deliver material social and/or environmental benefits to the local area100.

https://www.gov.uk/government/publications/civil-society-strategy-building-a-future-that-works-for-everyone
8 ANALYSIS

8.29 Whilst the burden of responsibility cannot be left to these ‘champions’ alone, they will play a crucial role especially in local authorities that struggle to innovate and adopt new and unfamiliar practices. Such roles must be provided with sufficient resource to achieve these objectives.

8.30 Since crowdfunding represents a challenge to existing practices and thinking within the public sector, it is vital to identify what additional support is needed to foster a more proactive, ambitious and innovative public sector to emerge in the cities and city-regions.

8.31 It was clear from our research with Bristol City Council, the Isle of Wight Council, and Leeds City Council, that these local authorities have created a wider ‘eco system’ of progressive initiatives and strategies to foster an entrepreneurial spirit that is both creative and less risk-averse.

8.32 Not every council has sufficient resources or personnel to develop similar entrepreneurial cultures and practices, however, so the wider adoption of crowdfunding as a viable new model of finance will depend upon assisting each local authority in its own particular context.

8.33 One of the principal barriers to adopting a less risk-averse strategy is a perceived threat to the reputation of a local authority or NHS body by being an ‘early adopter’ of a new model of finance, especially in the absence of a coherent policy context that offers some security.

8.34 Whilst remaining mindful of the need to manage reputational risk, it is also true that the long-term security of public bodies (e.g. institutional longevity; higher credit standing, etc.) means that there is lower risk to investors from public sector led crowdfunding than from some forms of high-street savings and investments.

8.35 As a solution to overcoming this risk-averse culture with respect to crowdfunding, the research team co-produced the decision tool presented in Section 5 of this report.

REDUCING THE ADMINISTRATIVE COST OF NEW MODELS OF FINANCE

8.36 In seeking creative alternatives to existing PFI and PPP models, local authorities reported feeling constrained by Government capital budgeting and accounting rules, rather than by a lack of available financing.

8.37 For example, we heard that smaller projects often require the same level of administrative effort to obtain funding, but were then far less attractive to existing forms of financing.

8.38 The reliance upon PWLB borrowing is driven both by the relatively low cost of capital and the fact that it is a simple, familiar and well-understood process within local authorities.

8.39 For crowdfunding to be viable in this context, therefore, it needs to offer both an equivalent cost of capital and to provide a similar administrative experience for under-resourced local authorities.

8.40 In seeking a solution to this, the research team developed a new Community Municipal Bond structure presented in Section 6 of this report.

IMPACT ON CURRENT MODELS OF FUNDING

RISK TO GENERAL AND LOCAL TAXATION

8.41 A common concern amongst our six case studies was the belief that the general public would expect large infrastructure projects be financed through general taxation.

8.42 This was especially the case for the three NHS bodies who continue to feel keenly the complex systemic changes to both their financial structures and modes of organisation.

8.43 Any change to the valuation of the NHS as a public good, to be collectively funded through general taxation, represents a clear and present risk to how the entire health system of the UK operates.

8.44 Furthermore, the different borrowing criteria and capital constraints applicable to NHS bodies represent a further challenge to the use of crowdfunding in this sector.

8.45 Similarly, local authorities were concerned that crowdfunding might be perceived as a new form of council tax ‘by stealth’. This concern was raised in response to a proposal that, in seeking to enhance the accessibility of crowdfunding for resident investors, local authorities could work with a crowdfunding platform to set a minimum investment amount for residents to be payable by standing order.
8 ANALYSIS

8.46 As such, the reception of public sector crowdfunding amongst the general public will depend upon the model not being perceived as somehow legitimating the further withdrawal of central state funding for public services.

8.47 At the same time, crowdfunding offers the potential to foster a greater understanding amongst the general public of the constraints under which the public sector now operates, helping to build trust in the visibility and efficiency of public service delivery.

8.48 Over time, it is possible (theoretically, at least) that this greater understanding between the public sector, residents and service users could lead to higher levels of support for taxation to deliver the projects communities need and/or to encourage the use of investment-based crowdfunding for public sector initiatives.

RISK TO PHILANTHROPIC AND CHARITABLE FUNDING

8.49 Our research also identifies a potential risk to the high levels of philanthropic and charitable donations made in the UK, especially to the NHS.

8.50 In becoming more accustomed to crowdfunding as an investment-based model, which facilitates financial support for socially beneficial causes for a return, the resident-as-investor may begin gradually to move away from the principle of gift making through donations.

8.51 Whilst levels of tax relief will play a part, one unintended outcome of using investment-based crowdfunding by public bodies could be a slow decline in levels of charitable donations with significant implications for those working in and/or reliant upon the third sector.

8.52 Should crowdfunding gradually replace philanthropic and charitable funding, then it may also assume some of the challenges common to third sector organisations of having to determine which projects are the ‘most’ or ‘least’ deserving when it comes to soliciting investments.

8.53 Great care must be taken to ensure that in pursuing the potential benefits of crowdfunding, the Government’s commitment to supporting charities and social enterprises is further strengthened and not undermined.

8.54 We stress that crowdfunding should be positioned as an alternative to traditional savings and investment products provided by mainstream financial institutions, and not as an alternative either to existing charitable donations or to existing forms of taxation.

8.55 In this context, crowdfunding becomes part of the social investment market, a sector that continues to grow as more people become increasingly conscious of the real world impact of their investment decisions. In short, that what we do with our money really matters.

8.56 A principal offer of crowdfunding is the opportunity for investors that are concerned about the outcomes created by their investments to move their money into transparently more socially and environmentally positive investments.

8.57 As a formal recommendation of this report, we propose that data on the real world impact of crowdfunding products is captured and measured in order to develop and/or further to refine comparison website tools.

8.58 The ambition here is to enable people to switch their savings and investments based upon the positive social and/or environmental outcomes generated and not just on lower monthly or annual price points alone.

8.59 In this way, crowdfunding can represent a more transparent and positively impactful model of finance than simply handing over responsibility for making investment selections to the hidden processes of high-street banks, investment funds and pension companies.

RESPONSE FROM MAINSTREAM FINANCE (E.G. THE BANKING SECTOR)

8.60 Our research did not model likely scenarios for the banking sector’s response to the growing prominence of crowdfunding as a model for social impact investment.
8 ANALYSIS

ATTITUDES TO ‘PLACE-BASED’ INVESTING

8.66 A number of concerns around perceived limits to ‘place-based’ social investment were raised by our case studies during the research. This centred on a perceived tension between the idea of investing in a specific region versus the idea that potential investors would be living in, or affiliated to, a given place.

8.67 On the one hand, the idea of place-based investing is attractive to public sector bodies seeking new forms of civic engagement. Through crowdfunding, local people could be encouraged to mobilise any available capital in order to invest directly in tangible projects that will deliver material community benefits they can physically see.

8.68 As such, the aim of the public sector to build new models of citizen engagement through crowdfunding ventures could be dependent upon the geographical and spatial proximity of those who invest.

8.69 On the other hand, it is an open question as to how much sustained investment might be raised from within a geographically proximate community. The scale of project ambition is likely to be compromised if investors need to be resident in a given area, especially within those UK regions with high social and economic inequalities.

8.70 These areas are likely to be the most in need of additional investment to improve public infrastructure, but our case studies were concerned that ‘place’ would offer relatively limited appeal to investors beyond the immediate area.

8.71 Indeed, whilst anticipated communications strategies are likely to appeal to feelings of civic pride and community need, it is not clear what the financial merits would be of excluding ‘non-local’ investors.

8.72 If the aim is to raise sufficient funds for the realisation of a place-based project that will materially benefit local residents, then should it matter if investors are also place-based?

8.73 Socially mobile individuals, perhaps now based elsewhere around the world, may nevertheless retain close emotional, familial, or civic connections to an area and could be motivated to invest substantial amounts of capital.

8.74 We identify a potential risk that representing place-based investment by ‘place’ (i.e. by a geographic boundary) could undermine the chance of raising the level of investment required for a given project.

8.75 It is unlikely that projects led by the public sector would be robust enough to reject funding from individuals beyond their own civic region who are motivated to invest in line with positive local outcomes (e.g. renewable energy, social care, and so on).

8.76 At the same time, opening up investment to those beyond a given geographic boundary runs the risk of underming the appeal to place and civic engagement that is likely to be a core message in communications strategies developed to generate local interest in the project. A balance will need to be struck in each case between place and investment.

FINANCING FOR SOCIETY Assessing the suitability of crowdfunding for the public sector

101 Davis and Braunholtz-Speight, 2016.
8 ANALYSIS

8.77 To mitigate the risk that non-local investors crowd out local investors – and to overcome potential misconceptions about place-based investing – a platform could initially restrict access to a given project by geography (e.g. through targeting postcodes) and only once local demand has been satisfied, then open up an offer to non-local investors. This could be a complex process to administer, however.

8.78 The balance may be struck indirectly, of course, as the investment appeal of a local project ebbs away at the periphery of a community.

8.79 Undoubtedly more significant is the challenge to aspirations of place-based investing represented by entrenched and hardening social and economic inequalities between regions, as the majority of crowdfunding investment still occurs in London and the South East (see Figure 2 on page 18 of this report).

8.80 All stakeholders will need to find ways of encouraging non-local investment into those UK regions where there is limited scope for mobilising local investors, but where the urgency of local need to find additional forms of finance for public infrastructure and services is often greatest.

8.81 Working hard to ensure that crowdfunding helps to alleviate, or at least does not further exacerbate, regional inequalities is vital if the sector is able to deliver on its promise of enabling positive social outcomes in comparison to mainstream financial institutions.
“There isn’t a shortage of ideas for transforming public services […] what there is a shortage of is access to funding and access to the resources that help deliver those schemes. Those last two things are obviously incredibly critical to transform some of our public services. So if we have an innovation agenda, we’ve got to get those two things right. And I think what this project is doing is trying to address an extra stream of income funding that would help with these projects and that’s why this is important.”

DAVE TARBET
NHS Royal Devon and Exeter
9 RECOMMENDATIONS

9.01 Our research has shown that there are a number of opportunities for the UK’s public sector to utilise crowdfunding as a new model of finance for public infrastructure projects.

9.02 If an equivalent cost of capital can be achieved when measured against existing forms of borrowing, and if administering the process through a platform can minimise impact upon already pressed public sector teams, there is additional scope for investment-based crowdfunding also to generate socially and environmentally positive outcomes via a blended returns business model.

9.03 These opportunities have not been fully exploited to date due to a lack of capacity, awareness and expertise within the public sector with respect to crowdfunding.

9.04 Understandably, public sector organisations have prioritised familiar forms of borrowing and linked processes in the absence of understanding and encouragement to look elsewhere.

9.05 Our research has addressed these factors by working collaboratively with external partners to co-develop a robust evidence base via six case studies that provide public sector organisations with a vital resource with which to assess the suitability of crowdfunding.

9.06 In order to build upon the work that we have undertaken in this first systematic study of public sector crowdfunding, we make the following list of recommendations:

R.01 IMPLEMENT A COHERENT POLICY FRAMEWORK FOR PUBLIC SECTOR CROWDFUNDING

9.07 The UK Government should use the findings of this report as part of a wider evidence base for the development and implementation of a new national policy framework for public sector engagement with crowdfunding.

9.08 A new national policy framework would signal clearly that the Government sees material social, environmental and economic benefit in using crowdfunding for public sector projects, as opposed to existing forms of financing.

9.09 In our view, greater collaboration across Whitehall between BEIS, DCMS, DHSC, HM Treasury and MHCLG will play a pivotal role in the mainstreaming and normalisation of crowdfunding as a legitimate option for the public sector. Without this, risk-averse cultures across public bodies could be further entrenched.

9.10 This collaboration should be coordinated by the Government’s Inclusive Economy Unit (GIEU) housed within DCMS and draw upon the work of Innovation in Democracy and the Responsible Business Leadership Group, as outlined in the Civil Society Strategy.

9.11 One output of this collaboration should be the development of standard template documentation for all public bodies to use in their feasibility assessment of crowdfunding as a new model of finance in order to minimise administrative costs. This would greatly aid the competitiveness of crowdfunding when judged against the experience of PWLB borrowing.

9.12 The UK Government should also ensure that the cycle of project management and procurement includes crowdfunding as part of the respected mix of financing options.

9.13 The opportunity to use the procurement process to stimulate the market throws the challenge of innovating finance models over to the bidders, so that they compete to develop the optimum structure for involving community investments in the business models for their projects.

9.14 As such, and we suggest in line with the 2012 Public Services (Social Value) Act, the nature of the finance – i.e. where the funding comes from – should become a key part of social value procurement.

9.15 The Government should also create a “how to” guide for procuring crowdfunding within a PPP procurement framework or exercise for use by public sector bodies, including how this impacts existing PPP and DBFM structures.
9 RECOMMENDATIONS

9.16 On a stand-alone basis, bidders should be notified that Government is keen to see direct resident investment into projects and so be encouraged to respond to tenders by including community investment as a point of differentiation in the market.

R.02 CHANGES TO STATUTORY LEGISLATION FOR COMMUNITY MUNICIPAL BONDS

9.17 A challenge to the Community Municipal Bonds product created through our research is that the rules relating to the IFISA were created before the concept was born. As a result, bonds issued by local authorities are not currently eligible to sit within an ISA.

9.18 As supported by the evidence submitted in this report, we strongly recommend that HM Treasury considers amendments to statutory legislation in order to extend the IFISA to include bonds issued by local authorities.

9.19 In our assessment, opening up Community Municipal Bonds to ISA investors would be revenue neutral for Government and could put a downward pressure on future Community Municipal Bond interest rates.

9.20 This would, in turn, reduce the overall cost of capital for the public sector and make the product more accessible to resident investors.

9.21 In our view, this would also help to obtain a clear sense of the volume of investment that this change would unlock and demonstrate appeal to the target group of investors.

9.22 Competition in an ISA-driven Community Municipal Bond market could also help to bring down the cost of local authority debt so that it is closer to UK Gilts prices.

R.03 DEVELOP AND DELIVER A STRATEGIC MARKETING CAMPAIGN FOR PUBLIC SECTOR CROWDFUNDING

9.23 The Government should work with all relevant stakeholders to develop clear and meaningful marketing and communications strategies at both the national and local level to signal crowdfunding as a new and legitimate model of finance for the public sector.

9.24 In developing these strategies, it is vital that crowdfunding is correctly positioned as an investment-based model offering a blended return and as an additional form of financing for public bodies only in the right circumstances.

9.25 This campaign should be targeted at specific audiences with the goal of improving the understanding of crowdfunding amongst public sector organisations, the general public, and wider retail investors who may be ‘early adopters’ as the market develops.

9.26 Public bodies considering a crowdfunding campaign should also develop clear and consistent messaging to local residents, which explains: what the material risks are to ensure the public’s lack of familiarity is not exploited; what the campaign is trying to accomplish; and, what the material social, environmental and economic benefits will be to the wider community as a result of the investment.

9.27 Whilst we are not marketing experts, our case studies all reported that it would be important to strive for simplicity in this messaging, both to encourage buy-in from the broadest range of community members and to enthuse potential investors.

9.28 We know from existing research that ‘being excited about a specific company or project’ has been ranked as more important than high financial returns for investors and so generating excitement for a given project through a coordinated marketing and promotions strategy is a crucial part of any crowdfunding campaign.

9.29 As our case studies also testify, it is crucial to find a senior colleague to ‘champion’ crowdfunding within the organisation who can operate across teams, acting as an internal project and communications manager for all the information being gathered and ensuring that enthusiasm and momentum is maintained.

9.30 This champion doesn’t need to be a finance or legal representative, but we recommend that these internal teams should be engaged as early as possible.

9.31 A campaign is also likely to raise many questions from potential investors around the details of the investment opportunity. It is important that the ‘champion’, and/or the selected crowdfunding platform administering the raise, can respond to these questions quickly and thoroughly.
9.32 The answers to these questions are likely to form the basis of their investment decision and so the response may be the difference between receiving an investment or not.

9.33 Local authorities should also consider the appointment of crowdfunding ‘champions’ drawn from amongst local residents to ensure crowdfunding projects deliver material benefits for local needs, perhaps as a part of the new Citizen Commissioners initiative outlined in the Civil Society Strategy.

9.34 To mitigate the risk that ‘non-local’ investors crowd out local investors, crowdfunding platforms should consider initially restricting access to a given project by geography (e.g. through targeting postcodes). Only once local demand has been satisfied should an offer be opened up to other ‘non-local’ investors.

9.35 This would help to privilege the needs of local resident investors without barring entry to anyone physically beyond the area who wishes to invest in a given project.

9.36 In all marketing materials, the public body should carefully consider the level of sophistication of the investor base, the type and amount of information offered to investors about the risks of the investment, and how much protection investors receive (e.g. a guarantee of the principal amount).

9.37 Any implicit subsidy for crowdfunding investors compared to the cost of commercial loans or normal local authority borrowing facilities could draw criticism that it is diverting resources that should form part of the wider council spending budget.

9.38 Beyond the public body and the general public, many successful campaigns also engage institutional partners to provide the initial finance, to build engagement and maintain momentum in a campaign.

9.39 These institutional partners can provide additional validation for prospective investors by demonstrating that the crowdfunding portion of the project has already received substantial backing from traditional sources.

9.40 Where appropriate, public bodies should also seek to leverage funds from institutional investors. This could be through the creation of a matching fund, which matches contributions from individual resident investors, or by having significant institutional contributions throughout the campaign.

9.41 These partners should be aware of the campaign plan (hence the need for a clear marketing strategy) and be told precisely how their funding is encouraging additional community investment.

R.04 CREATE AND SUSTAIN A CENTRAL REPOSITORY OF PUBLIC SECTOR CASE STUDIES

9.42 The creation of a central repository of case studies for public bodies to draw upon in assessing the suitability of crowdfunding is essential.

9.43 It would be feasible for such a database to be located and administered by the University of Leeds as an on-going output of the Financing for Society project, since this report and its findings represent a foundation for this evidence base.

9.44 Our recommendation is that the University of Leeds and DCMS should build on the insights and outputs generated by our research to begin collaborating in the creation of an open access database that is centrally stored and freely available to public sector organisations.

9.45 We also recommend working with existing partners and a wider group of relevant stakeholders to co-develop and to deliver tool kits, guides, professional development training, and knowledge exchange events that will ensure expertise is shared across the public sector.

9.46 This knowledge exchange programme needs to be rolled out in such a way that people can understand how the market works, who the key players are, and how the specific finance options work.

9.47 A programme of regional knowledge exchange workshops and/or ‘living labs’, potentially led by organisations such as Local Partnerships in collaboration with DCMS and the University of Leeds, should be organised to facilitate training and professional development opportunities for local authorities on the use of crowdfunding for the public sector.
9 RECOMMENDATIONS

9.48 The concept of Community Municipal Bonds produced via our research also needs to be made more widely accessible. Education campaigns would perhaps go some way to achieving this, focusing on the benefits and the risks that investing in bonds can bring with it. This training could be delivered centrally, perhaps by a professional body in the finance and/or crowdfunding sector.

R.05 INVEST IN WIDENING THE EVIDENCE BASE
9.49 The UK Government should provide additional funding to support the further development of case studies and Community Municipal Bond pilot projects, in order to grow the evidence base and to show examples of what works, for whom, and in which circumstances.

9.50 Whilst our six case studies were spread widely across England, further valuable lessons will be obtained by working with public sector partners in Scotland, Wales, and Northern Ireland.

9.51 As well as new case studies, additional funding to help existing partners to develop Community Municipal Bond pilot projects will help to mitigate against early failure, which could significantly compromise the appeal of crowdfunding for public sector bodies.

9.52 This could be achieved through a more ambitious version of the Financing for Society project, open to tender, to include 18-24 case studies at different stages of development (i.e. at the feasibility stage, or to pilot a real world trial of the Community Municipal Bond product with the public).

9.53 The Government should also encourage further innovative thinking by providing additional resources of ‘seed corn’, ‘pilot’ or ‘development’ finance to assist public bodies in taking projects through a business case process to establish the financial, legal and technical opportunities of crowdfunding.

9.54 One way of policing the barrier between crowdfunding as a new model of finance and more traditional models would be to capture the real world impact of crowdfunding, which is seldom accurately measured in either the short or long term.

9.55 It is therefore vital for this next phase of research to measure and to test the effects of crowdfunding in a real world context, specifically to assess:

• how the process is experienced by public sector bodies and whether or not it provides a more flexible and competitive source of capital for them; and,
• the extent to which positive and measurable social and/or environmental outcomes are realised through public sector crowdfunding.

9.56 Through an additional phase of this research, the UK Government would:

• learn how the insights and outputs generated by our research are put to work in a real world context;
• understand better the public’s response to the proposal to utilise crowdfunding as a new model of finance for the public sector;
• achieve far better regional insight across the whole of the UK;
• expand an evidence base to ensure that social value is delivered through public sector crowdfunding.

9.57 We propose that this data on the real world impact of crowdfunding products is captured and measured in order to develop and/or further to refine comparison website tools.

9.58 The ambition here is to enable people to switch their savings and investments based upon the positive social and/or environmental outcomes generated and not just on lower monthly or annual price points alone.

R.06 CREATE AN UNDERWRITING OR BRIDGING FUND FACILITY FOR PPP PROJECTS
9.59 A key challenge identified by the research is the risk that a crowdfunding platform does not have the capital available on the day it is required by the project, due to the uncertainty inherent in the timing of any specific crowdfunding event.

9.60 The UK Government should create an underwriting or bridging fund facility for PPP projects, as the model of PPP finance and the wider ecosystem that exists around this market has been developed to focus upon the needs of the institutional investment market, not the needs of crowdfunding as a new model of public sector finance.

9.61 Precedents do exist for this kind of facility. The Scottish Government recognised a similar challenge in delivering shared ownership at scale for an onshore wind development.

102 https://www.localenergy.scot/media/79714/Shared-Ownership-Good-Practice-Principles.pdf
103 https://www.scottish-enterprise.com
9.62 Their solution was the establishment of a revolving bridging finance facility, administered by Scottish Enterprise\textsuperscript{103}, which provided capital on commercial terms to commercial wind developers.

9.63 This allowed community investors to reserve their place in the onshore wind farm capital structure while they raised their own local capital with which to make the investment.

9.64 Although this was not tested in our research, a similar model could be set up to enable crowdfunding platforms to secure positions in small scale PPP projects, perhaps administered by the British Business Bank\textsuperscript{104} or via social finance intermediaries, such as Big Society Capital\textsuperscript{105}.

9.65 A further example of support comes from the market for SME finance, which was recognised as offering both poor service and high cost of capital. This was transformed by the introduction of P2P lending platforms, such as the loan-based model operated by Funding Circle.

9.66 The role of British Business Bank loan funds in supporting the creation of pipeline, retail confidence and momentum in the market was highly significant.

9.67 Applying the learning of this intervention (carried out at commercial rates of return) would help to establish the sector as both an asset class for retail investors and a credible new model of finance in addition to traditional state sourced means of borrowing.

9.68 The authors of this report welcome the opportunity to discuss the above recommendations with relevant teams and stakeholders within Government, across the public sector, and with crowdfunding platforms (contact details on next page).

\textsuperscript{103}https://www.british-business-bank.co.uk
\textsuperscript{104}https://www.bigsocietycapital.com
ABOUT THIS REPORT

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As authors, we would like to hear from you and welcome feedback on this report, its findings and our list of recommendations. Please send any comments to Dr Mark Davis via the contact details above.

THE PARTNERS

ABUNDANCE INVESTMENT is a Financial Conduct Authority regulated investment crowdfunding platform. It specialises in enabling the public to invest in and finance the development of low carbon and social infrastructure projects, both within the commercial and public sector. Abundance Investment is a founding member of the UK Crowdfunding Association (UKCFA) and has pioneered the development of public sector investment crowdfunding within the UK.
https://www.abundanceinvestment.com

LOCAL PARTNERSHIPS is a joint venture between the Local Government Association, HM Treasury and the Welsh Government. Their team of experts works solely for the benefit of the public sector. They provide trusted professional support helping the public sector meet the challenges it faces and achieve greater success. They help organisations transform the way they deliver projects, services and change at the local level. They also bring public and private sector experience that helps provide: confidence, capability and capacity to central and local Government, and other public sector organisations working across all areas of the public sector.
http://localpartnerships.org.uk

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USING THIS REPORT

This report was submitted at the close of grant to the UK Government’s Department for Digital, Culture, Media and Sport in March 2019. All details were correct at the time of publication.

The authors accept no responsibility or liability for subsequent actions taken with respect to the evidence provided herein, inclusive of the decision-making tool and Community Municipal Bond product, which were co-developed in good faith with public sector case studies to help assess the suitability of crowdfunding as a new model of finance.

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All use of this material, including our research outputs, must carry the following citation and full DOI hyperlink by way of acknowledgement on all documentation (internal or external) including websites and social media:


For further details of the research project, please direct interested parties to: https://baumaninstitute.leeds.ac.uk/research/financing-for-society/

BUILDING CASE STUDY EVIDENCE

A major finding of our research is the need to develop a central repository of case studies for public sector organisations to draw upon in assessing the suitability of crowdfunding within a specific local context.

To help us to build this repository, the authors wish to hear from any public sector organisation and/or crowdfunding platform that makes use of the findings in this report.

If you have any queries regarding the report’s findings, and/or wish to know what happens next with our research into crowdfunding, please contact Dr Mark Davis as the Principal Investigator on the project.
REFERENCES


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REFERENCES


APPENDIX A: CASE STUDIES
A1.01 All councils are facing enduring financial pressures, resulting in many placing emphasis upon commercialisation and privatisation in order to maintain service delivery.

A1.02 Bristol City Council explored the feasibility of investment-based crowdfunding as a means of raising finance for energy-efficiency projects in community tenanted buildings across the city.

A1.03 As a city, Bristol has a reputation for using its creative and independent spirit to lead on innovation, with its green initiatives leading to the award of the title of the European Green Capital in 2015.

A1.04 A wider ‘eco-system’ of policy initiatives provide an excellent environment to hear innovative proposals for creating opportunities to raise finance via crowdfunding – e.g. One City Plan\(^{106}\), City Leap 2018\(^{107}\), and the legacy of the Bristol Pound community currency\(^{108}\).

A1.05 The environmental agenda has to be considered in this frame. In November 2018, the city of Bristol declared a “climate emergency” and set itself the ambitious target of being 100% carbon neutral by 2030. Finding ways to finance this green transition is therefore an ever more urgent topic\(^{109}\).

A1.06 There is a significant amount of ‘local money’ from residents of Bristol that is invested outside of the city. With approximately 200,000 adults in Bristol alone, Bristol City Council calculates that there could be up to around £2bn held in Bristol residents’ ISAs.

A1.07 A successful crowdfunding venture could see a proportion of this money, or any additional savings held by local residents, redirected into supporting the low carbon growth of Bristol.

A1.08 Bristol has a strong track record in delivering energy efficiency projects in Council-owned buildings. Since 2005, Bristol City Council has been operating one of the UK’s largest Salix recycling funds for improving the energy efficiency status of public sector buildings\(^{110}\).

A1.09 Bristol City Council’s Energy Service has developed significant experience in complex energy efficiency projects: from project concept, through to energy audits, payback calculations, negotiating service level agreements, procurement and contract management.

A1.10 Salix has limitations, however, as it is not applicable to buildings where the energy savings do not directly benefit the public sector, typically charities and those providing socially-beneficial services. With these organisations being located in an energy inefficient building, they face either higher energy bills or compromises over how frequently the building can be heated and occupied.

A1.11 The financial payback from energy efficiency works is considered to be more difficult to forecast compared to other energy generation projects. Solar PV, for example, has benefitted from the Feed in Tariff fixed subsidy payment as well as predictable data of sunshine hours\(^{111}\).
This allowed for an accurate financial model to be created with easily defined payback periods meaning that these energy projects have been viewed as a more secure investment. These projects include many developed by community energy groups who have already utilised crowdfunding platforms to finance the delivery of solar PV installations.

“There’s tens of millions of funding being raised through energy crowdfunding projects, but I think that each individual that contributes is making their own financial assessment and risk assessment of the project. So each individual has got their own level of risk that they’re willing to take, and I think the old Feed-in Tariff ensured that it was low risk”.

RICHARD LOWE BRISTOL CITY COUNCIL

In Bristol, the Salix recycling fund has created over £4m of energy investments, with the benefits carefully monitored through the Council’s half-hourly energy bills. On this basis, Bristol City Council applied to the Financing for Society project for pilot funding to evaluate the possibilities of utilising crowdfunding to finance energy efficiency measures in council-owned buildings where the occupier is a charitable or community group.

PERCEPTIONS AND PRACTICALITIES OF CROWDFUNDING

Bristol City Council recognised that the term crowdfunding has different meanings for different people. From a modest survey of the occupants of ten council-owned buildings, the term ‘crowdfunding’ suggested to these residents the idea of gifting money to a particular cause (i.e. donation-based crowdfunding), or receiving a token of appreciation for the funding provided (i.e. rewards-based crowdfunding). In all cases, crowdfunding was assumed to provide no financial return.

“In my narrow experience, people are keen to fund projects that are local to them so they can see a direct benefit to their facilities. For example, charities have been raising money for schools for a few years now. That’s a form of crowdfunding with no returns, but people understand there’s a direct benefit to their children’s school from putting in 100 quid. Because with infrastructure, it can’t be something nebulous and something that’s distant to them.”

RICHARD LOWE BRISTOL CITY COUNCIL

A key learning outcome of the project is that engaging stakeholders and communities to understand the appetite for investment is vital to the success of any crowdfunding campaign.

A1.14 In creating a new structure for local investment, and to ensure the widest social benefit possible, there is a need to ensure that local people understand the offer being made – i.e. the crowdfunding proposition needs to be both financially accessible and include individuals who may need additional support to understand the offer being made.

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A1.16 In creating a new structure for local investment, and to ensure the widest social benefit possible, there is a need to ensure that local people understand the offer being made – i.e. the crowdfunding proposition needs to be both financially accessible and include individuals who may need additional support to understand the offer being made.

A1.17 Many at Bristol City Council shared the above view of crowdfunding. Early engagement of internal Financial and Legal teams was crucial to explain the investment-based crowdfunding model. When this method was clarified with the help of the research team and external advisors, it was acknowledged that similar investment mechanisms had been thought about before but never properly pursued by the council.

A1.18 Bristol City Council has not attempted crowdfunding as a method of raising finance before. Existing case studies were vital for helping to navigate internal stakeholders and decision-making processes.

A1.19 The Swindon example was cited as having used crowdfunding successfully to raise capital for their own environmental project and using an ISA to facilitate local investment in local projects. They developed a special purpose vehicle (SPV) to raise funds locally in order to purchase solar panels for a community solar farm\textsuperscript{12}.

\textsuperscript{12} See paragraph 3.52 of this report.
A1.20 The fact that other local authorities had utilised crowdfunding successfully made it more of a palatable topic to take forward in Bristol. Having the evidence from another local authority that had embarked upon a similar pathway and had successfully commissioned and delivered a project provided a lot of confidence to the council’s internal teams.

BARRIERS AND CHALLENGES
A1.21 Bristol City Council’s Legal Services team does not have prior experience of crowdfunding but does have considerable experience of corporate structures and public procurement regulations.

A1.22 In addition, the energy efficiency project does not involve the acquisition of valuable assets that could be sold in the future, but rather the purchase of lower-value fixtures and fittings. These would become embedded in the fabric of each building and therefore would not provide transferable value in the future.113

A1.23 As a result, Bristol City Council’s Legal Services team had some initial concerns regarding what risks this would expose Bristol City Council to. They wanted to know how the arrangement could be structured in a way that was both legally compliant and provided both the council and its investors with sufficient certainty and protection.

A1.24 Following internal discussions with Bristol City Council Energy Services and Financial Services teams, and with the crowdfunding platform Abundance Investment, the Legal Services team developed initial answers to a number of their questions, and two options for pursuing a crowdfunding project were devised.

A1.25 These two options were also considered with external lawyers who did not identify any significant impediments to proceeding with crowdfunding.

A1.26 The feasibility of crowdfunding was also tested against the established model of borrowing from the PWLB, which is how most local authorities seek to raise finance.

A1.27 There is growing recognition of the need to diversify these borrowing streams in order to ‘future-proof’ against any changes to the regulation or terms of PWLB loans. There is also some dispute over whether PWLB always presents the best value to the public sector. Bonds issued via a crowdfunding platform, for example, could well present an opportunity for lower interest rates.

A1.28 To be viable, internal stakeholders at Bristol City Council needed to be convinced that crowdfunding could match these rates and cost of capital, whilst also not creating additional transaction and administrative costs.

A1.29 Only at that point was it possible to assess the suitability of crowdfunding as a means of place-based social impact investing for Bristol’s residents. Nevertheless, engaging with stakeholders and communities to understand the appetite for investment remains vital to ensure both social and financial ‘buy-in’.

“The challenge is developing a business case that has a clear profit and positive cash flow proposition quite quickly. So, energy projects lend themselves well to that, as principally you are trying to reduce energy use or switching your generation to a clean source of energy and not buying energy from the grid. So those are clear profit positions. But, if you were going to help fund new park equipment, then that’s going to be a much more challenging profit position.”

RICHARD LOWE BRISTOL CITY COUNCIL

A1.30 Bristol City Council are now far more confident in the potential for crowdfunding to provide an alternative funding stream for the Council, provided that:

- the risks identified are adequately mitigated and external legal and financial advice is sought where needed;
- the project is structured in a financially viable way;
there is appropriate political appetite to proceed with the project; and
there is sufficient Bristol City Council capacity and resource to implement the project.

MAIN FINDINGS
A1.31 Throughout Bristol City Council’s involvement with the Financing for Society project, three potential options for pursuing crowdfunding were co-developed with the research team that would see a bond offer being made via a crowdfunding platform:

1 Bristol City Council would issue bonds directly (“Community Municipal Bond” option);
2 A newly-incorporated company, wholly owned by Bristol City Council, would issue the bonds (“NewCo” option);
3 A community interest company, wholly owned by a charity, would issue the bonds (“CIC” option).

A1.32 At a very early stage, the “CIC” option was excluded. This was due to its structural complexity and the fact that it would not sit within Bristol City Council’s existing corporate group or be owned by the Council itself. This left two viable options.

THE “NEWCO” OPTION
A1.33 The “NewCo” option was initially prioritised as it would sit within Bristol City Council’s existing corporate group of companies. It could ensure the new company had public liability in case the overall project did not succeed.

A1.34 On further analysis by internal and external stakeholders, however, this option was downgraded due to:

• additional governance arrangements required (i.e. appointment of company directors; board meetings; reporting requirements, etc.);
• complex contractual arrangements as Bristol City Council would require contracts with building tenants, the new company, and a third-party contractor for the energy efficiency works, creating multiple procurement arrangements that would need to be compliant with the Public Contracts Regulations 2015114;
• a complex flow of funds between Bristol City Council, the new company, the third-party contractor, and the community tenant;
• and finally, a resultant high cost of capital to manage the project.

THE “COMMUNITY MUNICIPAL BOND” OPTION:
A1.35 Analysed in more detail following the above conclusions, the “Community Municipal Bond” option was discussed with Bristol City Council’s Treasury Team and external lawyers to establish the following benefits:

• no new corporate structure would need setting up or managing;
• contractual arrangements and the flow of funds would be simplified as Bristol City Council would be both landlord and bond-issuer; and therefore,
• the cost of capital would be reduced; and finally,
• as bond-issuer, the crowdfunding investments could be secured against the long-term revenues of Bristol City Council.

A1.36 Under the “Community Municipal Bond” option, investor capital would be transferred from the investors to the sponsoring crowdfunding platform and on to the Council, which would then deploy the funds on the energy-efficiency project(s) to be carried out either by Bristol City Council or a third-party contractor.

A1.37 Bristol City Council would then need to enter into an ‘Energy Savings Agreement’ with the community tenant of the council-owned buildings where the energy efficiency measures are to be installed, in order to regulate the payment process.

A1.38 The saving on utility paid to the council would need to be carefully calculated based on the level of energy saving achieved by the proposed efficiency measures within each particular building. There may be limitations on what can be achieved in each building and further hurdles to cross in instances where the council did not directly own the building.

A1.39 Once the saving has been calculated, however, this could be equated to a percentage of a revised utility bill, subject to a de minimis (e.g. if the building is empty, or there is a seasonally warm period, a minimum payment would still be made to the council). A cap on that payment could also be included to provide some protection for the community tenant.

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See also the work of Mazzucato, 2013; 2018.
Assessing the suitability of crowdfunding for the public sector

**FIGURE 5: BRISTOL CITY COUNCIL’S “COMMUNITY MUNICIPAL BOND” OPTION**

- **Tenant**
  - Licence for works
  - Energy Savings Agreement
  - Payment of savings on energy bills
  - Energy efficiency works

- **Contractor**
  - Service Contract

- **Bristol City Council**
  - Terms + Conditions (accepting agency agreement)

- **Investor**
  - £500k capital + interest

- **Crowdfunding platform provider**
  -£500k investment
  - £500k capital + interest

- **Debenture Deed**
  - £500k investment

**KEY**
- Entity
- Core contracts
- Payments
- Actions
A1.40 The savings from the tenant would provide the basis for repaying the capital plus interest to the investors at prescribed intervals. Any shortfall would have to be met by Bristol City Council’s own funds, but any surplus could be potentially applied to other council projects and services provided that this was made clear in the information provided to investors at the outset.

A1.41 Whilst theoretical at this stage, the “Community Municipal Bond” model developed with the research team could provide a steady stream of ‘patient capital’ to the council. People don’t have good confidence in a bank or private investment that they might have had before, so I think a council backed thing does present a more confident platform for people to invest in.”

RICHARD LOWE BRISTOL CITY COUNCIL

A1.42 Bristol City Council concludes that there is a likely investment opportunity for 69 council owned buildings occupied by a community tenant to a total value of £600k. Issuing a Municipal Bond for this volume of work is feasible, but may not be worthwhile given the additional resources required to pursue the “Community Municipal Bond” option.

A1.43 Whilst the “Community Municipal Bond” option appears to be favourable, providing a suitable structure for a crowdfunding project, Bristol City Council still requires further legal, financial and technical advice before embarking upon the next phase of the project. This advice would need to clarify:

- Whether or not, if the Local Authority (Stocks and Bonds) Regulations 1974 as amended (the Bonds Regulations), have not been repealed, they grant the council the power to issue bonds without any restrictions that would materially affect the project;
- If the Bond Regulations have been repealed, that the council has the power to issue bonds under the general power of competence granted under s.1 of the Localism Act 2011, again without any restrictions that would materially affect the project;
- Whether unpaid tax would rank above the security awarded to bondholder debt;
- Whether an investor with less than £10,000 invested in the project who has not had such debt repaid would be able to group together with other investors in order to benefit from section 13(5) Local Government Act 2003;
- Whether there are any VAT implications in relation to Bristol City Council issuing the bonds;
- If the “NewCo” option was instead to be pursued, whether the s.756(3)(a) of the Companies Act 2006 exemption applies to crowdfunding through a crowdfunding platform provider, such that private limited companies can be used as issuing vehicles; or whether unlisted public limited companies should instead be used in order to comply with s.755 of the Companies Act 2006.

A1.44 Certain internal approvals would also need to be obtained before progressing with the project. The section151 officer would be required to approve the borrowing, in accordance with the Council’s scheme of delegations.

A1.45 In addition, in order to make the expenditure required to implement the project (e.g. installing the energy efficiency measures), it is likely that Cabinet approval would be required. This would need to be considered further depending on the extent of the cost, and whether Bristol City Council or a third party was implementing the measures.

A1.46 Aside from the legal considerations above, the following will also need to be completed in order to take the “Community Municipal Bond” structure further:

- Further financial modelling of the buildings in question needs to be completed. This will determine percentage return figures and allow for the offer to be built on this basis;
- Procurement of crowdfunding platform;
- Design and build of bond offer;
- Launch of bond offer.
FIGURE 6: BRISTOL CITY COUNCIL’S KEY DECISION PATHWAY
(CABINET AND FULL COUNCIL)

If there are changes at any stage, the report needs to get updated financial and legal comments and have approval from your Executive Director and Cabinet Member.
A1 BRISTOL CITY COUNCIL

LOOKING AHEAD AND NEXT STEPS

A1.47 Looking ahead, there is certainly significant interest in the “Community Municipal Bond” option at the corporate level, but in order to progress this option Bristol City Council’s decision pathway will need to be followed to get the relevant permission and agreement.

A1.48 Politically, the “Community Municipal Bond” option will need to demonstrate that there is confidence from investors in this type of bond instrument. At this stage, it is not clear what financial returns investors will see, and this could be a constraint depending on how attractive these rates will be and/or how appealing the social benefit to the community is deemed to be. As such, strategic marketing and community engagement will be key.

A1.49 Part of the benefit of a crowdfunding initiative versus more traditional borrowing is that it presents an opportunity to engage a new cohort of potential investors. This is where social investment comes in, as it is unlikely to be purely a financially driven decision, but instead one that people feel will benefit their own local community.

A1.50 In addition to this, there is the added benefit of getting people to think more about energy efficiency. It is important to make sure that the motivations of potential investors are understood fully before embarking on a marketing campaign.

CONCLUSION

A1.51 The participation of Bristol City Council as case study in the Financing for Society project has generated extremely useful and transferable insights that have opened up the possibility of crowdfunding being used in different applications.

A1.52 Bristol citizens need to be reassured that the Council is always seeking the best value for money by being innovative. Crowdfunding not only presents the opportunity to raise finance differently, but also offers benefits as a community engagement tool that has the potential to increase the participation of local people in decision-making processes within their community.

A1.53 Directly through Financing for Society, an exciting opportunity is being presented to Bristol residents to save and invest in local projects for social and environmental benefit. Many of the savings or investments made in traditional high street banking schemes will flow off-shore.

A1.54 In contrast, the Community Municipal Bond will contribute to local economic multipliers through stimulation of the supply chain and reduction in energy bills for the building occupier.

A1.55 Examining the potential that crowdfunding could bring has been an extremely valuable exercise and has brought about a genuine opportunity to finance energy efficiency projects and others across the whole council.

RECOMMENDATIONS

“I would ask the Ministers to understand the value to the local economy of retaining investment locally, for local benefits, and to listen to the needs of that community in making that happen. The projects won’t happen by accident, so we need the kind of incentive and confidence building that results in getting solar on a million roofs in the country, and then it will contribute considerably to the country’s energy needs. It can’t be relied upon solely for champions in each area. It has to be done centrally.”

RICHARD LOWE BRISTOL CITY COUNCIL

TO UK GOVERNMENT:

A1.56 Further small-scale ‘seed funding’ to enable other local authorities to explore the feasibility of crowdfunding for public projects (i.e. legal, financial, technical expertise).

A1.57 To facilitate a central repository of case studies for local authorities to draw upon as examples of best practice.120
TO CROWDFUNDING BUSINESSES:
A1.58 Further analysis from those in the crowdfunding business sector about what structures would be advisable for local authorities to consider when crowdfunding, particularly in relation to local authorities issuing bonds directly\textsuperscript{121}.

A1.59 The development of template documentation to keep the transaction costs low of the bonds. This would greatly aid the competitiveness of the interest rate to PWLB (i.e. standard documentation available for all local authorities to use).

TO LOCAL AUTHORITIES:
A1.60 Find a colleague to champion crowdfunding. This doesn’t necessarily have to be a finance or legal representative, but someone who can act as a project manager to all the information and make sure they keep up momentum in the exploration.

A1.61 Engage finance and legal colleagues as early as possible. Without them, your ideas will not come to fruition. By involving them from the outset, you are all working together on the journey and will end up with a much more cohesive outcome.

A1.62 Don’t be afraid to get some external advice from experts in crowdfunding mechanisms.

GENERAL:
A1.63 Generally the concept of bonds needs to be made more accessible. Education campaigns would perhaps go some way to achieving this, focusing on the positives and the risks that investing in bonds can bring with it, e.g. perhaps delivered by the UK Crowdfunding Association (UKCFA)\textsuperscript{122}.

A1.64 Training opportunities for other local authorities based on the findings from all the pilot partners in this Financing for Society project, e.g. CPD training workshop perhaps run by a national organisation (such as Regen)? This would likely need to be funded externally\textsuperscript{123}.

“There are some 400 unitary authorities in the country and we don’t want each one of them having to go and learn this stuff each time. So, once it’s been understood in one area, it can then be shared out.”

RICHARD LOWE BRISTOL CITY COUNCIL

\textsuperscript{121} https://www.ukcfa.org.uk
\textsuperscript{122} https://www.regen.co.uk
A2 ISLE OF WIGHT COUNCIL

CROWDFUNDING FOR REGENERATION PROGRAMME: COMMERCIAL, HEALTH, AND HOUSING

“I think crowdfunding is about talking to a new group of investors, perhaps inexperienced investors. I’m guessing most will see local benefits as being of much greater importance. I mean, if you’re helping to create jobs at the bottom of your road, this will be much more important to you than to an institutional investor who doesn’t really care where it is.”

JIM FAWCETT ISLE OF WIGHT COUNCIL

CONTEXT

A2.01 Within the Isle of Wight Council’s recently launched regeneration programme, there are a variety of small, medium and large scale projects in the development pipeline that will require a mix of public and private sector investment.

A2.02 Within this, public sector land has been earmarked for development and concept design work has already been undertaken across a number of sites, demonstrating viable and exciting development opportunities.

A2.03 Example projects include community and social facilities wrapping commercial space with general practitioner surgeries and extra care housing through to the redevelopment of Newport Harbour.

A2.04 In previous programmes, the council has explored and implemented innovative joint venture structures between the private and public sector. It was evident that during the financing phases of previous joint ventures, there was interest from local residents to help fund certain projects and initiatives, presenting an opportunity to make an attractive financial return while making a positive impact on the local community.

A2.05 Currently planning the start of this new programme, the council wanted to consider and, if appropriate, to develop a framework for utilising crowdfunding within the development programme to complement the planned use of public and private capital.

A2.06 The use of crowdfunding was believed to it with the council’s goal of including local residents in the development process while also maximising the local economic benefit of the regeneration programme, for example exploring concepts such as an ‘Isle of Wight Council ISA’.

A2.07 The council required an analysis of the potential for using crowdfunding across the pipeline of projects within the regeneration programme and, where use cases were identified, to develop guidance for how they can implement or encourage the use of crowdfunding.

A2.08 Through the Financing for Society project, the council worked with the research team at the University of Leeds and recruited a suitably qualified advisory firm to lead the project.

A2.09 This was believed to increase the chances of actionable output by ensuring the advisor built upon existing crowdfunding knowledge while considering the council’s specific requirements.

A2.10 Up to six projects in the development pipeline were assessed and projects categorised based on their intended delivery model. These models included:
- On balance sheet;
- Off balance sheet (PFI / PPP type models);
- Joint venture delivery;
- Private sector led, but where the council can encourage crowdfunding via non-traditional models, for instance planning guidance.

A2.11 Using example projects from the pipeline, crowdfunding was examined in different project categories. Illustrative case studies were produced demonstrating how crowdfunding could be used with the following issues considered for each project category:
- How crowdfunding can be implemented and key considerations/parameters;
- Financial costs and benefits of using crowdfunding;
- Non-financial costs and benefits of using crowdfunding;
A2.12 Recognising that crowdfunding can open up new models for development through the introduction of capital that comes from investors interested in the social output, not simply the financial output of infrastructure development, the exercise also considered whether crowdfunding offers the potential for new delivery models for the regeneration programme.

A2.13 In the context of the Regeneration Programme, the study assessed the pros and cons of establishing a Community ISA as a tax efficient means of investing across a portfolio of projects that meet the investor’s preferences.

A2.14 The project enabled the Isle of Wight Council to assess whether crowdfunding is applicable to and could benefit its regeneration programme. With the council still in the planning phase, our involvement in the Financing for Society research project was ideal as, though the pipeline of projects has been largely identified, the delivery models are still being designed.

A2.15 Our initial assessment was that crowdfunding could support the democratisation of the development process, involving the local community more fully in, and maximising the local economic benefit from, the regeneration programme.

PERCEPTIONS AND PRACTICALITIES OF CROWDFUNDING

A2.16 The study undertaken by Social Finance engaged with residents, independent financial advisers (IFAs), investors, crowdfunding platforms, business representatives and council staff to develop a picture of how crowdfunding may be used to provide part of the finance needed for public infrastructure projects.124

A2.17 There have been a few examples of crowdfunding on the Island. These have predominantly been reward-based, so are not necessarily indicative of the community’s willingness to invest in projects where they could earn a return. Any community investment scheme would therefore likely be a first on the Isle of Wight.

A2.18 IFAs indicated that, although residents are not familiar with crowdfunding, it could be recommended as an investment if the terms were attractive. The tax advantages of investing through an ISA were noted, but the lack of an established secondary market for crowdfunded investments was a concern.

A2.19 We were advised that most investors will be in the retirement bracket looking for investments of moderate risk with a yield, making investments with modest returns above inflation the most attractive.

A2.20 The survey of residents co-designed by Social Finance and the University of Leeds yielded relevant feedback, albeit from a relatively small sample size. One of the clear messages coming from residents through the survey was the lack of understanding around the different models of crowdfunding. 79% of respondents stated that they associated crowdfunding with pure donations, whilst only around a third of respondents associated crowdfunding with any of the other options.

“I think some people will see crowdfunding as a bit of a gamble. If you’ve got some spare cash and you can afford to lose that cash, it can be a bit of fun. But you might just do very well if you back the right horse.”

JIM FAWCETT Isle of Wight Council

A2.21 This also came through in responses throughout the survey, and in the social media responses to the survey, with many comments, such as ‘I wouldn’t donate to the Isle of Wight Council at all; that’s what we pay council tax for’.

A2.22 Residents expressed opposition to considering donating money to the council with no potential for a return. Almost two thirds of respondents would not currently consider donating to a project run by the Isle of Wight Council, which indicates the careful communications necessary if the council were to consider crowdfunding as a source of investment.

A2.23 It will therefore be important for the council to ensure the offer is clear and easily understandable, with clear delineation of potential returns, if it does seek to raise community investment.

A2.24 Residents indicated a preference to invest for community benefits, and a willingness to consider a lower return for some outcomes, such as improved healthcare, environmental conditions and transport links.

“I think, on the one hand, if you’re inviting the public to invest in a project then you want that to be a secure investment which provides a reasonable long-term return. But, on the other hand, people might be prepared to invest in projects that give them a lower rate of return or higher risk because they want to support local development.”

JIM FAWCETT ISLE OF WIGHT COUNCIL

A2.25 There was not a strong preference for investing through an ISA, though many were not aware of ISAs and their tax benefits.

A2.26 Previous, small-scale crowdfunding initiatives offer some useful guidance on how to run a campaign:

- A campaign requires persistent effort over the course of the fundraising period, and cannot just be posted, left and expected to be successful. This requires resources;
- Preparing materials to be posted, including videos and blog posts, can be useful in ensuring you have the available content to post and maintain momentum;
- Setting an appropriate target could improve results, by focusing efforts and making the goal seem more achievable;
- Having clearly defined deliverables and outcomes that will be funded by what is raised improves engagement with the campaign. The larger the amount being fundraised, the clearer you need to be about what benefits it will deliver;
- There must be a strong justification for giving, as there is not a lot of disposable income to invest in such programmes;
- Campaigns can be too front-loaded in their promotion and need to continue over the course of the project.

BARRIERS AND CHALLENGES

A2.27 The Isle of Wight Council case study identified the following opportunities for crowdfunding in a regeneration context:

- Can deepen community engagement and tap into people’s social as well as financial motivations to get projects funded;
- Mobilises supporters who might offer non-financial contributions, such as marketing or volunteering;
- Could enable marginal projects to be funded where Council resources are otherwise restricted;
- Offers some flexibility of documentation and potentially shorter timescales compared to traditional methods;
- Can increase community benefit from regeneration projects through access to finance that would otherwise be earned by external investors.

“When considering the viability of a project, you’ll probably get the same answer whether crowdfunding is involved or not. The question is whether people on lower incomes can become involved in the project. I’d like to see opportunities that are available to most people rather than something that’s restricted only to those with enough wealth to be able to take part.”

JIM FAWCETT ISLE OF WIGHT COUNCIL

A2.28 This should be balanced against the following challenges, however:

- Can have negative impact on diversity, equality and participation, due to limitations on those aware of and able to fund crowdfunding projects;
- There can be conflict between the priorities of the crowd and those of the project sponsor;
A2 ISLE OF WIGHT COUNCIL

- Running a crowdfunding campaign can involve significant investment of time and resource. Platforms vary in the support offered to sponsors;
- Other than for smaller projects of c.£3-5m or less, crowdfunding only offers a partial or marginal contribution to total project costs;
- The term ‘crowdfunding’ tends to be associated with donations, which can create a false image for a campaign that is designed to raise investment capital.

A2.29 The last point is particularly pertinent and was reinforced by the community survey where 79% of respondents stated that they associated crowdfunding with pure donations.

A2.30 We concluded that the term “community investment” would better describe debt or equity investments in regeneration or infrastructure projects.

CHALLENGES AT THE PROJECT STAGE

A2.31 The Social Finance report recommends that the Isle of Wight Council should not raise community investment at the pre-planning phase before a track-record of successful investment in this area emerges elsewhere in the UK, and before the community becomes more familiar with the concept of community investment.

A2.32 The risk at this stage of development is at its highest, and community investors are unlikely to be well-positioned to appraise such investments, even alongside other sources of capital investing on the same terms (which are likely to be well-diversified, to have a high-risk appetite, and/or to lend their expertise to the pre-planning process). It is also much cheaper for the council to fund these costs internally.

A2.33 The positive impact community investment may have on planning approvals is worth considering in each case and it may be that this element can be obtained via consultation and evidence of support without requiring community investment. The council should prioritise projects at a later stage of development.

A2.34 Given the maturity of the market, crowdfunding is most likely to support lower-risk debt financing. This is likely to be as a minority investor alongside others, and it is recommended raising at commercial rates on the same terms as institutional investors.

A2.35 The research found no evidence that the community would accept a return below PWLB interest rates, so crowdfunding is not currently a means through which the council can access cheaper capital.

A2.36 In our assessment, raising crowdfunding is likely to increase council transaction costs. It should therefore only be used where a compelling case for community involvement can be made. Given the favourable tax treatment, it is recommended raising debt in a form eligible for ISAs.

A2.37 The use of equity crowdfunding is not recommended for the council unless under exceptional circumstances. The market is not well-developed, does not benefit from the same regulatory treatment as debt crowdfunding, the barriers to astute investment are higher for less experienced investors, and active investors (e.g. developers) have indicated an unwillingness to invest alongside passive equity investors.

A2.38 It is recognised that there are a number of other practical issues that need to be considered, such as:

PROCUREMENT
- This includes the legal status of investment offer;
- There will be a need for clear documentation to be presented to potential community investors as well as the selection of a suitable crowdfunding platform to manage the transactions;
- It will also be necessary to consider how the council’s crowdfunding requirements will be included in the procurement of development partners and the need to accommodate the requirements of the primary funders in a crowdfunding environment;

TIMESCALES
- Crowdfunding may extend the fundraising period for projects because of the specific procurement requirements, the staff time and resources required to manage the process, and uncertain response times from investors;
A2 ISLE OF WIGHT COUNCIL

RISK ASSESSMENTS

- The degree of financial risk and exposure for the council can only be fully assessed once detailed costings are available and investment cases prepared for each project;
- It will be necessary, therefore, to make some early assumptions on which projects are likely to be attractive for crowdfunding and pose acceptable risk to council and to progress these prior to determining whether a community offering will be appropriate;

SCOPE OF THE CROWDFUNDING OFFER

- It will need to be determined who will be able to participate in the crowdfunding offer, primarily, whether it will be available to Isle of Wight residents / businesses only or nationwide.

MAIN FINDINGS

A2.39 We did not find evidence that the community would accept a return below PWLB interest rates, so crowdfunding is not a means through which the council can currently access cheaper capital.

A2.40 A Community Municipal Bond structure, as developed through the Financing for Society research, would see the council issuing a bond to investors. This could offer potential for the council to raise capital at close to, or even below, PWLB rates. Innovative delivery models such as this should be explored further.

A2.41 The Social Finance report considered the opportunities for crowdfunding to contribute to four live regeneration projects. Overall, it is recommended that the council initially choose a low-risk investment to introduce the community to crowdfunding. This crowdfunding investment is most likely to be fixed rate debt financing and eligible for an ISA.

A2.42 Once the community is more familiar with the concept, the council has more information on the quantum and preferences of investments, and the council has established fundraising processes, then it may consider raising funds for a portfolio of investments.

A2.43 If such a pilot is successful, community investors may wish to invest in multiple projects. If so, the council has a range of options to make this easier. A Community ISA or a single platform offering could be considered.

A2.44 The benefits in doing so are largely through diversification, which could open up crowdfunding to projects that are too risky to invest in on a stand-alone basis (e.g. projects that are pre-planning and require funding for feasibility studies).

A2.45 The use of crowdfunding in various delivery models was considered. In general, whether crowdfunding is appropriate will depend more on the type of capital required rather than the delivery model. Where other investors or partners are involved, however, their appetite to work alongside community investors will need to be tested.

A2.46 The study took the learning from these project assessments to develop a decision tool to allow the council to assess future projects at an early stage. The decision tool developed by Social Finance is intended only for use by the council in the current environment, since the council does not have a track record of successfully raising investment through crowdfunding.\(^\text{125}\)

A2.47 Beyond the community engagement profiled in the report, there is no concrete evidence of the Isle of Wight community’s willingness to invest, their capacity to invest, or their risk appetite for crowdfunding investments as the market for these does not currently exist.

A2.48 The recommendations are intentionally conservative to allow the Isle of Wight Council to support the development of the community investment market on the Island with less risk placed on both investors and projects that require finance.

A2.49 It is assumed here that the council, or the special purpose vehicle (SPV) considering taking crowdfunding, has full ownership of the site. Where the council has partial ownership, it will need to engage closely with other owners to ascertain their appetite to take on crowdfunding.

A2.50 Additionally, as the study found no evidence that community investors have fundamentally different risk-return preferences to other investors, the introduction of different tranches of debt or equity solely due to community investment was not considered.

\(^{125}\) For a decision tool inspired by this work but applicable across the public sector, see section 5 of this report
LOOKING AHEAD AND NEXT STEPS

“If the outcome of this project is to identify a range of secure investments that are open to a lot more local people to invest small amounts of money, and give them a better return than they’re getting from their savings accounts, and that led to some social good, then I think that’s a great outcome for everybody.”

JIM FAWCETT
ISLE OF WIGHT COUNCIL

A2.51 If in future the council builds a portfolio of crowdfunding-financed projects, regulation changes (e.g. to be more favourable to equity crowdfunding), the market evolves alongside community appetite to invest, or more information on investor capacity and risk appetite becomes available, the decision tool will need to be reviewed.

A2.52 We do not believe that crowdfunding will be used extensively as a means of securing finance that is not currently available to the council through PWLB. Our principle objective in using community investment would therefore be to stimulate participation in the regeneration programme and to maximise local benefit from the development.

A2.53 The report makes the following comments with regards to delivery models suitable for community investment:

**COMPLEXITY**
- We believe response rates will be higher for simpler investment propositions such as a council-backed fixed interest bond or debt instrument;

**GOVERNANCE AND INVESTOR RETURNS**
- Some investors may be interested to become involved in governance, but we have not so far identified evidence that investors might accept lower financial returns in exchange for governance involvement;

**SOCIAL IMPACT AND INVESTOR RETURNS**
- It is possible that impact investors would accept lower interest returns if the project sponsors provide a visible link to how this saving would be reinvested in better quality construction or support services but as yet we do not see any precedents;

**REVENUE PARTICIPATION**
- Further analysis would be required to determine if this additional complexity would be worthwhile;
- There are precedents for revenue participation models in the social investment marketplace but these are relatively rare;

**REWARDS**
- It would be an option to test if offering travel or tickets to Isle of Wight attractions encouraged the take up of a community investment tranche. We have not seen any evidence of this to date, however;
- More extensive consultation and survey would be needed to ascertain if potential investors would value this approach;

**RELATIVE SIZE**
- The selected Isle of Wight projects that have been reviewed are mostly large and this means that community investment raised via crowdfunding platforms would be the minority part of the funding;
- Most probably, the community tranche would be raised at the same time and on the same terms as other investors and therefore the potential for new delivery models will be constrained to a significant degree.

A2.54 Another option is to raise general funds for the council without the guarantee that they would be used for a specific project(s).

A2.55 The UK Municipal Bond Agency established in 2014 was an attempt to explore if local authorities with good credit records/ratings could pool their borrowing needs in a joint and several SPV and issue Minibonds at scale and rates that were cheaper than PWLB. This reflected the gap between PWLB rates and UK Gilt rates of 80-100 basis points.

A2.56 Response to date, however, has been weak and publicity surrounding councils that have faced severe financial difficulties has not helped to reassure investors that local authority credits are sufficiently strong.

A2.57 It seems likely, therefore, that smaller and medium sized councils without extremely strong credit ratings will find PWLB the cheapest source of long-term fixed rate borrowings.

126 https://www.ukmba.org
A2.58 This has not been tested in the Isle of Wight, which may consider offering a council-backed fixed interest bond with a community/impact focus at a rate similar to PWLB costs. Investors could hold these assets within an ISA if they chose.

A2.59 If such an investment was available as an alternative to purchasing Annuities for those individuals with maturing pension pots, this could stimulate significant demand.

RECOMMENDATIONS

A2.60 The main recommendations from our involvement in the Financing for Society project relate to the circumstances in which crowdfunding is recommended for public infrastructure projects.

A2.61 The council initially chose a low-risk investment to introduce the community to crowdfunding. This crowdfunding investment is most likely to be fixed rate debt financing and eligible for an ISA.

A2.62 Once the community is more familiar with the concept, the council has more information on the quantum and preferences of investments, and the council has established fundraising processes, it may consider raising funds for a portfolio of investments.

A2.63 Given the maturity of the market, crowdfunding is most likely to support lower-risk debt financing. This is likely to be as a minority investor alongside others.

A2.64 Raising crowdfunding is likely to increase transaction costs. It should therefore only be used where a compelling case for community involvement can be made. Given the favourable tax treatment, we would recommend raising debt in a form eligible for ISAs.

A2.65 We do not recommend the use of equity crowdfunding unless under exceptional circumstances. The market is not currently well-developed, does not benefit from the same regulatory treatment as debt crowdfunding, and the barriers to astute investment are higher for less experienced investors.

A2.66 Whilst currently unsuitable for the Isle of Wight Council case, the countervailing case for equity crowdfunding would highlight the number of volunteering hours given by investors, reduced opposition to plans, facilitation of the development process, and/or the governance of future community assets. Again, the costs, benefits and risks would need to be weighed within each local context.

A2.67 From our participation in this research, we would also identify further issues that may be valuable to other public sector bodies considering crowdfunding for infrastructure projects.

A2.68 The council should carefully consider the level of sophistication of the investor base, the type and amount of information offered to investors about the risks of the investment, and how much protection investors receive (for example, a guarantee of the principal amount).

A2.69 Any implicit subsidy for crowdfunding investors compared to the cost of commercial loans could draw criticism that it is diverting resources that should form part of the wider council spending budget.

A2.70 In addition, not all the crowdfunding investors will necessarily be Isle of Wight residents so there is a risk in such circumstances of a modest transfer of wealth to residents of other councils in the UK.

A2.71 Project level debt crowdfunding is likely to be more expensive than equivalent PWLB borrowing. A Community Municipal Bond model, however, envisages the council issuing a bond to investors and this could offer potential for the council to raise capital at close to or even below PWLB rates.

A2.72 Running a crowdfunding campaign is not as simple as applying, posting the campaign on a platform, and waiting for it to raise capital. A successful crowdfunding campaign requires significant investment from the outset and throughout the campaign process.

A2.73 Have a clear, consistent message throughout the campaign. It is important to develop a clear pitch for the campaign, which explains what the campaign is trying to accomplish and what the material benefits to investors will be, whether these benefits are financial or broader benefits to the community.

A2.74 This messaging should then be consistent across all communications. It is important to strive for simplicity in this messaging to encourage buy-in from the broadest range of potential investors.
A2.75 A campaign is also likely to raise many questions from potential investors around the details of the investment. It is important that the sponsoring platform can respond to these questions quickly and thoroughly. The answers to these questions are likely to form the basis of their investment decision, and the council response may be the difference between receiving an investment or not.

A2.76 In the early stages, personal conversations with potential investors can be particularly useful in securing buy-in, particularly to high net worth individuals who may be able to make significant contributions.

A2.77 Having an event launch can also be a good way to publicise the campaign, and attendees at the event can sometimes be encouraged to give initial investment at the event itself and/or help to champion the campaign locally.

A2.78 Secure investment from partners prior to launching the campaign. Many successful campaigns rely on institutional partners to provide additional finance, to build engagement, and to maintain momentum in a campaign. These institutional partners can provide additional validation for prospective investors by demonstrating that the crowdfunding portion of the project has already received substantial backing from legitimate sources.

A2.79 Funds from institutional investors can be leveraged in a variety of ways, such as through the creation of a matching fund (which matches contributions from individual investors over the course of the campaign), or by having significant contributions throughout the campaign. These partners should be aware of the campaign plan, and how their funding can be catalytic in encouraging additional community investment.
Assessing the suitability of crowdfunding for the public sector
**A3 LEEDS CITY COUNCIL**

**FINANCING FOR SOCIETY** Assessing the suitability of crowdfunding for the public sector

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**CROWDFUNDING FOR REGENERATION PROGRAMME: COMMERCIAL, HEALTH, AND HOUSING**

“So, I think what we felt through wanting to explore crowdfunding was, although it’s not going to be the way we’re going to fund everything, it’s an extra tool and in some circumstances it may be appropriate for us to deploy it. Particularly when there might be a community element to what we’re trying to achieve, or we want to ensure there is great buy-in to the scheme that we’re funding for.”

**TOM KNOWLAND LEEDS CITY COUNCIL**

**CONTEXT**

**A3.01** Leeds City Council has an ambitious plan to decarbonise the city’s infrastructure and to make Leeds a centre for green innovation. Leeds Climate Commission, a collaboration between Leeds City Council, local Universities, and wider stakeholders, is mapping the city to commercialise an estimated annual £277m of profitable low carbon projects.

**A3.02** Leeds City Council wants to ensure that the economic benefits of these projects are captured locally and that residents of Leeds participate in the low carbon transformation. This has been communicated through the city’s new Inclusive Growth Strategy 2018-2023 that prioritises “people, place, and productivity”.

**A3.03** The council wanted to test if crowdfunding could provide a platform to communicate Leeds City Council’s low carbon projects whilst stimulating investment from local/regional citizens and businesses.

**A3.04** Crowdfunding was little known within Leeds City Council at the start of our involvement in the **Financing for Society** project, but, as a direct consequence of our participation in the research crowdfunding is now seen as an exciting addition to the range of financing options that can be deployed.

“Within the local authority, I think it’s safe to say that our knowledge was pretty low, other than witnessing that there has been the Leeds Community Homes initiative that have used crowdfunding to help fund some social housing in the city. But I would say our knowledge was very low. Where would we go for information? I don’t think we knew where to look.”

**TOM KNOWLAND LEEDS CITY COUNCIL**

**AIMS AND OBJECTIVES**

**A3.05** We wanted to test the suitability of crowdfunding in relation to financing a rooftop solar project on buildings across the Leeds City Council estate in order to supply electricity.

**A3.06** Before our involvement in the **Financing for Society** research, this was going to be delivered via long-term Power Purchase Agreements (PPAs) with the solar panels held by a company owned by Leeds City Council.

**A3.07** As a result of the learning outcomes of the research, however, the Financial, Commercial (Legal) and Energy (Low Carbon) teams within Leeds City Council are now looking to implement the project using crowdfunding (subject to further due diligence and internal review). This will be most likely through the Community Municipal Bond structure developed through the research process and led by Abundance Investment and the University of Leeds.

**PERCEPTIONS AND PRACTICALITIES OF CROWDFUNDING**

**A3.08** Existing knowledge of crowdfunding within the Finance and Commercial (Legal) teams was low and it was apparent early-on that there was no easily accessible information or central repository of case studies for Leeds City Council to draw upon.

**A3.09** Leeds City Council is also a very entrepreneurial and creative council, with lots of experience from a strong social enterprise sector, a Revolving Investment Fund of innovative finance solutions, and as mentioned some practical crowdfunding experience via the Leeds Community Homes initiative.

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127 http://leeds.candocities.org/about-leeds-climate-commission
128 http://www.leedsgrowthstrategy.co.uk
130 https://leedscommunityhomes.org.uk
“Leeds City Council really encourages us to think in a kind of entrepreneurial way. So, to say, ‘right, we’re going to take part in a project to explore the use of crowdfunding’, no problem at all getting buy-in to that. Although it’s still relatively early stages of the overall project, our Finance and Legal teams are willing to participate, keen to learn.”

TOM KNOWLAND LEEDS CITY COUNCIL

A3.10 Four workshops were held throughout the research period with the Financing for Society project team and external organisations. These workshops:

• Introduced the concept of crowdfunding to key Leeds City Council stakeholders;

• Tested different approaches; and,

• Refined a model that could work within the constraints of council operations.

A3.11 Engaging with internal and external stakeholders during the research has secured high levels of support with Leeds City Council for replacing traditional capital (i.e. PWLB) with crowdfunding for three main reasons:

BUILDING A MORE ACTIVE AND ENGAGED CITIZENSHIP WITHIN LEEDS:

• Crowdfunding connects residents with Leeds City Council activities in a new relationship and offers the chance to build new connections and new communication channels with residents, to catalyse new models citizenship for socially-beneficial outcomes;

• Direct investment via crowdfunding is perceived as a way to build new connections and new communication channels with residents;

LOCAL ECONOMIC BENEFITS:

• Crowdfunding enables more local investment in Leeds City Council activities and helps to retain economic benefits within the community via material projects in the city and wider city-region;

DIVERSIFYING LEEDS CITY COUNCIL’S FUNDING SOURCES:

• Crowdfunding provides a new means of financing projects that secures some protection from any future changes to existing borrowing practices (e.g. PWLB).

“Now it’s administratively and logistically simple to administer through the internet, I think it’s important that a crowdfunding option is available to whoever is procuring for, or project managing, the project. So, when you’re on the cycle of project management and you get to write ‘well, how are we going to pay for this thing?’, that you know crowdfunding is a respectable option alongside all the other existing ones; and in the local authority case, that’s going to be the Public Works Loan Board.”

TOM KNOWLAND LEEDS CITY COUNCIL

BARRIERS AND CHALLENGES

A3.12 The principal barrier was that any borrowing from residents had to meet Leeds City Council’s test of being “affordable, sustainable, and prudent”. This meant the crowdfunding model being developed had to ensure that capital and transaction costs were not higher than existing forms of borrowing.

A3.13 Even with expectations of additional social and environmental benefits from crowdfunding, it was felt that there was a risk this new financing mechanism could increase costs at a time when front line services were already under considerable threat.
To overcome the above challenges, three different crowdfunding models were explored with the research team:

**MODEL ONE: LEEDS GREEN INFRASTRUCTURE TRUST (LGIT)**
- A charitable ownership structure could be developed for holding the solar assets off-balance sheet for Leeds City Council;
- This new organisation would sell electricity back to Leeds City Council via its own Power Purchase Agreement (PPA), with crowdfunding used to provide project finance to the organisation to pay for installation and operation of the solar panels;

**MODEL TWO: LEEDS PROJECT COMPANY**
- Leeds City Council assume ownership of a project company that sells power back to Leeds City Council via a PPA;
- As with LGIT model, crowdfunding is deployed to provide project finance to the organisation to pay for installation and operation of the solar panels.

**MODEL THREE: COMMUNITY MUNICIPAL BOND**
- This involves on-balance ownership of the solar assets, with the electricity produced being used on site to displace the purchase of power from Leeds City Council’s existing energy provider;
- In this case, crowdfunding is used to raise finance for the installation and operation of the panels via a Community Municipal Bond;
- An important difference is established, however. Under the Community Municipal Bond structure, crowdfunding investors are assuming council risk not project risk.

Over the course of the research, Models One and Two were discarded on the basis that:
- they would likely increase Leeds City Council administrative costs; and,
- the capital and transaction costs for the project finance would be too high to pass the council’s test of being “affordable, sustainable, and prudent”.

The off-balance sheet approach of Model One was also rejected on the basis that the long-term PPA could be perceived as being on-balance sheet. Any future changes to accounting rules could also formally bring the project back on-balance sheet at some stage.

The Community Municipal Bond model was therefore explored in more detail. It was deemed attractive providing that the total cost of capital (both interest and transaction costs) could match or better existing PWLB rates\(^\text{131}\).

If this affordability test could be met, then the broader social benefits of raising capital from residents would make the Community Municipal Bond proposition highly attractive for Leeds City Council.

This assessment represents a marked shift in the thinking and appetite for crowdfunding within Leeds City Council from the start of the Financing for Society research project.

The first task was to conduct a technical and commercial assessment of the Community Municipal Bond option that emerged from the research.

This assessment centred on three key issues:
- the ability of Leeds City Council to issue a bond on a crowdfunding platform;
- the ranking of debt alongside other Leeds City Council debt; and,
- the risk to the investor of lending money to the Council.

Leeds City Council’s own assessment was informed by a history of issuing municipal bonds to retail investors, with the last of these bonds repaid in the 1990s. This previous bond issue was overseen by the current Senior Treasury Manager at Leeds City Council, who recalled the cost of administering the bonds prior to the internet becoming too high as compared to other sources of capital.

Following advice from both legal (via Walker Morris LLP) and financial (via Abundance Investment) organisations facilitated by the council’s involvement in the research, Leeds City Council has identified no technical barrier to the council issuing Community Municipal Bonds via a crowdfunding platform.

In terms of the financial model, the assessment concluded that direct ownership of the solar assets on balance sheet via the Community Municipal Bond offer was the most attractive route for Leeds City Council.

\(^{131}\) For further details, see Section 6 of this report.
It is now our view that the risk to both the council and the bond investors to the low carbon project is low.

The question that remains at this stage is how attractive such an offer would be to retail investors, especially those within the city and wider city-region, given the additional social and citizenship benefits anticipated via the use of crowdfunding.

A Community Municipal Bond pilot is planned by Leeds City Council for 2019 to evidence this appetite further.

“So, hopefully it will be possible for a lot of people to participate in terms of geographical boundary. And if it’s successful, and this sort of model starts to develop, and we start to explore other financial mechanisms of which crowdfunding is an important element, then I can see those sorts of funding opportunities also at a larger geography, say, the region level. But they would still have some sort of local residence, rather than at the national level.”

TOM KNOWLAND LEEDS CITY COUNCIL

**RECOMMENDATIONS**

A3.28 Reflecting on our participation in the research project, Leeds City Council cite a number of key learning outcomes and offer recommendations, which are primarily addressed to HM Government.

A3.29 Renewable energy projects that are supported broadly across all political parties appear to be well-suited to crowdfunding as an alternative form of finance. It remains to be proven if other public infrastructure projects – such as roads, schools, social care facilities, and so on – are equally attractive or will be forced to confront the claim that these should be funded through general taxation.

A3.30 Large-scale and nationally significant infrastructure projects (NSIPs) may not be as viable for crowdfunding to provide the full finance required and/or may no longer represent value for money beyond a given threshold.

A3.31 In order to be credible as a mainstream alternative to traditional PWLB borrowing, the cycle of project management and procurement ought to include crowdfunding as part of the respected mix of financing options to embolden local authorities to assess alternatives.

A3.32 Given entrenched city-based and region-wide socio-economic inequalities, it is an open question as to how far the local community will be willing or able to invest in local authority projects.

“How much potential community finance is available in Leeds? Leeds is an enormously diverse city, with some areas which are very wealthy and some areas which are desperately poor. And those desperately poor areas will not have spare cash to put into crowdfunding projects.”

TOM KNOWLAND LEEDS CITY COUNCIL

A3.33 A central repository of easily accessible information and case studies of crowdfunding for public infrastructure would be extremely valuable.

A3.34 It is vital to share the expertise and findings from this research across the public sector and to distribute the learning outcomes and new models of finance developed through this important collaboration with the University of Leeds.
There are other things that could be provided, and it would make more sense to provide them centrally, such as tool kits, guidance, professional training, development training for finance and legal officers, and so on, benchmarking set examples of good practice, things to avoid, all that kind of stuff which would make much more sense to be provided centrally. It doesn’t mean that it has to be done by Government, but it should be part of a national approach.”

TOM KNOWLAND LEEDS CITY COUNCIL

A coherent policy framework for crowdfunding and alternative forms of financing for the public sector would further encourage local authorities to explore their borrowing and investment options.

A being able to acquire development finance to take projects through a business case / legal advice process would also encourage further innovative and creative thinking.

Working with the FCA to establish and to communicate the rights and protections for the ordinary retail investor will be vital if ‘place-based’ community financing options are to be successful.

“A.38 To ensure that the findings from this landmark research are shared with, and become part of the culture inside, HM Treasury, BEIS and MHCLG to ensure a coherent and consistent message from the centre is communicated to local authorities.

“The main problem in the field is the lack of Government consistency in policy terms, which makes investment really tricky because people are nervous about future policy shifts. It’s not actually acquiring finance. If you’ve got a good project, you can get finance for it. It’s having the correct policy environment that’s stable. That is the biggest barrier.”

TOM KNOWLAND LEEDS CITY COUNCIL
Assessing the suitability of crowdfunding for the public sector

A4 NHS DUDLEY CLINICAL COMMISSIONING GROUP (CCG) AND ARCHUS LTD.
“It’s getting the first couple off the ground. Once you get something physical and you can say ‘... in Barnsley it delivered one of these’, or with our project in Dudley, when you’ve got an image of a new health campus. Then I think you will very rapidly get that buy-in. I think it’s going to be quite hard work to get the first couple of projects done. But I do believe that they will be market-making and, once the general public can see that, and you can then present something in a different area and say ‘... here’s an image of what you will end up with. This will be a local health facility and you’ll also be investing in your local health facility’. So, I think it’s about giving some tangible examples.”

RICHARD DARCH ARCHUS LTD.

CONTEXT

A4.01 NHS Dudley Clinical Commissioning Group (CCG) have developed a Health Infrastructure Strategy plan that calls for the development of health hubs with primary care, operating at scale, co-located with other community and out-patient services, and replacing the current model of dispersed primary care and centralised acute care.

A4.02 One such area identified for a hub scheme is Kingswinford in order to improve the delivery of services throughout the region. The primary care infrastructure across Kingswinford faces challenges as some of the buildings need significant investment to address current standards and to meet future need.

A4.03 At present, they do not support multi-disciplinary team working and negatively contribute to a poor patient experience. The NHS England Five Year Forward View calls for larger facilities that bring together multiple services to work together to deliver better health outcomes132.

A4.04 The Kingswinford scheme delivers the following benefits:

- Future service viability to meet increased population levels during the life of the facility;
- The facility will provide high quality services making the most efficient use of existing resources to reduce inequalities in health;
- The Hub will provide a collaborative approach to the delivery of services, across many organisations, to improve health outcomes;
- The Hub will result in services being delivered in a safe and sustainable manner; and
- The Hub will deliver services closer to the community and support the delivery of services within a patient’s home.

A4.05 The scheme includes a Health Hub, Extra-Care Housing and Supported Living, Affordable Housing and Leisure Facilities.

A4.06 The healthcare elements of this development are planned to be delivered through the NHS Local Improvement Finance Trust (LIFT) vehicle that exists in Dudley, namely Dudley Infracare LIFT Ltd (LIFTCo). The funding and capital structure will require debt and equity with equity contributions from the LIFTCo including both public sector and private sector shareholders.

AIMS AND OBJECTIVES

A4.07 The aim of the project was to explore what and where the Kingswinford project, including its financial model, needed to change or to adapt in order to accommodate investment by local residents and the general public.

A4.08 Our research study with the University of Leeds forms part of a series of studies that aim to explore the potential for adopting democratic finance (crowdfunding) for the funding and delivery of social infrastructure projects. Our work with the University of Leeds focuses on a community project in Dudley in the West Midlands, which is planned to be developed through the NHS LIFT Programme.

FINANCING FOR SOCIETY
Assessing the suitability of crowdfunding for the public sector

A4 NHS DUDLEY (CCG) AND ARCHUS LTD.

“I think the view is that if it is presented well then actually it’s a very positive message [...] aligning a financial return with a health return, i.e. by funding health infrastructure through the community we’ve got access to that which can in turn help to improve and maintain health status. So, it’s not just a pure monetary gain. It’s ensuring the sustainability and security of local services and the facilities.”

RICHARD DARCH ARCHUS LTD.

A4.09 The proposition is that the debt requirement could be organised to be wholly or partly structured through a crowdfunded instrument and that this in turn will help to engender significant local support and allow the asset to deliver a health, social and financial return to the community served.

A4.10 It is also considered that this model could be scaled across the NHS LIFT programme, with 49 LIFTCos currently operating and covering 60% of the population of England. This could therefore be a significant outlet for crowdfunding of social infrastructure and in turn help to modernise the NHS Estate.

PERCEPTIONS AND PRACTICALITIES OF CROWDFUNDING

“I think the point about it is a lack of knowledge. So that, with our projects, we come to the stage where it needs some form of approval because the end results will be a facility where an NHS organization or primary care organization is going to take a lease. They need approval to take that lease. If the view is that this is not conventional in the way it’s being funded, those that just aren’t used to it and see it as unconventional may create a negative view on the approval process because they only like to approve things that they are familiar with. There is an education process for us internally to our organization.”

RICHARD DARCH ARCHUS LTD.

A4.11 It is considered that the key difference between bank debt and crowdfunding relates to who takes the risk and how.

A4.12 With bank debt there is an accessible pot of money provided on an on-going basis by shareholders. The bank assesses the investment merits of a project before lending an amount on what they regard as appropriate terms with the main risk management tool being the debt/equity ratio.

A4.13 Whilst (bank) shareholders are interested in the overall portfolio of projects, they are mostly unaware of the detailed terms of individual projects. The cost of capital is determined by the market for bank shares and the additional cost burden for bank customers is determined by the resource costs (mostly people costs) of running a bank, including project finance teams, etc.

A4.14 As examined in our research with Leeds, crowdfunding is project specific and facilitates individuals building a (wide) portfolio of projects. The managers of a crowdfunding business provide a high-tech software platform that can bring together lenders and borrowers, as well as assessing and categorising risks and securities.

A4.15 The observation is that crowdfunders are content with a risked return lower than a bank’s fully built up return requirement so, in principle, there should be scope to utilise crowdfundng at scale because of the potentially lower total cost base.

A4.16 This needs to be tested further with crowdfunders, but the prima facie evidence from the research suggests that there is indeed a place for the crowdfunding of health and social infrastructure projects at scale.
A4 NHS DUDLEY (CCG) 
AND ARCHUS LTD.

A4.17 As stated above there may well be a place for bank debt as the market matures and the investment sums required increase (e.g. NHS LIFT has so far delivered £2bn of infrastructure investment). This would present an opportunity for crowdfunding to be deployed as a ‘mezzanine’ layer of debt finance in the capital structure.

BARRIERS AND CHALLENGES

A4.18 If it is to be pursued through NHS LIFT, the Kingswinford Health Hub project will require a combination of equity and debt funding. The equity will be provided by the LIFTCo shareholders in the role of the LIFTCo as the developer. The senior debt for LIFT projects nationally has been provided through bank debt from institutions that are familiar with project finance.

A4.19 Given the focus of LIFT on improving both services and infrastructure for given geographies, however, the potential of crowdfunding to link local investment with local return on that investment is considered compelling.

A4.20 The issue to be addressed, and that has been the main focus of our work with the research team, is whether a capital structure that includes crowdfunding can provide a funding solution that is of a similar cost of capital to traditional bank finance.

A4.21 It is recognised that the affordability will need to be established across the full capital structure and so the equity returns have been modelled at a level that supports a part crowdfunded financing solution.

A4.22 The financial model built for the Kingswinford project has followed the structure of a project finance model widely adopted in the LIFT market and the wider project finance industry.

A4.23 The model has been constructed to show cash-flows over a 25 year term. The costs within the model include:

- Build costs;
- Equipment costs (Group 1 equipment or fixtures and fittings supplied and fixed by the contractor);
- Fees;
- Land costs;
- Lifecycle costs (to include replacement of systems and services over the life of the building, e.g. lifts, heating systems etc.);
- Facilities management costs (to include maintenance of the fabric of the building over its life).

A4.24 The model went through a number of iterations during the research, with the final version developed in conjunction with the research team and led by Abundance Investment. This model is currently being reviewed internally.

A4.25 The key driver for the development of this model was the required cost of debt which would be appropriate for funding through Abundance Investment as the sponsoring platform.

“What target returns do we need to achieve from crowdfunding, in order for it to be attractive? We think at the moment we can get it to a level where the crowdfunding element is not that much different than the blended cost of equity and debt. We haven’t completed that yet, but we know how we’re going to go about it. We’ve got the numbers in, but we’re still going to finish that off. But we feel pretty positive where we are now that the crowdfunding option will compare well with a normal funding structure.”

RICHARD DARCH ARCHUS LTD.

133 Mezzanine debt is the middle layer of capital that falls between secured senior debt and equity. This type of capital is usually not secured by assets, and is lent strictly based on a company’s ability to repay the debt from free cash flow. It is a form of debt often used in complex private financing models.
The result of adopting the target return of 4.5% for a crowdfunded product via Abundance Investment produced an initial equity return of also approximately 4.5%, if the target rent of £180 per m² was adopted. This was not considered acceptable to equity and so a re-calculation of the rent was undertaken based on achieving the minimum acceptable level of equity returns.

Through discussion with equity it was determined that a minimum target return of 8% could be established. This had the impact of driving up the rent to approximately £220 per m².

On review of current rents being paid for primary care premises, the £220 per m² was not considered an outlier and has been adopted in the model in order to deliver the target returns for the debt based Abundance Investment instrument and the returns for the equity sponsors of the project.

These returns and inputs are now being used to produce and to circulate a project financial model for review by all relevant parties.

This study has demonstrated that democratic finance solutions (i.e. crowdfunding) are a viable method of financing projects delivered through the NHS LIFT Programme.

It has also confirmed that crowdfunding is likely to have a higher cost of capital than traditional bank debt. The bank debt funding of projects in LIFT is a mature market and this helps with both cost of capital and approvals processes from credit committees in the institutions that have historically provided debt.

Given bank debt will have a lower cost of capital, equity will need to take a view on returns in order to make projects funded through crowdfunded instruments attractive to the end-user and occupier. This is a trade-off for equity between return and scalability if crowdfunding was adopted as a positive method of delivering a social return.

Given this analysis, one route that should be considered is for crowdfunding to be included in the capital structure as a “mezzanine” level of finance. This would allow lower cost of capital bank debt also to be provided and to enable equity returns to be aligned with the development risk (planning, design and construction) being taken by LIFTCo as the developer.

“The benefits to the local population in having that combination of private care and extra care delivers an asset that actually improves primary care services locally, and so improve health status and access to health services for a population which has high health needs. Secondly, it addresses a demographic in the elders in terms of access to affordable housing. There are plenty of high-end retirement villages, but them being affordable is a difficult space. We’ve been able to show you can deliver that in an effective way so there is a new asset, and avoids people going into nursing homes, and avoids people going through the revolving door of health care. So that’s a big tick. Third is that, because it needs primary care, then we have employment. So, there are three aspects to it.”

RICHARD DARCH ARCHUS LTD.

A4.30 This study has demonstrated that democratic finance solutions (i.e. crowdfunding) are a viable method of financing projects delivered through the NHS LIFT Programme.

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A4.34 It is considered that this route of a mezzanine layer for democratic capital should be pursued in further research for the sector.

LOOKING AHEAD AND NEXT STEPS
A4.35 The results of the model developed through the research with Leeds were presented at a meeting that had representatives from Community Health Partnerships, Dudley CCG, Abundance Investment and Dudley Infracare LIFTCo. The key assumptions and implications for each party were presented, including the impact on the overall affordability of the project.

A4.36 It was agreed that the next step would be to take the outputs from this study and incorporate into the required NHS Investment Appraisal structure and to support the production of an outline business case.

A4.37 Separate to this process, Dudley CCG are undertaking an internal exercise to determine the proposed Procurement Route for the Kingswinford Project and to confirm if NHS LIFT is to be the route chosen.

A4.38 The outputs from our research with the Leeds team are being used for this exercise and have been considered helpful in illustrating that LIFT, through adopting a crowdfunding solution, is a viable delivery and funding structure to bring the project to fruition.

A4.39 The planned timescales for this work are to confirm a procurement route by the end of December 2018 and to complete an outline business case by the end of March 2019.

CONCLUSIONS

“Yeah, I think they will [invest], because everybody loves their local hospital whether in a village community or up in Leeds, where everyone loves Jimmy’s and the LGI. I think it’s localism, and I think the NHS brand helps with the national element of this, which is why it aligns so well because it’s unusual in having both a local and a national appeal. And people are proud of it, people believe it’s theirs and I think allowing crowdfunding to increase that sense of ownership is a real positive. The other thing to say is the fact that pre-1948 there’s certainly a large number of hospitals that were funded in this way. They were funded through public subscription.”

RICHARD DARCH ARCHUS LTD.

A4.40 This project with the University of Leeds team has sought to inform the debate on whether crowdfunding could be an appropriate source of debt and funding for health care projects at scale.

A4.41 In particular, the research has tested the suitability of a crowdfunded instrument for a healthcare project procured and developed through NHS LIFT. The analysis has focused on a LIFT project as this would enable similar crowdfunded instruments to be applied at scale in the market.

A4.42 LIFT is a mature procurement route with informed sources of capital available to it to fund projects. Given this position, crowdfunded instruments are being compared in terms of competitiveness with traditional bank funding.

A4.43 The Leeds research has therefore given rise to a direct comparison of the costs, benefits, and risks of crowdfunding with bank debt that, in our assessment, is both novel and likely to be market-making.
Assessing the suitability of crowdfunding for the public sector
There is a need to develop funding opportunities and financing options for the public sector. There has to be an understanding that funding from central Government and local Government is going to be limited for the foreseeable future, but that investment is still desperately needed in many parts of the country for different things. My message is to ask Ministers to be open to the opportunity that crowdfunding will provide, leaving aside the politics of whether or not things ‘should’ be funded in that way, to allow local individuals to help shape their local communities.”

JANE FRANCIS FORMERLY NHS KING’S COLLEGE HOSPITAL

The Institute of Haematology is a project sponsored and operated by the partners of King’s Health Partners (KHP), a leading academic health sciences centre where world-class research, education and clinical practice are brought together for the benefit of patients.

KHP exists to translate cutting-edge research and existing best practice into excellent patient care. KHP has significant strengths in haematology across clinical care, research and education and a history of clinical academic leadership successfully driving developments in these areas with internationally competitive haematological clinical services and research programmes.

KHP’s vision is for an Institute of Haematology and a wider Clinical Academic Network that brings together the partner’s strengths in clinical service, research, and education, to deliver exceptional outcomes for patients.

The Institute of Haematology will be hosted and delivered by King’s at its Denmark Hill campus. It will be a single large building hosting laboratory, inpatient, outpatient, research and education uses operated by the KHP partners and third parties.

The proposed Institute of Haematology comes at a time of rising demand for high-quality healthcare across the country, and at a time of increasing capital constraints and affordability challenge within the NHS, impacting viability and limiting structuring and financing options.

Using crowdfunding for the Institute of Haematology has the potential to strengthen community linkages and to create a sense of genuine ownership between small investors and the Institute.

In terms of financial benefits, there is potential for crowdfunding to reduce cost of finance when combined with industry investment, philanthropic investment and partnership with the University.

It is expected that through community investment, enabled by crowdfunding, there will be a stronger alignment of interests between investors and the users of facilities, allowing for more flexibility in dealing with change over time.
“I think there is a lot more public awareness, since the financial crisis in 2008, that local authorities and public sector bodies can ill afford to do things that they would like to do and there is more interest in the public to try and support and to help their local public sector bodies.”

JANE FRANCIS FORMERLY NHS KING’S COLLEGE HOSPITAL

A5.09 Using crowdfunding to fund part of this multi-million pound project could attract good publicity if it all goes well, also potentially increasing charitable donations. Crowdfunding could also have a positive impact on the delivery of this project:

A5.10 The possibility of bad publicity in the case of negative issues arising and/or failures will incentivise all parties to be on their best behaviour.

PERCEPTIONS AND PRACTICALITIES OF CROWDFUNDING

A5.11 The King’s College Trust understands that crowdfunding has gained traction mainly thanks to new technologies and social media in the last couple of years. Peer-to-Peer lending platforms are now better known in the mainstream and there is a general desire to invest in things that are good for society.

A5.12 Crowdfunding also promotes a more proactive approach to citizen engagement and participation by offering socially conscious investors the opportunity to invest into a project they believe in.

A5.13 We do note limits to the active engagement of crowdfunders, which is not necessarily negative from the King’s College Trust’s point of view, e.g. the perception of involvement of the community into the crowdfunded projects versus their actual level of involvement.

A5.14 In effect, the structure of the project, the governance, and the amount raised through crowdfunding will determine the level of influence crowdfunders can have on these sorts of projects. For the Trust, the perception of community involvement will have a positive impact through public relations.

A5.15 There is no lack of financing sources for infrastructure projects and our research findings, facilitated by the team at the School of Sociology and Social Policy in Leeds, suggests that crowdfunding will not significantly lower the cost of finance.

A5.16 The benefits crowdfunding brings are therefore mostly non-financial:

• It is hoped that through the community investment, there is a stronger alignment of interests between investors and users of facilities, allowing for more pragmatic and less expensive solutions in dealing with change over time;

• Another benefit crowdfunders could add to the project is a potential interest in re-investing their profits into the project, or in the community, if they are given the opportunity;

• Finally, crowdfunding adds a public relations element to the project. The innovative nature of the project structure will attract good publicity, possibly leading to more donations. In addition, it forces everyone to be on their best behaviour to avoid bad publicity.

BARRIERS AND CHALLENGES

A5.17 For the above benefits to materialise, early engagement with the Department of Health and Social Care (DHSC), NHS Improvement, and other KHP stakeholders is advised to enable general principles for use of crowdfunding and ultimately to seek a ‘standard form’ for procurements.

A5.18 In addition, careful marketing and coordination needs to be deployed to ensure that fundraising benefits from the crowdfunding process rather than being adversely affected by it.
**A5 KING’S COLLEGE HOSPITAL**
**NHS FOUNDATION TRUST**

“The question that I’ve been asked is: ‘What impact will the crowdfunding project have on our charitable arrangements?’ I think there has been a nervous myth at the moment that we might be taking money away from the charitable income that we would generate. But I think exploring the opportunities will actually open up wider funding opportunities rather than robbing one to pay the other.”

**JANE FRANCIS FORMERLY NHS KING’S COLLEGE HOSPITAL**

**A5.19 KHP FACES THE FOLLOWING CHALLENGES IN DELIVERING THE INSTITUTE OF HAEMATOLOGY:**

- The NHS faces capital constraints, and consequently any finance provided, whether crowdfunded or not, needs to avoid capital budget, leading to particular contractual structures being needed. In particular linking the finance into a bundled contract with a construction contract and maintenance contract, i.e. DBFM contracts that need to go through public procurement in an NHS Trust setting;

- As a result the crowdfunding would be sourced by the winning bidder not the Trust (the Trust is not the borrower). This means that there are complexities as to how much control the Trust can exert over the use of crowdfunding;

- Inter-creditor issues with other lenders, given the financing requirement for this project, far exceeds the amount that crowdfunding can raise at a single point in time;

- This could be overcome by central Government acting as an underwriter of future debt raises to allow larger amount of crowdfunding contribution phased over a construction period.

“If the public body was looking to use crowdfunding it would have to pass the ‘value for money’ test. I think that the rules around PFI are quite constrained, and they can be quite complicated in terms of ownership and bond holder structures, those sorts of things. So I think if there was a more straightforward model for crowdfunding, even slightly constrained in terms of the returns on investment, then I think there would be a ‘value for money’ case and it would be more straightforward.”

**JANE FRANCIS FORMERLY NHS KING’S COLLEGE HOSPITAL**

**MAIN FINDINGS**

**A5.20** KHP has concluded that given the complexity of the programme it will not actively prioritise the inclusion of a crowdfunding element within the delivery model at this time, but that it may revisit this in the future and will continue to liaise with its advisors to monitor opportunities involving crowdfunding.

**A5.21** The scale and complexity considerations with the Institute project suggest crowdfunding of social infrastructure should be focused on smaller and less complex projects than the Institute of Haematology in the first instance.

**A5.22** If its use for the Institute is desirable, however, then its application can be done via a single tranche or a ring fenced element within a larger financing structure.

**A5.23** In sum, the Trust has considered the use of crowdfunding for the Institute of Haematology but will not be pursuing it at this time.

**A5.24** The primary reason for this is that the KPMG analysis facilitated by the Financing for Society project shows that the affordability of the Institute of Haematology for King’s College Trust and KHP partners is very tight, with net financial contributions from the Institute forecast only just to cover the cost of debt service associated with its construction.

**A5.25** The view that crowdfunding would not offer any material reduction in financing cost from plentiful supplies of private finance and institutional capital means that community involvement becomes a “nice to have” rather than a core benefit.
A5.26 The Trust would first like to pursue securing as much charitable and industry donations towards the project as possible, which will drive down the overall cost of finance.

A5.27 The constraints in this sector do not relate to the availability of finance, nor to the cost of finance, since the NHS is viewed as an undoubtedly strong covenant and could access financing at competitive rates from a wide range of sources.

A5.28 Rather, the constraints relate to limitations imposed on the ability of NHS organisations to borrow, linked to the international definition of national debt, and a clear objective in Government policy to control levels of public sector borrowing.

A5.29 The DBFM model enables the delivery of projects by a non-public sector partner, which then makes a facility available to NHS clients. For major schemes, however, considerations to the inclusion of crowdfunding within procurement of such a transaction should be investigated in future research.

A5.30 Scale was a key issue for the Trust to consider. In order to satisfy large funding requirements with crowdfunding, multiple fundraises would be necessary, split over time. Since the outcome of subsequent fundraises would be uncertain at the time of construction commencement, contingency financing would need to be in place should future fundraising not be successful in order for construction to commence.

A5.31 For pilot schemes therefore, it may be prudent to limit the use of crowdfunding to an amount considered viable (on a project specific basis) for a single fundraising event, with any additional requirement provided from alternative sources.

A5.32 Identification of smaller projects, or self-contained elements within the Institute, which could be ring fenced and to which crowdfunding could be applied may enable an early proof of concept to be delivered more quickly than the Institute of Haematology timescales would permit.

A5.33 Complexity was also a key consideration. A complex scheme with multiple sponsors, multiple end-users, and multiple uses, with the added complexity of a new and novel form of financing, makes highly complex schemes challenging to get off the ground.

“I think a central repository [of case studies] and sharing of information is essential. There is within the NHS various groups that share information and experience, and highlight challenges and problems, and how to resolve them as well […] The NHS may well be making the same decisions, or the same mistakes, that perhaps some other department might have resolved.”

JANE FRANCIS FORMERLY NHS KING'S COLLEGE HOSPITAL

LOOKING AHEAD AND NEXT STEPS
A5.34 The next steps in the process are:

- Early engagement with DHSC, NHS Improvement, and other KHP stakeholders;
- Further engagement and market soundings with established funders, sponsors and other platforms;
- Identification of smaller projects or self-contained elements within the Institute of Haematology that could be ring fenced and to which crowdfunding could be applied may enable an early proof of concept to be delivered more quickly than the Institute timescales would permit.
RECOMMENDATIONS

“I think there’s a need to balance the commercial expertise that you would find in the private sector with commercial expertise in Government. So I would expect there to be support from Treasury and other financial departments of the Government to support King’s in understanding what the options are. But I would also expect there to be a need to look commercially outside of Government at what the private sector is doing.”

JANE FRANCIS FORMERLY NHS KING’S COLLEGE HOSPITAL

A5.35 UK Government could further facilitate the use of community investment through acting as an underwriter, allowing crowdfunding to be raised in tranches over the construction of a project without risk to the procuring authority of finance not being forthcoming.

A5.36 This would allow significantly larger projects to be crowd-funded without long term impact on the public sector balance sheet and should be explored further.

A5.37 In addition, Government should consider what their approach will be on how to use crowdfunding within a public procurement process, focussing on public procurement of DBFM type structures.

A5.38 The use of crowdfunding in procurements have the potential to be used more broadly in social infrastructure.
A6 THE ROYAL DEVON AND EXETER
NHS FOUNDATION TRUST

FINANCING FOR SOCIETY Assessing the suitability of crowdfunding for the public sector
A6 THE ROYAL DEVON AND EXETER NHS FOUNDATION TRUST

CONTEXT
A6.01 The Royal Devon and Exeter NHS Foundation Trust is seeking to provide better quality care for patients with suspected dementia, including the development of elderly care residential accommodation that may take the form of a care village/dementia care home.

A6.02 There are a range of commercial options available for funding the development and ongoing delivery of the project, but the Trust has very limited capital finance of its own and would require any financing secured for the accommodation not to score against Capital Department Expenditure Limits (CDEL)\(^{134}\).

A6.03 A wide range of financing and commercial delivery options were explored at the strategic outline case stage and feasible options will be further explored in the outline business case in order to determine the optimal funding solution.

A6.04 Financing and delivery options include:
- Leasing: Operating leases, service inclusive leases, sale and leaseback arrangements and Income Strip leasing;
- PPP project finance;
- Financing from the community based Exeter Infrastructure Fund;
- Joint Venture Partnership with the private sector, with the land being the Trust’s equity consideration.

AIMS AND OBJECTIVES
A6.05 The inclusion of a tranche of crowdfunding could bring a range of benefits to the Royal Devon and Exeter Trust, the residents of the facility and the local community, in addition to garnering local interest in a way that would not be possible via traditional funding.

A6.06 This local ‘financial interest’ could then bring further benefits by way of:
- aiding the planning process through including citizens in the development phase;
- enhancing the marketing of potential new services to local residents; and
- increasing local awareness and engagement with/responsiveness to the needs of the community in order to build a closer relationship with the Trust.

“There isn’t a shortage of ideas for transforming public services […] what there is a shortage of is access to funding and access to the resources that help deliver those schemes. Those last two things are obviously incredibly critical to transform some of our public services. So, if we have an innovation agenda, we’ve got to get those two things right. And I think what this project is doing is trying to address an extra stream of income funding that would help with these projects and that’s why this is important.”

DAVE TARBET NHS ROYAL DEVON AND EXETER

\(^{134}\) https://obr.uk/forecasts-in-depth/tax-by-tax-spend-by-spend/departmental-expenditure-limits/
“Access to funding is one of our important resources or enablers to allow that change to happen. The public purse is challenged and constrained from a capital investment perspective, so the Department of Health has got limits on funding. So we’re starting to look at ‘public private partnership’ arrangements and I think where crowdfunding comes in is that it fits in with that sort of funding stream […] but there’s also a real community engagement aspect to it. It could well be that, with a local community feel, it’s so compelling to them they’re interested in putting their own investment into the project. That’s what we want to test.”

DAVE TARBET NHS ROYAL DEVON AND EXETER

PERCEPTIONS AND PRACTICALITIES OF CROWDFUNDING

A6.07 The Trust had limited knowledge or practical experience of crowdfunding before working with the Leeds-based research team. Perceptions mirrored those of the general public perception in regarding crowdfunding to involve the making of donations towards a specific project, with the expectation of a tangible, but non-financial, reward.

A6.08 Likewise, local people may share a perception of crowdfunding as involving communities pulling together to fund a local group or service. Some residents may have a broader experience of crowdfunding for local small and medium-sized enterprises (SMEs) that are looking for start-up capital, perhaps promoted by a friend, a relative, or via wider social connections (either materially or though social media connections).

“I can’t see why we would want to necessarily restrict based on geography. In the sense that, you know, if the most important thing is to get to the target level of investment, then why would you say to people who live beyond the boundary that they can’t invest? It doesn’t really make sense. I think it’ll be more of a natural boundary that’s established because I think there’s an argument to say that if you live far away, then why would you invest unless you saw this as a great investment?”

DAVE TARBET NHS ROYAL DEVON AND EXETER

A6.09 The research facilitated by the University of Leeds’s Financing for Society project included an assessment of financing options provided by three crowdfunding platforms, namely Abundance Investment, Capital Stackers135 and Triodos136.

A6.10 This work established that there is an appetite for platforms to assist the Royal Devon and Exeter Trust with:

- Providing junior or senior debt for projects;
- Funding the construction period or operational term period costs;
- Potentially lending into a PPP structure;
- Taking part in funding competitions to show value for money;

135 https://www.capitalstackers.com
136 https://www.triodos-im.com
FINANCING FOR SOCIETY Assessing the suitability of crowdfunding for the public sector

A6 THE ROYAL DEVON AND EXETER NHS FOUNDATION TRUST

- Accommodating public sector investment approval needs to accommodate this; and,
- Securing access to investors that have an appetite to invest their money.

BARRIERS AND CHALLENGES

A6.11 The most obvious and principal barrier is that crowdfunding has not previously been used for an NHS project.

A6.12 Convincing relevant internal and external approval bodies that crowdfunding is secure, deliverable and represents value for money is the main challenge from a public sector perspective, as identified through the research.

“How do we get that engagement internally and get people to see this as a real benefit? I think the answer is that we demonstrate that it kind of worked for our project and therefore is a real, genuine, and non-hypothetical option. That it’s been tested in an environment that, okay, is a little bit static because it’s just one project, but that could still demonstrate that it works or doesn’t work. I suppose even if it doesn’t work, you recognize that sometimes you might get to ‘prototype 55’ before it works, and that the first few didn’t work because there were things that we had to learn from the process. I’m quite happy that we explain that, you know, you’re not going to get there first time. If you close every innovation because the first prototype didn’t work, then you’d never get anywhere.”

DAVE TARBET NHS ROYAL DEVON AND EXETER

A6.13 Given this degree of caution and sensitivity to engaging in activities that could prove unsuccessful, and therefore garner criticism and risk reputational damage, the research began to focus on deliverability as understood from a financial perspective.

A6.14 Crowdfunding platforms may need to offer greater flexibility with regards to price competitiveness and deliverability, in terms of local take-up and the ability of platforms to raise the full amount required for large infrastructure projects.

A6.15 Managing public perception is crucial here. Marketing and communications strategies to raise awareness amongst new types of investors need to ensure that a wide section of the community is reached in order to realise the social benefit envisaged by crowdfunding platforms. This must include people who don’t currently understand much about the crowdfunding market beyond gifting to donation-based models.

A6.16 In this way, projects will be better able to access a regular supply of savings and investments that would otherwise leave the local community if handed over to mainstream financial institutions.
“But the market needs to expand into the ‘non-early adopter’ groups, to people who don’t understand much about this market. That way you get at the supply of savings that can be used for investment. Unless you break into that group, then I think it stays as a unique specialist area that has a small number of platforms and is only really sourcing its supply of money from those early adopters.”

DAVE TARBET  NHS ROYAL DEVON AND EXETER

MAIN FINDINGS

A6.17 Those seeking support for new forms of finance such as crowdfunding will need to quantify the community and economic benefits of a given project to demonstrate the added value of using this approach.

A6.18 This will help to offset what appears at present to be a deliverability issue of some crowdfunding solutions and the potential higher cost of capital than traditional mechanisms of public sector borrowing.

A6.19 Striking an attractive balance between deliverability, community benefit and economic feasibility would seem to be crucial in any assessment of the suitability of crowdfunding to provide a successful outcome for public investment.

A6.20 The research undertaken with the University of Leeds has shown that there would be interest from within the crowdfunding sector for the Care Village project, either by providing the full 100% of the funding required, or by taking a ‘junior’ financing role to raise only a percentage of the total funding requirement.

A6.21 If successfully applied, crowdfunding would have the additional benefit of bringing increased local interest into the project that could aid planning processes, provide a good source of marketing, and also increase local awareness of new, transformed or purely re-located public services.

A6.22 Awareness at all levels will be key to any future success of crowdfunding an NHS project. If platforms are to be considered as a viable additional source of funding, then the various funding options available from the many crowdfunding platforms need to be more widely understood by UK public sector bodies.

A6.23 Similarly, crowdfunding platforms also need to show that they fully understand the complexities of delivering public sector projects. The research undertaken by the University of Leeds is therefore a significant first step in this process.

LOOKING AHEAD AND NEXT STEPS

A6.24 The Outline Business Case for the elderly ‘Care Village’ is progressing within the Trust and is at the stage of finalising the clinical model of care.

A6.25 Once this is complete, the research findings will be used as a core part of the wider evidence base for developing the commercial case for different funding possibilities.

A6.26 At the time of submitting our case study report to Leeds, the Trust considers crowdfunding to be a viable component for the funding of the scheme, but we are unsure based on the research whether or not the full funding of the scheme could come from a single crowdfunding investment, or if there would need to be a consortium arrangement.
RECOMMENDATIONS

“The problem with building public services based on people who have money, and who want to invest in those specific types of projects, is that the choices that are made around those public services tend to be dominated by those who invest. If you look at philanthropy, for instance, there is an argument to say that if you want to be a great philanthropist then just pay more tax! Society will decide what the best use of those funds are, rather than you deciding on what you think you like. So if this is all about vanity projects for wealthy people then you’ve got to be careful with that sort of philanthropy approach. I think it plays back to that point which is that certain basic public services are just going to have to come through taxes.”

DAVE TAR BET NHS ROYAL DEVON AND EXETER

A6.27 The Royal Devon and Exeter Trust felt that it was for national policymakers to decide if there is real economic merit in using crowdfunding for public sector projects, as opposed to existing forms of financing.

A6.28 If so, then Government should signal this by providing clear answers to the following questions:

- In what sectors, and from what projects, would it be best suited?
- Would investment be limited to certain schemes and at certain values?
- A combined reaction from all stakeholders being required, how would this include increased stakeholder and market engagement?

A6.29 Many public sector approval bodies are not yet aware of the depth of crowdfunding platforms in the market and what they might be able to offer.

A6.30 In order to address the challenge of developing a better mutual understanding between crowdfunding platforms and public sector projects, a dedicated programme of awareness raising and the development of guidance materials should follow for local bodies to use.

A6.31 This should include a crowdfunding toolkit with a reference guide available from a newly created central repository of information and opportunities for knowledge exchange. The Trust concluded that this measure would be really important and is currently the biggest barrier to crowdfunding public sector projects.

A6.32 A knowledge exchange programme also needs to be rolled out so that people can understand how the market works, who the key players are, and how the specific finance options work.

“"You should avoid anything that keeps this fragmented, or specialist, anything that requires specialist knowledge to access it. It needs to be rolled out in a way that people can understand who the market players are and how the finance piece works. So I think that’s the central role. And you could imagine a Government department taking responsibility for this and, you know, the Government having some form of website that allows you to access the right advice, just giving you the information. That would be really important!”

DAVE TAR BET NHS ROYAL DEVON AND EXETER

A6.33 It could be that a Government department and/or the team at the University of Leeds takes responsibility for this, either singly or jointly, to build some form of website that allows public sector bodies to access key information and signalling where to find the right advice.
B EXTENDED SUMMARY

INTRODUCTION
B.01 This report investigates ‘investment-based’ crowdfunding as a new model of finance for the public sector.

B.02 There is a high level of public awareness about the financial challenges faced by the public sector as spending cuts become increasingly visible in towns and cities.

B.03 The UK Government’s Civil Society Strategy recognises that social value flows from thriving communities with strong financial, physical and natural resources, and strong connections between people.

B.04 The option to use ‘investment-based’ crowdfunding as a way of engaging local citizens by responding to their needs and concerns within the community, whilst at the same time offering them a competitive financial return for investing in regionally-led solutions to those concerns, appears attractive but untested.

B.05 Increasing resident (local authority) or service user (NHS) involvement in project ideation, for example, is something that the public sector could explore given the potential to enhance community engagement through crowdfunding activities.

B.06 In this context, we wanted to know if crowdfunding could offer better value to the public sector, and if the process as a whole could mirror that for the Public Works Loan Board (PWLB) or via Public Private Partnership (PPP) project finance as common sources of public sector funding.

B.07 We also wanted to use our research to help overcome existing knowledge barriers and to assess if the internal capacity required to develop crowdfunding for the public sector could be minimised.

B.08 To facilitate this work, the Financing for Society project tendered a total Pilot Fund of £300,000 that opened on 15th January 2018 and closed on 30th March 2018. Public bodies were eligible to apply for up to a maximum value of £75,000 each to be spent on a range of feasibility activities to explore the potential of public sector crowdfunding (see Section 2).

B.09 The independent project was funded by a research grant made by the UK Government’s Department for Digital, Culture, Media, and Sport (DCMS). The project was led by Dr Mark Davis working with Dr Laura Cartwright, both based in the School of Sociology and Social Policy at the University of Leeds, and co-created with our principal research partners: crowdfunding platform Abundance Investment; and Local Partnerships, a joint venture between the Local Government Association, HM Treasury and the Welsh Government.

B.10 Through this process, we worked with six case studies – three UK local authorities and three NHS bodies – along with external partners to evaluate the economic, legal, technical, and political potential of crowdfunding, resulting in a series of evidence-based recommendations.

WHAT IS CROWDFUNDING?
B.11 In its simplest expression, crowdfunding is a way of financing projects, businesses and loans through small contributions from a large number of sources, rather than large amounts from a few (see Section 3).

B.12 In practice, individuals deposit money on an online crowdfunding platform, committing that money to a specific project, business or loan, and have that relationship mediated by the platform.

B.13 Whilst crowdfunding is too often mistakenly associated only with gift making to socially-oriented initiatives via ‘donation-based’ business models, ‘investment-based’ crowdfunding (i.e. debt, equity) is the largest UK alternative finance sector by volume. This is where people provide capital on the basis of receiving a financial return.

B.14 Investment-based crowdfunding is regulated by the Financial Conduct Authority (FCA). In 2014, building on existing rules, they introduced new specific investor protection rules that provided a solid foundation for the sector’s continued growth to date.

B.15 The size of the UK crowdfunding market demonstrates that many people trust crowdfunding and are motivated to invest, with the market trend moving towards more investment-based crowdfunding. Research undertaken by the author for the FCA revealed that some investors are more prepared to accept a ‘blended return’ that realises social, environmental and economic outcomes.
B  EXTENDED SUMMARY

B.16 In the context of public sector crowdfunding, helping a local authority to deliver a better community service and/or helping an NHS body to provide better care locally, represent material opportunities for people to realise that blended return from their investment.

B.17 One of the principal opportunities represented by the emerging collaboration between the public sector and crowdfunding platforms is how to enable and to encourage further local investment by residents of any available resources for the good of their community.

B.18 Crowdfunding has been successful in the UK by using technology to remove layers of the traditional financial system. In so doing, it has created a better deal for investors and finance receiving companies. Crowdfunding has also introduced greater competition into UK finance markets for business.

B.19 A leading example would be the support given by the British Business Bank (deploying UK Government capital) to peer-to-peer (P2P) platform Funding Circle to grow the SME finance market by purchasing loans on the platform, which functioned both to encourage pipeline and to establish confidence for retail investors.

B.20 Public sector crowdfunding is still nascent, however. The state relies on private capital, whether that is through the purchase of Gilts or to finance Public Private Partnership (PPP) style projects. This private capital tends to be sought from large scale investors, such as pension and life companies.

B.21 One important question that our research considered, therefore, was the extent to which the competitive benefits found in crowdfunding markets for business can be replicated in the public sector by directly engaging citizen investors and tax payers.

KEY FINDINGS

B.22 Evidence from our six case studies indicates that investment-based crowdfunding has the potential to deliver a new model of finance that enables public bodies not only to source competitive capital, but also to connect and to communicate more effectively with their residents and service users in a way that builds local networks of trust (see Section 4 and Appendix A).

B.23 Our data also suggests that there is an appetite for investors to back public sector led projects.

B.24 We found that any community investment into either an NHS PPP project, a council or a council owned project, regardless of any anticipated social benefits, would still have to compete favourably with traditional sources of capital in terms of cost, terms of capital and its ease of use.

B.25 Two main barriers for the public sector that emerged during our research were:

- a lack of knowledge and expertise within public bodies with respect to crowdfunding as an investment-based business model; and
- a concern that current crowdfunding models could not better the capital costs or administrative costs of existing forms of public sector borrowing.

B.26 To provide solutions to these barriers, as key outputs from the research we have:

- developed a public sector ‘decision tool’;
- co-created a new Community Municipal Bond structure for the public sector; and
- found that crowdfunding can provide an alternative to private capital for small scale PPP projects in the NHS.

DECISION TOOL

B.27 To assist with assessing the suitability of crowdfunding for public sector projects, the research team created a decision-making tool based upon our work with all six case studies (see Section 5).

B.28 This tool provides a summary of how crowdfunding could be considered as part of the normal stages of a local authority’s project development process.

B.29 In particular, the tool highlights how project and investment risk can be transferred according to considerations of ownership, control and borrowing limits.

B.30 This ranges from full transfer of risk to the private sector through to full control and assumption of project risk by the local authority, despite the funds being raised for a specific purpose.

B.31 Crowdfunding is then mapped onto these potential scenarios, whereby crowdfunding assumes either project risk or local authority risk in cases where the authority has retained full ownership and control.
B EXTENDED SUMMARY

B.32 How due diligence is organised, and how the product is managed between a local authority and a sponsoring crowdfunding platform, will need to be factored in to the overall assessment of risk for a given project.

COMMUNITY MUNICIPAL BOND

B.33 Led by Abundance Investment, our research team worked closely with Bristol City Council and Leeds City Council to co-create a new Community Municipal Bond structure (see Section 6).

B.34 This was designed specifically to allow local authorities to raise capital efficiently and cost effectively, whilst also increasing civic engagement by connecting local residents directly to the activities of the issuing authority.

B.35 When compared to existing sources of local authority financing (e.g. PWLB, Municipal Bond Agency, Bond Issuance to institutions, Inter-Authority Lending), the issuance of a Community Municipal Bond has several key social impact benefits that help to make it attractive for public sector bodies. It:

- Drives local engagement in local authority activity by offering a new channel for communicating strategy and progress to residents, increasing awareness and fostering ongoing support for local authority activities;
- Redirects returns on capital to local residents who have invested in the bonds, ring fenced to be spent in the area;
- Potentially increases patronage from investors (relative to asset class); and
- Has the potential to encourage new donation-based income streams from civic minded resident investors, who may begin to donate bond interest payments back to the local authority for non-core services.

B.36 Community Municipal Bonds have the potential to command a lower cost of capital because project risk is managed by the local authority within its balance sheet and is not transferred to investors.

B.37 As our research with the case studies indicates, the risk of a local authority defaulting on its debt is very low. One of the principal benefits of this new model of finance, therefore, is that it allows greater transparency and hypothecation of investment capital inflows into the local authority, while holding the risk separately and having this risk managed via the local authority’s standard operating practice.

B.38 Our research also identifies Community Municipal Bonds as having the potential to fill a gap in the retail investment market for low risk income-generating financial products, offering returns and risk profiles comparable to UK Gilts and Annuities.

B.39 An initial analysis of current UK Gilts and Annuities rates of comparable lengths show that Community Municipal Bonds could provide investors with better risk-adjusted returns, while also remaining cheaper for local authorities than PWLB loans.

B.40 The proposal for local authority backed bonds that are secured on an asset could also provide a way of sustaining borrowing in those situations where local authorities have low credit ratings.

B.41 A challenge to scaling Community Municipal Bonds, however, is that the rules relating to the Innovative Finance ISA (IFISA) were obviously created before this new Community Municipal Bond structure was created. As a result, bonds issued by local authorities are not currently eligible to sit within an ISA.

B.42 As supported by the evidence submitted in this report, we strongly recommend that HM Treasury considers amendments to statutory legislation in order to extend the IFISA to include bonds. Whilst the ‘unwrapped’ return would still be competitive with traditional investment products in the event of non-eligibility, having the capacity to wrap the product within an ISA would put downward pressure on the cost of capital to local authorities.

B.43 In our view, this would also help to obtain a clear sense of the volume of investment that this change would unlock and demonstrate appeal to the target group of investors. The next step is to pilot the Community Municipal Bond structure in a real world context, which is one of several recommendations that we propose.

CROWDFUNDING TO REPLACE PRIVATE CAPITAL FOR PPP PROJECTS

B.44 Our research with three NHS bodies found that the relevant guidance on borrowing drives NHS project development toward the use of ‘project finance’ such as PPP structures (see Section 7).

B.45 PPP structures mean the project tends to be delivered on a Design, Build, Finance, Maintain (DBFM) basis by a non-public sector partner, which then makes a facility available to the NHS client.
EXTENDED SUMMARY

This PPP approach is increasingly seen as controversial, but it currently remains the dominant approach to NHS project delivery. Our research indicates that crowdfunding could provide a viable alternative that overcomes the political controversy with a new model of finance.

The three NHS case studies seeking finance represented a range of project scales and complexities. The largest project was put forward by King's College Trust, seeking £200m of capital for the development of a new Institute of Haematology.

The other two projects were smaller in scale. Royal Devon and Exeter NHS Foundation Trust was seeking around £20m for a new elderly care residential development. NHS Dudley Clinical Commissioning Group (CCG), through the relationship with Community Health Partnerships and their NHS Local Improvement Finance Trust (LIFT) framework, considered the use of crowdfunding in the delivery of their Kingswinford community care centre.

Our research suggests that crowdfunding may potentially offer a competitive source of senior and 'mezzanine' debt with respect to price and investment terms. As with the local authority context, by enabling retail investors to invest directly in a project, some of the layers of the traditional financial system are removed helping to create efficiencies in the process.

As the current model of PPP tends to rely on institutional capital, the needs of the service provider and the needs of capital often come into conflict. Capital looks to prioritise the protection of targeted investment returns, whereas service providers will focus upon optimising service delivery.

Crowdfunding appears to have the potential to align these interests far better by enabling service beneficiaries also to become investors. These investors are the decision-makers for their own capital in contrast to institutional money, which must refer to its mandate. More often than not, institutional money will be less flexible and focused solely on optimizing financial return.

A mix of motivations and outcomes is likely to emerge, however, since capital is unlikely to benefit directly from service use, and service beneficiaries may not achieve optimal financial returns from their investment.

The decision to create a PPP involves the transfer and/or sharing of project risk with investors. This is a familiar approach for existing crowdfunding investors and the communication of risk (and checking on the understanding of those risks) is already an important part of the role of an authorised crowdfunding platform. This would still hold for the process of issuing a bond within a PPP.

Introducing crowdfunding to PPP projects is not without its challenges, however, including the need for PPP projects to align a number of different investors, institutions and stakeholders around a financial close date. Indeed, there may be a need to align investors before this (e.g. when the PPP provider submits a bid, since financing often needs to be committed in advance).

As crowdfunding platforms do not have their own capital to deploy, but are required to raise capital against a specific project, it is challenging for them to be incorporated within this standard process.

Our research indicates that this might be easier to manage on smaller scale projects, as the risk of not raising the required funding decreases. On very large and ambitious projects, such as the one represented by the King's Institute of Haematology, the risk of a crowdfunding platform not raising sufficient capital to fill its allocation increases the risk for the entire project.

A second challenge raised by all three NHS case studies is that of determining precisely who benefits from the introduction of crowdfunding. For the NHS cases, the project equity was intended to be either entirely or partially owned by for-profit companies, which may undermine the appeal to community investors motivated by the public good.

In our assessment, if crowdfunding enables community investors to provide a lower cost capital for such projects, then ensuring that the additional benefit of their investment accrues entirely and demonstrably to society and not to the private sector is critical.
B EXTENDED SUMMARY

B.59 As a further response to this challenge, we pose the question as to whether the ownership structures of PPP projects need to evolve, and/or whether civic minded community investors could help to drive the emergence of a new and ‘not-for-profit’ PPP sector.

B.60 When thinking about finance, knowing the social value of different types of money matters. Assuming the overall cost of capital to be equivalent, if there is a higher social value in one form of capital than another, we would prefer to see this option selected.

B.61 Whilst finance is not a part of the government’s approach, we suggest that our thinking nevertheless aligns with the 2012 Public Services (Social Value) Act that requires people who commission public services to think about how they can also secure wider social, economic and environmental benefits.

CHALLENGES AHEAD

OVERCOMING A CULTURE OF RISK-AVERTION

B.62 Whilst our six case studies each demonstrated truly creative and ambitious thinking, it was noted that there still remains a culture of risk-aversion within public sector bodies (see Section 8).

B.63 A key barrier to pursuing a less risk-averse strategy is a perceived threat to the reputation of a local authority or NHS body by being an ‘early adopter’ of a new model of finance, especially in the absence of a coherent policy context that offers some security.

B.64 Subject to early evidence of success, this confirmed to us that subsequent support – including a coherent and consistent policy framework from UK Government; additional financial resource; knowledge exchange events; and changes to current procurement processes – will be needed if the uptake of crowdfunding as a new model of public sector finance is to scale rapidly and have the chance to realise identified benefits.

B.65 A crucial first step in this process will be creating initiatives to get relevant senior teams on board at the local level, as well as giving them the confidence that exploring the potential suitability of crowdfunding for a given project is both legitimate and encouraged.

B.66 Whilst mindful of the need to manage reputational risk, the long-term security of public sector bodies (e.g. institutional longevity; higher credit standing, etc.) means that there is potentially lower risk to investors from public sector crowdfunding than with some other forms of high-street savings and investments.

B.67 At a time of acute economic uncertainty, it is not just the public sector that requires support and reassurance. The UK public are also likely to be risk-averse, and so require clear and material incentives, if they are to consider changing the way they habitually use or invest their money.

B.68 One way of overcoming this could be the appointment of crowdfunding ‘champions’, from within a local community. This could be achieved through the appointment of new Citizen Commissioners and help to ensure that material social and/or environmental benefits are accrued to the local area. Not every council will have sufficient resources or personnel to run such an initiative, however, underscoring the need for further resourcing and support.

RISK TO GENERAL AND LOCAL TAXATION

B.69 A common concern amongst our six case studies was the belief that the general public would expect large infrastructure projects be financed through general taxation.

B.70 This was especially the case for the three NHS bodies who continue to feel keenly the complex systemic changes to both their financial structures and modes of organisation.

B.71 Any change to the valuation of the NHS as a public good, to be collectively funded through general taxation, represents a clear and present risk to how the entire health system of the UK operates.

B.72 Similarly, local authorities were concerned that crowdfunding might be perceived by local residents as a new form of council tax ‘by stealth‘. Evidence from Swindon Borough Council, however, offers a degree of confidence that residents can be positively disposed towards public sector crowdfunding.
**RISK TO PHILANTHROPIC AND CHARITABLE FUNDING**

**B.73** We also identify a potential risk to the high levels of philanthropic and charitable donations made in the UK, especially those sizeable gifts frequently made to the NHS.

**B.74** In becoming more accustomed to crowdfunding as an investment-based model, which facilitates financial support for socially beneficial causes, the resident-as-investor may begin gradually to move away from the principle of gift making through donations.

**B.75** To mitigate this risk, we stress that crowdfunding should be positioned as an alternative to traditional savings and investment products provided by mainstream financial institutions, and not as an alternative either to existing charitable donations or to existing forms of taxation.

**B.76** A principal offer of crowdfunding is the opportunity for investors that are concerned about the outcomes created by their investments to move their money into transparently more socially and environmentally positive investments.

**B.77** We also signal the importance of the banking sector’s response to the rise of crowdfunding since these and other mainstream financial institutions are unlikely to remain inactive.

**B.78** Whether their response to public sector crowdfunding will be in some way collaborative, or directly competitive, remains to be seen. Any changes to the market that are proven to deliver more socially-beneficial outcomes are to be welcomed, however.

**B.79** At the very least, providing greater competition in the market will ultimately help the public sector by bringing down the cost of capital and improving terms. If this was to be the sole effect of crowdfunding, we believe that this still would be beneficial to the public.

**ATTITUDES TO ‘PLACE-BASED’ INVESTING**

**B.80** A number of perceived limits to ‘place-based’ investment enabled by crowdfunding were raised by our case studies. These centred on a perceived tension between the idea of investing in a specific region versus the idea that potential investors would be living in, or affiliated to, a given place.

**B.81** On the one hand, the idea of ‘place-based’ investing is attractive to public sector bodies seeking new forms of civic engagement. On the other hand, it is an open question as to how much sustained investment could be raised only from within a geographically proximate community.

**B.82** On the assumption that crowdfunding can deliver on its promise of providing competitive capital, then in some respects it does not matter where the end investors live. Every pound that is raised should be welcomed if it saves the public sector organisation in reduced costs of capital.

**B.83** That being said, it is still imagined that a public body would want to prioritise local investors precisely because of the wider ‘place-based’ social benefits of using crowdfunding.

**B.84** To mitigate the risk that non-local investors may crowd out local investors, and whilst potentially complex to administer, a platform could consider initially restricting access to a given project by geography (e.g. through targeting postcodes). Only once local demand has been satisfied could the project be opened up as an offer to non-local investors.

**B.85** Another significant challenge to place-based investing is the entrenched and hardening social and economic inequalities between UK regions. It is far from certain how many members of a given local community would be able to participate in a public sector crowdfunding campaign.

**B.86** All stakeholders will need to find ways of encouraging non-local investment into those areas where there is limited scope for mobilising local investors, but where the urgency of local need to find additional forms of finance for public infrastructure and services is often greatest.

**B.87** In its ideal form, crowdfunding can be a solution to this challenge. A successful crowdfunding project has to balance the need for accessibility and involvement (usually via low minimum investment amounts of £5-£10) with the need to provide volume of capital where it is needed (and where local investment capital may be limited and constrained).

**B.88** Our research indicates that this challenge can be addressed by ensuring all investors, large and small, are treated equally in terms of their investment rights and the levels of communication and engagement with them as individuals.
At this stage in the development of public sector crowdfunding, it will be important to help both existing and new case studies to pilot projects with the public to explore how these challenges can be dealt with in practice. This is necessary to mitigate the risk that any problems with early experiments do not compromise the broader potential of crowdfunding for public infrastructure.

This is important because public bodies are also increasingly conscious of their role as ‘economies’ and are beginning to appreciate more fully the benefits of attracting inward investment, whether to fund businesses and/or to enable investment in socially and environmentally sustainable infrastructure.

Learning from the wider context of ethical investment, foregrounding the additional dimension of ‘place’ to the social investment offer can be a significant catalyst for action above and beyond concern for a particular issue or set of broad social and/or environmental goals. Whilst meeting the grand challenge of preventing climate breakdown can often seem too abstract or distant an objective, focusing upon positive action within a defined local area can be a powerful motivating factor.

Our research has shown that there are a number of opportunities for the UK’s public sector to utilise crowdfunding as a new model of finance for public infrastructure projects. To build upon this work, we make the following list of recommendations (see Section 9):

- The UK Government should use the findings of this report as part of a wider evidence base for the development and implementation of a new national policy framework for public sector engagement with crowdfunding;
- In our view, greater collaboration across Whitehall between BEIS, DCMS, DHSC, HM Treasury and MHCLG will play a pivotal role in the mainstreaming and normalisation of crowdfunding as a legitimate option for the public sector; and
- The UK Government should also ensure that the cycle of project management and procurement includes crowdfunding as part of the respected mix of financing options. For example, we suggest that the nature of the finance – where the funding comes from – should become a key part of social value procurement.

In our assessment, opening up Community Municipal Bonds to ISA investors would be revenue neutral for Government and could put a downward pressure on future Community Municipal Bond interest rates, in turn reducing the overall cost of capital for the public sector;

- As such, it is our view that the UK Government should open up the Community Municipal Bond product for IFISA investors so that the product can become more accessible to resident investors;
- This would also help to obtain a clear sense of the volume of investment that this change would unlock and demonstrate appeal to the target group of investors.

The UK Government should work with all relevant stakeholders to develop clear and meaningful marketing and communications strategies at both the national and local level to signal crowdfunding as a new and legitimate model of finance for the public sector;

- Public bodies considering a crowdfunding campaign should also develop clear and consistent messaging to local residents, which explains: what the material risks are to ensure the public’s lack of familiarity is not exploited; what the campaign is trying to accomplish; and, what the material social, environmental and economic benefits will be to the wider community as a result of the investment;
B EXTENDED SUMMARY

- Existing research shows that ‘being excited about a specific company or project’ has been ranked as more important than high financial returns for crowdfunding investors, signalling the importance of marketing in any crowdfunding campaign;
- Public bodies should appoint a senior colleague to ‘champion’ crowdfunding within the organisation, who can operate across teams, acting as an internal project and communications manager for all the information being gathered and ensuring that enthusiasm and momentum is maintained;
- Local authorities should also consider the appointment of crowdfunding ‘champions’ drawn from amongst local residents to ensure crowdfunding projects deliver material benefits for local needs, perhaps as a part of the new Citizen Commissioners initiative;
- To mitigate the risk that ‘non-local’ investors crowd out local investors, crowdfunding platforms should consider initially restricting access to a given project by geography (e.g. through targeting postcodes). Only once local demand has been satisfied should an offer be opened up to other ‘non-local’ investors;
- Where appropriate, public bodies should also seek to leverage funds from institutional investors, such as through the creation of a matching fund. These partners should be told precisely how their funding is encouraging additional community investment.

R.04 CREATE AND SUSTAIN A CENTRAL REPOSITORY OF PUBLIC SECTOR CASE STUDIES
- The University of Leeds and DCMS should build on the insights and outputs generated by our research to begin collaborating in the creation of a free, open access database. This would provide a central repository of case studies for public sector bodies to draw upon in order to assess the suitability of crowdfunding;
- This collaboration should also work with existing partners and a wider group of relevant stakeholders to co-develop and deliver tool kits, guides, professional development training, and knowledge exchange events that will ensure expertise is shared across the public sector, including making the concept of Community Municipal Bonds more accessible.

R.05 INVEST IN WIDENING THE EVIDENCE BASE
- The UK Government should provide additional funding to support the further development of UK-wide case studies;
- This could be achieved through a more ambitious version of the Financing for Society project, open to tender, to include 18-24 case studies from across the UK either at the feasibility stage or to run a real world trial of the Community Municipal Bond product with the public;
- It is vital to measure and to test the effects of crowdfunding in a real world context, specifically to assess: how the process is experienced by public sector bodies and whether or not it provides a more flexible and competitive source of capital for them; and, the extent to which measurable social and/or environmental benefits are realised through public sector crowdfunding.

R.06 CREATE AN UNDERWRITING OR BRIDGING FUND FACILITY FOR PPP PROJECTS
- The UK Government should create an underwriting or bridging fund facility for PPP projects, as the model of PPP finance and the wider ecosystem that exists around this market has been developed to focus upon the needs of the institutional investment market, not the needs of crowdfunding as a new model of public sector finance;
- The UK Government should draw upon existing precedents for this kind of facility. The Scottish Government provided a revolving bridge finance facility, administered by Scottish Enterprise, to allow community investors to reserve their place in an onshore wind farm development capital structure while they raised their own local capital; and
- The British Business Bank provided a revolving loan facility to the loan-based P2P platform Funding Circle to enable them to scale rapidly by deploying capital into the SME business sector while they built their retail investor base.

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