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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."

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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 fit 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'.

AIMS AND OBJECTIVES

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;

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- How crowdfunding can influence the funding structure and time to final investment decision;
- Procurement considerations for using crowdfunding;
- Community engagement considerations;
- Risks and mitigation for the council;
- Additional considerations for incentivising the use of 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."

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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.

[124] Social Finance, 2018.

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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."

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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."

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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;

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- 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.

CHALLENGES OF THE FUNDING TYPE

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;

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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 on the Island on a single platform or through a single fund (“Community ISA”).

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[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 on 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

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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."

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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[126] 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

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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 a s 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.

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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.