Economy, Energy and Tourism Committee

3rd Report, 2014 (Session 4)

Access to Finance and Alternative Financing Models

Published by the Scottish Parliament on 12 March 2014
Economy, Energy and Tourism Committee

Remit and membership

Remit:
The remit of the Committee is to consider and report on the Scottish economy, enterprise, energy, tourism and renewables and all other matters within the responsibility of the Cabinet Secretary for Finance, Employment and Sustainable Growth apart from those covered by the remit of the Local Government and Regeneration Committee and matters relating to the Cities Strategy falling within the responsibility of the Cabinet Secretary for Health, Wellbeing and Cities Strategy.

Membership:

Christian Allard
Richard Baker
Marco Biagi
Chic Brodie
Murdo Fraser (Convener)
Alison Johnstone
Mike MacKenzie
Margaret McDougall
Dennis Robertson (Deputy Convener)

Committee Clerking Team:

Clerk to the Committee
Stephen Imrie

Senior Assistant Clerk
Fergus Cochrane

Assistant Clerk
Diane Barr
Economy, Energy and Tourism Committee

3rd Report, 2014 (Session 4)

Access to Finance and Alternative Financing Models

The Committee reports to the Parliament as follows—

Background

1. During November to December 2013, the Parliament’s Economy, Energy and Tourism Committee conducted a short inquiry into the challenges facing Scotland’s businesses and other organisations in accessing finance. The purpose of the inquiry was to provide an update on the current situation with regards to conventional lending from the ‘high street banks’ and also to look at alternative financing models such as crowd-funding, direct equity schemes, business angel investments, Islamic financing etc.

2. Three evidence-taking sessions were held during this period¹, with the following organisations providing their views to us:

   - Royal Bank of Scotland
   - Bank of Scotland, part of the Lloyds Banking Group
   - Federation of Small Businesses in Scotland
   - Scottish Government officials
   - Scottish Investment Bank
   - Brewdog
   - twintangibles
   - LINC Scotland
   - Biogelx Ltd
   - Strathclyde University Incubator Ltd
   - Archangel Informal Investment
   - Islamic Finance Council UK
   - Scotland Europa
   - Community Energy Scotland

3. The focus of these sessions was on providing a fresh look at: the current lending situation from the ‘high street banks’, primarily for SMEs; the relevant policy of the Scottish Government and its economic development agencies; the

¹ For copies of the Official Reports of these meetings, see http://www.scottish.parliament.uk/parliamentarybusiness/CurrentCommittees/71507.aspx
current penetration and future potential of alternative finance models; the particular circumstances of funding spin-offs from our universities and research institutions; the current use and future potential for EU funds, and; a review of the situation with regards to the financing of community renewable energy and energy efficiency projects.

4. The Committee is grateful to all of those who provided written and oral evidence to us.

5. Our findings and conclusions are set out below and we give notice that, given the continuing importance of this issue to Scottish businesses, we may return to this subject during the remainder of this parliamentary session.

‘High street’ lending – an update

6. It is a well-established fact that the problems in the financial sector from 2008 onwards and the subsequent economic downturn globally and in the UK, led to a sharp contraction in both the volume of business lending from the ‘high street banks’ and also a tightening of the terms and conditions that were applied to those firms who were successful in applying for finance.

7. The issue for the Committee, however, was whether the situation had improved since this period and what the current position in Scotland was. At a UK level, evidence from the Bank of England suggests that credit conditions in the UK remain challenging. As shown in Figure 1, net lending to businesses weakened in 2009 and has remained subdued since.

Figure 1: Monthly change in financial institutions net lending to private sector, seasonally adjusted, UK (£m)

Source: Bank of England 2013 (Series LPMAVBR)
8. Up-to-date figures for Scotland are more difficult to come by. The Scottish Government’s most recent survey of access to finance in Scotland was conducted in February 2012. This showed “some evidence of an easing in supply constraints”.

9. Their survey also showed that, on supply, the percentage of firms who applied for finance but were rejected outright was 17% in 2012, down from 24% in the 2010 survey. Similarly, the overall percentage of total applications rejected outright was 15% in 2012, down from 21% in the 2010 survey. Overall, 84% of firms were able to access 100% of the money that they were seeking. This is up from the 2010 and 2009 surveys.

10. However, the Scottish Government’s 2012 survey also suggested that the refinancing/renewing experience of firms weakened slightly compared to the 2010 survey. Around 37% of firms who reported a change to their finance agreements when renewing a credit facility, highlighted an increase in costs, either in fees or interest rates. There was also an increase in the proportion of firms reporting an increased time taken for decision. From the perspective of the Scottish Government, there were still issues on both the demand and the supply sides, with some companies postponing their investments and some viable firms unable to secure funds at the levels they are looking for or simply not applying in the first place for fear of rejection.

11. Interestingly though, the perceptions of Scottish businesses on the costs of finance appear to have improved marginally relative to the 2010 survey. For the Federation of Small Businesses (FSB) in Scotland, “confidence is rising” amongst its membership but that the availability of finance was still a more critical issue than the cost of such lending.

12. In their evidence to the Committee, representatives of the Royal Bank of Scotland (RBS) and the Bank of Scotland (BoS), who together account for some 70% of business lending in Scotland in 2012, indicated that by late 2013, they were seeing “signs of recovery” and other “positive signs”, with BoS reporting that its half-year lending to the summer of 2013 was up 5.6% year-on-year.

13. At a UK level, the British Bankers Association (BBA) produces a regular statistical bulletin of lending statistics, segmented by nation/region within the UK. Table 1 below sets out the quarterly lending figures for banks in Scotland since 2012 Q4.

---

3 Ibid. page 4.
4 Ibid. pages 4-5.
8 Ibid, col 3561.
9 Ibid. col 3562.
10 Ibid.
11 Available at: http://www.bba.org.uk/statistics
Table 1: Banks Support for SMEs (Scotland)

<table>
<thead>
<tr>
<th></th>
<th>Q4, 2012</th>
<th>Q1, 2013</th>
<th>Q2, 2013</th>
<th>Q3, 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of overdrawn balances (No.)</td>
<td>1535</td>
<td>1467</td>
<td>1394</td>
<td>1331</td>
</tr>
<tr>
<td>No. of overdraft facilities approved (No.)</td>
<td>4531</td>
<td>5960</td>
<td>5008</td>
<td>4488</td>
</tr>
<tr>
<td>Value of overdraft facilities approved (£m)</td>
<td>163</td>
<td>134</td>
<td>171</td>
<td>136</td>
</tr>
<tr>
<td>Value of loan balances (£m)</td>
<td>5768</td>
<td>6198</td>
<td>6175</td>
<td>6101</td>
</tr>
<tr>
<td>No. of loan facilities approved (No.)</td>
<td>2634</td>
<td>3760</td>
<td>3625</td>
<td>3258</td>
</tr>
<tr>
<td>Value of loan facilities approved (£m)</td>
<td>309</td>
<td>374</td>
<td>434</td>
<td>407</td>
</tr>
<tr>
<td>New loans (£m)</td>
<td>363</td>
<td>280</td>
<td>421</td>
<td>295</td>
</tr>
<tr>
<td>Loan repayments (No.)</td>
<td>373</td>
<td>271</td>
<td>450</td>
<td>341</td>
</tr>
</tbody>
</table>

Source: BBA

14. The synopsis suggested by RBS to the Committee was one of a sharp contraction in business lending from 2008 and the need to now re-adjust since the “pendulum of lending” had “probably swung too far” away from where it needed to be. In its view, RBS suggested that there was around £50 billion of excess capacity in the SME market in 2007 which was reduced to £25 billion; that is, the level of debt in 2007 was not affordable. By 2013, RBS was suggested that there is now a £25 billion shortfall in lending to the SME sector in the UK.

15. The key to RBS and BoS in their plans to meet this shortfall were an emphasis on more localised credit decisions, better relationships between their staff and local businesses, better advice to business on the preparation of business plans.

Conclusions

16. Access to finance issues, particularly for SMEs, are still amongst the top priorities facing Scottish businesses. It is clear also to the Committee that there are some signs of an improving picture but that the situation is not yet resolved. We welcome the feedback from our two largest ‘high street lenders’ that they are ‘open for business’ and actively seeking new customers and we are encouraged by their reports of a recovery in their lending figures.

17. There are, however, further reforms and measures that we would like to see taken on-board and which we believe will help improve the situation. Firstly, we encourage RBS to implement the findings of its independent lending review. We want to see the bank demonstrate that it truly has adopted a process of full devolution of lending decisions to localised branches and relationship managers and that it has a well-resourced outreach programme to ensure the best possible relationships between its staff and their network of local businesses. Such banking principles should be fully adopted and endorsed at the highest levels amongst our other major lenders in Scotland such as BoS.

---

13 Ibid, col 3575.
18. Secondly, whilst we’d welcome greater competition on the high street for lending to businesses, it is not enough to simply see more of the same type of lending. More of the same is not greater competition. We encourage the Scottish and UK Government and the regulators to take all opportunities of breaking up the duopoly of lending with the establishment of new sources of credit, particularly those with a different range of products than the current providers.

19. Thirdly, whilst we very much welcome the proposed UK-wide survey of business lending to SMEs about to be conducted by the British Chambers of Commerce and the UK Government, we are surprised to hear from Scottish Government officials that they have no current plans for a similar, detailed survey in Scotland.\textsuperscript{14} We recommend that the Scottish Government consider updating its Access to Finance survey given that the data is now nearly two years old. Such a survey would provide policy-makers with the most up-to-date picture and would also afford the opportunity to drill down lending data by economic sector and geographic region to see if the anecdotal picture of anomalies facing some sectors (e.g. tourism) and/or some parts of Scotland (business lending outwith the central belt) are a reality.

\textbf{Alternative financing models}

20. The second major strand of our short inquiry looked at the current penetration and future potential of alternative finance models. Alternatives to traditional bank lending have always existed, for example loans from friends and family, pawnbrokers or through the issuing of community bonds. Nevertheless the revolution in internet-based technologies, from e-Bay onwards, has opened up new and innovative ways of raising finance. Since the financial crisis of 2008, demand for these alternatives has expanded at an impressive pace across the US and Europe.

21. It is clear though, with some impressive exceptions, that many Scottish SMEs are still not looking beyond traditional bank lending for start-up finance and growth funding. According to the FSB in Scotland, less than 30% of their membership of SMEs have any awareness of peer-to-peer lending and asset-based finance and that these figures are lower for Scotland compared to the UK.\textsuperscript{15} Some of the reasons for these findings and our conclusions are set out below.

\textit{Crowd-funding, peer-to-peer lending and direct equity schemes}

22. Crowd-funding is a method of raising finance – usually online through social media – from a disparate group of funders who each make a contribution towards the total financing of a project. Debt financing options are available through peer-to-peer (P2P) lenders such as Funding Circle and Zopa; however equity finance can also be organised by companies themselves, as in the case of the brewing firm Brewdog. Most small-scale projects use ‘reward-based’ schemes where investors provide financial support in return for some form of ‘in-kind’ reward, such as their name credited as an investor, free samples or discounted products/services.

\textsuperscript{14} Ibid. col 3571.
\textsuperscript{15} Ibid. col 3559.
23. Many websites now exist to promote crowd-funding and allow those with projects seeking funding to post business ideas (their ‘pitch’) and connect with potential funders. These are referred to as “platforms”.

24. The scale of crowd-funding activity in Scotland is difficult to quantify, as is its future potential. However, according to an independent charity - the National Endowment for Science, Technology and the Arts (NESTA) – over a three-year timeline, there is a £14.5 billion potential for crowd-funding within the UK.\(^{16}\)

25. One Scotland-based crowd-funding expert, Tim Wright of twintangibles, told the Committee that he saw this form of financing as “part of the financial mix” but one which is not a replacement for conventional forms of lending (e.g. project finance, business lending etc.).\(^{17}\) For Brewdog, the advantages of crowd-funding were that it provided extra funding that conventional forms of financing were “not able to provide” and it allowed engagement with the firm’s customer base.\(^{18}\) The firm also said that access to funds was quicker than other forms of conventional lending.\(^{19}\)

26. A number of issues were identified by the witnesses that would be beneficial to increasing the uptake of crowd-funding in Scotland. Firstly, better awareness amongst private sector companies and improved promotion of this financing route by public sector economic advice agencies and support schemes was cited.\(^{20}\) Tim Wright of twintangibles characterised the awareness levels of crowd-funding amongst the enterprise agencies and Business Gateway as “relatively low” and that these bodies would benefit from a more sophisticated understanding of how it works.\(^{21}\) In that way, they would be more able to pro-actively advise clients about crowd-funding.

27. Secondly, some cited the proposals\(^ {22}\) from the UK’s Financial Conduct Authority to regulate this form of lending as “seriously detrimental” to the growth of equity-based crowd-funding in the UK.\(^{23}\) They felt these proposals could stifle growth of this form of financing and that the sector was already subject to regulation to protect consumers/investors.

**Business angels and the commercialisation of research and intellectual property**

28. The second form of alternative funding considered by the Committee was that of investment by business angels. An angel investor or angel is an affluent individual who provides capital for a business start-up, usually in exchange for convertible debt or ownership equity.

---

\(^{16}\) Ibid, col 3591.  
\(^{17}\) Ibid.  
\(^{18}\) Ibid col 3588.  
\(^{19}\) Ibid col 3597.  
\(^{20}\) Ibid cols 3597 and 3599.  
\(^{21}\) Ibid col 3600.  
29. David Grahame of angel representative body LINC Scotland described this form of investment as “absolutely a niche activity” but nonetheless a small sector that “has a big effect”. He estimated that fewer than 2% of companies in Scotland access external equity to help them grow.\(^\text{24}\) However, according to him, the OECD has concluded that Scotland has “by some measure the most developed and active business angel market in Europe”.\(^\text{25}\) This view is supported by research conducted by Professor Colin Mason of the University of Glasgow who has stated in a paper on business angel funding that “In the case of Scotland, the number of identifiable [business angel] syndicates has grown from 2 to over 20 between 2000 and 2012, the most radical shift in market organisation of any region in Europe.”\(^\text{26}\)

30. In recent years, the outlook for angel investments has been difficult according to John Waddell of Archangel Informal Investment (one of the leading syndicates of angels in Scotland). He described the challenges facing angels from exiting from their investments as the worst since the collapse of the technology sector in the early 2000s.\(^\text{27}\) He stated that previously, the time period between investment and sale of the stake was about three years and that this has now increased to 10 years or more.\(^\text{28}\) He was, however, confident that there were encouraging signs in Scotland of improvement with larger firms beginning to be more active in acquisitions of smaller start-ups, thereby allowing angels to sell their equity stake and make a return on their initial investments.

31. For him, further improvements can be made provided that the Scottish Government and its agencies did not “interfere too much” and make changes to how the market operated, but simply continued to have a good interaction between policy makers and the sector.\(^\text{29}\) He was wary of constant interference by well-meaning public sector officials.

32. Figures 2 and 3 below, produced as part of the research paper published by Professor Mason (see above), provide some trend data on business angel activity in Scotland via LINC Scotland.

\(^{25}\) Ibid col 3685.
\(^{26}\) *The Transformation of the Business Angel Market: Evidence from Scotland*, Professor Colin Mason et al, Adam Smith Business School, University of Glasgow, UK.
\(^{28}\) Ibid.
\(^{29}\) Ibid, col 3687-8.
33. In terms of the role angel investments play in the commercialisation of intellectual property (IP) in the university and research sector, Dr Lightbody of Biogelx Ltd (a recent spin-out company) believed that there is a general reluctance in the academic sector to capitalise on their IP.\(^3\) He was supported by Gillian MacAulay of Strathclyde University’s Incubator Ltd who thought that more could be

\(^3\) Ibid col 3689.
done if there was a greater penetration of people within the universities with commercial acumen to commercialise research and technology.\textsuperscript{31}

34. For Dr Lightbody, one example of a programme which can assist with this issue is that of the Royal Society of Edinburgh's fellows programme which takes academics at PhD level and postdoctoral students and funds them on a 12-month business programme in partnership with businesses.\textsuperscript{32} Gillian MacAulay suggested revisiting the ties within a university between its science and technology course/departments and those focusing on business.\textsuperscript{33}

\textit{Islamic finance}

35. As part of this inquiry, the Committee also took evidence on the potential for Islamic financing in Scotland. This form of financing has certain restrictions on the nature of the investments that can be made (i.e. it focuses on 'ethical investing') and also on the prohibition in the lending against the charging and receiving of interest.

36. At present, whilst this form of finance could provide an alternative route for companies wishing to access finance, there are no Islamic banks based in Scotland; the Islamic Bank of Britain is based in the Midlands and is active also in London, although Scotland-based companies can of course approach it for finance.

37. Graham Burnside and Omar Shaikh of the Islamic Finance Council UK were both keen to stress that Islamic finance presents a significant potential source of funding for investment, mortgages, savings and pensions and that any activity in Scotland would most likely focus on the domestic retail and small and medium sized enterprise markets.\textsuperscript{34} They also stressed that Islamic finance is available to the wider business community and not just to those firms whose representatives adhere to the Muslim faith.

38. Both stated that in order for the sector to further develop in Scotland, there is a need to better promote the opportunities that this form of finance can offer and also promote the opportunities, such as renewable energy, that exist via a co-ordinated and targeted international engagement of investors in the Middle East.\textsuperscript{35}

39. One concrete suggestion was the creation of an 'ethical finance hub', supported by the Scottish Government, which would be a centre to promote this form of financing to the local business community and bring together interested parties.\textsuperscript{36} This is one of the ideas that the Islamic Finance Council UK had explored with the Scottish Government since 2008, but it has not been taken forward.\textsuperscript{37}

\begin{flushleft}
\begin{footnotesize}
\textsuperscript{31} Ibid.
\textsuperscript{32} Ibid col 3701.
\textsuperscript{33} Ibid col 3703.
\textsuperscript{35} Ibid, col 3731.
\textsuperscript{36} Ibid, col 3732.
\textsuperscript{37} Ibid, col 3731.
\end{footnotesize}
\end{flushleft}
Conclusions on alternative finance models

40. The Committee agrees with the many witnesses who gave evidence to us that alternative financing models, such as crowd-funding, angel investment, Islamic finance etc., offer Scottish businesses, particularly SMEs, a range of financing options for their business and its growth. Whilst these forms of finance are unlikely to ever replace conventional lending and project finance from the ‘high street’ banks, they are nonetheless a valuable alternative and one with the potential to grow in Scotland.

41. To improve uptake, we want to see a far better knowledge of such financing within our publically-funded economic development and advice/support programmes, such as the two enterprise agencies and the Business Gateway network. Businesses should not bring news of how these schemes operate to public bodies, rather it should be vice versa.

42. We also want to see these forms of finance appropriately, but not excessively, regulated. Whilst protection for the consumer/investor is critical, we do not wish to see innovative forms of finance choked off by unnecessary regulation. In this respect, we ask the Scottish Government to look at the FCA’s plans to regulate crowd-funding and ensure that the proposals are ‘fit-for-purpose’ and in Scotland’s interests.

43. One specific recommendation to the Scottish Government that we make in relation to angel funding is to welcome the views of the experts we took evidence from on the value of the co-investment fund and we would echo their view that the Scottish Government gives careful consideration to re-capitalising this fund to ensure it can continue to pump out as much money as possible to as many businesses as possible.

44. In terms of the commercialisation of research and intellectual property in our universities, we are grateful to those witnesses for shining a light on the current situation and their suggested ideas for improvement. We recommend that the Scottish Government and Universities Scotland take a look at the evidence we received on the commercialisation of IP and discuss how some of these ideas can be further developed, particularly to encourage a greater commercial awareness amongst our science/technology specialists in academia. The Scottish Funding Council may also wish to review how it rewards universities in terms of their efforts to commercialise IP, such as the links made between such institutions to commercialise IP and also within these institutions in terms of links between science/technology departments and courses and those focusing on business.

45. Finally, in terms of the potential for Islamic finance in Scotland, we ask the Scottish Government for an update on the ideas presented to it by the Islamic Finance Council UK from 2008 onwards, particularly the concept of an ‘ethical investment hub’.
Access to funds from the European Union (EU)

46. In addition to alternative funding models, the Committee looked briefly at the current penetration of the use of EU funds to finance Scottish businesses and options for improvement. Witnesses from Scottish Enterprise’s Brussels-based body, Scotland Europa, gave evidence to the Committee.

47. To date, estimates of the success of Scottish companies in accessing EU funds have been relatively impressive. Scotland Europa provided figures to demonstrate that 113 different Scottish firms had been supported to access EU funding streams (under the 7th Framework Programme) and that it had beaten its target of ensuring that more than 15% of support provided by the EU to Scottish businesses went to SMEs. Additionally, some of the EU Funds, such as structural funds, which are managed centrally in Scotland by the Scottish Government, have been used to support SMEs, and other EU programmes, such as INTERREG, have seen a number of successes for Scottish companies. From Scottish Enterprise’s perspective, over 3,000 firms have benefited from EU-funded support mechanisms.

48. One of the main limiting factors cited by some of the witnesses is the ongoing lack of awareness amongst Scottish businesses, particularly SMEs, about the opportunities on offer from EU initiatives. Also cited were the challenges and bureaucracy involved in funding applications. Lesley Cannon of Scotland Europa indicated that it was working hard with its partners and other agencies to get more companies involved, and was also working closely with Scottish Chambers of Commerce and the Federation of Small Business to improve awareness amongst their membership.

49. One new EU initiative which has the potential to offer Scottish business new forms of support is that of the COSME programme. COSME is the EU programme for the Competitiveness of Enterprises and Small and Medium-sized Enterprises running from 2014 to 2020 with a planned budget of €2.3 billion. COSME will support SMEs in the following areas:

- access to finance;
- access to markets;
- supporting entrepreneurs; and
- creating favourable conditions for business creation and growth.

50. According to Lesley Cannon of Scottish Enterprise, Scottish firms have access to the finances available under COSME and there is “no specific exclusion for Scotland.” However, according to the Committee’s EU Reporter, it should be noted that there are fewer intermediary bodies based in Scotland who can assist companies to access these funds than there are in other parts of the UK, thereby making accessing these funds more of a challenge for Scottish firms.

---

38 Ibid, col 3738.
39 Ibid, col 3741 and 3745.
40 http://ec.europa.eu/enterprise/initiatives/cosme/index_en.htm
Conclusions

51. The Committee welcomes the efforts of Scotland Europa and others to work with industry partners to raise awareness of funding opportunities from the EU as a way to increase take-up in Scotland. The importance of this task cannot be under-estimated given the scale of sums on offer and the highly competitive nature of many programmes, such as Horizon 2020 and the new COSME programme.

52. The support of both enterprise agencies and the Business Gateway network is particularly vital at this time given it is the start of the 2014-2020 funding period with the introduction of new funding programmes such as Horizon 2020 and COSME. The Committee therefore calls upon both enterprise agencies and the Business Gateway network to give maximum visibility to the potential that EU funds offer and to best promote these initiatives to Scottish businesses.

Financing community renewable energy and energy efficiency projects

53. The final area of interest for the Committee as part of this short inquiry was a brief review of the current situation for developers of community renewable energy and energy efficiency projects.

54. Jamie Adam of Community Energy Scotland gave evidence to the Committee on his view of the current state-of-play for financing such projects. He indicated that, in recent months, something of a gap had appeared in the funding of community energy, with the Co-operative Bank announcement that it is halting new investment in renewable energy; the bank had been one of the main sources of funding for independent and community energy efficiency projects.\footnote{Ibid, col 3747.}

55. He also cited the problems which in his opinion had been created due to the changes to the current regime for Feed-in Tariffs. In the UK Government’s recent review of Feed-in Tariffs, a system of annual degression was introduced which comes into force from April 2014. For wind turbines in the 100 kW to 1.5 MW bracket, this means that the Feed-in Tariff will be reduced by 5% a year, and if deployment of turbines is higher than expected, then this could increase to 10 or 20% cuts. This has meant that those community groups who have consented projects are trying to progress their projects as soon as possible to avoid the degression cuts, but are finding it hard to access finance as these projects can be deemed as too risky.\footnote{Ibid, col 3749.}

56. He also expressed concerns at the current charging structure operated by banks for the due diligence of community projects. He indicated that communities could potentially face a bank fee of £60,000 for this work with no guarantee that the bank will agree to lend at the end of the process. In his view, this fee is little changed whether the project is 1MW or 10MW, meaning that the smaller, community-level projects are paying similar fees to the larger, commercially-backed schemes but without the same access to resources to meet the upfront
costs. On this issue, Community Energy Scotland suggested that the Scottish Government could consider providing financial backing or a guarantee to mitigate that against the risk of a community project and this help reduce due diligence fees.

57. In supplementary evidence to the Committee, Community Energy Scotland gave further information on due diligence costs for community wind projects of around 900kW; see Table 2 below.

Table 2: Due diligence costs for a selection of community-led wind energy projects (£)

<table>
<thead>
<tr>
<th>Project</th>
<th>Total Project Costs</th>
<th>Loan value</th>
<th>Technical due diligence</th>
<th>Financial due diligence</th>
<th>Legal due diligence</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1.95m</td>
<td>1.75m</td>
<td>12k</td>
<td>7.5k</td>
<td>50k</td>
</tr>
<tr>
<td>2</td>
<td>1.7m</td>
<td>1.5m</td>
<td>9k</td>
<td>10k</td>
<td>50k</td>
</tr>
<tr>
<td>3</td>
<td>1.6m</td>
<td>650k</td>
<td>8k</td>
<td>5k</td>
<td>35k</td>
</tr>
<tr>
<td>4</td>
<td>1.6m</td>
<td>1.45m</td>
<td>7k</td>
<td>10k</td>
<td>55k</td>
</tr>
</tbody>
</table>

Source: Figures provided by Community Energy Scotland based on a number of anonymised projects

58. The figures above show that there is some variance, but in most cases the due diligence costs are approximately £60k. In its view, Community Energy Scotland believes that the costs faced by a local community remain roughly the same, regardless of whether the project is 200kW or 10MW in scale. It did note, however, that to some degree, it is difficult to separate out costs that would be incurred for design anyway from the due diligence costs (e.g. the uplift for design of electrical balance of plant by a certified, bank approved professional rather than just someone competent).

59. Community Energy Scotland stated that it had less experience of the costs of due diligence on commercial projects compared to community ones; in the case of funding where the lending is secured against other assets, it would always expect due diligence costs to be lower, and they would also generally be lower when lending to large organisations with many assets compared to smaller ones. It noted that most communities have few if any assets they can use as collateral, so would generally use non-recourse (project) finance, where the only asset the bank has a charge over is the turbine and the lease over the land it stands on. In these cases, it would expect the due diligence costs to be the same for community and commercial organisations. The only exceptions, in its opinion, might be that the bank may need more legal due diligence to deal with the relationship between a trading subsidiary and a charity than it would with a commercial organisation; a bank may also perceive more risk if the project is being developed by volunteers who haven’t done a wind or hydro project before, compared to developers who have done many.

60. One option more generally for Community Energy Scotland to improve the situation was for the Scottish Government to introduce a ROC banding for

---

44 Ibid, col 3753
community projects or for the UK Government to introduce a Feed-in Tariff better designed for community projects.45

Conclusions

61. The Committee continues to be very supportive of the potential that community-led renewable energy and energy efficiency projects offer and is concerned that recent changes to the regime for Feed-in Tariffs by the UK Government may be causing problems in the financing of these schemes. We recommend that the Scottish Government makes appropriate representations to the UK Government on the new degression system and draws to the Scottish Government’s attention our recommendations on supporting community-led development contained in the Economy, Energy and Tourism Committee’s Report on the achievability of the Scottish Government’s Renewable Energy Targets.

62. Furthermore, in light of the additional information we received from Community Energy Scotland (see above), we recommend that the Scottish Government holds talks with Scottish-based banks and project financiers to ensure that community-led projects are not artificially penalised when it comes to bank charges for due diligence fees.

45 Ibid.
Members who would like a printed copy of this *Numbered Report* to be forwarded to them should give notice at the Document Supply Centre.