Rialtas na hÉireann
Government of Ireland

Budget 2019

State Supported Loan Schemes: A Preliminary Analysis

AISLING KIRBY

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IGEES
Irish Government Economic & Evaluation Service

Executive Summary

Key Findings:

1. **Exchequer Costs:**
   - The State supported loan schemes considered in the paper are:
     Budget 2017: Agri Cashflow Support Loan Scheme (ACSLS)
     Budget 2018: Brexit Loan Scheme (BLS)
   - To date, the total upfront Exchequer cost of the two existing State supported loan schemes is €37m (€13.9m for the ACSLS & €23m for the BLS).
   - There is an element of risk exposure being placed on the State:
     - 40% of each ACSLS loan up to a maximum portfolio loss of 15%.
     - 40% of the BLS fund. The risk adjusted Exchequer exposure to loss is c5%.

2. **Financial Instruments:**
   - Although the purpose of loan schemes is not to replace grant support, loan schemes (such as the ACSLS and BLS) may represent good value for money when compared to the one-off nature of direct grants.

3. **Market Failure:**
   - There does not appear to be evidence of a significant market failure, particularly for working capital finance. However, the cost of credit for Irish SMEs is higher than for their competitors in other EU Member States.
   - There are a number of State supported and market led finance options available to primary producers, SMEs and small mid-caps.
   - A main difference between existing market offerings and the Budget 2017 and Budget 2018 State supported loan guarantee schemes is the cost of credit. Another key feature of the schemes is the absence of collateral requirements. The ACSLS loans were unsecured. Loans up to €500,000 were unsecured under the BLS.
   - Market failure is outlined in Regulation 2016/1613.

4. **Targeting of Loan Schemes:**
   - The loan schemes are offered on a *"first come, first serve"* basis to eligible borrowers.
   - Financial instruments should be seen as part of a broader response to building firms' resilience to Brexit-related risks.

5. **Measurements:**
   - The eligibility criteria relating to the ACSLS and BLS is fulfilled through a process of self-certification (i.e. tick box form).
   - At present, it is unclear what level of Brexit exposure each applicant faces beyond knowing that they face at least 15% direct or indirect trade exposure to the UK market.

1 Introduction

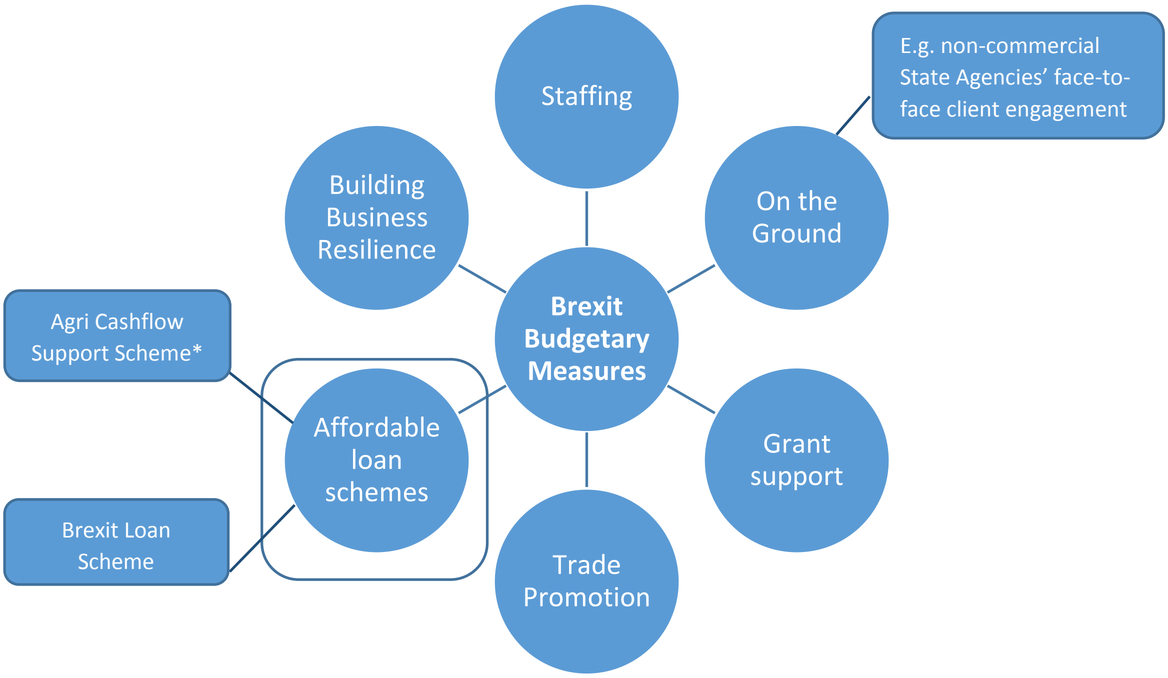
Key message:

- The Agri Cashflow Support Loan Scheme (ACSLS) and the Brexit Loan Scheme (BLS) provide affordable loans to primary producers, SMEs and small Mid-caps but utilising

1.1 Context

In response to the UK's decision to exit the European Union, the Government of Ireland introduced a number of specific Brexit measures in Budget 2017 and 2018. Measures to date can be divided into six overarching response streams. Each channel seeks to support enterprises facing Brexit-related challenges (Figure 1).

Figure 1: Budget 2017 and Budget 2018 Brexit Responses to Support Businesses



Source: Author's own diagram.
*Although not a Brexit Measure.

Brexit measures have been delivered through a number of channels such as, additional funding (total of c€6m in Budget 2017 and Budget 2018) primarily for staff resources within the Department of Business, Enterprise and Innovation (DBEI) and its enterprise agencies and €8.8m (over 2018 and 2019) committed by the Department of Agriculture, Food and the Marine (DAFM) for developing a National Food Innovation Hub[1].

In terms of additional Exchequer resources to date, Brexit responses have centred on providing affordable loan schemes to primary producers, SMEs and small Mid-caps (Figure 2). The ACSLS, notably, was not developed specifically as a Brexit Measure. Combined the Exchequer costs associated with the two existing State supported loan schemes amount to €37m to date (€13.9m and €23m, respectively). €11.1m of EU funds were also made available to fund the Agri Cashflow Support Loan

[1] Illustrative examples only. A number of other Brexit-related expenditure measures were introduced as part of the Government's Budget 2017 and Budget 2018 responses.

Scheme. The final cost of the State supported loan schemes is dependent upon take up and ultimate loan losses net of recoveries.

Figure 2: Existing Loan Schemes

a) DAFM

Agri Cashflow Support Loan Scheme

Purpose: Working Capital Loans

Target: Primary Producers

Fund Amount: c€150m

Upfront Cost: €25m

Rate: 2.95%

Duration: 1 - 6 years

Launched: 31 Jan 2017

Oversubscribed: March 2017

b) DBEI & DAFM

Brexit Loan Scheme

Purpose: Working Capital Loans

Target: SMEs and small Mid-caps who are either currently impacted by Brexit or will be in the future. 40% of the fund for food businesses.

Fund Amount: €300m

Exchequer Cost: €23m in total (D/BEI: €14m & D/AFM: €9m contributions respectively)

Rate: max. 4%

Duration: 1 - 3 years

Launch: 28 March 2018

Source: Author's own diagram.

1.2 Policy Rationale

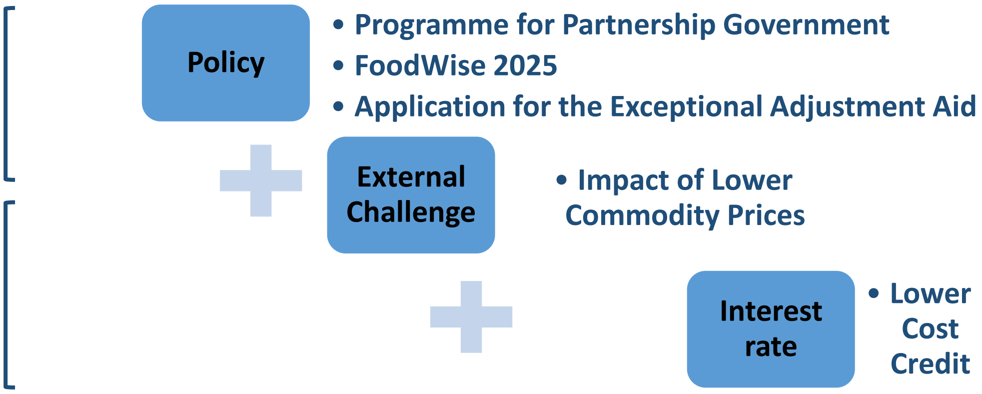
Agri Cashflow Support Loan Scheme:

The overarching objective of the c€150m ACSLS, as detailed by the DAFM, was to *"provide farmers with [a] low cost, flexible source of working capital and… allow them to pay down more expensive forms of short term debt, ensuring the ongoing financial stability of viable farm businesses"*[2]. The scheme was developed in 2016 at a time when farmers were faced sectoral and macroeconomic economic pressures.

Figure 3 describes the DAFM's rationale for the Budget 2017 ACSLS.

[2] https://www.agriculture.gov.ie/agri-foodindustry/agri-foodandtheeconomy/agri-foodbusiness/agriculturecashflowsupportloanscheme/

Figure 3: Department of Agriculture, Food and the Marine Rationale for the Agri Cashflow Support Loan Scheme



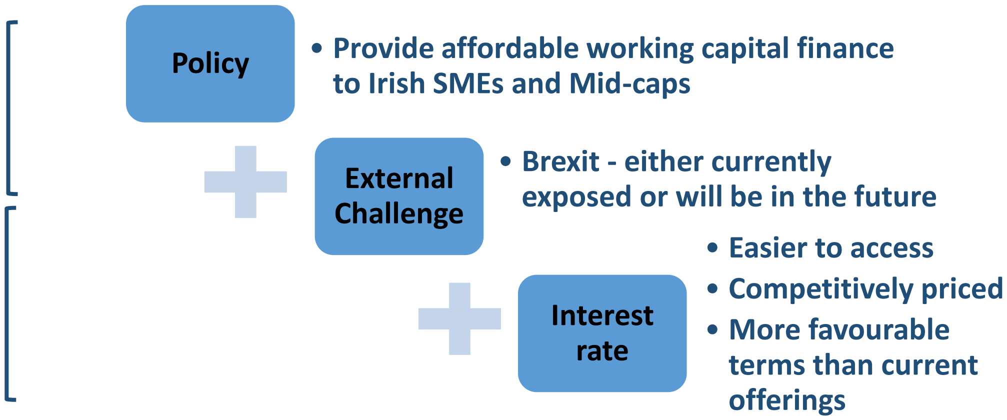
Source: Author's own diagram, based on information submitted to the Department of Public Expenditure and Reform from the Department of Agriculture, Food and the Marine as part of the 2018 Spending Review Process.

Brexit Loan Scheme:

According to DBEI, the Budget 2018 €300m BLS was put in place to *"provide affordable financing to businesses that are either currently impacted by Brexit or will be in the future"*[3]. In addition, the DAFM note that the scheme should, *"enable eligible Irish businesses to implement necessary changes to address the challenges posed by Brexit"*[4].

Figure 4 describes the DBEI and the DAFM's rationale for the Budget 2018 BLS.

Figure 4: Department of Business, Enterprise and Innovation and Department of Agriculture, Food and the Marine Rationale for the Brexit Loan Scheme



Source: Author's own diagram, based on information from Department of Business, Enterprise and Innovation and Department of Agriculture, Food and the Marine websites.

According to the financial regulation (No 966/2012), financial instruments are defined as *"any measures of financial support provided on a complementary basis from the budget in order to address one or more specific policy objectives of the Union. Such instruments may take the form of equity or quasi—equity investments, loans or guarantees, or other risk sharing instruments, and may, where appropriate, be combined with grants"*[5].

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[3] https://dbei.gov.ie/en/News-And-Events/Department-News/2018/March/28032018.html
[4] https://www.agriculture.gov.ie/agri-foodindustry/agri-foodandtheeconomy/agri-foodbusiness/brexitloanscheme/
[5] European Parliament (2017). Financial Instruments: defining the rationale for triggering their use.

Although the majority of enterprise supports in Ireland are offered through grant funding (more than €1bn), within an EU context, the number of financial instruments available have *"multiplied"* since the financial crisis[6]. This paper explores financial instruments, in the form of the Budget 2017 and Budget 2018 State supported loan schemes.

1.3 Methodology

This preliminary analysis of State supported loan schemes was undertaken by the DBEI Vote section in the Department of Public Expenditure and Reform (DPER) as part of the 2018 Spending Review process. The research was desk-based, relying on publicly available data and information sourced from the DBEI, the DAFM and the SBCI, material from the DBEI Vote section and academic literature. The paper is mainly qualitative in nature, and is supplemented by data on the ACSLS.

There are limitations in terms of the ex-post quantitative material that can be gathered, particularly in relation to the DBEI and DAFM BLS, given that the scheme was launched on 28 March 2018. However, based on the criteria, targeting of the scheme and existing literature, there are also a number of learning points to draw from the scheme.

In addition, as part of the 2018 Spending Review process, the DAFM is conducting a review of the Budget 2017 ACSLS. That analysis should provide more quantitative data and present specific findings on the Budget 2017 loan scheme.

1.4 Structure

In terms of the structure of this research, this paper:

- Outlines the rationale underpinning this analysis;
- Provides an overview of existing loan schemes and a preliminary assessment of the schemes;
- Briefly discusses the SME credit market and some of the financial options already available to primary producers and SMEs;
- Flags proposals for the development of a longer term Brexit Investment Loan Scheme;
- Assesses potential learning points from the two existing State supported loan schemes and;
- Recommendations and concluding remarks follow.

[6] European Parliament (2017). Financial Instruments: defining the rationale for triggering their use.

2 Research Rationale

Key message:

- The total upfront Exchequer cost of the two existing schemes is €37m to date, with a proportion of the risk exposure falling upon the State in the event of non-payment of loans.

2.1 Fiscal Context

The State has been able to increase expenditure in a targeted and sustainable manner in recent years. However, in the context of competing demands and finite resources, it is vital that any expenditure increasing measures are assessed in order to ensure the best return for the taxpayer.

This is particularly true in respect of any measures to support enterprises. Brexit notwithstanding, the Exchequer currently provides approximately €1.75bn annually on supports, through direct (e.g. grant supports) and indirect channels (e.g. taxation)[7]. Although the majority of enterprise supports are grants, the introduction of two Exchequer funded financial instruments in the form of loan schemes represent another form of policy support to enterprise in Ireland. The cost of both loan schemes to date has been significant, with a combined up front cost of €37m provided by the Exchequer and an additional €11.1m in EU funding for the ACSLS. Furthermore, a proportion of the risk exposure also falls upon the State in the event of non-payment of loans.

Potential longer term Brexit-related financing in the future has been signalled by DAFM and DBEI. The Exchequer costs and potential liabilities associated with existing Brexit-related loan schemes and possible future demands on the Exchequer for longer term loan schemes, have direct public expenditure implications.

2.2 Potential Market "Gap" and Cost of Credit

The paper will also assess the need for State intervention in this area. This will include exploring the availability of credit, from a demand and a supply perspective.

Credit demand within the SME sector of the Irish economy has remained subdued since the economic recession (c2009)[8]. Data from the Central Bank of Ireland also suggests that Irish primary industries and SMEs continue to deleverage at rates in excess of new lending increases (Figure 11). There is a need to explore further whether the provision of State supported loan schemes has a crowding out effect, particularly in light of credit demand trends, or whether the market would respond by launching similarly sectorally targeted schemes. This should be considered from within the context of the concentration in the Irish banking sector. Notably, however, loan guarantee schemes give eligible borrowers the opportunity to build a credit history and relationship with their banks.

Although SME credit demand has remained subdued, two State supported loan schemes utilising Exchequer funding have been introduced. The ACSLS (now fully subscribed, drawn down and closed) and the BLS (launched on 28 March 2018) have offered interest rates below market averages[9]. Any

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[7] Kane, F and D. O' Callaghan (2018). Overview of Enterprise Supports and the Labour Market. Department of Public Expenditure and Reform.

[8] The Central Bank of Ireland's SME Market Report 2017 H2 notes that *"The share of SMEs in Ireland reporting they did not apply for bank loans because of sufficient internal funding was 50.4 per cent in September 2017"*.

[9] Interest rates on non-financial corporation loans below €0.25m in Ireland averaged at 5% in July 2017, according to the Central Bank of Ireland SME Market Report H2 2017.

potential future Brexit Loan Schemes would likely charge interest rates that are also below the prevailing market rate. Thus, Government intervention in the private credit market (by way of Brexit-related loan schemes) could inadvertently create a dependency on cheap credit making some firms more vulnerable rather than less exposed to Brexit and other externally driven challenges. Furthermore, a number of finance options, aside from the ACSLS and BLS, exist in the Irish SME credit market at present.

2.3 Targeting and Purpose

In regard to the targeting of the schemes, the DAFM Budget 2017 ACSLS was specifically targeted at primary producers[10] in the Irish agri-food sector. On the other hand, the Budget 2018 BLS was targeted at SMEs and small Mid-caps[11] – with 40% of the fund made available for food businesses in light of the Brexit exposure faced by Ireland's agri-food sector to the UK market. Primary producers were excluded from applying for finance under the BLS. This was a requirement under the Innovfin counter guarantee scheme from the European Investment Fund. In light of the Brexit exposure likely to face Ireland's agri-food and SME sectors more broadly, this paper examines how existing schemes are targeted.

The paper also explores some of the *"appealing characteristics [of financial instruments] for policy makers"*[12] and the structure underpinning the loan guarantee schemes. Both schemes have clearly defined objectives in terms of what funds drawn down under the scheme can be used for and what cohorts the schemes intend to target. Funds under the two existing schemes could be used for the following purposes:

Agri Cashflow Support Loan Scheme:[13]

- Working capital in the form of:
    - Future working capital requirements
    - An alternative to merchant credit
    - To replenish working capital already used (prior to 31 December 2016)

Brexit Loan Scheme:[14]

- Future working capital requirements
- To fund innovation, change or adaptation of the business to mitigate the impact of Brexit

2.4 Measurement of Outputs and Outcomes

The appropriate targeting of the schemes to alleviate some of the issues arising from Brexit and other issues is a key consideration. At present there is a lack of clarity regarding the extent to which existing schemes have been targeted at firms facing Brexit challenges, the use of the funds and how the *"success"* of the schemes is/will be measured, e.g. by uptake, are the loan schemes helping firms to become Brexit-ready and whether or not they are sufficiently targeted at exposed sectors and regions of the economy. Finally, as with any Exchequer funded scheme, it is important that there is some measurement of outputs and the broader impacts of this support. The paper will attempt to analyse the outputs associated with both schemes and explore some possible data limitations.

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[10] Loans were available to all livestock farmers, tillage farmers, horticulture producers (including mushroom growers) and others involved in primary agricultural production (including poultry producers).
[11] See: https://sbci.gov.ie/brexit-loan-scheme for definition of SME and Small Mid-caps.
[12] European Parliament (2017). Financial Instruments: defining the rationale for triggering their use.
[13] https://sbci.gov.ie/products/sbci-agriculture-cashflow-support-loan-scheme
[14] https://sbci.gov.ie/brexit-loan-scheme

3 Overview of Budget 2017 and Budget 2018 Loan Schemes

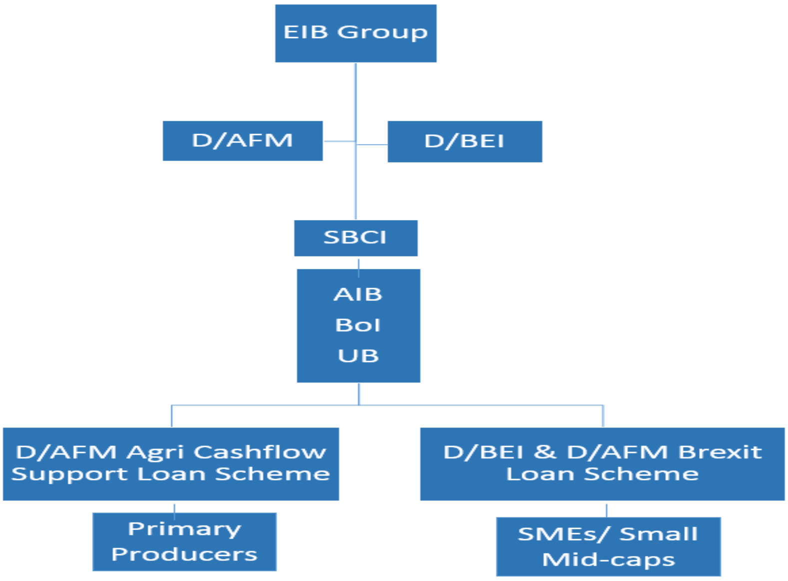
Key message:

- The existing loan schemes have been made possible through the leveraging of European support through the European Investment Fund (COSME and Innovfin).

3.1 Structure Underpinning Existing Loan Schemes

The Budget 2017 and Budget 2018 State supported loan schemes have been made possible through the leveraging of European support through the European Investment Fund (COSME[15] and Innovfin[16]). The loan schemes have been delivered by the Strategic Banking Corporation of Ireland (SBCI) who seek *"to enable the delivery of innovative policy measures that pull together a powerful mix of State and European supports and are delivered on a whole sale basis through frontline lending partners"*. Loans are then made available through the participating commercial on-lenders. Figure 5 describes the overarching structure underpinning the Agri Cashflow Support Loan Scheme (ACSLS) and the Brexit Loan Scheme (BLS).

Figure 5: Overarching Structure Underpinning Existing State Supported Loan Schemes



Source: Author's own diagram. See Appendix 3 for Glossary of terms.

The risk exposure associated with the ACSLS is set out as follows:

- The banks retains a minimum of 20% of the credit risk on the underlying loans.
- The guarantee covers 80% of each loan up to a maximum portfolio loss of 15%.

The risk exposure associated with the BLS is:

- Split 40:40:20 between the State[17], European Investment Fund and the three participating banks, respectively.

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[15] The EU programme for the competitiveness of Enterprises and SMEs.

[16] Under Horizon 2020, Innovfin offers a range of tailored products which provide financing to support research and innovation by companies – large and small, young and old – and to support promoters of research infrastructure.

[17] The risk exposure to the State is to the SBCI as an institution and not the State directly. The SBCI has its own balance sheet and capital to absorb losses. The risk is covered by the cash provided from the Exchequer and the European Commission leaving no residual risk.

Under any situation whereby there were any breaches of the EU State Aid Framework this would present a risk to the Exchequer.

3.2 Financial Instruments in the form of Guaranteed Loans

Key messages:

- Although the purpose of financial instruments is not to replace grant support, financial instruments may represent a policy option with less deadweight when compared to the one-off nature of agency funded grants.
- Unlike once-off grant payments, capital can be re-cycled for future use through financial instruments.

As previously noted, the Agri Cashflow Support Loan Scheme and Brexit Loan Scheme illustrate a shift towards improved access to finance through the use of risk sharing financial instruments, in the form of guaranteed loans.

Financial instruments have a number of appealing characteristics from a policy perspective (Figure 6).

Figure 6: Characteristics of Financial Instruments

Source: European Parliament (2017).

One of the main characteristics of financial instruments *"under conditions of economic uncertainty, fiscal deficits and bank-lending constraints is their self-sustaining (evergreen) nature"* [18]. In regard to the allocation of resources, unlike once-off grant payments, capital can be re-cycled for future use through financial instruments. Therefore, from an efficiency perspective, although the purpose of financial instruments is not to replace grant support, financial instruments may represent a policy option with less deadweight when compared to the one-off nature of agency funded grants.

Furthermore, financial instruments may be more appealing to Irish SMEs compared to equity finance, as there is evidence to suggest this cohort are reluctant to avail of this funding stream as an alternative to debt finance[19]. In addition, financial instruments are likely to represent an appropriate type of policy response to finance viable investment projects.

The risk-sharing aspect of loan schemes underpinned by guarantees allows for sharing of risks between private and public resources. For instance, the two loan schemes which have been introduced in Ireland split the risk of the funds between the European Investment Fund, State and the three participating commercial banks. The main objective of this risk-sharing instrument is to improve access to finance for primary producers, SMEs and small Mid-caps at a cost below the market average rate.

[18] European Parliament (2017). Financial Instruments: defining the rationale for triggering their use.
[19] https://www.finance.gov.ie/wp-content/uploads/2018/03/180312-Mapping-Review-of-Access-to-Equity-Finance.pdf

3.3 Agri Cashflow Support Loan Scheme

Key messages:

- The process of fulfilling the eligibility criteria underpinning the ACSLS was through self-declaration by loan applicants.
- Aside from usual bank lending assessment criteria, there were requirements to fulfil one of the EU's exceptional adjustment aid for milk and other livestock farmers' imposed on applicants

Overview:

The ACSLS was developed to make up to €150m available to farmers throughout Ireland at a low cost interest rate of 2.95%. This was the first publicly-funded access to finance initiative of its kind. The SBCI used €25m of funding from the Department of Agriculture, Food and the Marine (DAFM) and EU to leverage the scheme. Three Irish banks delivered the scheme; Bank of Ireland (€65m), Allied Irish Bank (€60m) and Ulster Bank (€25m).

The scheme was launched on 31 January 2017 and by the beginning of March 2017, all of the participating banks had reported that their funds were committed. DAFM's contribution of €25m included €11.1m of EU's 'exceptional adjustment aid for milk and other livestock farmers' *(as per Commission Regulation 2016/1613)* and €13.9m in Exchequer funding. The scheme incorporated a 2% interest rate subsidy paid to the three participating banks in arrears.

There were a total of 4,246 applications totalling c€145m. The average size of loans drawn down under the scheme was €34,127 and the average loan duration was 41 months[20]. As of 20 August 2018, €47.5m of the ACSLS was repaid[21].

Features:

A number of key features underpinned the loan scheme. Loans of up to €150,000 could be leveraged under the scheme for periods of between one and six years. The loans were unsecured (i.e. there was no requirement to provide security in the form of land or other assets) and were offered at a significantly discounted interest rate (2.95% APR), compared to market average rates on gross new lending to Irish primary industries (Table 1).

Table 1: Average Interest Rates on Gross New Lending to Primary Industries (% p/annum)[22]

	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
Primary Industries	5.45	5.16	5.08	5.05	5.07	5.16	5.00	5.25	4.56	4.52	4.85	5.06

Source: Central Bank of Ireland Business Credit and Deposits Statistics.

[20] https://www.agriculture.gov.ie/agri-foodindustry/agri-foodandtheeconomy/agri-foodbusiness/agriculturecashflowsupportloanscheme/

[21] The Strategic Banking Corporation of Ireland.

[22] In relation to this table, primary industries include agriculture, forestry, logging, mining and quarrying, fishing and aquaculture. According to the Central Bank of Ireland's explanatory notes, gross new lending *"details the amount of new credit facilities drawn-down during the quarter by SME counterparties, i.e. where this credit facility was not part of the outstanding amount of credit advanced at the end of the previous quarter. Gross new lending is defined in such a way as to exclude renegotiations and restructuring of existing loans. Gross new lending does not equate to loans sanctioned over the period"*. Table 1 is for illustrative purposes only and is not intended to offer a direct like-for-like comparison.

The scheme also offered an interest only period for between eighteen months and three years at the beginning of the loan period. Preliminary results indicate that just under 250 primary producers availed of this option.

Criteria:

In order to satisfy the requirements of the EU's 'exceptional adjustment aid for milk and other livestock farmers', applicants had to fulfil one of the following four criteria:

- Implementation of quality schemes or projects aiming at promoting quality and value added, i.e. a certified member of a quality assurance scheme run by a co-operative, processor or producer representative body or a certified member of the Bord Bia quality assurance scheme.
- Application of environmental and climate friendly production methods, i.e. participant in Ireland's current or previous Rural Development programmes, e.g. Green Low-Carbon, Agri-Environment Scheme (GLAS).
- Implementation of co-operation projects, i.e. a current member of a DAFM registered farm partnership.
- Training in financial instruments and risk management tools, e.g. financial training administered by Teagasc.

Similar to the €300m BLS, the process of fulfilling this criteria was through self-declaration by loan applicants. Aside from usual bank lending assessment criteria, there were no other requirements imposed on applicants applying for loans under the scheme. Loans under the scheme are subject to audit.

Assessment:

Key messages:

- A large amount of loans were used replacing merchant credit and overdrafts, and working capital needs. (SBCI-DAFM survey)
- The interest rate (2.95%) appeared to be lower than market offerings for working capital loans, which is a potential source of high demand.
- The regional distribution of loans (as a percentage of funds) to end June 2017 was Border (14%); Midlands (11%); West (11%); Dublin (<1%); Mid-East (9%); Mid-West (16%); South-East (17%) South-West (22%).
- The dairy and beef sectors drew down the majority of loans (84%).
- In some cases, financial instruments, rather than direct grants, may be a suitable support for some farmers, owing to potentially lower upfront Exchequer costs.
- Direct grants are likely to remain an important policy tool for sectors characterised by low average incomes, e.g. drystock/sheep farmers.

(i) Additionality[23]

According to the SBCI, the overarching purpose of the ACSLS is; *"to support farmers experiencing short-term financial pressure due to price and income volatility"*[24]. The SBCI, DAFM and the three partner banks (AIB, BoI and UB) also outline what is within and outside the parameters of the loan product (Appendix 2).

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[23] Additionality is defined as *"whether a support measure induces private investments that would otherwise not have been made"*.

[24] https://sbci.gov.ie/products/sbci-agriculture-cashflow-support-loan-scheme

This paper notes the following two points:

- It is unclear at present what the level of additionality associated with the scheme is (i.e. there is limited empirical quantitative information concerning the extent to which the scheme induced new lending, for example, *"future working capital requirements")*.

By way of an illustrative example, the purpose of the DBEI Credit Guarantee Scheme (see section 4) was to *"encourage additional lending to SMEs, not to substitute for conventional lending that would otherwise have taken place".*[1] Although the ACSLS was set up for a different purpose, the DBEI Credit Guarantee Scheme provides an example of a scheme where applicants have to provide evidence of initially being rejected for a loan due to one or two specifically stated market externalities. Thus, providing a measure of additionality.

By way of example, a RED C market survey commissioned by the SBCI and DAFM finds that of those surveyed[25], 42 percent used the loan scheme to reduce the "cost of debt on the farm by replacing merchant credit or overdrafts" while 35 percent of respondents used the loan scheme for "ongoing working capital needs". As stated that the ACSLS "provided low-cost flexible working capital finance to farmers"[26].

(ii) Interest Rate

The interest rate charged on loans drawn down under the ACSLS (2.95% APR) was far below rates offered for similar loan products in the marketplace (Table 1). This incorporated the application of the EU's Exceptional Adjustment Aid. In addition, the interest rate charged on the scheme was approximately 1% lower than the rate charged for loans under the State supported BLS and was also lower than the original 2016 Glanbia Milk Flex market led fund. From an expenditure perspective, there may be questions in regard to the appropriateness of the cost of credit under this loan scheme. The provision of State supported credit at low interest rates may give rise to some firms becoming dependent on cheap credit. This could lead to possible future Exchequer asks for further low interest rate loan schemes post-Brexit.

(iii) Demand

Although the oversubscription of the scheme provides evidence of high demand for this product, it is important to understand why this was the case. The language articulated by DAFM also suggests that the success of the Budget 2017 ACSLS, is measured by the rate of drawdown on the scheme[27]. It may be worthwhile to explore whether or not the oversubscription of the scheme by March 2017 is sufficient justification for any potential future Brexit Loan Schemes to be introduced.

In addition, the relationship between the low interest rate charged on loans drawn down under the scheme and the associated high level of demand should be considered.

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[25] Population of farmers who availed of the loan scheme; n=250

[26] https://www.agriculture.gov.ie/agri-foodindustry/agri-foodandtheeconomy/agri-foodbusiness/agriculturecashflowsupportloanscheme/

[27] Department of Agriculture, Food and the Marine Budget 2018 press release states that the provision of €25m for the development of potential Brexit loan schemes for farmers, fishermen and food businesses follows "on from the very positive reaction by farmers to the Agriculture Cashflow Support Loan Scheme, which proved that significant demand exists for low-cost flexible finance".

In the survey evidence conducted by RED C on behalf of the SBCI and DAFM, 68 percent of those surveyed who thought the loan scheme is better (n=212) indicated that *"Better/cheaper interest rates"* was the primary reason for this[28].

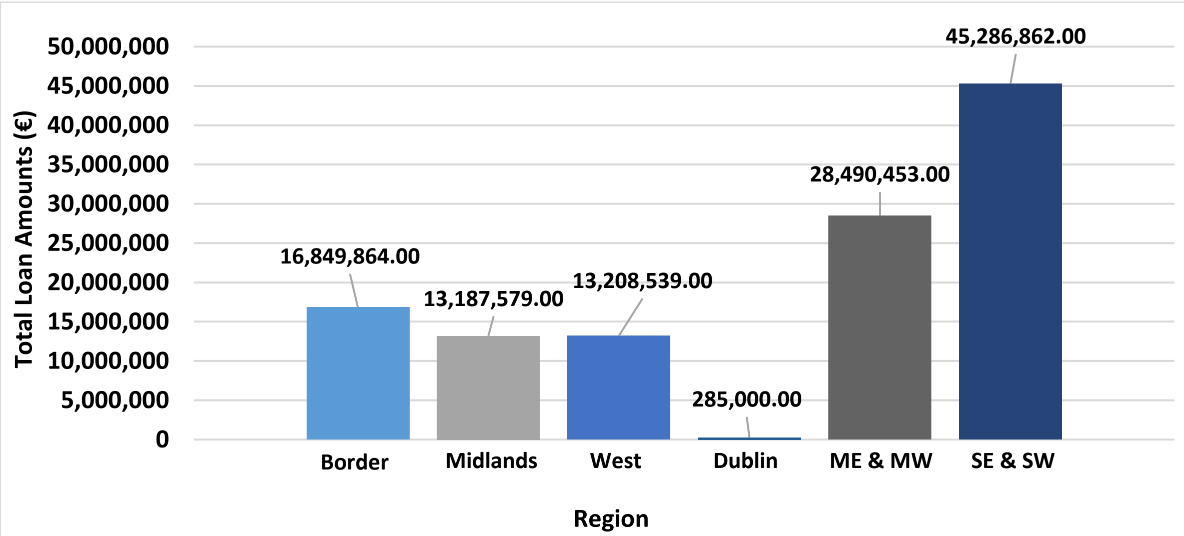
Furthermore, the SBCI noted the following in relation to the cost of credit and demand for the scheme; *"Risk-sharing was the key driver of the agri-cashflow support loan scheme in co-operation with the Minister for Agriculture, Food and the Marine, which was hugely successful in delivering €145 million in **low cost** (empahsis added) working capital loans, with an interest rate of 2.95%, to primary agriculture businesses. **The scheme was so attractive to borrowers that it was heavily oversubscribed** (empahsis added) and all of the capacity was fully accounted for within weeks of launch, far ahead of our expectations[29]."* Reference to *"low cost"* and *"so attractive to borrowers that it was heavily oversubscribed"* would also appear to draw a link between the cost of finance and the demand for the ACSLS.

The cost of credit would appear to have been significantly lower than market offerings for working capital loans at that time particularly given that the high demand and uptake of the scheme took place at a time when demand for credit within the Irish market more broadly was subdued.

(iv) Targeting

Although Brexit was not the focus of the ACSLS, insights can be gathered by examining the sectoral and regional distribution of loans[30]. To the end December 2017, c€145m of the €150m fund size had been drawn down by *"4,246 SMEs supporting 5,893 jobs"*[31].

Figure 7: Regional Spread of Loans drawn down to end of June 2017



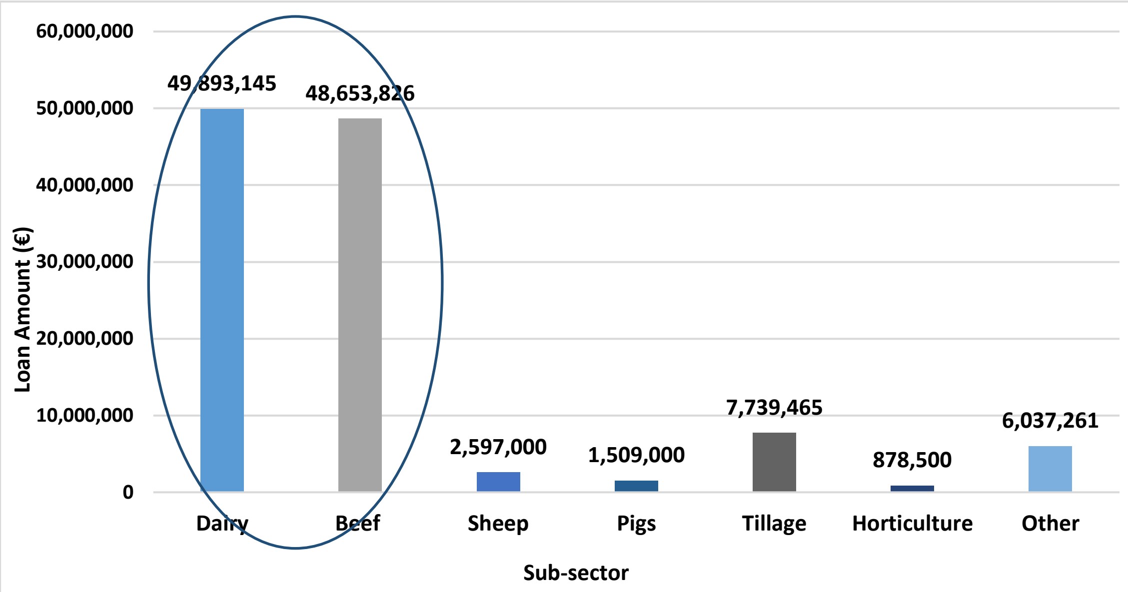
Source: Department of Agriculture, Food and the Marine.

[28] Strategic Banking Corporation of Ireland – Farmers Survey (June 2018).
[29] Joint Committee on Finance, Public Expenditure and Reform and Taoiseach debate (Tuesday, 27 March 2018). Overview of Operations: Strategic Banking Corporation of Ireland. See link: https://www.oireachtas.ie/ga/debates/debate/joint_committee_on_finance_public_expenditure_and_reform_and_taoiseach/2018-03-27/4/
[30] Data in relation to the outputs from the scheme are publicly available on the Department of Agriculture, Food and the Marine website to the end June 2017. Metrics for the year end 2017 will be utilised in the Department of Agriculture, Food and the Marine Spending Review paper specifically analysing the Agri Cashflow Support Loan Scheme.
[31] https://www.finance.gov.ie/what-we-do/banking/sme-credit-lending/

The regional distribution of loans (as a percentage of funds) to end June 2017 was Border (14%); Midlands (11%); West (11%); Dublin (<1%); Mid-East (9%); Mid-West (16%); South-East (17%) South-West (22%). A total of 36% of funds were drawn down in the Border, Midlands and West (BMW) region, while the Mid-East and Mid-West and South-East and South-West accounted for the remaining 64% of loans.

Data outlining the sectoral breakdown of loans is also publicly available to end June 2017 (Figure 8).

Figure 8: Sectoral Breakdown of Agri Cashflow Support Loan Scheme



Source: Department of Agriculture, Food and the Marine.

The majority of the funds drawn down to the end of June 2017 were allocated to the dairy and beef sectors (84%). Given that the Irish dairy and beef sub-sectors are particularly exposed to the UK market, exporting approximately c22% and c50% of total exports to the UK respectively, it would appear that a large number of loans under the scheme were drawn down by sub-sectors facing high Brexit exposure, it also broadly reflects the size of those sectors[32]. Sheep, pigs, tillage, horticulture, other sectors made up approximately 16% of funds drawn down to end June 2017.

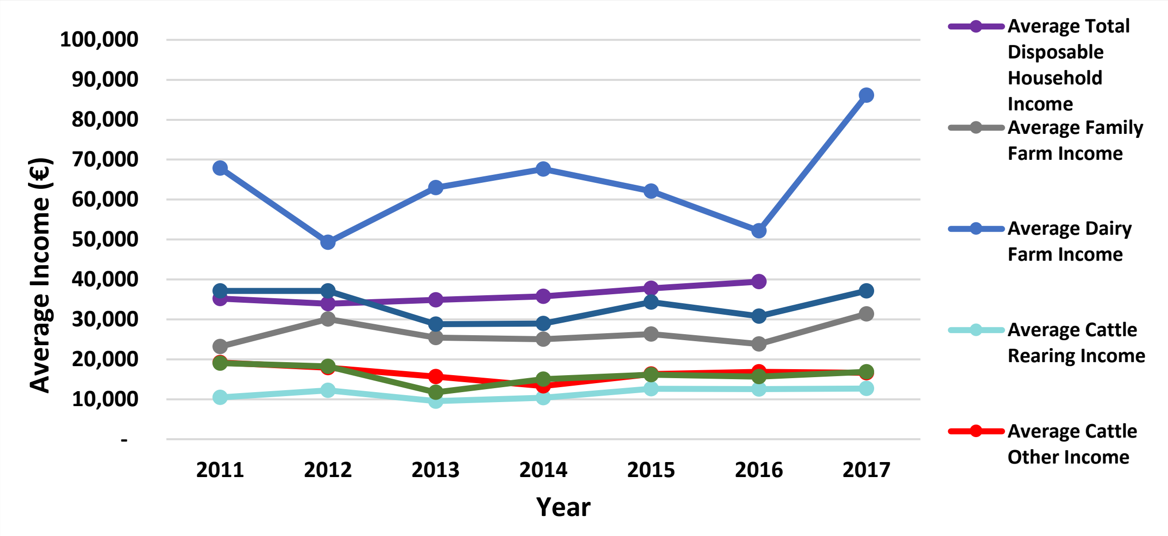
Based on Figures 7 and 8, the ACSLS was indirectly targeted at sectors and regions facing Brexit exposure.

The greatest proportion of loans drawn down to the end June 2017 were allocated to the dairy sector. This sector has experienced significant income fluctuations in recent years, however, Teagasc preliminary results for 2017 indicate that the average income for the dairy sector in 2017 exceeded €86,000[33]. On the other hand, average incomes on other farm incomes remained low. These sectors have experienced less income volatility but consistently lower incomes (Figure 9) than dairy enterprises, particularly in a post-quota environment.

[32] It must also be noted that Ireland's dairy and beef enterprises account for the highest percentage of gross agricultural output and the largest volume of Ireland's international agri exports and imports.

[33] According to Teagasc's National Farm Survey 2017 Preliminary Results, production (litres/ha), milk price (€/litre) and gross output (€/ha) increased *"for the dairy enterprise"* in 2017.

Figure 9: Average Income Trends (2011 – 2017)



Source: CSO and Teagasc National Farm Survey Preliminary Results 2017.

In light of the high proportion of on-farm investment undertaken on dairy enterprises in Ireland, along with higher output and profitability in comparison to other farm systems,[34] financial instruments may represent a suitable support (in some cases) for this farm system type, with potentially lower upfront Exchequer costs compared to direct grant type funding[35]. Direct grants are likely to remain an important policy tool for sectors characterised by low average incomes, e.g. drystock and sheep farmers.

3.4 Brexit Loan Scheme

Key messages:

- The process of fulfilling the Brexit and Innovation criteria underpinning the BLS is through self-declaration by loan applicants (i.e. tick box form).
- In the event that losses and administrative costs do not amount to the full provision of €23m, the difference will be refunded to the DBEI and the DAFM by SBCI, under the terms of the co-operation agreement.

Overview:

The DBEI and DAFM BLS was announced on Budget day 2018. The scheme was formally launched on 28 March 2018, with applications taken for loan eligibility from that date and subsequent lending applications open from 3 April 2018[36].

The total fund amounted to €300m, with an upfront Exchequer cost of €23m. The scheme will remain open for a two year period or until the scheme is fully subscribed. The maximum interest rate charged on loans under the scheme is 4%. The Exchequer cost split between the two Departments involved €14m provided by the DBEI with the remainder provided by DAFM. The overall risk of the scheme will be split on a 40:40:20 basis between the State, EIF and the participating banks respectively.

[34] Teagasc National Farm Survey 2017 Preliminary Results
[35] For example, the Targeted Agricultural Modernisation Schemes (TAMS) II, which is a capital grant scheme, has a total budget allocation of €395m under the 2014 – 2020 Rural Development Plan.
[36] AIB will open the scheme in June 2018.

Features:

There are a number of key characteristics underpinning the Budget 2018 BLS. The loans are being offered at a maximum interest rate of 4%, below the market average rates available to SMEs at present[37]. In contrast to the ACSLS, which offered loans for a duration of up to six years, loans drawn down under the BLS will be for periods of up to three years. Loan amounts ranging from €25,000 and €1.5m can be drawn down under the scheme, with loans under €500,000 being unsecured. The BLS also includes a potential interest only period, with the loan term and amount depending on the purpose of the loan.

The €23m cost to the Exchequer does not incorporate an interest rate subsidy, i.e. the financial providers under the scheme will offer the loans at a maximum interest rate of 4%. In the event that the losses and administrative costs do not amount to the full Exchequer provision of €23m, the difference will be returned to the DBEI and the DAFM by the SBCI under the terms of the co-operation agreement.

Criteria:

Given that the scheme was launched on 28 March 2018, substantive data on loans drawn down is understandably not available as of yet. As of 10 July 2018, the following metrics are publicly available on the BLS:[38]

- 151 applications to the SBCI.
- 132 of the 151 applicants were deemed eligible to seek loans under the scheme.
- 10 loans progressed to sanction at financial provider level. These loans total €2.49m of the €300m BLS fund.

Appendix Table 1 outlines the Brexit and Innovation criteria required under the scheme. Recipients must satisfy one of the Brexit-related criteria (A to D) and one of the Innovation-related criteria (1 to 11) to be eligible for the scheme. In addition, each applicant must submit a business plan in order to be considered for the scheme.

The process of fulfilling the Brexit and Innovation criteria underpinning the BLS is through self-declaration by loan applicants (i.e. tick box form). The use of the scheme is also subject to audit.

[37] Central Bank SME Market Reports

[38] Ireland, Dáil Éireann (2018), Parliamentary Question 30089/18.

Assessment:

Key messages:

- In the event that the losses and administrative costs do not amount to the full provision of €23m, the difference will be recoverable by the Exchequer.
- At present, it is unclear what level of Brexit exposure each applicant faces beyond stating that they estimate their own exposure at least 15% direct or indirect trade exposure to the UK market.
- It would be beneficial to establish how the outputs associated with loans drawn down for innovation purposes will be measured and the associated impacts, e.g. building businesses' resilience.
- The ex-post evaluation of whether loans were fully used for intended purposes under the scheme may prove challenging to fully ascertain.

(i) Cost to the State

In the event that the losses and administrative costs do not amount to the full Exchequer provision of €23m, the difference will be recoverable. The cost of the scheme to the State can be divided into two timeframes. First, the upfront Exchequer cost of the scheme and second, as with any financial instrument, there is an element of risk being placed on the State in terms of associated liabilities. For instance, under the joint DAFM and DBEI €300m BLS, the State would be liable for 40% of the loans under a worst case scenario whereby all loans defaulted (i.e. €120m of the €300m loan scheme)[39]. Therefore, additional liabilities on top of the upfront Exchequer cost of State supported loan schemes could potentially be incurred in future years.

(ii) Targeting

In regard to the Brexit specific targeting of the scheme, applicants must either export/import/have a combined export and import exposure/indirect exposure equating to at least 15% of business turnover to the UK market to fulfil the Brexit criteria set out in the SBCI BLS application[40]. At present, it is unclear what level of exposure each applicant faces beyond knowing that they estimate their own exposure at at least 15% direct or indirect trade exposure to the UK market. In terms of evaluating the scheme from a Brexit lens, a further breakdown of the exact percentage of trade with the UK would be beneficial in order to assess the degree to which the scheme is targeted at firms facing the largest exposure.

(iii) Purpose

Loans under the Budget 2018 BLS can be used for; future working capital requirements, to fund innovation or change or adaption of the business to mitigate the impact of Brexit. Further details in relation to how loans drawn down under the scheme will help to mitigate Brexit challenges would be beneficial. In addition, it would be beneficial to establish how the output associated with loans drawn down for innovation purposes will be measured and the associated impacts, e.g. building businesses' resilience.

(iv) Outputs

[39] This guarantee would only be fully called in in the unlikely event that all of the €300 million funding under the Scheme is both lent out and none of it is repaid. The risk adjusted Exchequer exposure to loss is c. 5%.

[40] See appendix 1 for full breakdown of criteria underpinning the scheme.

From an Exchequer perspective and when evaluating the BLS in the future, it is worth noting that the process of fulfilling the SBCI's Brexit and Innovation criteria will be based on self-certification. However, applicants are made aware that their application may be subject to audit. In addition, it is unclear at this point how or who will evaluate the efficiency and effectiveness of the scheme, i.e. assess whether the funds drawn down under the scheme were used for the intended purpose and what was the additionality relating to the scheme. From the financial provider's perspective, the primary focus will be to ensure that loans are fully repaid, especially in light of the risk sharing component of the scheme. Thus, the ex-post evaluation of whether loans were fully used for intended purposes under the scheme may prove challenging to fully ascertain.

3.5 Data Outputs associated with Existing Schemes

Key message:

- There is a need to ensure data is appropriately collected and recorded in order to allow for State supported loan schemes to be fully assessed in the future, i.e. to facilitate the measurement of outcomes and impacts associated with schemes.

Based on data relating to the ACSLS and the SBCI's BLS application form, there is a lack of clarity in regard to some of the data collected on the existing State supported schemes.

This paper notes that it would be useful for data collected by the participating banks and the SBCI, which is provided to the DAFM and DBEI to be supplied to Department of Public Expenditure and Reform where appropriate. Data on the schemes is likely to be beneficial to Department of Public Expenditure in terms of measuring the outcomes and impacts of the two existing schemes against the associated Exchequer cost, particularly in the context of ensuring continued sustainable management of public resources.

The majority of this Spending Review paper has focused on inputs associated with existing schemes. In order to appropriately evaluate the loan schemes from an expenditure point of view in future years, it would be beneficial to analyse the following data:

- Loan applications, approvals and drawdowns
  Although the ACSLS was fully subscribed within a few weeks of being launched in 2017, data in relation to the number of applications, approvals and drawdowns rates of loans under the BLS are not publicly available at present. In order to fully assess whether there was sufficient demand to justify the State intervening in the market by supplying working capital loans to SMEs and Small Mid-caps it would be beneficial to obtain this data.

- Sectoral/regional breakdown
  As previously discussed in this paper and flagged in existing literature, Brexit is likely to pose sector and region specific challenges for the Irish economy. A sectoral and regional breakdown of the loans drawn down under the schemes would be helpful in assessing the extent to which current schemes are targeted at firms facing Brexit-related exposure.

- Interest rate charged and interest only periods

Although the ACSLS explicitly charged an interest rate of 2.95%, the BLS states that the maximum interest rate to be charged on loans drawn down under the scheme is 4%. It would be beneficial to find out whether some firms were able to avail of loans under the scheme at a rate below 4%. In addition, it would be helpful to obtain information on the percentage of loan recipients who were able to leverage an interest only period under the scheme.

- Loan duration

  A breakdown of loan terms is available for the ACSLS, similar data for the BLS would be worth gathering in order to evaluate how long recipients have to repay loans under the scheme. This will be important to note as the true extent of the Brexit exposure that may be faced by primary producers, SMEs and Small Mid-caps is still unknown given that EU-UK negotiations are still in progress.

4 The SME Credit Market and Alternative Financial Options

Key Messages:

- There does not appear to be evidence of a significant market failure, particularly for working capital finance.
- There are a number of State supported and market led finance options available to primary producers, SMEs and small mid-caps.
- The main difference between existing market offerings and the Budget 2017 and Budget 2018 State supported loan guarantee schemes would appear to be the cost of credit.

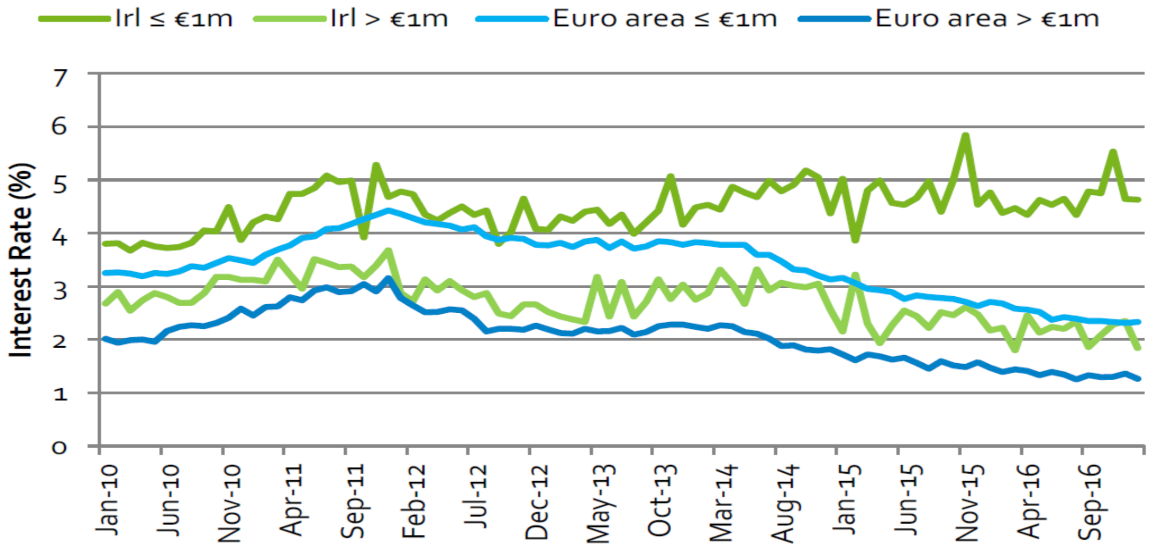
4.1 Characteristics of the Irish Credit Market

The Irish SME credit market is characterised by a number of defining features[41]. While the mean interest rate on bank overdraft and credit lines for SMEs in Ireland have declined, the costs of finance for SMEs in Ireland are higher when compared to Euro area averages[42]. There is also evidence of high concentration within the Irish SME lending market (particularly since 2010) as the three main commercial banks account for approximately 90% of the Irish SME lending market share. Higher credit risk premiums for SME lending also contribute to the divergence in interest rates vis-à-vis other EZ countries. Average interest rates for non-financial corporation (NFC) loans below €0.25m was 5% in July 2017. In addition, Irish interest rates have been more volatile (Figure 10) than Euro area rates in recent years.

[41] Central Bank of Ireland (January 2018) SME Market Report 2017 H2, National Competitiveness Council (June 2017) Costs of Doing Business in Ireland 2017 and National Competitiveness Council (December 2017) Ireland's Competitiveness Challenge 2017.

[42] National Competitiveness Council (June 2017). Costs of Doing Business in Ireland 2017.

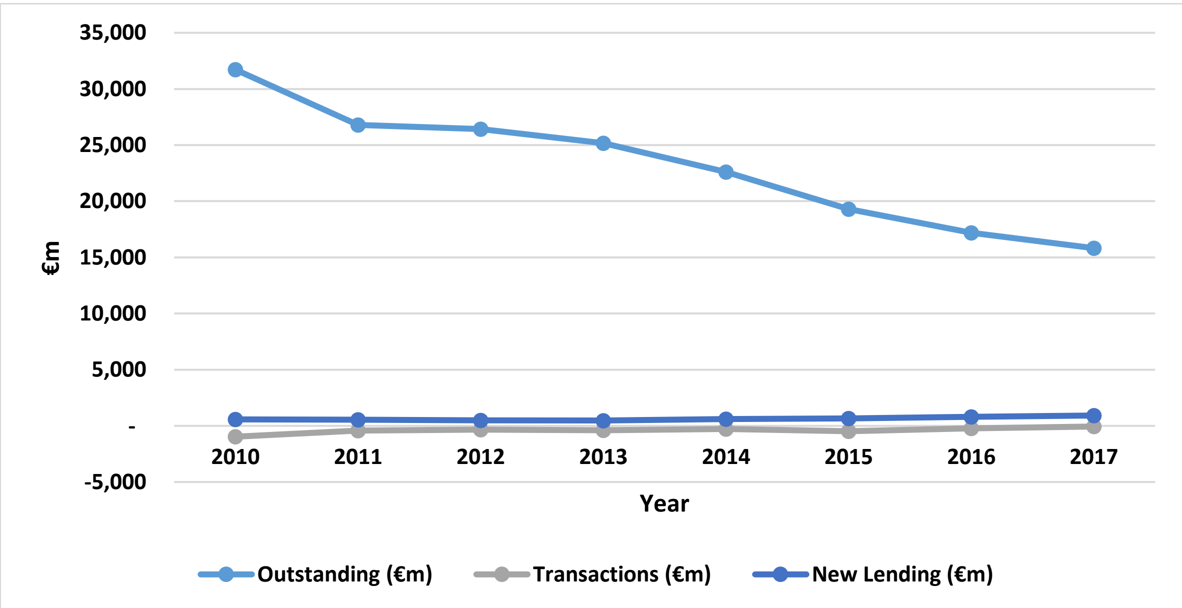
Figure 10: Interest Rates for Non-Financial Corporations (new businesses) by Loan Size (Jan. 2010 – Jan. 2017)



Source: National Competitiveness Council (June 2017).

Credit demand remains *"low"* in the Irish SME credit market and this is reflected in the percentage applying for bank loans which was 21% in September 2017[43]. As described in Figure 11, Irish resident SMEs are continuing to deleverage (as seen in the value of outstanding debt). This represents a pattern which has been evident since the economic downturn (circa 2009 onwards). Repayments on outstanding loans continue to exceed new lending to this cohort. The continuing presence of legacy issues and associated costs, primarily driven by property sector lending, may also be contributing to the gap between the stock and flow of lending to Irish SMEs.

Figure 11: Irish Resident SME Credit Market Trends (2010 – 2017)[44]



Source: Central Bank of Ireland Business Credit and Deposits Statistics.

[43] Central Bank of Ireland (January 2018) SME Market Report 2017 H2. Subsequent to the initial drafting of this paper, the Department of Finance has released the latest SME Credit Demand Survey (October 2017 – March 2018). According to the survey results, 26% of SMEs report that they requested credit in the six months between October 2017 and March 2018.

[44] Figures reported in Figure 11 represent an average of the quarter.

The Department of Finance Credit Demand Survey states that the main reason cited by businesses surveyed (between April – September 2017) who were not seeking credit was *"lack of credit requirements"*. Following a period characterised by high borrowing during the early 2000s, particularly for property-related loans, another possible reason for low demand for credit may be a higher level of risk aversion exhibited by SMEs since the economic downturn.

The main reason cited by SMEs requesting finance is for working capital related credit. From a supply perspective, the State supported Agri Cashflow Support Loan Scheme (ACSLS) and Brexit Loan Scheme (BLS) have been developed to meet market demands for this type of loan product.

Existing literature state that the Irish SME lending market remains particularly concentrated[45]. The three main commercial banks in Ireland account for approximately 90% of the Irish SME lending market share. Two of the adverse implications associated with this concentration, which have been cited in literature, are (i) possible credit supply issues [the supply of finance to the Irish SME sector is explored in the next chapter] and (ii) competitiveness challenges.

At present, there is evidence that Irish SMEs are continuing to decrease their debt-to-asset ratio[46]. Amidst Brexit-related uncertainty and other externally driven challenges, the benefits of supplying State supported credit to primary producers, SMEs and small Mid-caps at below market average interest rates may need to be assessed further. A 2014 study by the ESRI notes that *"high debt burdens relative to turnover can have negative effects"* and *"impedes performance and increases default probabilities"*. Given the Government's ongoing Brexit Preparations, questions may need to be asked about whether or not the capability and capacity of firms exposed to Brexit to meet debt obligations may weaken due to Brexit, particularly under a hard-type Brexit scenario.

4.2 Main Commercial Banks

Three of the main commercial banks in Ireland; Bank of Ireland, AIB and Ulster offer loans to farmers and SMEs (see Table 2 for examples). Although the terms underlying the loan schemes may not be as favourable as the State supported ACSLS and BLS, they do represent alternative existing financial supports available to indigenous sectors in the Irish economy.

Table 2: Illustrative Examples of Product Offerings for Farmers and SMEs through the 3 Main Commercial Banks in Ireland

Bank:		BoI	AIB	UB
Offerings:	**1**	Farm development loan	*"Backing Brave"* loans for small businesses and farmers	Young farmer start up package
	2	Land purchase agri loan	Farmer credit line	Dairy farm expansion loan
	3	Agri flex fodder support loan	Farm development loans	Beef stocking loan
	4	Stock purchase loan	Loans for start ups	Pasture loan

Source: Author's own diagram, based on information published on bank websites.

[45] For example; Lawless, M. O' Toole, C. M. and D. Lambert (2014). Financing SMEs in Recovery: Evidence for Irish Policy Options. Dublin; Economic and Social Research Institute and National Competitiveness Council (June 2017). Costs of Doing Business in Ireland 2017.
[46] Central Bank of Ireland (2017). SME Market Report H2 2017.

4.3 Other Private Market Offerings

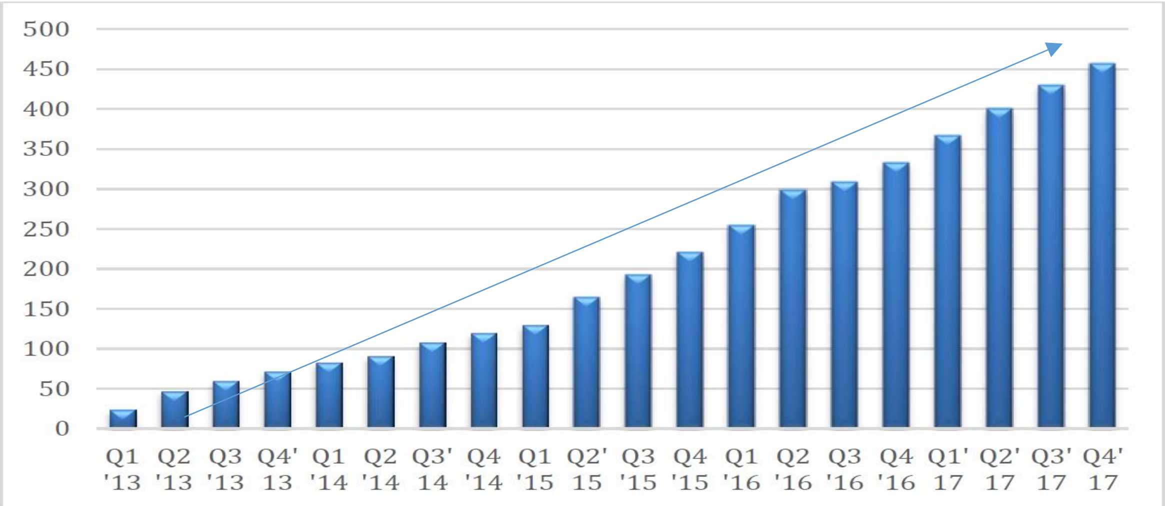
Rabobank Ireland has been operating in Ireland since 1994. The bank is a stakeholder in the MilkFlex loan scheme (described later in this chapter). Rabobank Dublin offer corporate banking, global client solutions and asset based finance focused primarily on food and agribusiness. Finance Ireland, who are also involved in the MilkFlex fund and offer SME and agri finance, is Ireland's largest non-bank lender. The provider offers are range of products such as; leasing, hire purchase, contract hire and rental agreements.

In addition to the illustrative examples of commercial bank and other private market offerings, the SBCI have a range of loan products available to the agri and SME sectors in Ireland. Along with the DAFM ACSLS and Budget 2018 BLS, Strategic Banking Corporation of Ireland (SBCI) products include; Agriculture Investment Loans and Investment and Working Capital Loans. Potential prospective borrowers must fill out a SBCI application form, with funds to successful applicants being made available through partner on-lenders[47].

4.4 Credit Guarantee Scheme

Another State supported initiative which was introduced to support lending to SMEs is the Credit Guarantee Scheme. Since the introduction of the scheme on 24 October 2012, the number of Credit Guarantee Scheme facilities has increased significantly (Figure 12). This illustrates the Government's commitment to providing lending to financially viable SMEs, who under normal lending criteria would not be in a position to obtain new or additional lending from banks.

Figure 12: Number of Credit Guarantee Facilities (2013 – 2017)



Source: Department of Business, Enterprise and Innovation (2018) 4th Quarterly Report of 2017 SME Credit Guarantee Scheme.

The State guarantees to cover 80% of the facility value up to a portfolio cap of 15%. The three banks in Table 2 are the participating lenders under the scheme. In terms of key characteristics of the scheme, loans of between €10,000 and €1m can be applied for, with loan terms of up to seven years

[47] The Strategic Banking Corporation of Ireland products are available through bank (Bank of Ireland, AIB and Ulster Bank) and non-bank (First Citizen Finance, Finance Ireland Ltd, Bibby Financial Services Ireland and FEXCO Asset Finance) lenders.

available under the scheme. SME borrowers under the scheme pay an annual premium (max. 2%[48]) to the Government in addition to the interest rate/other charges applied by the lender.

In terms of the regional distribution of loans under the Credit Guarantee Scheme, more than half (54.41%) were sanctioned for the East region[49]. In terms of increasing credit to SMEs in other regions of the economy, some regions did not receive sanction for a large number of loans, in particular Midlands and North regions. Thus, although the Credit Guarantee Scheme has increased lending to SMEs in the Irish economy since its introduction, some regions appear to have benefitted more from this scheme than others.

4.5 Microenterprise Loan Fund

Microfinance Ireland was set up in order to administer the Government's Microenterprise Loan Fund. The fund supports businesses with fewer than 10 employees with an annual turnover of less than €2m who may not be in a position to acquire funding through banks and other commercial lenders. Microfinance Ireland can provide unsecured business loans of between €2,000 and €25,000 for commercially viable proposals[50]. Some of the headline outputs from the scheme delivered from 2012 to September 2017 include; €21m of approved loans with 1,258 loans drawn down and 79% of loans granted outside Dublin[51].

4.6 Modern Lending Platforms

Aside from traditional commercial bank lending, which continues to be the primary source of funding for Irish SMEs, there are a range of other alternative sources of finance available to prospective SME borrowers. Over recent years, the presence of lending sources such as Equity Crowdfunding, Peer-to-Peer (P2P) Lending, Business Angels and Venture Capital have increased in the Irish market.

Equity Crowdfunding *"is the process whereby people (i.e. "the crowd") invest in an early-stage unlisted company… in exchange for shares in that company"*[52]. It represents an alternative source of equity funding for High Growth Potential Start-up and growth stage businesses.

There are two types of Peer-to-Peer (P2P) lending, P2P consumer lending and P2P business lending. P2P lending is another alternative means for Irish SMEs to access and maintain debt finance.

Business Angels are also present within the Irish economy. Business Angels invest capital in businesses which are at an early stage of development and may not be able to meet the criteria set out by mainstream lenders. State Agencies (Enterprise Ireland and InterTradeIreland) have established the *"Halo Business Angel Network"* (HBAN) which is specifically responsible for attracting Business Angel syndicates[53].

Venture Capital funding represents another alternative to traditional bank sourced finance. Through Enterprise Ireland, approximately €345m has been invested in the agencies' *"Seed and Venture Capital (SVC) Scheme"* over the course of four programme periods since 1994 which have raised a total of

[48] The annual premium for the period June 2018 to June 2019 is 1%.
[49] Dublin, Kildare, Meath and Wicklow.
[50] http://www.microfinanceireland.ie/what-we-do/
[51] Microfinance Ireland Report on the Microenterprise Loan Fund Scheme as at 30th September 2017.
[52] InterTradeIreland (2018).
[53] http://www.hban.org/About.8.html

€1.9bn[54]. The overarching objective of the scheme is *"to increase the availability of risk capital for SMEs to support economic growth through the continued development of the SVC sector in Ireland to achieve a more robust, commercially viable and sustainable sector".* There is evidence that the distribution of this SVC supported investments has been heavily skewed towards the Dublin region (68.5% of total investment)[55].

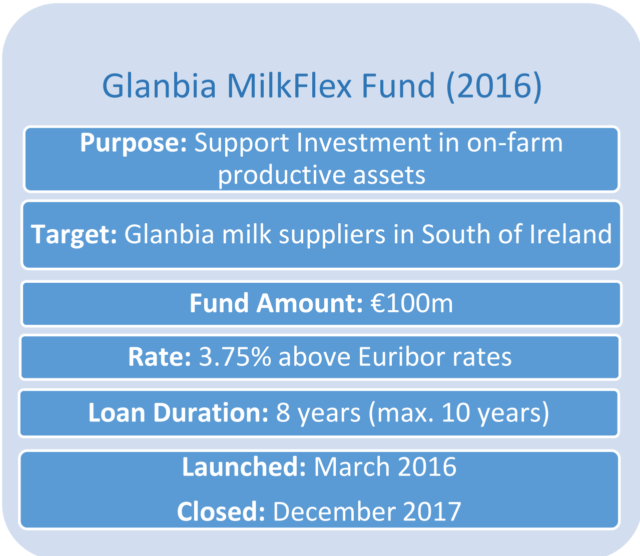
4.7 Non-traditional Lending

A number of non-traditional lending offerings exist within the Irish market, including the dairy sector MilkFlex fund. Additionally, a number of Credit Unions in Ireland have developed the *"Cultivate"* initiative to offer short to medium term finance for farmers[56].

MilkFlex

The *"Glanbia MilkFlex Fund"* represented the first lending scheme of its kind to be offered in the Irish market. A summary of key features underpinning the 2016 loan scheme are outlined in Figure 13.

Figure 13: Glanbia Market funded "MilkFlex Fund"



Source: Author's own diagram.

This co-operative led scheme was introduced prior to the State supported Budget 2017 €150m DAFM ACSLS. The scheme was put in place to offer affordable loans to farmers who were experiencing income volatility as a result of price volatility in the dairy market in 2016. In contrast to the DAFM loan scheme, which was targeted at primary producers more broadly, the Glanbia scheme was specifically

[54] Department of Business, Enterprise and Innovation (9 March 2018). Evaluation of the Enterprise Ireland Seed & Venture Capital Scheme.
[55] Department of Business, Enterprise and Innovation (9 March 2018). Evaluation of the Enterprise Ireland Seed & Venture Capital Scheme.
[56] There are 13 Credit Unions participating in the initiative. Loans of up to €50,000 are available for a max. 7 year term at a rate of 6.75% APR. Loans can be used to invest in new or second hand machinery, upgrade buildings and facilities, stock requirements, working capital or to increase cashflow. The loans do not require collateral, therefore reducing one financial friction faced by borrowers.

targeted at Glanbia milk suppliers in the South of Ireland, with a portion of the €100m fund[57] set aside for new entrants in the dairy sector.

The loan fund is managed by Finance Ireland, while Rabobank, Finance Ireland, the Ireland Strategic Investment Fund and Glanbia co-operative society invested in the scheme. The standard loan term under the scheme was eight years, with the potential to extend the term for up to an additional two years. The MilkFlex Fund was market driven, and offered a variable interest rate of 3.75% on loans above the monthly Euribor cost of funds, compared to a rate of 2.95% on loans drawn down under the Budget 2017 scheme[58].

In light of any potential longer term future schemes, flagged by Departments, it is interesting to note that a market led long term loan scheme was previously made available in the market. Furthermore, although the scheme sought to alleviate cashflow challenges, loans drawn down under the scheme could be used for investment purposes, such as *"milking platform infrastructure"*. Moreover, the scheme incorporated *"flex triggers"* in line with movements in milk prices and seasonality.

2018 Fund

On 1 May 2018, Glanbia co-operative society launched a €38m *"Advance Payment Scheme"* for members[59]. The scheme will offer interest-free cashflow support to Glanbia member dairy suppliers, with the objective of helping dairy farmers during times of income volatility. Similar to the initial 2016 scheme, the *"Glanbia Advance Payment Scheme"* will incorporate *"price triggers"*, whereby the scheme will automatically advance payments of up to 2 cents per/litre when the Glanbia Ireland manufacturing milk price, including VAT, falls below 30 cents/litre. Participants will not incur interest charges on the advance payments under the scheme, with the interest-free return payments only occurring once the Glanbia Ireland manufacturing milk price exceeds 31 cent per/litre, including VAT. MilkFlex loans also incorporate seasonality (from December to March inclusive) and disease triggers[60]. Unlike some traditional loan offerings no collateral was required, therefore, reducing one of the financial frictions faced by many in this cohort when applying for finance.

Loans could be drawn down for one of the following purposes:[61]

- Investment in productive dairy farm assets;
- Farm infrastructure;
- Dairy livestock purchases;
- Work related to environmental schemes, low emissions slurry equipment (TAMS funded and non-TAMS funded) etc.;
- Grassland or land improvement, including reseeding and drainage works;
- Technological improvements, e.g. milking robots;
- Refinancing of any loan, cash or cashflow used in/on dairy farm projects, which commenced on or after 1st March 2014 and;

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[57] The scheme was funded by issuing a five year exchangeable bond linked to a pledge of c4.3m Glanbia Plc shares.
[58] Euribor stands for *"Euro Interbank Offered Rate"*. The loans had an associated arrangement fee of 1.25% (4.18% APR).
[59] https://www.glanbiaconnect.com/news/glanbia-advance-payment
[60] Any disease officially listed by Department of Agriculture, Food and the Marine as a notifiable disease, e.g. Bovine Spongiform Encephalopathy (BSE), Bovine Tuberculosis, etc.
[61] https://www.financeireland.ie/wp-content/uploads/2018/06/MilkFlex-update-2018-v07-online.pdf

- Working capital requirements.

On 8 May 2018, the Minister for Agriculture, Food and the Marine announced the roll out of MilkFlex as a national product available through participating co-operatives.[62]

Overall, there are a range of finance options for primary producers and SMEs through a number of channels including the illustrative examples outlined in this paper; the three main commercial banks, other private market alternatives, the SBCI through partner on-lenders, MicroFinance Ireland, modern lending platforms such as equity crowdfunding and venture capital funding and MilkFlex loans, which are market led and specifically targeted at the Irish dairy sector.

5 Proposals for the Development of Longer Term Loan Scheme(s)

Key message:

- The proposed longer term Brexit Investment Scheme would likely require a higher risk coverage compared to the existing BLS due to the longer term nature of the scheme.

5.1 Evidence Relating to Possible Productivity, Investment and Finance Gaps

Productivity

The Organisation for Economic Co-operation and Development's Economic Survey of Ireland (2018) notes that the productivity gap between *"foreign"* and *"local"* firms in Ireland has widened. The report also recommends the *"further develop[ment] [of] alternative financing platform[s]"*[63].

Investment

Other recent literature finds evidence of an investment gap[64] in the Irish economy at present. Lawless et al. (2018) estimate that an SME investment gap of just over 30% exists and that financial frictions account for between 12% and 18% of this gap[65]. The paper argues that sub-optimal investment provides justification that addressing credit market issues will increase investment and economic activity. The paper notes that the majority of the investment gap is unexplained, however, the other factors contributing to the investment gap are not identified.

Given that at least 82% of the estimated investment gap is caused by factors not associated with financial frictions, consideration should be given to whether or not additional State supported loan schemes are the appropriate way to address the gap between actual and predicted investment levels. Furthermore, although there is evidence to suggest an investment gap, it may be worth questioning whether additional Exchequer resources should be funnelled into addressing financial frictions when they only explain 12 to 18 percent of the 30 percent investment gap estimated by the Economic and

[62] https://www.financeireland.ie/announcements/dairy-farmers-countrywide-to-have-access-to-flexible-unsecured-loans-as-milkflex-set-for-national-roll-out/

[63] Organisation of Economic Cooperation and Development (2018). Economic Survey of Ireland 2018.

[64] The difference between the unconstrained and the constrained level of investment.

[65] Lawless, M., O'Toole, C. and R. Slaymaker (2018). Estimating an SME investment gap and the contribution of financing frictions. Economic and Social Research Institute working paper 589.

Social Research Institute (with the Economic and Social Research Institute's results[66] representing upper bound estimates).

Finance Gaps

In addition to the estimated productivity and investment gaps in existing literature, the World Economic forum rankings suggest that Ireland performs poorly when compared to other European countries in relation to the availability of finance. Although Ireland ranks 16th for venture capital availability and 15th in relation to local equity market access, Ireland is ranked 24th out of 28 EU Member States for ease of access to loans, according to the index[67]. The Central Bank of Ireland and the National Competitiveness Council have also flagged that the cost of borrowing for Irish SMEs is greater than in other European comparator countries[68].

5.2 Proposed Longer Term Business Investment Scheme

In light of the above, the DBEI and DAFM, are currently developing proposals for a longer term business investment scheme with a Brexit focus.

The DBEI's *"Building Stronger Businesses: Responding to Brexit by Competing, Innovating and Trading"* paper (published November 2017) states that one of the Department's risk mitigation strategies for Brexit relates to the funding of enterprises[69]. The paper flags proposals for the development of a longer term *"Business Investment Scheme"* which would focus on business development to support enterprises in investing strategically for the post-Brexit environment.

DBEI's Action Plan for Jobs 2018 sets out *"Improving Access to Finance"* actions that will be taken over the duration of the 2018 plan to help mitigate some Brexit related challenges faced by businesses[70]. Aside from launching the Budget 2018 BLS, some of the other actions for improving access to finance outlined in the plan include:

- Consider the development of potential Brexit response loan schemes for farmers, fishermen and for longer term capital financing for food businesses; for which DAFM has secured €25m of funding in Budget 2018.
- Consider other sources of finance for SMEs impacted by Brexit. This action includes examining policy proposals for a new longer-term Business Investment Scheme to support businesses invest strategically for a post-Brexit environment (as previously mentioned) and engaging with the European Commission on the approval process on all Brexit-related State Aid issues.

Enterprise 2025 Renewed also highlights that *"access to a range of appropriate finance options"* continues to remain important[71].

The proposed scheme would be delivered through the SBCI and would likely require a higher risk coverage compared to the existing DBEI and DAFM BLS due to the longer term nature of the scheme.

[66] Lawless, M., O'Toole, C. and R. Slaymaker (2018). Estimating an SME investment gap and the contribution of financing frictions. Economic and Social Research Institute working paper 589.
[67] World Economic Forum (2014). Europe 2020 Competitiveness Report.
[68] Central Bank of Ireland SME Market Report 2017 H2 and National Competitiveness Council (June 2017). Costs of Doing Business in Ireland 2017.
[69] Department of Business, Enterprise and Innovation (2017). Building Stronger Businesses: Responding to Brexit by Competing, Innovating and Trading.
[70] Department of Business, Enterprise and Innovation (2018). Action Plan for Jobs 2018.
[71] Department of Business, Enterprise and Innovation (2018). Enterprise 2025 Renewed.

6 Recommendations

The main recommendations feeding from this preliminary analysis are presented below.

6.1 Recommendations

- Ensure data is appropriately collected and recorded in order to allow for State supported loan schemes to be fully assessed in the future, i.e. to facilitate the measurement of outcomes and impacts associated with schemes.

- Ensure that any further proposed State supported Brexit loan schemes are sufficiently Brexit targeted, if one of the stated purposes of a potential scheme is to mitigate Brexit-related challenges.

- Further assess whether or not the main Brexit measures in Budget 2017 and Budget 2018, in the form of affordable loan schemes, have the capacity to build Irish businesses' resilience sufficiently for possible future externally driven shocks to the economy.

- Further exploration in relation to the EU State Aid framework, in the context of existing schemes and any proposed future Brexit loan schemes would be beneficial.

- Any proposed future State supported loan schemes should include an element of additionality.

- Explore the use of financial instruments, as an appropriate form of policy intervention for specific sectors. This paper recommends that (in some cases) financial instruments may represent an appropriate policy support for profitable dairy farmers[72], in light of the lower upfront Exchequer costs compared to direct grant type funding. Direct grants and other subsidies are likely to remain an important policy tool for primary agri sectors characterised by low average incomes, e.g. drystock & sheep farmers.

- Although there is a need to balance the ease of access to credit and the targeting of State supported loan schemes, it would seem prudent to conduct ex-post evaluations to assess whether loans were used for the intended purposes stated during the application process.

- Determine whether or not the availability of affordable Brexit loan schemes has the potential to increase the exposure of some firms rather than reduce it, i.e. create a dependence on State supported low cost loan schemes and demands for scheme roll-overs.

- A survey during or after the completion of the Brexit Loan Scheme (BLS) may offer useful insights in relation to the extent to which the scheme was targeted at firms facing Brexit exposure and the impact the scheme had in terms of addressing some Brexit-related challenges faced by firms.

These recommendations should be considered in the context of evaluating existing schemes and in the design of any potential future schemes, which may be tabled by Departments.

[72] For example, dairy farmers seeking to make financially viable on-farm investments.

7 Conclusion

This paper has provided a high level overview of existing Brexit-related loan schemes underpinned by State supported guarantees. A summary of key points from this research are outlined as follows:

1. **Exchequer Costs:**
   - The most significant Exchequer costs relating to Brexit have been the introduction of two State supported loan schemes:

     Budget 2017: Agri Cashflow Support Loan Scheme (ACSLS)

     Budget 2018: Brexit Loan Scheme (BLS)
   - To date, the total upfront Exchequer cost of the two existing State supported loan schemes is €37m (€13.9m for the ACSLS & €23m for the BLS).
   - There is an element of risk exposure being placed on the State:
     - 40% of each Agri Cashflow Support Scheme loan up to a maximum portfolio loss of 15%; this capital guarantee has been provided for from within the initial €25m. Notably, 40% up to a maximum portfolio loss of 15% has also been guaranteed, owing to the COSME Counter Guarantee provided, by the EIF.
     - 40% of the BLS fund. The risk adjusted Exchequer exposure to loss is c5%.
     - Under a situation whereby there were any breaches of the EU State Aid Framework.

2. **Financial Instruments:**
   - Although the purpose of financial instruments is not to replace grant support, financial instruments (such as the ACSLS and BLS) may represent good value for money when compared to the one-off nature of direct grants.

3. **Market Failure:**
   - There does not appear to be evidence of a significant market failure, particularly for working capital finance. However, the cost of credit for Irish SMEs is higher than for their competitors in other EU Member States.
   - There are a number of State supported and market led finance options available to primary producers, SMEs and small mid-caps.
   - The main difference between existing market offerings and the Budget 2017 and Budget 2018 State supported loan guarantee schemes is the cost of credit. Another key feature of the schemes is the absence of collateral requirements. The ACSLS loans were unsecured. Loans up to €500,000 were unsecured under the BLS.

4. **Targeting of Loan Schemes:**
   - The loan schemes are offered on a *"first come, first serve"* basis to eligible borrowers.
   - Financial instruments should be seen as part of a broader response to building firms' resilience to Brexit-related risks.

5. **Measurements:**
   - The eligibility criteria relating to the ACSLS and BLS is fulfilled through a process of self-certification (i.e. tick box form).

- At present, it is unclear what level of Brexit exposure each applicant faces beyond knowing that they face at least 15% direct or indirect trade exposure to the UK market.

8 References

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9 Appendix

Appendix 1

Appendix Table 1: Department of Business, Enterprise and Innovation and Department of Agriculture, Food and the Marine Brexit Loan Scheme Criteria[73]

Criteria Type		Detail
Brexit-related	**A**	Do you export products, services or raw materials to the UK (including Northern Ireland) equating to at least 15% of your turnover?
	B	Do you import products, services or raw materials from the UK (including Northern Ireland) equating to at least 15% of your turnover?
	C	Does your combined exposure (A and B above) equate to at least 15% of your turnover?
	D	Are you indirectly exposed to the UK (including Northern Ireland) by transacting business in products, services or raw materials with an enterprise that is directly exposed to the UK (including Northern Ireland) equating to 15% of your turnover?
Innovation-related	**1**	At least 80% of the scheme loan will be spent on research and innovation activities with the remainder on costs necessary to enable such activities.
	2	You intend to enter a new product or geographical market, and the required investment is higher than 50% of average annual turnover in the preceding 5 years.
	3	You will have registered at least one technology right in the last 24 months and the purpose of the loan is to enable use of this technology right.
	4	You are an SME and research and innovation costs represent at least 10% of total operating costs in at least one of the last three years preceding this application, or in the case where there is no financial history, as per current financial statements.
	5	You are a small mid-cap, and research and innovation costs represent either: **a.** At least 15% of total operating costs in at least one of the three years preceding this application **b.** At least 10% per year of total operating costs in the three years preceding this application
	6	You have been awarded a Research and Development or Innovation prize by an EU Institution or EU Body over the last 24 months.
	7	You have received a grant, loan or guarantee from a European research and innovation scheme (e.g. Horizon 2020 or FP7) or regional/national research or innovation support scheme in the last three years, and are confirming that the loan is not covering the same expense.
	8	You are an early stage SME and have received an investment over the last 24 months from a venture capital investor or business angel.

[73] Applicants must also submit a detailed business plan with their loan application.

	9	You intend to use the loan to invest in producing, developing or implementing new or substantially improved products, processes or services or production or delivery methods (including business models) that are innovative, and where there is a risk of technological, industrial or business failure as evidenced by an external expert.
	10	You are a *“fast growing enterprise”* operating for less than 12 years with an average annualised employee or turnover growth greater than 20% a year, over a three-year period and with ten or more employees at the beginning of the period.
	11	You are operating in a market for less than seven years and research and innovation costs represent at least 5% of total operating costs in at least one of the three years preceding the loan application or, in the case of an enterprise (and particularly a start-up) without any financial history, according to current financial statements.

Source: Government of Ireland Brexit Loan Scheme Information Pack.

Appendix 2

According to the Strategic Banking Corporation of Ireland, Agri Cashflow Support Loan Scheme loans could be used for *"future working capital requirements (e.g. feed, fertiliser, trading stock, tax, other costs, etc.); as an* ***alternative*** *to merchant credit; or to replenish working capital already used (prior to 31 December 2016)"*. The Strategic Banking Corporation of Ireland also state that **loans cannot be used for *"refinance of undertakings in financial difficulties, refinance of existing debt (e.g. Term Loans/Leases/Hire Purchase, etc.)*** *or new investment"*.[74]

The Department of Agriculture, Food and the Marine state that loans could be used for *"working capital requirements; as a more sustainable* ***alternative*** *to short-term credit facilities; or as an* ***alternative*** *to merchant credit"*. Furthermore, the Department of Agriculture, Food and the Marine set out that one of the purposes of the loan is to ***"allow[ing] them [farmers] to pay down more expensive forms of short-term debt (e.g. merchant credit and overdrafts)"***. The language used by the Department of Agriculture, Food and the Marine varies slightly from the Strategic Banking Corporation of Ireland in regard to what the loans cannot be used for, *"****refinance of existing term loans; the refinance of undertakings in financial difficulties*** *(as opposed to cash flow difficulties, as defined in EU guidelines); or new investment"*.[75]

The partner on-lenders also detail what loans under the scheme can and cannot be used for. AIB (31 January 2017) stated that *"Loans can be to meet new working capital requirements;* ***refinance existing farm creditors or a portion of existing working capital****; or to replenish cash reserves utilised to fund capital expenditure prior to the end of 2016."*[76] The language used by BoI to describe how loans under the scheme can and cannot be used also varies from the other descriptions given by Strategic Banking Corporation of Ireland, Department of Agriculture, Food and the Marine, AIB and UB. BoI stated that loans can be used for *"working capital to fund day-to-day farms operations for 2017 including feed, fertiliser, trading stock, wages, taxes and more;* ***refinance of short term credit facilities, such as supplier trade credit, merchant credit and overdrafts; or refinance of business capital expenditure or assets were purchased from Cashflow prior to Dec 31st 2016"***.

[74] https://sbci.gov.ie/products/sbci-agriculture-cashflow-support-loan-scheme
[75] https://www.agriculture.gov.ie/agri-foodindustry/agri-foodandtheeconomy/agri-foodbusiness/agriculturecashflowsupportloanscheme/
[76] https://group.aib.ie/content/dam/aib/group/Docs/Press%20Releases/2017/aib-secures-60m-cash-flow-support-for-irish-farmers.pdf

Appendix 3

Appendix Table 2: Glossary of Terms

Abbreviation	Meaning
EIB	**European Investment Bank**
DAFM	**Dept. of Agriculture, Food and the Marine**
DBEI	**Dept. of Business, Enterprise and Innovation**
SBCI	**Strategic Banking Corporation of Ireland**
AIB	**Allied Irish Bank**
BoI	**Bank of Ireland**
UB	**Ulster Bank**
EU	**European Union**
UK	**United Kingdom**
SME	**Small and Medium Enterprises**

Quality assurance process

To ensure accuracy and methodological rigour, the author engaged in the following quality assurance process.

- ✓ Internal/Departmental
  - ✓ Line management
  - ✓ Other divisions/sections
  - ✓ Peer review (IGEES network, seminars, conferences etc.)

- ✓ External
  - ✓ Other Government Department
  - ✓ Peer review (IGEES network, seminars, conferences etc.)
  - ✓ External expert(s)

- ✓ Other (relevant details)
  - ✓Strategic Banking Corporation of Ireland