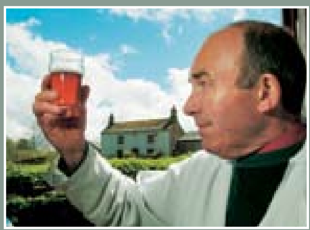
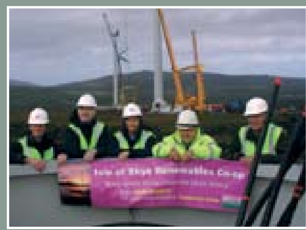
Community Investment











Using Industrial and Provident Society Legislation

Jim Brown

Co-operatives UK
THE UNION OF CO-OPERATIVE ENTERPRISES

Foreword

Community investment is about community engagement. It is about ordinary people investing their own money – sometimes small sums, sometimes larger amounts – to support the development of something they care about.

These ventures may be a local service – a shop or pub- or an enterprise with regional, national or even international benefit. The industrial and provident societies they become members of and put their money in embody the community ethic by providing a governance structure based on the democratic principle of one member one vote and members are the life-blood of industrial societies, not just because of the money the members invest in the venture, but also because their involvement and participation sustain and feed it.

Co-operativesUK has had a long history of registering, advising and supporting industrial and provident societies and has worked with many of the enterprises described in this publication. Its New Ventures Panel has been delighted to work with Jim Brown on his research and development. Co-operativesUK is also working closely with the Financial Services Authority to modernise IPS legislation and ensure it is fit for the purpose.

Democratic community engagement is a powerful force for regeneration and for new business ventures. IPSs marry and blend the roles of member, investor, customer and volunteer. The model had a great past and has an even greater future.

Dame Pauline Green

Chief executive, Co-operativesUK

About the author

Jim Brown is the principal consultant for Baker Brown Associates, a research and development co-operative specialising in the social economy and lifelong learning. Jim was the commissioning editor and principal author of *Co-operative Capital: A new approach to investment in co-operatives,* published by Co-operative Action in 2003. (www.bakerbrown.co.uk)

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1 Introduction

Community investment is the practice of communities investing capital in business ventures serving a social or community purpose. It is not a new phenomenon.

In the nineteenth century many consumer co-operatives and building societies were created by members of the local community investing capital in the business. Gradually, through the twentieth century, the practice of community investment became less common, as co-operatives and building societies built up their financial reserves, and fewer new societies were created.

But more recently there has been a revival of interest in community investment as a way of funding businesses with a strong social purpose. In 1984, the fair trade retailer, Traidcraft, caught the headlines with its first public share offer as a public limited company (plc). Over the next few years a handful of other organisations followed suit, including the Centre for Alternative Technology, Mercury Provident (which subsequently became part of Triodos Bank), the ICO Fund (part of Co-operative and Community Finance Ltd) and a fair trade finance organisation called Shared Interest. Shared Interest stood out among this five because it was the only one that used the Industrial and Provident Society (IPS) format; all the rest were structured as plcs.

The growth in community investment practices remained slow throughout the 1990s, but gradually increased in momentum towards the turn of the century. By 2003 there were 28 recorded cases of community investment. Most of this growth came from organisations adopting the IPS format: there were only three new plcs, compared with 20 new IPSs. Today, in 2008, there are 61 known cases of IPSs turning to community investment as a source of capital. More than £47m of community investment capital has been raised by 39 of these societies, who between them have more than 65,000 member shareholders.

In 2002, a government review of the not-for-profit sector, *Private Action, Public Benefit,* described IPS legislation as "a useful, but underused and outdated, legal form". As this publication will show, IPS legislation has the potential to be a highly suitable format for community investment, addressing a longstanding problem faced by many community initiatives in a radical and exciting way.

Since the beginning of the new millennium, the government has been keen to promote social enterprise and its close cousin, social investment. It has launched a range of initiatives to support and encourage social investment, including, most recently, in February 2008, a new £10m risk capital investment fund for social enterprises, matched by £10m from private investors, with the aim of building relationships between social enterprises and commercial investors.

Community investment is different. Instead of turning to the private sector and wealthy individuals for support, community investment is about engaging communities to invest in themselves. By harnessing the collective investment power of whole communities, relatively large amounts of capital can be raised in relatively small amounts from members of the community. In one case, a society raised more than £1.5m from its members, even though the median investment was only £30.

The full power of community investment does not stop with the amount of capital raised. Community investors are often the best customers of the venture, their loyalty contributing to its sustainability. It provides a new business model for communities to help themselves, and create viable ventures where the private sector has failed.

The purpose of this publication is to explain how the IPS format is being used as a vehicle for community investment. It starts by identifying some of the unique attributes of IPS legislation, such as democratic control and the limits on shareholding, and explains how these attributes support community investment. It also explains the importance of raising share capital for any enterprise, before exploring the special qualities of 'withdrawable share capital', which is another unique attribute of IPS legislation, and a key to the success of this format.

Community investment relies on a major shift in public attitudes towards how community initiatives can be funded. Buying shares in community ventures involves a leap of imagination for many traditional community activists, more used to organising charitable fund-raising events than planning a community share launch. The full potential of community investment is easy to imagine. Most people's savings and investments are far greater than the amount they could afford to donate to good causes. So if mechanisms are created to enable people to invest and save in good causes in their communities, there is the potential to raise far greater sums of money than are currently raised through charitable giving.

The use of a business model to deliver public and community services, is still a controversial issue for many people. Community investment adds a new dimension to the social business model, making the community not only the investors but also the owners of these new ventures. By ensuring that ownership is in the hands of the community, rather than a private investor, there is a far greater likelihood that these community ventures will continue to serve the interests of the broader community.

One of the best ways of learning how to harness community investment is to examine the practical experiences of those who have already done it. This publication focuses on the achievements of 61 societies who have turned to community investment in recent years, and explores what these examples have to offer as lessons for the future. It examines what constitutes good practice in a number of crucial areas, such as the return on investment offered to investors, and connections between investment and engagement. It also examines a range of practical issues such as the tax relief available to investors, and the exemptions available to IPSs from the regulations governing financial promotions.

Towards the end of the publication there is a practical step-by-step guide to getting started, along with a summary of the sources of further information for those who intend to launch their own community investment initiative.

In June 2007, HM Treasury launched a consultative review of IPS legislation with the aim of ensuring there is a "cost-effective legislative framework, which will enable [societies] to compete even more effectively in the modern economy, and to continue to fulfil their valuable social role". The results of this consultation and the government's response were published in December 2007, followed by proposals for legislative reform, which were published in July 2008. These proposals include scrapping the maximum limit on transferable shareholdings in IPSs by individual members (but leaving the maximum limit on withdrawable share capital at £20,000), a lowering of the minimum age a person can become a member and officer of an IPS, and changes to make it easier to dissolve registered societies. Consultation on these proposals closes in October 2008. This will be followed by further proposals to reform IPS legislation in coming months. Co-operatives^UK is working closely with HM Treasury and the FSA on these reforms; for the latest information consult its website (www.cooperatives-uk.coop).

2 The IPS format

There are approximately 8,200 Industrial and Provident Societies (IPSs) in the UK.

Between them they have over 10 million members. They range in size from The Co-operative Group, the world's largest consumer co-operative society, with a turnover in 2007 of £9.4bn, to tiny allotment societies dating back to the nineteenth century. Only a comparatively small number of societies have turned to community investment as a source of capital.

IPS legislation dates back to the mid-nineteenth century, but today all societies are corporate bodies registered under the IPS Act (1965). There are two main types of IPS: bona-fide co-operatives and societies run for the benefit of the community.

Co-operatives are run for the mutual benefit of members who 'use' the services of their society. This is based upon common economic, social and cultural needs or interests amongst the members. Typically, this common need or interest will define their relationship with the co-operative as a service user, customer, employee or supplier. Co-operatives have open membership – there should be no artificial restrictions on membership, and it should be open to anyone who meets the criteria for membership. Recent guidance from the FSA says that co-operatives can have investor-members who are not otherwise users of the society's services. Co-operatives can pay interest on member share capital and a share of the surplus, or dividend, based on the level of transactions with the society.

Community benefit societies are run primarily for the benefit of the community at large, rather than just for the members of the society. This means they must have an overarching community purpose reaching beyond their membership. Applicant enterprises must also have a special reason for being a community benefit society rather than a company, such as wanting to have democratic decision-making built into their structure. Although community benefit societies have the power to pay interest on members' share capital, they cannot distribute surpluses to members in the form of a dividend.

Like companies, IPSs have limited liability status, but otherwise they are significantly different to corporate bodies registered under the Companies Acts. IPS legislation has a number of unique attributes that make it the ideal format for community investment initiatives. These attributes include:

Shareholder democracy: One-member-one-vote, regardless of how many shares the member holds. Members have the collective right to appoint and dismiss directors, accept directors' recommendations for interest and dividend rates, and determine the affairs and rules of the society.

Withdrawable share capital: Societies have the option of issuing withdrawable share capital. This type of share capital is withdrawable by the member, subject to any conditions stated in the rules of the society. (IPSs can also issue transferable share capital, in the same way as companies.)

Limits on shareholding: All members must purchase at least one share in the society: IPS legislation contains no equivalent form to a company limited by guarantee. Individual members cannot hold more than £20,000 in shares, but there is no limit to the size of shareholding by one society in another.

Limits on share interest: The interest payable on shares must be limited to what is "necessary to obtain and retain enough capital to run the business". IPS co-operatives can also pay their members a share of the profits based on their transactions with the society, called a dividend.

Asset lock: Community benefit societies can install an asset lock that prevents the society being sold and the proceeds distributed among members. This is similar to the asset locks available to charities and community interest companies.

The combination of these special attributes means that IPSs are treated differently from companies when raising share capital from the public. The issue of withdrawable share capital by IPSs is not a regulated activity subject to the Financial Services and Markets Act (FSMA) and so societies do not have to be authorised by the Financial Services Authority (FSA) to issue it. There are also exemptions from regulations covering the approval of financial promotions, and compliance with the Money Laundering Regulations 2007 when issuing withdrawable share capital. Compliance with these regulations can be expensive, especially when the amount of capital to be raised is relatively small. An authorised public offering of share capital will normally cost at least £25,000 to £50,000, putting it out of reach for community ventures that need to raise less than £1m.

Despite these exemptions directors of IPSs still have a strong obligation to treat their potential members and investors fairly, and not to make false or misleading statements in their promotional documents.

IPS share capital

The ability to raise sufficient investment capital is vital for any enterprise. Banks and other forms of lending institutions are usually reluctant to lend to enterprises that cannot offer personal guarantees, or have not built up sufficient reserves to cover the loan. Share capital offers an alternative way of raising investment finance. The money invested by shareholders is fully at risk: if the enterprise gets into financial difficulties and is forced to close, all other creditors (including lenders) will be paid what they are owed before the shareholders are given back even a fraction of their investment. Lending institutions want to know how much share capital has been invested in an enterprise because this money acts as security against any potential losses. The ratio of debt (loans and other forms of borrowing) to equity (share capital plus reserves) is known as gearing. A gearing ratio significantly higher than 1:1 will normally put off lenders from making new loans to an enterprise.

Share capital is desirable for a number of reasons. Firstly, it provides societies with a potentially less expensive and less onerous form of capital than bank borrowing. Secondly, it reinforces member commitment to the society, as they risk losing their investment should the society fail. Thirdly, share capital acts as security to lenders, and might replace the need for directors of the society to provide personal loan guarantees.

Share capital reduces the need to generate and retain high levels of profit in the business. This can be vital for capital-intensive social projects which aim to provide an affordable service, such as social housing or low-cost office space for community projects. Instead of the society having to make and retain profits to provide the reserves it needs to acquire assets, the enterprise can rent the capital it needs from members. Withdrawable share capital has a similar advantage over loan capital. Many social and community projects avoid loans, not because they cannot afford the interest payments, but because they do not, or cannot, generate enough profits to repay the capital. Depending on what type of share capital has been issued, there may not be a requirement to repay the capital, at least not in the short-to-medium term.

In a private company, a member's shareholding usually determines their level of ownership and control over the business. Working to the principle of one share, one vote, a person owning a majority of shares will control the business. Private shareholders own all the assets of the business. If the business is sold, the proceeds of the sale are divided between the shareholders in proportion to the number of shares they own. Shareholders can also transfer or sell their shares to another person or entity, subject to any conditions set out in the company's governing document. The value of these shares, and the value of the whole enterprise, is determined by what a buyer is willing to pay. Whether it is a trade sale (sale to another business) or the sale of shares through a stock broker or stock market, the valuation of shares inevitably involves some guesswork.

In contrast, withdrawable shares in IPSs are not subject to speculation. The value of a member's share capital does not change, unless for some reason, the society decides it is unable to fully refund a member. If a society has issued withdrawable shares, these shares can only usually be withdrawn at, or below, the price the member paid for them. Most societies issuing withdrawable shares have rules that set a minimum period of notice the member must give if they want to withdraw some or all of their capital. Typically, this period can vary from one month to one year.

Most societies' rules also state that a member's right to withdraw capital is at the discretion of the board of directors. This type of rule means that a society's board can decide that it would be against the interests of the society to allow a member to withdraw their capital, which might be the case if the business faced trading difficulties, or a significant loss of confidence among its members. This type of rule also means that withdrawable share capital can be treated as equity, rather than debt, for accounting purposes.

Societies can, if they choose, issue transferable shares, in which case shares can be transferred at any price agreed between the seller and buyer. Transferable share capital can be traded directly between parties, or through a stock broker, or through a stock market, assuming that the shares are listed on that market. There are no IPSs listed on any of the UK stock markets. The valuation of transferable shares is a highly complex and inexact science, based on a wide range of variables. This is doubly the case if the enterprise concerned is an IPS, because the unique features of IPS legislation have a major impact on the value of the enterprise to shareholders. However, in most cases IPS transferable shareholders will expect to receive the price they paid for the shares.

3 Community engagement

Community investment is wholly dependent on community engagement: the ability to actively involve a community in the social purpose and mission of the venture.

It is important that individual members feel part of that community, and are prepared to put their mutual interests ahead of their self-interest. IPS legislation embodies this community ethic by providing a governance structure based on the democratic principle of one-member-one-vote, rather than one-share-one-vote. This is wholly different to companies limited by shares, including community interest companies limited by shares, where the principle of one-share-one-vote prevails.

The democratic nature of IPSs reinforces this community ethic by treating every member of the society as an equal, regardless of how much they have invested in the society. Members are encouraged to focus on their mutual and community interests, rather than their narrow self-interest. The ability of some members to invest more than others confers no special privileges, but this does not appear to discourage wealthier members from investing more. Typically, the amount invested by individual members varies from the minimum set by the society, to £20,000, the maximum currently allowable under law. (See page 5 regarding proposals to scrap the maximum limit for transferable share capital.)

Community engagement does not stop at investment and membership. In many societies members are not only investors but also customers of the enterprise, and in some cases may also be volunteer workers and directors. This extension of community engagement is central to the success of many societies. For instance, in a growing number of rural communities, people have come together to rescue the last remaining village store, transforming it from a failing private business into a vibrant community-owned enterprise. When members of the community become investors in the enterprise it is in their self-interest to become regular customers too. Because they have a democratic voice they can directly influence the business to meet their needs, providing them with the goods and services they want. They can have a say over pricing policies, in the knowledge that any profit resulting from the higher prices they pay as customers, is ultimately in their own interests as investors.

Democratic community engagement can provide societies with a powerful competitive advantage over other business models. This competitive advantage might be based on higher sales achieved through greater customer loyalty, the willingness of community investors to accept lower returns, or through members providing volunteer labour and support. By combining the roles of member, investor, customer and volunteer, there is scope for communities to develop sustainable businesses in markets where other business models have failed.

Whilst there is a compelling logic linking community investment and engagement, it still requires a major shift in public attitudes towards investment and community benefit. Owning shares and pursuing a social purpose simply don't go together in most people's minds: they are far more comfortable with the idea of donating to a good cause, rather than investing in one. Furthermore, most people are savers, not investors, and have no direct experience of buying and selling shares. Less than a quarter of the population are shareholders, and fewer than 10% have ever bought shares directly. So the idea of becoming a shareholder probably seems strange to most people. And the idea of becoming a shareholder in a community venture must seem stranger still.

But, over the last 20 years, attitudes to investment have been changing. The shift from guaranteed state and company pensions, to personal pensions, which can fluctuate in value, has made people more aware of investment processes. The growing popularity of ethical investment funds shows that people are becoming more concerned about how their money is being used. Ethical investment hit a record high of £8.9bn at the end of 2007, with over three-quarters of a million individual accounts held in ethical investment funds. These funds avoid investment in business activities that might be damaging to people, communities and the environment: this is referred to as 'negative screening'. Some investment institutions are beginning to develop 'positive screening' for their ethical investment funds, investing only in organisations that are achieving social and/or environmental benefits.

However, most ethical investment funds are also obliged to obtain the highest possible financial return for their investors and are also restricted to investing in companies that are traded on a regulated stock exchange. They cannot invest in good causes where the financial returns are restricted by their legal format, such as charities, IPSs and community interest companies, or where the investment cannot easily be sold. There is a need to develop mechanisms which extend investment opportunities to include organisations that operate within the third sector.

Public attitudes towards the third sector are changing too. The most popular ways of supporting a good cause continue to be through gifts, donations, participating in fundraising events, and through volunteering. But there is a limit to what most people feel they can afford to give or do on a voluntary basis. People are looking for new ways of supporting good causes, and for ensuring that their savings are put to good use. The success of the Charity Bank is based on the principle of using people's savings deposits to provide loans to good causes. Community investment takes this principle two steps further. It invites people to directly invest some of their savings in community ventures, and to invest in the form of share capital rather than loans. Investors need to be aware of the risks associated with their investment, and that they should only invest what they can afford to lose. But underlying these changes is a growing belief and acceptance that the business model can be used to achieve a social purpose.

4 IPS community investment practices

The modern use of IPS legislation as a vehicle for community investment began with the fair trade movement.

Just like community investment, the fair trade concept challenges conventional economic wisdom. Instead of allowing the power of concentrated wealth to drive prices for poor producers down through the floor, organisations such as Oxfam, developed a new relationship with producers in the third world: guaranteeing producer co-operatives a premium price if their members meet defined standards in pay and labour conditions; and if the premium is spent on social projects, such as education or health.

A pivotal moment in the development of the fair trade movement came in 1989, following the collapse of the International Coffee Agreement, which sent prices to record lows and threatened the livelihoods of millions of smallholder farmers. Oxfam, together with Traidcraft and other partners, accepted a shipment of coffee from three coffee growers in Mexico, Peru and Costa Rica, which was sold through charity shops, church halls and local events. These partners created Cafédirect, the UK's largest fair trade hot drinks company, which has become a household name. Much less well known, but no less vital to the history of fair trade in Britain, is a community benefit society called Shared Interest.

Shared Interest provides working capital to finance fair trade deals. Without this working capital, producers would have to wait much longer before they were paid. This working capital has been provided by the members of Shared Interest. It now has 8,575 members who have between them invested £25.5m. Shared Interest used IPS legislation to provide a format for members to invest withdrawable share capital and engage in the issues of fair trade in a practical and lasting way.

Growth in numbers

Shared Interest pioneered the use of IPS legislation as a vehicle for community investment in 1990. It was four years before another organisation followed its example. In 1994, Industrial Common Ownership Finance (ICOF) set up an IPS called ICOF Community Capital, with the intention of raising investment capital to lend on to co-operative enterprises. This society now has nearly 500 members, who between them have invested over £800,000.

Since 1994, there has been a steady acceleration in the number of ventures using IPS legislation to attract community investment. Figure One illustrates the growth in the number of societies with community investment from 1995 onwards. The chart is based on data for 49 societies, all of which are still in existence and are known to have raised in excess of £10,000 of community investment from their members. It is possible that there are more than 49 societies that have raised more than £10,000 in community investment. The FSA does not currently publish data on the share capital of IPSs.

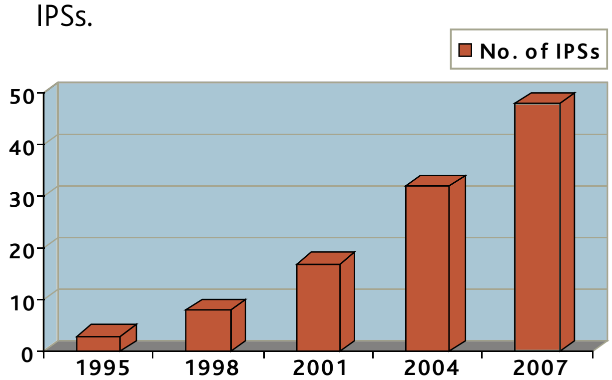


Figure One: Growth in the number of IPSs with over £10,000 of community investment

Photograph courtesy of Shared Interest.

Shared Interest

Shared Interest was established in 1990 by Mark Hayes, its first managing director, and Traidcraft, a fair trade retailer. The purpose of Shared Interest is to provide financial services to fair trade organisations, principally by providing the working capital to fund transactions between producers and retailers. It was launched with a £100,000 loan from Traidcraft, Joseph Rowntree Charitable Trust and Oikocredit, a co-operative based in the Netherlands established by the World Council of Churches to offer micro-finance in developing countries. Oikocredit had already established the practice of community investment and engagement, encouraging its members to provide the capital it required and to play an active part in its management.

Shared Interest registered as an IPS community benefit society and soon had 200 members and £300,000 of capital, inherited from an Oikocredit sister organisation based in Scotland. By 1994, Shared Interest had raised over £4m from its members and was ready to establish its own clearing house with the International Fair Trade Association. Since then, the number of members and the amount these members have invested has grown steadily. The most recent figures available, for March 2008, show there were 8,575 members with £22.7m in withdrawable share capital and a further £2.8m in repayable loan stock.

The average share account balance of members in 2007 was £2,572. During that year, 345 new members joined the society and 274 members withdrew from membership, representing a membership turnover rate of just over 3%. Share capital withdrawals for 2007 were £1.6m, or approximately 7.4% of total share capital. However, this was more than replaced by the inflow of new investment for the year, totalling £2.7m. Members must give six months notice for withdrawals. Interest is payable on share capital, set at bank base rate minus 4%; its current interest rate is 1.5%.

Members are encouraged to get actively involved in the society by becoming Shared Interest Ambassadors. This involves activities such as speaking to groups, staffing exhibition stalls, distributing leaflets and generating local media coverage. Ambassadors are given training and a resource pack, along with support from a team at head office. Shared Interest has now set itself the ambitious target of increasing member investment to £75m by the end of 2012.

Details of the societies represented in Figure One are contained in two tables. Table One lists the 39 societies formed since 1990 that are known to have raised in excess of £10,000 in members' share capital. The average amount of share capital per society is more than £1m and the median (the mid-point, where half of the societies have more share capital, and half have less) is just under £120,000. Table Two lists ten smaller societies that have each raised in excess of £10,000 in community investment, although not all in the form of members' share capital. All but one of these societies are community-owned stores. Typically, they attract community investment in a variety of ways, including donations, loans and gifts. Table Three lists a further 12 societies that are planning to launch a community investment initiative in the near future. Taken together, these three tables provide strong evidence of growth in community investment using IPS formats.

The growth in the number of enterprises using IPS legislation as a vehicle for community investment is concentrated in four areas of trade: community finance, community energy, community services, and community assets such as land and buildings. The common characteristic of all these areas of trade is their strong community focus and identity, underlining the reason why they are drawn to community investment. Each of these areas has developed its own approach to community investment, and has important lessons to teach other sectors that want to attract community investment. The remainder of this section of the publication will examine each of these four areas in turn.

So far, community investment in IPSs is proving to be a safe activity. There is only one example of an IPS with a significant amount of community investment share capital actually failing as an enterprise, with the consequent loss of member capital. Out of This World was an ethical food retailer, launched in 1995 as an IPS consumer co-operative. Customers were encouraged to become members and to invest in the growth of the enterprise. Committed to the principles of organic, fair trade, eco-friendly and local retail trading, Out of This World, which had stores in Newcastle, Nottingham, Leeds and York, built up a membership of over 16,000 customers. The balance sheet for January 2006 shows that it had member share capital of £1.47m. In its first five years, Out Of This World experienced heavy trading losses, amounting to over £1.3m. It became profitable in 2001, and was to remain profitable until 2007, when a return to heavy losses tipped it into insolvency. The failure of Out of This World had nothing to do with it being an IPS, but it does serve as a timely reminder of the risks associated with equity investment in any enterprise.

ICOF Community Capital

ICOF, now known as Co-operative and Community Finance (CCF), was established in 1973 by a small group of successful common ownership co-operatives to create a revolving loan fund to support new co-operative ventures. In 1976, it received a major boost when an Act of Parliament granted it £250,000. More than 120 loans totalling £725,000 were made from the fund between 1976 and 1994. ICOF had already established another fund in 1987, called ICOF plc, which raised £550,000 in preference shares, redeemable after 10 years. ICOF Community Capital, was launched in 1994 as an IPS offering withdrawable share capital, and initially raised £455,000. Since then ICOF Community Capital has become CCF's most popular loan fund, and now has member investment exceeding £800,000.

Community finance

There are good reasons why the practice of community investment should begin in the community finance sector. The sector is acutely aware of the need for financial reserves, and of the latent financial power of communities. Many of the new community development finance institutions (CDFIs) have built on the pioneering experiences of ICOF, now Co-operative and Community Finance (CCF), and the Aston Reinvestment Trust, formed in 1997. As the name implies, Aston Reinvestment Trust promotes the principle of reinvestment by communities themselves. It has over 200 members who have invested more than £455,000 in share capital, and has balance sheet assets exceeding £1.67m.

Of the 39 IPSs listed in Table One there are 14 whose principal trade activity is finance. All but two of these, Shared Interest and Citylife, are CDFIs, independent financial institutions that provide finance for individuals or organisations in disadvantaged communities. CDFIs have been central to the government's social investment strategy, and have benefited from the creation of Community Investment Tax Relief (CITR), introduced in 2002. The relief is worth up to 25% of the money invested, spread over five years, and is only available through CDFIs accredited by the government. CITR is applicable to most forms of investment in CDFIs, including share capital, but only if the shares carry no present or future right to be redeemed within five years of their issue. It is not known whether any of the IPS CDFIs listed in Table One have issued shares which qualified for CITR.

Community investment is far from being the most dominant form of capital investment in CDFIs. Less than £2m has been raised through community investment, compared with the total capital base for the CDFI sector of £569m. Despite the tax relief that is available to CDFIs, there has not been a major drive to raise community investment capital from the communities they serve.

In contrast, one of the financial institutions listed in Table One, Citylife, which is not a member of the CDFA, and does not qualify for CITR, has raised nearly £4.5m from its 1,300 supporters. Citylife is a community benefit society which raises finance from local communities and

Table One: Societies with more than £10,000 in member share capital (2007*)

Name	Trade sector	Date registered	Type of society	Share capital	Total member investment	Number of members
Shared Interest	Finance	1990	Community benefit	£21,733,000	£24,552,000	8,447
ICOF Community Capital	Community finance	1994	Community benefit	£789,399	£807,984	489
Tablehurst and Plaw Hatch Community Farm	Farming	1996	Community benefit	£112,100	£112,100	1,121
Sherwood Energy Village	Regeneration	1996	n/a	£50,000	£50,000	n/a
Baywind Energy Co-operative	Renewable energy	1996	Co-operative	£1,994,067	£1,994,067	1,334
Aston Reinvestment Trust	Community finance	1997	Community benefit	£455,350	£455,350	238
Rootstock	Community finance	1998	Co-operative	£261,248	£261,248	165
Hesket Newmarket Brewery	Brewery	1999	Co-operative	£135,000	£135,000	90
Ulster Community Investment Trust	Community finance	1999	Community benefit	£17,300	£17,300	66
Citylife	Community finance	1999	Community benefit	£92,210	£4,488,324	1,300**
The Phone Co-op	Telecommunications	1999	Co-operative	£1,637,130	£1,637,130	6,735
Salford Money Line	Community finance	2000	Community benefit	£119,014	£119,014	15
South Coast Moneyline	Community finance	2000	Community benefit	£98,494	£98,494	45
Ekopia Resource Exchange	Community assets	2001	Community benefit	£620,000	£630,000	264
Derby Loans	Community finance	2002	Community benefit	£55,986	£55,986	32
Black Country Reinvestment Society	Community finance	2002	Community benefit	£100,250	£100,250	30
London Rebuilding Society	Community finance	2002	Community benefit	£132,850	£132,850	89
Moelyci Environmental Centre	Farming	2002	Community benefit	£29,914	£29,914	418
The Old Crown (Hesket Newmarket)	Public house	2003	Co-operative	£220,500	£220,500	147
Leicestershire Moneyline	Community finance	2004	Community benefit	£33,010	£33,010	15
Money Line Yorkshire	Community finance	2004	Community benefit	£27,275	£27,275	26
Fenland Green Power Co-operative	Renewable energy	2004	Co-operative	£2,660,000	£2,660,000	1,110
Westmill Wind Farm Co-operative	Renewable energy	2004	Co-operative	£4,400,000	£4,400,000	2,304
Storth Community Co-operative	Retail store	2004	Co-operative	£11,000	£11,000	n/a
Berrynarbor Community Enterprise	Retail store	2004	Co-operative	£14,500	£14,500	113
Melmerby and Fellside Village Shop	Retail store	2004	n/a	£12,500	£12,500	65
Fordhall Farm	Farming	2005	Community benefit	£744,050	£744,050	8,000
Fair Finance	Community finance	2005	Community benefit	£21,000	£21,000	2
FC United of Manchester	Football	2005	Community benefit	£250,000	£250,000	3,440
Community and Co-operative Publishing	Publishing	2005	Community benefit	£11,550	£11,500	40
Headingley Development Trust	Regeneration	2005	Community benefit	£50,941	£50,941	708
Boyndie Wind Farm Co-operative	Renewable energy	2005	Co-operative	£730,000	£730,000	715
Witherslack Community Shop	Retail store	2006	Co-operative	£25,000	£36,000	n/a
Natural Food Store	Retail store	2007	Co-operative	£100,000	£100,000	200
Myfootballclub Society	Football	2007	Community benefit	£990,500	£990,500	28,300
Ecos Fund	Land and buildings	2007	Community benefit	£650,000	£650,000	110
Mustard Seed	Community services	2007	Community benefit	£90,000	£160,000	15
Torrs Hydro New Mills	Renewable energy	2007	Community benefit	£100,000	£100,000	200
Isle of Skye Renewables Co-operative	Renewable energy	2007	Co-operative	£812,000	£812,000	570
			Total	£40,387,138	£47,711,787	65,658

Table Two: Societies with less than £10,000 in share capital, but more than £10,000 in member investment (2007)

Name	Trade sector	Date registered	Type of society	Share capital	Total member investment	Number of members
Unicorn Grocery	Retail store	1995	Co-operative	£43	£300,000	43
Blisland Community Association	Retail store	2001	Community benefit	£1,460	£50,000	146
Brockweir and Hewelsfield Village Shop	Retail store	2001	Community benefit	n/a	£70,000	69
Stillington Community Association	Retail store	2003	Community benefit	£2,480	£45,000	248
Sulgrave Village Shop	Retail store	2004	Community benefit	£650	£40,000	150
East Knoyle Community Shop Association	Retail store	2004	Community benefit	n/a	£22,000	295
Laughton Village shop	Retail store	2004	Community benefit	£1,150	£33,000	115
West Meon Community Shop Association	Retail store	2006	Community benefit	£3,500	£28,500	350
Woodgreen Community Shop Association	Retail store	2006	Community benefit	£3,500	£15,500	350
Radley Village Shop Association	Retail store	2007	Co-operative	£1,500	£20,000	150

Table Three: Societies planning community investment launch in near future

Name	Trade sector	Date registered
High Street Organics	Retail store	2002
Worth Community Property Trust	Land and buildings	2006
Local Food Links	Food	2007
Totnes Renewable Energy Society	Renewable energy	2007
Unity Wind	Renewable energy	2007
Lammas Low Impact Initiatives	Land and buildings	2007
Wye Community Farm	Farming	2007
Shop at Hesket Newmarket	Retail store	2007
Wessex Community Assets	Land and buildings	2007
Good Fuel Co-operative	Renewable energy	2008
Kilbraur Wind Energy Co-operative	Renewable energy	Not yet registered
Lightweight Community Transport	Transport	Not yet registered

Key:

n/a = information not available

* = data based on 2007 annual accounts where available; some data is for earlier years, or taken for other sources.

** = supporters, not members

then lends it to local enterprises and projects addressing social and economic exclusion. Citylife raises most of its finance through a series of redeemable bond issues, rather than as withdrawable share capital, which accounts for only £92,000 of its total reserves.

Community energy

Although community investment is relatively under-exploited in the community finance sector, its potential has been fully demonstrated in the renewable energy sector, largely thanks to the pioneering work of Energy4All, a development agency that specialises in creating community-owned wind farms.

Energy4All was set up by the people who created the first community-owned wind farm in the UK, Baywind Energy Co-operative, in Cumbria. Bombarded by enquiries from people who wanted to replicate their success, they decided to create Energy4All in 2002, which is owned by the co-operatives it assists. So far it has five member co-operatives, with a further three under development. It has raised over £10m in community investment funds and pioneered the use of IPS legislation as a community investment tool.

The IPS co-operatives developed by Energy4All, (Isle of Skye, Baywind, Westmill, Fenland and Boyndie) stand out from most of the other IPSs listed in Table One in a number of important ways. They are all offering much higher rates of interest on their shares, well above prevailing building society interest rates, reflecting perhaps the commercial risks involved in developing and operating a wind farm. This is in line with FSA policy which states that the interest payable on shares must be limited to what is "necessary to obtain and retain enough capital to run the business". Westmill Wind Farm, the largest of the community-owned wind farms created by Energy4All, has forecast a 12% per annum return over the 25 year lifespan of the project. This is a higher rate of return than a CIC could offer, which is subject to a double dividend cap.

All the co-operatives developed by Energy4All have issued transferable share capital. Members are free to sell (transfer) their share capital, subject to board consent, to a third party whenever they want. Transferable share capital can be more appropriate for capital-intensive projects, such as wind farms, where the capital is tied up in physical assets and it would be difficult to meet members' demands for the withdrawal of capital. A higher rate of interest is often necessary to make transferable share capital attractive to third party purchasers. Transferable share capital issued by IPS co-operatives is not exempt from regulation as a financial promotion, and requires authorisation and the publication of a prospectus. This introduces an additional layer of cost, only affordable by larger and more profitable community projects such as wind farms.

Energy4All emphasises the importance of community engagement in the success of its projects. Community members are not only a vital source of investment capital, but they are also important in winning the community support needed for such developments. According to Energy4All: "one of the most effective methods to engage people is through ownership where benefits of developments to both individuals and communities are real and tangible".

The Energy4All approach to developing community energy projects is being replicated by H_2OPE (Water Power Enterprises), a CIC established in 2007 with the intention of helping communities develop small-scale hydroelectric schemes, harnessing the latent energy of disused river weirs. Its first project, which completed its community investment share launch in early 2008, is Torrs Hydro New Mills. This is a much smaller development than any of the Energy4All supported projects, with a total capital outlay of about £0.25m, half of which has been covered by grants. Torrs Hydro is a community benefit society issuing share capital that is withdrawable after an initial three year holding period, subject to 180 days notice. Because it is a community benefit society, it is exempt from regulation under the FSMA 2000. This means that it was not required to produce a prospectus, nor did it need the approval of an FSA authorised person. It is forecasting a maximum interest rate of 7.5% pa, although it does make it clear that prospective

Westmill Wind Farm Co-operative

Westmill Wind Farm, in South Oxfordshire, was established in 2004 as a co-operative society, under the guidance of renewable energy specialists, Energy4All. Built on a former airstrip owned by Adam Twine, an organic farmer, the wind farm is the first 100% community owned wind farm in the UK. It consists of five 1.3MW turbines, capable of generating sufficient electricity to power the equivalent of 2,500 homes.

Over half of the funding for the £7.6m construction came from a fully-authorised public share issue of IPS share capital that is transferable and, after five years, withdrawable subject to limits. This share capital provided the leverage to secure a loan from the Co-operative Bank for the rest of the funding.

The initial public offer, made in November 2005, sought to raise £3.75m, with first preference given to applicants living within a 50 mile radius of the farm. Westmill produced a share offer prospectus, published in accordance with the Prospectus Regulations, and vetted by the FSA. The costs of making the share offer amounted to £150,000, comprising of:

- £58,500 for the services of Energy4All in managing the project
- £20,000 in professional fees (solicitors and accountants)
- £31,800 for printing, distribution, publicity and promotion costs
- £34,000 for processing of share applications
- £5,700 FSA vetting fee.

The share launch was a huge success, and by the time the offer had closed, three months later, Westmill was over-subscribed, with more than £4m sent in by applicants. This made it necessary to scale back some of the applications, giving preference to local applicants.

But it was not all straightforward. In August 2006 the turbine suppliers announced delays to the schedule for delivery, which by January 2007 resulted in Westmill having to negotiate a deal with new turbine suppliers. Eventually, an agreement was reached with the original suppliers, but at a much higher cost, which meant that Westmill had to appeal to their members for an additional £850,000 in share capital. The response, once again, was overwhelming. A further £1.25m was raised from the 2,382 members in just three weeks. From there on, the project progressed rapidly. Construction began in August 2007, and the first turbine was erected in January 2008, with electricity being generated by mid-February 2008

The Westmill prospectus contained financial data which forecast an initial interest rate on share capital of 5% pa gross, rising to an average of 12% pa over the 25 year life of the project. Members were required to invest a minimum of £250; if they wanted to qualify for Enterprise Investment Scheme (EIS) tax relief the minimum investment was £500. With EIS relief the effective average annual gross returns are predicted to be more than 15% over the full life of the project.

Photograph courtesy of Energy4All

Shares are only transferable for the first five years (although this would affect EIS relief), after which shares can be transferred, or withdrawn up to a maximum of 5% pa on a first-come, first-served basis at the discretion of the board. Cash reserves from trading surpluses will be accumulated in a depreciation fund to allow all remaining shares to be repaid in full after the twenty-fifth year.

Artist's impression courtesy of H_2OPE.

Torrs Hydro New Mills

New Mills is a small town on the edge of the Peak District in Derbyshire. It is surrounded by beautiful countryside, intersected by fast-flowing small rivers, which were the source of power for the industrial revolution of the nineteenth century. The Torrs, a gorge where the River Sett joins the River Goyt, is the site of a weir that used to feed water to an old mill which burnt down in 1912. The weir is still intact and, in the view of local community activists, provides a perfect location for a small hydro-electric scheme.

With support from a specialist development company, H_2OPE, a scheme was designed using a reverse Archimedean screw, capable of generating up to 70kw of electricity. Full planning permission was obtained in 2007, along with an extraction licence from the Environment Agency to use the river, and a lease from the landowner, the local town council. It was estimated that the whole scheme would cost £226,000 and would generate revenues of approximately £20,000 per annum. Pre-tax profits, after year three, are projected to be in the region of £11,000 to £15,000.

To pay for the scheme, it was forecast that grants and loans totalling £100,000 could be obtained, leaving a shortfall of £126,000. In order to fill this gap, a community benefit society was registered in September 2007 and a share offer made to the public, seeking to raise £126,000 in share capital. Shares would be withdrawable on 180 days notice, but only after an initial period of three years in which they are non-withdrawable. The board also has the powers to write down the value of shares, if the liabilities of the society exceed the value of its assets.

The minimum investment was set at £250. It was forecast that the society would be able to pay a maximum of 7.5% interest per annum on share capital after an initial period of three years. They also received advanced assurance from HM Revenue and Customs that the share offer qualified for Enterprise Investment Scheme (EIS) tax relief, worth 20% of the cost of the shares for members who invested the minimum qualifying amount for EIS of £500. The share offer opened on 23 November 2007 and was set to close on 31 January 2008. Despite early promises of support, share applications arrived slowly at first. There were worries too about rising costs, with the price of the equipment being purchased from Germany affected by the falling value of the pound against the euro. But as the deadline approached there was a rush of applications, with over £35,000 arriving in the final week. A little under £100,000 was received from just over 200 applicants. More than half the applicants lived in the local SK22 postcode, and another 15% lived within a 20 mile radius of New Mills, with just 30% of applicants living further away. The shortfall of £26,000 against the original target was met by additional grant funding and a small loan from the Co-operative Bank.

The voluntary board of directors described themselves as overwhelmed by the response, and were still catching up with the administrative task of processing all the share applications a couple of weeks after the offer closed. They put their success down to four things: a clear and obvious social purpose, a robust business model, an effective media campaign which got national radio and regional TV coverage, and the support of professional advisers, H_2OPE.

members should not expect to receive any interest on shares in the first three years.

In line with guidance from the FSA, Torrs Hydro New Mills provided prospective investors with enough information to make an informed assessment of the financial prospects of the society, which it refers to as its prospectus. This type of voluntary prospectus, or offer document, is a matter of good practice for any IPS offering a combined social and financial return to its community.

The community energy sector has demonstrated the potential for raising investment capital from the community, offering a financial and social return based on a sound business model. Wind and water power generation are reasonably predictable business activities, although they do carry some risk, and require significant levels of expertise to set up. Engaging the local community as investors also strengthens their support in planning applications and other issues associated with local development. Energy4All has also demonstrated that there is a community of interest prepared to back IPS wind power schemes, making it easier to attract finance for each successive scheme, as it establishes its track record and builds up its database of supporters.

The practices in this sector also raise some interesting questions about whether IPSs should issue withdrawable or transferable share capital. The regulatory costs of issuing transferable share capital are higher, and the arrangements for transferring shares are less straightforward, because it means creating a secondary demand for the shares. This secondary demand for shares is most likely to come from existing members who want to increase their shareholding. But there is no guarantee that the demand for extra shares from existing members will be sufficient to meet the supply of shares for sale. The only alternative is to attract new members. This could be done by creating an ethical stock exchange, which would act as a marketplace for the buyers and sellers of community investments.

Withdrawable share capital is cheaper to issue, and the arrangements for disposing of shares more straightforward for members. But the danger of withdrawable share capital is the pressures it may place on the organisation and its ability, at any one time, to meet the demand for withdrawals. This might mean setting aside some of the capital as a liquid contingency fund, or else setting up a mechanism to continually attract new members and investors, in order to replace the capital of departing members. Another alternative in capital-intensive or new-start societies is to restrict or suspend the withdrawability of share capital, although this might deter some potential investors from investing. It is normal practice for IPSs to have a provision in their rules that gives their directors the discretion to refuse a member's request to withdraw their share capital. The International Accounting Standards Board makes this a requirement for withdrawable share capital if it is to be treated as equity on the balance sheet of an IPS.

Community services

There are good reasons for financing community services through community investment. Community investment provides a mechanism for strengthening the bonds between a local service and its customers. This is illustrated by the growth in the number of community-owned shops in the UK. The Plunkett Foundation currently lists 170 community-owned shops in its directory, 107 of which are IPSs. Most of these shops serve rural communities where the shop is the hub of the community. Over the last decade, many rural food stores have been closed, unable to cope with the combined pressures of supermarket competition, commuter populations and rising property prices. Community-owned stores work to the principle of community engagement, where the customer becomes the owner, and may also be the volunteer worker, manager and investor in the enterprise. These multiple roles strengthen the loyalty of the customer to the enterprise, and, simultaneously, strengthen its financial position, leading to sustainability.

There are only five community-owned retail stores in Table One, which lists IPSs with more than £10,000 in member share capital. Community-owned stores dominate Table Two, which lists societies that have raised more than £10,000 in member investment, although not in the form of share capital. The nine community-owned stores in Table Two have, on average, over 200 members and member investment of £36,000, although most of this investment is in the form of gifts, donations, loans and income from fundraising events, rather than share capital. The fact that most stores choose to raise finance from their communities using these more traditional methods, probably reflects a lack of familiarity with the concept of community investment, rather than a rejection of this method.

The power and potential of community investment using IPS share capital is demonstrated by an urban equivalent to the village store. The Natural Food Store in Leeds raised over £100,000 in IPS share capital from 200 local people. The shop had faced closure until a group of concerned residents formed a project group, developed a business plan, and held a series of public meetings where investment pledges of £100 or more were sought. It took just two months to raise the community investment, which exceeded the original target of £90,000. The shop became a community-owned enterprise in November 2007.

Another urban food store, Unicorn Grocery in Manchester, raised £350,000 from its community when its landlord threatened to sell the premises to property developers. This IPS workers' co-operative offered loan stock to its customers, rather than share capital, because it wanted to retain its practice of workers' control, a principle wholeheartedly supported by its community investors.

Photograph courtesy of Unicorn Grocery

Food stores are not the only form of community services to benefit from community investment. Ekopia Resource Exchange is a community benefit society, which was established in 2001 to act as a community investment vehicle for the rural community of Findhorn in North East Scotland. It raised £620,000 in share capital from 264 members, with the money used to support a series of 'eco-village' projects including two wind turbines and a residential visitor centre.

In the Lake District village of Hesket Newmarket, in 1999, a group of enthusiasts came together to purchase a small local brewery when its owners decided to retire. A total of £135,000 in IPS share capital was raised from 90 members who each invested £1,500. Four years later, in 2003, a second IPS co-operative was established to purchase the pub next door to the brewery. This time, £220,500 was raised from 147 member customers.

Mustard Seed is a small Christian charity operating in South Kerrier, Cornwall. It provides social care services for disabled people in the community. It wanted to extend its services to include supported accommodation. It needed to raise a total of £320,000 to buy and convert its first property, which would provide accommodation for four people. With support from social investment organisation, Resonance, it launched a community benefit society in 2007 which has raised £160,000 from 15 members, sufficient to match a commercial loan and to enable it to buy a property. It is currently offering an interest rate of 3.5%.

Community services are not necessarily confined to local geographic communities. The Phone Co-op is a national provider of telecommunication services and is an IPS co-operative, owned and controlled by its customers. The Phone Co-op serves a community of interest, who share its values and co-operative principles. It is a good illustration of the effects of scale on community investment: a relatively large amount of capital can be raised through small contributions from a large number of supporters. The Phone Co-op has over 6,700 members, and although the median investment is just £30, the total member investment is more than £1.6m.

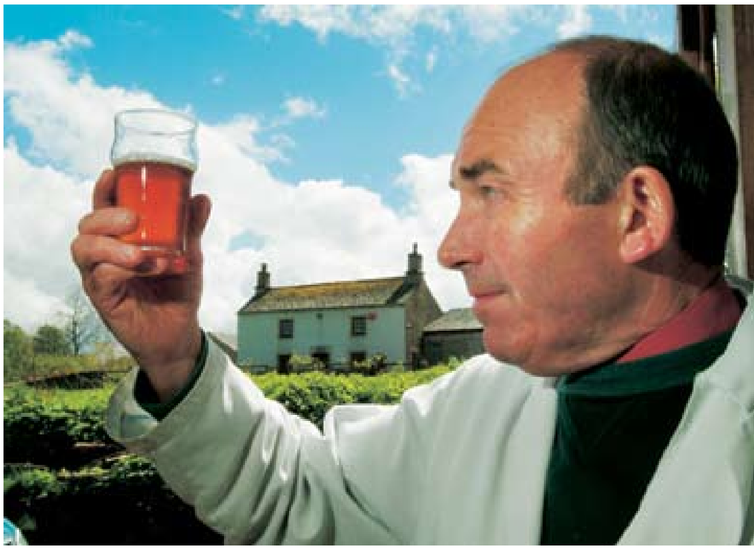
Football provides another example of how a large amount of capital can be raised, if there are a large number of supporters who are each prepared to make at least a small contribution. FC United of Manchester, is a community benefit society established in 2005 by Manchester United fans who were unhappy about the sale of their club to foreign owners. The new club was admitted to the second division of North West Counties Football League, putting it nine levels below the Premier League. The club, which has over 3,400 members who between them have invested £250,000, has gained promotion in both of its first two years of competition. FC United are passionate about three things: football, democratic control and community engagement.

Myfootball Club Society is another example of a large number of supporters, each making a small contribution, raising a significant amount of capital. This is a community benefit society, formed in July 2007, which already has 28,300 members, who have each invested £35: giving the club a fund of just under £1m, enough to buy an existing club, Ebbsfleet United, in a division only four levels below the Premier League. As befits an IPS, the club is democratically run, with modern technology enabling members to vote for team selection, player purchases and all other major decisions affecting the club.

Whether it is a geographic community or a community of interest, community investment can be a powerful way of engaging supporters, by creating a bond between the individual and the organisation. Community investment does not depend on a handful of wealthy investors. If the project or enterprise can appeal to a sufficiently large community then the size of individual shareholdings can be relatively small, and still add up to a sizeable investment.

Community assets

There are surprisingly few projects involving community investment in community assets, such as land and buildings, given the need for



Photograph courtesy of Hesket Newmarket Brewery, © Paul Carter

investment capital in this area, the willingness of communities to invest, and the scope for developing relatively low-risk investment models. The only example in Table One of an IPS successfully raising community investment for a community building project is the Ecos Fund. This is an initiative supported by the Wessex Reinvestment Trust (WRT), a rural CDFI based in South West England. It received funding from the Esmée Fairbairn Foundation and Friends Provident Foundation for an initiative called the Financial Mechanisms Project, which sought to increase the flow of investment into community initiatives and social ventures.

The Ecos Fund was one of four pilot schemes devised by the Financial Mechanisms Project, the others being Wessex Community Assets, Local Food Links and High Street Organics. A new set of IPS community benefit society model rules were developed by the Financial Mechanisms Project, to specifically cater for community investment. These rules have been approved by the FSA, and were used by Torrs Hydro.

The Ecos Fund, which was established in February 2007, aimed to raise £1.5m to invest in Ecos Homes, an established green property developer and subsidiary of the charity Ecos Trust. Ecos Homes had previously completed a housing project financed through unsecured loans provided by 21 supporters. A prospectus was issued in May 2007, which stated "it is expected that Ecos Fund will be able to pay

Photograph courtesy of The Phone Co-op

The Phone Co-op

The Phone Co-op is an ethical telecommunications services provider, selling everything from broadband to landline phone rental, including mobile phone services, website hosting and other internet services. It was established in 1998 by the current chief executive, Vivian Woodell, who started the business in his spare time, with the aim of providing affordable phone calls to not-for-profit organisations. Within a year it had converted into an IPS co-operative society, in response to the growing consumer demand for an alternative to the then dominant British Telecom.

Like other IPS co-operatives, The Phone Co-op has an open membership policy. When customers start buying a service from The Phone Co-op they are invited to become members, by opening a withdrawable share account and investing a minimum of £1. This entitles the customer to a vote at the AGM, to elect directors, and to receive a dividend based on their purchases from the co-operative, currently set at 1.5%. They also receive interest on their share account, currently paid at 5.5% gross per annum.

Membership has grown quickly and steadily in line with the growth of sales and customers. Over half of all Phone Co-op customers have chosen to become members. The annual turnover in 2007 was just under £7m, more than 100 times greater than its first year sales. Membership stands at 6,735 and these members have invested over £1.6m. An analysis of shareholdings in 2006 found that more than two-thirds of the share capital was provided by less than 4% of the membership. There were nine members with the maximum allowable shareholding of £20,000. The average investment per member was just over £200, whilst the median investment was just £30.

Share capital has increased every year since the co-operative was established. The net growth rate in share capital still exceeds 25%, with new deposits outweighing withdrawals by a significant margin. Withdrawals stood at 14.3% of the total share capital in 2007, outstripped by new deposits which stood at 32%. Members can withdraw their share capital at one week's notice, although this is usually waived.

The Annual Report for 2007 says that its strong balance sheet puts it "in a very strong position to pursue acquisitions and other growth opportunities in the future". It allocates some of its surplus to a Co-operative and Social Economy Development Fund, currently standing at over £1,100,000, which is invested in other co-operatives and social enterprises.

between 8% and 9% annual interest rate to investors before tax." When the offer closed, the fund had raised £650,000, including £499,000 invested by Rathbone Greenbank Investments on behalf of nominees. This form of investment does not transgress the IPS limit of £20,000 on individual shareholdings, although the Ecos Fund did decide to modify its rules to cater specifically for nominee accounts.

Wessex Community Assets, which used the same model rules as the Ecos Fund, was not successful in attracting sufficient investors to be deemed viable in the short term. The purpose of Wessex Community Assets was to act as a revolving loan fund for community land trusts. It too issued a prospectus, which set a minimum shareholding at £100, but did not state a target amount to be raised by the offer, or make any firm commitments on the financial return investors might expect; instead, an illustrative figure of 3% per annum was mentioned. At the close of the offer, in November 2007, it had attracted only £9,200 of external share capital (plus £20,000 from its sister organisation, Wessex Reinvestment Society). This was significantly below the £100,000 thought necessary for the new fund to be viable.

WRT have concluded that the share offer would have been more effective if Wessex Community Assets had been raising capital for a specific community land trust, which would have made it possible to target the local community, and have provided investors with greater certainty about what they were investing in. WRT also say that its marketing of the share offer could have been improved, by making it more project-specific and by following up direct mail contact with potential investors. There are plans to relaunch the fund in the near future.

Tablehurst and Plaw Hatch Community Farm provide clear evidence that highly-targeted community investment propositions can work. These two farms in East Sussex are used by Emerson College, an international Rudolf Steiner adult education centre. In 1995, the charities that owned the farmland were contemplating selling the businesses until a group of supporters stepped in with a proposal that the community should purchase the farm business, with ownership of the land and buildings remaining with the charities. A community benefit society was established and, to date, over 1,100 people have bought £100 shares, providing the farm business with the working capital it required. The society does not offer any interest on its withdrawable share capital, which is treated more like a cross between a free loan and a donation by the members.

A similar approach has been adopted by Fordhall Farm in North Shropshire. This organic farm was saved from development, and the tenant farmers saved from eviction, when nearly £0.75m of share capital was raised through a high-profile campaign, championed amongst others by the Guardian newspaper, and led by the son and daughter of the retiring tenant farmer. Fordhall Community Land Initiative is a community benefit society with exempt charity status. Its website invites members of the public to buy £50 shares, which it describes as "completely non-profit making", to make a donation, or provide an interest free loan. Elsewhere, its literature makes it clear that "members of the society will be rewarded primarily through a social and an environmental dividend rather than a monetary dividend". Shares are withdrawable subject to twelve months notice.

Moelyci Environmental Centre in North Wales is a good example of how local communities can help themselves, without the need for high-profile campaigns. When local residents heard Moelyci Farm might be sold to developers, they established an IPS to purchase the land and turn it into an environmental centre and intermediate labour market project for long-term unemployed people. Starting with an initial membership of 200 people in 2002, the society has now grown to over 500 members, with share capital exceeding £30,000.

Photograph courtesy of Fordhall Farm

5 Lessons for the future

Community investment works best when it engages the support of a known community for a specific project or venture with a relatively low risk profile.

In some cases the financial return on the investment can be less important than the social return. These cases include projects that have a high public profile, or where the social purpose is supported by a well-organised community of interest, such as a faith group. The financial return may also be less important for initiatives that would normally be supported by volunteer work or charitable donation.

However, where community projects are competing in commercial markets, as is the case in the community energy sector, it is important to offer competitive financial returns, whilst continuing to emphasise the broader community benefits of the project. Tax incentives can be a key element of this financial return.

Initiatives which offer opportunities to invest directly in a specific project or venture, appear to fare better than opportunities to invest in investment funds or in ventures where the need for community investment is not absolutely clear. It also helps to have a defined community, ideally one which has an existing relationship with the project or venture. For instance, the Natural Food Store in Leeds was able to appeal to its existing customers, as were The Old Crown pub in Cumbria and many of the community-owned stores listed in Tables One and Two.

Most IPSs are exempt from regulation under the FSMA when issuing share capital, the exception being co-operatives issuing transferable share capital. But even when an IPS is exempt, it is vital to fully inform prospective investors about the investment opportunity so that they are able to understand what they are investing in, and the risks associated with the investment.

The FSA has recommended good practice in this area for exempt co-operatives, which is described in more detail on page 34. These recommendations do not apply to community benefit societies, but it could be considered good practice for them to provide this information, especially where the society is a new venture, or if the capital is needed for the survival of the enterprise. The FSA refers to this information as an offer document, and it should not be confused with a share prospectus, a document which complies with the Prospectus Regulations and has been approved by the FSA.

More than two-thirds of the IPSs listed in Tables One and Two are community benefit societies. The choice whether to register as a co-operative or a community benefit society should be straightforward, but the boundaries between the two types of IPS are becoming increasingly blurred in practice. The FSA has accepted that co-operatives can recruit members whose only relationship with the enterprise is that of investor. This is the case for all the wind energy co-operatives in Table One: it is simply not possible for the members of these co-operatives to be customers because the electricity is fed directly into the National Grid and sold to electricity distribution companies, who in turn sell it to the end-user. The members of these co-operatives are strong supporters of wind power, which they believe is of benefit to the broader community. Nearly all of the community-owned stores listed in Table Two are community benefit societies, despite the fact that their members are highly likely to be customers, and, more closely fit the co-operative model. One of the defining principles of co-operation is concern for community, which commits all co-operatives to work for broader community benefits.

From a community investment perspective there is not much difference between a co-operative and a community benefit society: both can issue either transferable or withdrawable share capital, and both can offer the same interest rates. The main difference is that community benefit societies are exempt under the Prospectus Regulations 2005 from having to issue a prospectus when offering transferable share capital. Another major difference is the legislation allowing community benefit societies, but not co-operatives, to introduce an asset lock. An asset lock may influence an investor's judgement about the financial and social return being offered. Ultimately, the choice between registering as a co-operative or a community benefit society will be determined by fine judgements of intent and purpose. Ventures that put the interests of members before those of the broader community are best suited to the co-operative model, and vice versa.

The issues surrounding the choice between issuing withdrawable or transferable share capital are more complex. Withdrawable share capital is less regulated and more straightforward for members to understand, but presents societies with the responsibilities of anticipating members' requests for withdrawal. It is reasonable to expect some members to want to withdraw their share capital for personal reasons that have nothing to do with the performance of the society. For instance, Shared Interest had gross withdrawals of 7.5% of share capital in 2006, and The Phone Co-op had gross withdrawals of 14.3% of share capital, although in both societies new deposits far exceeded withdrawals, resulting in a net increase in share capital. These societies cater for withdrawals by actively recruiting new members, and encouraging existing members to maintain or increase their investment. It is common practice for societies, including these two, to maintain share accounts for their members where the account is credited with the interest payable to that member each year, unless their account has already reached the maximum permissible. Most members will choose to leave the interest in their accounts, thereby boosting the share capital held by the society.

The situation is different for societies that make an initial offer of share capital, but do not intend to recruit new members on a continuing basis. This is typically a matter for societies developing capital projects such as land and buildings, or renewable energy installations. A continued influx of new member capital might strain the ability of the capital project to maintain interest rates. But without new members the society must have some form of contingency fund if it has issued withdrawable share capital. For instance, Westmill share capital is transferable and, after five years, withdrawable, but subject to a ceiling in any one year of 5% of the total share capital issued. This is provided for in the Westmill business plan through a depreciation fund which envisages winding up the society after 25 years and returning all the share capital to members.

The problem with issuing transferable share capital is the lack of a suitable secondary market to manage the transfer of shares. IPS share capital cannot be listed on the London Stock Exchange, nor probably on any of the junior exchanges such as AIM, Plus Markets and ShareMark. Whilst there is talk in social investment circles of creating a social stock exchange, the proposal is only a little further forward than it was when it was first proposed five years ago in the publication *Co-operative Capital*. A number of social enterprise plcs which have issued transferable share capital use the matched bargain services of stockbrokers Brewin Dolphin, and this could be a possibility for IPSs.

Looking to the future, many of the more difficult choices facing IPSs will become easier to make when the options are better understood. This can best be achieved by giving greater publicity to current practices and encouraging the FSA to be more transparent in its judgements. A good example of where greater transparency would be beneficial is the judgement surrounding the registration of IPS community benefit societies. Currently, anyone planning to register such a society must provide “special reasons” why it should be registered as an IPS rather than a company. Whilst most applicants know that the principal special reason is a desire to operate on a democratic basis, it is not clear what other special reasons may exist, beyond the very limited guidance provided by the FSA.

The scope for growth in community investment is considerable. The community energy sector has demonstrated how to harness community investment, combining geographic communities with communities of interest to form a powerful alliance, capable of raising millions of pounds. The key to success has been the role of the business development organisation, Energy4All, in providing the knowledge and expertise to establish new ventures. This model has been replicated by H_2OPE, who specialise in the development of water power schemes. This sector has also shown the importance of a sound business model, capable of paying good financial returns and delivering broader social benefits. EIS tax relief is an important element of this financial return, especially for capital projects such as renewable energy, which can take several years before they return a profit. The introduction in July 2007 of a £2m ceiling on how much can be invested in a single enterprise in any one year is a significant setback for larger projects in this sector.

The success of the community energy sector could be replicated in a wide range of community-based capital projects. Community land trusts are an obvious and immediate target; Table Three lists two ventures, Lammas Low Impact Initiatives and Worth Community Property Trust, which are already heading in that direction, and would benefit from the support of an Energy4All-type business development organisation. Affordable housing, community buildings, offices and workspaces, could all be future targets for community investment initiatives. More innovative and cutting-edge projects could include community-based telecommunications services and community-owned health centres.

There are clear benefits to focusing on a single project or venture, supported by a strong business case, and a real need for community investment. This is the principal lesson emerging from the Financial Mechanisms Project run by WRT (see page 21). It has implications for community development finance institutions, and the scope for them to use their IPS structures as a fundraising vehicle. The key may be to focus on either a community of interest, in the way that Shared Interest has done, or on a much more tightly defined geographic community investing in highly visible community projects, in the way that Ekopia has done (see page 20). Another way of stimulating community investment in CDFIs would be to offer investors Community Investment Tax Relief (CITR). Investment in withdrawable share capital can qualify for CITR when it is offered by accredited CDFIs.

Withdrawable share capital and one-member-one-vote democracy are unique to the IPS format; they create a powerful dynamic within the business model, especially when the roles of investor and customer are combined. This is demonstrated by The Phone Co-op, where customer satisfaction is central to the sustainability of the business. The management and elected directors are under pressure to maintain customer satisfaction, or else face the withdrawal of share capital. The same processes will come into play with the Natural Food Store, and wherever else the roles of investor and customer are combined.

Some community-owned stores have taken the process one stage further, combining the role of volunteer with those of investor and customer, improving the sustainability of what might otherwise be a marginal business. Encouraging the community to invest capital, rather than donate cash, emphasises the underlying nature of the project as a community-owned enterprise. Community investment engages the community, not only as investors, but also as customers and volunteers, giving members control over the business model and the mutual benefits for the community. The same principles could be applied to a wide range of community services, ranging from adult care to youth work, providing that the underlying business case is sound.

Above all else, there is a pressing need to promote the concept of community investment, and to help people become conversant with and confident in the idea of investing in community-based projects and ventures, capable of achieving both a financial and a social return. The growing number of practical examples of community investment will help. But there is also an important role to be played by development agencies and development practitioners in supporting community investment initiatives. Policymakers have a part to play, ensuring that the unique qualities of the IPS format as a vehicle for community investment are recognised by government institutions and agencies. Finally, regulators can play their part too, by providing clear guidance about the IPS format.

Photograph courtesy of Energy4All

6 A step-by-step guide to getting started

1. The germ of an idea

All projects and ventures have to start somewhere, so, if after having read this publication, you think you have an idea worth developing, why not give it a go. As an IPS requires a minimum of three founder members (or two founder members if they are IPSs) then a good place to start would be to see if you can persuade at least two other people that your idea is worth developing.

Community investment is most effective when it is used to finance a business venture with a clear social purpose. This combination of the business model with social purpose is extremely important. If the idea is solely focused on social outcomes, then it will be better to develop it as a charitable project funded through grants, gifts and donations. If the idea is purely a commercial proposition then investors will expect the best financial return available. Community investment is about offering a financial and social return, and this must be central to your idea.

You need to be sure you have the time and resources to develop your idea. Few of the ventures described in this publication were developed in less than 12 months. Some, like Westmill, have taken over 12 years to develop from the germ of an idea to a fully-funded venture. There will also be expenses associated with your research and development, registration and legal fees, marketing, promotion and community consultation. Identify where the money will come from to cover these costs.

2. Learn from experience

Has someone already done what you want to do? This publication lists over 50 societies that have already developed community investment initiatives. Have any of them developed the same or a similar idea to your own? What can you learn from their experiences? How could you improve on their practices? With the help of these organisations you may be able to identify sources of expertise and experience that can help you drive your idea forward. Build your network of professional support, and start to plan how you will pay for this support.

3. Community support

You need to win the support of either a geographic community, a community of interest, or a combination of the two. If you decide to focus on a geographic community, think carefully about how you define its boundaries. Smaller, tightly defined communities are more likely to win a higher proportion of support, but from fewer people. Larger geographic communities will have weaker identities, and proportionately fewer people are likely to become members. Communities of interest are hard to construct from scratch; try to identify existing organisations that represent these interests, and build relationships with them. When you have developed your business case (see next step), organise open meetings with your target community to test the level of support for your idea.

Establish a database of your supporters, and make sure that once you have established contact with your supporters, you maintain your relationship with them through regular contact. Create opportunities for supporters to get involved in your project, identifying a series of tasks which you can give them that will move your project forward.

4. The business case

Developing a strong business case for the project or venture is crucial. Keep the business model as simple as possible, so that people can understand what you are proposing, and have confidence in the financial and social returns you are predicting. Think carefully about how you intend to engage your community. Will they just be investors and supporters, or will they also be potential customers, service users, or volunteers?

The business case needs to be robust, and can be strengthened by your target community supporting the venture in more ways than just as investors. Communities can help reduce the cost of community services by providing volunteer support, or improve the efficiency of the business by drawing on local knowledge to target services more accurately. Identify and analyse the risks associated with your business model. What could go wrong, and what are your contingency plans if this happens?

Next, think about the scale of the venture you are planning to launch. If it is too small it might not be a financially viable concern; if it is too large you might not be able to raise sufficient capital to get started. Also think about the scope for starting small and growing the business in line with demand. This will have a bearing on the launch of your venture (see Step 9)

When you are confident about the viability of your business model and the scale of your proposed venture, prepare your business plan. There are many sources of advice and support for preparing business plans.

5. Capital finance plan

A key element of your business plan will be how you intend to raise the necessary capital finance. There are three main types of finance you should consider. Grant finance from sources other than your target community is best of all. Equity finance from the community is the next best source of capital. Debt finance is the final option. Most initiatives involve a mix of all three. Debt finance is easier to secure when grant and equity finance are already in place. This is where the principle of gearing comes into play (see page 7); lenders may consider making loans up to the same amount as the equity invested in the enterprise. For instance, the Westmill share prospectus sought to raise £3.75m in share capital and £2.26m in loans.

6. The community investment proposition

There are several matters to address when formulating your community investment proposition, all of which will have a bearing on its success. You need to choose between issuing withdrawable or transferable share capital, and the consequent arrangements for members to exit from their investment. The issues associated with this choice are reviewed in detail on pages 7-8. This decision will also affect whether the investment offer will be exempt from regulation as a financial promotion.

Next, you need to establish your policy on the interest to be paid to shareholders. According to the FSA, the interest rate paid by an IPS must be limited to what is "necessary to obtain and retain enough capital to run the business". There must also be firm evidence in your business plan that the venture can afford the interest rate. Finally, you need to check whether the investment will qualify for any form of tax relief (see page 35) This could be a significant inducement for investors.

7. The community investment offer

Not all IPSs will need to raise community investment capital before they start trading. For instance, The Phone Co-op did not require a large amount of capital to get started. Its share capital has built up over time, mirroring the growth in its customers and members. But in many cases, the launch of the venture will depend on raising sufficient share capital in order to secure other forms of capital finance before trading can commence.

If you do need to make an initial community investment offer, the first thing to check on is whether this will be a regulated financial promotion (see page 34). This is something that you should have already considered when you were choosing between offering withdrawable or transferable share capital. If it is a regulated financial promotion you will need to secure the services of an 'authorised person' recognised by the Financial Services Authority (FSA), and issue an approved prospectus in accordance with the regulations. The authorised person also needs to approve any other promotional materials you may produce about the offer.

The FSA has issued voluntary guidance (see page 34) for community investment offers which are exempt. It recommends that you produce an offer document, containing sufficient information for potential investors to make a proper financial assessment of the offer. This should include full financial information about the proposed venture, and the projected returns on the investment. You should also think carefully about whether to set a minimum investment level. Practices vary widely, with minimum investment levels ranging from £1 to £1,500.

It is also a matter of good practice to establish an offer period (opening and closing dates for applicants), together with the target amount you hope to raise in this period, and your contingency plans if you fail to meet these targets, or if your offer is over-subscribed. Offer periods are usually about three to four months long. Making an offer during the summer or winter holiday periods might affect your success.

The offer document is your key marketing tool. It should be clear and easy to understand, yet fully informative and capable of answering any questions potential investors may have about the risks associated with the investment and the potential social and financial returns.

8. Legal registration

You should register your society before launching your community investment offer. The choice between registering as a co-operative or as a community benefit society should be relatively straightforward (see page 6). If your community investors will also be your customers, or will be the primary beneficiaries of your venture, then a co-operative structure is probably most appropriate. If your venture will be for the benefit of the broader community, then a community benefit society will be most appropriate.

IPSs are registered by the FSA (see page 31). You need to submit the rules for your society which will be scrutinised by the FSA, and you will be charged a fee of up to £950. Alternatively, you could use the model rules of a sponsoring body, who will charge you for this service, which will reduce the registration fee charged by the FSA according to the number of amendments you make to the model rules. If you are registering a community benefit society you will need to state the 'special reasons' why you want to be registered as this type of society (see page 6).

9. Launching your community investment offer

Long before your offer period starts, you should have been building your community support and have developed a database of supporters, based on the meetings you have held with your target community. A website is another essential marketing tool, which enables supporters to find out more about your progress. Invite visitors to your website to register their interest in your plans, obtain their contact details, and provide opportunities for them to get involved. Inviting supporters to make voluntary pledges of how much they would like to invest can be useful in gauging the level of support.

Think carefully about the resources you will require to make a successful offer. Public meetings, publicity campaigns, direct mailings of the offer document and processing of investment applications, all have to be planned for and executed in an efficient manner. If you intend to process all the share applications yourself, be prepared for a last minute rush, and make sure you are able to keep applicants informed about the progress of your offer. If your offer is successful, be prepared for the inevitable flood of enquiries after the offer has closed, and factor-in the cost of dealing with late applications.

7 Further information

IPS registration process

Since 2001, IPSs have been registered by the Mutuals Section of the Financial Services Authority (FSA), which took over this role from the now defunct Registry of Friendly Societies. An IPS can be established with a minimum of three founder members, or two founder members if they are both IPSs. Applicants must submit a set of rules for the society (equivalent to the 'Mem & Arts' of a company) that show that its purpose and structure comply with the legislation.

Registration of an IPS is generally more expensive than registering a private company or CIC, primarily because the FSA scrutinises the rules of each applicant society. The cost can be reduced by registering through a sponsoring body offering suitable model rules: standardised governing documents which have been pre-approved by the FSA. The cost of registering with the FSA using model rules ranges from £40 up to £950, depending on the number of amendments. The sponsoring body will also charge for the use of their model rules, and for any assistance they provide with amendments. (Contact details of relevant sponsoring bodies are provided on page 36.)

Mutual Societies Registration
Financial Services Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS
Telephone: 020 7066 8002
Email: mutual.societies@fsa.gov.uk
Website: www.fsa.gov.uk/Pages/Doing/small_firms/MSR/index.shtml

FSA Mutuals Public Register
http://mutuals.fsa.gov.uk/Search.aspx

Operational duties

Once registered, a society is required to keep proper accounts and submit an annual accounting return to the FSA, accompanied by a set of accounts. It must also give the FSA notice of any change of its registered office and apply for approval for any amendments to its rules, or changes to its name. Societies must also pay the FSA an annual fee (known as a periodic fee), which currently ranges from £50 to £395, depending on the size of the total assets of the society. This fee covers the cost of filing annual returns, amendments to rules and recording of charges.

Every society must have a board of directors, and the process for appointing and removing directors will be set out in the rules of the society. Every society is obliged by law to have a secretary, who is responsible for ensuring that a range of duties and responsibilities are carried out. Further information on the duties of the secretary and the board of directors is available from most sponsoring bodies.

It is important to bear in mind the cost involved in maintaining a large membership. As well as keeping an up-to-date record and share account for each member, members must be granted all their rights, as set out in the rules of the society. IPS rules usually grant members the right to attend an annual general meeting, to receive and approve the annual accounts, and to approve the interest rate on share capital, and the dividend on transactions if it is a co-operative. Members will also usually have the power to elect directors and pass special resolutions. The cost to the society of maintaining these rights can be considerable, which explains why some societies state a minimum level of shareholding in excess of £50 or £100.

Co-operatives^UK is a membership organisation and provides information and support on a wide variety of topics relating to the operational duties of IPSs, including those of secretaries and directors. It has a number of model rules for bodies wishing to register as IPSs, and is in the process of developing a community investment model.

Co-operatives^UK
Holyoake House
Hanover Street
Manchester
M60 0AS
Telephone: 0161 246 2900
Email: info@cooperatives-uk.coop
Website: www.cooperatives-uk.coop

Asset locks

An asset lock is a rule in the governing document, backed by legislation, which prevents members from distributing the accumulated assets of the enterprise to themselves. Asset locks are a central feature of charities, where the purpose of the asset lock is to encourage donors to give to the charity, safe in the knowledge that their gift cannot end up being used for private benefit. Asset locks are also central to CIC legislation, and when this legislation was being developed, steps were taken to extend the principle of asset locks to community benefit societies. This was achieved through the Co-operatives and Community Benefit Societies Act 2003, which enables community benefit societies to introduce rules creating an irreversible asset lock. The same scope does not exist for co-operatives. Instead, they are covered by the same safeguard against demutualization as that which applies to building societies: there must be a 75% vote in favour of converting into a company with at least 50% of those eligible to vote doing so.

The Community Benefit Societies (Restriction on use of assets) Regulations 2006
www.opsi.gov.uk/si/si2006/20060264.htm

Charitable status

The Charities Act 2006 introduced changes to the regulation of organisations that qualify for exempt charity status. Currently, community benefit societies can apply to HM Revenue and Customs for exempt charity status. But this is set to change in the future, with the Charity Commission possibly having a more direct role. Charities in Scotland are regulated by the Office of the Scottish Charity Regulator (OSCR). At the time of writing this publication the Charity Commission had not announced how it will treat applications from IPSs for charitable status.

Charity Commission
PO Box 1227
Liverpool
L69 3UG
Telephone: 0845 3000 218
Email: See website for contact details
Website: www.charity-commission.gov.uk

Office of the Scottish Charity Regulator
2nd Floor
Quadrant House
9 Riverside Drive
Dundee
DD1 4NY
Telephone: 01382 220446
Email: info@oscr.org.uk
Website: www.oscr.org.uk

HMRC Charities
St John's House
Merton Road
Bootle
Merseyside
L75 1BB
Telephone: 0845 302 0203
Email: charities@hmrc.gov.uk
Website: www.hmrc.gov.uk/charities

Converting an existing organisation into an IPS

It is possible to convert a company registered under the Companies Act of 1985 into an IPS. This includes a company limited by shares and a company limited by guarantee, but does not currently include a company that is also registered as a community interest company, although this may change in the future.

Given that it is not permissible to convert a company limited by guarantee into a company limited by shares, the right to convert a company limited by guarantee into an IPS is the only way an organisation that was a company limited by guarantee could introduce a share capital structure.

Further information about converting companies into IPSs is available on the FSA website: www.fsa.gov.uk/Pages/doing/small_firms/MSR/pdf/co_conversion.pdf

Community energy

Energy4All specialises in developing community-owned wind farms, using IPS community investment. It has established a step-by-step guide for communities interested in establishing a community wind project.
See www.energysteps.coop

H_2OPE provides a similar service for people who want to establish community-owned hydroelectric schemes.

Energy4All Limited
Unit 33, Trinity Enterprise Centre
Furness Business Park
Barrow-in-Furness
Cumbria
LA14 2PN
Telephone: 01229 821028
Email: info@energy4all.co.uk
Website: www.energy4all.co.uk

H_2OPE (Water Power Enterprises CIC)
2 Garrs Lane
Grassington
North Yorkshire
BD23 5AT
Telephone: 07964 106037
Email: see website for contact details
Website: www.h2ope.org.uk

Community finance

The Community Finance Development Association is the trade body for community development finance institutions (CDFIs) in the UK. It provides information and support to CDFIs, including those which are accredited by the government for Community Investment Tax Relief.

Community Finance Development Association
Room 101
Hatton Square Business Centre
16/16a Baldwins Gardens
London EC1N 7RJ
Telephone: 020 743 0222
Email: info@cdfa.org.uk
Website: www.cdfa.org.uk

Community-owned shops

The Plunkett Foundation supports rural communities that want to set up and run a community-owned shop. It is currently managing the Village Core Programme which provides financial start-up packages of up to £40,000 per shop.

Plunkett Foundation
The Quadrangle
Woodstock
Oxfordshire
OX20 1LH
Telephone: 01993 814377
Email: virsa@plunkett.co.uk
Website: www.virsa.org

Regulation of financial promotions

The Financial Services and Markets Act 2000 established the FSA as the single regulator for the financial services industry. The Act gave the FSA powers to regulate and control a wide range of financial activities, including the offer of financial securities such as shares and debentures. It applies restrictions to certain regulated activities (Section 19) and to financial promotions (Section 21). The Regulated Activities Order 2001 (see Article 18) does not treat as a regulated activity any corporate body, including IPSs, offering their own shares or debentures.

The Financial Services and Markets Act also classifies as an exempt offer (See Schedule 11 paragraph 18d) any securities issued by an IPS community benefit society, as long as the proceeds are used for its own purposes.

When a corporate body offers securities for sale to the public this may constitute a financial promotion, and be subject to regulation, requiring the organisation to use the services of an FSA approved person. The role of this person is to approve all financial promotion leading up to an investment. The Financial Promotion Order 2005 (see Article 35) exempts IPSs offering debenture stock, loans and bonds, from this financial promotion restriction. Moreover, withdrawable shares issued by an IPS are not treated as a controlled security and therefore financial promotions relating to them are outside the financial promotion restriction (The Financial Promotion Order 2005 Schedule 1 Paragraph 14(2)(b)).

The Financial Services and Markets Act 2000 also prohibits transferable shares being offered to the public without an approved prospectus (Section 85). For financial promotions of transferable share capital above a certain limit, currently set at the equivalent of 100,000 euros, or offered to more than 100 people, the enterprise is required to publish a prospectus authorised by the FSA. This adds significantly to the costs of any promotion. However, the Prospectus Regulations 2005 provide exemption from having to issue an authorised prospectus for community benefit societies issuing transferable share capital (Schedule 11A Paragraph 7).

Investors in financial promotions that are communicated or approved by firms authorised by the FSA potentially have two important rights: they can make complaints to the Financial Ombudsman Scheme, and they may be eligible for compensation from the Financial Services Compensation Scheme. Investors in exempt promotions do not have these rights.

The FSA provides the following guidance to IPSs that are exempt from having to comply with financial promotions regulations:

> *"(a) any offer document sent to prospective investors should contain sufficient information to enable investors to make an informed assessment of-*
>
> > *(i) the assets and liabilities, financial position, profits and losses and prospects of the society and of any guarantor; and*
> > *(ii) any rights attaching to the securities; and*
>
> *(b) the society makes on-going disclosures to the holders of their securities so that those holders and any prospective investors can take investment decisions on a fully informed basis."*

Taken from: Investor membership of co-operatives registered under the Industrial and Provident Society Act 1965, Policy Note, Michael Cook and Ramona Taylor, FSA, 2006.

The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001
www.opsi.gov.uk/si/si2001/20010544.htm

The Financial Services and Markets Act 2000 (Financial Promotion) Order 2005
www.opsi.gov.uk/si/si2005/20051529.htm

The Financial Services and Markets Act 2000 (Exemption) Order 2001
www.opsi.gov.uk/si/si2001/20011201.htm

The Prospectus Regulations 2005
www.opsi.gov.uk/si/si2005/20051433.htm

Tax relief

There are two forms of tax relief available for community investment: the Enterprise Investment Scheme (EIS) and Community Investment Tax Relief (CITR).

The EIS is designed "to help smaller higher-risk trading companies to raise finance by offering a range of tax reliefs to investors who purchase new shares in those companies". Investors can reduce their income tax liability by 20% of the amount invested. The minimum size of investment is £500 and the maximum is £500,000. The shares must be held for a minimum of three years. Only certain types of trading activity qualify for this scheme. The main categories include manufacturing, distribution, restaurants and catering, transport, construction, energy and water supply, and some types of business services. Excluded activities include dealing in land, commodities, shares and banking, property development, farming, and residential care.

In July 2007, new restrictions were introduced to the EIS, which included an upper limit of £2m on the amount of share capital that can be raised, and that the enterprise must employ fewer than 50 people at the time of the share issue. At least five recent IPS share offers have been approved by Her Majesty's Revenue and Customs for EIS tax relief, including Westmill Wind Farm, Fenland Green Power, Torrs Hydro, Local Food Links, and High Street Organics. To qualify for this tax relief, shares must be non-redeemable and held by a member for longer than three years.

CITR is a form of tax relief only available to investors in accredited Community Development Finance Institutions (CDFIs). The relief is worth up to 25% of the money invested, spread over five years. CITR is applicable to most forms of investment in CDFIs, including IPS withdrawable share capital, but only if the shares carry no present or future right to be redeemed within the first five years of their issue. Investment in CDFIs does not qualify for the EIS.

An introduction to the Enterprise Investment Scheme (EIS), HMRC, 2007
www.hmrc.gov.uk/eis/guidance.pdf

Community Investment Tax Relief guidance, HMRC
www.hmrc.gov.uk/specialist/citc_guidance.htm

Enterprise Investment Scheme Association (EISA)
www.eisa.org.uk

8 IPS model rules sponsoring bodies

The following list is of sponsoring bodies that have produced model rules used by one or more of the societies mentioned in this publication.

The Financial Services Authority (FSA) maintains a list of all sponsoring bodies that have produced model rules. Organisations which use these model rules and submit an application via the relevant sponsoring body may be eligible to pay a lower application fee.

Co-operatives[UK]
Legal Services
Holyoake House
Hanover Street
Manchester
M60 0AS
Telephone: 0161 246 2900
Email: info@cooperatives-uk.coop
Website: www.cooperatives-uk.coop

Energy4All Limited
Unit 33, Trinity Enterprise Centre
Furness Business Park
Barrow-in-Furness
Cumbria
LA14 2PN
Telephone: 01229 821028
Email: info@energy4all.co.uk
Website: www.energy4all.co.uk

Land for People Limited
31 High Street
Welshpool
Powys
SY21 7YD
Telephone: 01938 556819
Email: jonathan@landforpeople.co.uk
Website: www.landforpeople.co.uk

Radical Routes
c/o Cornerstone Resource Centre
16 Sholebroke Avenue
Leeds
LS7 3HB
Telephone: 0845 3304510
Email: info@radicalroutes.org.uk
Website: www.radicalroutes.org.uk

Wessex Reinvestment Trust
The Threshing Barn
Woodhayes
Luppitt
Honiton
Devon
EX14 4TP
Telephone: 01404 549139
Email: enquiries@wessexrt.co.uk
Website: www.wessexrt.co.uk

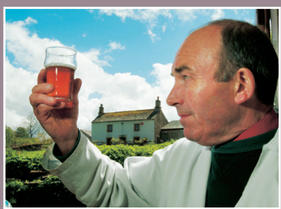
From The Old Crown pub to The Phone Co-op, from Westmill Energy Co-operative to Fordhall Farm and to a raft of village and community shops: all these have used Industrial and Provident Society (IPS) legislation to raise significant sums of money and empower and engage their member owners.

Since 2005 there has been a doubling in the number of community investment initiatives which have used IPS legislation to offer their communities the opportunity to invest in share capital. Community investment is about people investing their savings in community projects. More than £47 million has been invested by over 65,000 people.

IPS legislation has a number of unique features, which makes it a highly appropriate vehicle for establishing and developing sustainable community-led enterprises. These features are neither well known, nor well understood, by those promoting and developing social enterprises.

Jim Brown of Baker Brown Associates, commissioned by Co-operatives^UK has written a study of this growing phenomenon. *Community Investment – Using Industrial and Provident Society Legislation,* gives an overview of this grass roots movement, describes how it's been done and how to do it. Developed in close liaison with the Financial Services Authority, this is the first authoritative overview and guide.

This is essential reading for the business development and regeneration professional and for those many activists who want to make a difference in their community.



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