E3M

M O N E Y

FINANCING SOCIAL ENTERPRISE GROWTH

Real stories of how social businesses are accessing and shaping innovative social investment options

MARKETS MODELS MONEY MEASUREMENT EUROPE

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FINANCING SOCIAL ENTERPRISE GROWTH

E3M and Social Investment

Social investment is a rapidly evolving field. The examples outlined in this publication show how E3M Members are working with specialist funders and expert advisors to pioneer the use of a range of different financial tools to raise the capital they need to grow. Access to finance will remain a key strand of the work of E3M. Over the coming year we will continue to review experience in this field and share the collective knowledge of E3M Members and Partners.

WELCOME

Social enterprises are used to breaking new ground. And, when you are doing work that consistently challenges the status quo, it can be difficult to find the capital to fuel that work.

E3M social enterprises all trade in public service markets. They have developed from different starting points: charities that have moved into trading, public service spinouts and new start social ventures.

Like many businesses, they need finance for asset acquisition, working capital, and growth capital to finance business acquisitions and new contracts. They need significant finance on acceptable terms which doesn't ask them to divert their mission.

Those in the business of social change are known for being innovative. In this publication, we share learning from our events and discussions with our members to show how social businesses and their supporters are paving the way with new and creative finance deals and instruments.

Read on to discover the insights on offer from those using everything from unsecured loans to bond issues (unlisted and listed) and quasi-equity deals. We also cover democratic finance and examine some fascinating case studies which illustrate how tax reliefs are being used to boost access to investment.

We would like to thank Big Society Capital for supporting our 2014 finance seminar and this publication; we hope you find it a useful and stimulating reading.

Jonathan Bland, founder of E3M and Director of Social Business International

"We sometimes use the services of mainstream lenders, the same as everyone else. But we have a social supply chain target for spending on ethical and local social enterprise. We'd rather buy from an ethical bank, even if it's more expensive."

Dai Powell OBE
CEO,
HCT Group

What to bear in mind before you approach a lender

Top Tips from Ruth Foreman, Baker Tilly

While discussion around social impact is important, fundamentally social enterprises are still businesses operating in the same environment as a normal business. This is never more acute than in the world of raising funds. The same risk perspective applies and there are the same issues. Even if a lender or investor loves what a business does, it is still a commercial investment decision which needs to stack up. Cash flow is core.

What you need to know:

- Investors will manage their risk around asset backing or sometimes around the pay back period
- Historical financial data needs to be well presented
- The market you're in needs to be fully described and articulated
- Be upfront about anything you need to disclose, so you control the conversation. Lenders will look into your history without telling you
- You need to be on top of regulations and legislation
- Investors will also look at your dependence on key individuals as a risk. Ensure there are good succession plans and a team that can step up if needed
- Lenders will want you to articulate social value in a way they can understand

Striking gold: Golden Lane Housing celebrates buying its final property using bond capital in 2013

NEW AND EMERGING FINANCE OPTIONS FOR SOCIAL ENTERPRISE

"Our clients are increasingly interested in ever sophisticated and developing models of social finance. We believe in putting social enterprises in the driving seat - they are in a good position to know what they need in terms of capital and what will work for them. We don't have the exact social finance ecology out there, but we are seeing different and more differentiated capital - angels, crowd funding and so on; it's a positive time. It feels like we moved on a lot during 2014 and products are evolving for the market."

Luke Fletcher
Partner advising charities and social enterprises,
Bates Wells Braithwaite

TYPES OF FINANCE COVERED IN THIS PUBLICATION

Unsecured Debt – A straightforward loan with a fixed or variable return which doesn't ask for security. This is rarely on offer from a mainstream bank.

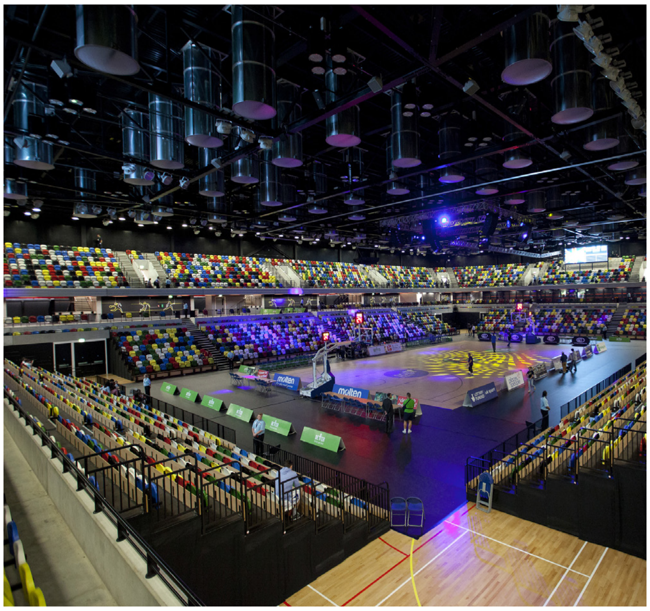
Unlisted Bond – A way of raising money from a number of individuals or institutions which requires asset(s) as security. Often more flexible than bank loans with lower interest rates. Investors are usually paid back over five years.

Listed Retail Charity Bond – A bond listed on a stock exchange that is specially developed for charities seeking £10m - £50m of unsecured debt from a number of individuals and institutions. Generally has a lower return rate than a bank requires. Investors can buy and sell individual bonds and are usually paid back over 12 years.

Quasi-equity investment – A loan that offers a shared risk between investor and investee. The social enterprise pays a return/ interest based on its performance.

Mixed/ tiered deals – Where two or more lenders work together to provide different types of debt and/ or equity investment, and where one lender takes on more risk.

Democratic finance – This is where a social enterprise draws in a grant, loan, equity or a mixture of these from a large number of individuals (typically the general public or a community of interest), for example through crowd funding or a public share issue.



Capital wins: Investors flocked to put cash into GLL's bond, which helped the social enterprise take over Olympic venues in East London

E3M

> *"What we look for from a lender is: how will they guarantee a return, at what rate and over what time period? Will they add an increased percentage on our rate of interest because we have no assets and therefore constitute a higher risk, and if so, what is the difference between a social lender and a high street bank? Will a lender genuinely value our social impact as much as a financial return? How supportive is the lender and do their aims align with ours?"*

Sarah Sharlott
CEO,
Realise Futures CIC

1. UNSECURED DEBT

Key features:

- Fixed returns
- No asset required
- Interest usually higher on unsecured loans than on secured loans

Jonathan Jenkins, CEO of the Social Investment Business, explains how his organisation makes investments

Social enterprises have traditionally struggled to access unsecured debt which has hindered flexibility, growth and development. Perhaps the social enterprise does not have any assets to use as security or its assets are central to supporting clients, for example a homeless hostel or a dementia care centre. Lenders can be reluctant to take on a risk without security, but the options are growing for social enterprises looking for unsecured debt.

The Social Investment Business is focused on helping develop unsecured debt products for social enterprises and charities and looks at the prospect it is investing in rather than the security available. We work alongside them to manage its risk. Social enterprises will borrow from the Social Investment Business for various purposes and at various stages of the business's life. A little more than 65% of the loan book is unsecured. Only the assets directly invested in are ever held as collateral.

Since the end of 2012 SIB, through managing a variety of external funds and money from it's own foundation, has provided over 1,300 grants and unsecured loans totalling more than £380m. These have been issued to more than a thousand organisations with an average loan of £277,000 over nine years.

Examples of Social Investment Business investments:

1. Woodlands Hospice and Charitable Trust which received a £400k unsecured loan at 6% over 20 years from the Futurebuilders Fund to build a 15-bed inpatient unit to provide palliative care.

2. Alt Valley Community Trust, which supports lifelong learning in Croxteth (Merseyside), took two investments via the Adventure Capital Fund. The first was a £200,000 loan to purchase and refurbish a 'communiversity'. The fund was a pilot to test the interest rates that community enterprises could repay, and half of this first investment was at just 1% over eight years with a three year capital holiday. The other half was repayable by evidence of social impact. The second investment to the Trust was £176,000 to purchase and refurbish a sports centre. This came in the form of a 10-year loan with 6% interest over 10 years and a 2-year capital holiday, plus a £44,000 grant. The interest rate was higher this time as the fund was still in pilot phase and different levels of interest rate needed to be tested.

3. Future Health and Social Care - via the Social Enterprise Investment Fund, the Social Investment Business invested £3.11m in this Birmingham-based social enterprise to buy 30 apartments for people with mental health issues and learning difficulties. This consisted of nearly £2.7m at 6% over 20 years, plus a grant of more than £400,000.

All of the Social Investment Business managed funds and those of its Foundation have their own specific criteria. For example one criterion for the Futurebuilders England Fund requires projects to have at least 51% of their profits come from public sector contracts. The Social Enterprise Investment Fund only funded organisations delivering health and social care services and the Adventure Capital Fund only invested in local community enterprises looking to develop assets and/or deliver services needed in the communities they served.

The main criterion for the investments, as is often case with social investors, is that the social enterprise has to prove that it would be unable to access mainstream, commercial finance. The Social Investment Business also provides grant funding for investment readiness.

> *"Money from social investors is never going to be cheap and involves more due diligence than with the mainstream lenders, but they have lot of experience and are focused on social change. They are good at putting in the 'first or last brick', i.e. helping you kick off your project when no one else is interested in order to generate further interest, or offering the final bit of finance for a project."*

Chris Loftus
Business Development Director,
Social adVentures

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2. BOND ISSUES

Since 2012 there has been around a dozen social enterprise and charity bond issues. It's still a new area for social enterprises to explore and with each new bond, fresh ground is quickly being broken.

2.1 Unlisted Bond

Key features:

- May require assets as security – decided on a case by case basis (but rarely required by Triodos for example)
- Fixed rate interest
- Runs for a maximum term of five years (investors prefer a shorter commitment)
- Has a fixed gross annual interest rate between 4-6%
- Not covered by financial compensation scheme

Case study: GLL

Nature of business: Community leisure services

Turnover: £163m

Bond offer: £5m bond, 5% interest, 5 years (Triodos Bank)

GLL has ordinarily used it's own profits for reinvesting in the business. But, in 2012 with ambitious growth targets to deliver, it decided it needed an extra injection of capital. However, even with a good track record and a predicted turnover of more than £200m in 2015, raising unsecured debt remained a challenge.

The offer

Triodos suggested a simple, catchy offer for GLL to put to investors - a £5 million unsecured bond, with a fixed 5% interest over five years.

> *"Straight away we had a captive audience of potential investors. GLL is owned by its 6,500 staff and we wanted them to be involved. We also had 250,000 members and thought it could be a good idea to invite them in too. It wouldn't have worked if we had just said to investors that we needed the money to grow, we needed something tangible for them to invest in."*

Phil Donnay
Finance Director,
GLL

GLL offered discounts on memberships and free periods of gym subscription to member investees in exchange for them investing anything from £200, and for institutional investors, anything from £2,000.

This was to be an unlisted bond because the costs of listing bonds of less than circa £50m were seen as financially prohibitive at the time.

Appealing to investors

To encourage investors, three projects were chosen to showcase the use of the funds. The projects included a programme to bring the heritage site the Charlton Lido back into use, along with turning the London Olympic venues into public facilities. Institutional investors liked the idea of converting elite sports centres into community venues.

Costs

The total cost of raising the bond was approximately £180,000, which included circa £20,000 for lawyers, plus the same again for due diligence. There was a lot of detailed preparation involved which took about six to eight weeks and the production of an investment memorandum for the bond was a significant part of the work.

Fortunately, GLL was awarded £150,000 from the government's investment and contract readiness fund to help cover some of these costs. Triodos promoted the bond for three months (some institutions might need longer because their board cycles are quarterly) and raised all the money - half from retail investors, i.e. staff and members, and half from institutional investors.

How to increase the attractiveness of an unlisted bond

Top Tips from Dan Hird, Triodos Bank

Unlisted bonds can't be traded on a stock exchange and are not covered by the financial services compensation scheme, which can discourage investors. You can make these bonds more attractive by:

- Using a secondary trading platform (like Ethex)
- Having a buy back policy for extreme circumstances like death
- Offering a short bond term of less than 5 years
- Offering high social impact and/or a higher interest rate
- Considering the option of offering equity in the business

2.2 Listed Retail Charity Bond

Key features:

- Listed on a stock exchange
- For registered charities only
- Fixed rate interest led by market
- Unsecured but the social enterprise might be required to have the value of the bond available on the balance sheet for the duration of the bond
- Retail bond issues are usually for 12 years, but can be shorter

Case study: Golden Lane Housing

Nature of business: Supported housing for people with a learning disability

Turnover: £11.5m

Bond offer: £11m, 4.4% interest, 7 years - with option of extension (Allia)

In the late 1990s, when Golden Lane Housing (GLH) was founded as a subsidiary of the learning disability charity Mencap, the housing association would use a local authority grant as deposit for a new property and a bank loan for the full cost of the building.

Today, the social enterprise, which manages 700 properties (500 owned) providing facilities and maintenance services, finds it difficult to get new loans on acceptable terms.

"Banks are focused on loans being secured against properties and a high up front deposit. The bond option was not as attractive as a grant, but was a very effective way of securing capital to further our mission. And, the terms were better than with a loan."

Alastair Graham
CEO,
Golden Lane Housing

Early in 2013, GLH put out a £10m fixed term unlisted bond issue with Triodos, offering a 4% return over five years. It was the first step towards raising £30 million to give 250 people with a learning disability the chance to live independently in specially adapted homes. Being associated with a big name like Mencap attracted a lot of positive media attention, which was useful for bringing in investors.

There could have been a challenge around whether investors would go for a 4% gross fixed interest return, but in the end the strength of GLH's balance sheet and a £74m property portfolio and £35m net assets was attractive.

A new way?

For the next £11m raise, Alastair Graham, CEO of GLH, approached social enterprise support organisation Allia to discuss bond options. Allia had been issuing unlisted bonds for charities since 1999 but always felt that such bonds suffered from a lack of interest and a lack of weight because investors like to see bonds listed on a stock exchange, with a daily changing price and the ability to buy and sell quickly.
Allia believed that unlisted bonds did not offer the same flexibility for the investor, but recognised that the cost of organising such a relatively small bond and listing could be prohibitive. In addition, charities can't legally list on a stock exchange, they need to create a PLC listed subsidiary vehicle to raise the investment.

Allia knew there was a significant demand for listed bonds but it needed the weight of a bigger firm involved to help bring costs down. Working with Canacord Global Investment Bank, Allia created a special purpose PLC listed vehicle so it could do smaller bond issues more cost-effectively. The Retail Charity Bond that was created is a white label type product that offers a fairly standardised approach on behalf of the charity, and means the bond can be listed on the London Stock Exchange.

A sell out

GLH issued its £11m bond using this system in June 2014 and within eight days it was over-subscribed. The terms were just under 4.4% over seven years, which was led by the market. The social enterprise was a solid option for investors because it has large asset base and a strong track record of bringing in income.

What to consider before issuing a bond

Top Tips from Dan Hird, Triodos Bank and Simon Steeden, Bates Wells Braithwaite

- Are you in a position to issue bonds? It will depend on your commercial business model and debt capacity
- Issuing bonds can be intensive work, sometimes taking over six to nine months. Do you have any other options?
- Do you already have a pool of people in your network who might be interested? (this is much more important for unlisted bonds as access to institutional investors will be more limited)
- Are you comfortable with social impact reporting?
- Might investors accept some interest by way of social return?
- You, or those advising you, will need to think about rules regulating financial promotions. Bonds under €5m, generally benefit from less regulation
- If not met for any reason, the obligation can lead to a public restructuring of the outstanding debt at best

2.3 Using bonds to fund SIBs / payment-by-results contracts

In 2012, with a view to eliminating rough sleeping in central London, the Greater London Authority (GLA) set up a three year payment-by-results / Social Impact Bond (SIB) contract.

SIBs are not bonds in the traditional sense. The government sometimes creates SIBs as a way of funding public sector work upfront. It will set social goals for an organisation(s) to meet and open up a SIB to investors to fund the organisation to achieve the social goals. If the goals are met, the government will pay the investors their money back, sometimes with interest.

Half of the £5m GLA contract was offered to homeless charity St Mungo's. Because payment was dependent on how much St Mungo's achieved on the contract, they had to fund their work upfront somehow. The charity calculated that it needed about £900,000 as working capital. St Mungo's put in £250,000 of its own money, which showed investors they were committed, and raised the remainder with a three year unlisted bond via Triodos, which offered 6.5% interest.

3. QUASI EQUITY DEALS

Key features:

- Return paid is related to the performance of the social enterprise
- Investor has no stake in the company, but it may take a seat on the board
- No/ low return paid if the social enterprise does not meet expectations
- The upper limit of the return can be capped
- Flexibility on returns and repayments, as agreed by all parties

Case study: HCT Group

Nature of business: Transport, community transport and training

Turnover: £43.7m

Requirement: £4.5m shared risk capital (Bridges Ventures)

In 2010, HCT Group needed roughly £4.5m of investment to meet its capital requirements for three to five years. CEO Dai Powell was keen to share some of the risk with investors, wanting to offer an equity type arrangement with variable returns related to financial performance. Such an option was virtually non-existent for social enterprises at the time.

In a pioneering move, the social enterprise worked with fund manager Bridges Ventures to create something called a 'social loan' to act as quasi equity for social enterprises.

HCT Group needed to get some legal advice to see if this type of instrument would work for a registered charity, but otherwise, the arrangement was quite straightforward. According to Antony Ross, Partner and Head of Social Sector Funds at Bridges Ventures, it works when the leadership team really believes in growing the social enterprise and is keen to bring in whatever investment is required.

HCT brought in £2m in quasi-equity/ social loan: £1m from Bridges Ventures and the rest from Big Issue Invest and the Futurebuilders Fund. The other £2.5m was a standard fixed-rate loan comprising of investment from Bridges, Rathbones, institutional investors and others.

> *"While the deal wasn't the biggest in social investment terms, it marked a watershed moment by allowing a social enterprise to share more risk and reward with investors. This gives 'proof of concept' that social enterprises can now compete on a more level playing field in the capital markets. With innovative structures like the social loan, we break down the barriers between investors seeking value and investors seeking values."*

Dai Powell
CEO,
HCT Group

The deal meant a place for Ross on the board of HCT Group. From there he was able to support the business and observe its commitment to delivering on impact, as part of the deal.

In such deals Bridges Ventures is looking for a financial return which sits well alongside the social impact. HCT Group has been happy with the arrangement and has so far met its targets. Its first repayment on the debt was paid early in 2015 and the performance-based interest payments have been made in-line with the original forecast.

HCT Group noted that some commissioners can view quasi-equity as debt, even though the social enterprise is not always obliged to pay a return. This may be an issue when tendering for public service work as it makes the social enterprise look like it's in a weaker financial position than it is.

Bridges Ventures believes that this type of finance is a good option for social enterprises, particularly if their business model does not allow the issuing of shares and thus has limited access to risk-shared capital. It is also an alternative to pure loan debt, which often comes with the pre-requisite of security against a property.

In the spring of 2015, HCT Group set out to take on another similar loan, this time with financial returns directly linked to social impact. That is, the more social impact created, the lower financial returns paid to investors. This is still a rare arrangement in the sector.

Case study: Care and Share Associates (CASA)

Nature of business: Social care provider

Turnover: £10.5m

Requirement: Up to £1m shared risk capital (Bridges Ventures)

In 2010, CASA was looking to 'change up a gear' to be fit for purpose, and wanted to work with a partner to bring in social investment to enter new areas and develop the business. It wanted a partner that would work very closely alongside the organisation and help it become stronger. CASA partnered with Bridges Ventures in a six-month long process. It involved someone from Bridges Ventures sitting on the board, significant due diligence and investment pitches. Guy Turnball, MD of CASA noted that he had to "sharpen up, wear a suit, work towards a stronger leadership role and not bring my dog into work any more".

CASA needed patient capital and was offered £1m by Bridges Ventures. It drew down £440k to build CASA into a robust platform and adopt a common brand for its entities. The majority of this was quasi-equity which appeared on the balance sheet as a patient loan with interest linked to CASA's performance.

Since the investment, CASA has experienced significant growth. It is only now that it is seeking further investment to grow into new territories. The remainder of the money from Bridges Ventures is still available, but given that CASA now has a longer and more stable trading history, it has decided to go back out into the market to seek a range of alternative investment offers.

> *"There were fierce internal discussions and it was challenging. Things happened very fast and we had to rethink elements of our business, including our social franchise model.*
>
> *But without Bridges we wouldn't be here, we were half the size and losing money. We are now turning over £10.5m. We did have to give up some control to them, which wasn't easy. But we have a new business plan and want to now keep driving the performance of the enterprise. We've restructured into a single employee-owned entity. Our growth plans include diversifying into more complex care, involving the employment of nurses and taking our unique brand of employee-owned health and social care to new areas."*

Guy Turnball
MD,
CASA

4. TIERED MIXED EQUITY AND DEBT

Key features:

- Often involves more than one type of finance
- Often involves a principal lender that will take on the main risk

Case study: Homes for Good CIC

In 2013, social entrepreneur Susan Aktemel founded social lettings agency Homes for Good CIC, specifically working with social tenants in Glasgow. The city has 183,000 people on housing lists, sometimes waiting 12 years for a home and then having to take any property offered to them without a choice on location. She had accumulated a small buy-to-let portfolio and wanted tenants to have a choice between properties, as well as help with additional support needs.

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In 2014 Aktemel sought an investment partner, which is where LGT came in, creating Homes for Good Investments as a special purpose vehicle (SPV) to invest in 120 properties over three years. The SPV will be managed by the Homes for Good CIC until 2022 and estimates that it will serve 600 – 800 tenants over the lifetime of the investment. Social enterprises are also in the supply chain, offering extra social impact.

> *"The economics of the deal would only really make sense with bank financing as the cost of capital is lower from a bank than from us and we didn't have the full £6m needed for the project ourselves. But, we had to make a big enough commitment to the deal in order to entice a banking partner on board and show them this was something worth investing in."*

Chris Hunter
Investment Manager,
LGT

LGT split the ownership of the SPV between itself, Susan Aktemel and Homes for Good CIC – 40% each for Aktemel and the CIC and 20% for LGT, along with a return on the loan that was offered. The entrepreneur needed to be financially incentivised; this was a long term commitment for her and was going to take a lot of work to deliver on the plan. LGT also wanted the CIC to be a large shareholder and to help lock in some of the social mission through it.

LGT was able to offer a £2m commitment and structured half as equity and half debt, spread over four tranches. With the first tranche, Aktemel had to buy a minimum of ten properties and house social tenants. That would unlock the second tranche and LGT hoped it would sufficiently deliver proof of concept so that they could then bring in bank financing.

LGT felt it was an attractive financial deal when structured in the right way. There were good yields available on properties as prices were very depressed in Glasgow. In this case there was the prospect for capital growth if taking a long-term investment. Charity Bank agreed to offer bank finance, refinancing LGT money a few months after every tranche, so that LGT could keep investing in new properties.

Charity Bank felt that this was an attractive deal because all the heavy lifting had been done. With a clever structure and LGT taking a development risk it allowed the Bank to come in and provide finance at a very competitive rate. Refinancing once all the tenants were in substantially reduces the bank's risk and meant it could therefore offer a competitive rate.

> *"This isn't a typical deal for us. This isn't a charity and it's classified as mixed motive. It's a very exciting deal. I hope they will all make some money because this will attract commercial money into the sector; other banks will want to get involved and this will tackle waiting lists. No one has been tapping into the housing sector like this and we're extremely excited to be able to participate."*

Caspar Mackay
Head of Credit,
Charity Bank

5. DEMOCRATIC FINANCE: CROWD FUNDING AND PUBLIC SHARE ISSUES

Key features:

- Draws in cash from very wide range of people, increasing supporter base
- Can come in the form of loans, equity, grants or a mixture
- Returns can be fixed or variable
- Can be used to raise very small amounts of cash all the way up to £5m

Crowd funding and public share issues are still used fairly infrequently by social enterprises. But they can act as a good way to bring local people on board to invest in the venture. An investment from the public can also act as a catalyst for new money.

For example, at the end of 2014 Newquay Community Orchard, run as a mental health, education and sustainability project, raised £66,000 in 28 days. Using the website crowdfunder.co.uk, the project raised £15,000 from the public and the rest of the money arrived in match funding from trusts, local ventures and companies.

Crowd funding raises tend to be under the £100,000 mark, but can be higher, co-ops also have community share issues which are between the £50,000 - £500,000 mark, but there are a growing number of ways social enterprises can raise bigger finance from the public. Below we look at Energy4All which specifically works with community energy projects, to show the potential in this space.

Case study: Energy4All (E4A)

In 2014, a team running West Solent solar farm project in Hampshire raised £2.5m through crowd funding. After initially receiving £150,000 from investors using the Seed Enterprise Investment Scheme (offering tax breaks to people investing in start-ups) in six weeks it raised the full amount needed for the farm.

The West Solent project was one of six renewable energy projects organised by E4A last year. Four were multi-million pound ventures and two raised seed funding of £150,000 each.

E4A has been facilitating public share issues in the renewable energy space since 2002. It organises community ownership of energy cooperatives, run by local boards and re-invests profits back into the community.

E4A has raised more than £30m share capital from ordinary people, and that's escalating, with £10m raised in 2014 alone. It has supported 16 projects so far and believes that this approach gives social enterprises control of their destiny; they don't have to wait around years for grants, they can raise a share issue from the public right now.

From a legal and financial regulation standpoint, this is a relatively new way to raise finance and the picture is regularly changing. With co-ops and other social enterprise models, the Financial Conduct Authority is concerned about protecting investors who might be entering a risky project and that co-ops / organisations are sufficiently reinvesting back into the community. Bates Wells Braithwaite is working in this area to make it easier and smoother for social enterprises to do such raises.

Energy4All public share issue - the financial details:

- A co-op/ or social enterprise supported by E4A will mostly pay a return of about 5% a year on the original amount invested, but returns are not guaranteed. If the project doesn't do well, there is no obligation to pay a return
- The 'exit' is the capital repaid gradually over the 20 year period, however some people prefer to keep their money in the project permanently
- There's no capital growth of the actual investment. Even if the project makes huge amounts of money, the focus is on paying the investment back with the fixed interest
- Investees can be local or outside of the area and invest anything from £100
- E4A takes a variable fee from the funds raised. Generally this is around 4%, but, for easier projects with captive investors already engaged, it can be much less
- Shares through E4A are transferable through a platform on the E4A website, which means they are not exempt from financial regulation.

Sharing risk and reward: HCT Group and Bridges Ventures designed a new type of deal in which variable returns related to financial performance were offered (quasi equity in the form of a 'social loan') I Photograph: RouteONE

SOCIAL INVESTMENT DEALS TAKING ADVANTAGE OF TAX RELIEFS

There has been some confusion around how social enterprises can benefit from the Community Investment Tax Relief and the more recently developed Social Investment Tax Relief. Here we explore some of the rules around the reliefs and see how social enterprises are using them in practice.

1. COMMUNITY INVESTMENT TAX RELIEF (CITR)

CITR – key points to note

By Dan Hird, Triodos Bank

- Can be used by businesses or individuals
- To qualify, the investment needs to go through an accredited CDFI
- Investors are not protected by any government compensation scheme
- Depositors will generally get interest on their money as well as CITR tax relief which is equivalent to a 25% income or corporation tax refund spread over five years
- The purpose of the loan has got to be sufficiently risky for it to qualify for CITR. It can't just be a safe investment. For example, a loan secured against a freehold property, for example
- There are a variety of other rules around qualifying for the relief. For example, 25% of the CITR money raised by the CDFI must be deployed in the first year in the form of loans to qualifying social enterprises

Designed to support investment in disadvantaged communities, CITR (as is the case with the new Social Investment Tax Relief) can be used to support financing for social enterprises that are seeking a debt loan.

Triodos is one of the social investors that has tried to use the CITR effectively. This is through two organisations - Midlands Together and Bristol Together. Both are Community Interest Companies (CICs) focused on providing construction jobs for young men at risk of re-offending.

The business model works through Midlands Together buying properties in need of refurbishment. The young men then work on them alongside experienced professionals, with the aim of selling the buildings on for a profit. Profits are designed to cover all costs and allow capital left over to be recycled into new properties. The process is then repeated.

The team had prior experience of running Bristol Together and renovating 16 properties. Financial returns had been quite challenging and getting initial investors was difficult even with offering CITR. No bank would look at such a financially risky project.

Triodos decided to use its experience of supporting Bristol Together to try to create a more sustainable version in the Midlands. It looked to raise a five-year bond of £3m million for Midlands Together, split into two parts.

Working together: A crew at Midlands Together work hard to get properties up to scratch for resale

> *"This is cutting edge stuff, all approved by HMRC and the Department for Business, Innovation and Skills. It could really open the doors for new structures that could use CITR. In around a month, we raised the half a million from high net worth individuals who were very socially minded and could afford to lose money. We decided not to promote the offer to the general public as the risk profile was too high."*

Dan Hird
Head of Corporate Finance,
Triodos Bank

Bond structure

'Series A' the first secured part of the bond was for £2.5m with a return of 4% pa. Investors in this would have first charge on assets if the project defaulted.

The 'Series B' bond covered the remaining £0.5m. It was ranked behind the Series A bond and was therefore a much riskier proposition and so to encourage investors Triodos offered interest at 6% pa plus CITR.

Series A money was to be used to acquire the freehold properties, which is not an eligible activity for CITR, whereas the Series B money was to be loaned to social enterprises to enable them to employ young ex-offenders to complete refurbishment works. The Series B part acted as a type of equity in the business, improving the security position of Series A because it ranked behind it (meaning it's the first to lose out on a default).

For this to work, Midlands Together CIC had to achieve accreditation as a Community Development Finance Initiative (CDFI) as these are the only organisations which can offer CITR.

Series A was harder to raise, but Triodos brought in the full amount through institutional investors and more high net worth individuals (HNWs). Triodos believes that it's a really good deal for those in the 45% tax band. Investing in Series B could effectively generate 15.1% gross return when you combine the 6% return with a tax refund.

2. SOCIAL INVESTMENT TAX RELIEF (SITR)

SITR can be used by charities, Community Interest Companies and Community Benefit Societies but not co-ops. With agreement through HMRC, it allows individual social investors to put up to £1m into social organisations and claim back up to 30% of their investments against their tax bill.

SITR in action

Triodos worked with three homelessness charities - P3, YMCA Derbyshire, and The Y Leicester - helping them to secure a £3m contract (called Ambition East Midlands) through DCLG's Fair Chance Fund. The £3m contract was structured as a Social Impact Bond (SIB) and it was designed to support about 300 young homeless people in Derbyshire and Leicestershire to find accommodation, education and employment.Triodos and the charities needed to raise £600,000 of working capital to fund the SIB upfront (SIBs work on a payment-by-results principle) and Triodos decided to use this as an opportunity to test the SITR process.

The three charities involved invested £120,000, i.e. £40,000 each in equity, to demonstrate commitment. Triodos then brought in two institutional social investors who lent £430,000 between them in the form of a three-year loan note with a 7% return, plus a proportion of retained profits available at the end of the SIB. The additional profit share element was an important part of this for Triodos Bank and reflected and rewarded the equity-type risk that these investors were taking in an outcomes-based contract.

The remaining £50,000 was provided by a small group of individuals in the form of unsecured loan notes benefitting from SITR. In accordance with SITR rules, the loan notes issued to SITR investors rank below (last to get profit) the two institutional investors and on a par with the charities' equity investments. Triodos Bank structured the SITR loan notes as an unsecured 7% loan with no profit share meaning that investors get the benefit of SITR.

Triodos Bank also advised on a second Fair Chance Fund deal led by charities P3 and CCP in Gloucestershire. This was a smaller deal with a contract value of £1.5m aiming to support 150 young people. The Bank raised £310,000 through an identical deal structure but the difference this time was that the SITR investment portion (also £50,000 in total) was taken up by a wealth management firm, UBS, on behalf of their clients. This meant SITR got onto a wider radar and the Bank has seen an increasing interest in SITR from independent financial advisors.

UBS invested via the Bristol SITR Fund. Launched by social finance intermediary Resonance at the start of 2015, it is the first fund of its kind. The fund has around £5m to invest in local social enterprises focused on inner city poverty and there is a vision for six to eight such funds in cities across the UK.

SITR rules and regulations:

- Only €344,827 maximum can be raised by a social enterprise in a SITR deal because of a complication with EU State Aid rules. However, the Treasury has committed to go to Europe and get State Aid clearance which could see it rise to €2 million and bring on more deals
- Capital gains on an SITR investment itself are relieved, so there is no tax on any profit made on the investment
- The enterprise doing the raise must have fewer than 500 employees and £15m assets at time of the raise. If the business is bigger than this, it might consider setting up a smaller sister entity, but this needs to be a commercial operation set up to generate a profit/ surplus
- The social enterprise's business activity can't be in excluded low risk sectors such as property development, land, purchasing, financial services or feed in tariffs
- Investment needs to be in new shares or unsecured and subordinated debt
- SITR can be used for equity and debt, but debt needs to look as much like equity as it can and there's a requirement that the debt needs to be ranked at the same level as the lowest ranked equity. Bates Wells Braithwaite is in discussions with the Treasury about this.

SITR – key points to note

By Katy Jones, ClearlySo

- The investment has to be genuine risk capital that's going to be in for a while
- The investment must not give investees any preference on the business if it winds up
- Some see investing through trusts as tax efficient and aren't clear whether SITR offers anything extra. This needs to be discussed on a case by case basis
- A lead investor can't have more than a 30% stake in the business, but playing around with what they actually pay for shares could be an option
- For some investors ClearlySo has found a 5% return combined with the relief is not enough, they look solely at the return, not the relief when negotiating.

THE SOCIAL INVESTMENT MARKET IN 2015 AND BEYOND – VIEW POINTS

CHANGE FOR THE FUTURE

Nick O'Donohoe, CEO of Big Society Capital, looks at the changing face of social investment and explains how BSC is directing its resources and energy in the market

This is a very different market compared to when we started working in it in 2012. There's a lot more funding available. If we include match-funding, we've allocated £359 million of available capital to the market, which is substantially higher than what was available in 2012. The pools of money are bigger. When we started, you couldn't find much more than a single pool of money with more than £10 million of investable capital.

Through us, more than 100 organisations have accessed capital in one way or another. We're expected to get £600 million over five years from dormant bank accounts. To date, from the four high street banks we have about half of that. We've committed £180 million of this, some into loan funds or equity, some invested in to SIBs and some into other types of investment. The money we've invested into Charity Bank, for example, is essential. It would have been difficult for them to attract core/ Tier 1 capital from anyone else.

In our strategy overview in 2014, we looked at what we wanted to provide for the future. To us, it's important to provide finance for social SMEs in situations where there is risk of market failure and it's difficult to access capital, where there is a high loan to value ratio (i.e. those who might need to borrow 100% of the capital they need). We also look to support those social ventures that are unable to offer security on loans.

We want to try to provide small investments, under £200,000, where there is a gap in the market. We've worked with the Big Lottery and Cabinet Office on this, supporting the launch of Access – the Foundation for Social Investment, to enable more investments and grants for smaller social organisations. We also want to see greater flexibility on returns and support those doing things differently to bring new arrangements to the market.

We want to encourage mass participation in social investment through mechanisms like crowd funding and community share issues. So far, we've funded those who have lent to community energy products – we were a cornerstone investor in Threadneedle's ISA eligible fund for community energy, which has been very successful in attracting investment. In addition, we've made a couple of investments into crowd funding platforms and put capital into a community shares underwriting fund.

BSC hopes to see the growth of capital on both sides – on the small raises of £50,000 - £100,000 which are needed to get projects off the ground, but the market also needs big projects to interest traditional investors.

> *"We were set up to build the market rather than be it, and this market only works if we can bring people alongside us who have capital. This involves a significant amount of work and education on the side of potential investors. But, there's a whole range of different potential sources of capital coming through now."*

Nick O'Donohoe
CEO,
Big Society Capital

WHAT NEXT?

Jim Clifford, Director of Impact and Advisory Services, Bates Wells Braithwaite shares his views on how the social investment market is developing

I think social investment is developing its scope so that there are lots of different nuances it can deliver for. We should celebrate this, rather than get scared by some of the rules and regulation evolving around it. I think we have to recognise that social investment is not just about pure fundraising, there's far more than that being created here - it's about growing the profile of social enterprises and these new and evolving deals are about growing the market.

It's interesting to see enterprise models across Europe developing and we're seeing cross border funding and grants, as well as social enterprises migrating their models across members states.

In parallel with this, I also feel there is an opportunity to increase transparency and sell our stories better through the medium of impact measurement which is getting more and more user friendly. Social enterprises should try to give simple and straightforward messages about what they are delivering and for who. The European Commission GECES (Group of experts of the Commission on social entrepreneurship) sub group on social impact standards gives us a great platform for this.

However, this is not about social enterprise being investment ready, but about social enterprise with its aligned funders being impact ready. The finance needs to serve the organisational purpose – social and economic – and not insist that enterprise dances to its tune. Great funders are embracing this way forward, and are supporting great delivery of social outcomes.

"We have so many opportunities for growth. The issue for us, and similar businesses, will be carrying more upfront risk in terms of people capacity to deliver alongside the continued financial assistance from banks, at a percentage that is seen as reasonable to the level of income. One can see the benefits of blending funding sources to meet this need, but it will need to be done in a manner that is proportional and timely to the investment required. Social finance will need change a bit to help make this happen."

Andrew Burnell
CEO,
City Health Care Partnership CIC

FURTHER INFORMATION

allia.org.uk

bakertilly.co.uk

bigissueinvest.com

bigsocietycapital.com

bridgesventures.com

bwbllp.com

charitybank.org

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triodos.co.uk

unity.co.uk

www.beinvestmentready.org.uk

DISCLAIMER

This publication does not provide comprehensive financial and legal advice and we suggest that anyone considering raising finance through one of the mechanisms outlined here seeks appropriate professional advice.

What is E3M?

E3M is an initiative that supports a group of leaders from the largest and most successful UK social enterprises that trade in public service markets. E3M is supported by partners to provide expertise and to share knowledge about the key ingredients for successful social enterprise growth.

E3M aims to be a catalyst for change, in particular developing thought-leadership on key issues for social enterprise growth where there are gaps in current thinking.

The work of E3M focuses on three Ms: Markets, Money and Models. When the interactions between these are right it can make all the difference to the success of a social enterprise. Each of these key elements is underpinned by another M: Measurement.

Many of the E3M activities have a European dimension (the "E" in E3M), in particular the new opportunities emerging at European level for social business. These range from the new EU policies on social enterprise, social investment and social innovation to pan-European trade and exchange of knowledge.

At the heart of E3M is a Social Enterprise Leaders Club with a programme of activities for members and a series of knowledge sharing events open to non-members.

E3M was developed by Social Business International (SBI) and has the support from four Core Partners: Bates Wells Braithwaite, The University of Northampton, Baker Tilly and Charity Bank.

MARKETS MODELS MONEY MEASUREMENT EUROPE

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