Finance meets philanthropy

CHARITABLE BONDS AND SOCIAL IMPACT BONDS ARE AMONG THE SOLUTIONS TO MAINTAINING FUNDS FOR GOOD CAUSES IN AN AGE OF AUSTERITY, AS **GRAHAM BUCK** DISCOVERS.

In what threatens to be a prolonged new age of reduced funding and austerity measures, the ability to harness capital specifically to tackle social problems has become essential. The funding gap can be narrowed by organisations developing financial products to generate cash and also appeal to investors. Those already established will gain a higher profile in the lean years ahead.

CHARITABLE BONDS Among the pioneer organisations to have enjoyed success in this field is Allia. A charitable organisation initially known as Citylife, Allia was set up in 1999 to raise funds for urban projects to tackle unemployment and social disadvantage. This was achieved through the new concept of charitable bonds – a response to the growing interest in combining social investment with philanthropy to raise money for projects that found it difficult to attract funding. Over in the US the Calvert Foundation had begun similar pioneering work four years earlier as a not-for-profit organisation offering community investment notes.

"It was hard persuading people to make charitable donations as unemployment is too often regarded as either the individual's own fault, or a problem that can only be addressed by the state," says Allia's chief operating office, Phil Caroe. "We decided simply to change the nature of the request, to one based on saving rather than giving."

Allia's first offering, the Sheffield Bond, was issued soon after its formation. Carrying zero interest, the bonds nonetheless proved successful in covering costs and generating a surplus that was allocated to local projects as grants. It also established the organisation as a campaigning charity and paved the way for further offerings in Sheffield, the North-East, South Wales and east London.

To date, bonds worth around £16m have been issued on behalf of organisations such as Tomorrow's People, North East Launch Pad, Bromley by Bow Centre and Community Links. Most recently £2.5m was paid for a

social bond by technology group ARM Holdings, which, like Allia itself, has its head office in Cambridge and was keen to fund a local project. This figure was promptly matched by another technology firm based near Cambridge, TTP Group. Other major names to have invested include Nomura Bank, Close Brothers, bakery chain Greggs, Sage, department store Fenwick, Hayes Travel and publisher Trinity Mirror.

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At the same time Allia has become more of a fundraising service provider to other charities. Its remit has broadened to "support any cause that offers people a better future". A greater diversity of charities lining up to raise funds through its charitable bonds include Centrepoint, Papworth Trust and sustainable transport group Sustrans.

"We decided that it might be time to reposition ourselves from being principally a campaigner for city regeneration, hence our recent rebranding," says Allia's chief executive, Tim Jones. Allia dropped its former title of Citylife and took on its new name last December. "Having established a track record of success, we wanted to achieve a bigger social impact by making our charitable bond mechanism available as a fundraising tool to help many more great charities raise more money."

Allia describes the basic premise behind charitable bonds as straightforward: the bonds follow relatively simple banking principles but the proceeds are used for social benefit instead of private profit and the returns are increased as Allia has low operating costs.

For potential investors, the attraction is that cash reserves must be kept somewhere, and the charitable bond provides a highly secure investment vehicle. At the same time it redirects to society funding that would otherwise be appropriated by payments such as corporation tax to the government, bonuses to staff and dividends to shareholders.

Allia's bonds to fund philanthropy are offered on behalf of approved charities, although investors in the bonds can suggest a cause they'd like to support. Both individual and corporate investors select their cause and the rate of return they require from their investment – currently a repayment on maturity of 100%, 105% or 110% after five years, although Allia is testing the possibility of higher rates for sizeable corporate investments. Allia calculates the present value of the repayments due to investors and then lends that amount to an AA-rated social housing provider at a fixed interest rate.

Allia says that the margin, or arbitrage, is equal to what any bank could obtain in the social housing market. By not having the same costs as the bank, Allia can donate the net yield to the investors' chosen charities. The amount that the charity receives depends on the size of the margin and the return chosen by the bondholder.

"It's a plain vanilla low-risk investment, and for the owners of capital it's a way for them to manage cash reserves and deliver their CSR [corporate social responsibility] objectives at the same time," adds Jones. "We lend on the money to five-year investment-grade debt issued by an AA-rated social housing provider, so the bondholders can easily carry out due diligence and satisfy themselves that their investment is secure. They can get a return comparable with what the bank might offer, while the margin benefits their chosen cause instead of their bank."

The organisation is now conducting a due diligence exercise with Grant Thornton, so there is an independent report attesting to its bonds, while a separate report by New Philanthropy Capital will review whether this is an efficient and effective method of philanthropy.

SOCIAL IMPACT BONDS A more recently formed entity is Social Finance, established in 2007 to assist the development of a social investment market in the UK. The organisation's remit is to bring together individuals with expertise in finance, consultancy and the social sector to develop suitable investment propositions and the development of a social investment bank – recently renamed the Big Society Bank. The social investment bank has attracted a number of major names from both the charities sector and the world of private finance.

Among Social Finance's innovations has been the development of social bonds, also known as social impact bonds (SIBs). These provide upfront funding from investors, rather than the government, for prevention and early intervention services directed at some of the toughest social problems. SIBs also have the support of the coalition government's Conservative members at least, although the first SIB run by Social Finance was announced in March 2010 by Jack Straw, the previous justice secretary.

Social Finance describes a SIB as "a form of outcomes-based contract in which public sector commissioners commit to pay for significant improvement in social outcomes – such as a reduction in offending rates, or in the number of people being admitted to hospital – for a defined population". SIBs could also involve a local authority borrowing funds to invest in a social impact programme, such as helping vulnerable teenagers to remain in education, employment or training.

As an innovative way of attracting new investment around such outcomes-based contracts to benefit both individuals and communities, SIBs harness private investment to pay for interventions delivered by service providers with a proven track record. Investors receive returns from the public sector on the basis of improved social outcomes, but risk not recovering their investment if improvements are not achieved.

Social Finance set out the case for SIBs in a report that argued that the bonds offered several advantages over "outcomes-based commissioning", the term used for contracts under which organisations must attain predefined targets before they are paid. It suggested that outcomes-based commissioning was a flawed approach because too few third-sector organisations have sufficient working capital to bear the risk of an outcomes-based payment contract. By contrast, SIBs enable the service provider's costs to be covered by investors upfront.

The organisation's first offering, entitled the One SIB, was launched in September 2010 in the criminal justice sector. The private finance package generated was used to fund "through the gates" voluntary organisation work with 3,000 short-sentence prisoners at Peterborough Prison to break their cycle of reoffending after release.

The £5m raised came from 17 investors, two of them in the US, and will fund rehabilitation work being undertaken by voluntary organisations with the prisoners over the next six years. The organisations will engage with short-term prisoners in jail to improve their education, skills and confidence so they can better integrate into the community. Once they are released, the support will be maintained – unlike the probation service, which does so for longer-term prisoners only.

The aim is for this SIB to be the first in a series. It is estimated that SIBs targeted at the justice sector to support a roll-out of programmes with proven ability to reduce reoffending could deliver cost savings to the taxpayer of up to £900m over a five-year period. Social Finance believes that a £50m bond could fund sufficient rehabilitation work to cut the reoffending rate for short-sentence male prisoners, currently at 60%, by a fifth. The resulting reduction in pressure on prison space would enable four prisons to be closed within five years and cut running costs by £62m.

Across the Atlantic, its sister organisation in Boston is working with the authorities on a Pay For Success bond, and the state of Massachusetts recently put out tenders for the first such offering.

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Social Finance intends to develop similar offerings that address such social issues as children in care, substance addiction and reducing the number of unnecessary hospital admissions. Currently it is working with Essex, Liverpool and Manchester councils on developing SIBs to fund services targeted at vulnerable children and teenagers and their families, to reduce the number that go into care.

Will support from investors be forthcoming? Social Finance's chief executive David Hutchinson, who was formerly head of UK investment banking at Dresdner Kleinwort, reports interest from the private banking networks in response to a growing sense among their clients that they would like to invest in social progress more directly. There have also been approaches by charitable investors from outside the UK.

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For more on Allia and its charitable bond offerings, see www.allia.org.uk
For more on SIBs, see www.socialfinance.org.uk/work/sibs