

A large, multi-lobed hot air balloon with alternating red and orange segments is shown from a low angle, floating against a bright blue sky with scattered white clouds. The basket of the balloon is visible at the bottom, with a person inside. The balloon is positioned on the left side of the frame, with its basket hanging down.

A brief handbook on social investment

Produced by City of London Corporation

September 2012

Important Notice

This handbook is produced by the City of London Corporation, which is responsible for its contents. It is published in accordance with the Financial Services and Markets Act 2000 (Financial Promotion Order) 2005 (2005/1529). It has been approved by Bates, Wells Braithwaite London LLP, a firm of solicitors authorised and regulated by the Financial Services Authority (registered FSA number 466148).

This handbook provides a general overview of social investment and of the nature and shape of the UK social investment market. It is intended to provide contextual information only and is not intended to promote, recommend or endorse any particular investment opportunities. Any organisations or products mentioned are described solely for the purpose of illustration and by way of example.

This handbook is not therefore intended to be an invitation or an inducement to engage in investment activity or to constitute financial advice in respect of social investments.

All investment and commercial activities carry risk and social investments are no exception. As the social investment market is relatively new, the risks which apply to a specific social investment opportunity may be uncertain or difficult to assess.

Any person thinking about making a social investment should conduct due diligence and consider taking appropriate financial and other advice. No person should base any investment decision on the general information about the social investment market contained in this handbook.

Foreword

Now is the time to reinvent the way investment decisions are made. No longer can we consider philanthropy as the only way to create social benefit. We need to encourage a new way of thinking about investment which allows for blended returns, which places consideration of the longer term impact of an investment alongside the considerations of risk and return. Latest research from Boston Consulting Group predicts that, from a social investment market size of £165m in 2010, the demand for social investment will increase to closer to £0.75bn in the next three years. The challenge is to make investors and investees ready and able to provide and receive the types of finance that enables them to deliver lasting benefits to society, whilst offering acceptable financial returns. Developments, including the establishment of Big Society Capital, and investments by Deutsche Bank, HSBC, Cooperative Bank and the City of London Corporation all point to the gradual development of a new and attractive asset class.

The City of London is working to cement its position as a global centre for social investment. Several leading social investors are already based here and innovative social instruments have been created here. The City of London Corporation is supporting projects that will develop the market infrastructure, as well as using a portion of our own funds to encourage a range of projects in economically and socially deprived areas of London. We encourage you to use your professional expertise to help develop, manage and distribute products and services which embed social benefit into the investment decisions of your organisations and of your clients.

**Mark Boleat, Chairman Policy and Resources,
City of London Corporation**

We believe the time for social investment has come. Social investment demonstrates that it is possible, when investing, to do well and to do good at the same time.

Big Society Capital was established as the world's first social investment wholesaler with cross-party political support with the aim of building the social investment market in the UK with up to £600 million in capital from dormant bank accounts and from investment by the big four UK high street banks.

Big Society Capital was launched in April 2012 and is now up and running and making investments including investing in social investment funds and backing institutions that are growing the market. Our objective is to leverage more private finance, investing alongside us into charities, social enterprises and social businesses in the UK.

We very much welcome this handbook produced by the City of London Corporation as a helpful guide for those wanting to understand better the development of social investment in the UK. It should help financial institutions, trusts, foundations and others assess the opportunities and practicalities of engaging with this new and developing market.

The ideas being developed in the UK are being followed around the world. We believe the social investment market has the potential to become a ground-breaking asset class in its own right which will make lasting positive changes to introduce new and innovative ways of addressing social issues in the future.

**Nick O'Donohoe, Chief Executive Officer,
Big Society Capital**

What is social investment?

Social investment is the provision and use of capital with the aim of generating social as well as financial returns. Social investment carries an expectation of repayment of some or all of the finance. It can cover loans, equity, bonds, and is sometimes used alongside other instruments, such as guarantees or underwriting. As with any other investments, where the investee business performs well, returns generated may be principally reinvested in the business, as well as offered to investors.

Investors in social outcomes weigh up the balance between the social and financial returns which they expect from an investment, according to their own priorities. They will often accept lower financial returns in order to generate greater social impact.

What is the vision for its use?

The vision for social investment is two fold: for investors, it is to consider how returns are made and how they are then distributed as part of their routine investment allocation process. For investees, the vision is to adapt the financial tools applied in the mainstream capital markets for social organisations, for them to continue or expand their activities to serve more people. In practice, this could supplement or replace other sources of finance. It enables organisations to forward plan and reduce their dependency on short term financing, such as grants. This is also likely to improve outcomes and efficiency.

Where does it sit in an investment portfolio?

Social investment complements, but is significantly different from, philanthropy, sitting between donations and commercial investments. It could form part of a Socially Responsible Investment allocation (SRI), and is a critical component of a commitment to impact investment.

Main uses of capital by social organisations

Most organisations seek finance to provide working capital, as reserve finance, to scale up, to diversify or pilot new goods and services, or to acquire assets. Delivery of public sector contracts requires considerable up-front working capital. As in the mainstream SME sector, the stage of an organisation's development may determine the purpose and the type of capital sought.

Size of the UK social investment market

Whilst there is significant asset backed lending by mainstream investors into social organisations, the amount of investment offered to generate social returns has been considerably smaller; it is currently estimated at under £200m¹. Of this, the non 'asset backed' capital is estimated at less than £50m², and has been almost exclusively provided to social organisations by social investors rather than mainstream lenders. Likely demand for social investment is estimated to increase to nearer £0.75bn by 2015³.

Social enterprises are thought to contribute at least £24bn⁴ to the UK economy. Research shows that social organisations have greater resilience and higher growth rates than their mainstream counterparts, in spite of a difficult economic environment⁵.

Types of social investors

High net worth individuals, charitable trusts, social and ethical banks, public bodies, development finance institutions, Government and certain financial institutions, such as pension funds and investment houses, have all engaged in social investment to date. Additionally, individuals provide capital for the social sector through placing deposits with social lenders. In general, retail opportunities for social investment will grow in line with the sector's track record, as it is heavily protected by consumer protection regulations. Investor momentum is gaining ground and the European Union is looking to include social investment in its Europe 2020 job creation agenda⁶.

What types of social investment products exist?

Products are increasingly designed with potential investors' key considerations in mind. Some products directly link the impact generated with the returns that are offered to investors (such as social impact bonds). Other products provide fixed or variable rates of return, depending on the organisation's ability to generate revenue through its social mission. As the legal structures of organisations in this sector differ to those in the mainstream, products are often adapted and structured to meet the sector's specific requirements. For example, 'quasi-equity' offers a performance related investment and can be used where there is no ability on the part of the investee to offer share capital.

Investments can be made directly into social enterprises or into intermediary funds for onward investment. Below are some illustrative examples of social investment product developers:



The Allia Retail Charity Bond programme allows charities to raise medium term loans of £3 million or more through the retail bond market. The bonds will be sold through stockbrokers, wealth managers and IFAs. They can be purchased by retail investors, held in an ISA or SIPP and traded on the London Stock Exchange. The coupon and term of the bonds will be specific to each issue.

Allia is also developing a capital-protected social impact bond programme aimed at socially motivated retail investors. www.allia.org.uk



Big Issue Invest Limited (BII) has developed and is developing social investments funds which provide loans, equity and quasi-equity to social enterprises often operating in the poorest UK communities in the fields of education, health and social care, homelessness and job creation. www.bigissueinvest.com



A £15m Results Fund is proposed which will aim to stimulate the creation of social impact bonds aimed at the lives of communities and people most in need. The fund aims to invest in third sector organisations competing for payment-by-results contracts. Returns will be based on delivery of outcomes.

www.bigsocietycapital.com



The FSE Group manages social investment funds which aim to generate positive social and financial returns, some of which operate on a co-investment basis. Their portfolio includes funds with a community energy focus and a focus on early stage funding in viable enterprises which operate with a primary social purpose.

<http://thefsegroup.com>



Resonance is a social investment intermediary which has developed and is developing social investments funds including those with a social property focus: www.resonance.ltd.uk



Disability charity Scope has set up a £20m bond programme to grow services that support disabled people. Scope's sterling bond is listed on the Luxembourg Euro MTF market. The first bonds have been issued and attracted a range of investors including institutional investors with ethical investment portfolios. The proceeds from the first issue will be used to expand income generation activities including Scope's charity shop chain. Investing for Good arranges and distributes the bonds: www.investingforgood.co.uk



Social Impact Bonds attract new investment into delivery of outcomes-based contracts that benefit individuals and communities. Existing and forthcoming social impact bonds operate in areas of criminal justice, rough sleeping, vulnerable children and joblessness. www.socialfinance.org.uk/work/sibs



Symbiotics provide a range of fund management activities for clients including for Oxfam, the non-governmental development organisation, to help further its international impact objectives of poverty relief and women engagement through the use of financial instruments. www.symbioticsgroup.com



Truestone Impact Investment Management is a UK based fund management company which is actively involved in impact investing, seeking to generate financial and social returns to investors from different geographical and sector investments. www.truestoneimpactinvestment.co.uk

Direct investments are also being made into social organisations, including, for example, those early stage or start-up winners of the Big Venture Challenge.

www.bigventurechallenge.com/winners

Internationally, the GAVI Bonds, have been highly successful at raising commercial capital to finance vaccination programmes.

www.iffim.org

Previous social investment deals have included Bridges Social Entrepreneurs Fund, Social Stock Exchange Ltd, Triodos New Horizons Fund, the 'Bristol Together Bond' and HCT Group.

Do tax incentives apply in social investment?

Currently, there are no specific tax reliefs that apply to social investment. Instead, the mainstream venture capital schemes, which in the UK provide significant incentives to investors, are available to the social sector. However, most of these tax relief schemes are largely dependent on equity investments into structures which are wholly shareholder owned. This fits poorly with one of the fundamental principles of social enterprises, in which the majority of the surpluses are reinvested in the organisation and / or to the community, rather than distributed to shareholders.

New fund structures under development seek, as far as possible, to harness the incentives provided by the enterprise investment scheme (EIS) and venture capital trusts. This has led to the creation of EIS structures for community share offers and the development of socially focused venture capital trusts.

The community investment tax relief (CITR) can be applied to debt based lending into disadvantaged communities but is underused and has been cumbersome to manage.

HM Treasury's current review of the fiscal regimes operating in social investment is welcomed as an opportunity to reconsider how best to incentivise investment into this sector.

The tax treatment of a social investment depends on the individual circumstances of each investor and may be subject to change. Any person or organisation considering a social investment should consider taking advice in relation to the tax consequences.

Investment Readiness: building a demand pipeline

The development of a 'pipeline' of investable organisations is a vital aspect of building a marketplace for the sector. Just as in the mainstream, investors seek to identify those organisations with greatest potential for social and financial returns.

Cabinet Office has recently launched a £20m investment readiness programme, comprising of a three year £10m Investment and Contract Readiness Fund (ICRF) to support organisations to become ready to take on investments or bid for larger contracts. This programme is managed by Social Investment Business⁷. www.thesocialinvestmentbusiness.org. The second component of this programme is a £10m Social Incubator Fund, managed by the Big Lottery Fund (http://www.biglotteryfund.org.uk/prog_social_incubator_fund)

Other highly intensive support schemes, such as Impetus Trust, Social Business Trust and CAN Investment, have been supported through venture philanthropy and pro-bono support. The Young Foundation has recently launched the Accelerator programme and UnLtd provides early stage start-up support for social entrepreneurs⁸.

Building a social investment marketplace

Role of the intermediaries in social investment marketplace

Big Society Capital (BSC) was launched in April 2012 with £400m of unclaimed assets and £200m of equity from the Merlin Banks⁹. This wholesale institution is the first of its kind in the world and was established to develop and shape a sustainable social investment market in the UK. BSC's role as a wholesale financier is designed to bring millions more in investment into the social sector than BSC could bring alone. See www.bigsocietycapital.com

BSC invests in a range of **social investment finance intermediaries (SIFIs)**, which are organisations that provide appropriate and affordable finance and support to social sector organisations that are tackling some of our most intractable social problems. Any fund, whether from the mainstream financial services sector or social sector, if it fits these criteria and BSC terms, can receive investment from BSC as a SIFI.

SIFIs provide loan capital through bank and non-bank finance, and / or financial support services. Examples of such SIFIs include ClearlySo, Locality, Resonance, Social Finance¹⁰. Mainstream consultancies, such as Deloitte¹¹ and PwC¹², are actively supporting high potential social entrepreneurs.

Additionally, crowdfunding¹³, debt-refinancing, share trading and product information platforms are operating or are under development to help match capital to social need. Specifically, Shared Impact and Ethex¹⁴ are under development to be ready to service the retail market as it develops. The Big Lottery Fund, NESTA and Social Investment Business have all contributed significant capital to the building of this sector. Many local authorities are offering loan finance to their social providers. Social and ethical banks, such as Charity Bank, Triodos, Ecology Building Society and Unity Trust, have provided the backbone of the sector's balance sheets to date. Additionally, several mainstream banks, including RBS and HSBC have established specific initiatives to support social enterprises. Investment banks such as Deutsche Bank, J.P. Morgan and Goldman Sachs (US) have also engaged in social finance initiatives.

Extending the investor base

Current regulations make it considerably easier to give money away than to lend or invest money for social benefit. The government is reviewing the existing regulatory framework with a view to finding a balance between the need for consumer protection whilst meeting the increasing appetite for investing for social good¹⁵.

Over time, the Cabinet Office envisages the development of retail products, such as Social ISAs, and social investment within Self Invested Personal Pensions (SIPPs), once track record and consumer confidence is established¹⁶.

Public sector commissioning: present spend for future savings

The opportunities for the public sector to commission services on the basis of long term social value provides a potentially fruitful marketplace for social organisations and investors alike. Effective delivery of these services could reduce demand for future government services, thus providing savings out of which to pay investors. Community assets, disability and healthy living are areas that are likely to demand high levels of future financing to meet society's needs. There is a potential role for larger scale institutional investors to engage in social investment in these sectors, as part of a portfolio of assets.

Understanding investors' concerns: liquidity, suitability, and risk mitigation

Social investment product creators are increasingly aware of mainstream investors' requirements when considering a social investment product¹⁷.

Liquidity

Liquidity is critical – more funds are offering opportunities to exit by using mixed assets and by developing trading platforms to build up secondary markets in products.

Risk Management

Risk mitigation is increasingly catered for to attract early stage capital through the use of 'tiered' financing, in which grants or first loss capital underpins an investment (see reference to Big Venture Challenge above).

Track Record

Data on track record of the organisations within this sector is under development and is increasingly available; improved access to data and measurement of social and financial outcomes provides the analytical underpinning on which investors will be able to price risk alongside valuing the social outcomes generated.

Suitability

Suitability of an investment for a client is a fundamental principle of financial advice. The social investment sector is working closely with Independent Financial Advisors and the relevant professional bodies, to provide a methodology to establish how to assess suitability for social investments.

All investment and commercial activities carry risk and investors considering social investment should think about taking appropriate advice in relation to the risks involved.

Building on the UK's expertise in social investment

The UK is recognised as a global leader in social product and infrastructure design. Social impact bonds are now being adapted internationally; the Social Stock Exchange is due to open in 2013; Big Society Capital is a unique institution and a world-first; charity bonds have already raised interest nationally and abroad. To ensure a secure place for the UK in this growing market, we need to harness the renowned expertise and professional skills of the City to help us remain competitive and innovative in product design, distribution, asset management and fund structuring. Your knowledge of the market place and of investors' needs can help us put global sources of capital to good use.

Creating an enabling environment

The UK needs to communicate the power of social investment to support society whilst offering positive and sustainable investment opportunities. It needs to create the culture shift required to blend market mechanisms for social outcomes. The UK tax regimes, legal and regulatory structures need to be both domestically and internationally attractive and competitive to encourage institutional and individual investors in to these opportunities over time. In this way, the UK can make optimal use of opportunities such as the forthcoming EU regulatory framework for social venture funds¹⁸.

The UK needs to be ahead of the curve, anticipating and exceeding the likely demands for fund managers to meet minimum criteria around sustainability and responsibility. Ireland, Luxembourg¹⁹ and Liechtenstein are seeking to use tax regimes and regulatory efficiency to attract prospective responsible investment capital pools – estimated at €200-€400bn - and such jurisdictions are keen to extend their reach further into impact investment.

Your skills for social investment

Your role as champions and adopters of the opportunities to generate both financial and social returns from your investment decisions speaks volumes about your organisations. Whether investing with your own institutional funds, or advising your clients on social investment opportunities, your involvement builds the trends and the track record for the sector. Through your engagement, the culture can move to encompass the vital consideration of the impact of investment decisions, alongside the more familiar assessments of risk and return.

The UK needs to add to the growing number of enterprises that hold their own in the market place whilst delivering social returns. Your skills can help guide this process. You can provide the mentoring skills and the business analysis required to help the sector reach a scale that can transform the social and economic needs of the current generations, whilst building a society that can meet future generations' needs.

London as a global centre for social investment

London combines a creative buzz, a traditional culture, and an expertise in designing and trading financial instruments, all within a convenient time zone and global location. The City of London aims to harness these qualities for social investment, whilst the financial sector re-establishes its credibility as a centre for financial acumen and integrity.

London 2015 Vision

Our vision is for London over the next three years to showcase a flourishing, active international marketplace for social investment, where not only are products designed which are fit for purpose, but where sufficient, appropriate types of capital are gathered, dispersed and recycled efficiently; where individuals or institutions, from the UK or abroad, who are motivated to invest socially, are able and incentivised to do so; and where enterprises can secure the capital they need to compete to deliver goods and services in contracts which reflect the true future value of their social outcomes.



References

- ^{1,2} Lighting the Touch Paper: Boston Consulting Group and Young Foundation 2011, CDFA Annual Survey, 2012 <http://www.bcg.com/documents/file92199.pdf>
- ³ Sizing the Future social investment market, Boston Consulting Group, 2012
- ⁴ Fightback Britain, Social Enterprise UK, 2011 (see ⁵)
- ⁵ Social Enterprise Live, FightbackBritain
http://www.socialenterprise.org.uk/uploads/files/2011/11/fightback_britain1.pdf ;
RBS SE 100: <http://www.socialenterpriselive.com/se100>
<http://www.socialenterpriselive.com/section/se100/management/20110711/vibrant-sector-defies-downturn-powerful-growth>
- ⁶ European Commission Social Business Initiative
http://ec.europa.eu/internal_market/social_business/index_en.htm
- ⁷ See <http://www.beinvestmentready.org.uk/social-ventures/find/> for full list of ICRF approved providers
- ⁸ <http://www.growingsocialventures.org>; <http://www.unltd.org.uk/>
- ⁹ Barclays, HSBC, Lloyds Banking Group, RBS and Santander UK
- ¹⁰ <http://www.clearlyso.com>; <http://locality.org.uk/>; <http://www.resonance.ltd.uk/>;
<http://www.socialfinance.org.uk/>;
- ¹¹ Deloitte Social Pioneers Programme;
http://www.deloitte.com/view/en_GB/uk/about/community-investment/social-innovation/index.htm;
- ¹² PwC Social Impact Initiative: <http://firestation.pwc.co.uk/>
- ¹³ Financing through the aggregation of small amounts of money provided by a large crowd of people, usually via a website with a retail focus.
- ¹⁴ www.sharedimpact.org and www.ethex.org.uk
- ¹⁵ NESTA report: Investing In Civil Society:
<http://www.nesta.org.uk/library/documents/InvestingInCivilSoc.pdf>
- ¹⁶ Cabinet Office Update on Growing the social investment marketplace
http://www.cabinetoffice.gov.uk/sites/default/files/resources/Growing_the_social_investment_market_progress_update_V2.pdf
- ¹⁷ City of London Corporation investor Perspectives into Social Enterprise Financing
<http://www.cityoflondon.gov.uk/business/economic-research-and-information/research-publications/Documents/research-2011/Investor%20Perspectives%20on%20Social%20Enterprise%20Financing.pdf>
http://ec.europa.eu/internal_market/investment/social_investment_funds_en.htm
- ¹⁹ PwC The Third Sphere: <http://www.pwc.lu/en/microfinance/docs/pwc-publ-third-sphere.pdf>

About the City of London Corporation

The City of London Corporation has three roles: we support London's communities by working in partnership with neighboring boroughs on economic regeneration and skills projects. Plus the City of London Corporation's charity City Bridge Trust makes grants of more than £15 million annually to charitable projects across London and we also support education, with three independent schools and three City Academies – plus a primary school and the world-renown Guildhall School of Music and Drama. We also help look after key London heritage and green spaces including Tower Bridge, Museum of London, Barbican Arts Centre, City gardens, Hampstead Heath, Epping Forest, Burnham Beeches, and important 'commons' in south London. And – with its heart in London's Square Mile – we also support and promote the 'City' as a world-leading financial and business hub, with outward and inward business delegations, high-profile civic events, research-driven policies and a long-term approach. See www.cityoflondon.gov.uk for much more on our uniquely diverse role, including the City of London Police, etc.



Author:

Katie Hill

Social Investment Advisor,
City of London Corporation

Contact:

City of London,
PO Box 270,
Guildhall, London,
EC2P 2EJ

Tel:

+44 (0)207 332 3524

Email:

corporateresponsibility@cityoflondon.gov.uk

www.cityoflondon.gov.uk