

Reengineering Social Impact Bonds



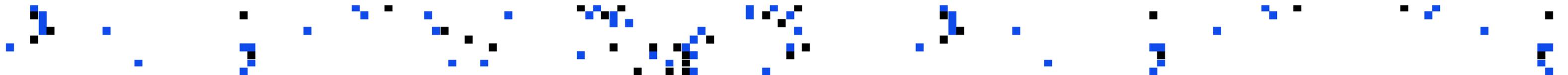
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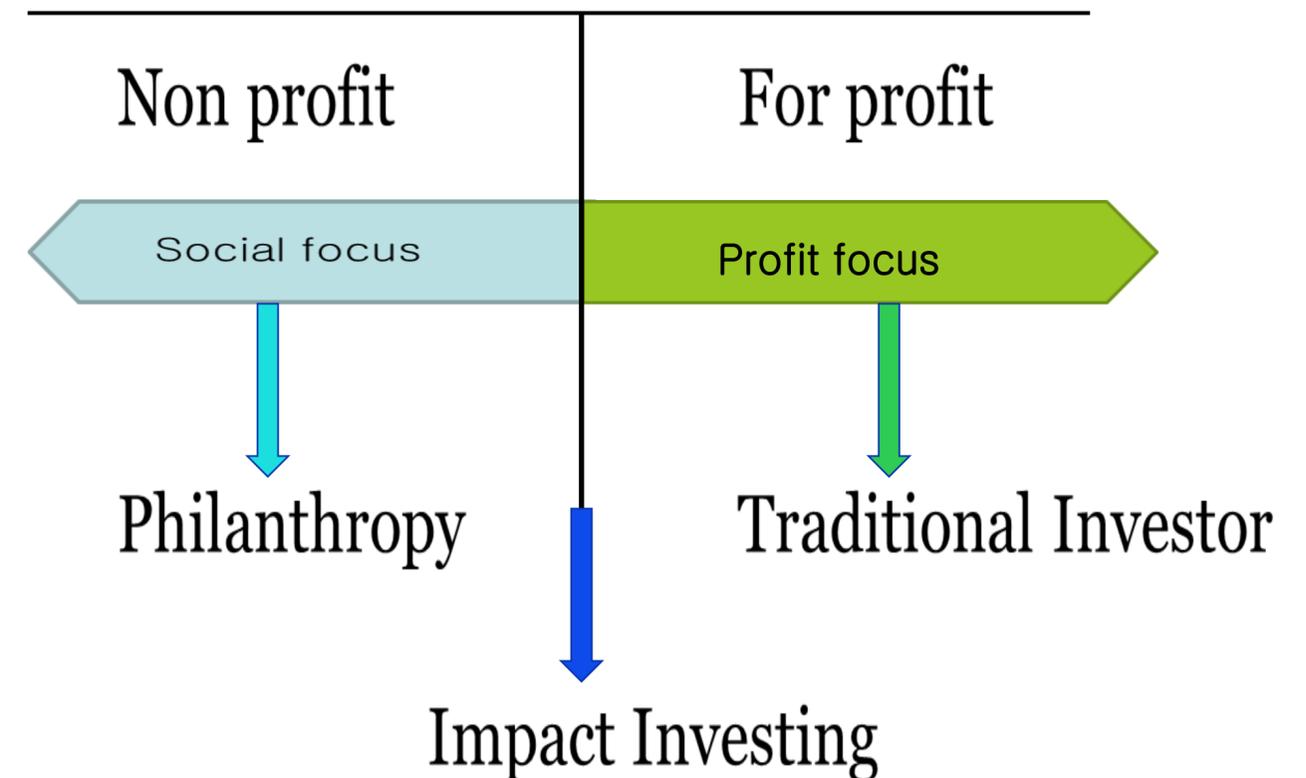
Reengineering Social Impact Bonds

- Working paper with co-author Joanna Nash (UTS Associate).
- A version of this paper was submitted to The Treasury in response to their Social Impact Investing Discussion Paper in February 2017



Impact Investing

- Impact investing recognises that investments can pursue financial returns while also intentionally addressing social and environmental challenges
- These investments can be through for profit and not for profit businesses but they all require two things in common
 - There must be the intention to generate measurable social and/or environmental impact
 - There must be the intention to generate a financial return

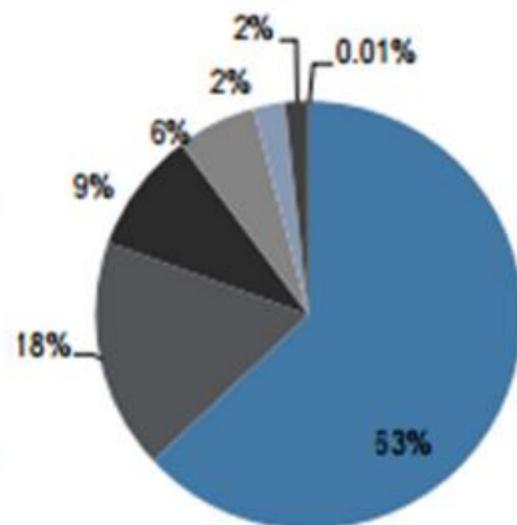


Market Structure

JP Morgan 2015: Eyes on the Horizon: The impact investor survey

Figure 22: Total AUM by investor type
n = 145; AUM-weighted average; Total AUM = USD 60bn

- Fund manager
- Development finance institution
- Diversified financial institution / Bank
- Foundation
- Other
- Pension fund or Insurance company
- Family office



Source: GIIN, J.P. Morgan.

Deployment of Social Impact Investment by Instrument

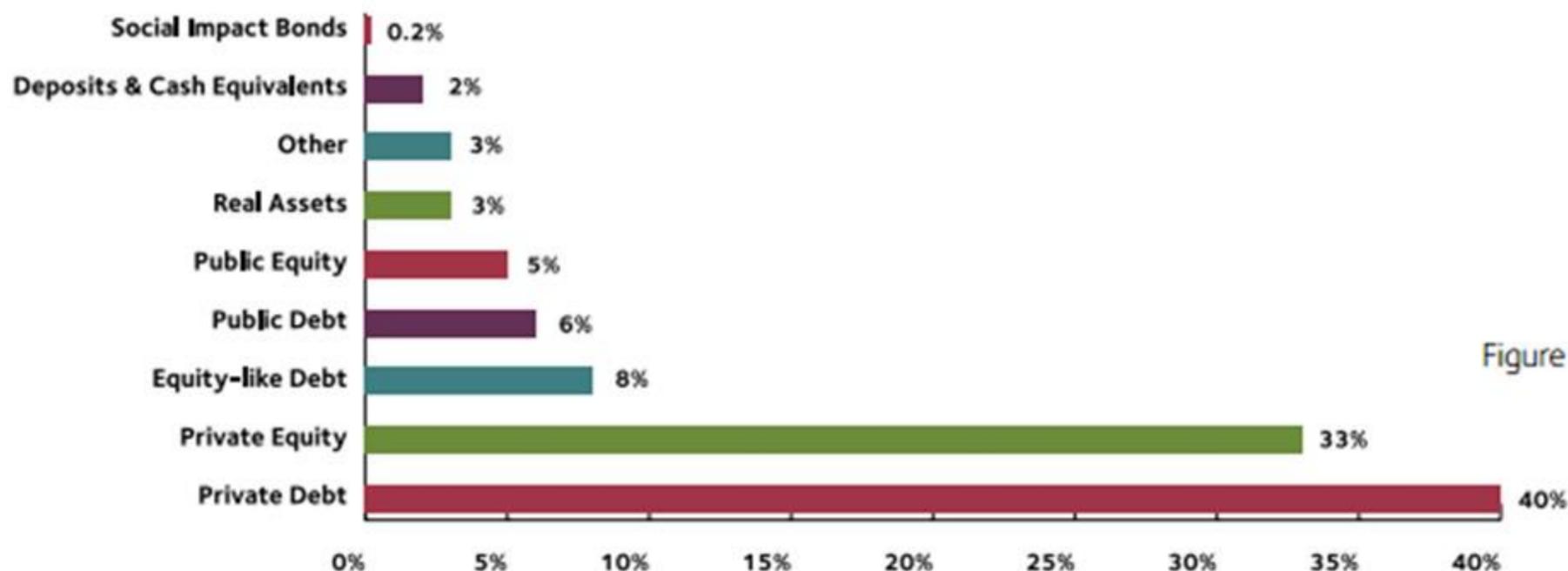


Figure 3

Deployment of Social Impact Investment by Sector

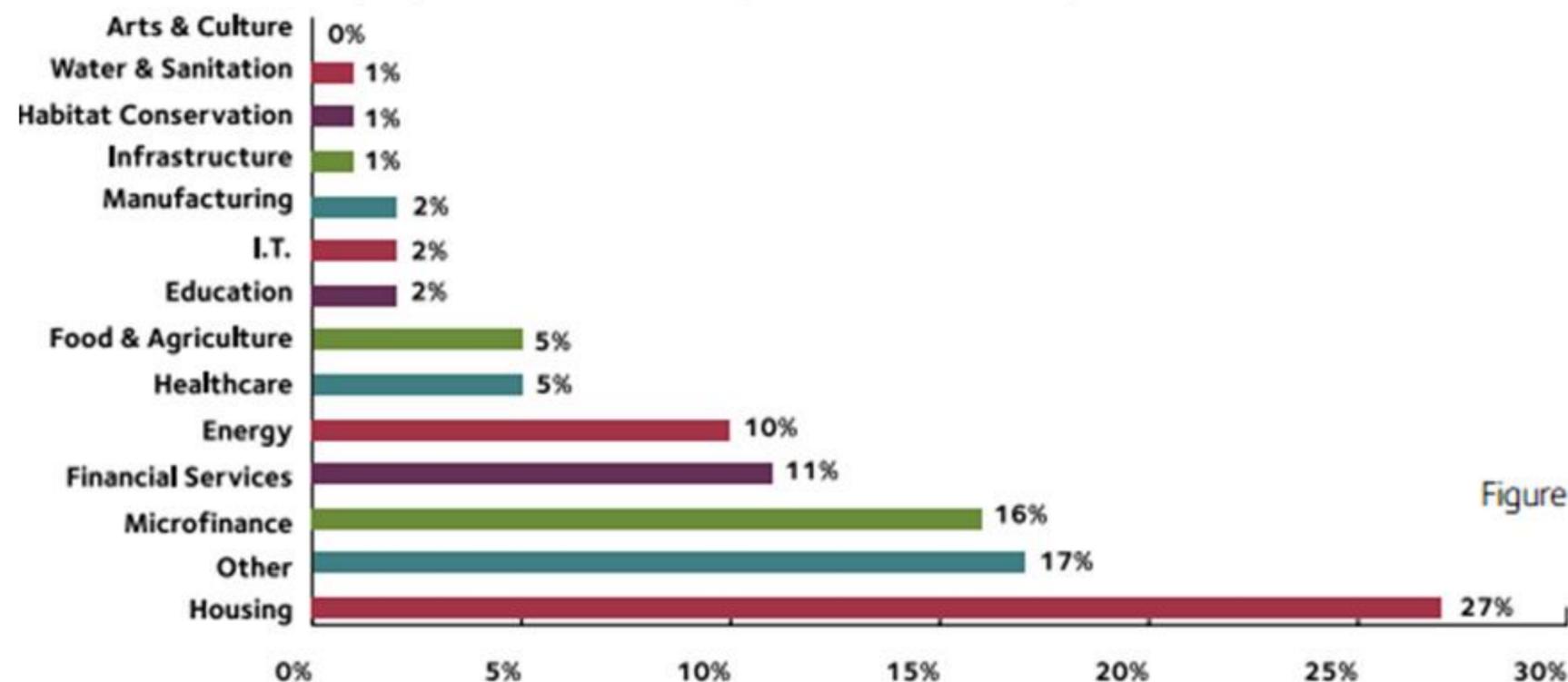
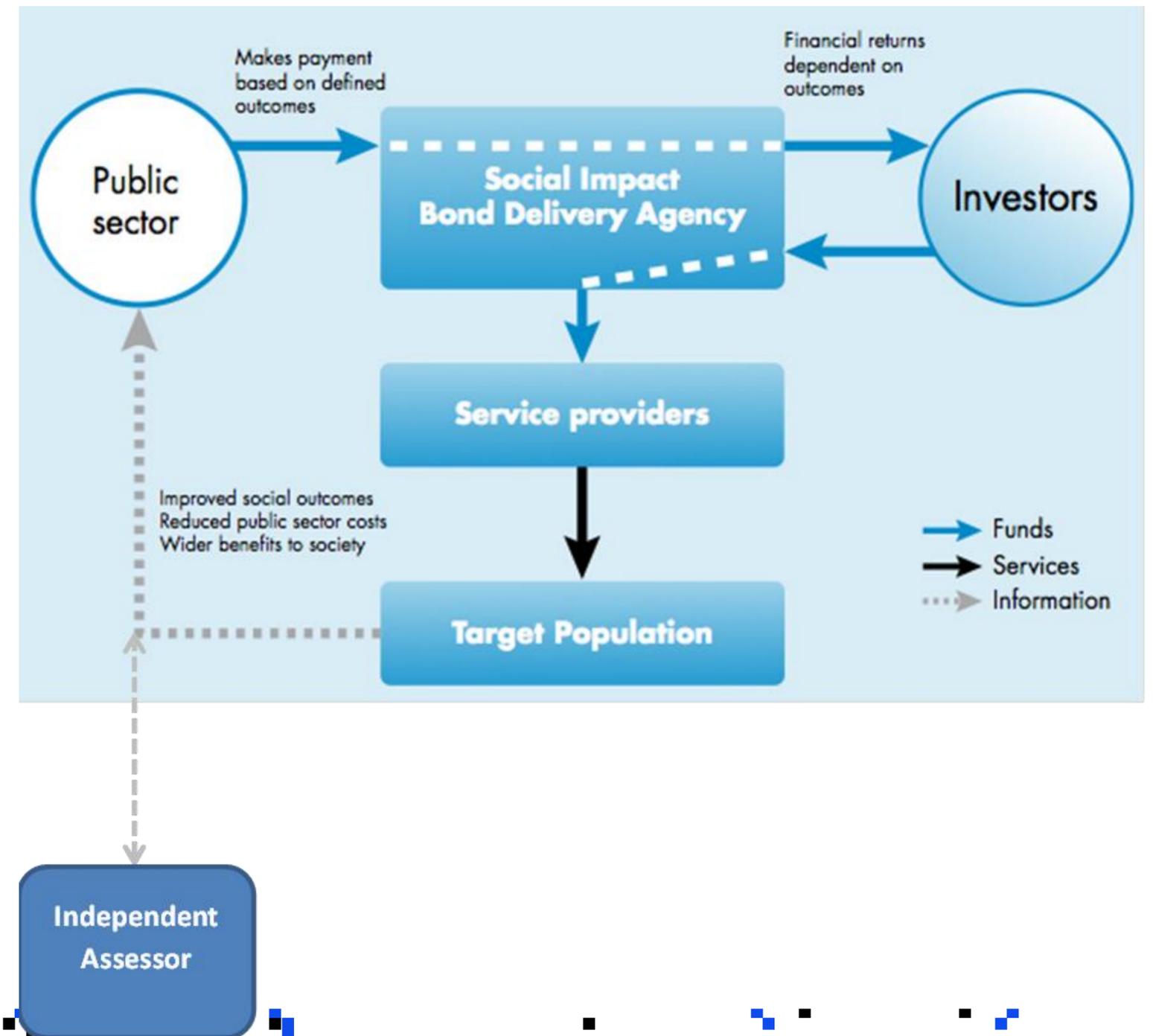


Figure 4

Social Impact Bonds (SIBs)

Like other impact investments initially a need is identified, a service provider has a solution, a government sector or similar who will benefit financially from the solution and investors to provide the funds – an intermediary is usually involved e.g. Social Ventures Australia or Goldman Sachs who arrange the deal between all the parties.

An auditor (or similar independent assessor) measures the success and savings to govt.



Goal to make SIBs a more viable financial instrument

Look at the complexity of impact investments,



Financing side: Charities and other social enterprises often believe these instruments are too complex and avoid them as a funding source.

Often favouring equity and small loans.

Investment side: Issues include risk measurement, liquidity and some uncertainty in Australia around fiduciary duties for Superannuation funds.

Financing side

Usually a charity or similar organisation – unused to financing instruments.

Each project is unique in its structure

Complexity is to some extent in the deal arranged between the parties

Example: Newpin Social Benefit Bond first in Australia

Problem: More than 18,000 children in out-of-home-care in NSW

Program: Work with families to safely return children to their families or prevent them from entering care in the first place – managed by UnitingCare Burnside (Newpin)

Target: Around 700 families of which 55% have at least one child under 5 in out-of-home-care

Govt. Savings: approx. \$95 m over long term – around 50% retained with balance to UnitingCare and investors.



Return to Investors: Variable depending on restoration rate achieved;
 interest rate = 3% + [0.9 x (restoration rate – 55%)]

Results 2016: Restoration rate = (Restorations – Capped Reversals)/(Restorations + Unsuccessful Exits) = (105- 1.5)/(105 + 40) = 65.17%

Return in 2016: Return = 3% +[0.9 x (67.17 – 55)] = 12.153%



Investment side

SIB possible variations:

- First payment may not be for more than one year
- Coupon payment may depend on success or otherwise at each stage of the project
- Coupon payment may have an upper or lower cap
- There may be no coupon payments for the duration of the bond
- There may only be part payment of face value at maturity
- There may be an increase in the size of the face value at maturity
- There may be a government guarantee

Some Corporate bonds are similar e.g. guaranteed bonds, income bonds, zero-coupon bonds and speculative or junk bonds.



Investment side

Ratings of bonds by Moody's, Standard and Poor's etc. based on credit worthiness of the product.

There are also ratings on the complexity of the bond e.g. Australia Ratings provide an indicator of the complexity of a debt security's terms and conditions

Range of risks:

Capital guaranteed; may be at levels e.g. 70%

Yield guarantee; often for a period of time

No guarantee

Type of project – past performance by type or organisation involved



Investment side

Liquidity: two sources – term and secondary market

Secondary market – currently little available with a few attempts;

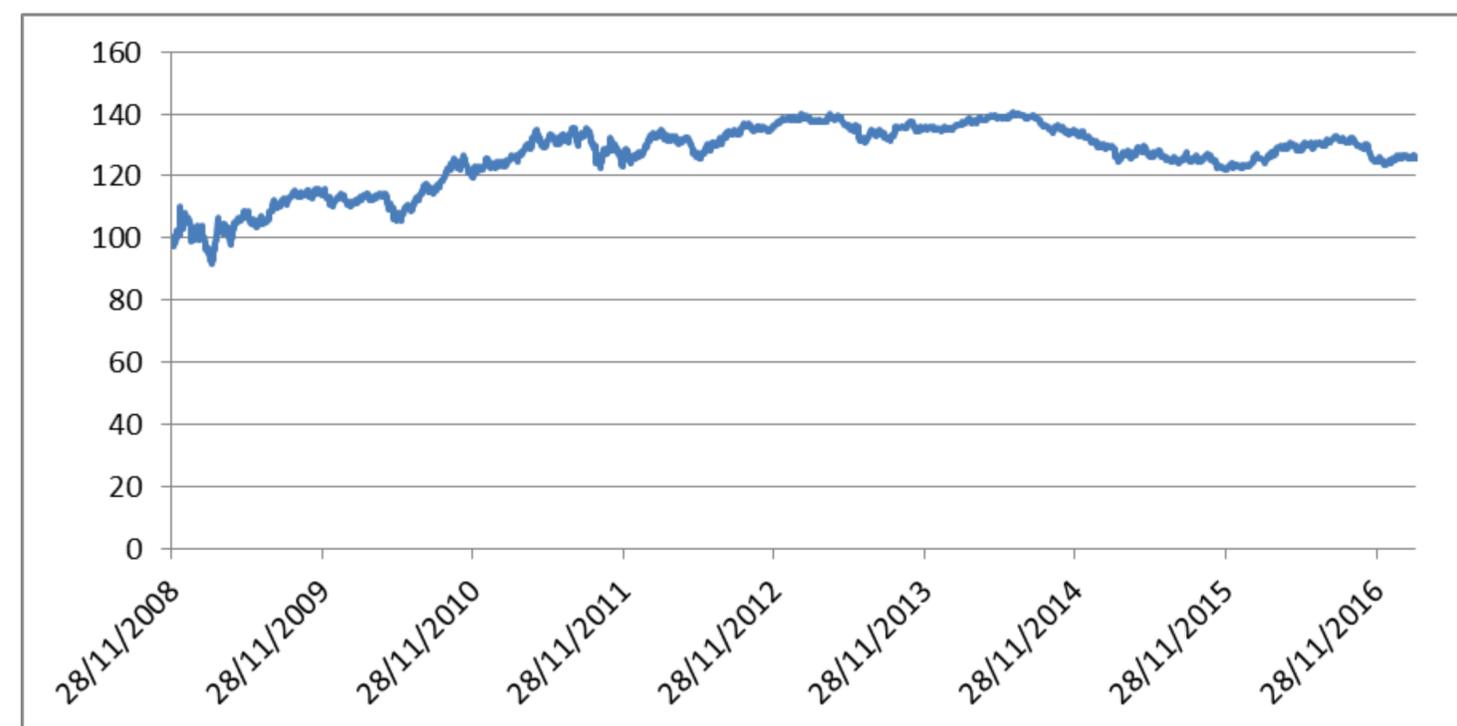
Social Venture Connexion in Canada, Singapore Impact Exchange and Social Stock Exchange in UK;

- SSX launched 2013; First regulated exchange for investments with potential to deliver viable returns and adhere to social and/or environmental mandates and missions.

Green Bonds: listed on dedicated platform on Luxembourg Stock Exchange since 2016 as well as included in Corporate Bond Markets globally

S & P Green Bond Index:

First Green Bond issued in Australia by the Victorian Govt. in 2016 raised \$300m.



Investment side

London Stock Exchange platform: SPV called Retail Charity Bonds plc – idea to provide a simple and transparent structure for charitable organisations to access £10-50 million of unsecured loan finance via the retail bond market at affordable transaction costs.

Name	Issue Date	Maturity Date	Coupon value	Price range Last 5 trades	Total Volume last 5 trades
Greensleeves Homes Trust	15/3/17	30/3/26	4.25%	100.37 – 100.66	52,500
Charities Aid Foundation	4/4/16	12/4/26	5%	111.31-112.75	37,500
Hightown Praetorian & Churches Housing Assoc. Ltd	20/4/15	30/4/25	4%	105.00-107.00	210,800
Golden Lane Housing	15/7/14	29/7/21	4.375%	106.88-108.75	79,100

Investment side

Government Role: 2014 Inquiry into financial system supported law reform to allow better access to wholesale investments by professional investors and for APRA to provide clearer guidance to super fund trustees to invest in impact investments.

Placed emphasis on benefits and savings to Govt. and stated it should play a catalytic role in facilitating this market by providing 'explicit public endorsement' for private sector participants and as a facilitator – remains unclear how far this goes.

Social Impact Investing Discussion Paper 2017 by Commonwealth Treasury call for feedback on Aust. Govt. participation in social impact investment market.

UK: tax incentives for charity bonds and can include in Self Invested Pension Funds which have 45% tax relief. Can also be included in Individual Savings Accounts which are tax free on any interest earned up to a set amount. Their Social Investment Tax Relief allows investors to claim up to 30% of deal costs as a tax deduction.



Conclusion

UK research shows 77% of retail investors prefer social to conventional investment and 35% would accept a reduction in final payout.

JP Morgan predict \$1 trillion impact investment market, this indicates as little as 1% of the capital available could fulfil this requirement.

They found the target financial returns principally sought:

Where to from here?

