benevolent society

Submission to the Senate Economics References Committee on Finance for the not for profit sector

The Benevolent Society
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1 Introduction

The Benevolent Society appreciates the opportunity to make a brief submission to the Economics References Committee's Inquiry into finance in the not for profit sector. We would also be pleased to give evidence at a public hearing to elaborate on the submission, if this would be helpful to the Committee.

1.1 About The Benevolent Society

The Benevolent Society is Australia's first charity. For almost 200 years we have been leaders in identifying the evolving needs of the community and in pioneering vital social reforms and services. The Benevolent Society's goal is to help people overcome barriers preventing them from participating fully in society, and in so doing, to help create caring and inclusive communities and a just society.

Through our support services we meet the specific needs of individuals, especially those who are disadvantaged or vulnerable. We also work with communities, connecting people across gender, age and cultural divides to create a renewed sense of optimism and belonging. We believe everyone in Australia should be able to enjoy a decent quality of life, no matter what their circumstances.

A snapshot of The Benevolent Society

- The Benevolent Society is a secular, not-for-profit organisation. We employ over 800 staff assisted by 700 volunteers who, in 2011, supported more than 31,000 people.
- Our largest areas of work are with children and families, older people, people with mental illnesses, community development, financial literacy and leadership programs. We operate from 55 locations mostly in New South Wales and Queensland.
- Our revenue in 2011 was $75 million. Approximately 85% is spent directly on our services. A further 8% is spent on leadership programs, social initiatives and research.
- We receive financial support from federal, state and local government departments, businesses, community partners, trusts and foundations. In 2011, three quarters of our income came from government sources. Fundraising, trust and foundation grants provided another 4%, client fees generated 9% and our investment income contributed 6%.
- The Benevolent Society is a company limited by guarantee with an independent Board.

The Society has a keen interest in supporting initiatives that will enable not for profits to have better access to capital. The Society was instrumental in the establishment of Social Ventures Australia (SVA) in 2002 along with The Smith Family, WorkVentures and AMP Foundation. Among other goals, SVA is actively seeking to expand the market for social finance in Australia (and has provided a separate submission to the Inquiry).

In 2010 The Society was also a partner, along with Mission Australia, the Brotherhood of St Laurence, and Social Ventures Australia, in the establishment of the Goodstart consortium. The consortium successfully raised $22.5 million in a social bond raising to fund the acquisition of the ABC Learning Centres across the country, now being run by the not-for-profit Goodstart Childcare Ltd organisation.

2 Social Investment Bonds

As mentioned, through its involvement in Goodstart, The Society has experience in successful raising of capital for social purposes through social bonds. The original GoodStart bond offered a 12 per cent coupon to investors over eight years and was effectively a mezzanine debt instrument.

More recently The Benevolent Society has also sought commitments from investors to participate in social bonds to assist in funding of our Apartments for Life (AFL) development. To date, this has been less successful. The AFL issue is closer to corporate bonds and therefore offers a lower coupon.

The Apartments for Life development (proposed for a site owned by the Society in Bondi in Sydney's east) will offer a new concept in retirement living and aged care that enables older people to stay connected to their local community. The project has been developed as a response to the ageing of the population and the widely-accepted need for new models of housing, care and support for older people. As its name suggests, it will offer older people a chance to remain in their own home – in this case an apartment – throughout older age and avoid having to move when their health declines and they require increasing care and support. [1]

The Society's experience is that while there is significant interest in social bonds and the Apartments for Life project itself, the market is in its early stage of development. Our experience is similar to that of Lifehouse which has endeavoured to raise funds in this way for a new cancer centre. It has become apparent that the Goodstart situation had a number of unique features, including investment by government, that are not likely to re-occur and that if a social bond market is to develop greater assistance will be needed.

Secondly, that if we are required to rely on philanthropist funding alone, it is unlikely the social bond market will develop in any meaningful way. .

2.1 Feedback on current social bond issues

Market reaction

The initial research we (and Lifehouse) conducted was positive. We spoke with a number of Private Banks, Financial Planning Groups, Private Ancillary Funds (PAFs) and High Net Worth individuals who all thought social bonds were a good concept. However, although we have

[1] For more information about the Apartments for Life project see www.bensoc.org.au

together spoken to over 500 potential investors, converting initial interest into funding commitments has proved challenging.

Philanthropic investors did not see the bond as a way of increasing their existing commitments. Instead they preferred to just continue making donations and to maximise their investments.

At the same time, return-focused investors struggled to value the social return and therefore worried that the overall return was too low.

Without a new group of investors we are concerned that social bonds will not be viable.

Retail investors

For many charities retail investors might provide a useful source of funds for a social bond raising. However, based on our experience, meaningful commitment by retail investors and their advisers will require the development of a research product. That is, the advisers require a Research Report / Credit rating on a product before it can be placed on the Approved Product Lists for their various planning groups. Our discussions with potential rating agencies suggest that until the market develops further they are hesitant to commit resources to the sector.

Private Ancillary Funds (PAFs)

With over $1.5B in over 500 PAFs in Australia, we thought this would be the perfect investment for this group, as they have to allocate 5% a year to maintain their ATO status. However, most PAFs have trustees and management committees that consider it their fiduciary duty to maximise economic returns from their investments.

Funds managers

Currently, fund managers hold similar attitudes to PAF investment committees. They cannot currently support an investment product that contains elements of both social and financial return.

2.2 A small undeveloped market

From the extensive market feedback we have received during our efforts to market social bonds, it is clear that in the absence of a catalyst, this will remain a small underdeveloped market. In this scenario, the social bond market will be unable to provide meaningful capital towards the construction of social infrastructure.

3 Role of Government

In our opinion, Government support is required to stimulate the market. This could be achieved in a number of ways, with the two most obvious being:

- a government guarantee
- a top up of coupon or beneficial tax treatment.

3.1 Government guarantee

The Federal Government could provide a guarantee of repayment for qualifying social bonds. Unlike financial institutions, charitable organisations would be unable to pay for this guarantee. However, if potential investors could be completely confident of the return of their principal, then we would expect that significant additional demand would be uncovered.

3.2 Increased yield

We expect that the Government would be hesitant to guarantee the credit of a large number of charitable organisations. Accordingly, we believe that a top up of coupon or beneficial tax treatment might be a better answer. The advantage with this structure is that a small top up of coupon – either in cash or via tax credit – could lead to a large increase in social investment. One possible way to do this would be via franking credits which have the benefit of being tax neutral across different tax rates (PAF, super fund, corporate, individual).

3.3 Franking credits (50%) on interest paid

An illustration of how franking credits would work for different categories of investors is at the Appendix. This approach would benefit all types of investors including:

- those who pay nil tax such as retirees using their self-managed super fund and PAFs – in the example given after tax return improves from 6% to 9%.
- self-managed super funds in pre-retirement (15% tax rate) – after tax return increases from 5.1% to 7.7%
- corporates (30% tax rate) – after tax return improves from 4.2% to 6.3%
- individuals on a high marginal tax rate (46.5%) – after tax return improves from 3.2% to 4.8%.

We consider that this approach would attract investors for 'right reasons' – as opposed to the old film funds and Infrastructure Bonds which were only useful for individuals on high tax rate who just wanted their tax refund.

The advantage of the franking credit is that it is an established form of tax relief and would be seen to have the ATO stamp of approval.

We would recommend that franking credits be limited to bond issues for funding of capital infrastructure for social purposes (for example, for buildings and equipment for health services, aged care, services for people with disabilities, accommodation for homeless people) but not for recurrent operations.

Impact on Government of offering a franking credit

The most logical investors are self-managed super funds (SMSFs). For the purposes of illustration, we could assume that 1% of SMSF funds ($400b) were invested in bonds attracting a franking credit, raising $4 billion. Of this 1/3rd would be in retiree accounts and 2/3rds in non retiree (i.e. paying 15% tax on interest)

Funds raised through SMSFs (1% of total)	$4b
Total Interest paid @ 6%	$240m
Current tax paid on non retiree portion	$24m
Franking credit applies – tax refunded	$96m
Potential opportunity cost to Govt	$120m

In relation to PAFs, if we assume that 5% of the $1.5b currently invested in PAFs is invested in social bonds, this would raise a further $75m

Funds raised through PAFs (5% of total)	$75m
Total Interest paid @ 6%	$4.5m
Franking credit refund	$2.25m

In total this would mean that almost $4.1b was available for the development of much-needed social infrastructure, bringing in addition a large multiplier impact on the economy from such projects and from on-going employment. The cost to Government would be $122m pa for 5 yrs.

Total raised	$4.1b
Opportunity cost to Govt in offering franking credit on interest	$122m pa for 5 yrs

4 Conclusion

The Benevolent Society believes that social investment bonds have the potential to become an important source of funding for important and much needed social infrastructure, but only if they attract some government support. Otherwise, the market will remain small and undeveloped.

APPENDIX A:

Social bonds - Improved return using franking credits

FV	100
Coupon rate	6%
Coupon payment	6
Franking credit (50%)	3.00

	A	B	C	D
Investor type	Retirees' Super Funds PAFs	Super Funds - pre retirement	Corporates	Individual on Top Marginal Rate & Medicare

With franking credits				
Individual tax rate	0.0%	15.0%	30.0%	46.5%
Coupon received	6.0	6.0	6.0	6.0
Franking credit	3.0	3.0	3.0	3.0
Grossed up income	9.0	9.0	9.0	9.0
Tax assessed	0.0	1.4	2.7	4.2
Less: Imputation tax offset	(3.0)	(3.0)	(3.0)	(3.0)
Tax payable / (refund)	(3.0)	(1.7)	(0.3)	1.2
Net income after tax (cash coupon - cash tax)	**9.0**	**7.7**	**6.3**	**4.8**

Without franking credit				
Individual tax rate + Medicare levy	0.0%	15.0%	30.0%	46.5%
Assessable income	6.0	6.0	6.0	6.0
Tax payable	0.0	0.9	1.8	2.8
Net income after tax	**6.0**	**5.1**	**4.2**	**3.2**