Submission to Productivity Commission Draft Research Report, October 2009

'Contribution of the Not-for-Profit Sector'

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CONTENTS

1. EXECUTIVE SUMMARY

Community Sector Banking (CSB) welcomes the opportunity to make a submission to the Productivity Commission on the Draft Research Report on the 'Contribution of the Not-for-Profit Sector'.

CSB is a joint venture between Bendigo and Adelaide Bank and Community 21, a company owned by twenty not-for-profit organisations (refer www.csbanking.com.au).

CSB was formed to enhance the capacity and capability of the sector, and to increase its social outcomes through the management and creation of new streams of financial capital.

CSB manages deposits and facilitates the provision of loan facilities to the sector. CSB also provides ancillary financial services and builds financial solutions that demonstrate how existing capital may be leveraged to maximise the total available capital to the sector.

As such this submission concentrates on Section 7 of the Draft Research Report*, Not-for-Profit Funding*.

2. SCOPE OF THE SUBMISSION

CSB has worked extensively with various members of the sector to bring together the understanding of the sector and its demand for capital with the understanding of organisational risk management requirements.

It is with this understanding and the recognition that the NFP sector requires a "cocktail" of capital solutions which will impact positively on society, that CSB has focussed on the development of innovative solutions that deliver increased financial capital for the NFP sector.

Importantly while the sector has relied on Government contract income, service fee income and philanthropic support, its ability to maximise positive social impact rests on how it is able to leverage existing capital and this in turn will require mobilisation of credit and equity markets.

There is however, a degree of market failure (the inability of the markets to respond or meet the demand of the sector) and this is partly a function of the organisation's appetite and understanding of risk and access to risk management tools.

For the sector to achieve its aim of improved social outcomes, it is clear that co-contribution by the private sector, through social investment and philanthopy, will be vital if the sector is to maximise the use of Government contributions.

How different streams of financial capital work together is also a key factor in maximising the level of capital into the sector and the contribution of Government.

The solutions CSB has been developing are designed to meet the requirements of its respective stakeholders.The ability of these solutions to be implemented rests on the collaborative responses from all stakeholders.

This submission makes recommendations that seek to;

- Incentivise integrated stakeholder and market response;
- Further develop the Community Development Finance Markets;
- Provide a framework to channel Government, Institutional and retail investment funds;
- Provide a framework to underpin the sustainability of income streams into the sector;
- Provide a framework to increase the outcomes from leveraging existing capital and mobilising new streams of capital.

3. COMMENTS ON DRAFT RECOMMENDATIONS

Draft Recommendation 7.2

Broadening Gift Fund Deductability

CSB is supportive of broadening DGR status and Tax deductability with an emphasis on rural and regional not-for-profit organisations and organisations that are engaged in social benefit activities which facilitate improved social outcomes through “mission related investing”. (CSB understands the taxation complexities for NFPs and supports the Commissions recommendation in the Report at 7.1 to explore a single national application process for tax status endorsement)

Draft Recommendation 7.3

Encourage Cost Effective Giving

CSB is supportive of this recommendation to explore options in promoting and supporting planned giving from individuals, small business and the corporate market. In particular, strategies that encourage certainty and continuance of contributions and an ability to leverage contributions are highly recommended.

Draft Recommendation 7.4

Working Party on Access to Capital

CSB endorses the establishment of a joint working party and would welcome the opportunity to participate. In addition, strategies and/or products that promote and enable philanthropic and Government contributions to support risk mitigation requirements of financial Institutions and capital markets are highly recommended.

Support for CDFI and related Community Development Fund structures are an integral part of this recommendation.

4. NFP ACCESS TO CAPITAL AND THE DEBT MARKETS – (OUR EXPERIENCE TO DATE)

Our submission is structured around Section 7 of the Draft Research Report and provides examples of how such recommendations may be applied to improve access to capital and the sustainability of the NFP sector**.**

Institutional lending in the sector has been bound by more stringent credit practice than many small enterprise and/or corporates of the same size.

This in part is driven by credit providers not wanting, under any circumstances, to take action against a NFP which could have broader impacts on the organisation's constituents and/or on the brand risk of the financial institution.

Conversley, many NFP Boards are also reluctant to leverage off their balance sheet and take on debt - which in the event of default could have significant impacts on their customers and on themselves. In particular this reluntance may not be driven by the potential recourse as a Director but rather on a reputational and community impact basis.

For this reason, the approach is not what is our second and third way out, it is that we need to ensure that it is near impossible for the NFP to fail.

At the same time there are increased demands on the NFP to diversify income streams, commercialise operations and take on debt when in fact its own understanding of risk and risk mitigation is clearly lacking.

From a financial institution perspective the NFP will be required to demonstrate sustainable income streams, asset backing, appropriate performance and/or business risk management capability and experience. Whist this is not too different from generic business lending criteria it would be normal that an institution seeks Directors Guarantees from small business and this is clearly inappropriate and generally not available to a NFP organisation.

An inhibitor to accessing finance has also been the surity of income streams. Government contracts are generally too short, and the ability to assign Government income streams requires the endorsement of Government and this is not always forthcoming.

It would also seem that the Government's existing capital contributions may have greater impact through incentivising and supporting NFP's that have the potential to leverage to do so.

Most finance is related to capital expenditure and or asset acquisition, while working capital and lines of credit are generally linked to secured income streams.

Given the risk averse nature of organisations, and the sector itself, there is clear market failure and a tendancy to over engineer the credit process such that there is a gap between the credit profile of the NFP and the credit requirement of the institution.

That is not to say, that the credit requirements are inappropriate and a mechanism is not needed to be built that "plugs the gap" between these risk profiles in order to maximise the use of existing capital and access to increased capital.

This gap may be plugged through the access to a broader range of capital, much like an SME or corporate which raises equity to plug the gap between institution credit risk and the total capital required of the business.

From the NFP perspective this broader range of capital may be achieved through:

- Community assets transferred to the NFP;
- Transfer of existing State Government activities and income streams e.g. Department of Housing stock;
- Philanthropy and donations;
- Government co-contributions, contracts and surity of income streams;
- Quasi equity solutions, Notes and subordinated debt structures.

Slides 1 and 2 (refer annexure) of this document provides a diagrametic view of these structures as it relates to affordable housing and economic stimulus for employment and social enterprise opportunities.

Slide 4 provides a review of "Kids Super" which is a life long savings program with funds vested in the child. Kids Super proposes an initial Government contribution for each new born child and encourages co-contributions from families. A proportion of the accumulated funds would be allocated to Community Social Infrastructure and Sustainability Funds. While investment strategies would be governed by appropriate trustee requirements, the funds would be invested in societal development as identfied by such research as the Intergenerational Report and the Productivity Commission's report on an ageing population, thus providing another source of social financial capital. Initial estimates are that risk and yield protection can be achieved over the long term.

These models are based on the fundamental of managing each stakeholders respective objectives and risk management issues and may be adapted to other social infrastructure assets such as childcare, agedcare and disability housing for example.

In particular, these models focus on leveraging Government contribution and social asset backing where the fundamental objective is driven by maximising the use of this capital through incentivising and mobilising credit and equity markets.

Based on our experience in this market, CSB believes that consideration should be given as to how the Government supports the development of financial structures and CDFI's that bring together an integrated capital approach to mobilising credit and equity markets.

5. PHILANTHROPY, COST EFFECTIVE GIVING, BEQUETHS AND BROADENING GIFT FUND DEDUCTABILITY

Stimulating philanthopic support is a key component of accessing capital and ability to effectively leverage capital.

Strategies designed to build increased awareness and measurability of the impact of social capital on the economy will encourage greater philanthropic and social investment participation from individuals, business and equity markets as multiple streams of value are evidenced for the participants.

In addition, increased awareness will build greater alignment and understanding of the interests between the NFP, the corporate and the individual.

Strategies that encourage sustainable strategic corporate social investment may also encourage greater payroll giving.

To build sustainability in corporate gifting the launguage needs to move from a "gifting" language to a "social investing" language where the activities of the NFP deliver measurable benefit to the corporate e.g. Health Insurance companies supporting NFP's focused on impoved "well being" solutions deliver a long term risk mitigation benefit.

Increasing philanthriopic support and leverage will enable increased outcomes and a more efficient use of Governement contributions.

The growth in PPFs and PAFs has been significant and the resultant increase in contributions to NFP's with DGR status has a clear positive impact.

However, whilst changes have been made to mandate a percentage of corpus distributed as grants, the real potential exists in incentivising outcomes based social investment of its corpus. This would create another level of capital, "patient capital," which may be used as part of the broader cocktail of capital solutions.

There is however a perceived or actual conflict between protection of risk and yield as governed by the respective Trust Deeds and that of meeting the broader objective of the Foundations.

On other opportunities, it is also noted that investing in the local social economic solutions appears to not only make sound economic sense but by its nature has a flow on mutliplier economic benefit that improves the local GDP. As such local investors in community development have multiple levels of return.

The issue is that there is not a clear pathway for such investments to occur, either directly or through superannuation.

CSB is of the view that strategies which increase awareness and build evidence of the multiple streams of economic, cultural, social and sustainability value from investing in social assets should be encouraged.

Further, that consideration should also be given to incentivise PAF/PPF's to invest corpus in social outcomes such as CDFI's, Community Social Infrastructure Funds, Community Social Enterpise Funds and should also be encouraged to broaden the Trust Deeds to consider not only risk and yield protection but to balance the investment criteria with social impact of that investment.

Bequeths and Equity Release Products

An untapped co-contribution market also exists on the back of Australia's largely unleveraged owner occupied asset backing.

The very high level of owner-occupied housing amongst retirees provides an opportunity for the Government to facilitate liquidity mechanisms (such as equity release) to enable retirees to voluntarily access the surplus wealth in their homes to augment their retirement incomes in order to have a dignified retirement.

Models such as the "*Homesafe*" Equity release product, which we also refer to below with respect to home care solutions, provides a mechanism for individuals to control gifting in their own lifetime by bringing forward contributions that would usually be left as a bequeath in the hands of the estate.

The product itself, while demonstrating a range of social and investor benefits, relies on volume and liquidity to manage risk and return for the investors. This in turn relies on increased investment.

The ability of new initiatives and products, or asset classes, of this nature to break through and build investor confidence is a factor of developing appropriate Government and social asset support mechanisms and/or direct investment of Government.

CSB recommends that consideration should be given as to how the Government can incentivise investor behaviour into products that have compelling social benefit.

6. GOVERNMENT CO-CONTRIBUTIONS, CONTRACTS AND SURETY OF INCOME STREAMS

Debt and equity markets rely on sustainable and security of income streams.

Whilst not in all cases, the current Government contract framework with short term one year review contracts places difficulty on NFPs to appropriately plan for the future.

In addition, philanthropic contributions also remain largely ad-hoc and at the yearly discretion of the respective Trust or donor.

CSB is supportive of the Draft Recommendation 11.1. It is recommended that consideration should also be given to NFP funding

agreements having the capability to be assigned. Philanthropic markets should also be encouraged to commit to longer term support.

7. QUASI EQUITY SOLUTIONS

Most NFP's will be formed under an association or limited by guarantee structure.

The ability to raise equity in the normal corporate sense is limited by the inability of the NFP to pay a dividend to an investor.

However, structures may be developed that provide certain NFP's, in particular those with asset backing or larger NFP's with secure income streams, the opportunity to issue or access quasi equity products underpinned by the asset backing and or income streams of that respective asset.

Quasi equity products are investment instruments that operate like subordinated or performance based loans. They are generally coupon based and demonstrate longer term returns than standard debt products.

Slide 3 (confidential) demonstrates an Affordable Housing model where the NFP issues different class notes. A and B class notes represent pure debt related products while C class notes reflect a longer term investment strategy.

In some cases, models that split property assets and managed assets also provide a framework where investment can be received in the property asset owning vehicle, perhaps a Trust, with the actual services being managed by the activities of NFP which in turn pays rent. This mechanism, provides a more normalised investment framework as the investor is supported by income yield from rental and then capital growth.

Critically the enhancement of income, asset backing and access to philanthropic support is seen as a requirement to maximise the leverage opportunity for the NFP and maximising the access to capital.

The National Rental Affordability Scheme (NRAS), as outlined in Annexure 3, demonstrates how economic stimulus of this nature closes the gap between the yield demonstrated by the asset and that required by the market to attract debt and equity.

Bringing together different classes of capital contributions while in part designed to manage risk and yield in the institutional debt and equity markets, provides the Government maximum outcome for capital employed.

It is also considered that Government support does not need to be a direct risk mitigation tool but rather an income enhancement tool that the NFP can utilise in a manner that supports debt and quasi equity.

As mentioned above, the *Homesafe* equity release product could provide a framework where capital is released to support the delivery of home care services. In order to do this, however, there is a need to further develop the investment market and to provide a framework where it could underpin the liquidity in the market and enhance the capacity of the NFP sector to access capital. This could be achieved through

- The existing Government contribution to home care, $1.7billion could be better leveraged to provide a framework where home care participants could release asset backing to finance home care and underpin the capability of the NFP service provider to access capital.

- Alternatively, the Government could also invest directly in the equity release product and bring liquidity to the market. In this manner existing contribution move from a grant to an investment and potential to develop a revolving fund strategy.

Importantly, these strategies are not about the Government taking on unacceptable risks, it is designed to utilise Government contributions to build society in a manner that maximises and stimulates co-contributions.

CSB recommends that support is required to develop capital solutions that stimulate positive market responses that leverage Government and Philanthropic contributions.

CSB's and other CDFI's ability to bring forward and implement, what are largely models to broaden social financial capital for the sector, rests on collaborative support from respective stakeholders and as an emerging market all CDFIs would welcome any Government support to accelerate and broaden their activities.

8. SUMMARY

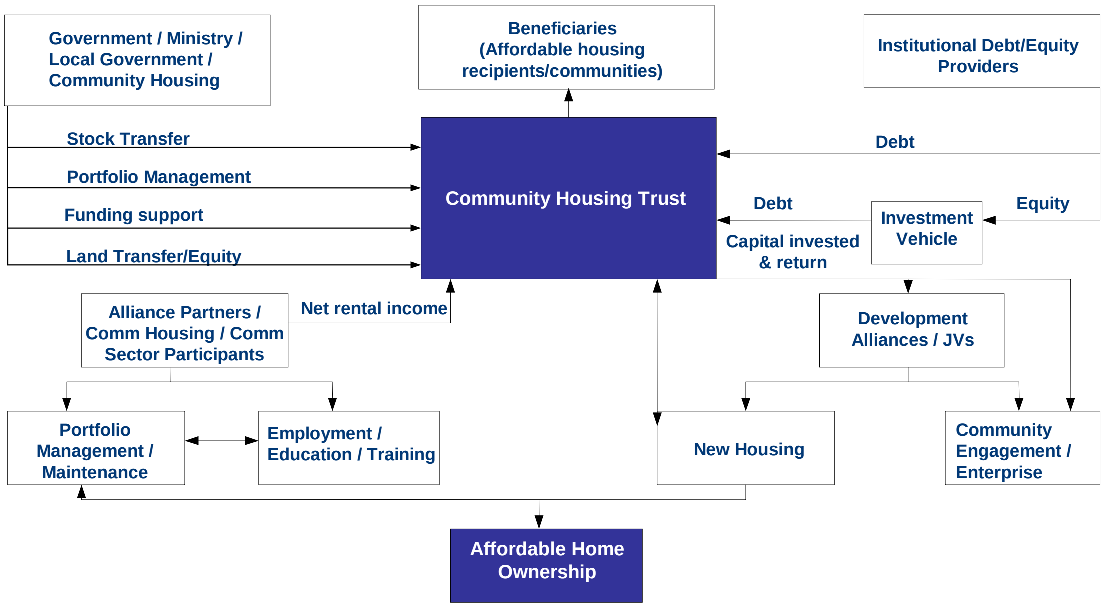
CSB is a business that has been built in partnership with the NFP and private sectors. This business has been designed to enhance the capacity and capability of the sector, by increasing and improving social impact and community development. It does this by managing existing financial capital and through the development of new streams of financial capital.

CSB's focus has been on the development of models which seek to maximise the use of Government support to promote co-contributions from philanthropy and debt and equity markets.

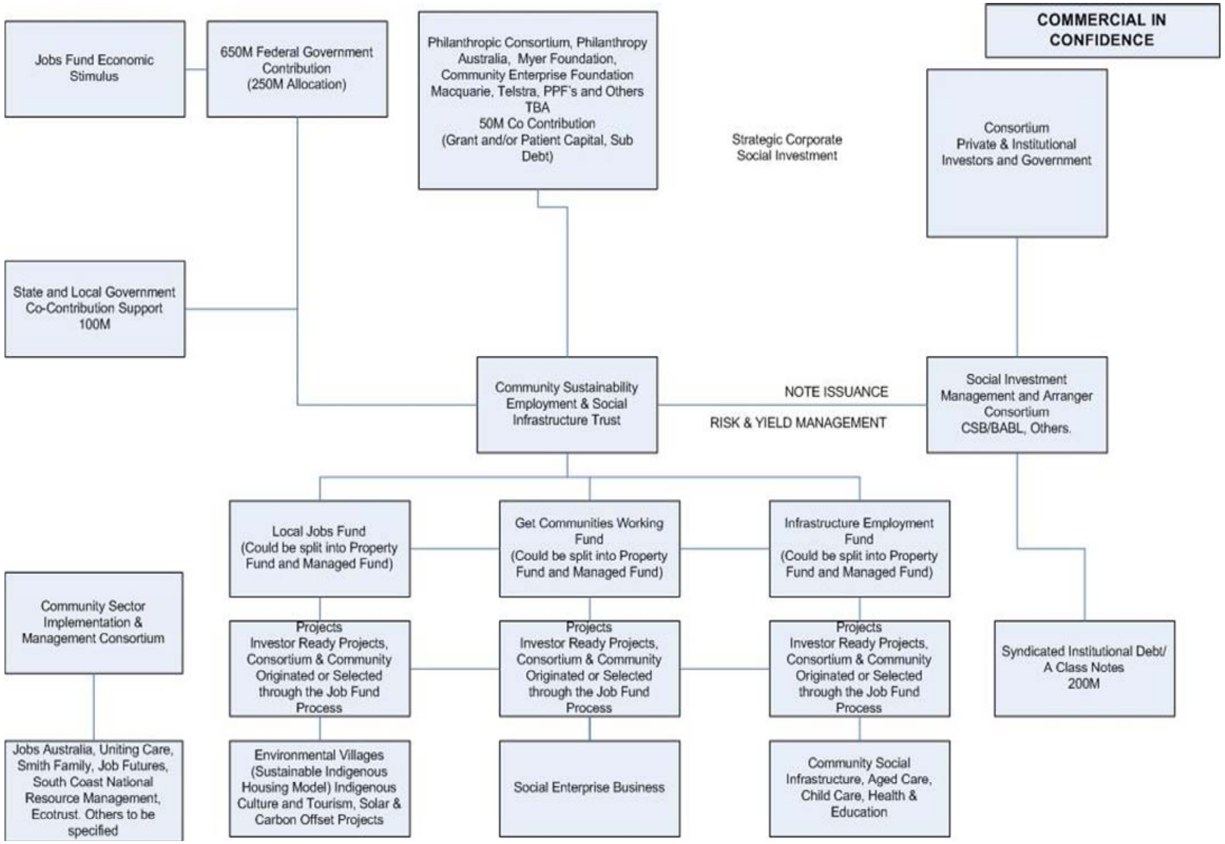
9. ANNEXURES

Slide 1

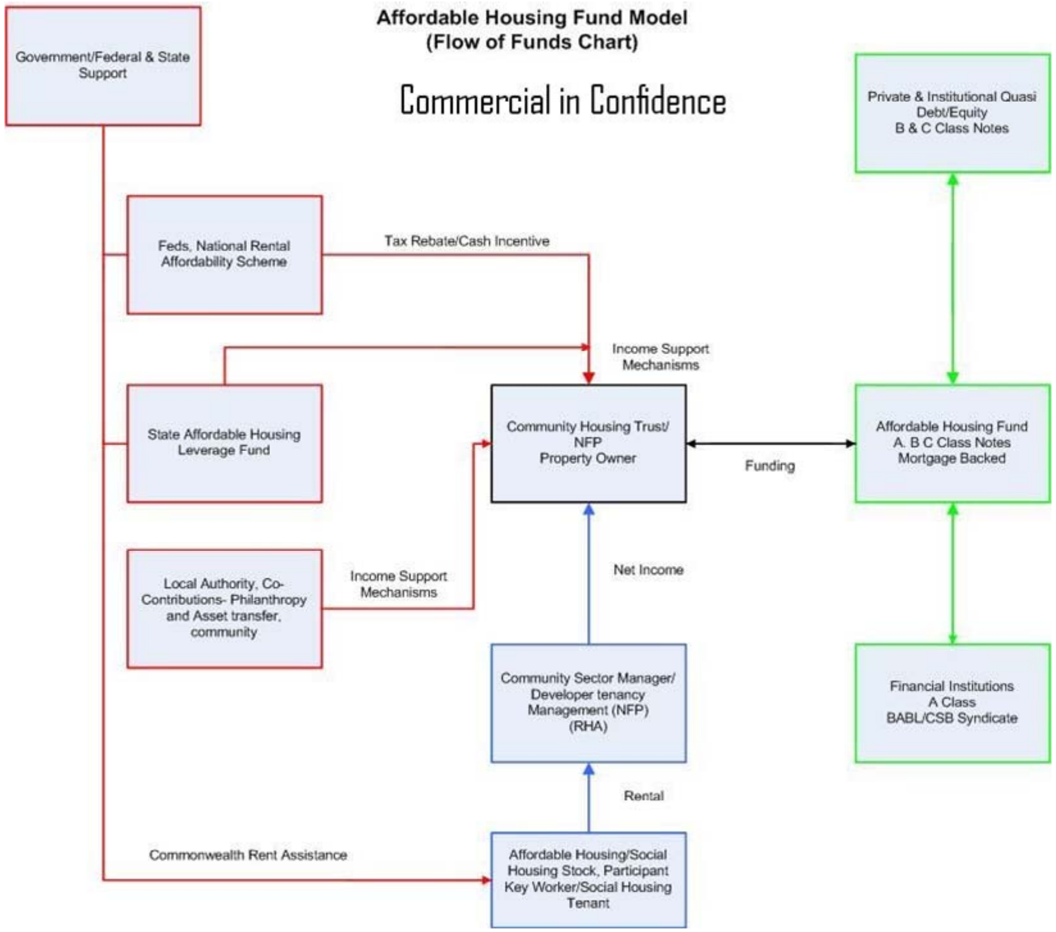
Affordable Housing Model



Slide 2


COMMERCIAL IN CONFIDENCE
Jobs Fund Economic Stimulus
650M Federal Government Contribution (250M Allocation)
Philanthropic Consortium, Philanthropy Australia, Myer Foundation, Community Enterprise Foundation Macquarie, Telstra, PPF's and Others TBA
50M Co Contribution (Grant and/or Patient Capital, Sub Debt)
Strategic Corporate Social Investment
Consortium Private & Institutional Investors and Government
State and Local Government Co-Contribution Support 100M
Community Sustainability Employment & Social Infrastructure Trust
NOTE ISSUANCE
RISK & YIELD MANAGEMENT
Social Investment Management and Arranger Consortium CSB/BABL, Others.
Local Jobs Fund (Could be split into Property Fund and Managed Fund)
Get Communities Working Fund (Could be split into Property Fund and Managed Fund)
Infrastructure Employment Fund (Could be split into Property Fund and Managed Fund)
Community Sector Implementation & Management Consortium
Projects Investor Ready Projects, Consortium & Community Originated or Selected through the Job Fund Process
Projects Investor Ready Projects, Consortium & Community Originated or Selected through the Job Fund Process
Projects Investor Ready Projects, Consortium & Community Originated or Selected through the Job Fund Process
Syndicated Institutional Debt/ A Class Notes 200M
Jobs Australia, Uniting Care, Smith Family, Job Futures, South Coast National Resource Management, Ecotrust. Others to be specified
Environmental Villages (Sustainable Indigenous Housing Model) Indigenous Culture and Tourism, Solar & Carbon Offset Projects
Social Enterprise Business
Community Social Infrastructure, Aged Care, Child Care, Health & Education

Slide 3


Affordable Housing Fund Model
(Flow of Funds Chart)
Commercial in Confidence
Government/Federal & State Support
Feds, National Rental Affordability Scheme
Tax Rebate/Cash Incentive
Income Support Mechanisms
State Affordable Housing Leverage Fund
Community Housing Trust/ NFP Property Owner
Funding
Private & Institutional Quasi Debt/Equity B & C Class Notes
Affordable Housing Fund A. B C Class Notes Mortgage Backed
Local Authority, Co-Contributions- Philanthropy and Asset transfer, community
Income Support Mechanisms
Net Income
Community Sector Manager/ Developer tenancy Management (NFP) (RHA)
Financial Institutions A Class BABL/CSB Syndicate
Rental
Commonwealth Rent Assistance
Affordable Housing/Social Housing Stock, Participant Key Worker/Social Housing Tenant

Slide 4

Chart 6 Potential Investment Types

The proposed structure for Kids Super™