BACKGROUND

CCA together with SVA has brought a group of experts together to develop a number of key recommendations to provide to the Senate Economics Committee as they inquire into Finance for the NFP sector.

Many of the participants have already made submissions to the Inquiry and/or presented evidence. The Committee have indicated to CCA they are particularly interested in understanding if any collective consensus exists across key players in developing their recommendations to Parliament.

Twenty seven submissions have been received from organisations across the NFP and finance sectors and government and hearings have been held in Canberra, Melbourne and Sydney. A list of submissions at Attachment A.

The Senate Inquiry is occurring at a time of significant reform for the NFP sector. The signing of the first National Compact between government and the Australian NFP sector in 2010 heralded a new approach by government to acknowledge and support the role of NFP organisations in Australia. The establishment of an Office for the NFP Sector within the Department of Prime Minister and Cabinet, the establishment of the NFP Reform Council and the proposed establishment of the new Australian Charities and NFPs Commission (ACNC) represent a commitment to necessary and overdue regulatory reform.

The evidence base around the sector is also growing. Recent reviews including the Productivity Commission Report into the Contribution of the NFP Sector in 2010, Senate Inquiry into Disclosure Regimes for Charities and NFP organisations 2008, and the review of Australia's Future Tax System 2010, all made recommendations about the need for reform within the sector and within government.

The Federal Government has committed to promoting social enterprise, reducing compliance costs for NFP organisations, encouraging a diversification of financing options to build a more sustainable funding base, streamlining and refining the regulation of NFPs and charities, developing a clearer definition of charities, establishing less bureaucratic reporting requirements while building community transparency, and working to improve relationships between government and the NFP sector.

The Senate Inquiry represents another opportunity for the sector to develop a policy framework to build their capacity.

The terms of reference for the inquiry is to explore mechanisms and options for the development of a robust capital market for social economy organisations in Australia, including:

(a) the types of finance and credit options available to NFP organisations, social enterprises and social businesses, the needs of the sector and international approaches;
(b) the role and current activity of financial intermediary organisations and how these can be strengthened;
(c) strengthening diversity in social business models;
(d) the development of appropriate wholesale and retail financial products and services;
(e) government actions that would support the potential for social economy organisations involved in the delivery of government services to access capital markets;
(f) incentives to support investment in the sector;
(g) making better use of the sector's own financial capacity, including practices relating to purchasing of products and services and use of reserve capital;

(h) making better use of the corpus of philanthropic foundations and trusts to make investments in Australia's social economy organisations, expand socially responsible investments and impact investments and any current barrier to their investment;
(i) policies, practices and strategies that affect the availability of capital markets for social economy organisations on social innovation, productivity, growth and workforce issues in these sectors; and
(j) any other related matters.

This paper seeks to collate the issues raised through the various submissions that respond to terms of reference as they relate to the key players to provide a basis from which our roundtable of experts can develop a set of recommendations which we can provide to the Committee.

KEY ISSUES FOR DISCUSSION

Types of finance available

Since the 1990s the banking industry has developed products and services for NFP organisations including reduced fees, particular accounts and transaction conditions (day-to-day finance). Community Sector Bank serves the sector with a full range of services and JB Were provides financial advice and professional services to organisations.

Foresters and others note that access to capital and investment has been less successful, defining the types of capital required including hard development capital for fixed assets, closed working capital to assist with short-term cash flow, open working capital to meet immediate needs before monies are raised or committed and soft development capital for growth, innovation, capacity.

The Productivity Commission and others distinguish between funding (grants and philanthropy) and finance (debt or equity capital). JB Were suggest that there is not one single type of capital for the sector or one source to provide it and names sources as government, philanthropy, income from fees for services, impact investment and capital markets. They argue the broad range of finance options should be embraced to match needs with available sources of funding, noting that philanthropy is a small part of the funding picture and cannot be the major source of finance for the growing needs of the sector (Sub 19).

While the main focus for funding organisations has been through grants, most of the submissions identified the sector and social enterprises as being undercapitalised. Foresters identify fair and flexible capital in the following forms which will vary over the life cycle of the organisation:

- Secured loans (for asset acquisition)
- Standby facilities
- Overdraft facilities
- Unsecured loans
- Quasi-equity
- Equity
- Patient capital (loans that are offered for long terms and flexible terms, with reduced expectations of high financial returns but expectations of positive social returns)

Community Sector Banking identifies working capital, lease finance and other financial products as more appropriate capital sources for growth than debt finance (Sub 10).

JB Were notes that small to medium sized organisations have limited access to forms of finance and credit options and restricted to donations, sponsors and government support. They also note the increased professionalization of financial assets by larger NFP organisations that generate revenue internally or use assets as security (Sub 19).

Social Traders notes that the biggest gap in finance for social enterprises is during start-up and early stage development (Sub 7). Some of the specific concerns of social enterprises highlighted by Social Traders include: the high risk nature of start-ups is exacerbated by lack of business experience by social entrepreneurs and NFPs; high profit margins are unlikely so longer repayment cycles are needed; and lack of a specific legal structure for NFPs.

A lack of financial literacy, financial capacity and capability are all causes of financial exclusion, for mainstream financial institutions, NFP organisations and social enterprises.

Key findings:

- *Transaction or day to day banking options are available for the majority of NFPs but do not recognise the specific needs of NFPs.*
- *Access to finance (debt or equity capital) is more elusive for NFP organisations with limited products available*
- *There are a variety of sources of capital needed over the life cycle of an organisation or enterprise*

Discussion points:

- *What actions can be taken to address the gaps in access to finance:*
    - *Which products or sources of capital are best suited to the different stages in the life cycle of an organisation?*

Role of financial intermediary organisations

Community Development Financial Institutions (CDFIs) have a key role in assisting organisations to be investment ready and developing community asset building strategies to assist them secure funds and purchase assets (Sub 11).

The Productivity Commission found that intermediary organisations are largely absent in Australia which may reflect the ad hoc nature of funding in the sector (Sub 7).

Intermediaries that can build new capital in markets and ensure the flow of capital can result in social impact have a significant role to play in reducing costs and risks and reporting on financial and social performance. A description of the role of CDFIs is outlined by Foresters (Sub 4):

- Providing specialised financial services appropriate to people, groups and organisations excluded from mainstream services;
- Engaging individuals, groups, organisations and communities in developmental opportunities that can build their financial capabilities;
- develop economic security and eventually establish a degree of financial sustainability (including financial literacy and capability education);
- Fostering community economic development in disadvantaged and underinvested communities

- Providing access to capital (through investment, loans, debt finance and / or equity) for organisations, businesses and individuals who would otherwise not be able to access loans or other capital;
- Developing innovative financial mechanisms that facilitate financial inclusion of individuals, organisations, and enterprises.

The key attributes of CDFIs include independence, focus both on the arena of microfinance and personal finance, and on the broader goals of ensuring access to financial services and products by those groups and organisations excluded from mainstream services. They stimulate the economic development of under-invested and excluded communities (Sub 4).

JB Were note the challenges for financial providers including achieving volume, having to tailor packages to suit NFPs and generate returns to cover increased cost of creating tailored packages. Intermediaries have a significant role to play in developing markets for impact investments – including legal frameworks, marketing, transactions, systems, reporting and advice. They note the success of the role of intermediary in establishing GoodStart Childcare Limited which was able to draw on different types of capital including philanthropic, hybrid and commercial investments (Sub 19)

Some submissions argued CDFIs do not neatly fit into the current regulatory framework. JB Were notes they typically fall under ASIC and the Financial Service Reform and Corporation Acts under the regulation of Australian Prudential Regulation Authority (APRA). CDFIs in UK and US have emerged with the support of regulatory bodies and flexible regulation.

That framework should also recognise that CDFIs are a broad umbrella of organisations with a range of focus areas and groups.

Definitional issues remain with CDFIs in Australia, and there may be some benefit in clarifying the functions and status of CDFIs to enable a better regulatory framework.

The Social Investment Taskforce in the UK has argued for a wholesale investor to provide long term capital for the growth of intermediaries and an effective social investment market. It will not be a grant maker but rather co-invest in funds, offer loan finance, strengthen existing intermediaries, invest in infrastructure and invest in innovative financial products. They argue the Big Society Bank (to be established by the UK Government from dormant bank accounts to fund the social sector) should be used for this purpose and provide an information hub for social investors and enterprises, research best practice and social impact, and build capacity in markets by promoting best practice (Sub 16).

The Social Enterprise Development and Investment Fund has committed $16 million matched by social investors to provide flexible, tailored financial products and support to social enterprises. Its impact will need to be evaluated over time to inform future investments. In addition, the government should provide a response to the consultation process into the design of the SEDIF held October-December 2010 which addresses the adequacy of the financial contribution, the function of the funds and demand beyond the scope of the current fund.

Social Business Australia calls for a Social Enterprise Fund managed by Fund Managers to finance projects assessed as viable and sustainable, to grow loan funds, to support enterprises that comply with work conditions, OH&S and other standards, to produce investment principles and lending guidelines that are public, create clear accountability for decisions made in relation to the growing social enterprise capital market. With or without public funds for social enterprises, there is a need for investment principles and lending guidelines that work for the finance and community sectors.

Key findings:

- *There are few intermediaries active in Australian context.*
- *Mainstream financial institutions have challenges in tailoring packages for NFPs and social enterprises and CDFIs have a key role to play in growing finance options.*
- *Regulatory frameworks may not suit the development of CDFI industry.*
- *Intermediaries have grown with different regulatory settings in UK and US.*
- *Public funds have been made available to develop financial products for social enterprises through the SEDIF program but it will need to be evaluated*

Discussion points:

- *What regulatory conditions are needed to support development of intermediaries including CDFIs?*
- *Is there a role for a wholesale investor to grow financial market in Australia?*
- *How could investment principles and lending guidelines be best developed that work for both finance and NFP sectors?*

Strengthening diversity in social business models

There is much diversity in the way social enterprises and social businesses have emerged and grow in Australia. Foresters argue that while the various terms applying to social business firms and enterprises are used interchangeably there is merit in developing Australian definitions of organisational structures, as different types of financial exclusion will apply to different types of enterprises (Sub 4).

Catherine Brown and Associates argues that clarity rather than diversifying social business models is more important to broaden the understanding of social businesses to charities and financiers and the lack of definition is confusing to potential investors (Sub 11).

Social Businesses Australia note the varied forms of social businesses and enterprises than has grown up in Australia including cooperatives, employee owned businesses and hybrid mutual forms, but argues any definition should be based on a social enterprise definition that places them in the sphere of trade and commerce – that is, generating most of their income from the marketplace to fulfil social aims, and recognising the broad nature of social enterprise funds (Sub 14).

Foresters have identified the main types of financial exclusion for social enterprises relate to both capital and low cost banking, as products have been underdeveloped for this sector.

Finance and capital for social enterprise start-ups is a major barrier to growth in the sector, and there is no tradition of venture philanthropy or social venture capital in Australia. Funding for micro-enterprises is limited and in its infancy (Sub 4).

Tax concessions could assist the development of some social business models, like micro-enterprise. Law Firm Mortimer & Associates outlines how the Landcare Revolving Loan Fund was established in 1998, providing microfinance to farmers in north-east Victoria. The Fund received DGR status and income tax exemption and capital was secured from no interest loans and donations.

While the Rural Industries Research Development Corporation (RIRDC) reported on the project and recommended that government consider investing in the Fund as a cost effective and responsible use of public money, public funds were not made available. RIRDC indicated Government concerns could be addressed through: due diligence; ATO endorsement requirements; micro-enterprise loan fund lending criteria; and government grant/loan contract terms.

It is noted that the lack of a single legal entity that applies to social enterprises could be a barrier (Sub 14). Several submissions note that most social enterprises were hesitant or unable to take on equity investments, due to their legal form which prevents them from disbursing dividends (Subs 2, 6, 7).

SVA suggest a more appropriate alternative would be a quasi-equity investment whereby the financial return is dependent on the operating success of the enterprise. Social Traders also argue for a structure that encourages equity as the main form of capital rather than debt financing and note that the current for-profit legal structures do not allow for funds from philanthropy to be accessed.

Social Traders suggest a hybrid legal structure be explored to enable access to equity capital and tax deductible finance (both debt and gift) that could stimulate investment in the social capital market.

Mt Buffalo Community Enterprise highlight that the current ASIC regime does not recognise a place in the Corporations Act for organisations motivated by social goals, not profits. Under the Act, MBCD is unable to issue a disclosure statement with financial projections greater than 2 years which they say is discriminatory against small investors and does not support accurate and informative disclosure (Sub mission 24).

A number of submissions note the legal structures created in the UK for social enterprises (Community Interest Company) however it is also noted by the PC and others that these are still in early stages and have not yet been fully tested. Likewise the CIC would not apply directly to Australian context given many organisations are incorporated under state and territory systems.

Mainstream banks will also need to understand social enterprise business models and culture which could be an important function of intermediaries.

SVA suggest a key challenge for social enterprises whose focus is on employment for the long term unemployed, people living with a disability or mental illness or other disadvantage, is the significant support costs in enabling people to gain and stay in employment. Employment support funding could be made available within current and new Job Services Australia contracts. This doesn't require new money, just a better use of current resources. This could be considered as part of the next round of JSA contracts, which will start in 2012. (Sub 2)

Social Firms Australia calls for an ongoing subsidy tailored to offset these additional operational costs – which is made available to all employers who commit to employ a number of people with a disability or particular disadvantage. They cite Germany's model of requiring all employers with at least 20 jobs to provide 5% of jobs to people with a disability. If this is not met employees are required to pay a fee to finance disability employment programs (Sub 22).

Social procurement practices of government also have a role to play in creating customers for products and services that deliver broad public benefit (Sub 7). The Victorian Government's Expert Support Panel which supports social procurement practices of local government is one model in practice.

Social Firms Australia recommend the creation of a whole of government social procurement approach as well as a tax incentive to businesses that offer contract to social enterprises or local providers, noting the decline in procurement from Australian Disability Enterprises to cheaper offshore providers (Sub 22).

Many social enterprises in Australia have been started by large, mainstream NFPs, but this requires these organisations to develop new skills in developing a business. NFPs may be interested in moving from running programs to developing an enterprise but may need to develop new skills (Sub 14).

Community-business partnerships could be one way to share learning between sectors. Businesses involved in these partnerships have reported there is much to learn from the NFPs on how to manage tight budgets and resources, empower staff and clients and policy development.

Key findings:

- *Clarity is needed on the definition of social businesses and enterprises for the Australian context to reduce confusion and apprehension about supporting innovation from investors, finance, government and NFP sectors.*
- *Tax concessions and public funds for different types of social enterprises, e.g. micro-enterprises could support expansion.*
- *There is no legal entity applicable to social enterprises in Australia.*
- *There are high support costs for social enterprises engaged in employing the long term unemployed.*
- *Social procurement models adopted by governments and businesses could assist the growth of social businesses and enterprise in Australia.*
- *Developing social business models and enterprises by NFPs requires business skills and resources.*
- *There is a need to recognise the increasingly grey area growing on the continuum between NFP to for profit.*

Discussion points:

- *How can we best clarify terms to describe social businesses?*
- *What sorts of government support can be provided to grow diversity of social businesses?*
- *Is a new legal form or asset class required for social enterprises and what are the current restrictions for operating social enterprises?*
- *What role could community-business partnerships play in strengthening and diversifying social business models?*

<u>Development of wholesale and retail financial products and services</u>

Foresters note that approaches to address financial exclusion have been small scale and localised (Sub 4). They see a clear role for banks and financial institutions to respond to market failures by:

- Building products and services for excluded people and organisations;
- Helping to build specific entities like social banks, community development intermediaries; and
- Partnering with other community service organisations (CSOs) who can act as a filter between excluded people and mainstream financial institutions

Raising awareness of these issues with financial institutions also rests with the sector and governments. The development of partnerships to address these issues will be critical. Intermediaries and sector organisations could have a key role to act as a filter between excluded organisations and mainstream financial institutions. It is also suggested the government should have a key role in educating both the investor community and social economy organisations on funding options and mitigation strategies (Sub 11).

Creating 'low-profit markets' could create opportunities for social businesses to focus on generating a small surplus but focused on maximising social impact. Foresters Community Finance model works in this way, offering loans with commercial rates of interest to NFPs for the purpose of asset building and are capitalised by social investors.

As mentioned above the UK is exploring how its Big Society Bank can be used to develop wholesale retail products for NFPs and social enterprises.

Key findings:

- *Mainstream banks and financial institutions have a clear role to develop new products and services.*
- *Lack of understanding of the needs of the NFP/social impact sector by the financial sector is hampering the growth of new products.*

Discussion points:

- *That mainstream financial institutions examine possible partnerships to support and develop different models for investing in the NFP sector.*
- *That the NFP sector articulates and publicly discusses financial needs and the role non-grant capital could play in increasing their impact.*

Role of governments in supporting social economy organisations to access markets

While the inquiry is focused on access to markets or finance, the way organisations are funded by government can adversely impact on their ability to develop reserves or build capacity (Subs 1, 4, 15).

Submissions referred to cost-shifting and under-financing, short term contracts and timing of agreements, poor regulation and a compliance burden not consummate with activity taken by organisation.

Compliance burdens are often not commensurate with output or measuring outcomes. The contracting environment and reporting based on outputs and units is at odds with a social innovation framework that is seeking to deliver outcomes through new forms of finance, social impact bonds, leveraged investment and place-based entrepreneurship (Sub 15).

Foresters notes the challenge of operating shortfalls on organisations and suggests there is a growing gap between the available revenue for program delivery and operating costs, which is plugged by diversification of funding, fundraising and use of earned income. These consequences of these shortfalls include an inability to develop reserves, reliance on grant funding, lack of capacity to save for assets, reduced capacity for innovation, difficulty in long term funding (Sub 4).

While recognising the issues of funding are separate to those of finance (untied grants and philanthropy verses debt or equity capital which compensates investors), if funding is inadequate or poorly timed, organisations will be less likely to be in a position to borrow capital or take on risk.

A better understanding of the operating shortfall and where it is having the greatest impact on service delivery and innovation is needed. While there is plenty of anecdotal evidence and case studies which were referenced in the PC Report, the development of the evidence base of the impact of contracting needs more work from sector and government.

The Compact does commit government to action to reduce red tape, streamline reporting, and improve funding and procurement processes. The commitment must be backed up by action plans and outcomes.

Christian Super notes that the long history of disclosure regimes and reporting by NFPs through contracting could also provide comfort to investors. Developing appropriate disclosure regimes that are appropriate to the sector are an important factor (Sub 11).

It is also recognised that governments do have a role in exploring new ways of funding programs run by the NFP sector such as the NSW Social Impact Bond Trial being run in collaborating with CSI.

The Productivity Commission made a range of recommendations to achieve best practice in contracting, including better understanding the frameworks in place, the establishment of a Community Service Effectiveness to improve knowledge and evaluations, and a national registrar to consolidate Commonwealth regulation for tax status, cross jurisdictional fundraising and a single portal for financial reporting. Many of these recommendations have been accepted by government and are being implemented although the form of these frameworks is yet to be determined.

Key findings:

- *Operating cost shortfalls impact on organisational ability to innovate and take on risk.*
- *Compliance regimes are inappropriate and can be at odds with outcome focused programs and policy.*
- *Need a better understanding of the impact of the contracting environments on NFP growth and sustainability.*

Discussion points:

- *How can the National Compact be used to develop contracting and procurement best practice.*
- *What are the key actions governments could take to develop best practice, e.g. length of contracts, better not more regulation, streamlining accountability requirements.*
- *What other actions can government take to support NFP service providers to access markets, how can it be an enabler?*

Incentives for investment in the sector

Sir Ronald Cohen notes the 'enabling environment' that was created in the US and UK to foster investment in venture funds, largely through tax reform and regulation. He argues a similar approach is now needed for social enterprise and investment – tax incentives, changes to activities of foundations and financial institutions (Sub 16). He also notes the creation of the Community Development Finance Association (CDFA) which brought together government, banks and investors with social enterprises to form a voice and partnerships to achieve a new investment environment.

1. Role of Bonds

Social impact bonds provide a mechanism to fund the delivery of social outcomes in a different way to contracts and grants – to reward investors through additional Government contributions or reward based on the cost benefit to Government arising from the social and economic benefit of that investment.

Studies of the social impact bond markets established in the UK demonstrate a positive correlation between the financial strength of an organisation and the social impact it delivers and there is a cost benefit to government and communities in maximising social impact.

The SIB market is nascent in Australia.

The submissions broadly agree that the development of a social impact bond market needs government support and be linked to other strategies including community development finance initiatives.

Chris O'Brien Lifehouse at RPA notes that their market research of 500 potential investors is evidence the market for social bonds will not develop without government support. Likewise the Benevolent Society in its experience in the GoodStart consortium proved that investment by government provided much needed assistance to enable the success of the venture, and that philanthropic support alone will not enable the bond market to develop in a meaningful way (Sub 25).

Benevolent Society believe a new group of investors are needed to make social bond market viable – this could includes retail investors, Private Ancillary Funds and Fund managers – but these are all unlikely to invest until the market is more established and a marriage can be found between social and financial return (Sub 25).

Lifehouse at RPA also raise the need for better tools to provide 'independent valuation on social return', similar to the carbon credit market, to enable investors to have a tangible asset over and above the principal investment and provide the general public with a value attached to social projects (Sub 8).

Some possible ways in which government could support the development of social impact bonds include the use of tax concessions, including changes to income tax legislation and franking credits.

- YMCA call for changes to Income Tax Legislation to enable the creation of Australian Charity Bonds (ACBs) as a bond delivering tax exempt income returns, issued by eligible charities to fund social enterprises (Sub 1).

- Chris O'Brien Life House at RPA also calls for a government guarantee of repayment for qualifying social bonds to uncover additional investment and build confidence in investors (Sub 8). Christian Super notes this guarantee would give social impact bonds an equivalent credit rating to the guarantor, in this case an AAA rating of government (Sub 12).

- Lifehouse at RPA suggest a franking credit also be considered to increase social investment in SIBs. They suggest a franking credit on interest paid which is tax neutral across the various tax rates. These would be limited to bonds issued by PBIs registered as DGR and only for infrastructure and equipment being built (Sub 8). Benevolent Society agree with a franking credit of 50% on interest paid to target a range of investors including retirees paying nil tax, self-managed super funds in pre-retirement, corporates and individuals on high marginal tax rates – which would improve their tax rates. They believe it would have the benefit of attracting investors for the right reasons as opposed to infrastructure bonds and film funds. They also suggest franking credits are established tax relief and have ATO credibility or stamp of approval.

Benevolent Society also sees a role for government to guarantee the repayment for qualifying social bonds which NFPs are unable to pay for.

The Archerfish Foundation argue that the approach to SIBs to date has been a contracting model for purchasing specific social outcomes, usually for smaller projects, to increase cost effectiveness and shifts risk from the government to private sectors. The success of this form of SIB depends on regulatory environment, high interest payments (or coupons) and the government being the final determinant of the success or otherwise of the service in achieving its outcomes. They also refer to the US experience that relied on privileged tax treatment of bond returns (Sub 17).

They argue a new type of bond be developed to target policy failures with greater costs and impacts to state and society, where most often the programs are not delivered by NFP but by government agencies e.g. recidivism amongst offenders leaving prison. They argue the bond to be applied should resemble private equity where investors subscribe to a fund manager that manages a portfolio of projects. The fund manager negotiates a contract (or bond) with government that commits government to repay agreed capital investments and make incentive payments contingent upon the fund manager meeting agreed outcomes. A new service delivery organisation may be created to meet the outcome so existing or new organisations may be developed, or it may not use any NFP – whoever can best meet the outcomes being sought through the bond. The Foundation argues this approach directly confronts the failure of public agencies to achieve social outcomes. (It could also enable the flourishing of new, innovative and effective NFPs, consolidations and lower barriers for smaller NFPs to access capital).

Taxation relief they suggest should sit with fund managers, not individual investors that can be distributed to private investors focused on social outcomes and effectiveness. They also propose that various state based funding programs be consolidated and re-evaluated for seed funding SIBs of the first order.

JB Were also suggests a similar model for a new form of bond (arbitrage) be established.

<u>Tax incentives for social enterprises</u>

SVA also details some of the tax incentives which have been used in other countries which include tax credits for investing in CDFIs, with mixed success. SVA suggest that DGR Status could be for social enterprises that are unable to pay their loans could convert this into a donation (Sub 2).

As a way of fostering microfinance, DGR status and income tax exemption for eligible funds which meet a set of criteria could be considered, as was the case with the Landcare Revolving Loan Fund Limited (Sub 5).

<u>Unrelated Commercial Activity</u>

Several submissions refer to the future of tax concessions for unrelated business income generated or held by charitable organisations.

Some believe that the introduction of a tax will have a negative impact on revenue in the sector such as lenders take on a more restrictive approach to build existing social models, incentive in for investment, reduce the capacity of organisations to leverage off or borrow against its own equity.

The related reform proposed by Treasury is not consistent with the policy intent of the government announced at the last election. There was discussion around how Treasury's response to the Word decision actually prevents the accumulation of funds, limiting the opportunity for organisations to become more entrepreneurial. It has been argued the focus should be purpose, not activity.

The National Rental Affordability Scheme (NRAS) was launched by Federal Government in 2008 and represents a supply side intervention to encourage the construction of affordable rental properties. Tax credits or cash payments are provided over 10 years to investors providing affordable housing, which is provided to residents at a minimum of 20 percent below the market rate. In practice, nearly all NRAS properties are managed by not-for-profit housing providers, where the credit is provided as an equivalent cash payment. Among not-for-profit providers, rents are often at least 25 percent below the market rate (partly due to satisfy charitable tax law requirements).

A review of NRAS concluded that the number of affordable rental homes in Australia increased and the standard residential net income return for not-for-profit housing providers increased from 2 to 5 percent. The review found that the program was initially funded to support 50,000 new homes, however is expected to eventually expand to twice this figure. Nonetheless, the review found that the program was considered less successful in targeting Australia's most unaffordable markets and failed to attract the interest of institutional investors who required more aggregation, liquidity and clear risk profiling. (CSI Sub 27).

Key findings:

- *The Australian Social Impact Bond market is nascent and may require tax concessions to encourage investment.*

Discussion points:

- *How can the social bond market be developed more fully – what role could government play?*
- *Does the issue of SROI/how best to measure social impact need to be discussed? Should an agreed measurement tool, or process for determining impact, need to be developed?*
- *How can tax treatments of commercial activities of NFPs be best maximise social impact and provide financial capacity.*
- *How do you mobilise the investment sector into a new investment class or hybrid form of investment?*
- *What lessons can be learned from the National Rental Affordability Scheme?*

<u>Making better use of the sector's financial capacity including practices relating to purchasing of products and services and use of reserve capital</u>

JB Were notes the challenges facing the sector in building financial capacity including:

- Inadequate resources and skilled personnel to oversee relationships and transactions;
- Lack of intermediaries to facilitate outcomes between buyers and sellers of finance;
- Under-developed understanding of risk in NFP and finance sectors;
- Cultural expectations within organisations regarding debt and risk;
- Inability of sector organisations to offer collateral to secure debt finance;
- Sector outcomes may not be 'monetised' and therefore unable to be used to pay back commercial investors (Sub 19).

The Productivity Commission found that many NFPS failed to recognise the value to their organisation of hiring intermediary services and that a culture in NFPs arises from a strong community service focus can discourage investment in the development of business and governance capabilities. This is supported by a range of submissions that argued reluctance to take on debt was due to a lack of business experience and knowledge.

Community Sector banking noted the need for skills based Boards and that financial decisions need to be underpinned by business cases, cash flow analysis and performance risk analysis (Sub 10). Developing these skills is a key tenet of any investment to build the capability of the sector, and supported by an appropriate regulatory framework.

The sector's approach to surpluses is usually to redirect them in the year they are received into service provisions or future program enhancement. While most organisations are actively seeking to improve their services, as long as the immediate priority is program delivery, financing and capital renewal is often a far way from organisation's' primary focus. This is compounded by the cultural barriers evident in the way NFPs are governed and conservative approaches to risk management. We need to better understand why these barriers exist, strategies to alleviate them and build long-term planning into organisational governance models and this is likely to involve education and training (Sub 15).

Several submissions call for training in effective purchasing practices and use of reserve capital.

Likewise state wide purchasing programs to create a better negotiating position for large number of organisations could be useful through peak bodies to reduce risk.

<u>Sector Assets and Land Titles</u>

While the ABS produces data on the current sources of income for the social services sector, we do not understand enough about what the current assets of the NFP sector are and what their net worth might be. (Nor do we have a picture of the income streams and assets of organisations more broadly than the social services sector).

YMCA also mention that NFPs often do not have effective title to land or other assets, they cannot enter into commercial partnerships to contribute to a capital program (Sub 1).

Government support for existing capital facilities used by NFP service providers was also highlighted.

Key findings:

- *There are a range of cultural and practical barriers for NFPs in increasing financial capacity.*
- *There is a lack of understanding of the value of NFP sector owned assets.*
- *Ineffective title to land or other assets constrains the ability of NFPS to enter commercial partnerships.*

Discussion points:

- *How can sector organisations realise their value, better understand risk.*
- *How can we better understand the role of assets in increasing financial capacity?*
- *Are there any considerations for sector procurement practices that could increase financial capability, what has worked or not worked?*
- *How best do we support organisations to become investment ready?*

Role of philanthropic foundations and trusts

SVA call for a legal structure of Private Ancillary Funds (PAFS) to be changed so those funds can make investments that deliver both a social and financial return (Sub 2).

The Productivity Commission has recommended that options be explored which allow foundations and trusts to invest in social enterprise type organisations which is currently not allowed under rules for DGRs. Foundations could also have scope to link business philanthropists with NFP and provide business mentoring and support.

Community Sector Banking calls for a better understanding of how the corpus of PAFs can be distributed investments, noting there are few social impact products that provide a pathway to foundation funds (Sub 10).

The UK Charities Commission is allowing foundations and trust to allocate a portion of assets to social investments (Sub 16).

The Benevolent Society has found through its own social bond program that philanthropic investors did not see the bond as a way of increasing its existing commitments, and preferred to continue making donations and maximise their investments (Sub 25).

It is worth noting that Philanthropy Australia was engaged by the Commonwealth Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA) to explore strategies to encourage greater levels of giving among Australia's high and ultra-high net worth individuals (HNW and UHNW) and reported in February 2011. The report had a number of key recommendations including:

- strengthening the philanthropic sector's capacity to promote and cultivate giving by supporting the development of a strong, sustainable national peak body;
- appointing Philanthropy and Giving Ambassadors;
- establishment of a national Registrar for Community and Charitable Purpose Organisations;
- establishment of dedicated structures to improve communication between the ATO, Treasury and the philanthropic sector
- a structured promotional program aimed at aspiring and next generation HNW and UHNW groups and professional advisors;
- a research program to map philanthropic activity; and
- the development of social investment products and markets

Key findings:

- *Philanthropy is only one source of capital for sector finance, and cannot be the only source.*

- *Foundations and trusts could be used more effectively to invest in social enterprise models and other financial capacity of the NFP sector.*

Discussion points:

- *What can be done to increase the impact of corpus funds and PAFs?*

Other issues

A Coherent Voice and Taskforce

In recognising the embryonic nature of the social capital market in Australia, several submissions recognise the role of the Social Investment Taskforce in the UK and a similar body could assist the development of a strategic framework to shape policy. Sir Ronald Cohen has emerged as a key advocate and voice on approaches to social investment as Chair of the UK Social Investment Taskforce. It is worth noting the Taskforce

Other submissions recognise that while a steady demand for new sources of finance may exist in the sector, there has been a lack of a strong and coherent voice demanding responses from governments and markets (Sub 4).

It is interesting to note that only 27 submissions were received and very few submissions were from social enterprises or NFP organisations. This may be due the large number of reviews and consultation processes in recent times. However, if we consider an inquiry was being held into finance for the car industry, it would be interesting how many submissions may be received, not only from the industry but also from third parties – suppliers, financiers and retailers in the supply chain.

Those in the sector's supply chain should also have a voice on these issues of capacity and capability as well as empowering communities and service users to have a voice on the future of the sector.

Research on NFP finance needs

A recurring theme of all submission was the little empirical data and research about NFP finance needs. A concerted and resourced effort needs to be made to better understand where the greatest needs are to understand the role of a NFP market and build the policy platform. Research is also focused on 'economically significant' organisations, but does not necessarily include smaller organisations or social enterprises where the need for finance and capital is greatest. (Sub 4)

The future of the sector and new social innovation

It is questionable that the NFP sector can continue to maintain compound growth of 7% a year as it has done for over a decade. Even given this growth there remains an ongoing need for capital renewal. Overseas trends suggest that while ongoing government engagement and support of the sector remains critical, new forms of financing the not-for-profit sector are being developed primarily out of necessity. A broad and clear vision for the sector is needed, that includes the breadth of capacity issues discussed in the submission received for this Inquiry and through the PC report. CCA is actively seeking to build this vision, through partnerships with members, NFP organisations the private sector and government.

The increasing role of social entrepreneurs and the young graduates who are socially minded but not necessarily looking at a NFP model to achieve social impact should also be recognised and the growth of social enterprises and other social innovations.

Taking the reform forward and relationship with existing reform initiatives

JBWere referred to the need to avoid a disjointed and sporadic approach to reform which would be supported by the sector.

Discussion points:

- *What does a vision for the sector include, who is responsible for its development and how can it be developed?*
- *What could a Social Investment Taskforce look like and who should be involved?*
- *How can a greater understanding and evidence base be developed about social economy finance needs?*
- *How can an inquiry into finance issues sit with other reforms such as tax concession reviews, establishment of a regulator etc., and who is best to take it forward to ensure consultation?*
- *Where do superannuation funds as an investment option fit in sector finance or should it?*

Finance for the not for profit sector

Submissions received by the Senate Economics Committee

1 YMCA Australia (PDF 447KB)

2 Social Ventures Australia (PDF 48KB)

3 Corney and Lind (PDF 10KB)

4 Foresters Community Finance Ltd. (PDF 197KB) Attachment 1(PDF 2118KB) Attachment 2(PDF 4349KB) Attachment 3(PDF 1234KB)

5 DF Mortimer and Associates (PDF 66KB) Attachment 1(PDF 616KB) 2(PDF 165KB) 3(PDF 194KB)

6 Productivity Commission (PDF 1012KB)

7 Social Traders Ltd (PDF 122KB)

8 Chris O'Brien Lifehouse at RPA (PDF 123KB)

9 Department of the Prime Minister and Cabinet; Department of Education, Employment and Workpl Relations (PDF 1836KB)

10 Community Sector Banking (PDF 591KB) Attachment 1(PDF 363KB)

11 Catherine Brown and Associates Pty Ltd (PDF 183KB)

12 Christian Super (PDF 401KB)

13 Positive Solutions (PDF 60KB)

14 Social Business Australia (PDF 225KB) Attachment 1(PDF 959KB)

15 Community Council for Australia (PDF 273KB)

16 Social Finance Ltd (PDF 659KB) Attachment 1(PDF 390KB)

17 The Archerfish Foundation (PDF 539KB)

18 SENTECH (Social Enterprise Technologies) (PDF 92KB) Attachment 1(PDF 2770KB) Attachment 2(PDF 1079KB) Attachment 3(PDF 4426KB)

19 JBWere (PDF 648KB)

20 Hepburn Community Wind Park Co-operative Limited (PDF 135KB)

21 Social Finance Pty Ltd (PDF 391KB)

22 SoFA (Social Firms Australia) (PDF 286KB) Attachment 1(PDF 117KB)

23 Fundraising Institute Australia (FIA) (PDF 24KB)

24 Mt Buffalo Community Enterprise (PDF 3014KB)

25 The Benevolent Society (PDF 198KB)

26 Many Rivers Microfinance (PDF 137KB) Attachment 1(PDF 275KB) Attachment 2(PDF 154KB) Attach 186KB)

27 The Centre for Social Impact (PDF 681KB)