Funded by the European Union

PORTUGUESE SOCIAL INVESTMENT TASKFORCE

The Portuguese Social Investment Taskforce was divided in three sub-groups: (1) Knowledge creation and market intelligence, (2) Capacity-building and readiness towards impact and social investment, and (3) Financing mechanisms for social innovation and incentive structures to attract new sources of capital.

SUB-GROUP #3 – FINANCING MECHANISMS FOR SOCIAL INNOVATION AND INCENTIVE STRUCTURES TO ATTRACT NEW SOURCES OF CAPITAL

This sub-group identifies a range of innovative mechanisms in which investors can use to fund social innovation alongside potential tax incentives to help attract more capital to the sector. Members identified two priority areas, outlined in the table below, to research in order to inform the final recommendations of the Taskforce. The research notes below outline, for each priority area:

(1) What question(s) are we trying to address with this potential recommendation?

(2) What did other countries do to address this issue?

(3) What are the main lessons learned?

(4) What is unique about Portugal that should be considered when adapting to the Portuguese context?

The recommendations suggest that Portugal should: (1) test and pilot a range of new instruments for financing social innovation, and (2) create initiatives and schemes that attract new sources of capital and have sufficient flexibility to evolve as the market develops.

#	Priority area	Case studies	Key learnings	Priority
3.1	Assess the potential of innovative social finance mechanisms to finance social innovation	New York City Acquisition Fund (US) The Social Investment Business (UK) Duo for a Job SIB (Belgium) Buzinezzclub SIB (Netherlands) CAF Venturesome (UK) Empower Community Bond (UK)	Cornerstone investors can signal the investability of projects and attract co-investors Social investment products need to have a range of risk/return profiles which address the differing requirements of social sector organisations and investors in the sector The SIB model is an innovative financing mechanism which has shown to be adaptable to for different market contexts and social issues. There is scope to develop investment instruments which attract funders who are particularly interested to fund and invest in their local community	High
3.2	Identification of incentive structures to attract new sources of capital to the sector	Social Investment Tax Relief (UK) 90/10 Solidarity Funds (France)	Tax incentives can help mobilize new sources of capital Tax incentives with a range of features – e.g. upfront tax relief, deferred taxation – can attract different types of investors Schemes that facilitate the involvement of individual investors in social investment have been effective in attracting more sources of capital to the sector	Medium

This page was intentionally left blank.

PRIORITY AREA 3.1: ASSESS THE POTENTIAL OF INNOVATIVE SOCIAL FINANCE MECHANISM TO FINANCE SOCIAL INNOVATION

What question are we trying to address with this potential recommendation?

The financing needs of Portuguese social organisations are not being met by traditional sources of capital. The latest data available on the Satellite Account for the Social Economy suggests that social economy organizations had net unmet financing needs worth more than €750 million, in 2010. Moreover, current financing instruments available are not suitable to meet the needs of social organisations – this mismatch is a key challenge that new financing mechanisms could overcome.

Innovative financing solutions are needed to reduce this funding gap. Products must address the needs and concerns of both social organisations and investors. This note identifies a range of social investment mechanisms/products that have (1) mobilized new capital for the sector, (2) changed the way some existing sources of capital is being deployed; and (3) addressed the needs of social sector organisations.

What did other countries do to address this issue?

Six examples of innovative social finance mechanisms/products were reviewed to understand their structure and benefits:

Purpose	Live example	Rationale
Identifying appropriate risk/return profiles and understanding the multiple roles investors can play (e.g. subordination and leverage)	New York City Acquisition Fund	The Fund provides financing to help local and non-profit housing developers to purchase properties/land to construct affordable housing. It used a guarantee provided by the City of New York and foundations to leverage senior debt from banks.
	The Social Investment Business	The largest social investor in the UK. As manager of substantial government funds through the Futurebuilders and SEIF programmes, and its own endowed funds, TSIB has made over 1,300 investments in social organisations ranging from under £5,000 to almost £7 million since 2002. It provides social organizations with different forms of financial and non-financial support.
Product development (social impact bonds and shared participation agreements)	Duo for a Job SIB (Belgium)	This first Belgian SIB brings together the Brussels Agency for Employment, the non-profit Duo for a Job and a group of social investors who have partnered with the aim of reducing unemployment among young migrants in Brussels.
	Buzinezzclub (Netherlands)	This first Dutch SIB is funding an intervention delivered by Buzinezzclub who is working with 160 young people in Rotterdam. This programme helps unemployed young people who have no qualifications in making a transition to employment or return to school.
	CAF Venturesome	A social investment fund that supports social organisations through providing capital in the form of a Revenue Participation Right, an entitlement to a specific percentage of gross annual revenue.
Mobilizing a wider investor base	Empower Community bond	£10m socially-focused investment into solar energy for social housing. The first UK social investment deal which attracted institutional investors.

Identifying appropriate risk/return profiles and understanding the multiple roles investors can play (e.g. subordination and leverage)

New York City Acquisition Fund (overview)

The NYC Acquisition Fund aims to address the shortage of affordable housing in New York by providing finance to local and non-profit housing developers who were struggling to access capital. The Fund offers low-cost financing to organisations seeking to acquire private property and land for the construction of affordable housing.

The fund has a 'but-for' structure, as it would not have been able to raise capital from banks but for a guarantee being provided. The fund attracted senior debt from a consortium of banks through a guarantee worth £40.65 from the City of New York and foundations (Ford Foundation, Rockefeller Foundation and FB Heron Foundation). The fund closed at $192m with c. £151.35m coming from banks.

Since its launch, the Fund has committed $210m to 41 projects. The result has been the preservation and creation of an additional 5,100 affordable housing units in New York City.

The Social Investment Business

The Social Investment Business (TSIB) was launched, in 2002,[1] to provide financing and support to charities and social sector businesses which had 'viable, but non-bankable' business models or projects. It is the UK's largest social investor and manages both government and its own endowed funds to support social organisations that serve the community. TSIB currently manages six funds with different objectives and requirements, such as grant funding and debt financing. This means TSIB is able to signpost social sector organisations to the fund which is most suitable for to meet their needs – subject to the criteria applicable to each fund.

- ***Capacity-building***: (1) Big Potential and (2) Impact Readiness Fund
- ***Regional and community***: (3) Liverpool City Region Impact Fund and (4) Community Investment Fund
- ***Early stage***: (5) Big Venture Challenge
- ***Improving access to finance***: (6) Third Sector Loan Fund

The Third Sector Loan Fund is particularly relevant to Portugal. It is designed to encourage mainstream institutions to invest in funds that finance charities and social enterprises. The Fund has £30m to invest through secured and unsecured loans.

The Third Sector Loan fund is built on a £1.5 million repayable grant from the Social Investment Business, which has agreed to bear first loss and forego any profits. The UK's wholesale social investment bank, Big Society Capital (BSC), has committed £15 million of risk capital and will be next to bear any losses. BSC will receive all net returns from the fund. Santander will provide £13.5 million of senior debt on a fixed-income returns basis and will only face losses if the other investors lose all their capital.

The CEO of The Social Investment Business has noted that "[their] £1.5 million investment has catalysed a fund 20 times that size, creating the UK's biggest fund offering straightforward loans to help charities and social enterprises make even more impact. This is a radical way for philanthropists to make their money work much harder to create change."

Product development (social impact bonds and shared participation agreements)

Social Impact Bonds were first pioneered in the UK and have developed a strong global following, with 35 SIBs now launched across 7 countries. While the most advanced SIB markets are UK, US and Australia, we have selected the Duo for a Job SIB from Belgium and the Buzinezzclub SIB from the Netherlands because they

[1] Established in 2002 as Adventure Capital Fund, TSIBs parent charity.

demonstrate that the concept can be effectively used in the civil law jurisdictions of Mainland Europe, and for their particular relevance for Portugal, both in terms of process and the topics they address.

Duo for a Job SIB (Belgium)

The Duo for a Job SIB was launched in April 2014 to tackle youth unemployment amongst young migrants in Brussels. The intervention adopts a new approach to professional insertion of migrants by matching each individual in the programme with experienced local retirees. Together, youth and retirees form duos who work together for a period of six months to connect the young person with relevant networks and professional opportunities. Success will be measured according to the one-year reemployment rate (people who have accumulated more than 90 days of employment within one year or have obtained a permanent contract after the programme has ended). The performance of a treatment group of 180 people will be compared to a control group of 6,200 people with similar characteristics.

In terms of relevance for Portugal, it is worth highlighting the following features of the Brussels SIB:

- The total amount raised from investors for this SIB was €234,000 to be called semi-annually during two years, which is significantly lower than similar projects in the UK and the US;
- One of the investors is Bank Degroof Foundation, which is a Belgium Foundation focused on the education sector, demonstrating that geography and sector-related projects are important variables to consider when attracting social investors;
- Successfully achieving the targeted employment levels will result in outcome payments which ultimately provide a return to investors. This is on a tiered basis according to the level of success, but there is an overall cap on return to investors of 6%.

Buzinezzclub SIB (Netherlands)

The Buzinezzclub SIB was established in March 2014 in Rotterdam to support 160 unemployed young people aged between 17 and 27 in their transition from welfare benefits to employment or return to school. This programme targets young people who have been unemployed for an extended period and who possess no basic qualifications. Often, they have a troubled past.

The municipality of Rotterdam has agreed to pay for the outcomes that a young person on the programme is supported into stable employment or education re-entry. The amount varies according to how quickly this outcome is achieved and as a result, the welfare savings that are achieved – in essence, the municipality shares a proportion of the savings achieved as a result of the programme.

The investor return is capped at 12% a year. Interestingly, the service delivery organisation – Buzinezzclub – also runs a certain risk if young people are not placed at work or education. Therefore, the delivery organisation also earns more if it over performs[2]. The risk-sharing approach and the incentives for over performance are relevant learnings for potential SIB development in Portugal.

ABN AMRO and Start Foundation have together invested €680,000 in this intervention, which will last for two years.

CAF Venturesome

Venturesome is a social investment fund, launched in 2002, by Charities Aid Foundation (CAF) that provides capital to charities, social enterprises, and community groups when access to grants and/or traditional financial institutions is difficult.

[2] Source: Els Sol, Journal Zeggenschap September 2014

Venturesome offers financial support of between £25,000 and £250,000 using Revenue Participation Agreements (a type of quasi-equity instrument). Through this legal arrangement, Venturesome acquires a Revenue Participation Right that entitles it to a share of the social sector organisation's gross annual revenues.

CAF[3] believes that this type of agreement offers several advantages over debt and equity investments for both social organizations and investors:

For social organisations: (1) it better aligns the cost of capital with business performance, (2) it is less costly and time-consuming than raising equity finance, and (3) there is no dilution of ownership and control.

For investors: (1) the investee's legal structure is not a constraint, (2) it offers an opportunity to achieve a higher IRR than a loan, and (3) it is a flexible method of investing directly into growing trading activities.

Since it launched, CAF has invested over £12.5m in 200 small or medium social enterprises through quasi-equity instruments.

Mobilizing a wider investor base

Empower Community Bond (overview)

Empower Community raised £10m though issue of a bond to finance the purchase and management of solar photo-voltaic (PV) panels installed on over 2300 social housing properties. The product focused on addressing fuel poverty and introducing new investors to the market.

Social Finance supported Empower Community to structure a bond which would fit within an institutional pension fund portfolio, and to raise investment. The 20 year loan pays investors an inflation-linked annual return. Investors are protected through four features: (1) Empower/Gentoo suffers first loss from underperformance; (2) Minimum cash buffer maintained at all times, (3) Insurance contract and favourable repayment terms for loss of assets and (4) Full security over assets.

The Empower Community Bond achieved its goals. Tenants will have access to free daytime energy, and with net profits from the project will be reinvested in the local community. It also introduced a new investor, a pension fund, to the social investment market.

What are the main lessons learned?

The analysis of the case studies above has highlighted several key learnings:

Cornerstone investors can be used to signal the investability of a project, and encourage other sources of capital to invest.

Social investment products should have a range of risk/return profiles in order to encourage the development of a wide investor base and meet the different needs of social sector organisations. For example, the use of tiered structures, including subordination and/or first-loss structures to bring in a broader range of investors for whom the overall risk profile would have otherwise been too high.

Geographically-focussed investors can be used to finance projects in areas where there are funders particularly interested in the local community. This can help facilitate the development of partnerships between social sector organisations and sources of funding. Both the Belgium and the Dutch SIB have demonstrated that national/regional Foundations, corporations and other investors may be attracted to invest in pilots and demonstration projects in their own community.

[3] For more information on the CAF's case study, please visit: www.cafonline.org/pdf/VenturesomeQuasiEquityMarch2008.pdf

What is unique about Portugal that should be considered when adapting to the Portuguese context?

Developing new ways for financing social innovation will require coordination among investors, intermediaries and social organisations seeking investment.

The recent announcement of Portugal Inovação Social is an important milestone in promoting innovative financing mechanisms. It will become Portugal's social finance wholesale institution and will have a mission to develop the social investment market.

Portugal Inovação Social has a mandate to implement two types of funds:

- A retail structure committed to providing unsecured debt capital (that offers below-market interest rates, long-term maturity and longer grace periods) and quasi-equity instruments (such as Shared Participation Agreements).
- An outcomes fund designed to promote the development of social impact bonds.

Fund development in the country should also take into account the experience of Fundo Bem Comum – an investment fund launched in 2011 with the mission of funding business projects developed by long-term unemployed individuals who are over 40 years old. Key learnings have emerged from this experience, such as the lack of an investible pipeline and the mismatch between the type of finance available and the need of ventures applying for funding.

Launching pilot funds and projects will help test different models and provide examples of best practice to market participants. In particular, Portugal Inovação Social has the opportunity to create feedback loops to capture the benefits and limitations of the capital available to the market to inform how it allocates funding in the future.

PRIORITY AREA 3.2: IDENTIFICATION OF INCENTIVE STRUCTURES TO ATTRACT NEW SOURCES OF CAPITAL TO THE SECTOR

What question are we trying to address with this potential recommendation?

Funding for social organisations in Portugal is often provided by foundations, public sector (through fee for service contracts), CSR departments of corporations and, in some case, wealthy individuals. These funders have limited resources to invest. The social sector currently has a €750 million financing need. For the sector to develop, it needs: to (1) better allocate existing resources and (2) mobilize new pools of capital.

Social Investment Lab research has identified five types of potential social investors in Portugal: (1) high net worth individuals, (2) foundations (excluding the IPSS with foundation status), (3) Venture Capital Funds, (4) Corporate Social Responsibility budgets and (5) Business Angels.

These potential investors can be encouraged to engage in the market through creating frameworks that incentivize them to fund social organisations.

What did other countries do to address this issue?

Two different approaches to incentivisation from the UK and France are reviewed as examples of how to attract new sources of capital to fund social innovation.

Purpose	Live example	Rationale
Test tax incentives to increase the investor base	UK Social Investment Tax Relief (UK)	The UK Social Investment Tax Relief (SITR) seeks to increase investment into the social sector through creating tax incentives. It is a pilot initiative that came into effect in April 2014.
Enable mass market participation	90/10 Solidarity Funds (France)	The 90/10 Solidarity Funds were designed to increase the potential resources which could be invested in social organisations through the involvement of individual investors. In 2008, the opportunity (but not the obligation) to invest in such funds were made mandatory for all corporate employee-savings plans and corporate pension funds.

Test tax incentives to increase the investor base – UK Social Investment Tax Relief

Following consultation with the social investment sector and strong advocacy from the sector, the UK government recently implemented the Social Investment Tax Relief (SITR) with the objective of providing an equivalent incentive for social investment. SITR is a tax relief that can be claimed, in the UK, by individual investors who have made qualifying debt or equity investments into social organisations.

The key benefit is 30% upfront tax relief on the total amount invested (up to £1 million per year). SITR has eligibly criteria for both investors and social sector organisations.

Private Investors: can claim tax relief if the funding provided to the social organisation meet specific criteria.

- Equity: (1) Purchased shares are paid in cash at the point of issuance, (2) Shares must not carry any right to a dividend which is fixed or greater than a reasonable commercial rate
- Debt: (1) cannot be secured, (2) must not carry preferential rights over any other debt obligation that the organisation has and (3) Interest rates shall not be higher than the reasonable market rates.

Social organisation: must meet the following requirements in order to be eligible for SITR investments:

- Carry out a qualifying trade, independently of being a charity, a community interest company or a community benefit society;
- Have a social mission lock, (i.e., their social purpose must be established and regulated);
- Not employ more than 500 staff;

- Not have annual gross assets that exceed £ 15 million.

Although access to SITR is relevantly new, several social investment products are trying to utilise the scheme. The first investment which used SITR was made in November 2014 to fund a charity that tackles food waste.

It is worth highlighting that the development of the SITR drew on the experience of the Enterprise Investment Scheme (EIS) which was a tax relief established to encourage investment in young growth companies and provide them with access to risk capital which would not have otherwise been available to them. SITR substantially mirrors the EIS relief which is generally been regarded as highly effective in attracting investment in the sector. For example in 2012/13, £900m was invested using this tax incentivised structure.

Enable mass market participation – 90/10 Solidarity Funds (France)

Solidarity Funds were established in 2001 with the aim of providing funding for social organisations through the participation of retail investors. The 90/10 structure arises from the need of ensuring adequate investor protection according to the financial regulations for the retail market. These funds invest between 5%-10% of their portfolio into social organisations, while the remaining portfolio is invested in traditional securities.

A major milestone took place in 2008 when all corporate employee-savings plans and corporate pension funds became obliged to offer at least one such fund to employees in corporate pension plans, alongside the other more traditional funds they could select for investment. Even though there is no obligation for employees to allocate any part of their pension contributions in the Solidarity Fund, assets under management of these funds has increased seven-fold - from €478 million in 2008 to €3.7 billion in 2013. This scheme currently reaches over 2,300 social organisations.

To qualify as a social organisation which can be invested in under this scheme, the following criteria apply:

- Ensure that at least 1/3 of its staff is comprised of workers who are employed as part of a work integration program, which entails training and integration of long-term unemployed individuals, people with disabilities, ex-convicts, and others; or
- Ensure that management is elected by the workforce, members or owners of the organization, while abiding by rules concerning pay for executives and staff (effectively establishing a salary ceiling).

The social sector in France is mostly comprised of cooperatives and mutuals which qualify for the second part of the criteria. Historically, a major part of the funding available from this scheme has been channelled through social investment intermediaries who are rooted in the French social sector and ensure an adequate allocation of resources into social organisations.

What are the main lessons learned?

The case study analysis suggests that tax incentives can be an effective way of directing capital towards specific asset classes.

Tax incentives can help mobilize new sources of capital. UK's HMRC has reported that between 52% and 87% of the finance provided through EIS would not have been invested in small, unquoted companies if the EIS relief had not existed and that, for every £1m in forgone tax, there has been an estimated increase in sales of £3.3m and 65 jobs created.

Tax incentives with a range of features – e.g. upfront tax relief, deferred taxation – can attract different types of investors. EIS investors have indicated that the 30% upfront income tax relief is a key factor in their investment decision. The research also suggests that other tax EIS benefits such as exemption from capital gains taxation and deferral of certain taxes are also important. Moreover, **Social investment tax incentives should allow investors to invest together to achieve scale (incentivizing potential cornerstone investors).**

Mass participation in the market through retail investors can be an efficient way of attracting more funding to the sector whilst developing the intermediary market. Nearly 1 million retail investors have participated in this scheme[4].

What is unique about Portugal that should be considered when adapting to the Portuguese context?

Portugal should draw on initiatives such as the SITR and the 90/10 Solidarity Funds, to explore the potential for incentives to encourage social investment. There is a need to adapt these learnings to the Portuguese context in order to accommodate national regulations.

Social investment schemes developed for Portugal should also take into account and build upon existing initiatives including:

- ***The fiscal scheme of "mecenato" (patronage)***, which already includes the possibility of deducting up to 140% of the amount granted in donations to social organisations (capped at 8/1000 of the total revenues of the grant-maker).
- ***The co-investment scheme with business angels***, whereby for each Euro invested by business angels, EU funds will invest 2 Euros.

Incentive schemes should reflect market need and their development should involve close engagement with Portugal Inovação Social, intermediaries, and investors.

[4] Finansol, http://finansol.org/uploads/files/6b498030a083d5b250e55e3b0720c9754edc6cf0.pdf

[PROPOSED RECOMMENDATIONS FOR CONSIDERATION BY THE TASKFORCE]

SUB-GROUP #3 – FINANCING MECHANISMS FOR SOCIAL INNOVATION AND INCENTIVE STRUCTURES TO ATTRACT NEW SOURCES OF CAPITAL

The members of sub-group #3 have identified two priority areas – (1) Assess the potential of innovative social finance mechanisms to finance social innovation, and (2) Identification of incentive structures to attract new sources of capital to the sector.

This research note encompasses the analysis of these priority areas, which will be used to inform the final recommendations of the Taskforce, as highlighted below.

[RECOMMENDATION]

Priority area 3.1 - Assess the potential of innovative social finance mechanisms to finance social innovation

The analysis of these priority areas have suggested the following high-level recommendation, which should be discussed and validated by the Taskforce members:

"Develop financial instruments that are suitable to finance social innovation, such as Social Impact Bonds and Shared Participation Agreements"

[RECOMMENDATION]

Priority area 3.2 - Identification of incentive structures to attract new sources of capital to the sector

The analysis of this priority areas have suggested the following high-level recommendation, which should be discussed and validated by the Taskforce members:

"Consider fiscal and mass-participation incentives that contribute to mobilising more financial and non-financial resources to the social sector"