Committee:	Date:
Social Investment Board	20th June 2013
Subject: Progress Report	**Public**
Report of: Chief Grants Officer	**For Decision**

Summary

This paper introduces today's presentation from the agencies involved with the City of London Corporation's first social investment, the Small Enterprise Impact Investment Fund.

It seeks your authority to bring indirect investments to future meetings.

It provides an introduction to a possible high-risk, high impact ring-fenced allocation within your Fund.

It recommends that you do not consider investment in existing housing association bonds.

It recommends that you appoint two new advisors to your Fund.

Recommendation:

That you note the contents of the report

That you authorise officers to bring indirect investments to your Board for consideration

That you do not consider investment in existing housing association bonds.

That you appoint FSE Group and Social Investment Business / Investing for Good as advisors to your Fund on the same basis as your current advisors, Social Finance.

Main Report

Presentation

1. At your request, today's meeting includes an opportunity to hear from representatives of organisations involved with the City of London's first social investment. The Small Enterprise Impact Investment Fund (SEIIF) emerged from work led by the international charity Oxfam, with support from the City of London Corporation, to strengthen economic development in low income countries. Focused on the provision of affordable credit to small and medium sized private enterprises in the global south, the SEIIF is intended to generate positive social returns as well as a 5% IRR for its investors.

2. SEIIF is managed by Symbiotics, a Swiss microfinance specialist currently managing over $200m through more than 20 microfinance funds. Both Oxfam and Symbiotics have invested their own funds in SEIIF and the City Corporation (through its Policy and Resources Committee) took to the decision to invest $500,000 in July 2012.

3. Vincent Dufresne, Head of Asset Management and Fabio Sofia, Head of Investor Relations will join today's meeting from Symbiotics. Oxfam will be represented by Nicholas Colloff, its Director of Innovation.

4. The following summary is based on SEIIF's investor prospectus and is intended for reference for today's presentation:

Fund size

- Target size of 100m USD raised over 3 years with 25m USD raised by the end of 2012, and 50m USD by end 2013

Term and liquidity

- 5 year investment period
- Early redemption charged at 1.5% per remaining annum (paid to the Fund)

Return to investors

- Capital preservation with a target return equal to or above 5% pa in USD terms
- Return subject to performance across a blend of debt and equity investments made by the Fund to a range of for-profit small enterprise financing intermediaries based in low to middle income countries which in turn invest in domestic businesses with 10 – 100 employees

Social benefit

- Economic growth in low to middle income countries, with a particular focus on women's empowerment and food security
- The Fund will address the unmet demand by SMEs for access to capital (Oxfam estimate that of SMEs in target regions without access to capital, rates are: up to 20% in East Asia; up to 25% in South Asia and up to 40% in Africa)
- The Fund aims to invest the first USD 25m in 12 target SEFIs spread across 5 regions and 9 emerging economies. The Fund estimates that subsequent financing will help over 1,000 small enterprises employing over 12,000 people, two thirds of which will be women

Investment Committee

- Vincent Dufresne, Chair (Symbiotics SA)
- Alan Doran, Vice-Chair (Oxfam GB)
- Geetha Tharmaratnam, Independent Member (Investment & ESG Principal, Aureos Capital)
- Gavin Stewart, Independent Member (CEO - Scottish Widows Pension Fund)
- Stephen Acheson, Independent Member (Head of Fixed Income, Standard Life Investments)

Investment Manager

Symbiotics SA, Switzerland

Investment Structure

Specialized Investment Fund (SICAV-SIF) (an on-shore Luxembourg investment fund) with quarterly valuations

Total Expense Ratio and fees

- 2% pa as follows:
  Fund Manager (Symbiotics) 1.25% pa
  Impact Adviser (Oxfam GB) 0.25% pa
  Agent Bank (CACEIS) 0.4% pa
  Other (audit, legal, tax) 0.1% pa
- No entry, exit or performance fees

6. Latest quarterly financial and social performance reports on the SEIIF are appended to this paper for further reference.

Investment Pipeline

7. Whilst officers are examining a direct investment opportunity in the UK, it has not been possible to complete due diligence in time to bring this proposal to today's meeting.

8. The portfolio update presented in non-public papers to your meeting shows the pipeline of investment opportunities, and notes that many of these are for investment funds. Social investment funds are typically designed to allow investors to place capital into a pool from which onward investments are made in social organisations, and are normally focused on a particular geography or social theme. Social investment funds present investors with a wider range of investment opportunities, as well as greater opportunities to diversify and reduce risk.

9. At your meeting on 23rd April 2013 you discussed the growing number of social investment fund opportunities, and the Chief Grants Officer's paper to that meeting included a discussion on fees. As noted, the costs of placing a social investment, especially through investment funds, are often higher than mainstream market benchmarks (normally 2 – 2.5%). These fees are associated with the emergent nature of the social investment market where there is not yet standardisation of investment deals, and where investees are required to incur additional costs for monitoring and reporting social benefit.

10. Whilst you have expressed a preference for direct investment, officers encourage you to consider indirect investments (notwithstanding their relatively high fees) where these are in line with your investment criteria. This will allow you to invest more of your Fund and support the development of the social investment market which in turn should help in the longer term to lower benchmark fees.

High Risk Allocation

11. At your meeting on 23rd April 2013 you asked officers to examine options for ring-fencing part of your £20m allocation for high impact, earlier stage, and potentially high risk investments that may not be secured by assets.

12. As highlighted at your seminar on 14th February 2013, the majority of social investment issued so far is in the form of secured lending. Social investors typically prefer to back organisations that can provide evidence of reliable revenue streams and a track record of high performance.

13. Many social purpose organisations lack a strong asset base on which to secure lending, and these organisations often have legal structures that place a limit on the distribution of returns to investors. This can make it particularly difficult for organisations to secure early stage investment, particularly when this is sought for innovative work. The combined effect is to create a funding gap, and recent research from the Big Lottery Fund and Big Society Capital estimates that there will be demands for approximately £1bn social investment over the next five years, largely in the form of unsecured debt.

14. Big Lottery research indicates the majority of early stage social business activity seeks finance within the £10,000 to £100,000 range, usually as working capital. Whilst there are a growing number of programmes that seek to identify and support high potential social businesses, the limited number of investors prepared to take on high-risk social financing restricts the potential of this section of the market.

15. One of the objectives of your Fund is to develop the social investment market, and you could play a valuable role by allocating a small amount of capital to high risk, high impact social investment propositions. Preliminary analysis indicates that it may be possible to ring fence between £250,000 and £450,000 for high risk investments with write off rates between 50-100% without negative impact on your Fund's target total return. Officers will present a paper on options for a high risk allocation at a later meeting.

Housing Association Bonds

16. At your meeting on 23rd April 2013 you asked officers to research opportunities for your Fund to invest in housing association bonds.

17. Housing associations are private, not-for-profit organisations (the majority have charitable status) and exist to provide low cost social housing at sub-market rent levels. Collective turnover was £13.8bn as of March 2012. Operating surpluses are often used to provide community or neighbourhood services such as childcare support or social welfare programmes.

18. Whilst housing associations have delivered a collective operating surplus over the past five years, they have also sought external finance to develop affordable homes and bring existing stock up to required standards. As of December 2012 housing associations had total reported borrowing of £67.9bn of which 94% was secured. It is estimated that 70% of the debt is issued at fixed interest rates.

19. Housing associations are authorised to access private finance through bank lending (which currently accounts for 90% of external finance) and bonds. Over the past three years the sector has sought to raise £5bn p.a., and is likely to increase its borrowings in the future as government grants are scaled back.

20. £4bn of housing association bonds were issued in 2012 and the total outstanding issuance is £12bn. The majority is secured and has a fixed coupon of, typically, 5%. Larger associations are able to issue own name bonds with medium-high credit ratings whilst smaller associations raise finance via intermediaries such as GB Social Housing and The Housing Finance Corporation.

21. There is currently very little liquidity in secondary markets for housing association bonds and this prevents active bond managers from investing in social housing bonds. As such, the majority of investors invest on a ‘hold to maturity’ basis, with maturities ranging between 20 – 30 years. One study indicates than 90% of all social housing bonds issued since 2008 have been purchased by only 13 investors.

22. Some housing associations do access capital through private placements, and these have included placements with charitable trusts. Since 2006 over £1bn has been raised through private placements, and is unlisted, lacks liquidity on secondary markets and is usually held to maturity. Transaction sizes for private placements have averaged £20m for 10 year plus durations.

23. One housing association currently offers retail bonds that are quoted and traded on the London Stock Exchange. Places for People has £140m bonds in circulation, although it would be hard to deem these investments with identifiable social impact as the housing association has already received the bond proceeds.

24. Whilst housing associations generate a number of positive social benefits through offering affordable and secure tenancy to low-income households and by investing in community and neighbourhood regeneration, it is difficult to attribute existing bond issuance (whether retail, private placement or other bonds) to measurable social impacts.

25. Despite the relatively high annual return, officers recommend that you do not consider existing housing association bonds as suitable for your Fund given the difficulty relating these investments to specific social impact and the generally long maturity on these products. In addition, officers also highlight that housing association bond risk may grow as central government grants to the sector decline, welfare reform is rolled out and regulation is reviewed. Members should note that Moody’s has stated the sector may be subject to multiple-notch downgrades in the near future.

26. Existing housing association bonds are not deemed suitable given your investment criteria, but officers will examine new products as issued for suitability. Members may wish to consider the possibility of engaging an appropriately qualified organisation to examine whether a dedicated social investment property fund could be created.

Advisors to the Social Investment Board

27. Currently, you have only one independent advisor appointed to your Fund, Social Finance Ltd. You agreed at your 14th December 2012 Board meeting that you wish to appoint a ‘pool’ of social investment advisors and to delegate authority to the Town Clerk, in consultation with the Chairman and Deputy Chairman, to draw up a list of other suitable organisations for approval at this meeting.

28. This action was taken forward, and a call to submit an expression of interest was sent to thirteen appropriately qualified organisations. By the deadline of 5th April 2013, six of these had responded, and the details of their specifications were drawn up in a matrix. Three of the most suitable agencies were selected for interview and met the Chairman and Tim Wilson of City Bridge Trust on 8th May to discuss how they might support your work.

29. Two of the agencies, The FSE Group and The Social Investment Business Group / Investing for Good / The Good Analyst would be useful advisors to your Board and are recommended for appointment.

30. The FSE Group (hereafter 'FSE') is a non-profit Community Interest Company established in 2002 to provide fund management, consultancy, and business angel support to socially-oriented small and medium enterprises. FSE's small staff team has substantial commercial experience, and the organisation currently has £32m funds under management. FSE has been involved in several high-profile, pioneering social investment initiatives, including the first Social Impact Venture Capital Trust, a new fund for renewable energy initiatives with social impact, and advisory services on social investment readiness to social enterprises. FSE has social investment due diligence and appraisal expertise that would be a useful asset to your Fund.

31. The Social Investment Business Group / Investing for Good / The Good Analyst (hereafter 'SIB') is a partnership of organisations led by one of the largest social investment intermediary organisations in the UK. To date SIB has arranged over £160m loan finance to social enterprises and charities and a further £200m in grant funding. This support has been targeted to social sector organisations working in a broad range of disciplines including offender management, employment support, environmental services, and social care. SIB is widely recognised as a leading organisation concerned with developing the UK social investment market. SIB proposes to work in partnership with Investing for Good and The Good Analyst Ltd. The first is an FCA regulated agency which is recognised as a leader in the arrangement of charitable bonds. The Good Analyst Ltd is a company that has developed a proprietary social impact tool which is regarded as close to an industry standard.

32. Both The FSE Group and The Social Investment Business Group / Investing for Good / The Good Analyst would be useful additions to your pool of advisors. Officers will continue to work with the Chairman and Deputy Chairman to identify suitable advisors to your Fund.

Recommendations:

That you:

a) note the contents of the report,

b) authorise officers to bring indirect investments to your Board for consideration

c) do not consider investment in existing housing association bonds at this stage

d) appoint The FSE Group and The Social Investment Business Group / Investing for Good / The Good Analyst as advisors to your Board. Their services to be engaged on the same spot purchase basis as your current advisors (Social Finance).

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