Submission to:

The Treasury

Consultation on Social Impact Investing

February 2017

Introduction

This submission outlines five key areas where the Community Council for Australia believes there is scope to support a stronger and more effective impact investing market in Australia.

CCA is particularly interested in ensuring impact investing enhances our communities and the organisations that serve them rather than just representing a way of saving government money or opening up new deals for the finance sector. Although there is nothing inherently wrong with government savings or new forms of investment, maximising the benefits to the community is the focus of CCA and its members.

Impact investing has the potential to strengthen our communities, but it is not the solution to all social problems or funding shortfalls.

CCA has consulted with members (see listing in appendix 1) in framing this submission, however, it is important to note that this submission does not override the policy positions outlined in any individual submissions from CCA members.

The content of this submission includes: a brief background to CCA; an overview of the current context for the NFP sector; a listing of five key issues associated with impact investing, a summary listing of support measures for impact investing in Australia, and a conclusion.

CCA welcomes the opportunity to provide input into this consultation and would be happy to engage in detailed discussion about any proposals arising from The Treasury consultation process.

The Community Council for Australia

The Community Council for Australia is an independent non-political member based organisation dedicated to building flourishing communities by enhancing the extraordinary work undertaken by the charities and not-for-profit sector in Australia. CCA seeks to change the way governments, communities and not-for-profits relate to one another. It does so by providing a national voice and facilitation for sector leaders to act on common and shared issues affecting the contribution, performance and viability of NFPs in Australia. This includes:

- promoting the values of the sector and the need for reform
- influencing and shaping relevant policy agendas
- improving the way people invest in the sector
- measuring and reporting success in a way that clearly articulates value
- building collaboration and sector efficiency
- informing, educating, and assisting organisations in the sector to deal with change and build sustainable futures
- providing a catalyst and mechanism for the sector to work in partnership with government, business and the broader Australian community to achieve positive change.

Our success will drive a more sustainable and effective charities and not-for-profit sector in Australia making an increased contribution to the well-being and resilience of all our communities.

Context: not-for-profit reform

The NFP sector encompasses over 600,000 organisations - from large to very small, and employs well over one million staff (around 10% of all employees in Australia). Australia's 54,000 charities collectively turn over more than $130 billion each year and hold over $260 billion in assets. In the last decade, sector growth has continued at more than 7% a year, a figure that is higher than any other industry group.

These facts tell only a small part of the story. The real value of the NFP sector is often in the unmeasured contribution to Australian quality of life. NFPs are at the heart of our communities; building connection, nurturing spiritual and cultural expression, and enhancing the productivity of all Australians. Collectively, they make us a more resilient society.

The importance of the NFP sector is now being internationally recognised with many governments putting in place measures to increase NFP investment and productivity. Smaller government and bigger community is a common theme, driven in part by savings, but also by a commitment to greater civic engagement, social entrepreneurship and productivity within the NFP sector.

In Australia there are currently various initiatives seeking to: promote social enterprise; reduce compliance costs for NFPs; encourage a diversification of financing options to build a more sustainable funding base; streamline and refine the regulation of NFPs and charities; establish less bureaucratic reporting requirements while building community transparency; increase volunteering and philanthropy; improve relationships between government and the NFP sector; promote impact investing; and increase sector performance measurement. CCA supports all these activities.

The establishment of the Australian Charities and Not-for-profit Commission (ACNC) is the first time the NFP sector has had an independent regulator dedicated to serving their needs and enhancing their capacity. It has already proved to be a positive step towards red tape reductions, increased transparency, and trust in the community by prospective volunteers and donors. The national charities register has also provided invaluable information.

While the recent history of the NFP sector is framed by growth and reform, new issues are emerging. The level of volunteering and individual philanthropic giving as a percentage of income has still not recovered to the highs of 2009. Revenue available to governments is effectively falling in real terms against a backdrop of increasing demands and higher community expectations. Competition for fundraising and services has increased. In the context of this slow down in a previously impressive level of annual growth, the NFP sector is slowly building a collective voice seeking real reform that will provide substantial savings to government as well as tangible benefits to the community.

Given the size of the sector and its critical role in our community, the Federal Government can achieve real economic and social benefits if it chooses to strategically invest in this reform process to strengthen our communities and our NFPs. There have been numerous reports and recommendations relating to the NFP sector over the last decade, but relatively few have been acted upon.

In seeking to enhance the resilience and capacity of Australian communities, it is important to acknowledge that there is a shortage of capital investment across the NFP sector. In many charities, there is a delicate balancing act between investing in doing more and investing in the capacity to do better. Most charities lean towards doing more, offering more services. Consequently, the charities sector generally suffers from a lack of investment in infrastructure, facilities, IT, professional development, monitoring and evaluation, reporting and communication. These are not areas that are popular with philanthropists or government funders, but can be vital to sustainability and effectiveness.

Key issues relating to impact investing in Australia

1. Purpose of impact investing

CCA strongly supports the potential of impact investing to provide public benefit through attracting new sources of capital and applying this capital to address a wide range of social issues. CCA also recognizes the benefit of attracting diverse expertise and generating innovative ways of approaching social problems.

As pointed out in the Treasury Discussion Paper on Social Impact Investing, there are many barriers holding back the potential growth of the impact investing market in Australia. Most of these barriers relate to the way each component of the market – government, private capital and NFPs - typically operates. This includes not only the structures and processes within each market component, but also culture, language, expectations, ways of operating and communicating. CCA is particularly interested in the barriers relating to NFPs.

It is important to acknowledge that NFPs working to build community capacity and address social issues are almost invariably focused on local solutions, services and direct engagement with their communities. This effort to better serve their communities can be all consuming. When thinking about how to enhance their organisations, most will talk about needing to offer more and better services to their communities. Leveraging the existing organisational assets (mostly property and reserve funds) within the mainstream financial markets is often a challenge, let alone looking for new forms of investment. The most common ways of gaining new income to support their services have been: increased government funding; increased returns on fees and service costs; and increased philanthropy. As noted in the context setting, for over a decade these income streams have been growing at more than 7% per annum. This growth has now stalled. The infrastructure across the NFP sector is increasingly being run down as organisations seek to make up funding shortfalls by depleting organisational expenditure in the non-direct services areas. While providing some short-term reprise, this approach impacts negatively on long term sustainability. Some recognize the need to merge with others or to consolidate an inefficient federated model of duplicated operations, but making the large-scale changes involved in mergers and increased collaboration requires a set of resources including time and expertise that is not always readily available. Many NFPs would welcome new investment, but have limited exposure to the investment market.

Other parts of the impact investment eco-system have their own limitations. Finance managers are focused on actively seeking out new investments with viable margins that will appeal across different capital markets. Governments are increasingly seeking to reduce expenditure while still meeting community expectations in critical areas including welfare, health, education, housing and employment.

CCA does not see impact investing being about propping up NFP service providers struggling with income shortfalls. Nor should impact investing just be about providing a new set of deals for clever finance managers, or enabling governments to cut funding of core services or reduce their responsibilities to the community.

Impact investing offers the potential to meet the needs of all three key players, while also increasing community benefit. It is this shared goal of stronger communities that needs to inform the development of the impact investing capital market, not the needs of the market itself or of any one player. Impact investing should never be only an extension of existing capital markets or a way for government to avoid meeting community needs. For CCA, this focus on building flourishing communities is the critical principle and the reason for supporting impact investing.

2. Measurement of impact and outcomes

Measurement of impact and outcomes are a critical aspect of most impact investments. What is being bought or invested in and what are the returns beyond the economic benefit to investors? Given the significant role of measurement in all impact investing, CCA believe it is important to clearly outline the current NFP perspective on measurement of outcomes and impact.

There is no contention that measurement of outcomes and impact is strongly supported within the NFP sector. People who work in the NFP sector want to do good work and want to know their work is making a difference. Time and again across the NFP sector, research and consultations have highlighted that it is not a lack of will that impedes better measurements across the sector, but a lack of resources – predominantly time and expertise. Time and again governments and other funders refuse to fund appropriate resources to enable meaningful measurement frameworks to be developed.

The ad hoc and sporadic availability of comprehensive measurement of outcomes across many areas of NFP activity is a testimony to the lack of incentives for NFPs to divert their resources into measurement. Most sources of income for NFPs either presume the work that is being done is effective (the usual philanthropic approach) or are predominantly interested in levels of activity rather than outcomes or impact (the usual government approach).

The Productivity Commission highlighted the issue of measurement in their major report into the Productivity in the Not-for-profit Sector released in 2010. Measurement was the subject of the first substantive chapter in the report (Chapter 3). The main recommendation of the Productivity Commission was the development of a common evaluation and measurement framework appropriately supported by funders of programs and services. The benefits of adopting this approach are enormous.

Adopting a shared measurement framework that identifies outcomes and impact is not only fundamental to improving program and service delivery, it is also the very basis of any impact investing activity. Endless collection of invoicing and activity statements is not a measurement of outcomes. As the Commonwealth Financial Accountability Review Discussion Paper released in 2012 argued:

It is preferable to have fewer, more meaningful indicators that focus on what matters.
*(*CFAR Discussion Paper: *Is less more? Towards better Commonwealth performance.* Chap. 7, pg. 50*)*

NFPs have repeatedly shown they can provide meaningful outcome measures if given the opportunity to do so. Many seek their own sources of funding to enable such evaluations, knowing how critical measurement is to both improving their practices and seeking more support.

There are, for instance, organisations that can clearly demonstrate how they reduce youth imprisonment rates and recidivism. They can also show the savings to government through their interventions. This information is often not standardised and is discounted. It is also an unfortunate fact of government process that the impact investment required to deliver the savings may come from a different area or level of government than where the savings are made. Why should a Health Department save a Corrections Department money by providing drug treatment to dependent offenders? It is an added cost to the Health Department even though it reduces the need for prison beds.

It is not a lack of methodologies, but a lack of investment in outcome measurement that is one of the biggest barriers to impact investing in Australia. Supporting more investment in better outcomes measurement should be a major priority for The Treasury purely on productivity grounds. It is also a clear priority for anyone interested in promoting or extending the level of impact investing in Australia.

3. Scale and investment readiness

Where is the runway of investment ready proposals an impact investment capital market could invest in? The short answer is no such runway exists, primarily because there is still limited investment in enabling NFPs to develop appropriate proposals.

The first major issue is scale. If it costs $150,000 to set up an impact investment deal - meeting costs, legal costs, business cases and appropriate expert advice - then even a deal of $2 million has already lost 7.5% before it starts so an investment needs to return over 13% to be worth pursuing. If the deal is for $200 million (much bigger scale) then the establishment costs remain similar so the set-up costs will be less than 0.1% of the overall investment. Larger scale investments with lower returns are more feasible.

The vast majority of NFPs cannot offer scalable investments. Only 5% of all charities (around 2000 charities in total) have a turnover greater than $10 million. Even if a charity has a scalable investment proposal, how do they do the work required to translate a good idea into an investment ready proposal? This work is expensive and time consuming, and requires a level of expertise that usually needs to be bought into most charities. CCA has also found that many Boards of charities are very risk averse and reluctant to engage in any form of borrowing or higher level investment.

Impact Investing Australia and others have created various funds to assist in supporting charities and others to develop investment ready proposals, but a great deal more work needs to be done in this space.

Experience overseas, particularly in the UK, suggests that early support for the development of investment ready proposals is a critical component in building the impact investing capital market.

CCA believes there is scope for government and investors to support the role of intermediaries and new investment readiness funds to help build a smoother runway for charities and NFPs willing and able to use impact investing as a way of improving their communities.

4. Freeing up new capital

There are numerous barriers to capital being used in an impact investing capacity, some created by government. Superannuation funds, Public and Private Ancillary Funds are not sure where impact investing sits in relation to their responsibilities as prudent financial managers. There is an implied disincentive to step beyond the safe boundaries of equities and other accepted investments. One way of addressing this reluctance is to create new investment guidelines and policies.

CCA has been a strong supporter of the French 90/10 rule for superannuation funds. France has required all employees to be given the option of investing **5-10%** of their superannuation into 'solidarity organisations' (the equivalent of our charities) since 2001. In 2008 the French Government regulated that all super funds needed to provide this option to employees and since that time the amount invested has grown from $700 million to over $5.5 billion. This has stimulated social entrepreneurship, created opportunities to achieve social impact, and improved the capital base and capacity of solidarity organisations.

The success of the French 90/10 rule shows what could be achieved if Australia chose to provide employees with some choice about how their superannuation contributions are invested. If just 2% of the MySuper funds were invested this way it would generate around $8.5 billion, or enough to provide housing to over 50,000 Australians struggling to maintain secure and appropriate accommodation including the homeless.

CCA believes this measure would provide a massive boost to the impact investing capital market. It could also be transformative in encouraging the NFP sector to find ways of establishing social enterprises and other investment opportunities to strengthen our communities.

There are also questions currently about the degree to which a social return can be treated as a benefit in the same way as a financial return. Superannuation funds are required to show they have applied appropriate investment strategies in managing their funds, and the application of funds to achieve a social benefit with a diminished financial return – which may not be acceptable to some regulators.

Similarly, the managers of a large Public Ancillary Fund may choose to use their corpus as the primary beneficial vehicle rather than distributing a small amount from earnings each year. For instance, if a PuAF has $100 million in assets and was historically distributing $5 million a year in accordance with PuAF requirements, could the fund choose not to distribute any money, but instead invest $80 million in a major new impact investment such as new affordable housing or establishing additional dementia beds? The benefits of an $80 million investment in social benefit would probably easily exceed the benefits of distributing $5 million, but this raised the important question of how such an investment is to be treated by regulators including the ATO.

Allowing the returns on impact investing to be treated as a benefit equivalent to a financial return may be critical in freeing up capital that can be invested in achieving positive social and economic outcomes.

5. Role of governments

Governments talk about wanting to reduce costs and focus more on outcomes, but government performance measurement and investment approaches rarely reflect these policy goals. Most government officials view any investment where there is an expectation of a financial return as carrying much higher levels of risk than grant making. This is partly because staff across government Departments feel much more confident in assessing and managing grant-making risks. This approach reduces government contracting to activity based performance measures and the counting of services. There is very little measurement of outcomes or the achievement of policy goals.

Similarly, governments tend to be reluctant to offer longer term guarantees of funding, or to underwrite risk outside of grant processes. Even co-investing with private equity presents a challenge to many government departments. New emerging vehicles for impact investing, such as government bonds and pay on result approaches, have been difficult to establish despite the positive benefits they provide to many communities. Consequently, governments around Australia are not significant players in the Australian impact investing space.

From an NFP perspective, each new government procurement process seems to operate in a vacuum with little use of past performance data to inform future contracting. This is particularly true where the performance information traverses a number of policy and program areas, or involves different government agencies.

All too often the fundamental elements that drive performance – the competency and capacity of the individuals, management teams, organisations, their relationship with their customers and their communities, the capitalisation, business plans, other investors, competitors, etc. – are simply not factored into either the performance management and reporting processes or the risk management framework adopted by governments. Instead, governments tend to focus on inputs and outputs, invoicing for services and straight measures of activity and compliance.

If government is genuinely interested in promoting impact investing there are many well informed and demonstrated policies readily available that would not only stimulate the market, but also drive new investment. Some of these options are listed in the section below.

Summary of measures to support impact investing

Measurement

Supporting the development of an agreed measurement framework for charities and NFPs has long been on the agenda. The many *ad hoc* efforts across various government departments and differing levels of government are patchy at best. Expecting charities to develop their own measures in various program areas without appropriate resourcing is only compounding the issue.

Impact readiness funds

Experience in Australia and overseas has shown that impact readiness funds can provide an important stepping stone for organisations that are close to being able to offer innovative impact investment opportunities.

Intermediaries

Supporting the role of intermediaries will be important into the future. A joint government initiative with high level advisory firms and established intermediaries like Social Ventures Australia would make the preparation of investment ready proposals more feasible for many across the NFP sector.

Impact Investing Australia

Supporting major policy initiatives, such as Impact Investing Australia, which bring together key players to help stimulate the impact investing market, can be very important for the impact investing market in Australia and internationally.

Impact Capital Fund

In the United Kingdom, the creation of the Big Society Bank was a real catalysing factor for the impact investing market. A similar investment by government into a dedicated impact investment capital fund would undoubtedly deliver the same benefits in Australia.

Government guarantees

Offering more surety around government income streams, wherever possible, will reduce risk and increase investment opportunities.

Removing red tape and other government barriers

New impact investing guidelines are needed to offer comfort to superannuation trustees and trustees of Public and Private Ancillary Funds if impact investing is to be seen as legitimate way of managing their investment funds.

French 90/10 rule

Adopting a system where people can choose to have a percentage of their superannuation contribution invested in impact investment funds has been successful overseas and would certainly stimulate the impact investing market in Australia.

Conclusion

CCA strongly supports the potential of impact investing to bring about positive changes in our communities.

The impact investing market is growing slowly in Australia, but if it is to become more effective and deliver better outcomes across communities, it needs more support from governments and others.

It is important to emphasise that impact investing is not the panacea to all social problems and should never be the primary approach in addressing complex social issues.

NFPs are keen to be part of the emerging impact investing market and to find new ways of working across government and across private investors, but only when the focus is on improving our communities.

Some good work has already been done in Australia through Impact Investing Australia, Social Ventures Australia and others, but this work needs to be taken to scale with more considered support from government and from private capital.

The government can choose to be active in this space and ensure the impact investing market grows quickly and effectively, or it can rely on the *ad hoc* and often under-resourced efforts of leaders in this area to drive ongoing reform within and beyond government.

As the major investor in social welfare, health, education and public housing, it is clearly in the government's interest to better leverage existing expenditure in achieving positive outcomes for all Australians.

Impact investing can and does bring about measurable change in communities when done for the appropriate purpose and with well thought through policies and practices in place.

CCA welcome this consultation and hope that it indicates the government is more willing to offer much needed support for impact investing into the future.

CCA believe there is real potential to deliver sustainable benefits to communities across Australia if a well-structured impact investing market can be nurtured in Australia.

Current Membership – Community Council for Australia ***Attachment A***

Access Australia's National Infertility Network
Access Housing
Adult Learning Australia
Alcohol, Tobacco and Other Drugs Association ACT
Arab Council Australia
Arthritis Australia
Australian Charities Fund
Australian Council for International Development
Australian Healthcare and Hospitals Association
Australian Indigenous Leadership Centre
Australian Institute of Superannuation Trustees
Australian Major Performing Arts Group
Australian Women Donors Network
Benevolent Society
Business Council of Cooperatives and Mutuals
Carers Australia
Centre for Social Impact
Church Communities Australia
Churches of Christ Vic and Tas
Community Based Support (Tas)
Community Broadcasting Association of Australia
Community Colleges Australia
Connecting Up
Drug Arm Australasia
Ethical Jobs
Everyman
Foresters Community Finance
Foundation for Alcohol Research and Education
Foundation for Young Australians
Fragile X Association of Australia
Fundraising Institute of Australia
Good Samaritan Foundation
Good to Give
Hammondcare
Hillsong Church
Justice Connect
Life Without Barriers
Mater Foundation
Mission Australia
Missions Interlink

Musica Viva Australia
Non Profit Alliance
Our Community
Palliative Care Australia
Philanthropy Australia
Playgroup Qld
Port Phillip Housing Association
Power Housing Australia
Probono Australia
Queensland Water & Land Carers
Reach Foundation
RSPCA Australia
SANE
SARRAH
Save the Children
Scope
Settlement Services International
Smith Family
Social Ventures Australia
St John Ambulance
Starlight Foundation
Ted Noffs Foundation
Touched by Olivia
Variety Australia
Volunteering Australia
Wesley Mission
White Ribbon Australia
World Vision
YMCA Australia
Youth Off the Streets