

JOURNEY TO SOCIAL INCLUSION

A case study summary of the J2SI Impact Investment Transaction
Prepared by Centre for Social Impact

more
than
money



Introduction

For almost a decade, Sacred Heart Mission's (SHM's) Journey to Social Inclusion Program (J2SI) has supported people to break the cycle of homelessness. The program works on the premise that self-sustained, long-term housing provides a solid foundation to improve people's lives. J2SI is a three-year program for people experiencing long-term homelessness that provides clients with:

1. Assertive case management and service coordination
2. Rapid access to housing and support to maintain tenancy
3. Trauma-informed care in recognition of the events that have shaped people's lives
4. Progressive skills development for social and economic inclusion
5. The capacity for self-management and independent living

The first two J2SI programs were delivered from 2009 to 2012 and 2016 to 2019 supporting 40 and 60 people respectively. The third iteration of the program for 180 people over 5 years in 2018 commenced delivery through the Victorian Government's first Social Impact Investment (SII). The investment used an innovative finance model by combining funding from the Victorian Government and low-cost debt from the Catholic Development Fund (CDF). A significant component of the structure is the use of philanthropic guarantees provided by NAB Foundation, William Buckland Foundation, Orcadia Foundation and Robert & Irene Gilbert. Importantly, this was the first time a philanthropic guarantee had been included in a pay-for-performance social impact investment in Australia, which significantly lowered the cost of capital.

An important step in supporting social impact investing, innovative finance mechanisms and cross-sector partnerships in Australia, is sharing lessons through the case study and this summary report.

Social Impact

Results from J2SI, 2009-12 and preliminary findings from 2016-19 indicate the approach has led to substantially better housing outcomes (31% more clients in stable housing; and 85% of clients in independent housing) and health outcomes (45% higher reduction in hospital bed days) for clients compared to the control group for years 2 to 4.

The initial J2SI pilot has been extensively evaluated using a randomised control trial (RCT), which is considered the 'gold standard' of program evaluation. By having robust measurement and long-term results, J2SI can confidently demonstrate that providing targeted support to those experiencing homelessness will result in a more cost-effective approach for governments, compared to the current system. Currently, these people are offered limited targeted support, leaving them to navigate the homelessness service system (e.g. criminal justice, health and crisis services) on their own which can be confusing, and difficult to understand.

Transaction Overview

The financing model for delivery of J2SI under the Victorian Government contract was not a traditional social impact bond (SIB), as program finance covering working capital was secured by SHM from a single debt provider, CDF. To lower the cost of this funding to an affordable level for SHM, the J2SI transaction model includes third party philanthropic guarantees. It is the combination of low cost debt and guarantees that sets it apart from a traditional SIB. The guarantees effectively underwrite SHM's share of the program delivery risk (and therefore performance payment) and enabled SHM to access project finance. Figure 1 provides an overview of the J2SI transaction structure.

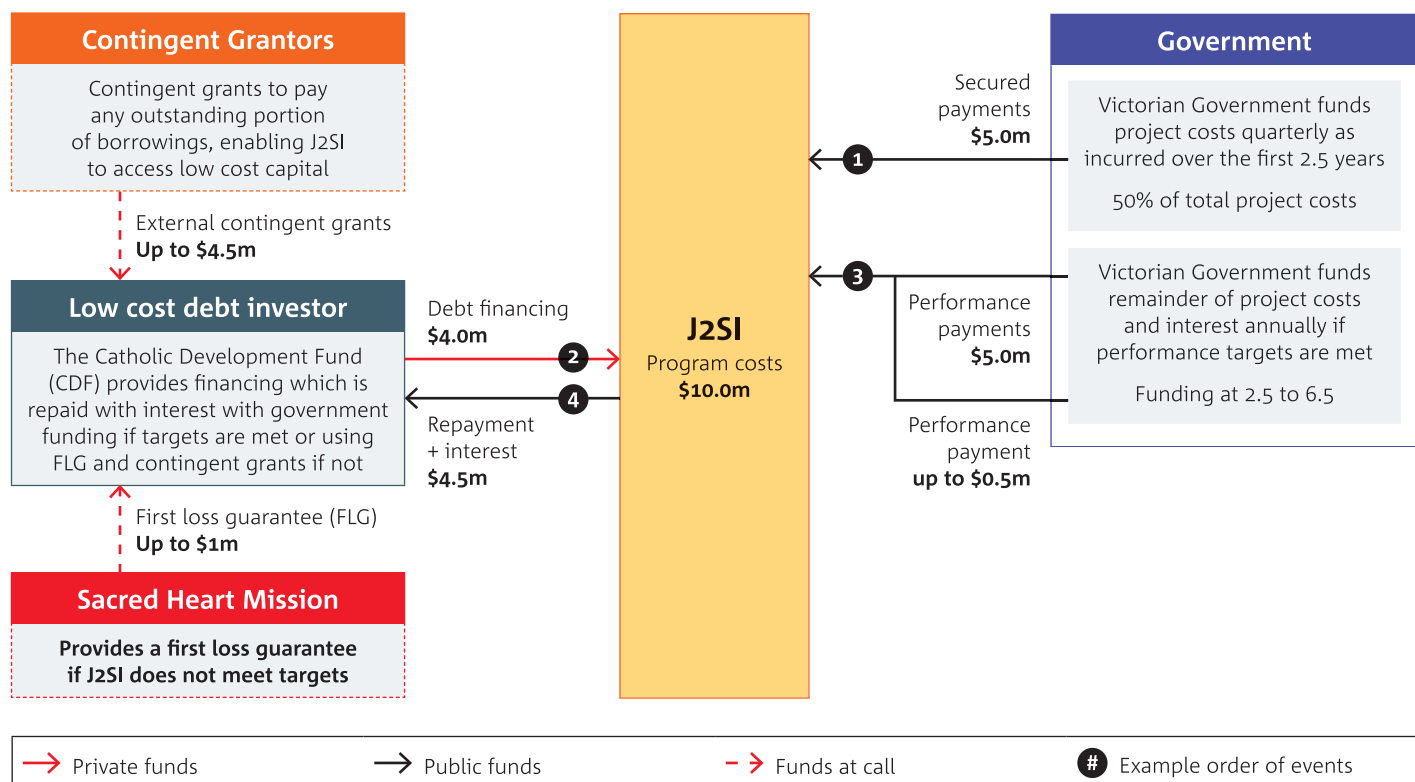


PHILANTHROPIC GUARANTEES & BENEFITS TO PAFS/PUAFS



Figure 1: Summary of the J2SI Transaction Structure (adapted from the new SHM communication pack)

Overview of the J2SI low cost debt / contingent grants financing structure



All values are indicative as actual values are commercial in confidence

Philanthropic Guarantees

In order to access the debt finance from CDF, SHM sought philanthropic guarantees or contingent grants to underwrite its project-delivery risk, with the Victorian Government carrying the balance of risk. This reduced the cost of the debt capital from CDF from an unsecured rate to a secured rate. In contrast, for a SIB, social impact investors seeking social and financial return provide preliminary financing for delivery of the program. This is repaid with interest if government targets are met or the investors lose some of their investment if the performance targets are not met. This is the critical difference between the traditional SIB and the J2SI financing structure.

Benefits to PAFs/PUAFs

The structure has additional benefits for philanthropic organisations – notably Public Ancillary Funds (PuAFs) and Private Ancillary Funds (PAFs) that have Deductible Gift Recipient Item 2 Status (DGR2) awarded by the Australian Tax Office. Due to Commonwealth Government reforms made in 2016, PuAFs and PAFs with DGR2 status can provide eligible charitable organisations with a range of support, including land, loans and guarantees, at a discounted rate. Charitable trusts that are not ancillary funds, such as testamentary trusts and wills, are not eligible for this benefit.

CONTEXTUAL ISSUES & CHALLENGES WITH COMMUNICATIONS AND POSITIONING

Contextual issues:

A nascent SII market in Australia

The SII market in Australia is nascent and emergent. Private market activity, including charitable trusts, remains limited. Momentum has largely been finance led, rather than impact led, which is the pattern of impact investing markets globally. The J2SI transaction sits at the impact end of the spectrum, which means it needed credit enhancement or subsidy to meet the need of investors seeking risk-adjusted return.

With the emergent state of SII in Australia, there is a need to build a stronger and more attractive pipeline of investments. Communication and advocacy with the market is required to build interest in the potential of SII and the use of guarantees, as part of a pay-for-performance transaction to improve credit enhancement and make more funding available.

Complexity

The complexities of SIBs, pay-on-performance and similar hybrid SII's were challenges for the J2SI transaction. These included high transaction costs associated with the complexity of due diligence and risk assessment, which many Australian charitable trusts have neither the resources nor internal capacity to sufficiently bear; and understanding the risk associated with the program underperforming or failing to satisfy contractual outcome measures. Ongoing communication and further case study development about the successes, challenges and lessons as transactions come online, is needed to increase the flow of similar SII transactions.

Challenges with communications and positioning

Clarity

The J2SI SII is a complex hybrid arrangement, mixed between a traditional SIB and a guarantee proposition. This represented a challenge for SHM to provide a clear value proposition to potential guarantors partners, even for experienced advisors and sophisticated investors who were familiar with SIBs. Further refinement and simplification of investment memoranda and communications should be included in future transactions involving philanthropic guarantors.

Positioning

To reflect the introduction of the guarantee structure into the model meant shifting away from SIB specific language to reflect the unique elements of the transaction. This represented an initial communications challenge in positioning the transaction as it represented a SII for the debt funder, CDF, however the transaction did not constitute an impact investment for the philanthropic guarantors.

The value proposition of the 4/5% for PuAFS and PAFS

Early communications did not outline and quantify the benefits of the potential use of the guarantee as part of minimum distribution requirements. This led to difficulties explaining the upside of participation in the transaction as a philanthropic guarantor. Ensuring clarity around the difference between the market rate and the cost of capital once a guarantee is placed before raising capital is critical.

Furthermore, ancillary funds have a gifting benefit by claiming discount as part of their statutory obligation to distribute 4% (for PuAFs) and 5% (PAFs). The timing of pitching to ancillary funds may be important. Early in the financial year enables ancillary fund managers to build the opportunity into their distribution cycles. Later in the financial year may assist those that are under their distribution threshold. Either way, it should be acknowledged that gaining support via this sort of mechanism may take several months of elapsed time for each charitable trust.



CHALLENGES FROM THE GUARANTEE AS AN INSTRUMENT

Aversion to the term quarantine

For many who work in the finance industry, the term ‘guarantee’ is associated with loan failure. In addition, many were challenged by the concept of guaranteeing program ‘performance’ (rather than the purchase of a capital asset) and found this difficult to process. Alternate terms such as ‘pledge’ or ‘contingent grant’ should be considered in future transactions.

Perceived complications of due diligence for a guarantee

There was an expressed view that guaranteeing the J2SI transaction required additional or different due diligence that was beyond the capacity of even the most sophisticated decision-makers. However, if the guarantee is positioned as a 'grant' or 'contingent grant', this allows ancillary funds and charitable trusts to assess program performance and view the transaction with higher risk tolerance.

Perceived and real transaction costs

The J2SI guarantee represented a range of transactional challenges and perceived barriers, for example resolving legal and accounting concerns. The preparation of standard advice on accounting and legal matters would reduce the transactional costs for philanthropic guarantees.

Views about the role of government

There was a sense that because the evidence base for the J2SI intervention is so strong, government should be directly procuring the program. This view, which extends to an aversion to the SIB model in general, led to the rejection of the J2SI opportunity by some parties. This perhaps needs to be considered in screening possible targets for future participation.

Addressing the challenges

Since closing the J2SI Transaction, SHM has taken several steps to address some of the challenges raised above including:

- Producing a new pitch book which simplifies communication, including making it clear the opportunity is not an investment proposition;
- Obtaining a class ruling from the Australian Taxation Office (ATO) to provide guidance on how to quantify the gifting benefit for ancillary funds; and
- Working with the Victorian Government to develop template financing documents to enable review and adoption of the fully guaranteed transaction structure by others.

The above steps may assist in providing greater clarity for potential participants in future transactions of this nature (notably ancillary funds) and reduce the transactions costs for other transactions that adopt this structure (in other jurisdictions in Australia).

Full report available here:

The full report was prepared by Dr Michael Moran, Libby Ward-Christie and Prof Kristie Muir, Centre for Social Impact.

<https://www.nab.com.au/content/dam/nabrwd/documents/pds/social-impact/nab-journey-to-social-inclusion-case-study-2019.pdf>

Key contacts:

Suzanne Findlay,
Sacred Heart Mission
sfindlay@sacredheartmission.org

Lucy Doyle,
NAB Strategic Giving
lucy.doyle@nab.com.au

James Waddell,
NAB Sustainable Finance
james.waddell@nab.com.au

David Sweeting,
NAB Foundation
david.sweeting@nab.com.au

