29th May 2009

Manager
Contribution of the Not for Profit Sector
Productivity Commission
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This submission responds to the request of the Commission in its April 2009 Issues Paper for comments in respect of:

1. Extent to which institutional arrangements and regulations restrict the financing options available to not for profit organisations; and

2. Emerging trends and developments which are likely to impact on the future capacity of the sector.

Specifically, this submission identifies the need for the development of a robust community development financial institution (CDFI) sector in Australia to expand and strengthen the financing options available to third sector. Furthermore, it encourages consideration be given to the establishment of new legal entities and supporting regulation to encourage and facilitate investment by philanthropists and private investors alike in a socially inclusive Australia.

This submission is written in my role as the Heloise Waislitz Fellow, an annual Fellowship established by the Asia Pacific Center for Social Investment and Philanthropy (APCSIP) at Swinburne University of Technology through a grant from The Pratt Foundation. The views expressed in this submission are not to be taken to be the views of APCSIP, Swinburne University, The Pratt Foundation or any affiliate of these entities.

Yours sincerely,

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Comments are invited on the extent to which institutional arrangements and regulations restrict the financing options available to not for profit organisations. If significant restrictions exist, what options are there to overcome them?

The not for profit sector and, more broadly, the third sector[1] in Australia has to date relied almost solely on capital from government and philanthropic sources having been largely excluded from accessing capital from mainstream banks. Consequently, difficulties in accessing capital are experienced by many parts of the third sector leading to many organisations being unable to grow or new organisations with potentially important social innovations being unable to move beyond concept[2]. Urgent attention needs to be given to establishing new ways for the third sector to access capital in order to ensure the important role it plays in our society is not constrained but allowed to optimize its contribution to establishing a socially inclusive Australia.

A critical source of capital lacking for the third sector in Australia is community development financial institutions (CDFIs). In the US and UK, CDFIs have played and increasingly play an essential role in providing credit, financial services and other services to underserved markets and populations, including third sector organisations.

CDFIs are sustainable, mission-driven, independent financial institutions that supply capital and business support to individuals and organisations whose purpose is to create economic opportunity and social capital in disadvantage communities or under served markets. Inherent to their nature CDFIs provide social and financial returns to their investors. CDFIs use flexible capital products to meet the needs of third sector organisations to effectively serve these markets while managing their inherent risks. There a four types of CDFIs: community development banks, community development credit unions, community development loan funds (including microenterprise loan funds) and community development venture capital companies.

The roots of the CDFI industry in the US dates back to the early 1900s with the community development banks and credit unions being the most mature institutions in the sector. Loan funds are much newer, with 78% of this sector established in the 1980s and 1990s and 12% established after 2000, while venture capital funds are newer still.[3] The 1990s saw the CDFI sector expand dramatically spurred by two government initiatives:

1. the creation of the CDFI Fund in 1994, a government agency that provides funding to individual CDFIs and their partners through a competitive application process; and
2. revised Community Reinvestment Act (CRA) regulations in 1995 which explicitly recognize loans and investments in CDFIs as qualified CRA activity.

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[1] The term third sector encompasses voluntary and community organisations, charities, social enterprises, cooperatives and mutuals both large and small. Importantly, the term includes a new spectrum of emerging enterprises that blur the traditional boundaries of non-profit and for-profit organisations but have at the core of their existence the goal to further social, environmental or culture objectives

[2] Lyons M et al (2006) *Mobilising Capital for Australia's Nonprofits: Where is it needed and where can it come from?,* National Roundtable of Nonprofit Organisations Limited, Melbourne

[3] Providing Capital Building Communities Creating Impact, CDFI Data Project Fiscal Year 2006 6th Edition at http://cdfi.org/uploads/other/CDP_fy_2006.pdf

Furthermore, the growing record of success of CDFIs inspired confidence and attracted new sources of support and funding. As at May 2009 there were 842 certified CDFIs in the US[4], and during the 2006 fiscal year US$4.75 billion was invested by 505 CDFIs to create economic opportunity in the form of new high-quality jobs, affordable housing units, community facilities and financial services for low income people[5].

In the UK, CDFIs also have a long history however have developed most during the late 1990s and early 2000s coinciding with official recognition, policy initiatives and financial support. The establishment of the Social Exclusion Unit in 1997 by the Prime Minister's Office recognized the value of CDFIs in enterprise promotion, regeneration and financial inclusion leading to the birth of the Social Investment Task Force in 2000. The five recommendations of the Task Force were a package of interlocking initiatives designed to create a system that could support development of community finance, drive investment in under-invested communities and encourage entrepreneurial growth and financial inclusion. The recommendations were:

1. A Community Investment Tax Relief (CITR) to encourage private investment in profit-seeking and not-for-profit enterprises targeting community development in under-invested communities.
2. Establishment of Community Development Venture Capital Funds (CDVCs) through a matched funding partnership between Government on one hand and the venture capital industry, entrepreneurs, institutional investors and banks on the other.
3. Disclosure of individual bank lending activities in under-invested communities
4. Greater latitude and encouragement for charitable trusts and foundations to invest in community development finance, even when these include a significant for-profit element
5. Support for Community Development Finance Institutions[6]

As at the end of March 2007, the Community Development Financial Association (CDFA) reported that 61 member organisations held investment and loan portfolio totaling £287 million with total capital of £569 million[7].

More recently, the Commission on Unclaimed Assets after consultation with more than 1,000 third sector organisations recommended using money from dormant accounts to create a Social Investment Bank to provide the third sector with greater access to a wider variety of investment instruments thus increasing their capacity to innovate, grow and meet emerging social needs. This recommendation was in response to the conclusion of the Commission that, "if the third sector is to continue to grow and meet its goal of supporting marginalized communities in a way that neither the state nor the private sector can, it urgently needs greater investment and professional support. Suitable capital should be available for organisations at all stages of development, from

[4] Certified Community Development Financial Institutions, United States Department of the Treasury at http://www.cdfifund.gov/docs/certification/cdfi/CDFIbyState.pdf
[5] Providing Capital Building Communities Creating Impact, CDFI Data Project Fiscal Year 2006 6th Edition at http://cdfi.org/uploads/other/CDP_fy_2006.pdf
[6] A report and letter to the Chancellor of the Exchequer from the Social Investment Task Force Report October 2000
[7] McGeehan, S and N Goggin (February 2008) Inside Out 2007, Community Development Finance Association, London at http://www.cdfa.org.uk/documents/InsideOut2007_000.pdf

charities without trading revenue all the way to social enterprise that reinvest some or all of their profits in their mission and commercial businesses with social purpose."[8]

Looking beyond the data and facts in respect of the emergence of CDFIs in the US and UK to a select number of CDFIs the potential impact that the development of a similar CDFI sector in Australia can be easily seen.

Shorebank, America's first community development bank, has since its inception in provided US$3.3 billion in cumulative mission investment to individuals, real estate and small business owners, minority-owned businesses, faith-based and nonprofit organisations, and environmentally beneficial projects. Calvert Social Investment Foundation, a leading community development loan fund, has since the launch of its innovative program of Community Investment Notes in 1995 raised US$130 million from the general public to provide affordable investment capital to build healthy communities and strong local economies across the US and the world. Triodos Bank, established in The Netherlands in 1980 and now with offices in the UK, Belgium and Spain, offers a comprehensive range of banking services for social businesses, charities and groups along with a variety of savings accounts for individuals. Triodos Bank mobilizes this capital to lend to organisations and businesses pursuing positive social, environmental and cultural goals. Bridges Ventures, the UK's first community development venture capital fund established as a direct result of the recommendations of the Social Investment Task Force 2000, has £120 million under management in two Venture Funds and the Bridges Social Entrepreneurs Fund. The Venture Funds invest equity in ambitious businesses with the potential to make strong financial returns and to have a positive social impact, while the Social Entrepreneurs Fund is invested into scalable social enterprises delivering high social impacts and operating sustainable business models. Further detail of these organisations is provided at Appendix 1.

Importantly, each one of these organisations have leveraged private investment dollars by providing opportunity for the general public including individuals, institutions – ranging from major corporations to pension funds to insurance companies - and foundations to invest in community development and drive social change through the power of investment.

In Australia, organisations that could currently come under the banner of CDFIs are Bendigo Banks' Community Sector Bank, Fitzroy Carlton Credit Cooperative, Foresters Community Finance, Indigenous Business Australia and Maleny Credit Union[9]. Despite the ground breaking work of these organisations, a CDFI sector in Australia remains in the nascent stages of development and far from delivering maximum impact to Australia's third sector.

In looking at the growth and emergence of the CDFI sector in both the US and UK it is clear that policy initiatives and financial support, combined with stakeholder engagement, were critical factors to its development. Similarly, to build a strong CDFI sector in Australia will necessitate a collaborative, cross-sector partnership across the public, private and third sectors. Political support from government must be backed up practically by a supportive legislative environment and sufficient investment. Expertise of

[8] www.unclaimedassets.org.uk
[9] Burkett I and B Drew (October 2008) Financial Inclusion, market failures and new markets: Possibilities for Community Development Finance Institutions in Australia, Foresters Community Finance, Australia

the private sector must be contextualized to the unique needs of the third sector and seamlessly integrated with rich expertise within the third sector. Private sector investment must be mobilized from both philanthropists and financial investors to leverage financial support from government and open access to the broader capital markets. Successful collaboration leading to the development of a robust CDFI sector in Australia will expand capital access of the third sector, thus enhancing its financial resilience and enabling improved service delivery while simultaneously delivering social and financial returns to all stakeholders.

What are the most significant trends and developments that have impacted on the efficiency and effectiveness of the not for profit sector? How has the sector responded to these? Are there emerging trends and developments which are likely to impact on the future capacity of the sector?

A number of recent initiatives in the UK and US are important for consideration by the Productivity Commission in looking at the financing options available to the third sector. Broadly, these initiatives establish new legal and tax structures to accommodate the rise of social enterprises that sit between traditional non-profits and traditional businesses and that are playing an increasing role in regenerating disadvantage areas, empowering local communities and delivering new, innovative services.

Community Interest Company[10]

> A new type of company, a community interest company (CIC), has been introduced in the UK designed specifically for social enterprises that want to use their profits and assets for the public good. CICs provide social enterprises with the flexibility of operating “commercially” under the company form, but with special features – asset lock and capped dividend distribution - to ensure they are working for the benefit of the community without the need for charitable status.
>
> From a financing perspective, the CIC form expands access to finance for social enterprises as CICs are able to raise capital from the issuance of shares, albeit a capped share that restricts the level of dividends in order to protect community benefit.

Program Related Investment (PRI)[11]

> In recent years, as nonprofit organisations have sought to expand their financing options and social enterprises have emerged, increased attention has been placed in the US as to how foundations can expand the way in which they provide capital to nonprofit organisations beyond traditional grant-making. Program related investments (PRIs) are the principal tool used by foundation to go beyond grant-making and include financing methods such as loans, loan guarantees, link deposits and equity investment in charitable organisations or commercial ventures with charitable purpose. The key differentiating factor

[10] http://www.cicregulator.gov.uk/

[11] http://www.irs.gov/charities/foundations/article/0,,id=137793,00.html; http://foundationcenter.org/getstarted/faqs/html/pri.html;

between a grant and a PRI, is that a PRI involves the potential of investment income and return of capital within an established timeframe.

For the recipient, the primary benefit of PRIs is access to capital at lower rates than may otherwise be available. For the funder, the principal benefit is that the repayment or return of equity can be recycled for another charitable purpose. PRIs are valued as a means of leveraging philanthropic dollars.

Despite PRIs having been in place for over thirty years, only a few hundred of the thousands of grant making foundations in the US make PRIs and even fewer have instituted formal PRI programs. The reasons typically quoted for limited use of PRIs are uncertainty surrounding the rules of the US Internal Revenue Service (IRS) for PRIs combined with hesitation of foundations to use their endowment principal for this purpose.

Discussion and debate is active in the US as to how the challenges limiting the use of PRIs can be removed and, in turn, ease the capital constraints of nonprofit organisations and social enterprises by having the corpus of foundations working to further their charitable purpose. The establishment of the new L3C vehicle (see below) is one recent initiative to spur increased PRI, and increasingly CDFIs are establishing products that facilitate PRIs by foundations.

Low Profit, Limited Liability Company (L3C)[12]

In the states of Vermont and Michigan in the US, a new legal form of business entity – a low-profit, limited liability company (L3C) – has been created to bridge the gap between non-profit and for-profit investing by providing a structure that facilitates investments in socially beneficial, for-profit ventures[13]. Unlike a standard limited liability company (LLC), the L3C has an explicit primary charitable mission and only a secondary profit concern. But unlike a charity, the L3C is free to distribute the profits, after taxes, to owners or investors[14]. Put simply, it is the for-profit with a nonprofit soul.

The driving force behind the creation of the L3C is to attract capital to support socially beneficial, for-profit ventures. The vehicle has thus been designed to dovetail with the IRS regulations in respect of a PRI and facilitates tranched investing to increase attractiveness to commercial investors. For example, a L3C can accept a PRI from a foundation investor that takes the first risk position and introduce subsequent senior tiers of capital less risky and more profitable above the base capital of the PRI. These subsequent tiers may offer a combination of market rate returns to appeal to commercial investors or below market returns to appeal to investors willing to accept a portion of return in the form of enhanced social welfare.

Accordingly, the L3C acts to bring together foundations, trusts, endowment funds, pension funds, individuals, corporations, other for-profits and government

[12] http://americansforcommunitydevelopment.org/links.html
[13] http://en.wikipedia.org/wiki/L3C
[14] http://www.nonprofitlawblog.com/home/2008/07/l3c.html

entities into a single organisation designed to achieve social objectives while also operating according to for-profit metrics.

Efforts to expand the financing options available to the third sector in Australia should, in addition to the establishment of a CDFI sector as discussed above, include appropriate consideration of the introduction of new legal entities. Legal entities that recognize the value of hybrid organisations spanning the boundaries of traditional non profit organisations and for profit businesses. Legal entities that encourage and facilitate increased cooperation between diverse funding sources ranging from trusts and foundations, institutions and private individuals. Introducing new legal entities able to facilitate investment in the third sector of just a small percentage of the $1.2bn corpus held in 769 prescribed private funds (PPF)[15] or the $1.17 trillion held in superannuation assets would significantly leverage government investment in the third sector and provide unheralded opportunity to enhance social welfare in Australia. Importantly, new legal forms must be accompanied by the appropriate regulatory support to encourage participation by private investment. For example, the new proposed guidelines for PPFs as discussed in paragraphs 1.32 - 1.37 of the Explanatory Material: Tax Law Amendment (Prescribed Private Funds) Bill 2009 circulated by The Treasury on 15 May 2009[16] would incorporate an explicit allowance within the permitted investment strategies for a PPF to actively invest a portion of its corpus in the establishment of a CDFIs or new legal forms.

Removing the financial constraints and optimizing the financial resources of the third sector is a vital component to building a socially inclusive Australia. Valuable lessons are available from CDFIs around the world or more recent initiatives – such as CICs or L3Cs – that promote increased financing options for the third sector. Critical to success, and perhaps the starting point beyond being open to taking lessons from international best practice, is a willingness of all stakeholders – public and private - to work collaboratively to adopt new approaches. Approaches, that while inevitably involving risk, have the potential to yield benefits that far outweigh the risk of not trying and being left with a financially constrained, thus sub-optimal, third sector.

[15] http://www.philanthropy.org.au/ppfs/index.html
[16] http://www.treasury.gov.au/documents/1541/PDF/090514%20-%20EM%20-%20master%20update%203%20(consultation%20version).pdf

APPENDIX 1: Selected Examples of US and UK CDFIs

Organisation	Entity Type	Description
Shorebank[17]	Community Development Bank	ShoreBank is America's first community development bank focused on providing banking services for individuals, real estate and small business owners, minority-owned businesses, faith-based and nonprofit organisations, and environmentally beneficial projects. It began in 1973, when its founders acquired a bank in a declining neighborhood on Chicago's South Side to demonstrate that banks can be powerful tools for positive community change. Shorebank has since expanded its focus from one neighbourhood to 25 on Chicago's South and West Sides, as well as neighbourhoods on Detroit's East Side and Cleveland's upper East Side. Shorebank held assets of US$2.4 billion as at 31 December 2007 and recorded net income of US$4.2 billion during the 2007 fiscal year. Since inception, Shorebank has completed US$3.3 billion in cumulative mission investment. ShoreBank helps its customers build their own wealth, strengthen their communities and work towards a healthier environment by offering: • Savings, checking, CD and IRA accounts (consumer banking or retail banking services) • Opportunities for socially motivated people and organisations to make deposits that support community development and conservation (Development Deposits) • Money management classes • Home mortgages that can also cover rehabilitation costs • Financing to purchase and renovate apartment buildings (real estate loans) • Business loans and cash management services (business banking) • Loans, deposits and cash management services specifically designed for faith-based and other nonprofit organisations (nonprofit banking) • Loans that contribute to a healthier environment by reducing energy consumption, rebuilding on vacant or contaminated sites, reusing existing structures, or that support "green" businesses (conservation loans, environmental banking). Shorebank is part of Shorebank Corporation which is America's first community development and environmental bank holding company. This structure recognizes that it takes more than a bank to build strong, sustainable communities and a healthy environment; by regulation, banks are restricted in the activities they undertake and the amount of risk they can assume. ShoreBank Corporation addresses these limitations by creating complementary organisations – banks, affiliated nonprofits and business development and consulting services - designed to meet other customer needs in each market. Shareholders of Shorebank Corporation include financial institutions, foundations, insurance companies, major corporations, and individuals.
Calvert Social Investment Foundation[18]	Community Development Loan Fund	Calvert Social Investment Foundation (Calvert Foundation) launched its innovative program of Community Investment Notes (CINs) in 1995 and has since raised US$130 million from the general public to provide affordable investment capital to build health communities and strong local economies across the US and the world. The impact areas of Calvert Foundation include affordable housing, microfinance, small business funding, fair trade, community facilities development, social innovations,

[17] www.shorebankcorp.com
[18] www.calvertfoundation.org

Organisation	Entity Type	Description
		and environmental issues. The CIN is senior unsecured debt of Calvert Foundation, a 501(c)(3) non-profit organisation organized under the laws of the US, which is a public offering that can be purchased by individuals, institutions and foundations through a broker or financial planner, directly through the foundation, or online at MicroPlace.com, a broker/dealer operated by eBay. The minimum investment is $1,000 (or $100 online) for a term ranging from 1 to 10 years and with an interest rate selected by the investor of between 0 to 3%. The CIN classifies as a PRI for foundations, and is increasingly the tool used by investment adviser for their clients, pension funds and corporations looking to invest in the community. Calvert Foundation is also in the midst of developing Support Certificates, a new financial instrument for accredited investors that will entail an "equity-equivalent" investment in Calvert Foundation with the purpose o providing a layer of risk capital to support the CIN activity of Calvert Foundations. Support Certificates will be available for three, five and seven year terms at flexible rates of return. Support Certificates will classify as PRI for foundations.
Triodos Bank[19]	Community Development Bank	Triodos Bank (Triodos) is one of Europe's leading ethical banks. Established in 1980 in The Netherlands, Triodos enables money to work for positive social, environmental and cultural change. Triodos offers a comprehensive range of banking services for social businesses, charities and groups along with a variety of savings accounts for individuals. Triodos Bank only lends money to organisations and businesses pursuing positive social, environmental and cultural goals. Triodos is a public bank with thousands of customers and shareholders. The principles and independence of Triodos are guaranteed through a special share-holding trust which protects the social and environmental aims of the bank. Triodos has offices in the UK, Belgium, Spain and The Netherlands as well as an International Development Investment Unit which finances fair trade and microfinance in developing countries.
Bridges Ventures[20]	Community Development Venture Capital	Bridges Ventures (Bridges) was founded in 2002 and was the UK's first community development venture capital fund following the recommendations of the Social Investment Task Force 2000. Bridges currently has £120 million under management in two Venture Funds and the Bridges Social Entrepreneurs Fund. The Venture Funds invest equity in ambitious businesses with the potential to make strong financial returns and to have a positive social impact in at least two ways: 1. Regeneration through the investment in ambitious businesses in the most deprived 25% of the UK and which deliver a strong multiplier effect as they spend money and recruit in these areas. 2. Sustainable businesses whose social impact is intrinsic to what they do – environment, healthcare and education. The Bridges Social Entrepreneurs Fund is an initiative of the Bridges Charitable Trust to address the funding gap often faced by fast growing social enterprises looking to scale. Launched in November 2008, the fund

19 www.triodos.co.uk
20 www.bridgesventures.com

Organisation	Entity Type	Description
		has so far raised £4.25m for investment in scalable social enterprises delivering high social impacts and operating sustainable business models. Investors in Bridges include banks, pensions, endowment funds and trusts, corporates and others, and individuals. The initial £40 million capital raise of Bridges for its first Venture Fund comprised £20 million from the private sector and £20 million in the form of matched investment from the Government. A portion of the Government's matching investment was subordinated, in that it takes the first risk and has a capped return. The availability of this type of matching investment was crucial to attracting private sector investment to a new field, where returns where not yet proven.
Social Finance Ltd[21]	Social Investment Bank	Social Finance Ltd was launched in 2008 to lay the foundations for the establishment of a social investment bank as recommended by the Commission of Unclaimed Assets. It aims to demonstrate the need and potential of a social investment bank, and build the expertise needed to run such, prior to the release of capital from dormant accounts. Social Finance's ambition is to transform the ability of the third sector to respond to society's changing needs by enabling greater access to a variety of investment instruments. Services offered by Social Finance include: (1) financial product development; (2) market intelligence; (3) capital raising; and (iv) capital deployment and management.

[21] www.socialfinance.org.uk