THE LESSONS

we have learned

When we set up SASC, we knew social investing was going to be challenging. Not least because everyone told us it would be. And the people telling us included the Social Investment Business and Big Society Capital, the sector experts who were entrusting us with their money.

In 2012, we were already in a low interest rate environment where commercial investment funds were struggling to provide their clients with attractive returns. Meanwhile, as a start-up social investor, SASC was setting out to invest for a double bottom line. We needed to generate both social impact; and a financial return for our investors.

Our work to date has been fascinating and constantly rewarding for all of us at SASC. It has also been even harder than any of us expected. One of the most important reasons is the continuing austerity in government spending. This has left the organisations we are here to support squeezed between increasing demand for their services on the one hand, and reduced income and margins on the other.

We would like to share with you some of the lessons of the last three years.

LESSON #1 / DEPLOYMENT, DEPLOYMENT, DEPLOYMENT

The SASC project is, in theory, simple: can we put our funds to work by making investments into inspiring organisations that can deliver social impact – and get our investors' money back, with some interest?

Deployment (putting our funds to work) is key to everything we do. It gives our investors confidence that we are doing a good job (although of course getting the money out is only half the story). It enables organisations to deliver social impact. And it keeps our team motivated. Most importantly, doing deals is contagious – we have noticed a clear link between the number of investments we are completing and the quality (but not necessarily the quantity) of the applications we receive. We are finding that the people and organisations we work with often refer other opportunities to us.

No matter how much analysis and theory you bring to the table, until you can point to actual investments completed your voice struggles to be heard. We are well aware that we need to try and provide a distinct social investment offering.

We realised we needed to do more than just set out our stall and offer more of the same – we needed to be creative and to find a way to offer something that organisations needed but were unable to obtain elsewhere. Here are some of the ways in which we are doing this:

One avenue is to look for areas where market changes create new opportunities. The financing environment for community energy changed dramatically in end of 2015: government subsidies for generation were withdrawn at the same time as tax incentives for investors fell away. We stepped in to provide a range of financing solutions. These have helped inspiring communities to take ownership of renewable assets and generate long term income streams to support the most deprived individuals within their locality.

We looked back at the work that had been done by our partner SIB in previous programmes they had run, and realised the power of blended finance. Advancing a combination of grant and loan was an idea that felt like it was going out of fashion, but we saw many situations where we believed this was the right way to proceed. Many organisations applying to SASC had sustainable business models, but they were not sustainable enough to service the upfront debt required to get the project started. They needed a grant to cover a portion of the initial costs. This would catalyse a sustainable future in which the organisation could go on to deliver social impact year after year.

We discuss blended finance and outcome based finance further below.

LESSON #2 / BLENDED FINANCE TO DRIVE IMPACT

The combination of grant and loan can be a powerful tool for driving greater impact. SASC always thought that combining different types of funding could produce something greater than the sum of the parts. Our Third Sector Loan Fund brought together three such strands: repayable grant from SIB, investment from Big Society Capital, and a loan from Santander. This addressed each investor's different risk/return needs and created something more powerful than any one of the investors could do on its own.

We went on to see an opportunity to blend different types of funding when we in turn make our own investments into organisations. This involves advancing a grant and a loan together. Some organisations have sustainable business models, but are unable to support repayable finance covering the whole sum they need. Providing part of the finance in the form of a grant bridges this gap.

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In the autumn of 2015, we launched an innovative partnership with Power to Change. Power to Change is a £150 million foundation that supports community businesses across England. Working with Power to Change has enabled SASC to complete five of the investments contained in this report that otherwise would not have been possible. We continue to work on other projects as we try to find new ways of aligning the strategic goals of Power to Change with the mandate of our Community Investment Fund.

'Community business' (Power to Change's focus) and 'social impact' (SASC's mission) often overlap, but not always. Many organisations that apply to SASC would be able to support a blended investment, but do not meet the definition of a "community business". SASC is keen to identify other grant funders, currently working in areas that overlap with our funds, who could partner with us to expand the blended offering. There is a challenge, though. Blended investment gives a wider range of inspiring organisations a onetime leg up to a sustainable future. Nonetheless, some grant makers hesitate because they view blended investment as a subsidy for lender returns. This is a complex discussion with robust arguments on both sides that requires more space than we can devote to it in this report. But one lesson is undeniable: collaboration is catalytic. Funders with different types of finance working together will result in organisations and projects coming to life that would otherwise never get traction.

LESSON #3 / A DIFFERENT APPROACH TO OUTCOMES BASED FINANCE

The creation of Social Impact Bonds (SIBs) was an important response to the trend towards commissioning on an outcomes or payment by results (PBR) basis. Early SIB deals did much to bring different investors together to fund innovative interventions. To date, however, despite significant grant and subsidy, the level of growth predicted for SIBs has been less than desired. SASC believes that getting outcomes based financing right is a key test of whether social investment will ever reach the scale it needs to become more than a "cottage industry".

At SASC, we believe outcomes based financing should be as easy to understand, flexible and inexpensive as possible. We see our role as helping third sector providers win and then successfully deliver payment by results contracts. We should play a supporting role, rather than being the focus of any commissioning process. Where possible, the aim should be to elevate third sector organisations from subcontractor to prime contractor. If external support is required around issues such as performance management, we believe there must be a process in place to transfer skills to the delivery organisation over the life of the contract. Trust is vital: between investor and provider (delivery organisation), and between provider and commissioner. Risk and reward should be shared appropriately between us as an investor and the provider. If SASC makes a positive return, then the provider should also earn some surplus, and vice versa (as long as this does not put the provider's overall finances at risk). The absolute level of return to the investor must reflect the risk it is taking – including how innovative the intervention is. All of this means that trust and alignment of interests are key to the SASC PBR financing structure.

Where structure is concerned, SASC looks first for simplicity. We only accept complexity (eg the use of a Special Purpose Vehicle or SPV) if that will genuinely help delivery of the contract. Complexity increases the upfront and running costs of a SIB financing. This has become a sticking point for both providers and commissioners.

On the following page Family Action CEO David Holmes describes his experience of working with SASC to take on investment for PBR.

Spotlight on outcomes based finance

DAVID HOLMES, FAMILY ACTION CEO

FAMILY ACTION'S STORY

Family Action has been providing community-based services to support vulnerable families, children, and adults since 1869. We have 145 services across the UK ranging from Children's Centres to intensive home-based family support and from therapeutic services for children recovering from abuse to supported housing for adults with mental health issues.

Two years ago, in a context of continuing financial austerity, Family Action decided to explore social investment as part of a strategy to diversify our income base and prioritise innovation in our service delivery. We spent months developing a bold, new, intensive service for adolescents in care who were experiencing multiple placement moves, who were going missing regularly, were at risk of exploitation or offending or who were otherwise at significant risk. The model we developed was exciting, but unproven. How could we persuade local authorities to commission such a service without a substantial evidence base? And how could we manage cash flow in year one without putting a substantial amount of the charity's reserves at risk? Who might help us?

Well, we tried and failed to persuade the DfE to invest in the service through its Innovation Fund. And what grant making trust would be willing to invest enough money to enable our service to prove its worth? But we refused to give up – we knew the service was needed. Every Director of Children's Services in every local authority across the country will know by name a number of young people who are unable to settle in care who they are deeply worried about – this service was for those young people. And so we turned to social investment.

We spent a lot of time talking to different social investors to find an investor and a deal that was right for us. We knew we didn't want a social impact bond. We wanted a more flexible financial product with less intensive governance, but with risk sharing too. With consultancy support we found the right investors for our deal – Social and Sustainable Capital and the Esmee Fairbairn Foundation.

Together we created something different: an unsecured loan to help with cash flow while the service proved its concept. We agreed that if the

service succeeded in achieving stretching target outcomes for our young people, then the investors would benefit financially and if the service failed altogether, the investors would share the closure costs with Family Action. We also created a payment by results structure for the service that would be attractive to commissioners. After much discussion with a number of local authorities the service was eventually commissioned by two of those we approached.

Family Action's social investment-enabled service has been up and running for four months now and it is working! As a CEO I have learned that social investment is fundamentally a deal and you need to find the right deal for your charity. Our Chair and trustees worked alongside the executive team throughout the period when we were exploring social investment. We considered social investment together at four consecutive Board meetings in 2015 – from first principles to finally agreeing a deal.

True innovation is rarely easy and social investment is not a free ride. You have to come up with a great idea and get the best deal you can. To achieve that the executive team and the Trustees (and indeed the investors) all need to be performing at the top of their game – sparking off one another, challenging one another, but ultimately coming up with an idea and a deal that will fly. Fundamentally, the executive team and the charity's trustees need to trust and support each another, but that does not mean they need to agree on everything. Robust healthy challenge is just what is needed when deciding if social investment is right for your charity.

Our Chair, Bryan Portman, says that taking social investment is a leap of faith, but it does not have to be a leap in the dark! He's right about that – the key to social investment is getting the deal right. Be prepared for lots of detailed work and intense scrutiny of your proposal by your Board and at least the same amount of scrutiny of your proposal, your charity's finances and the strength of your executive team and Board by your chosen investors. But do explore social investment – if you find the right deal the potential of social investment is amazing. In our case, it may transform young lives forever.