SOCIAL INVESTMENT TAX RELIEF: TWO YEARS ON

Abigail Rotheroe and Plum Lomax, July 2016

This paper provides a review of the use of Social Investment Tax Relief (SITR) on its two year anniversary. It includes an analysis of the SITR deals completed to date[1] and the views of key stakeholders in this area. NPC has written this report in partnership with Big Society Capital (BSC).

NPC estimates that £3.4m has been invested across 30 organisations to date in SITR deals—these include both direct investments in enterprises and investments through SITR funds.

The average turnover of an enterprise raising SITR capital is £615,000, with assets of around £1m and the majority have less than 10 employees. Enterprises to date have been highly concentrated in two regions (Scotland and the South West) due to the prominence of the fund managers Social Investment Scotland and the Resonance Bristol SITR Fund—however the pipeline of future deals appears more evenly spread across the UK.

The amount of capital raised in an average deal is just over £100,000. The average cost of capital is 4.8% pa over a five year period. Deals take around four months to complete. About 80% of deals to date have been loans, with the rest community shares or social impact bonds (SIBs). The average size of investment by an investor is around £20,000, but has been as low as £230 in community share offers.

Background

Social Investment Tax Relief (SITR) is a relatively new tax break which helps social enterprises and charities raise finance from individual investors by offering those investors 30% income tax relief on loans or equity investment into their organisations. It is available for investments made on or after 6 April 2014 and is modelled on the existing Enterprise Investment Scheme, levelling the playing field with the tax relief currently available to more traditional business.

SITR offers charities and social enterprises the opportunity to raise money directly from investors who are interested in creating social impact and are prepared to invest on appropriate terms for the business.

'SITR has supported our work to save the heartbeat of the village.'

Calum Currie, Chair, Portpatrick Community Benefit Society

Raising investment through SITR may be less costly for organisations and also offers patient capital—a scarce resource—because repayments of the principal of the SITR loans cannot begin until three years and one day after the investment has been made. In this way, SITR can be a useful tool for social entrepreneurs looking for investment to develop their early stage venture into a sustainable business. To see the eligibility criteria for SITR, see Big Society Capital's leaflet *An essential guide to Social Investment Tax Relief*.

Big Society Capital is encouraging the development of SITR and launched GET SITR, a free package of support to help organisations use SITR. NPC surveyed all those signed up to GET IT and found almost 60% of organisations have become more interested or are considering SITR as a result of BSC's support.

[1] We contacted the ventures and intermediaries that BSC know have been involved to date, but there may be others.

SITR market—deals concluded to date

Just over half of the deals completed to date have been direct investments, while the rest are through the two currently active funds—the Resonance Bristol SITR Fund, managed by Resonance, and the SIS Community Capital Fund, run by Social Investment Scotland.

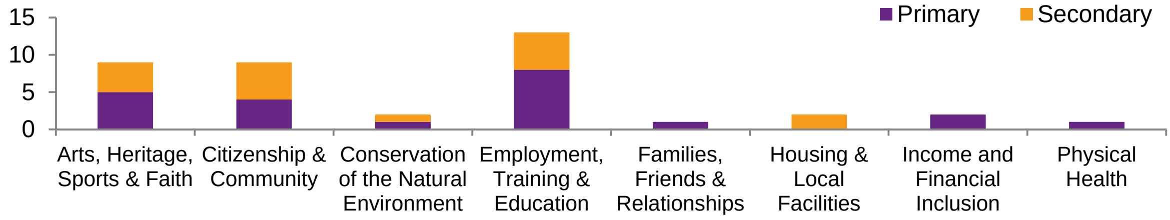
Organisation	Organisational form	Type of investment	Size of deal	Duration	Fund or Direct
FareShare South West	Charity	Loan	£70,000	6 yrs	Direct, arranged by Resonance
FC United of Manchester	Community Benefit Society	Loan	£270,000	3 yrs	Direct
Aspire Gloucestershire	Charity	Social Impact Bond	£50,000	3 yrs	Direct
Ambition East Midlands	Charity	Social Impact Bond	£100,000	3 yrs	Direct
Freedom Bakery	Community Interest Company	Loan	£48,000	4 yrs	Direct
Burley Gate Community Shop and Post Office	Community Benefit Society	Loan	£57,000	n/a	Direct
Delivered Next Day Personally	Community Interest Company	Loan	£50,000	3 yrs	Direct
Shofar Day Care Centre	Charity	Loan	£200,000	7 yrs	Direct
Clevedon Pier	Community Benefit Society	Community shares	£250,000	n/a	Direct
Breadshare	Community Interest Company	Loan	£20,000	3 yrs	Direct
Portpatrick Harbour Community Benefit Society	Community Benefit Society	Community shares	£100,000	n/a	Direct
Stockwood Community Benefit Society	Community Benefit Society	Loan	£260,000	6 yrs	Direct, arranged by Resonance
South Bristol Sports Centre	Charity	Loan	£250,000	6 yrs	Resonance Bristol SITR Fund
Paper Arts	Community Interest Company	Loan	£200,000	6 yrs	
Bristol 24/7	Community Interest Company	Loan	£150,000	6 yrs	
Dundee Gymnastics	Charity	Loan	£44,000	6 yrs	SIS Community Capital Fund
Broxburn United Sports Club	Charity	Loan	£50,000	6 yrs	
Street League	Charity	Loan	£100,000	6 yrs	
Just Trading Scotland	Charity	Loan	£100,000	6 yrs	
MacDougall of Dunollie Preservation Trust	Charity	Loan	£30,000	6 yrs	
Scottish Traditional Boat Festival	Charity	Loan	£50,000	6 yrs	
Edinburgh Sculpture Workshop	Charity	Loan	£25,000	6 yrs	

In addition, the fund manager Triple Point has invested £900,000 of its clients' capital in eight deals qualifying for SITR, with deal sizes ranging from £50,000 to £150,000, within the healthcare and education sectors. The analysis on the following pages includes the 22 deals in the table above, but excludes the Triple Point deals.

We estimate that £3.4m of investment that qualifies for SITR has been raised since July 2014 across 30 organisations.

About the organisations

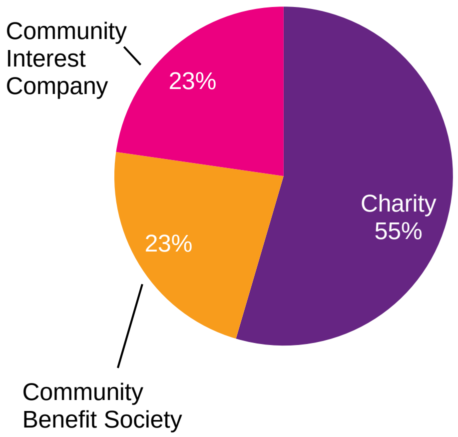
Number of deals by primary and secondary social issue



Geographic location of organisations

Region	Number of organisations
South East	0
London	1
North West	1
East of England	0
West Midlands	2
South West	6
Yorkshire & the Humber	0
East Midlands	1
North East	0
Scotland	11
Northern Ireland	0
Wales	0

Organisational form

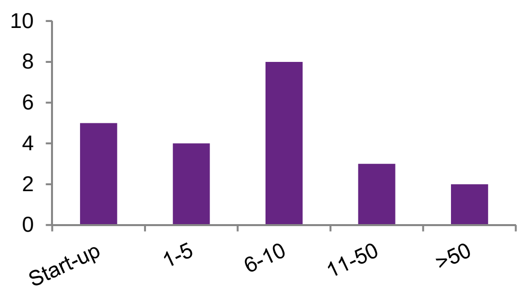


Age of organisation at time of investment

Age	Number of organisations
Start-up	5
Less than 3 years	4
3- 5 years	2
6-10 years	2
More than 10 years	9

Size of organisations by revenue (pre-investment)

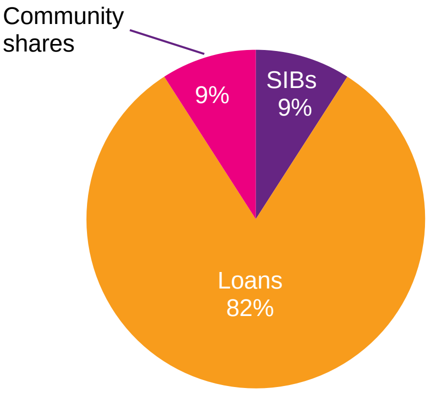
Size of organisations by number of employees (pre-investment)



The average revenue of organisations that have completed SITR deals is around £615,000 and the average number of full-time employees is 10. The amount of assets varies widely, with the range being from £12,000 to over £6m—the average enterprise has assets of just over £1m.

About the deals

Type of investment



Number of deals by cost of capital

Cost of capital	Number of deals
<2%	2
2-4%	6
5-7%	14

Characteristics of average deal

Amount of investment raised (SITR)	£113,818
Duration	5 years
Cost of capital	4.8%
Time to raise investment	4 months
Time taken on pre-assurance from HMRC	7 weeks

Although the average cost of capital for all deals has been 4.8%, direct deals (excluding the two SIBs) have incurred a lower cost of 3.1%, with the average driven down by community share offers—forecasting payouts up to 2% pa. Deals within fund structures, meanwhile, have a higher cost of capital of 6%, but have access to a pool of investors. These deals compare to the cost of capital for other forms of unsecured lending to charities and social enterprises, anecdotally in the range of 6-11%. In more than half the deals, the amount of capital raised through SITR was part of a bigger investment raised—for example FC United of Manchester raised total capital of £6.5m, with only £270,000 through SITR, to build a new stadium and facilities.

Use of proceeds

In order to qualify for SITR, the money raised has to support a 'qualifying trade', which in essence means any trade other than activities which are excluded, such as property development (to make a profit)[2], personal lending and electricity generation. Of those deals concluded to date, over 40% of enterprises were raising capital to develop or refurbish premises—Portpatrick Harbour in Scotland is using proceeds to refurbish the harbour to generate income through visiting boats. Some organisations are using proceeds to develop a trading activity—FareShare South West is expanding its income-generating catering arm (it uses surplus food to cater at events, festivals and weddings). Other use of proceeds includes start-up costs and general working capital to expand the business or develop programmes or services.

About the investors

Investors, both in funds and investing directly in enterprises, have so far been a mix of high-net-worth individuals (HNWIs) and angel investors, sourced through the fund managers' existing networks. There have also been a number of retail investors—often members of the local community in the case of the community share investments where the average investment size is as low as £230. Some independent financial advisors (IFAs), such as Paradigm Norton and Ethical Futures, have built considerable knowledge and capacity in social investment and some of their more sophisticated investors have invested in these deals. Eight IFAs have introduced clients to social investment through the Resonance Bristol SITR Fund. Of the deals to date, around ten reported that the tax relief gained on the investment was essential to their investors' decision, with a further five stating that the tax relief was 'nice to have but not essential'.

Investors and size of investment

	Average number of investors	Average investment size	Number of deals
Direct investments	146	£7,331	12
Fund investments	31	£21,008	10

[2] For more on which property transactions can and can't qualify for SITR, see BSC's report *SITR and property development*.

Emerging lessons

NPC conducted a number of interviews as part of this analysis: with organisations that have raised SITR finance to date, fund managers setting up or running SITR funds[3] and financial advisers that have investors in SITR deals. The following lessons were gathered through these conversations.

'SITR is an excellent development. It brings credibility to the social investment sector.'

Richard Child, Paradigm Norton

Organisations involved in raising repayable finance through SITR found that moving towards self sufficiency and sustainability often requires a culture shift within the organisation. However the process of taking on SITR investment does not just bring capital; it also broadens networks and brings additional expertise which can help the business develop.

Fund managers running SITR funds have found SITR-based lending to enterprises achievable and have reasonable pipelines going forward. Investors are attracted to the clarity on timeline and exit route, and the organisations benefit from the three year period before capital begins to be repaid as this makes SITR money akin to patient capital—much needed for growing social enterprises.

'SITR is the government's best kept secret.'

Annika Tverin, Bright Futures SITR Fund (Social Finance)

Fund managers also thought that increasing the investment limit would enable enterprises to raise a greater proportion of their total project funding through SITR and should encourage more deals to take place. Community shares are more complex, requiring a co-operative or community benefit society structure—but shares can leverage in additional sources of funding and lock in customers.

It is still very early days for advisers and investors—many investors see their investment as primarily philanthropic because the market is so young, track records are non existent and it is impossible to assess the risks.

'Investors and advisers are still not sure if it is philanthropy or investment.'

Gavin Francis, Worthstone

Organisations looking to raise funds direct from investors, as opposed to through funds, mentioned that the key challenge is finding and accessing socially motivated investors. For most investors these are the first investments in social enterprises that they have made, but they are prepared to accommodate the higher risk profile that SITR investments require. The majority of investors said that their primary interest was in the social objectives of the investment, with a local community aspect playing a key role.

'People invested because they wanted to be part of something that will influence and change lives in North Manchester.'

Andy Walsh, General Manager, FC United of Manchester

However the 30% tax relief is an important and connected secondary factor which rewards the investor for the risk taken. Investors providing loans are investing in anticipation of receiving their capital back, but the actual level of financial return over and above the capital repayment and tax relief is not a determining factor at this stage in the market.

'SITR provided another incentive for local people to invest.'

Leon Dodd, Treasurer, Burley Gate Community Shop & Post Office

[3] Resonance, Social Investment Scotland, Bright Futures SITR Fund (Social Finance) and Triple Point.

SITR going forwards

It is still early days for SITR—it's only two years since its introduction. But progress is being made with at least 30 deals to date and £3.4m raised. This is ahead of Treasury forecasts for limited immediate take-up by 2015/16 financial year and compares well to the launch of the Enterprise Investment Scheme (EIS) in 1993/4. The EIS scheme—to help smaller, higher risk trading companies to raise finance offering a range of tax reliefs to investors—raised £41.4m across 425 companies in the first two years.[4]

The average pre-investment revenue of the organisations that have raised SITR finance so far is around £615,000. There are over 11,000 charities in England and Wales with an income over £500,000. Clearly not all of these will be in a position to generate revenue through trading services, but it highlights the market potential. Indeed Big Society Capital is aware of another 40 deals on the horizon.

To get a feel for the deal pipeline, NPC surveyed all the organisations signed up to the GET SITR campaign, for which there are over 260. The survey received 12 responses, equally split between charities and community interest companies. The sectors they work in mirrored the three where most deals have taken place—'employment, training and education', 'citizenship and community' and 'arts, heritage, sports and faith'. Likewise, on average, organisations considering SITR have less than 10 employees and revenue of around £580,000. However they are more geographically diverse compared to deals concluded to date. So far organisations have been heavily concentrated around Scotland and the South West. In the pipeline there is at least one enterprise considering SITR in each of the 12 regions in the UK, with three in the East of England where nothing has yet been done.

However the respondents highlighted two common barriers to raising SITR investment:

- Not having the expertise required to either develop appropriate business plans or prepare financial documents.
- Not knowing how to find investors.

Future support for further development of SITR should take these into account.

GET SITR campaign

GET SITR is the first campaign that Big Society Capital has run as part of its market champion activity aimed at supporting frontline social enterprises and charities. The three main aims of the campaign were:

- Raise awareness of SITR with social enterprises and charities across the UK.
- Support advisors and providers of support to the sector to understand how SITR works.
- Share the knowledge and learning of the early adopters of SITR through case studies and other resources.

Campaign highlights

GET SITR

260+ campaign subscribers

22 SITR deals

35 new resources (emails, guides, case studies, webinars and films)

600+ Event reach

[4] HM Revenue & Customs (2016). *Enterprise Investment Scheme and Seed Enterprise Investment Scheme.*

GET SITR recognises the barriers and has been working to try to provide additional support in this area through:

- The provision of a webinar designed to help advisors and providers of support to have a better understanding of SITR, which is still available to view.
- Support from a range of professional partners, including legal firms, tax specialists and investor research.
- Sharing case studies and learning.
- The publication of a number of free resources.
- Working with Worthstone, The Intelligent Partnership, Social Angels and a range of other partners who might be interested in establishing SITR funds to raise awareness of SITR and support an increase in potential investors.

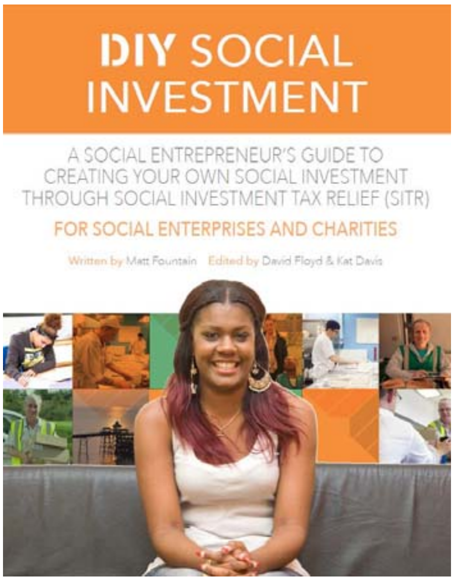
Find out more

The below resources are available to download from Big Society Capital's website www.bigsocietycapital.com:

An essential guide to Social Investment Tax Relief

DIY social investment: A social entrepreneur's guide to creating social investment through Social Investment Tax Relief (SITR)

SITR and property development



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About NPC

NPC is a charity think tank and consultancy which occupies a unique position at the nexus between charities and funders, helping them achieve the greatest impact. We are driven by the values and mission of the charity sector, to which we bring the rigour, clarity and analysis needed to better achieve the outcomes we all seek. We also share the motivations and passion of funders, to which we bring our expertise, experience and track record of success.

NPC has been at the forefront of developing impact measurement practice within the social investment world. Our work in this area has built on our experience of working with and designing measurement frameworks for social organisations over the past decade.

Improving the impact of social organisations, funders, and the sector as a whole, is core to NPC's charitable mission. We have extensive experience of the social investment market and in developing impact measurement frameworks and conducting evaluations.

NPC has worked with funders, social enterprises, charities and supranational bodies to develop guidance and best practice so understands all aspects of the social investment world.

In the past year NPC has worked with three social investors to help them measure and report on their impact. This has varied from an in-depth theory of change and measurement framework (using our Four Pillar approach) for an impact first direct investor to an impact assurance approach for a financial first investor. We have also worked with a number of social enterprises directly advising them on developing impact measurement frameworks at the start up stage and also with social enterprises looking to scale and attract social investment for the first time.

For more information about our work on social investment, or about any of our other services, please get in touch with Abigail Rotheroe via Abigail.Rotheroe@thinkNPC.org

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