



IMPACT INVESTMENT AUSTRALIA

Submission to the Working Group on Affordable Housing,
March 2016



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Executive Summary

Introduction

The purpose of this submission is to inform the Working Group about the relevance and application of **Impact Investing to the issue of Affordable Housing**. It will consider developments both globally and locally in seeking to address each of the discussion questions raised in the Issues Paper.

This Submission also goes to the unique window of opportunity for Government to help accelerate growth in the impact investing market. Thereby, enabling private capital at greater scale into not only Affordable Housing but also other areas where there is societal need or assets in communities on which to build.

Impact Investing in Affordable Housing

Investment into Affordable Housing by its nature is an impact investment in so far as it **combines financial returns with design for positive social impact** including improved access to housing for the more economically vulnerable. That is, all of the four streams of innovative finance explored in the issues paper are impact investments, just in different investment classes. **Social impact bonds** [SIBs] are one form of impact investment, housing bonds are another and other financial models extend from those focused on infrastructure only to a combination of infrastructure and services. The point of definition is important for Governments' engagement with the market where framing and expectations influence the shaping of the market.

In Australia, there is a lot of evidence based work that has been done around Affordable Housing which can be drawn upon. Federal and State governments are already engaging with the market most recently in NSW, with Expressions of Interest called for in relation to the Social Affordable Housing Fund, [SAHF].

There are however many communities and community sector organisations in urgent need of accommodation for the people they support. Even if accommodation is available, often it is on unsuitable terms or is not fit for purpose resulting in high social and financial costs. Examples include the placement of young people with disabilities in aged care facilities and poor quality accommodation outcomes for some indigenous communities.

Impact investments globally in the Affordable Housing sector have typically **focused on both public and community housing** delivery. **Superior overall outcomes** have been achieved **where models encourage independence and opportunity** rather than simply sustain a tenancy. Asset based investment which provides only the stock goes some way to addressing short term lack of supply, however, long durations of tenancies constrain the breadth of the investment impact. **A combined approach providing both Affordable Housing and complementary services** such as education and training resulting in better employment outcomes can move individuals to a more economically sustainable position and **encourage movement up the housing continuum**. There are a number of examples globally, including the Living Cities Catalyst fund [USA] and Real Lettings Property Fund [UK] that combine this service and infrastructure layer providing accommodation or Affordable Housing for the aged, people with disabilities and the unemployed.

An additional source of capital in the market is needed that enables investment to buy or build this necessary housing. Community Housing organisations in Australia continue to experience difficulties in securing capital at terms that enable sustainable expansion at scale. If this capital was currently accessible from purely commercial investors these deals would already be happening. What is **missing is the socially motivated capital that de-risks the transaction and facilitates the entry of more mainstream investors** such as pension funds and family offices who have capital at scale to bring to the problem.

What is observable globally is that where catalytic capital has been forthcoming, whether through government and philanthropic grants or via purpose driven wholesale institutions such as Big Society Capital, many transactions which would have failed on purely market terms have succeeded.

The role of government in Impact Investing

Impact investing provides government with a powerful tool for meeting more demand for Affordable Housing. It is not a silver bullet but can add options **for delivering better societal outcomes for people** and communities as well as **relieving structural challenges to the budget** through the **leverage of government funds** to mobilise private capital. Designed well, impact investment initiatives can help Governments direct capital with greater efficacy, across Affordable Housing and a broader range of social outcomes.

Like in other nascent market contexts, a more active role for the Government in expanding impact investment is critical. **Government has clear roles to play as a market facilitator and market participant**, enabling greater private investment and removing existing barriers to entry. It is also the standard setter ensuring the regulatory environment does not create unnecessary barriers to effective participation.

International evidence and local experience demonstrate the powerful effect of government leadership in developing impact investment. Relatively modest measures and the **signaling effect of government leadership can create a significant multiplier effect**, in capital and impact. In the short to medium term this may require some government investment to catalyse the market, reduce risks for new entrants, build track record and enhance investor confidence. Designed well, such investment should generate benefits over time that far exceed the cost

The market is at an inflection point. Interest is building, including from investors, as demonstrated by the Impact Investing Australia 2016 Investor Survey. Without a productive partnership with Government, there is a real risk that interest will wane and the market will not reach its scale potential, not just in affordable housing but more broadly across the social spectrum. **The time to act is now.**

Changing the Game

The establishment of an appropriately funded independent wholesale institution in the Australian market would change the game. It could both provide and/or be the go to point and convener for this necessary layer of socially motivated capital. **Impact Capital Australia (ICA), is such an institution.** The vision for ICA is straightforward: to create a new and independent organisation that has capital, mission and mandate to drive the market towards impact at scale. ICA would be an independent engine for the market with two key roles: as a mainly wholesale investor to grow and encourage, not compete with, new and existing intermediaries, and that of market champion.

The elements highlighted in the issues paper as pivotal to attracting more institutional capital and reaping the lessons from international practice: an efficient capacity to raise wholesale funds; specialist intermediaries; and appropriate delivery systems are addressed in the design for ICA.

ICA would provide significant stimulus to unlock private capital for housing and social infrastructure. It can bring the coherent focus needed for scalable transactions to be delivered. This would encourage a range of intermediaries and approaches to meet growing demand for affordable stock and in key areas of reform where demand is growing such as aged care and disability support. Thus enabled, community sector or housing organisations would have an expanded range of options including borrowing from a funded specialist lender to grow their assets, leasing from appropriately designed social property funds or aggregating capacity to raise capital through bonds. Investment for ICA would not be restricted to infrastructure related to Affordable Housing but would **extend across a range of priority policy areas including employment, disability services and health.** It would promote approaches that deliver better outcomes as well as more capital and stock.

A detailed Blueprint has been developed for how ICA can and should be brought to market. The strategy and design has been developed with leaders from across sectors. It is **grounded in deep understanding** of the local market and lessons learned internationally. There is a **clear and accountable plan for implementation.** This is a **unique opportunity for Government to collaborate with the private sector, philanthropy and the community sector.** A Government commitment would incentivise and accelerate commitments from others. It would deliver immediate leverage through private investment into ICA and a multiplier effect in Investment and impact.

Developing the market

Targeted policy to build the impact investment market would also **expand the policy and financing toolbox** for policy priorities beyond Affordable Housing. **Impact Investment supports jobs, growth and productivity** by providing access to appropriate investment capital for small and medium enterprises tackling social issues and operating in communities that need employment opportunities and economic resilience.

While the centrepiece of the Australian Advisory Board on Impact Investing's policy recommendations is ICA, the effectiveness of this institution and overall development of the market would be **enhanced by a number of complementary policy measures**. These include: **removing regulatory barriers** and facilitating growth, **building government capacity and leadership**, and developing **capacity for commissioning that improves outcomes** and reduces costs over time.

There is **strong alignment** between these policy recommendations and **the Australian Government's National Innovation & Science Agenda and the industry and innovation initiatives of State Governments to support enterprise development and innovation**. More explicit focus on social innovation and the impact investment to fuel it within the design of the innovation agenda would **unlock both social and economic benefits for our communities**.

This Submission is directed towards Affordable Housing in the context of development of the broader market for impact investment. Well-designed policy can make a significant contribution to development of the overall market. This broader market development would be needed for initiatives in housing to realise the potential multiplier effect for the longer term. The Australian Advisory Board on Impact Investing and Impact Investing Australia welcome opportunities to engage with the Australian Government and the Working Group in this process.

Introduction

Impact Investing Australia and the Australian Advisory Board on Impact Investment, (AAB) welcome this opportunity to engage with the Australian Government and the Council on Federal Financial Relations Working Group on the issue of Affordable Housing.

This Submission proposes measures designed to deliver immediate impact and inform longer term, targeted strategic policy for development of the impact investment market and its application to Affordable Housing.

As the Issues paper sets out, the impost on government of the capital expenditure required to address the infrastructure needs in Affordable Housing is untenable. Delivering greater value for public money and unlocking other sources of funding and finance is critical to meeting demand in an environment where Government budgets are under pressure and demand in some areas of social service is rising faster than GDP.

Pressing issues related to Affordable Housing such as homelessness, long-term unemployment and poor outcomes for Indigenous communities affect not just those experiencing disadvantage, but ultimately the prosperity of all Australians. Impact investing brings with it opportunities focused on innovation and different approaches to problem solving, bringing together the evidence and experience, skills and resources from government, business and communities, and from different disciplines in new combinations to answer the question: How can things be done differently to achieve a better result?

What is Impact Investment

Impact investment covers the field of investments that are designed to deliver measurable positive outcomes for society and a financial return.

Impact investments can be found across all financial product types. The difference is that a third dimension - *impact* - is added to the more conventional dimensions of risk and return employed in investment decision making.

Impact investing is a powerful tool; it is not a silver bullet. It does not relieve governments of their responsibilities, but can help with more effective delivery. Over time, it can play a role in developing structural alternatives to mobilising finance for Affordable Housing and more broadly across societal issues by enabling:

- More effective targeting of limited resources;
- Different combinations of public and private capital that create a multiplier effect;
- New ways to incentivise better outcomes, innovation and prevention to tackle associated difficult and costly social issues; and
- More options to build local capacity and promote sustainable social and economic development in communities of high need.

Investment into Affordable Housing is, by its nature is an impact investment in so far as it **combines financial returns with design for positive social impact**. The impacts can range from improved access to housing for the more economically vulnerable to a range of broader health and educational benefits depending on the design.

That is, all of the four streams of innovative finance explored in the issues paper are impact investments, just in different investment classes. **Social impact bonds** [SIBs] are only one form of impact investment, housing bonds are another and other financial models extend from those focused on infrastructure only to a combination of infrastructure and services. The point of definition is important for Governments' engagement with the market where framing and expectations matter to how the market is shaped.

Appetite for Impact Investment

Impact Investment is a growth market globally. The Social Impact Investment Taskforce established under the UK Presidency of the G8 (Social Impact Investment Taskforce) found there was real potential for a global market in excess of US\$1 trillion. The analysis conducted by JB Were, for the IMPACT-Australia report in 2013, forecast market potential of \$32 billion within a decade.

Impact investors span many sectors and include progressive foundations and family offices, companies, banks, insurance companies, pension and investment funds, governments and individuals. Impact investors typically have different priorities and varying appetites for risk and return (both social and financial). A common feature of impact investments is collaboration between different market participants and the forms of capital they control.

There is investor appetite in the Australian market, including from institutional investors. The Impact Investing Australia 2016 Investor Report surveyed 123 investors, accounting for more than A\$333 billion of Australia's funds under management. Within the next five years, those already active indicated they aim to triple their impact investment portfolios. Investors not yet active strongly expect to consider social impact in investment decisions within the next five years, and more than two thirds of respondents expect impact investing to be more significant in the next five years. Respondents, particularly institutions, indicated that housing is a significant area of interest. An overview of the survey results is provided in **Appendix 2**.

Benefits of impact investment

The opportunity to develop impact investment has two key benefits:

- the mobilisation of more resources toward positive social impact, both within and beyond the Affordable Housing space in particular unlocking private capital for public good and creating a more significant multiplier effect for government expenditure; and
- more and better ways to tackle really difficult issues affecting society through improved efficacy, innovation, scale, and cross sector collaboration.

Beneficiaries of impact investing span a wide variety of groups:

- *“Socially motivated entrepreneurs and organisations gain access to appropriate finance and support in ways akin to that available to commercially focused entrepreneurs;*
- *Mainstream financial markets benefit from access to appropriate finance for initiatives and services that create positive impact in the community;*
- *Communities benefit when they can finance new opportunities to develop services and infrastructure, and generate jobs – increasing the flow of capital into communities towards more positive cycles of employment and economic activity;*
- *Small to medium sized enterprises gain access to appropriate investment capital and business support that helps them grow their businesses, create jobs, and ride out difficult times;*
- *Philanthropists benefit with options to generate greater impact and leverage through their activities;*
- *Investors have greater choice and new opportunities to put their money to use in ways that make a financial return and also benefit society;*
- *Institutional investors have more options for fulfilling their duties as fiduciaries and diversifying their portfolios;*
- *Governments achieve better outcomes and greater flexibility to target spending and encourage more private capital into areas where there is a need for new solutions.”*

Australian Advisory Board Strategy: Delivering on Impact 2014

This Submission outlines a package of first steps towards a comprehensive whole of Government approach to the development of impact investment, as a market and as a tool to deliver better outcomes not just in Affordable Housing but more extensively across Australian communities. Impact investing is not the only answer to the very complex issue of Affordable Housing, but it is a targeted and outcome focused approach to drive innovation in this area of social policy.

Market Context: Barriers to large-scale investment

Like mainstream investment, impact investment has a market context. Key features of a well-functioning market include: confident and informed demand; efficient matching of supply and demand; variety in investment mechanisms; and resilient supply of capital.

Encouraging and establishing intermediaries that can bring together capital and investment opportunities is a vital component of a well-functioning market. The opening up of pathways for connecting supply and demand is critical through the early stages of field development and essential to longer term scale.

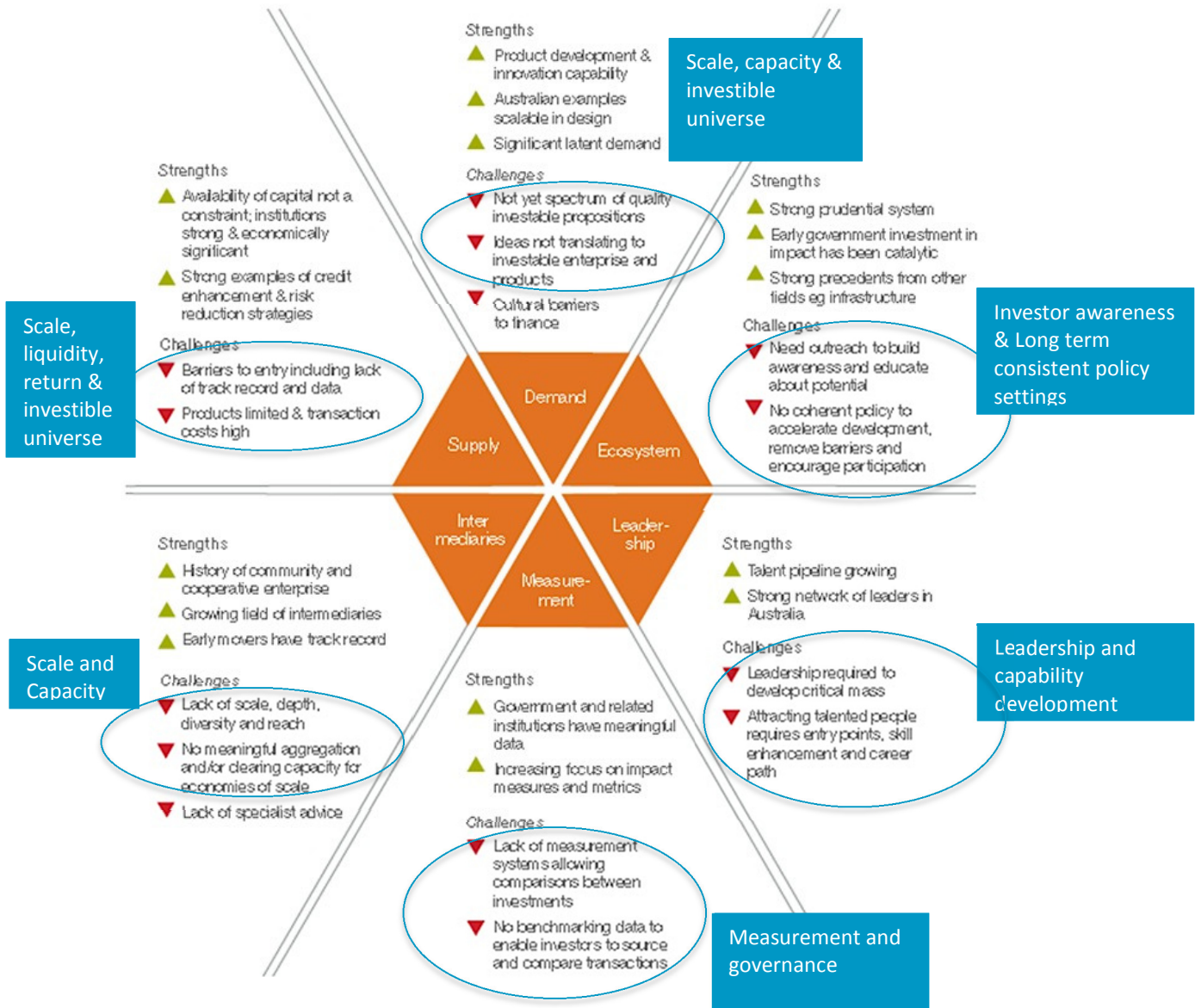
There are enormous benefits to be realised, in Affordable Housing and more broadly, from the development of a strong Impact Investing market. However, in any nascent market, infrastructure for the market needs to be developed, and the regulatory and enabling environment needs to be supportive and not present unnecessary barriers to effective participation. In the short to medium term, this will require government investment and policy setting to: catalyse the impact investing market; reduce risks for new entrants; enable the establishment of track record; and enhance investor confidence. Relatively modest measures and the signalling effect of Government leadership could create a significant multiplier effect, in capital and impact.

The Issues Paper identifies a number of barriers potentially restricting large scale investment in Affordable Housing. These included: small size, illiquidity and/or low risk adjusted return of investment opportunities; low investor awareness; the need for consistency of long-term policy settings; low visibility of project pipelines; and the need for strong governance. These are largely consistent with the analysis of the strengths and challenges for the development of the impact investment market overall as concluded by the Australian Advisory Board on Impact Investing, AAB (2014). This built upon work of the Productivity Commission (2010) Senate Economics' References Committee (2011) and stakeholder and market consultations (2012 and 2014). A summary of the analysis is provided as **Figure 1**.

Additional challenges identified by the AAB included the need for strong measurement frameworks to enable strong governance and, ongoing leadership and capability development.

Challenges of these types are familiar for new and developing markets and they can be overcome by both building on the existing strengths within the Australian market and with some targeted intervention from government. The AAB strategies draw from what has worked in the development of other markets and assets such as private equity and infrastructure, and what has worked in impact investment elsewhere in the world.

Figure 1: Strengths & Challenges in the Australian Market



Australian Advisory Board Strategy: Delivering on Impact 2014

Impact Investing in Affordable Housing

Impact Investment in Affordable Housing

Investment into Affordable Housing by its nature is an impact investment in so far as it aligns financial returns with the social impact of improved access to housing for the more economically vulnerable. In Australia, there are many communities and community sector organisations in urgent need of accommodation for the people they support. Even if accommodation is available often it is on unsuitable terms or is not fit for purpose resulting in high social and financial costs. Examples include the placement of young people with disabilities in aged care facilities and poor quality accommodation outcomes for some indigenous communities.

Additional sources of capital in the market are needed that enable investment to buy or build this necessary housing. Community Housing organisations in Australia continue to experience difficulties in securing capital at terms that enable sustainable expansion at scale. If this capital was currently accessible from purely commercial investors these deals would already be happening. What is missing is the socially motivated capital that de-risks the transaction and facilitates the entry of commercial investors such as pension funds and family offices who have capital at scale to bring to the problem.

The establishment of an appropriately funded independent wholesale institution in the market could provide and be the go to point for this necessary layer of socially motivated capital. Thus enabled, community sector or housing organisations would have an expanded range of options including borrowing from a funded social lender to grow their assets or, leasing from a social property fund.

What is observable globally is that where catalytic capital has been forthcoming, whether through government and philanthropic grants or via purpose driven wholesale institutions such as Big Society Capital, many transactions which would have failed on purely market terms have succeeded.

In some cases, such as the New York City Acquisition Fund, that has meant more capital available for housing than would otherwise have come into the sector, and on more favourable terms. In other cases, such as Living Cities or the Healthy Futures Fund, this can mean more focus on the services and amenity including education and health services that are critical to outcomes and achieve more than simply additional housing stock.

Successful Impact Investment Models in Affordable Housing Globally

There are already many successful impact investing models in the Affordable Housing area which have potential for adoption in Australia.

These range from those addressing only infrastructure funding needs to those going further into both infrastructure and complementary service provision. **Case 1: The New York City Acquisition Fund** illustrates the powerful effect relatively small amounts of socially motivated catalytic capital can have in directing and attracting capital for Affordable Housing.

Case 1: New York City Acquisition Fund

Case Study: New York City Acquisition Fund, USA

The NYC Acquisition Fund was formed in 2006 to overcome the shortage of property available for the development of affordable housing in New York City. It provides flexible, advantageous capital to affordable housing developers to acquire property. The Fund is an example of a layered structure where Financial First and Impact First investors invest together with the former earning market rate returns and the latter earning submarket returns. The Financial First investors are a consortium of banks including Bank of America, JP Morgan Chase and HSBC. The Impact First investors are led by the City of New York with allied foundations such as the Ford and the Rockefeller Foundations. The maximum loan amount is US\$15M for the acquisition of existing occupied buildings and US\$7.5M for the acquisition of vacant land although the Fund has flexibility around this. All borrowers must contribute 5% of the total acquisition and pre-development costs as equity.

Impact:

Since inception the fund has significantly contributed to the refurbishment of existing affordable housing units or new development and construction of affordable housing units. To date, 7476 housing units have been created or preserved. The success of the fund has spurred the creation of similar funds in Los Angeles, Atlanta and Louisiana.

Catalytic Capital:

The initial US\$200M of capital was funded with US\$162M from the bank consortium and the balance provided by the Impact First investors. This implies leverage on catalytic capital of 4.4x. The fund has grown in size with US\$273m now invested.

Source: New York City Acquisition Fund Website and Bridges Ventures and the Parthenon Group, Investing for Impact

Social property funds have proved particularly successful in this area. **Case 2: Cheyne Capital's** agreement with Luton Council in the UK is a good example of this.

Case 2: Cheyne Capital

Case Study: Cheyne Social Property Fund, UK

Cheyne Capital is one of the largest alternative asset managers in Europe with around US\$7bn under management [2014]. Its Social Property Fund, launched in 2014 was developed in response to an identified failure in the market for social sector organisations for whom property is essential to front line delivery.

The Fund's objective is to increase the capacity of social sector organisations by buying and developing properties suited to the needs of the organisation and their beneficiaries, and leasing them on attractive and extended terms to organisations to deliver their front line services.

Initial investment in the fund was £55m and it is targeting an ultimate fund size of £300m.

Impact:

In a recent transaction, Cheyne Capital has signed an agreement with Luton Council to develop 80 new affordable housing units in a town with a waiting list of 6,600 households. The Cheyne Social Impact Property fund has acquired the brownfield site from Luton Council after securing full planning permission for one and two bedroom flats. Luton council has entered into a long term lease with the fund and will have full nomination rights over the units which will be offered at below market rates.

Catalytic Capital:

This is one of the first instances in the UK of private capital replacing the funding for social housing previously provided by government grants. Overall targets for the fund are for an IRR of 10-12%.

Source: Big Society Capital Case Studies

Impact investing globally in the Affordable Housing sector has however delivered superior overall outcomes where it has encouraged independence and opportunity rather than simply sustained a tenancy. Asset based investment which provides simply the stock goes some way to addressing short term lack of supply however long durations of tenancies constrains the breadth of the investment impact. A combined approach providing both Affordable Housing and complementary services such as education and training resulting in better employment outcomes can move individuals to a more economically sustainable position and encourage entry to the private rental market.

Case 3: The Real Lettings Property Fund illustrates, an effective combined approach. In a community housing initiative in the UK, Resonance and St Mungo’s have successfully been offering Affordable Housing with a service overlay for almost three years in London with the Real Lettings Property Fund (RLPF). This social property fund is another type of impacting investing model that, with government support, could potentially be adapted to an Australian context.

Case 3: Real Lettings Property Fund

<p>Case Study: Real Lettings Property Fund, UK</p> <p>Resonance and St Mungo’s have successfully been using a infrastructure and service model in affordable housing for almost three years in London. The vehicle is the Real Lettings Property Fund (RLPF). RLPF acquires properties, and targets tenants who are vulnerable to homelessness but who are not supported by existing social housing programmes.</p> <p>The fund is structured as a Limited Partnership which invests in one and two bedroom properties across London, with income generated from rent by letting the houses out to Real Lettings. The rent level is set at the Local Housing Allowance rate.</p> <p>The RLPF measures the positive impact on tenants, including improvements in their ability to access other private rental sector accommodation as they build savings and a track record as a tenant. Tenants are also supported to progress towards employment and build resilience against homelessness through social connections and financial management skills</p>	<p>Impact: The RLF has acquired over 300 properties and has helped ~1,000 people who faced homelessness.</p> <p>In its second social impact report last year, RLPF reported a 98% success rate in maintaining tenancies along side other positive aspects of impact.</p> <p>Catalytic Capital: Initial catalytic capital of £57m from investors including Big Society capital was released into the market. Resonance is now seeking to further prove this impact model and has recently launched the National Homelessness Property Fund with an investment of £30 million (£15 million from three local authorities and £15 million from Big Society Capital). They are looking to grow the Fund to £60 million and take it to other cities across the UK.</p>
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Source: Big Society Capital Case Studies

Case 4: The Living Cities’ funds are another example of how a layer of lower risk adjusted return capital can be leveraged to support infrastructure and service outcomes in the Affordable Housing area. These funds created a multiplier effect of almost 30 times to enable financing of \$US16bn.

Case 4: Living Cities' funds

Case Study: Living Cities

Living Cities demonstrates how combining different types of capital can deliver leverage for social change and community infrastructure. Living Cities is a fund manager established in 1991. The fund is a partnership involving 22 of the world's largest foundations and financial institutions. They pool **different types of capital** to enable **fit-for-purpose finance** on behalf of low-income individuals in cities across the US.

Living Cities works with leaders from across sectors to develop and **scale new approaches** to bring about significant improvement in the economic well-being of people with low incomes living in US cities. **Innovative capital** is one of the key tools, utilised in combination with other innovations, research, networks and convenings to **accelerate the uptake of promising solutions to social problems**.

Its Catalyst Fund is ranked as one of the top 50 Impact Funds in the ImpactAssets50. Its portfolio of investments ranges from affordable housing to social impact bonds.

Impact:

Financing has helped build schools, affordable housing, clinics, childcare and job training facilities, and other facilities and services for low-income communities across the US.

Catalytic Capital:

The structure allows participation of different investors and different types of capital from grants to commercial capital. Living Cities capital has been leveraged nearly 30 times, resulting in over US\$16B of financing. Capital is utilised in combination with other tools and innovations for impact at scale.

Source: Living Cities Website

Important in any discussion on impact investing is recognition that its potential is not limited to one specific social issue. While there is undoubtedly a role for impact investing in addressing the problem of the lack of Affordable Housing, it extends well beyond this into other areas of social and environmental need. **Case 5: The Healthy Futures Fund** is one such example. The fund is a response to the clear association between poverty and disease, addressing the issue by incorporating a health lens into traditional community development work. It aims to foster collaboration between Affordable Housing developers and healthcare providers who often work side by side in low income areas but rarely in a co-ordinated fashion.

Case 5: Health Futures Fund

Case Study: The Healthy Futures Fund, USA

The initial \$US100m fund was launched in 2013 with Founding partners including Local Initiatives Support Corporation (LISC), Morgan Stanley, and the Kresge Foundation. A second tranche of US\$100m was raised in November 2015 with US\$25m of new investment already identified.

The Fund is a response to the clear association between poverty and disease, addressing the issue by incorporating a health lens into traditional community development work. It supports broader efforts to improve the quality of life in distressed neighbourhoods.

The fund uses a unique financing structure that leverages New Markets Tax Credits, (NMTCs), Low Income Housing Tax Credits, (LIHTC) grants and loans to help new developments get off the ground and to connect existing housing and health services. NMTCs are designed to spur the commercial redevelopment of disinvested areas. They have attracted more than \$38 billion in direct investments, generating \$8 of private investment for every \$1 of federal funding. [See Appendix for details of NMTCs and LIHTCs].

Impact:

To date, the fund has helped local providers extend health services to 40,000 people while also supporting more than 400 new apartments that are affordable to low-income families. Its impact targets are to extend this to Federally Qualified Health Centers supporting 100,000 in patient capacity and 450 units of affordable housing

Catalytic Capital:

The \$US100m initial investment was US\$63M in equity through the LIHTCs and NMTCs (Morgan Stanley) and \$37M in loan and grant capital (Kresge Foundation, LISC, Morgan Stanley). The fund has become a new capital source for investment in health centres with a goal of ongoing future capital raisings enabled by a deeper understanding of the credit risks of health centres.

Source: Healthy Futures Fund Website

The Healthy Futures Fund is enabled by US government tax credit programs aimed at new market development in poorer communities and Low income housing. This interplay of different policy levers to make possible investment into communities underlines the need for an approach that takes into account the different parts of the market for clear government leadership to drive broader market development.

The role of government

Government has a critical role to play

Internationally and in Australia there is a track record for government action underpinning the emergence of growth and new industries. In Australia this has included venture capital, research and development, green and renewable technology and business model innovation for structural adjustment. Enough has been tried in other early markets and elsewhere in the world to develop impact investment, that we can proceed with confidence to build on the strengths and address the challenges.

A role for government in Australia to encourage and support impact investment has been supported by the Productivity Commission¹, Senate Economics References Committee², the Australian Advisory Board³, the Joint Standing Committee on Foreign Affairs, Defence & Trade and, the Financial System Inquiry (FSI).

“Government intervention can play a catalytic role both in facilitating the functioning of the ecosystem and targeting actions to trigger its further development. However, these actions should provide incentives for the engagement, not the replacement of the private sector and should be conducted in a manner conducive of the market.” FSI Report 2014

The FSI also expressly agreed with the OECD’s assessment of the role of governments and concluded it *‘sees merit in Government facilitating the impact investment market’*.

The role of governments in financial markets is well established. There is a dynamic, but also relatively well defined toolbox. It includes setting the regulatory environment and fiscal policy addressing market failures, and stimulating new market opportunities. The role in promoting innovation is also relatively well established, although not as routinely applied in the social policy domain. Not all elements of this toolbox require regulatory or policy change. Some are practical in their orientation. That includes priming the pump for appropriate capital, encouraging new enterprises and talent, sharing data and promoting collaboration.

Proactive roles for governments as market builder, market steward and, where appropriate, market participant were supported by the Social Impact Investment Taskforce and the National Advisory Boards across the G7 countries and Australia and the EU. This followed an examination of the market ecosystems across those countries as part of the Taskforce process and is being picked up by other countries as they join the Global Social Impact Investment Steering Group (Global Steering Group) that has succeeded the Social Impact Investment Taskforce.

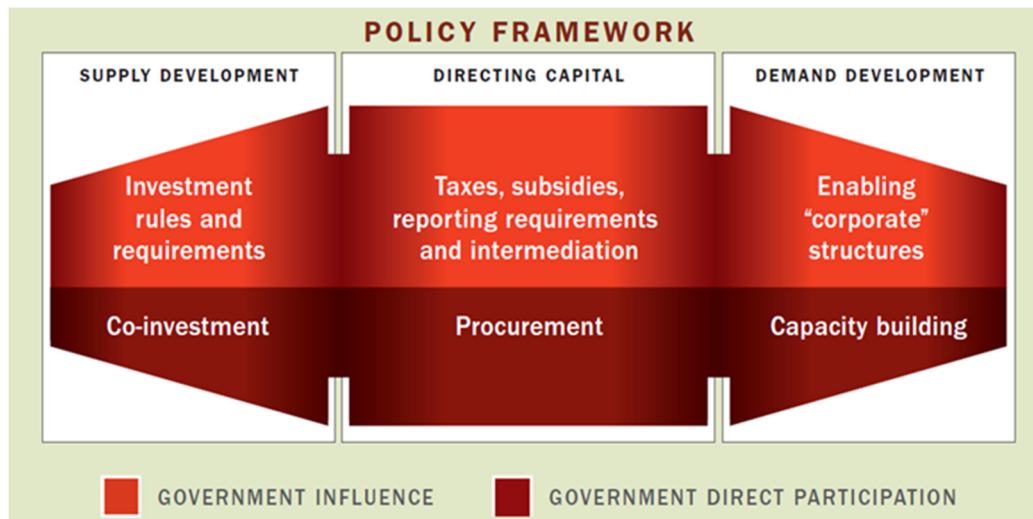
¹ *Contribution of the Not for Profit Sector*, Productivity Commission, 2010

² *Investing for good: the development of a capital market for the not-for-profit sector in Australia*, Senate Economics Committee, 2011

³ *Delivering on Impact*, 2014, Addis, McLeod et al, 2014

The opportunity to direct capital to particular social issues, like Affordable Housing, is shown in the context of these roles in **Figure 2**.

Figure 2: Policy Framework



Source: **Impact Investing: Policy Analysis & Design, Thornley et al, 2011**

The policy objectives of governments’ role in each of those functions is summarised in the tables below. It outlines the twin goals identified by the FSI of facilitating market development and, encouraging innovation in both service delivery and to tackle social issues. In a Federal System, the levers for different levels of government will likely be different, in particular with respect to regulation.

Facilitate Market Development			
Role	Market Builder	Market Participant	Market Steward
Policy Objective	<ul style="list-style-type: none"> ▪ Increase resources to impact driven organisations ▪ Develop impact investment system with a range of participants ▪ Provide incentives to encourage greater participation and scale in early stages of market development 	<ul style="list-style-type: none"> ▪ Better targeted government spending and direct capital to policy priorities ▪ Increase flow of investment to social purpose organisations and social objectives 	<ul style="list-style-type: none"> ▪ Remove barriers to investment ▪ Reduce red tape preventing greater participation by investors

Encourage Innovation in Social Service Delivery			
Role	Market Builder	Market Participant	Market Steward
Policy Objective	<ul style="list-style-type: none"> ▪ Increase resources to impact driven organisations ▪ Encourage willing talent to tackle issues affecting society and build and grow effective social purpose organisations 	<ul style="list-style-type: none"> ▪ Increase focus on efficacy and outcomes ▪ Orient funding to provide incentives for innovation and effective solutions 	<ul style="list-style-type: none"> ▪ Ensure regulatory frameworks enable a range of impact – driven organisations ▪ Remove red tape that impedes sustainable blended models of profit and purpose

Adapted from Social Impact Investment Taskforce, 2014 and Addis in Nicholls et al (eds) 2015

Stakeholder engagement is essential to ensure: a design and implementation that works for the market; the achievement of the stated social impacts and; operation within appropriate government probity and value for money requirements. Seemingly straightforward considerations, (for example indexation rates), can affect the extent to which the market can, and will, engage. Political risk is also a significant consideration for investors. Therefore, where possible initiatives that either provide some degree of certainty or deliver structures or processes, (for example, new social impact investment funds), that can operate with a degree of independence, are helpful in building market confidence and engagement.

In addition to market impacts, implementation strategies need to take into account relevant capability. This can require skills that currently sit across boundaries within government as well as between government and other sectors. This can be addressed through targeted advice and clear governance as well as building areas of expertise within government.

Design and capability challenges can be addressed, effectively and to deliver quality outcomes. Existing processes, used effectively, can be powerful tools in developing initiatives with confidence in probity and value for money. For example, the Social Enterprise Development & Investment Funds initiative was highlighted by the Australian Public Service Commission as an example of innovative policy executed well (State of the Service Report, 2010-11).

Policy Measures

Measures needed to develop an impact investment market & how they support objectives in Affordable Housing

The policy measures outlined below draw on lessons from local and international experiences in impact investing related to Affordable Housing and other societal issues. They also consider the evolution and development of other parts of the financial system. They reflect significant work that has already been done including the strategy and initiatives led by the AAB in conjunction with over 50 senior business leaders and Impact Investing Australia. Lessons accessed through global networks including the work of the Social Impact Investment Taskforce and Global Steering Group, have also been drawn from.

The measures go to different dimensions of the market equation: demand, supply intermediaries and the enabling environment. Increasing the flow of capital without attention to the role of intermediaries is unlikely to succeed on its own. Like other developing markets, impact investment needs: support intermediaries; demonstration of investment performance; and platforms and channels to overcome information asymmetries.

The focus of the policy recommendations made here centres on growing the impact investing market in Australia, including for Affordable Housing. There are additional positive policy actions which would encourage impact driven entrepreneurs and enable social enterprise development which we have not included in this submission.

The centrepiece specifically designed to drive market development is Impact Capital Australia, an independent engine for the market with two key roles. Firstly that of mainly a wholesale investor to grow existing market participants and encourage new intermediaries to enter the market, and secondly as a market champion. Additional measures included are designed to remove regulatory barriers, build government capacity and leadership, and develop capacity for commissioning that improves outcomes and reduces costs over time.

Changing the Game

Impact investment is at the stage of development where there is significant interest, but proactive steps are needed to unlock capital, bridge the gap between supply and demand and encourage new market participants to enter what they see as uncharted waters.

“Unfortunately, relatively few appear willing to step up to the hard and uncertain work of sparking and nurturing the innovations that ultimately generate a robust flow of investable, high-return impact investments. It is as if impact investors are lined up around the proverbial water pump waiting for the flood of deals, while no one is actually priming the pump!”

Bannick & Goldman, 2012

The Social Impact Investment Taskforce identified key pieces of market infrastructure to ground and accelerate development of impact investment that will be required in all local markets. First among these is a wholesale institution to support and grow intermediaries and act as market champion. The Australian Advisory Board on Impact Investment, after market consultation, reached the same conclusion. It identified a cornerstone social impact fund as the key breakthrough needed to take the market to a tipping point. Independence for such an institution is important to avoid moral hazard (Productivity Commission, 2010) and develop market confidence.

Impact Capital Australia is designed to be that institution. It would encourage long-term, market oriented responses at scale and develop delivery capacity.

Impact Capital Australia - Overview

Impact Capital Australia (ICA) would be an engine for the impact investing market in Australia. It would help unlock further private capital and demonstrate efficacy and impact in Affordable Housing alongside other societal issues. ICA would be a new, independent organisation equipped with capital, mission and mandate to drive the market towards impact at scale. It would have two key roles: investor and market champion. Its investment mandate would have three central elements: clear impact, financial viability and contribution to market development.

ICA would need sufficient capital to send a strong signal to the market and to operate self-sufficiently. Analysis indicates that **initial capital of \$300 million** would be required to achieve both of these objectives. The **design provides for 50% of this to come from governments; that is critical for the mandate and signalling effect as much as for the financial model.** The initial capital contributions to ICA have been modelled as follows: government 50–60%; mainstream financial institutions 35–40%; community sector, philanthropy and other investors 5–15%. ICA is designed to become self-sustaining within 7 years. It is scalable from this base, but requires critical mass to fulfil its mandate and become independent.

ICA presents a unique opportunity for the Australian Government to collaborate with the private sector, philanthropy and the community sector. Government commitment would incentivise and accelerate commitments from others. The proposal for Government to provide the cornerstone funding represents a serious, but relatively modest investment for significant catalytic effect. It is supported by rigorous design. ICA would deliver private sector leverage of 1:1 in its capital base and a significant further multiplier effect through its investments over time.

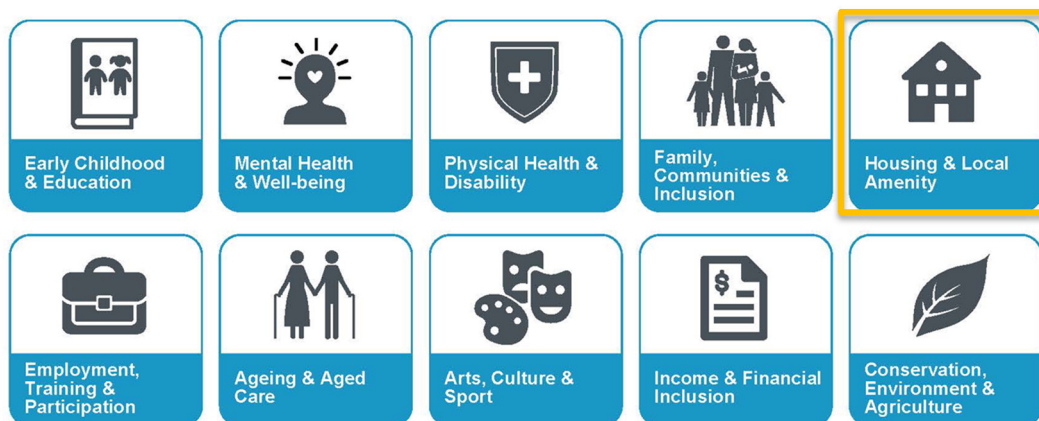
Benefits would flow to:

- Australian communities and the economy through more resources available for social purposes, new approaches to solving old problems and greater transparency and accountability for outcomes.
- The market, investors including banks, and intermediaries from ICA as a market champion that is prepared to go first, unlocks new capital and creates new opportunities for investment with impact.
- Governments through delivery of greater public value from improved outcomes, a more significant multiplier effect for funding they provide and from more capacity to target scarce public resources.
- The social and environmental sectors from greater access to a wider range of funding and finance options.
- Philanthropy from potential to achieve more impact from strategic use of its grants and investment capital.

ICA's unique contribution to Affordable Housing

ICA would direct private capital to priority areas such as Affordable Housing. It would focus on service innovation as well as infrastructure. Investment would be targeted to jobs and growth for communities doing it tough, through place based investment strategies. Other initiatives undertaken by Government in Affordable Housing can be designed to complement ICA's and, it can amplify their effect and impact through its work. However, ICA's mandate has been designed to be broader than just one policy priority area. Its remit of developing the infrastructure and intermediaries within the impact investing market is expected to have a more significant multiplier effect across a range of outcome and policy areas as indicated by **Figure 3**.

Figure 3: Outcome areas



Source: Blueprint to Market, 2015

ICA would be a unique institution in the impact investing market. Intermediaries already active in the market cannot fulfil the role of ICA. They need to focus primarily on fulfilling their missions and developing their own businesses. They cannot, on their own, encourage and support other intermediaries and market infrastructure. Without the benefit of scale, they may also struggle to invest in significant development of new investment products or complex large transactions without some support being available.

As a wholesale investor, ICA would invest in impact vehicles being taken to market by intermediaries. These are expected to take a range of forms across impact investment types including Affordable Housing. There are a number of nascent proposals in the market already, but they have not yet been developed because this form of wholesale funding source is not clearly available. The type of investments that ICA could seed in the Affordable Housing area are:

- a social housing investment bank or fund to create purpose built Affordable Housing for low income families, people with disabilities or to integrate aged care accommodation in the community;
- a social impact bond fund focused on social service based investments across the outcome areas specifically associated with the housing affordability issue eg. Training programs leading to better employment outcomes; and
- a fund to invest in aspirational small and medium enterprises in low-income communities where Affordable Housing is an issue. Communities that have previously experienced lack of investment to generate impact in jobs and local economic activity.

A number of organisations, in their submissions to the FSI, supported development of such a flagship like ICA as part of the Australian financial system. More have contributed to developing the detailed Blueprint for this institution and how ICA can be operationalised. That blueprint is grounded in deep understanding of the local market and lessons learned internationally. There is a clear and accountable plan for implementation. An extract from the Blueprint for Impact Capital Australia is provided with this Submission as part of **Appendix 1**. Additional information on the financial model and the proposed governance and roadmap for implementation are also provided in **Appendix 1**.

Further steps in market development

The effectiveness of both ICA and the market would be enhanced by a number of complementary policy measures. These include: removing regulatory barriers and facilitating growth, building government capacity and leadership, and developing capacity for commissioning that improves outcomes and reduces costs over time.

Removing regulatory barriers & facilitating growth

Regulation is an important element of the enabling environment for impact investing in Affordable Housing and more broadly. Removing barriers and identifying disincentives to participation is critical to market development. There are several no-cost or low cost options to improve the enabling environment in Australia. They include:

- **Fiduciary Duties:** Clarification of the fiduciary duties of philanthropic and superannuation trustees to put beyond doubt that impact can be considered in addition to risk and return by fiduciary decision makers.
- **Program and Mission Related Investment:** Ensure program and mission related investment is enabled to provide greater flexibility for philanthropic trusts and foundations to direct capital toward achieving their social mission through mission related investment.
- **Social Infrastructure Assets:** Assess the extent to which regulatory issues, accounting and balance sheet treatment of social infrastructure assets, including housing, is limiting capacity to attract private capital to these assets. This can be done within the context of the consultation on innovative ideas to boost Affordable Housing.
- **Unsolicited proposals:** Extend provision for unsolicited proposals to be brought forward from current parameters to include a transparent framework for unique proposals to develop the impact investment market or leverage private capital for policy priorities at scale. To achieve a consistent approach across jurisdictions, this could draw upon, or even expand, the processes in place through Infrastructure Australia.

Fiduciary duty is an important mechanism of stewardship in the position of trust held by those responsible for philanthropic and superannuation trusts. However, the interpretation of those duties can sometimes be narrower than the intent or the objectives require to ensure prudence and responsibility in the management of other peoples' money. Additional guidance can put the position beyond doubt that impact can be considered in addition to risk and return by fiduciary decision makers. Done well, this would build confidence and encourage mobilisation of capital.

In the US, the Department of Labor has recently issued guidance regarding 'economically targeted' investments made by retirement plans covered by the Employee Retirement Income Security Act. In essence, this guidance safeguards the primacy of the financial health of pension arrangements but acknowledges that:

*"Fiduciaries may not accept lower expected returns or take on greater risks in order to secure collateral benefits, but may take such benefits into account as "tiebreakers" when investments are otherwise equal with respect to their economic and financial characteristics. The guidance also acknowledges that environmental, social, and governance factors may have a direct relationship to the economic and financial value of an investment. When they do, these factors are more than just tiebreakers, but rather are proper components of the fiduciary's analysis of the economic and financial merits of competing investment choice."*⁴

⁴ See www.dol.gov/ebsa/

The Australian Prudential and Regulatory Authority (APRA) response to the interim report of the FSI included a statement that:

“...does not prohibit impact investment where appropriate risk and return considerations are met. Indeed, the standard does not make any distinction between different types of investments.”

APRA further stated that:

“Working within the existing statutory framework APRA would, however, be open to considering the need for additional guidance regarding social impact investment, to the extent that a lack of clarity regarding APRA’s expectations was seen to be an unnecessary barrier to additional social impact investment by trustees.”

Corresponding guidance for philanthropic trustees would also help mobilise capital. Following a report of its Law Society, the United Kingdom Charities Commission has been developing such guidance. In France the ‘90/10’ rule mandates that employees with access to a Plan d’Epargne Enterprise have the opportunity to invest in funds that place 5-15% of their capital in social purpose organisations growing capital in these funds from \$700 million in 2007 to \$5.5 billion in 2013. An adaptation of this measure has recently been proposed for Australia by the Community Council of Australia.

Program and mission related investment should also be designed for the Australian context. Well-designed policy to make clear that philanthropic trusts and foundations can mobilise a proportion of investment capital aligned with their mission even at rates regarded to be below market rate of risk adjusted return would reduce market constraints. This would help fill funding gaps between grants and commercial capital, encouraging the flow of more capital overall. Any discount on market rate could be attributed to grant making requirements. This is consistent with current practice allowed by the Australian Taxation Office for trusts to make leased premises available at a discount to market and treat the difference as part of their grant funding.

Mobilising this type of quasi-philanthropic investment capital would be a significant stimulus for social and financial innovation. It would enable a greater role for philanthropy in attracting more capital for social purpose and deploying its available capital for greater impact. Also, this approach would encourage foundations to work in close collaboration with the private sector to align their social goals and financial tools. Further, it would enable more effective and creative utilisation of the corpus of philanthropic trusts and foundations for the purposes for which those pools are created and already receive favourable tax treatment.

Similar approaches are being adopted in the United States and United Kingdom. These are being utilised to powerful effect by foundations including the Gates Foundation and FB Heron Foundation. For example, the Gates Foundation PRI approach adopted in 2009 involved allocation of more than \$1.5 billion by 2012. Examples of investments include the Global Health Investment Fund and Aspire Public Schools investing in quality schools for low-income communities and students in the United States.

Proposals to adopt a more streamlined version of the (so-called) mission and program investment regimes have recently been tested favourably with the market in Australia by Philanthropy Australia.

The way in which **social infrastructure assets** are held and accounted for on Government balance sheets is reported by the sector to be a barrier to greater private investment. This needs to be further examined through stakeholder consultation and cost benefit analysis to assess the extent to which regulatory or process issues are limiting capacity to attract private capital to these assets, including housing. This can be done within the context of the consultation on innovative ideas to boost Affordable Housing.

Unsolicited proposals have increasingly been utilised as a mechanism to bring forward private sector interest and ideas to mobilise infrastructure investment. There is no similar avenue consistently available in the context of investment to deliver significant social investment or public goods. A well-designed and transparent process to enable unique proposals to come forward would broaden the potential for

Government and the community to benefit. It would create a greater incentive for the development of innovative proposals because there would be a defined pathway for their evaluation and potential partnership with Government. To achieve a consistent approach across jurisdictions, this could draw upon, or even expand, the processes in place through Infrastructure Australia.

Promoting outcomes focus, efficacy & innovation

There is increasing focus on the outcomes achieved with public funds leading to innovative approaches to tackling social issues and service delivery. In the context of Affordable Housing, the aim should be to incentivise and enable those with workable solutions to build scale and those with ideas to innovate and develop new solutions.

This policy measure proposes promoting better outcomes, efficacy & innovation starting with design and feasibility for 2 initiatives with a view to moving quickly to a decision on implementation. The focus is building capacity to use market based mechanisms to attract capital to achieve strong social and economic outcomes, including through collaboration between the Federal and State Governments.

The development work relates to the following:

- **A dedicated Outcomes & Innovation Fund** to support proof of concept and scaling what works through outcomes based commissioning, including social impact bonds.
- **Protocols for data sharing** to inform efficacy and innovation and facilitate more efficient and effective allocation of existing resources to achieve social impact.

More options for outcomes based contracting are being explored in a range of jurisdictions including Queensland, South Australia, ACT and NSW. That includes Social Impact Bonds (SIBs), a financial innovation that links financial performance to social performance and, in many cases, reduced cost to Government. These instruments are being used extensively overseas in a range of jurisdictions from the UK to Ghana. Global experience suggests there is a strong case for linking social service outcomes with the social infrastructure required for Affordable Housing to achieve a more encompassing solution to the underlying social issues.

A focus on innovation, evidence and opportunities for collaboration is also needed. There is an opportunity for the Australian Government to incentivise more of this activity and the innovative financing mechanisms to support it.

A dedicated Outcomes and Innovation Fund would be a powerful approach to support State and even local Governments' activity through funding for feasibility, proof of concept and top up payments to account for benefits of overlapping responsibility between State and Federal Government.

Design is critical for such an Outcomes & Innovation Fund to be successful for the Australian federal system and yield credible evidence of program or policy impacts enabling direction of a larger share of resources towards evidence-based, outcomes oriented practice. Robust design would also help ensure the initiative builds capability, yielding better social impact measurement, better commissioning of services and stronger engagement with citizens and communities to reward innovative and scalable solutions to complex social challenges.

Well designed, such an initiative would solicit the strongest proposals from market nationally in areas of key social and service delivery challenges. It would enable the first concrete action at Federal level on SIBs in a manner that facilitates collaboration, investment and learning at a scale that cannot be achieved in a single transaction. The Australian Government would benefit from the data collected and lessons learned and all jurisdictions could benefit from opportunities for replication and scaling of what works. In addition to the multiplier effect of increased focus on efficacy and innovation, this would provide a structured opportunity for collaboration with State Governments.

Similar approaches have been utilised elsewhere. For example, the US Federal Government proposed a \$300 million Social Impact Fund to provide incentives for State and local governments to fund feasibility and other approaches to outcomes based funding. A Social Impact Bond Bill (US) before Congress is also intended to promote more evidence based and innovative solutions. The European Investment Fund is also developing a platform combining funding, capability development and collaboration to promote outcomes focussed approaches across the European Union. Under the stewardship of the Global Steering Group, work is underway on feasibility for a global literacy fund that would target funding of US\$1 billion.

“A decisive move to focus on purchasing outcomes, (by governments and other commissioners), is the clearest way of simulating flow of revenue to impact-driven organisations that rewards them more directly for the social value they create. This can have a profound effect on the way impact is delivered as well as ensuring that innovation and effectiveness is incentivised.”

The Social Impact Investment Taskforce, 2014

Data availability, including data relating to the cost of social services, can highlight where there is room to do better, sending signals to the market for more entrepreneurial approaches to tackling issues. This is recognised in the data sharing initiatives of the Australian Government, including under the National Science & Innovation Agenda, and of State Governments including NSW and Queensland.

Initiatives around the world are putting greater focus on measurement of the efficacy of social initiatives. For example, Inspiring Impact (UK) is a collaborative initiative between the UK Cabinet Office and others to drive more effective measurement and evidence based decision making.

The UK Cabinet Office, for example, published the unit cost of over 600 areas of service provision to send signals to the market, and promote innovation and encourage new financing mechanisms based on results. Related work underway in NSW, as part of its Social Impact Investment Policy, will publish cost and performance data. A Statement of Opportunities, including data on four areas of service delivery, was published in February 2015 to inform market soundings and expression of interest design for impact investment opportunities.

There are sensitivities about privacy for some data. However, key information and metrics can be identified as useful to the market and agencies to encourage more open engagement about the relationship between the investment in prevention and the true costs of dealing with the effects of social issues.

Feasibility for these initiatives would reduce establishment risks and costs, and may reduce any future quantum of seed funding required, although, if announced, also raise an expectation that they will be delivered and that the Government will provide funding.

Government Engagement & Leadership

Up to this point, other countries in the Social Impact Investment Taskforce process have had both sector and Federal Government engagement in the Impact investing dialogue but Australia has not. The Australian Government is welcome to nominate an appropriately qualified observer to both the Global Social Impact Steering Group and Australian Advisory Board.

This policy recommendation involves low cost measures to building government capacity and leadership and connecting the Australian Government at the forefront of developments. The following straightforward steps build on the foundations developed in the market:

- Accept the invitation for an appropriately qualified senior Australian Government Official Observer to join Government Observers from other countries on the Global Social Impact Investment Steering Group and the Australian Advisory Board.
- Ensure that innovation policy, including at national level under the Innovation and Science Agenda, has whole of government remit by including social aspects of innovation.
- Nominate designated Ministers to champion development of impact investment, ideally supported by central agencies and in particular Treasuries, who can lead engagement with banks and financial institutions, major corporations, venture capital providers, entrepreneurs, community sector, philanthropy and government agencies and encourage collaboration.
- Other jurisdictions follow the NSW example to establish an Office of Social Impact & Investment to provide a centre of excellence and capability and drive public sector capacity to engage with the market and private sector for a more efficient and effective allocation of existing resources to achieve social impact.

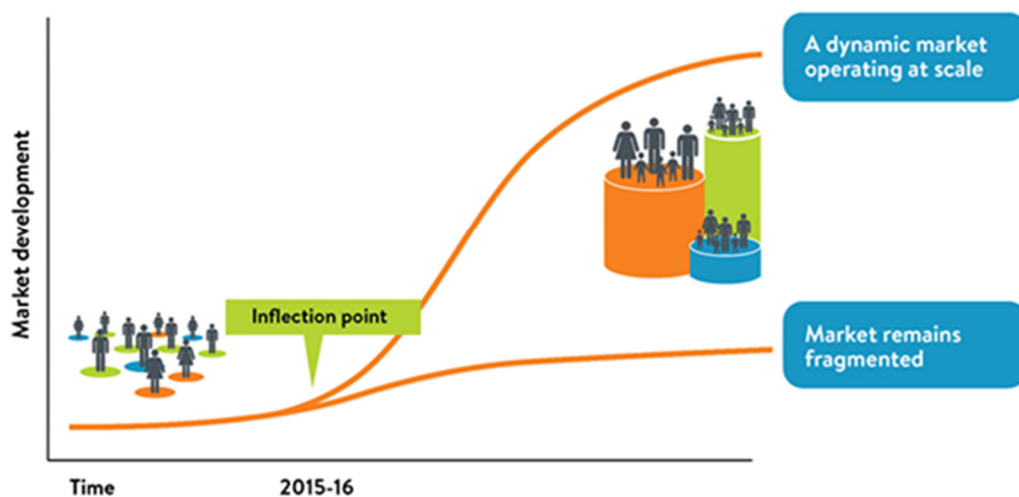
This would send a clear signal to the market in Australia and across participating countries that governments are engaging to better understand the market and its options and are open to collaboration in particular with the private sector. It would also help accelerate government understanding of the market, capacity for effective action and development of networks and relationships.

The time to act is now

Impact investment can make a significant contribution not just to the issue of housing affordability but more broadly across the social landscape. The Social Impact Investment Taskforce concluded there is enormous potential for a global market for impact investment to reach US\$1 trillion. Within the domestic context, the first survey of Australian investors on impact investing initiated by the Australian Advisory Board for Impact Investing suggests high investor interest [see **Appendix 2**].

The time to act is now. Global momentum is building and Australia has already established a leadership position in the global effort. Australia has an important opportunity to be competitive regionally and globally in this growth market.

Figure 4: Inflection point in market development



Source: **Blueprint to Market, 2015**

The market is at an inflection point (**Figure 4**): there is a path toward scale, mainstream engagement and real impact. There is also a future where interesting, incremental steps continue to deliver niche activity and interest at the margins. One where interest wanes as willing capital and talent is left on the side-lines without sufficient focus and infrastructure to capitalise on the strengths available and overcome the challenges familiar to new markets. What happens next matters a great deal.

Conclusion

Developing the impact investment market and its potential to drive change will take time. The pace of development can and should be accelerated. Australia already has a global leadership role, which reflects the quality of thought leadership and transactions, dynamism of the social sector and its role on the Social Impact Investment Taskforce, and on its successor the Global Steering Group. Leadership and interest from across sectors provides a strong foundation.

Australian representation on the Social Impact Investment Taskforce and, the opportunity it has provided to convene a cross-sector leadership group in the AAB, provides a unique platform. A platform from which to build a productive partnership with governments and facilitate collaboration between governments and other actors in the market.

There is a clear opportunity to create common platforms and infrastructure to link Australia's market to the region and to global markets. Enough has been trialled elsewhere to know what is required for the market to act with confidence. There is demand for funding and a pressing need for innovative solutions. There is money poised to invest.

Targeted strategic initiatives can bring the pieces together and make real breakthroughs possible. If the opportunity is missed, our communities and economy will be the poorer for that. If the opportunity is seized, impact investment in Australia can become a material additive driver of capital and innovation focused on delivering positive impact contributing to Australian society.

Well-designed policy can make a significant contribution. The Australian Advisory Board and Impact Investing Australia welcome opportunities to engage with the Australian Government and the Working Group in this process.

Appendix 1: Impact Capital Australia

About ICA

A detailed Blueprint has been developed for how ICA can and should be brought to market. A copy is included as part of this Appendix and provided as a separate document.

The strategy and design has been developed with leaders from across sectors. It is grounded in a deep understanding of the local market and lessons learned internationally. There is a clear and accountable plan for implementation.

The vision for ICA is straightforward: to create a new and independent organisation that has capital, mission and mandate to drive the market towards impact at scale. ICA is designed to be different: independent, collaborative, proactive, agile and transparent. It would have two key roles: investor and market champion.

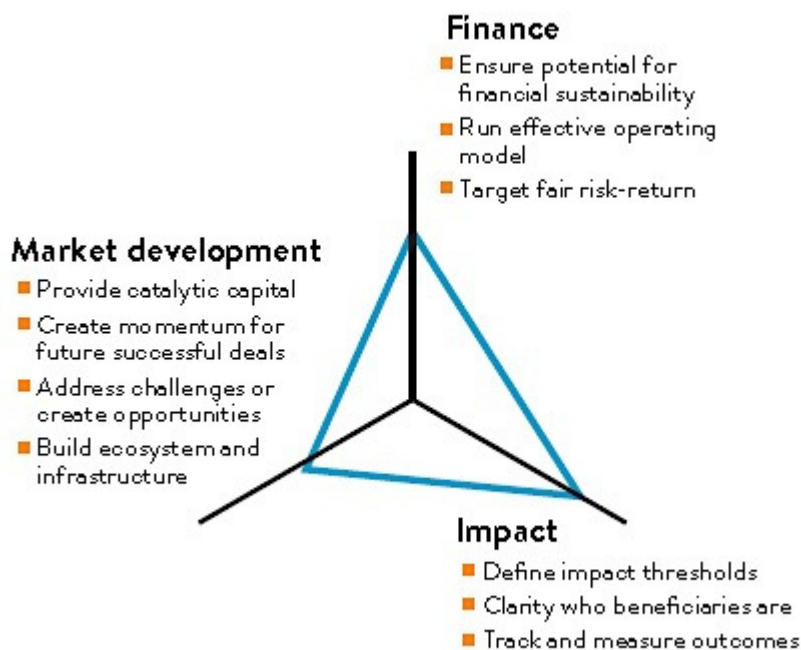
Its mission would be to act as a catalyst and build a dynamic market by:

- Investing in intermediary vehicles and products in key impact sectors
- Originating societally focused, impactful, innovative and scalable solutions
- Implementing strategy to encourage diversity, innovation and growth

Its investment mandate would have three central elements: clear impact, financial viability and contribution to market development (**Figure 5**). ICA's predominant investment focus would be wholesale, providing finance to existing market participants to grow their reach and impact, and encouraging more participants to enter the market because capital is more readily available to them.

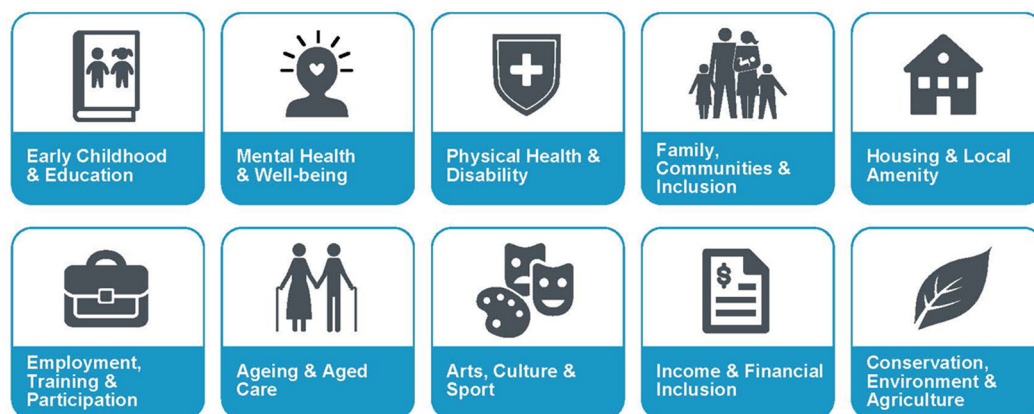
To be effective, ICA would also need capacity to be proactive to fill market gaps where deals would otherwise not happen, and where its participation would send a market signal that unlocks the potential for transformative approaches and for resources that would not otherwise be available.

Figure 5: Portfolio dynamics for impact



All investments would need to demonstrate impact in one or more of the outcome areas that define the portfolio (Figure 6).

Figure 6: Outcome areas



Source: Blueprint to Market, 2015

Examples of potential wholesale investments for ICA could include:

- a fund to invest in aspirational small and medium enterprises in communities that have experienced lack of, or withdrawal of, investment to generate impact in jobs and local economic activity;
- a social impact bond fund focused on social service based investments across a range of outcome areas;
- a social housing investment fund to create purpose built accommodation for people with disabilities; and
- a fund that makes investments, to support new business models that enable new approaches to tough social issues or enable social purpose organisations to do more of what works.

Beyond its investments, ICA would have a clear role as market champion, targeting barriers to growth, actively developing and openly sharing expertise, knowledge and tools. It would build meaningful engagement with communities, sector experts and with regulators and governments.

This role in combination with its investment mandate would position ICA to 'grow the pie', creating a multiplier effect, by delivering greater value from public investment and unlocking private capital and talent, and expanding the potential for impact.

Financial Model for ICA

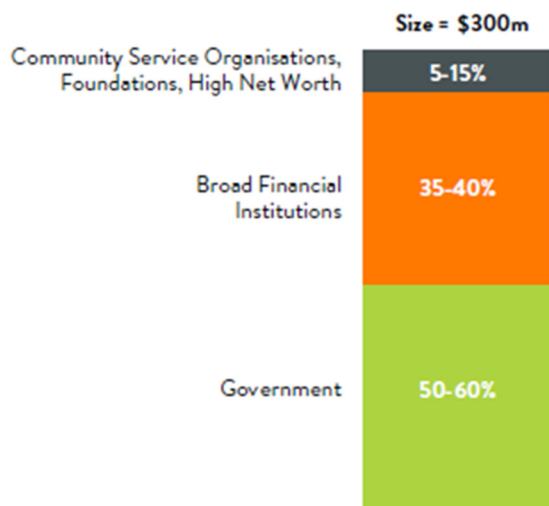
Impact Capital Australia, ICA would need sufficient capital to send a strong signal to the market and to operate self-sufficiently. Modelling indicates that **initial capital of \$300 million** would be required to achieve both of these objectives.

Initial capital contributions to ICA (Figure 7) have been modelled: Government 50–60%; mainstream financial institutions 35–40%; community, philanthropy and other investors 5–15%.

ICA's income stream, including interest earned on seed funding would support the origination function and fund market building activity and the establishment and operating costs.

The terms of funding are likely to be different for each of the categories of capital provider: grant funding from governments; debt or hybrid contributions from major financial institutions on terms that include preservation of capital but with a return below full commercial rates; and debt or hybrids from community sector and other investors on terms that meet their fiduciary duties. Initial modelling anticipates ICA would have a self-sustaining cash flow profile within 7 years.

Figure 7: Initial Capital Structure for Impact Capital Australia



Source: Blueprint to Market, 2015

Initially conceived by the Australian Advisory Board as a \$350m fund, a rigorous process was put in place to validate the capital requirements for ICA thereby reducing this to \$300m. Underpinning this is a financial model developed by Impact Investing Australia together with a Working Group of senior leaders and A.T. Kearney, and predicated on ICA's proposed business operating model.

The first step in this process was the construction of an economic model to better understand the key financial levers of the business across the elements of revenue, capital and expenses. The economic model also considers the tangible and intangible drivers of value, such as brand and government policy changes, to enable appropriate risk recognition and assessment across these dimensions. The economic model was further broken down and tested for key sensitivities. These identified sensitivities form the basis of the most significant variables and assumptions around which the financial model is built.

Once the initial financial model was constructed, a sub-committee of the Working Group with extensive experience in financial markets and analysis rigorously examined assumptions and sensitivities. The financial model went through extensive and iterative revision as part of this process.

The modelling indicates that \$300m is the total capital required to ensure a sustainable business model for ICA. The first 5 years of cumulative net income would result in a deficit which would need to be supported by ICA's initial capital. Over a 10 year period, this deficit becomes a surplus as investments mature enabling ICA to self-sufficiency. It is anticipated ICA would reach net positive cash flow in 7 years with steady state cash flow in 10 years, based on an assumed life cycle of investments at 7 years. Capital contributions to ICA would need to be patient to correspond with the underlying investment profile.

A summary of the economic model, sensitivities and financial model are included in the full Blueprint document provided.

Governance & Leadership

Clear, transparent and accountable governance is a minimum requirement for ICA. Its governance principles are designed to enable it to execute its unique mission and mandate effectively and for impact, financial return and the benefit of the market as a whole (**Figure 8**).

ICA's mission and mandate for the public good would be embedded in its Constitution and in the policies that govern its operations. ICA also needs to be independent and not be reactive to, or inhibited by, shorter-term drivers, vested interests, or changes in the political environment.

Legal advice has been obtained from Ashurst on regulatory and compliance considerations and structuring and governance. Policies and processes would be put in place to embed the requirements and ensure it is compliant with relevant licensing and regulatory requirements. It would be transparent and accountable to the public and market. It would operate collaboratively, including with its founding partners.

Figure 8: Structure and governance would ensure conformity to the agreed mission and mandate



Source: Blueprint to Market, 2015

ICA has been constituted as a public company with a Constitution that embeds and safeguards its mission and mandate. The Board of the organisation would have responsibility under the Corporations Act for its stewardship. A majority of the Board would be non-executive directors to safeguard the independence of the organisation.

A committee structure would be put into place to oversee key aspects of governance and operations. Additional expertise may be sought, in particular to ensure that expertise and evidence on social impact, on investment and on markets are brought together in appropriate combinations.

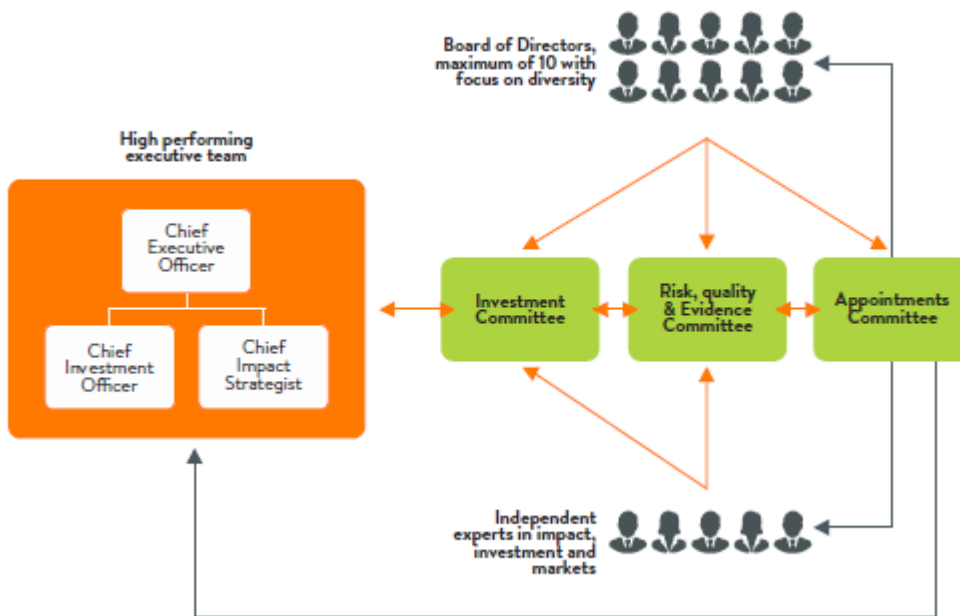
ICA would also be accountable for performance as an organisation, as an investor and as a market champion. It would have structured and rigorous processes for measurement and reporting. It would report on impact achieved, financial performance and market development outcomes. Those processes would embed accountability for impact achieved, financial performance and market development effects.

In addition, ICA would proactively seek to establish a reputation in the market for excellence, integrity and transparency; and operate on a basis where transactions with which it is involved reach the market with effective execution and monitoring of impact.

ICA would have a first rate Board of committed Australian leaders that combines diversity of experience and perspectives with individual credentials, providing ICA with stewardship to operate with excellence, integrity and impact (**Figure 9**).

A highly effective team led by a first rate executive would be critical. Based on the lessons from other impact funds, the team would be constructed to integrate investment professionals, impact strategists and systems expertise for maximum capacity to deliver across the three core elements of impact, financial viability and market development. Over time, ICA would become an important training ground for talent.

Figure 9: ICA would have a leadership structure to support effective execution & accountability



Source: Blueprint to Market 2015

ICA would recruit people with clear values-alignment with its mission, excellent track record, skills, experience and reputation to satisfy expectations of government, regulators, and other investors and to build confidence with the social and impact investment sectors. Across the team, there would need to be capacity to deliver against all dimensions of the mission and mandate.

For the purposes of establishing ICA, leadership from the Australian Advisory Board on Impact Investing would work with key stakeholders including government and other founding capital providers to establish an appropriately credentialed Board to make initial appointments.

Once operations are established, an Appointments Committee of the Board would be responsible for nomination of future Board members and key executive positions including Chief Executive Officer, Chief Investment Officer and Chief Impact Strategist. Board Committees would comprise members of the Board and appropriately qualified external parties that bring particular expertise.

Implementation & Accountability

ICA can be delivered in line with all requirements of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act) and the *Commonwealth Grants Rules and Guidelines* (CGRGs). The design for ICA and the proposed founding partnership in that for Government specifically meets all of the 7 key principles under the CGRC, including integrated governance arrangements to mitigate risk. Performance monitoring is built into the design and would be reflected in contracting arrangements, including for impact reporting to be made publicly available.

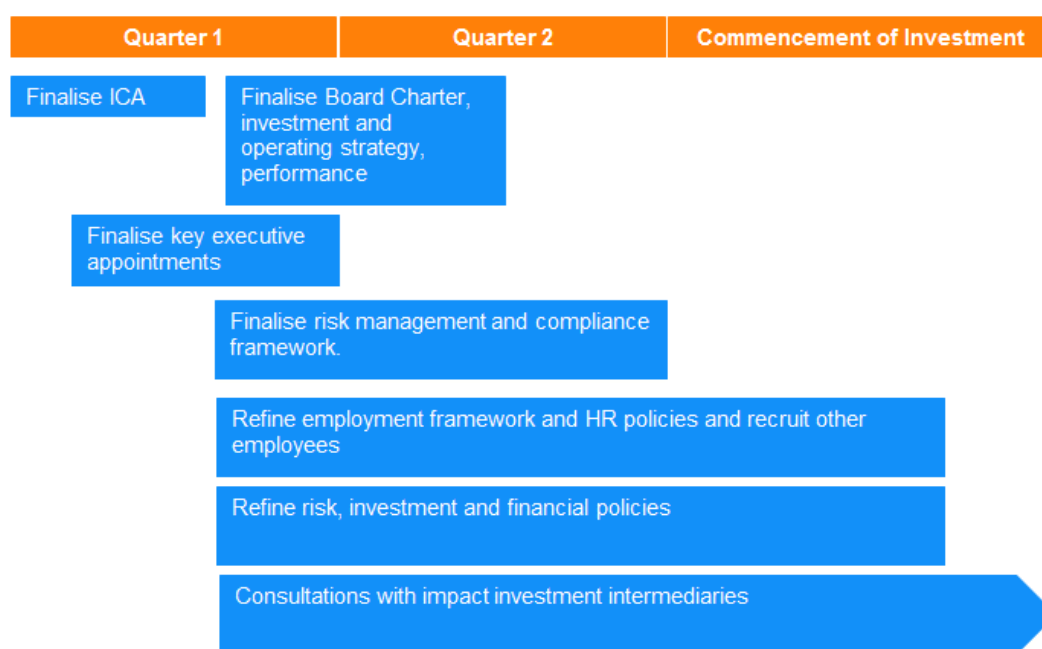
The implementation plan is already in advanced stages of development. Work to refine this is on-going through process of securing founding partnerships with Government and financial institutions to enable ICA to be operational as quickly as possible once the initial capital is secured. The plan recognises that an establishment phase during which key personnel are engaged and proper accountabilities and governance are established would be essential before funding can be deployed in the market. An outline of the key implementation milestones is provided in **Figure 10** with more detail on the tasks in **Figure 11**.

Ensuring that the robust policy logic and design and the governance and accountability mechanisms are mapped and reflected in contract arrangements with Government would be an essential step. Initial delivery of value for money would include securing partnerships with financial institutions and other private and community sector partners.

An independent Board of highly qualified and experienced leaders would be appointed as a first step as stewards for the implementation. Appointment of a CEO and other key executive roles including the Chief Investment Officer and the Chief Impact Strategist is a priority.

Operationalising the Governance architecture (as outlined) would also be a priority. This includes finalising a Board charter, establishing investment and operating policies and putting in place a framework for measuring and reporting on ICA’s operating and financial performance, including impact. In addition, a risk and compliance framework together with related policies would be adopted. Effective risk management would be critical in ensuring the ultimate integrity and sustainability of ICA as an organisation and no investment would be made before this is in place.

Figure 10: Key implementation milestones would ensure a strong basis for ongoing governance



Source: Impact Investing Australia

This implementation stage for ICA would be relatively fast and its organisational structure would evolve from the core as it builds capacity. It may be necessary to retain specialist advisors to provide advice to the Board during this initial phase to ensure that all of the compliance obligations are met and processes established in a manner that meets the intention of best practice governance, risk management and delivery.

Figure 11: Key implementation tasks would involve rigorous framework, policy and systems development

	Quarter 1	Quarter 2
Legal and Governance	<p>Finalise ICA Board</p> <p>Obtain required licences e.g. Australian Financial Services Licence</p> <p>Put in place financial delegations from Board to Executive</p> <p>Define Board Charter clarifying role and risk/control Framework</p> <p>Formalise Board operating structure including role of sub-committees</p> <p>Finalise Risk Management and Compliance Framework</p> <p>Formalise organisational structure & employment plan</p> <p>Establish impact and investment performance frameworks</p> <p>Establish Corporate plan and reporting frameworks</p>	<p>Publish Board charter and operating, investment and performance policies</p> <p>Establish Board sub-committees</p> <p>Implement performance and reporting systems</p> <p>Publish corporate plan</p> <p>Embed risk management & compliance systems</p>
Personnel	Finalise key executive appointments	Recruit other key personnel
Finance and Operations	<p>Establishment tasks including: office accommodation & set up, insurance, auditors, tax registration, software and systems, communication and IT contracts, service contracts etc.</p> <p>Develop a more detailed forward budget</p> <p>Refine initially identified areas of potential investment</p>	<p>Formal launch</p> <p>Document policies and procedures relating to: financial operations, HR and Finance delegations, procurement, accounts management, stakeholder and media communications</p> <p>Engage market, in particular financial intermediaries</p>
Communications	Develop stakeholder and media communications strategy	<p>Design and establish ICA website</p> <p>Ongoing communication materials</p>

Source: Impact Investing Australia

Appendix 2: Impact Investing Australia Investor Report 2016 - Extract

Executive Summary

There is an undeniable and growing interest in impact investing – an investment approach that intentionally seeks to create both financial return and positive social or environmental impact that is actively measured. Attitudes and perspectives around investment and wealth are shifting; major social and environmental challenges of our time need solutions; and governments are grappling with short and long-term budget constraints against a backdrop of lower economic growth and ageing populations. Sitting at the intersection of this confluence of factors is impact investing.

We are proud to present the results of our inaugural impact investing survey of 123 Australian investors, who account for more than A\$333 billion⁵ of Australia's A\$2 trillion funds under management. This survey – conducted in September and October 2015 – provides us with the opportunity to move to a data-driven approach focused on the Australian context. It includes perspectives from investors already active in the field as well as those yet to consider impact in their investment decisions.

Key Findings

1. Interest and activity in impact investing spans a broad spectrum of investor types in Australia, however, institutions dominate the dollar value available for investment.
2. More than two thirds of all investors expect impact investing to become a more significant part of the investment landscape in the coming years. Those not yet active in the field strongly expect to consider impact as a metric in decision making in the future. Active investors would ideally triple the size of their impact portfolios over the next five years.
3. Among active investors, mission alignment is the primary motivating factor for allocating funds to impact investments. Other factors include client demand, financial returns, diversification benefits and corporate social responsibility.
4. The geographic location of the social or environmental impact is more important for investors not yet active in impact investing than for active impact investors.
5. Active impact investors invest mostly in the impact areas relating to children and/or issues affecting young people and clean energy. They are also interested in deals that address housing and homelessness. Investors not yet active in impact investing are interested in children and/or issues affecting young people, Indigenous peoples and communities, education and health.
6. Active impact investors prefer real assets, pay for performance instruments and private equity or venture capital, while investors not yet active in impact investing have no consistent preference for investment types.
7. Most investors expect competitive market rates of return from their impact investments. Some trusts and foundations and not-for-profit organisations are open to considering below market rates of return.
8. Active impact investors expect well-documented evidence of social impact; many also indicated they seek third-party verification of impact and/or reporting that aligns with global standards.

⁵ While this figure represents the aggregate value provided by respondents, we recognise that it includes both superannuation funds and asset managers, who may be managing assets on behalf of those super funds.

9. Active impact investors require more investable deals, proven financial track record and evidence of social impact to increase their allocations to impact investment.
10. Those not yet active in impact investing require more reliable research, information and benchmarks, more deals and, a recognised investment framework to enter the market.

Conclusions

Five key themes emerge from the findings of this survey:

1. There is growing momentum and interest in impact investing from Australian investors. To maintain that momentum, supply of 'investable' deals must increase to meet rising demand.
2. Institutions dominate assets under management in Australia. If the impact investment market is to achieve scale in Australia, institutions will need to be active participants. For institutions to participate, they will need more deals of sufficient scale. Health and housing appear to be two areas of unmet demand that offer scale and are impact areas of preference for institutions.
3. There appears to be an unmet need from investors for financial services and advice that incorporate social and environmental impact. Lack of reliable research, information and benchmarks and no recognised investment framework are cited as key deterrents to investors entering the market.
4. Impact investing crosses multiple sectors and disciplines. There is a need to provide forums that bring people and organisations together to share those diverse experiences and perspectives, and create a common language to enable meaningful dialogue and convergence. There is a growing body of research, insights and evidence around social impact, however, this resides in pockets within sectors and is not yet readily available or visible across sectors to broader market participants who may find it useful in their own decision making.
5. A systems-approach is a critical factor to further develop the market in Australia. For instance, more evidence of social impact is key for active investors to consider increasing their allocations to impact investments. However, demonstrating social outcomes within the timeframe of a typical transaction may not be realistic. Systems-level research linking longer-term social outcomes with lead indicators and specific output measures may provide a more practical base from which the market can develop. This may also direct less of the administrative burden of measurement to service providers, who can least afford it, or investors, who largely expect competitive market-based returns on their impact investments. This would also provide an opportunity for a common language and framework to emerge more quickly than if the market develops on a bespoke deal-by-deal basis.

The full report is available at: www.impactinvestingaustralia.com

Appendix 3: US Tax Credits Supporting Impact Investing

New Market Tax Credits

Healthy communities have their own economic engines. Supermarkets, office complexes, entertainment venues, recreational facilities and a range of local merchants all provide goods and services and create jobs. They are a community's backbone and as they thrive they strengthen the citywide and regional economies to which they are so closely connected.

Too often though, distressed communities simply cannot access the kind of capital needed to make the transformation to vibrant and healthy communities. This is where the New Markets Tax Credits [NMTC] play a role.

What are New Market Tax Credits?

The NMTC program was enacted in 2000 to attract investment capital to low income neighbourhoods that have been left behind by the traditional private marketplace.

Under the program, investors receive a tax credit for making equity investments in certified Community Development Entities [CDEs], which in turn use the proceeds to make loans and investments in businesses, real estate projects and community facilities located in low-income communities.

The credit totals 39% of the original investment amount and can be claimed over a period of seven years. The investment cannot be redeemed before the end of the seven-year period.

CDEs apply competitively to the Treasury Department for the authority to offer the tax credits to their investors. The application process is rigorous with generally less than one in four applicants being selected to receive credit allocations in any given year.

What are the Outcomes?

To date, over US\$38 billion has been invested in low-income communities through the NMTC program, supporting a wide variety of activities including: small businesses, manufacturing facilities, for sale housing, charter schools, healthcare centres, child care centres, shopping centres and grocery stores, to name a few.

Seventy-three percent of the projects are located in severely distressed communities, characterised by poverty rates greater than 30%, median family incomes of less than 60% of the area median income, or unemployment rates at least 1.5 times the national average.

Through 2013, NMTCs financed 3,800 businesses and real estate projects, helping to develop or rehabilitate 123 m square feet of real estate and creating or retaining close to 375,000 jobs.

It has been estimated that the NMTC generates over \$8 of capital for every \$1 of federal subsidy.

The Government Accountability Office Reported that an estimated 88% of NMTC investors said that they would not make the same investment without the NMTC.

Source: Local Initiatives Support Corporation [LISC], 2015 Policy Brief

The Low-Income Housing Tax Credits

The Low-Income Housing Tax Credit, [LIHTC] stimulates investment in Affordable Housing in underserved inner-city and rural communities and in higher cost suburban communities across the USA. It provides low-income families with a safe and decent place to live and, by lessening their rent burdens, free up additional income that can be spent on other necessities or put into savings for education or homeownership. The LIHTC is also a vital community and economic development tool, creating jobs and catalysing redevelopment in struggling communities.

What is the Low-Income Housing Tax Credit?

The LIHTC is an important federal resource available to support the development and rehabilitation of Affordable Housing. It currently finances about 90% of all new Affordable Housing development in the USA.

How the credit works:

- Federal tax credits are allocated to state housing finance agencies by a formula based on population.
- Each state agency establishes its Affordable Housing priorities and developers compete for an award of tax credits based on how well their projects satisfy the state's housing needs.
- Developers receiving an award use the tax credits to raise equity capital from investors in their developments.
- The tax credits are claimed over a 10 year period but the property must be maintained as Affordable Housing for a minimum of 30 years.
- Because tax credits can be recaptured for any noncompliance, investors maintain close supervision over the properties to ensure their long-term viability and compliance with IRS and state allocating agency requirements.

Units funded by the LIHTC must be affordable for people earnings no more than 60% of the area median income [AMI] although most residents have far lower incomes.

Eligible residents can be charged a maximum of 30% of their qualifying income in rent. Qualifying income is typically 50-60% of AMI.

What are the Outcomes?

Since its inception, the LIHTC has spurred the development of more than 2.7m quality homes for working families, seniors, disabled veterans, and people at risk of homelessness.

Each year, the LIHTC finances about 100,000 units of Affordable Housing and creates approximately 95,000 jobs in the construction and property management industries.

The LIHTC properties outperform market-rate housing properties with occupancy rates topping 96% and a cumulative foreclosure rate of just 0.62%.

The units tend to be occupied by very low-income families, with 42% of the units occupied by families making less than 30% of the AMI; and 80% of the units occupied by families making less than 50% of the AMI.

Source: Local Initiatives Support Corporation [LISC], 2015 Policy Brief

Sustainability of NMTC and LIHTC as Policy Tools

The FY2017 US Budget solidifies support for both the NMTC and LIHTC. The President proposed to expand and make permanent the New Markets Tax Credit, which promotes investments in low-income communities. Under legislation signed into law by President Obama in December 2015, US\$3.5 billion in New Markets Tax Credits will be available annually through 2019. The Budget would make the program permanent with an annual allocation of US\$5 billion. Further funds were also allocated for the reform and expansion of the LIHTC program.

Source: Budget of the U.S. Government, Fiscal Year 2017, Office of Management and Budget

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Appendix 5: About Impact Investing Australia

Impact Investing Australia was established to grow the market for impact investing for the benefit of all Australians.

Created in response to an industry-identified need for dedicated leadership, facilitation and capacity building, we provide a focal point for market development, collaborating with and bringing together leaders in the field to build the infrastructure needed for impact investing to thrive. We do this as a public good for the benefit of all market participants and as a contribution to fulfilling the promise for the best Australia can be and contribute.

Our focus is on enabling more people and organisations to participate in the market for impact investing, from social enterprises and not-for-profit organisations in need of capital, to investors looking to make a social or environmental impact alongside a financial return. Our work complements and amplifies existing local innovations and activities, as well as connecting with international initiatives to develop a global market for impact investment.

We lead Australia's participation in the Global Social Impact Investment Steering Group (successor to the Taskforce established under the UK Presidency of the G8). We established the Australian Advisory Board on Impact Investing that sits alongside National Advisory Boards of other participating countries, leading development of the market in Australia and contributing to global market development. A significant part of our work is in driving implementation of an ambitious strategy to grow the impact investing market in and from Australia.

Impact Investing Australia invites individuals and organisations interested in being part of this promising market, growing new market opportunities for social and economic value, and establishing themselves as leaders in this growing field, to join with us.

We are grateful to the more 60 senior leaders who are collaborating in delivery of key actions to develop the market. Our supporters and many volunteers help make this work possible; without them we could not do this work.



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