Bridging capital into communities: A practical guide for policy makers

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Contents

Glossary of terms

Charity - A charity is an organisation with specific purposes defined in law to be charitable – and is exclusively for public benefit.

Community Development Finance Institutions (CDFIs) - They are locally-rooted non-profit lenders that provide debt finance to businesses and individuals through a relationship based approach to lending. They are also social enterprises themselves and provide finance to those who are underserved by mainstream providers.

'Impactful SME' or 'SMEs creating social impact' - For the purposes of this report, we use these terms to refer to SMEs which operate in the most deprived communities and / or are led by or serving marginalised or underserved groups. The terms social enterprise, charity and 'impactful SMEs' are not mutually exclusive.

Marginalised and underserved groups - Our use of the term 'marginalised or underserved groups' includes black and ethnic minoritised or other minoritised groups such as women and LGBTQ+. When referring to specific data points, we use the terminology of those organisations from whom we source the data.

Social enterprise - Based on the SEUK and Social Enterprise World Forum definitions, a social enterprise must have a primary social or environmental mission that is clearly expressed in its governing documents; reinvest the majority of its surplus into its mission; and be independently run in the interests of its mission.

Social investment - For the purposes of this report, this means any form of repayable finance (unsecured loan, mortgage, bond, repayable grant etc.) or equity that is given to or invested in social enterprises or charities.

Social impact investment - This typically refers to any form of repayable finance with the aim of creating positive social impact alongside a financial return. For the purposes of this report, we use this term to mean investments which are made directly into social enterprises, charities, or SMEs which create social impact through operating in deprived communities or are led by or serving marginalised or underserved groups.

The universe of social impact investment is wider than we discuss in this report. For example, it also includes social property which stood at £2.9 billion at the end of 2020, and impact venture which was £670 million at the end of 2020. Both market segments fall out of scope for this report.

Small and Medium-sized Enterprises (SMEs) - In the UK, a small and medium sized enterprise (SME) is defined as one that has fewer than 250 employees.

Subsidy - A benefit given to an individual, business, or institution usually by the government. It can include grants, guarantees and tax reliefs, among other tools. The subsidy is typically given to remove some type of market failure, and it is often considered to be in the overall interest of the public, or given to promote a social good or economic policy. In this report we focus on the three types of subsidy mentioned above, although other forms of subsidy may be used to further government policy objectives.

Voluntary, Community and Social Enterprise organisations (VCSEs) - These include small local community and voluntary groups, registered charities both large and small, foundations, trusts and the growing number of social enterprises and co-operatives. These may also be referred to as third sector organisations or civil society organisations.

1. Executive summary

1.1. Scope and methodology

This report - commissioned and funded by DCMS and de.ivered by the Impact Investing Institute and Big Society Capital (BSC) - considers the effectiveness of government subsidy - grant, guarantee and tax reliefs - in supporting investment into social enterprises and charities, as well as small and medium sized businesses (SMEs) which create social impact through specific characteristics - in particular, their location in the most deprived communities or being led by or providing goods and services to a margnalised or underserved group. The purpose of the report is to improve the understanding of policy makers about where these subsidies are already playing an effective role in the market's development, and how they could be better harnessed to drive market growth.

Government subsidy directly responds to failures in the financial and other markets, aiming to enable social enterprises, charities, and SMEs which create social impact to receive the investment they need to grow, thrive, and in turn increase the amount of social or environmental impact they deliver.

This report examines the advantages and limitations of these government subsidies in the context of the following four policy objectives:

1. Growing the local economy and social economy particularly in deprived areas;
   a. Leveraging more and new sources of private capital at scale
   b. Specifically supporting social enterprises, charities and SMEs located in deprived areas
   c. Specifically supporting social enterprises, charities and SMEs led by and/or serving marginalised communities
   d. Growing and building financial resilience of social enterprises and charities
   e. Building a sustainable market for social impact investment
2. Increasing investor participation in the social impact investment market;
   a. Reducing risk of higher risk or less proven investments, thereby improving risk/return
   b. Subsidising operational costs of delivery by lender
   c. Reduces complexity for investors
3. Better tailoring capital to the needs of social enterprises and charities and SMEs in deprived areas or led by and/or serving marginalised communities; and
   a. Improve affordability for investees or reduce other accessibility barriers
   b. Provides flexibility of products to frontline businesses
4. Facilitating non-financial support (e.g. technical assistance) for social enterprises and charities, and SMEs in deprived areas or led by and/or serving marginalised communities
   a. Provides technical assistance / capacity building for borrowers, supporting deployment

The research and engagement undertaken for this project demonstrates that government subsidy can be effective at meeting these four policy goals. However, each of the subsidy tools is a better fit for a different context and policymakers and other market builders must make choices about which of the four policy goals to prioritise when designing subsidy policy. This report aims to elucidate which tool can best deliver for which policy priority, and support policy makers in understanding where best to deploy subsidies in the future, including how they can be combined to positive effect. The executive summary is presented below which includes a comparative table, with more detailed analysis of each subsidy type presented in sections 3.2.

Across the UK there are many enterprises which are a significant source of public benefit in addition to playing a vital role in the UK economy. For example, the UK's 100,000 social enterprises employ 2 million people and contribute £60 billion to the UK economy, while also delivering public services, health provisions and community cohesion.[1] There are also thousands of SMEs operating in our most deprived communities or led by, or serving, marginalised or underserved communities, which reap social benefits by creating jobs and economic opportunity in areas which have historically suffered from under-investment.

Lending to social enterprises and charities as well as impactful SMEs is central to tackling some of the major policy agendas of the day from boosting productivity, pay and living standards to restoring a sense of community, local pride, and belonging. Investment in these organisations helps advance all four of the objectives in the Levelling Up White Paper[2], as detailed in the table below. For example, social enterprises often thrive in places where other businesses struggle: they have created and sustained over 600,000 jobs in the most deprived communities, around 30% of their total jobs created. In short, the social enterprise sector numbers a highly inclusive, purpose-driven set of organisations delivering value in the most deprived parts of the country in pursuit of public benefit.

Figure 1: The contribution of social impact investment to Levelling Up

Levelling Up Objectives[6]	Contribution of social impact investment
1 Boost productivity, pay, jobs and living standards by growing the private sector, especially in those places where they are lagging;	**Social Enterprise UK's Commission on Social Investment** found that social enterprises are more likely to exist in left-behind places and have a strong track record in employment. Despite accounting for only 1.7% of the UK's business population, they employ 5% of the UK's workforce (2 million people). For every £100,000 of turnover, social enterprises create 3 jobs, compared to 0.66 jobs created in the private sector. The **annual Responsible Finance report** states that 93% of CDFI SME lending is made outside of London and the South East and 94% of CDFI customers have been previously declined by another lender.
2 Spread opportunities and improve public services, especially in those places where they are weakest;	Social enterprises deliver products and services for marginalised communities in the most deprived areas of the UK. Half of social enterprises help young people into employment; the same proportion support mental health needs in their communities and roughly two in five address health and social care issues. A DCMS **report** found that between 2016-2020, VCSE organisations delivered 7,330 government contracts worth £17bn - 5% of the total contracts awarded. Over 75% of VCSEs deliver public contracts where they are based, with strong links to and knowledge of that locality. **Recent research** into the UK's 72 social outcomes contracts which are delivered by VCSEs found that £139m of cost to commissioners created £1.4bn of value, resulting in a benefit cost ratio of over £10 for every £1 spent by government.
3 Restore a sense of community, local pride and belonging, especially in those places where they have been lost; and	CDFIs invest in businesses and social enterprises which are pillars of their local communities and reinvigorating community pride and local high-streets. A report on the community business market found that community businesses were central in communities and 61% of them operated as a community hub. 97% of them work to improve community cohesion and 95% increase community pride and empowerment. They are also four times as likely to be led by people from minoritised ethnicities, compared to SMEs.
4 Empower local leaders and communities, especially in those places lacking local agency	Social enterprises are much more diverse organisations than traditional SMEs. 47% are led by women, 31% have directors from ethnic minority backgrounds, and 22% operate in the most deprived areas of the UK. Whereas, **government data** shows that 16% of SME employers are women-led and 5% are minoritised ethnicity-led. Investment in the social enterprise sector is therefore supporting marginalised leaders who otherwise would miss out on mainstream finance provision.

However, to grow their impact, social enterprises, charities and SMEs which create social impact need access to finance to build resilience and grow trading income. This includes debt, equity, or quasi-equity (the latter is where payments to investors are linked to particular milestones, rather than a fixed payment schedule) for investment in buildings, assets, and people. The most recent Social Enterprise UK market survey reports that 17% of social enterprise respondents plan to seek investment to increase the rate of growth of their business.[3] Another survey indicates 23% of social enterprises cite access to finance as a barrier to growth, compared with 13% of mainstream SMEs.[4] While this has improved in recent years and some social enterprises, charities, and SMEs in deprived communities or led by and / or serving marginalised groups can and do access mainstream finance such as high street banks many cannot[5], or find that the types of financial products available to them are not a match for their type or stage of business model.

Over the past 20 years the social impact investment market has developed and evolved to meet the financing needs of these organisations who are at different stages of their enterprise development, helping them to sustain and grow their organisational resilience and impact. Social impact investment provides a range of different financial products, from unsecured small loans and early stage venture capital to secured bank loans and large property investments. For the purposes of this report we use social impact investment to refer more narrowly to investments made directly into organisations which are social enterprises, charities or SMEs creating social impact through operating in deprived communities or are led by or serving marginalised and / or underserved groups. Social impact investment is a tool in the toolkit which sits alongside mainstream finance and conventional grants, and attracts other resources to support the social and economic impact that social enterprises, charities and SMEs have.

Big Society Capital (BSC) estimates the size of the UK social impact investment market, which it defines as investment into organisations that exist "wholly or mainly for the benefit of society", as £6.4bn, an eight-fold growth since 2011, representing over 5,400 transactions compared to 2,600 in 2011[7]. However, this broader optimistic picture disguises significant challenges, with certain parts of the market continuing not to reach their full potential.

For example, social non-bank lending constituted £113.7m out of a total of £1,232m of deals in 2020 (9%), compared to £29.8m out of £211m in 2011 (14%). While this is positive growth of almost 5x in the risk capital available, it does lag behind the development of other parts of the market such as social banks and charity bonds. This is worthy of particular attention as many of the most highly impactful enterprises in communities are asset locked charities and social enterprises, with debt as their primary point of access to social investment.

There are also sectors of the market which have substantial capacity and hunger to take on capital to meet the enterprise demand they are experiencing, but investors remain unable to fund them for a variety of reasons. For example, there are currently 25 business lending CDFIs based across the UK who over the past 5 years have lent over £1bn to SMEs unable to get term finance from banks, with a large proportion of lending focused on regions which have missed out on finance to date.[8] A recent industry study suggested that annual lending could be doubled within 3 years if capital was made available.[9] Additionally the 2021 social enterprise market survey reports that a third of all social enterprises surveyed (34%) applied for external funding or finance (from traditional grants to repayable finance) in the past 12 months, a figure which has remained steady over the years and is significantly higher than for SMEs.[10]

As explored in more depth below, although many of social enterprises, charities and SMEs creating social impact have business models that are viable, they can often be lower return than purely commercial ones, as they serve a highly vulnerable clientele and the price of their products or services often cannot be increased to make more compelling business models or they lack assets of sufficient value. Additionally, smaller loans can be uneconomical for investors who will face disproportionately high management fees. This is exacerbated by a lack of track record in investing in these organisations by mainstream lenders, lack of familiarity with the business models they employ and a changing and uncertain subsidy landscape.

Given the public benefits delivered by social enterprises, charities, and SMEs creating social impact, as well as the large scale of the challenge inherent in levelling up the UK, government and quasi-government bodies have sought to utilise various tools to improve the financing of this important sector and leverage in additional resources alongside their own. A mixture of grants blended with investment capital, guarantees and tax reliefs have been used, including:

Blended Finance

Government was vital in the establishment of Access, the Foundation for Social Investment (Access) in 2015. Access is a UK leader in providing small-scale, patient, affordable and flexible financing to social enterprises and charities through blending grants with investment capital.

Guarantees

Guarantees such as the Coronavirus Business Interruption Loan Scheme (CBILS), which provided loans to small businesses with insufficient capital or security to meet lender's normal requirements.

Tax Reliefs

Tax reliefs such as Community Investment Tax Relief (CITR), which incentivises individuals and organisations to invest in CDFIs and Social Investment Tax Relief (SITR), which incentivises individuals to invest in social enterprises and charities.

All three domains of subsidy have played a role in strengthening social impact investment and in turn enabling socially motivated investors to channel capital to the enterprises that need it most to grow their social impact.

This report primarily considers the effectiveness of these grant, guarantee and tax relief subsidy approaches in the UK and also considers use of these tools internationally where they are instructive on the subsidy's potential to grow the overall social impact investment market, attracting more capital and supporting the resilience, sustainability and impact of the enterprises.

The research and engagement undertaken for this project demonstrates that government subsidy can be effective at meeting the four policy goals (listed on page 4). The executive summary is presented below which includes a comparative table, with more detailed analysis of each subsidy type presented in section 4.2.

As the UK economy rebuilds after COVID-19 and the government develops its levelling up agenda, social enterprises, charities and SMEs in our most deprived communities or led by and / or serving marginalised groups and those that finance them have a central role to play. If better enabled by the use of effective subsidy, including in combination, these organisations can fully unlock their potential to contribute to thriving and sustainable markets, reducing regional inequality and connecting communities with government support.

The Impact Investing Institute and Big Society Capital delivered the work using a combination of literature survey, desk research, case study selection and interviews with 16 stakeholders from the social impact investment sector. We believe it is the first detailed comparative analysis of these subsidy tools and should be viewed as an initial attempt at evaluating the benefits and disadvantages of each policy lever. The report is not intended to comment on the roles of policymakers or the implementation of future policy. As well as informing policymakers, we hope it will provide a foundation for further debate and engagement on this topic.

1.2. Barriers to social impact investment that government subsidy is targeting

The barriers which make it harder for SMEs to access appropriate sources of finance include a number of market failures, which are often exacerbated by for social enterprises and charities as well as SMEs operating in deprived areas or led by and/or serving marginalised groups. In what follows, we hone in on the evidence for the developing social investment market around persistent, long-term market failures for social enterprises and charities.

- **Information asymmetry**: This is marked by a lack of track record, intermediaries and secondary markets and uncertainty of risks and returns, especially when investing in social enterprises and charities with new, untested or unfamiliar business models. This market failure prevents the traditional funding channels from supplying the volumes of finance necessary to support the growth of social enterprises and charities.
- **Positive externalities may not be 'priced' into the business model**: Social enterprises and charities create substantial social value which is often not reflected in the revenues they receive from customers (often the government or consumers) as well as in the financial returns made by investors. This can mean that returns are lower than may be the case for a purely commercial organisation with equivalent risk. This lower return can limit the pool of investors who are able and willing to risk their capital for a modest return. The current lack of consistency in measuring and reporting on social impact created by the enterprise also means that the returns gained by investors don't account for the additional positive social impact their investment is unlocking.
- **High transaction costs and occasionally inefficient deployment**: Many social enterprises and charities are small (i.e. revenues below £100,000) and require lower levels of funding, meaning that transaction and due diligence costs associated with these investments can be higher. This cost is passed on to investors, increasing the challenge of attracting them. This is compounded by slow or uncertain deployment paths given the time it can take to build relationships and trust for first time borrowers.
- **Lack of assets**: Many social enterprises and charities do not have assets of sufficient value to use as collateral due to their average age and size. They may also be less likely to offer a personal guarantee from a director. Lack of assets can reduce access to finance, meaning the secured lending available to those with assets on the high street is not available to non-asset backed enterprises.
- **Legal structures**: The traditional angel/venture capital route is often not suitable as charities are not legally able to issue equity and raise commercial venture capital. Additionally social enterprises do not generate the kinds of shorter-term, exit opportunities at high values that are generally required for the level of risk that venture capital investors take.

Interestingly, recent research based on data from the Longitudinal Small Business Survey has found that UK non-profit SMEs, social enterprises and socially-oriented SMEs are all less likely to apply for loans compared to commercial SMEs.[11] However, if the application takes place, social enterprises are more likely to obtain the funding compared to commercial SMEs. This indicates that different barriers exist for different types of impactful business and that they vary at different stages of the investment process.

Importantly, while social impact investment addresses specific market failures, it also creates new and thriving markets which supply capital to those enterprises who are contributing most to disadvantaged communities and underserved people. This can range from locally-based organisations serving their local community in need of investment under £100,000 to larger enterprises tackling homelessness in need of tens of millions of pounds. Using these policy levers to support social impact investment can allow policymakers to leverage additional resources alongside socially-minded investors in order to tackle the substantial challenges inherent in levelling up the UK. Investment sources may range from banks to pension funds to high net worth individuals. While increasingly engaged, these asset owners often find it difficult to allocate their capital to the social impact investment sector due to the barriers such as risk, scale, track record and information.

1.3. Blending of grants key findings

Grants are sums of money given to organisations or funds without any expectation of a financial return. They can be categorised as follows:

- **Blended structures**: This occurs at a fund level where the fund takes on a grant and blends it with the investment capital which is then used to provide repayable finance to the frontline enterprise. The most typical example is where the grant is used to repay investors up to a certain percent if some of their capital is lost due to defaults (also known as 'first loss'). Another example is where the grant pays a portion of the management fees of the investment fund. The presence of the grant improves the risk/return profile for investors, attracting investment into areas that would not have otherwise received it and enabling investors to offer terms for the enterprise that better meets their needs.
- **Blended products**: These are finance packages that enterprises can access directly that combine repayable finance with a separate grant that doesn't need to be repaid, and/or advice and business support which is free to the enterprise and is known as technical assistance.

The UK government, including arm's length bodies such as the National Lottery Community Fund, Arts Council England and Sports England, as well as the Dormant Assets Scheme which is administered by HMG, have contributed significant amounts of capital in these types of products and structures to catalyse social investment since 2004.[12] Charitable foundations, trusts and philanthropists have also provided some grants to catalyse social investment, however this has so far been at a smaller magnitude.

Government has deployed grant for blend through vehicles including the £142m Futurebuilders fund (2004)[13] and through Access (2018-2022) (£60m of Dormant Asset commitments to date)[14] among many others. A helpful summary of government social investment funds has been compiled by Flip Finance,[15] and more recently New Philanthropy Capital.[16] Other significant case studies of grant in blended finance structures include Nesta's Arts and Culture Impact Fund,[17] and the Club Capital Fund with British Gymnastics.[18]

In the US, the charitable foundation sector plays a significant role as first loss capital that expressly intends to leverage more and new capital to address social problems. This is less common practice in the UK.

High level findings for each of the 4 policy priorities:

Growing the local and social economy: Using grants to subsidise blended finance models is effective at leveraging private capital to support social impact investment in deprived communities and places which miss out on access to mainstream finance and has a strong track record in reaching the most disadvantaged places. Policy outcome in practice: The £23m Nesta Arts and Culture Impact Fund leveraged £18m of new private capital using £5m grants. Half of Access's Growth Fund loans are in the most deprived 30% of neighbourhoods in England.[19]

Helping investors participate in the social impact investment market: Grants can be used effectively to leverage private finance into blended structures helping "bridge the gap" between investors who make the investment and the enterprises who receive it. There is a trade-off between the cost and flexibility of the product and the capital leveraged, with smaller deals in the social impact investment market being linked with lower leverage. Policy outcome in practice: While a typical leverage ratio for social investment might be 1:1 or 1:2, Futurebuilders did not seek to leverage any private capital while the Nesta Arts and Culture Impact Fund saw £5m grant for blend leverage £18m private capital showing the mix achieved depends on the choices made by those designing it.[20]

Better tailoring product: The provision of grants for blended finance has significant potential to tailor products to suit the unique needs of social enterprises, charities and SMEs which create social impact, making it more patient, affordable and accessible. Importantly, these tailored products would otherwise not exist. Policy outcome in practice: Access' Growth Fund has an average deal size of £67,000, much smaller than other social investment programmes. The average interest rate for the Growth Fund is 7.2% and average loan term is 51 months.[21] While this might not appear significantly lower than an average high street loan, the difference is that the risk for these investments is much higher. Furthermore, Futurebuilders data which was 100% funded by government shows an average interest rate of 5.45%, an average loan duration of 13.8 years, and variations being applied to a significant number of investments to support investees through difficulty.[22]

Facilitating non-financial support: Grants can be used to provide additional capacity and technical support to target organisations. Policy outcome in practice: In a developing world context, 30% of blended finance transactions in 2020 had a technical assistance component.[23] In the UK, Access has facilitated 628 investment readiness grants for social enterprises and charities, for example for business planning, cash flow forecasts and measuring impact, worth a total of £8.52m which have given investors the confidence to go on to invest.[24] Analysis of the Reach Fund suggests that each £1 spent on these grants unlocks £7 of new investment.[25]

Analysis:

- Blended finance structures and products must balance a wide range of interests - the requirements of the capital providers, the constraints of the grant source, the objectives and needs of those delivering the funds and the needs of enterprises that the programme will ultimately serve. Despite this, they have shown to leverage private capital especially from mission-led and socially-minded investors while delivering a product that enterprises need and would otherwise not exist.
- Through their provision of capital which is more affordable, flexible and patient, in the UK there are good examples of blended structures and products being well suited for small and early-stage social enterprises and charities, where the tool has been applied over the past 5 years, as well as during periods of economic volatility due to the speed by which they can be delivered.
- While guarantees have a stronger track record in leveraging private capital, grants typically allow for the highest degree of flexibility. Guarantees have enabled larger volumes of lending to happen on standard terms however grants enable higher degrees of flexibility in terms, and with capacity building support alongside. This has enabled social investors using grants to reach deeper into marginalised communities. For example, the Recovery Loan Fund, backed by the RLS guarantee, has also taken on grant to deepen its reach. Amongst other things the grant has enabled the fund to reduce its minimum loan size from £100k to £50k for black and minoritised ethnicity-led social enterprises and charities, as well as provide unrestricted grants alongside the loans of up to 100% of the value of the loan if needed.
- Those interviewed reported that, over time, loan and grant blends can reduce grant-dependency for social enterprises and charities. By taking on repayable finance that they would not otherwise, they are able to grow new sources of income such as through trading while reducing their reliance on other income streams such as charitable donations.
- Both Access's blended structure and products are well regarded, with all stakeholders, as well as independent evaluations, being positive about the model and the impacts being achieved.
- Despite these benefits, there are currently too few blended finance structures and products to fully realise the potential of the tool, with the level of blended finance flows heavily reliant and restricted by the limited availability of public or philanthropic grants.
- Considering blended finance is overcoming persistent market failure, a significant and enabling opportunity for the social impact investment sector is a long-term, reliable source of grant for the sector to mount blended structures and products. This would support sustained market development and also help to attract other grant funders and investors.

1.4. Guarantees key findings

A guarantee is an agreement that a third party will repay the lender if the borrower defaults. Guarantees are mainly issued at deal level but can be assigned at the portfolio level too. In the UK social impact investment sector, a key guarantor is the government.

From 1981 to March 2020, the UK government guaranteed over £6.5bn of loans: through the Small Firm Loans Guarantee (1981-2008) and Enterprise Finance Guarantee (January 2009-March 2020).[26] These schemes enabled about 3,000 loans to be approved per annum, but stakeholders report minimal uptake from the social impact investment sector.[27] One of the reasons for this was that businesses had to obtain over 50% of their income from trade, which a number of charities in the UK do not. This was linked to competition regulation in existence at the time. One scheme (now closed due to Brexit) - the EU Programme for Employment and Social Innovation (EaSI)[28] – was accessible to UK social enterprises but its use by UK social enterprises was low, with only 29 beneficiaries between 2014 and 2020.[29]

The pandemic catalysed a wave of new government guarantee schemes that in turn increased the volume of guaranteed loans to £70bn issued to 1.5m firms. The new schemes, including the Coronavirus Business Interruption Loan Scheme (CBILS)[30] and its successor the Recovery Loan Scheme (RLS)[3,1] have been well received by social enterprises and charities and actively used by social investors in their work. For example, the Resilience and Recovery Loan Fund, backed by CBILS, was set-up by Social Investment Business and its partners to make the scheme simpler and easier to understand and access for social enterprises and charities and interested investors. It won Social Investment Deal of the Year at the 2021 Social Enterprise UK awards voted for by the sector. [32]

Design aspects of CBILS and RLS (contrasted with other guarantee schemes) enabled this uptake: charities could use CBILS and RLS, as the trading income of 50% restriction was not applied to their organisational types. CBILS also had no guarantee fee for the borrower and provided appropriately high coverage of up to 80% of the loss amount, with RLS also providing coverage of up to 70%. The lenders also benefited from a fee discount for both CBILS and RLS if they were CITR accredited, which includes social investors such as Social Investment Business. The Resilience and Recovery Loan Fund finished with £28m in total investment, backed by CBILS.[33] The Recovery Loan Fund, which is currently making use of RLS, has raised a further £21.5m to deploy to social enterprises and charities.[34] It should be noted that the design of guarantee schemes may be restricted by competition regulation.

The CDFI sector also benefited from CBILS and RLS. In the first 3 months following the launch of CBILS, CDFIs lent 250% more than during the same period the previous year. This protected 7,000 jobs up to December 2020.[35] By the end of 2020 the CDFI sector's CBILS lending totalled £63 million, with an average loan of £110,000.[36]

In the US the government has used guarantees extensively to build the CDFI sector, allowing eligible CDFIs to raise bonds of $100m or more with a 100% federal guarantee. Over $1.6 billion has been channelled into the CDFI sector as patient, cheap capital using this tool.[37] In the US, guarantees are also provided actively by the foundation sector, with foundations often deploying them to leverage private sector finance. It is worth noting that the successful raising of capital in the US CDFI sector, which is worth c.$2 trillion in total, is arguably a result of the Community Reinvestment Act, federal legislation which requires banks to lend to all communities, including distressed and disadvantaged ones. In the US, the CDFI sector also includes the social housing sector, which further inflates the figure.

Analysis:

- Guarantees can be most powerful for de-risking investments and mobilising investors for whom the risk of capital loss would otherwise be too high or may be suited to making lower risk / return investments. While other subsidy tools do indeed de-risk investments, guarantees have done so in larger volumes and are arguably the most efficient, as the subsidy is only paid out in the event of default. They have proven particularly helpful during periods of economic volatility when there is a high priority to mobilise capital to on the ground organisations but private capital, given the economic context, tends to become highly risk averse.
- Guarantee schemes were out of reach of many social investors up to the pandemic when positive changes were made, with important strides being made by the British Business Bank. Key changes to guarantee coverage, fee and portfolio cap, amongst others, enabled guarantees to better respond to the needs of social enterprises and charities, and SMEs in the most deprived communities or led by and/or serving marginalised communities - e.g. enabling lending on accessible terms to organisations unable to provide assets as collateral. This can multiply the benefits by enabling the creation of products which address a number of policy priorities. Interestingly, around 30% of CDFI loans were covered by guarantees even before the pandemic.[41]
- While CBILS was more accessible than historic schemes, the Resilience and Recovery Loan Fund (RRLF), backed by CBILS, failed to penetrate marginalised communities: less than 40% of BAME-led organisations that applied were deemed eligible for investment, compared to over 90% of women-led organisations.[42] This is where fund design, but also the combination of schemes - e.g. a grant blend and guarantee - can be helpful. Taking the learnings from the first fund, the successor to the RRLF (the Recovery Loan Fund, managed by Social Investment Business) worked with grant provider, Access, to lower eligibility thresholds even further for social enterprises and charities led by people from black and minority ethnicities.[43]
- The US CDFI sector is instructive, showing that well-designed guarantees with higher coverage can catalyse significant sector growth. Combining learnings from the use of guarantees in the US market with the relative success of CBILS and RLS underscores the potential positive impacts for the social impact investment sector for maintaining a guarantee scheme that is accessible to charities and social enterprises, and impactful SMEs.

High level findings for each of the 4 policy priorities:

Growing the local and social economy: Guarantees which are designed in an accessible way for VCSE sector businesses and CDFIs can successfully provide affordable, accessible finance to this sector. Policy outcomes in practice: The Resilience and Recovery Loan Fund (RRLF), designed to issue loans backed by CBILS financed 77 charities and social enterprises to the value of £25m. These loans were blended with an additional £4m in grants.[38]

Helping investors participate in the market: Guarantees are particularly well suited to leveraging additional investment, including mainstream finance, to the VCSE and CDFI sector. They are a familiar tool to investors and arguably the most successful in mobilising large volumes of capital of all the subsidy tools. Policy outcomes in practice: the US Kresge Foundation provided a $5m guarantee to leverage $132m for health centres in the US.[39]

Better tailoring product: While in themselves guarantees target the barriers to investors, rather than the investee, when delivered through social lenders they can be used to create financial products which would not otherwise be accessible, albeit on terms that are less flexible than loan and grant blends. Policy outcomes in practice: the CDFI sector's CBILS and RLS lending totaled £114m in 2022, enabling the CDFIs to lend to businesses in marginalised communities which had previously been turned down by mainstream lenders. For example, in 2022, 94% of those businesses lent to by CDFIs had been declined by another lender.[40] CDFIs provide tailored financial products to investees, charging between 0-12% interest rates according to their impact report. By bringing down the risk to investors, it is possible to deliver higher risk loans at an affordable rate.

Facilitating non-financial support: While guarantees in themselves don't provide any non-financial assistance to businesses, they can be successfully leveraged by socially-minded lenders to create lending offerings which do include this type of additional support. Policy outcomes in practice: CDFIs provide 16,550 hours of investment readiness support to businesses and social enterprises and 16,100 hours of post-loan support to businesses and social enterprises. Typically the presence of grant would enable this level of non-financial support although in the case of CDFIs, it's the lower cost of borrowing through subsidy tools including guarantees that enables them to offer this additional provision.

1.5. Tax reliefs key findings

Tax reliefs are designed by the government to incentivise certain activities, often particular types of investments, by offering individuals or organisations a reduction in their tax obligation.

There are currently four UK tax reliefs relevant to social impact investment:

- **The Enterprise Investment Scheme (EIS)** and **Seed Enterprise Investment Scheme (SEIS)**: they incentivise individuals to invest in start-ups in the UK for initial income tax relief of 30% (EIS) to 50% (SEIS – into very early-stage businesses). Social enterprises can seek finance from EIS and SEIS investors but uptake is minimal: they either do not meet the requirements or find that the schemes fail to respond to their specific needs (e.g. the 'risk to capital' clause prevents those who can issue shares from using EIS/SEIS if they own a community asset).[44]
- **Community Investment Tax Relief (CITR)**, launched in 2002, incentivises individuals and organisations to invest in CDFIs.[45] The tax relief is worth up to 25% of the value of the investment in the CDFI, spread over 5 years (5% per year).
- **Social Investment Tax Relief (SITR)** launched in 2014, incentivises individuals to invest in social enterprises (Community Interest Companies and Community Benefit Societies) and trading charities by offering a reduction of 30% of the investment in that year's income tax.

Analysis:

- EIS and SEIS can technically be used by community enterprises and social enterprises, as well as social ventures such as those invested in by Bethnal Green Ventures. In reality access is restricted.
- CITR is well understood by those who have utilised it, and is facilitating a flow of capital into 20 of the 35 CDFIs that it seeks to target. Its potential could be maximised through greater awareness and education among those investors who have not engaged with it to date and through further improvements to its design.
- SITR requires changes in order to fully realise its ambition. HMT estimated that total SITR deal flow would be £83.3m in the first 3 years but it only achieved £5.1m.[49] Currently over 180 organisations have availed themselves of the tax, delivering £18.6m of investment since 2014.[50] A number of factors have inhibited its growth: restrictions on eligible trading activities (e.g. excluding the most proven social enterprise business models); a lack of awareness of the relief; widespread belief that SITR was too similar to EIS and not targeting the specific needs of charities and social enterprises; slow administrative processes around the relief; and unclear or insufficient guidance on its uses. [51]
- A tax relief for social enterprise should be the ideal fit – scalable, adaptable, avoiding dependency on subsidy and encouraging risk-taking, but SITR as currently designed constrains that potential. Enabling social enterprises and chairites to use the relief to (for example) develop properties, and simplifying terms around investment subsidiaries and ownership restrictions, would enable better uptake of the relief.
- Tax reliefs have been used consistently by governments to deliver policy objectives such as economic growth, tackling market failures and creating social value. While the UK tax schemes are not fully delivering on these objectives for the benefit of social impact investment, if designed appropriately they have the potential to do so.

High level findings for each of the 4 policy priorities:

Growing the local and social economy: When designed with the beneficiaries in mind, tax reliefs can be successful in stimulating local economic growth as well as supporting social enterprises and charities and CDFIs. Between 2002 – 2018, CITR generated £145m of investment into CDFIs, facilitating £127m of lending into small enterprises in disadvantaged communities. Statistical data shows that from the financial year 2017-18 to 2020-2021, CITR raised a further £72m, bringing the total to £218m.[46] Since 2014, over 180 investments have been conducted using SITR, totalling £18.6million.[47]

Helping investors participate in the social impact investment market: Tax reliefs can attract new investors as CITR, although the scale of this has not been as high for SITR due to the design, continuity and appropriateness of the relief. Tax reliefs are however unique in their ability to leverage retail investment, e.g. SITR which enables investment through community shares. The Spotted Cow is a community hub that offers a bar, restaurant, Post Office and B&B under one roof. They used SITR to raise £277,000 through community shares at a rate of 3% over 3 years.

Better tailoring product: Tax reliefs can create products which are better suited to the needs of enterprises, for example through reducing the cost of borrowing. Creative use of SITR in a crowdfunding context has enabled charities and social enterprises to set their own terms for investors and take on small amounts of investment from a large number of investors.[48] However, the current schemes, in particular SITR, are too often not accessible to the VCSEs wishing to use them due to the restrictions on eligible trades e.g. enterprises focused on community energy are not eligible for SITR.

Facilitating non-financial support: There is some evidence of facilitating non-financial support but not through design.

1.6. Summary table

Each subsidy type is rated as Red, Amber or Green depending on the extent to which that lever delivers on each of the policy goals.

RED: the subsidy has shown little or no track record or success
AMBER: the subsidy has shown some track record or success
GREEN: the subsidy has shown substantial track record or success

The report has found that while there are strengths and weaknesses to each subsidy tool, none of them provides a complete solution. It concludes that to achieve the full sweep of goals, the government must use them simultaneously to allow their different strengths and weaknesses to compliment and compensate for each other.

Policy goal	Blending of grants with investment capital	Guarantees	Tax relief
Growing the local economy and social economy, particularly in deprived areas: • Leveraging capital • Targeting deprived places • Targeting marginalised groups • Growing financial resilience and sustainability of VCSEs • Building a sustainable market	Can be successful at attracting private capital especially from mission-led and socially-minded investors by lowering risk for investors. Has enabled access to finance in deprived places through improving availability, affordability, patience and flexibility of capital in these places. There is not yet a strong track record for lending to enterprises run by underserved or marginalised groups but evidence is emerging in this area. Effective at building the financial resilience and sustainability of enterprises. Considered to have some success at building a sustainable social investment market, through the development of intermediaries and a track record, but this is reliant on finite grant subsidy.	The potential of guarantees to attact private capital is significant and track record has been demonstrated since guarantees have been introduced which meet the needs of social enterprises and charities. They are arguably the most efficient way of attracting new capital at scale as the subsidy is only repaid in the event of default, and they improve the financial resilience and sustainability of enterprises. Guarantees in themselves aren't targeted at deprived and/or marginalised communities, but the way they are used by social impact investors can be significantly targeted. They are contributing to building an intermediary market of investors, through the development of intermediaries and a track record, but these are dependent on the terms of the guarantee.	Tax reliefs can be highly successful at attracting private capital and achieving their policy objectives, but this is dependent on the design principles and application. The scale and success of EIS and SEIS demonstrates this, however, these reliefs have not been designed to cater to the needs of social enterprises and charities or the policy objectives explored in this paper. CITR is successful at mobilising investment into impactful SMEs. From 2002 – 2017, it channelled £145m into CDFIs, facilitating £127m on onward lending to SMEs creating social impact. This is estimated to have created over £1.5bn of value to local economies, with a cost to the taxpayer of c. £36 million.[52] Statistical data shows that from financial year 2017-18 to 2020-2021 CITR raised a further £72m, bringing the total to £218m.[53] SITR's uptake has been insufficient in driving social investment flow into marginalised areas.

Policy goal	Blending of grants with investment capital	Guarantees	Tax relief
Helping investors participate in the social impact investment market: • Improving risk/return profile • Subsidising operational costs • Reducing complexity	Blended finance structures and products can de-risk investments, for example by partially absorbing losses, in order to attract investors. While complex to set-up for the fund manager or development agency, that complexity should not be passed on to the investor. Working on a significant scale in developing world markets and in the US, its potential has not been fully realised in the UK.	Guarantees are a familiar, efficient tool which substantially reduces risk and mitigates losses to investors to leverage capital, particularly in turbulent times. Most UK guarantees have not supported social investment to date (with the exception of CDFIs' use of schemes) but CBILS has catalysed new participation in the market. Guarantees can be designed in a way which reduces the operational costs for the lender. Programmes which utilise guarantees can be created to reduce the complexity for investors.	EIS and SEIS were not designed to encourage investors to participate in the social investment market. CITR has been successful in encouraging investment into CDFI's. SITR has underperformed in its aim to encourage investment into social enterprises and charities, partly because of the complexity of and restrictions around the relief. Tax reliefs can be targeted at specific investor groups, which distinguishes it from the other tools, unlocking new forms of investment which wouldn't otherwise be possible.
Better tailoring capital to the needs of social enterprises and charities and SMEs in deprived areas led by and/or serving marginalised communities: • Improving affordability and reducing other accessibility barriers • More flexible product	Blended finance structures and products have a strong track record in enabling small-scale, unsecured loans on affordable, patient and flexible repayment terms for social enterprises and charities. Grant can help investors using other subsidy tools - e.g. guarantees - to make their offerings more targeted and accessible by providing bolt-on non-financial support.	Improves the accessibility and, to an extent, the affordability of capital by allowing for increased availability of lower-cost finance, where it would not otherwise be offered, especially on an unsecured basis. However, guarantees are standardised and generally inflexible, and not as suitable as other levers for enabling smaller deals and offering tailored products to social enterprises, charities and impactful SMEs. Notably, there is often a trade-off between scale (where guarantees have performed well) and individual flexibility.	EIS and SEIS have not provided tailored capital to social enterprises and charities. CITR has proven successful and is considered to be well tailored to the needs of CDFIs. In theory it only subsidises costs to the intermediary (CDFIs) and it is up to the CDFIs whether the cost reduction is passed onto the borrower. For those organisation s who are eligible to use SITR, it has been particularly successful at enabling investments which are affordable e.g. 5-6% - and patient e.g. 3+ years. It can also allow investees to set their own terms e.g. under equity investments through community shares. However, overall, too often organisations wishing to use SITR are not eligible.
Facilitating non-financial support for social enterprises and charities, and SMEs in deprived areas or led by and/or serving marginalised groups: • Providing capacity building /technical assistance	Blended finance products are highly successful at facilitating non-financial support. Blended finance structures, which can co-exist with blended products, don't usually facilitate non-financial support as this is not their purpose. The financing of technical assistance is a major feature of blended structures in a developing world context but less common in the UK outside of Access.	Guarantees reduce the cost of providing loans for CDFIs, enabling them to deliver more pre and post-application support to investees. However, this outcome is reliant on the strategies of impact investors which may utilise guarantees, rather than being an inherent aspect of design.	CITR reduces the cost of providing loans for CDFIs, enabling them to deliver more pre and post-application support to investees. There has been some limited anecdotal evidence of SITR deals resulting in support between the investor and organisation. However, SITR also creates a substantial need for support among investees because of its complexity. Overall, facilitation of non-financial support isn't an inherent feature of tax reliefs.

2. Scope and methodology and complementary work

2.1. Scope and methodology

This project, led by the Impact Investing Institute and funded by DCMS with support from Big Society Capital, has examined the advantages, limitations of and suitability of the different subsidy types available to the public sector and other market actors - aiming to create a thriving social economy with access to appropriate finance. This study focuses on evaluating three main types of subsidy –grants, guarantees and tax reliefs – to ensure they are as effective as possible in achieving the following four key policy goals and overcoming the attendant barriers.

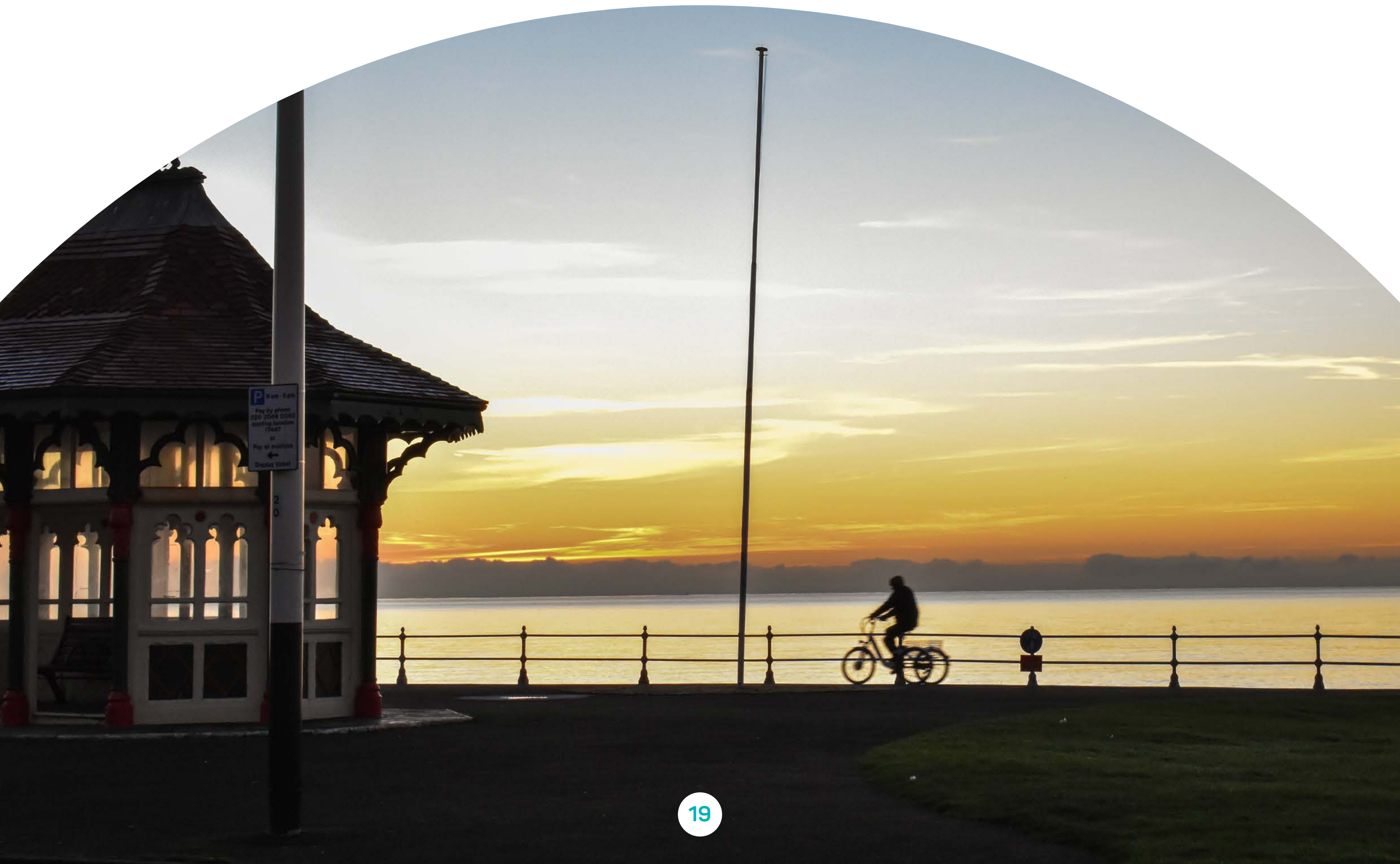
1. Growing the local economy and social economy particularly in deprived areas:
    - Leveraging more and new sources of private capital at scale
    - Specifically supporting social enterprises, charities and SMEs located in deprived areas
    - Specifically supporting social enterprises, charities and SMEs led by and/or serving marginalised communities
    - Growing and building the financial resilience of social enterprises and charities
    - Creating a sustainable social impact investment market
2. Increasing investor participation in the social impact investment market
    - Reducing risk of higher risk or less proven investments, thereby improving risk/return
    - Subsidising operational costs of delivery by lender
3. Better tailoring capital to the needs of social enterprises and charities and SMEs in deprived areas or led by and/or serving marginalised communities
    - Improving affordability for investees or reduce other accessibility barriers
    - Provides flexibility of products to frontline businesses
4. Facilitating non-financial support (e.g. technical assistance) for social enterprises and charities, and SMEs who are in deprived areas or are led by and/or serving marginalised groups
    - Provides technical assistance / capacity building for borrowers, supporting deployment

The Impact Investing Institute and Big Society Capital delivered the work using a combination of literature survey, desk research, case study selection and interviews with 16 stakeholders from the social impact investment sector. We believe it is the first detailed comparative analysis of these subsidy tools and should be viewed as an initial attempt at evaluating the benefits and disadvantages of each policy lever. The report is not intended to comment on the roles of policymakers or the implementation of future policy. As well as informing policymakers, we hope it will provide a foundation for further debate and engagement on this topic.

2.2. Complementary work

There are multiple ongoing projects and developments contributing to this reflection and policy development, including:

- The report by the Commission on Social Investment, 2022, 'Reclaiming the future: reforming Social Investment for the Next Decade' which consulted over 300 social enterprises across every region and nation of the UK.[55]
- The recently published report by New Philanthropy Capital (NPC), 'Review of grant subsidy for blended finance to support civil society', commissioned by DCMS.[56]
- Big Society Capital and the Access Foundation have commissioned a piece of research that will look at the topic of catalytic capital here in the UK and the barriers that exist to make more of this funding available from investors. This work is hosted within the Association of Charitable Foundations (ACF) and is intended to also look beyond the traditional base of catalytic capital providers of trusts and foundations and will be published in the second half of 2022.
- The Beacon Collaborative has established a commission aimed at stimulating more impact-led investing by the wealthiest individuals and family offices and will publish their findings in the second half of 2022. They estimate there is untapped potential of well over £1 billion among individual investors to invest for social impact.[57]



3. Analysis of effectiveness of government subsidy for social impact investment

3.1. Barriers to social investment that government subsidy is targeting

While socially impactful enterprises can and do access mainstream finance, there are barriers to the growth of the social impact investment market anchored in the fact that delivering social impact in the most deprived areas often results in lower return business models and either is (or is perceived to be) higher risk. In what follows, we hone in on the evidence for investments into social enterprises and charities where cited barriers include:

- **Information asymmetry**: A market failure which results from continued uncertainties about the risks and returns of investments made into social enterprises and charities. This market failure prevents the traditional funding channels from supplying the volumes of finance necessary to support the growth of social enterprises and charities.
    - While the **track record** for investments into social enterprises and charities compared to traditional ones is growing, as a whole it remains substantially less developed than for mainstream SMEs due to its scale. The lower level of historic transaction data increases the uncertainty faced by potential investors.
    - Investors are often **unfamiliar with the business models** employed by social enterprises and charities, many of which may be innovative, novel and untested. This further increases uncertainty and deters investment.
- **Positive externalities may not be 'priced' into the business model**: Social enterprises and charities create substantial social value which is often not reflected in the revenues they receive from customers (often the government or consumers) as well as in the financial returns made by investors. This can mean that returns are lower than may be the case for a purely commercial organisation with equivalent risk. This lower return can limit the pool of investors who are able and willing to risk their capital for a modest return. The current lack of consistency in measuring and reporting on social impact created by the enterprise also means that the returns gained by investors don't account for the additional positive social impact their investment is unlocking.
- **High transaction costs and occasionally inefficient deployment**: Many social enterprises and charities are small (i.e. revenues below £100,000) and require lower levels of funding, meaning that transaction and due diligence costs associated with these investments are higher compared to traditional SMEs. This cost is passed on to investors, increasing the challenge of attracting them. This is compounded by slow or uncertain deployment paths given the time it can take to build relationships and trust for first time borrowers.
- **Lack of assets**: Many social enterprises and charities working in the most deprived areas, often run by people from historically marginalised communities, do not have assets of sufficient value to use as collateral. This can be due to lower property prices in more deprived parts of the country. The secured lending that is available to those with assets on the high street is not available to these non-asset backed enterprises. For example, a registered charity which provides support and training to adults with learning disabilities in Derby needed to access investment to acquire a property to expand its training capacity – but didn't currently own an asset to secure that loan against.
- **Legal structures**: The traditional angel/venture capital route is often not suitable for as charities are not legally able to issue equity and raise mainstream venture capital (VC) and those social enterprises that can issue equity do not generate the kind of shorter-term, high value exit opportunities that the VC models require. Many therefore cannot take equity investment at all, making them reliant on debt alone or quasi-equity finance.[58] Those social enterprises that can take equity may find that the VC culture of scale and optimising financial returns might not be a good fit. Additionally some categories also face further legal restrictions to raising finance. Community businesses such

as community pubs, hubs and football clubs who raise money through community shares are typically unable to access all the capital they need due to the legal limit of £100,000 on how much you can invest.[59] For example, Clifton Community Arts Centre runs a community arts centre in Wellington, Shropshire and raised £40,000 through community shares, but needed to supplement this with other sources of financing.[60]

Social investors face many of the investment challenges that their social enterprise and charity clients also experience.

- **Social investors making small loans (e.g. sub £250k) face proportionately higher transaction costs than when making larger loans, and this is compounded by slow or uncertain deployment paths**. The 2021 State of the Social Enterprise Survey reported the median amount of repayable finance which social enterprises seek to raise is £50,000.[61] However, transaction costs for undertaking due diligence and making and managing investments are (within certain margins) fixed which proves challenging for serving organisations at this scale.

Facing these headwinds, without support social investors can struggle to deliver the type of product that social enterprises and charities delivering for the most vulnerable need. While such lending does indeed still occur, as noted in the market growth figures above, the full potential of the sector isn't being realised.

3.2. Analysis of key types of subsidy

Government subsidy has a vital role to play in helping overcome some of these barriers: grants, guarantees and tax reliefs have all proven important tools, both in the UK and internationally, to help social enterprises, charities, and SMEs creating social impact to access finance. The effective use of subsidies enables both investors to invest in products and platforms that meet the profile and scale they are seeking; and helps funds create products that are fit for purpose for organisations operating in a complex environment but creating impact in communities and delivering on government priorities.[62]

These tools can offer strong value for money for the government as a way of achieving its priorities and creating societal impact.

3.2.1 Blending grants with investment capital

3.2.1.1. Definition and purpose

Grants are sums of money given to organisations or funds without any expectation of a financial return. In the context of strengthening the social impact investment sector in the UK, they commonly come from **the UK government including arm's length bodies such as the National Lottery Community Fund, Arts Council England and Sports England, as well as the Dormant Assets Scheme which is administered by the UK Government**, which have contributed significant amounts of capital in grants to catalyse investment into social enterprises and charities since 2004.[63] Additionally the Scottish, Welsh and Northern Irish governments are notable providers of grants to catalyse the social investment market, for example the Scottish Government recently allocated £30 million to the Third Sector Growth Fund, a proportion of which may be in the form of grant.[64]

Charitable foundations, trusts and philanthropists have also provided some grants to catalyse the social investment market however at a smaller magnitude.

The purpose of grants is contingent on where the grant is applied: either in investors' blended finance structures, vehicles and funds; and / or as blended finance products.

- **Blended structures**: The grant occurs at a fund level, where the fund takes on a grant and blends it with the investment capital which is then used to provide repayable finance to the frontline enterprise. The most usual example is where the grant is used to repay investors up to a certain percent if some of their capital is lost due to defaults (also known as 'first loss'). Another example is where the grant pays a portion of the management fees of the investment fund.

- **Blended products**: These are finance packages that enterprises can access directly that combine investment that needs to be repaid with a grant that doesn't need to be repaid and/or advice and business support which is free to the enterprise and known as technical assistance. For example, the Access Growth Fund provides a mix of grants and loans to social enterprises and charities. On average 16% of the amount provided to each organisation is as a direct grant.[65] Prior to taking on the investment, some of the organisations also have access to the Reach Fund which helps them overcome barriers to raising social investment. For example, building their capacity to manage debt, financial modelling of new revenue streams.

  Another example is the Northern Cultural Regeneration Fund which provides up to £150,000 to organisations, where up to 33% of the investment could be given as grant, but the grant must only be used for capital expenditure.[66] Investees also have access to Prosper North, a two year long business support programme.

  Blended finance structures and products "bridge the gap" between investors who make the investment and the enterprises who receive it, enabling investors to invest in a product which meets the profile and scale they are seeking, creating a product that would not otherwise exist and is fit for purpose for impactful organisations. For example through being unsecured, offering a more affordable rate, or longer terms (or a combination of all three). Vitally, the investment structures and products must balance the requirements of the capital providers, the constraints of the grant source, the objectives and needs of the investors delivering the funds, and needs of the enterprises that the programme will ultimately serve. Stakeholders interviewed for this research also believed that the flexible nature of blended finance products can help to reduce grant dependency in the sector. One interviewee consulted for this research noted that in the longer-term, they were able to gradually decrease the ratio of grant to loan.

By opening up much bigger pools of capital to channel into the impact areas that public and philanthropic organisations are targeting, blending grants with loans increases the amount of money available to charities, social enterprises and other impactful SMEs on the frontline. They are viewed by some public and philanthropic funders as a powerful tool to mobilise additional capital into the issues and causes they care about.

3.2.1.2. Data and examples of key schemes

For many in the UK social investment sector, the field's development starts with the government-funded Futurebuilders initiative which began in 2004, and from 2008 was managed by Social Investment Business.[67] The £142m social investment fund provided grant and loan financing to social enterprises and charities in England in order to help them bid for, win and deliver public service contracts. The fund was wholly government-backed, providing £121.6m in blended deals to 175 organisations, £4.6m in grant-only deals to 183 organisations and £17m through 27 loan-only deals. Importantly there was no private capital in the Fund, but over 40% of the investment was disbursed into the 20% most deprived areas in the UK.[68]

There were also other important government initiatives at this time such as the Social Enterprise Investment Fund (SEIF) and Communitybuilders, and there is a chronology in the 2022 report by New Philanthropy Capital (NPC), 'Review of grant subsidy for blended finance to support civil society'.[69] SEIF, for example, managed by Social Investment Business and capitalised by the Department of Health, invested more than £100m into over 600 organisations working across a range of health and social care areas including disability services, mental health, substance misuse and carers' organisations.

The most significant current contribution of grants to the social investment sector is via Access - the Foundation for Social Investment (Access).

Access - The Foundation for Social Investment, about the Growth Fund - "This programme is not only blending finance but has to blend interests, incentives and requirements from a range of partners that have come together with this common goal."

CASE STUDY

Access: The Foundation for Social Investment (Access)

Access was established in 2015 with a £60m endowment commitment from the Cabinet Office, £22.5m grant from the National Lottery Community Fund, and £22.5m investment capital from Big Society Capital into the Access Growth Fund with a mandate to widen the reach of social investment to allow usually smaller social enterprises and charities to access investment. Additional funding of Access has also occurred over time: their programmes benefitted from a further £60m injection of dormant bank account money since the organisation's founding.[70]

Access' more mature blended finance offering is the Growth Fund, a blended finance structure working in a wholesale capacity through 14 social investor intermediaries who then provide blended finance products – i.e. loans and grants - to social enterprises and charities. The Growth Fund has made over 600 investments in the sector since 2016 with an average deal size of £67,000, much smaller than other social investment programmes.[71] The median turnover of a Growth Fund borrower is under £250,000 and the programme has supported organisations with, on average, half the income and one eighth of the assets of those who normally attract social investment. A quarter of loans made by the Growth Fund include the most deprived 10% of neighbourhoods in England, and more than half in the most deprived 30%.[72]

Access also provides the following blended products to enterprises:[73]

- Enterprise development support, in the form of grants and learning support, through the Enterprise Development Programme, a five-year programme that offers tailored support to organisations looking to explore new or grow existing enterprise models to increase their resilience. 155 organisations, across six sectors – homelessness (20), youth (22), equality (37), and mental health (54), Environment (10), Black and Minoritised Communities (12) are part of the programme.
- Investment readiness grants from the Reach Fund, provided to social enterprises and charities referred by a list of approved social investors, or 'Access Points'. The investment readiness support plan is designed by the social investors and provided to an organisation that requires extra support, for example on business planning, cashflow forecasts, or measuring impact etc., to raise investment. The Reach fund has awarded 628 grants, with average grant size of £13.6k, and total grant volume of £8.52m. Analysis of the Reach Fund suggests that each £1 spent on these grants unlocks £7 of new investment.[74] An example of a typical grant is the support given to Homeless Oxfordshire to improve their business plan and go on to apply for funding from Resonance.[75]

Taking the learnings from the aforementioned programmes, Access and partners have launched a number of new blended structures and products such as 'Local Access'[76] and the 'Flexible Finance for the Recovery Programme'.[77] In some cases these have combined grant with other policy levers. For example, in August 2020, to widen the reach and accessibility of the Recovery and Resilience Loan Fund (RRLF), £4m of grant funding was made available by Access alongside the RRLF. Grants were only awarded alongside RRLF loans, which were guaranteed by CBILS, if it was clear that the COVID-19 interruption to organisations' business models meant they would struggle to meet a viability threshold for a loan without the grant. They ranged in size from £40,000 - £300,000 and constituted 20% to 40% of the loan amount.

Furthermore, Access supports the strengthening of the social investment infrastructure through the Connect Fund. This £6m fund, managed in partnership with the Barrow Cadbury Trust, provides grants and investments to infrastructure organisations to improve the social investment sector in England, as opposed to frontline social enterprises and charities delivering goods and services. In Phase 1 (2017-2020), the Connect Fund awarded £2.8m in 82 grants and one investment across eight themes, while in Phase 2 (2020-2023) Connect Fund has awarded £430k in 12 grants across three themes.

In addition to Access, the UK has several other recent examples of both blended finance structures and products. An example of a blended structure is Nesta's Arts and Culture Impact Fund which provides loans to arts, culture and heritage organisations that have a positive social impact on the communities they live in.[78] Now the world's biggest social impact investment fund for the creative arts, the fund was formed using a £5m grant from Arts Council England and the National Lottery Heritage Fund and a further investment of £18m from several investors including Big Society Capital and Bank of America. The grant acts as a 'first loss' layer which makes for a reasonable risk/return profile for the investors and when blended with the patient social impact investment capital, the fund can issue affordable, flexible, and unsecured loans.

Government's participation in the Everyone In Social Investment Pilot

This report focuses on examples where the government's role has been to provide grants. However, government and other public sector bodies can also participate as investors as illustrated by the Everyone In Social Investment Pilot:

- In 2021 the Department for Levelling Up, Housing & Communities (DLUHC) provided £15m, which Big Society Capital matched with £15m, to invest £30m into a collection of homelessness investment funds managed by Social and Sustainable Capital, Resonance and Bridges Fund Management. The purpose is to support those who are homeless or at risk of becoming homeless through the provision of 244 housing units. The DLUHC investment combined with and helped catalyse £112.5 million of additional investment at the time from public bodies, including the Greater Manchester Combined Authority (GMCA) and Greater London Authority, trusts, foundations and pension funds.[79]
- The homelessness investment funds use this money to purchase existing housing from the property market in partnership with local organisations and make them available at Local Housing Authority rent levels to ensure they remain affordable. Tailored support from social enterprises and charities who specialise in housing vulnerable people is also made available to help residents maintain their tenancies, including addiction services, education and employment support and counselling.[80]

Beyond the UK, blended finance structures are used extensively in developing world contexts and have become more prominent in recent years. Convergence, the global network for blended finance, estimates that by 2021, the aggregate blended finance flows globally totalled over $160bn. Much of this investment is concentrated in the developing world and emerging markets, with Sub-Saharan Africa historically representing the largest portion of blended finance activity. The region attracted almost two-thirds of blended finance transactions in 2020.[81] In the 5-year period between 2014 and 2019, global blended finance flows amounted to approximately $9bn per annum.[82] Blended finance vehicles are used to address both perceived and real risks facing market-rate investors in order to help them enter the social impact investment market.[83] Importantly, blended finance is defined by Convergence as the use of catalytic capital from public or philanthropic sources to increase private sector investment in sustainable development, meaning it includes the blend of grant and investment capital, but is not that exclusively.

Outside of the UK, in the US there is a more developed and established practice of using grants for blend in structures. Here the US charitable foundation sector plays a significant role and expressly intends to leverage more and new capital to address social problems. A typical example of this is the California FreshWorks Fund-Term Debt Facility. The California Endowment, JPMorgan Chase foundation, and US Treasury's Community Development Financial Institutions Fund jointly provided $7.5m in grant in the form of first-loss capital that helped leverage $125m of investment. The facility provided loans to grocers in food deserts in California.[84] Research carried out by Convergence found that a technical assistance component was integrated into 30% of blended finance transactions in 2020 – most of these in the developing world.

In many cases these blended finance structures are the first step to then distributing blended finance products. There are exceptions here, with some foundations issuing grants and loans in combination. Esmée Fairbairn for example is a charitable foundation which has committed £50m to social investment over the past 10 years, often combining grant and loan in this way.[85] Additionally Power to Change have focussed on blended finance products. For example, their 'More than a Pub' programme offers tailored business support to communities to buy their local pub with community shares, and access to loans and grant to make up any shortfall.[86]

3.2.1.3. Analysis of effectiveness

Policy objective 1: Growing the local economy and social economy, particularly in deprived areas

The colours indicate an overall assessment of whether the policy lever has achieved the stated policy objectives

Assessment	Evidence / example
Lever more & new sources of private capital at scale: Both blended finance structures and products have a good track record in leveraging private capital from mission-led and socially-minded investors like Big Society Capital, trusts and foundations or social banks. Blended structures do so through the provision of concessionary capital (usually in the form of 'first loss') which de-risks the investment and attracts additional capital. Blended products can also attract private capital by de-risking. When the grant is accessed directly alongside the loan, de-risking is a result of the grant being used to reduce the debt burden to an affordable level. It may be used by the enterprise to cover some of its interest costs. On the other hand, grants which help enterprises to become 'investment ready' can help de-risk the investment and give confidence to the investors to invest. There is a trade-off between the cost and flexibility of the product and the capital leveraged, with smaller deals in the social investment market being linked with lower leverage. Arguably guarantees have a stronger track record on leveraging private capital while grants have a stronger track record on delivering smaller-scale, more flexible capital.	**Responsible Finance** delivered the RF Fund 2012-2019, a place-based social impact investment fund which used £30m of Regional Growth Fund grant to leverage £45m of co-investment from Unity Trust Bank and Co-operative Bank. Through recycling, it lent £89m in total and supported 11,771 jobs. [87] **Plymouth City Council** invested £2.5m into their **Social Enterprise Investment Fund**, leveraging a further £5m from investors. So far 21 businesses have benefitted, creating 130 jobs.[88] The £23m **Nesta Arts and Culture Impact Fund** for socially driven arts, culture and heritage organisations in the UK, which leveraged £18m of new private capital using £5m grants. The **Club Capital fund** used £4m in grants from Sports England and British Gymnastics to lever in £3.5m of investment capital from Big Society Capital and Bank Workers Charity.[89]
Specifically supporting social enterprises and charities / SMEs in deprived areas: Both blended finance structures and products can be targeted at enterprises in underserved and deprived communities through improving availability, affordability, patience and flexibility of capital. Of all the subsidy tools, they have a particularly strong track record on this.	In 2019-20 social investor Key Fund awarded a total of £5.8m (£4m in loans and £1.8m in grants), with 73% of awards going to the 30% most deprived neighbourhoods in England.[90] Their **Northern Cultural Regeneration Fund**, a £3.1m blended structure funded by DCMS to support cultural social enterprise in the North of England, invested 25% of its funds in the lowest 10% areas.[91] 26% of **Access's Growth Fund** loans are in the most deprived 10% of neighbourhoods in England and over half are in the most deprived 30%.[92] Over 40% of **Futurebuilders** investments are disbursed in the 20% most deprived areas in the UK and 64% of investments are in the most deprived 40% of communities.[93] By comparison in 2020 UK SME bank lending stood at 7% in the 10% most deprived neighbourhoods, 14% in the lowest 20% and 23% in the lowest 30%.[94]
Specifically supporting social enterprises and charities / SMEs led by and/or serving marginalised communities: Blended finance structures and products do not have a strong track record in supporting black and minoritised ethnicity-led enterprises due to an insufficient focus to date on improving access to finance for this group. There is now significant progress being made with a number of new initiatives and funds being developed. Emerging evidence is starting to suggest that blended finance models can reach these target groups, but there is more work to be done to turn this potential into reality.	While loan and grant blends have successfully enabled lending to enterprises in geographically underserved/marginalised communities, there are areas of marginalisation (e.g. ethnicity) which remain underserved. A 2019 survey found that black and ethnic minority-led social enterprises were applying for and receiving finance at just one quarter of the level as the rest of the social enterprise sector.[95] Arguably this is due to awareness of these issues and targeting and design issues rather than the underlying efficacy of the tool. Social Investment Business, alongside the Ubele Initiative and Create Equity, is combining £2m of grant from Access with a similar proportion of loan from the Recovery Loan Fund to support black and minoritised ethnicity-led charities and social enterprises. Investors who have come onboard include MFS Investment Management and the Church of England.[96] Responsible Finance's RF Fund made 16% of its loans to BAME-led businesses and 24% to female-led businesses.[97] In 2019 5% of UK businesses were BAME-led and 15% were female-led.[98]

Policy objective 1: Growing the local economy and social economy, particularly in deprived areas

The colours indicate an overall assessment of whether the policy lever has achieved the stated policy objectives

Assessment	Evidence / example
Growing and building financial resilience and sustainability of social enterprises and charities: Enterprises supported by blended finance structures and products have been shown to improve their financial resilience and growth. Evidence shows that beneficiaries grow their revenue following investment, helping them become less reliant on grants and more financially independent.	**Access Growth Fund** independent evaluation showed that recipient social enterprises and charities increased revenue by 43% in the three years following social investment, staff numbers increased by 50% on average, and their total assets increased from an average of £180k to £268k.[99] **Futurebuilders** recipients employed 16% more staff in the three years following investment. Unrestricted funds and reserves relative to spending had improved 7 years after receiving a loan, meaning they were **more resilient to financial shocks** than they were before taking on social investment.[100] Internal reporting shows that organisations that received a Futurebuilders loan were four times more likely to go on and receive further loans, compared with organisations that only received a grant. **Cooperatives UK's Community Shares Booster Programme** provided grants of up to £10,000 to help businesses prepare their community share offer. However, it was designed to ensure that they have a long-term sustainability plan in place to avoid future grant dependency. Since 2012, the programme has raised over £155m through community shares and supported over 440 businesses, 92% of which are still trading.[101]
Building a sustainable market for social impactinvestment: Both types of blended finance have also been found to develop the intermediary market for social investment with a number of intermediaries becoming adept at delivering grants in financial structures. The success blended finance structures and products have in channelling capital into these businesses also develops the sustainability of the market by building a track record for what remain often untested investments and business models. The relative high quality of evaluation of blended structures and products provides data which can be used to evidence the viability of certain investments. However, market sustainability is reliant on the continued provision of grants, which currently is patchy and inconsistent.	The **Access Growth Fund** has increased the number and capability of social investors, e.g. 10 out of 15 social investors within the Growth Fund had no prior organisational experience of specifically managing a loan portfolio.[102] It is important to note that this growth in the potential pool of intermediaries is only beneficial if they continue to engage in social investment. Access's **learning hub** and the granular availability of some of Social Investment Business's data (e.g. **Futurebuilders** and the **Resilience and Recovery Loan Fund**) are examples.

Policy objective 2: Helping investors participate in the social impact investment market

The colours indicate an overall assessment of whether the policy lever has achieved the stated policy objectives

Assessment	Evidence / example
Reducing risk of higher risk or less proven investments, thereby improving risk/return: Blended finance structures can leverage substantial additional capital and bring new investors onboard by improving the risk/return profile of investments. Blended finance products aren't designed to primarily reduce the risk of investments, but they can do this (as described under policy objective 1 above).	**Impact Investing in Frontier Markets - Sarona Frontier Markets Fund 2:** $15m first-loss capital was provided by MEDA, Global Affairs Canada and Overseas Private Investment Corporation to leverage $150m of investment In a UK social investment context, a typical leverage ratio might be 1:1 or 1:2. **Futurebuilders** did not leverage any private capital while the **Nesta Arts and Culture Impact Fund** saw £5m grant for blend leverage £18m private capital showing. The mix achieved depends on the choices made by those designing it. Analysis of the **Reach Fund** suggests that each £1 spent on these blended products unlocks £7 of new social investment.[103]
Subsidises operational costs of delivery by lender: Blended finance structures and products can be designed to do this. Particularly important where deal sizes are low and operational costs are proportionally higher.	The **Access Growth Fund** contributes towards the costs of making lots of small loans; so that the investor can afford the proportionally higher transaction costs of making loans, which are £67,000 on average, that can often exceed interest / fee income at this level. This use of the grant is a small proportion of the total grant amount. It was provisionally set at 10% but has been flexed higher when required.[104]
Reduces complexity for investors: While blended finance structures can be complex to set up for the fund manager or development organisation, when designed well they enable investors to invest who would not otherwise do so and can also be a strength where new partnerships are created.	**Nesta Arts and Culture Impact Fund** has attracted types of capital from different groups of investors into one simple structure that doesn't require more time for due diligence, reporting and monitoring than a usual fund structure: • £5m concessional capital - £3m repayable grant from Arts Council England and £2m repayable grant from Heritage Lottery Fund act as a first loss buffer • £16m mezzanine debt layer – £6m loan from Big Society Capital, £6m Nesta's endowment, £3m Freelands Foundation and £1m loan from Esmée Fairbairn • £7m senior debt - including from Bank of America • Capital is drawn down in this order 1) grant layer 2) mezzanine layer (pro-rated) 3) Senior debt. Capital is then repaid in the reverse order. However, it's vitally important for there to be a market actor with relevant experience from financial to legal in creating such blended finance structures and products, and can provide advice to others, as there is a tendency for over-engineering.

Policy objective 3: Better tailoring capital to the needs of social enterprises and charities and SMEs in deprived areas or led by and/or serving marginalised communities

The colours indicate an overall assessment of whether the policy lever has achieved the stated policy objectives

Assessment	Evidence / example
Improve affordability for investees or reduce other accessibility barriers: Blended finance structures have enabled significant lending that is lower cost, smaller-scale (sub £150k), unsecured (no collateral), and over longer time horizons than would otherwise be possible. Importantly, these tailored products would otherwise not exist. Blended finance products - e.g. where a separate grant is provided alongside the repayable finance - have improved affordability for the investees and helped overcome other accessibility barriers by reducing the debt burden to an affordable level. Blended finance structures and products can be designed to deliver these benefits to deprived areas and/or marginalised groups, although as explained above this potential hasn't always been maximised. **Grant can also help investors using other subsidy tools - e.g. guarantees - to make their offerings more targeted and accessible by providing bolt-on non-financial support.**	The **Access Growth Fund**, with grant from the National Lottery Community Fund and investment capital from Big Society Capital, has made over 600 investments in the sector since 2016 with an average deal size of £67,000, much smaller than other social investment programmes. The average interest rate is 7.2% and loan term is 51 months.[105] This fund supported organisations with, on average, half the turnover and one-eighth of the assets of those who normally attract social investment. Futurebuilders, fully backed by the government, offered an average interest rate of 5.45%, and an average loan duration of 13.8 years.[106] The Recovery Loan Fund, backed by the RLS guarantee, has also taken on grant to deepen its reach. Amongst other things the grant has enabled the fund to reduce its minimum loan size from £100k to £50k for social enterprises and charities led by black and minoritised ethnicities as well as provide unrestricted grants alongside the loans of up to 100% of the value of the loan if needed. The NPC Review of Grant Subsidy for Blended Finance to support civil society found that "On the one hand, grant subsidy can increase the affordability of investment capital for VCSEs by subsidising a lower interest rate than is justified by the risks to the investor. On the other hand, grant subsidy can increase the availability of investment capital for VCSEs by subsidising the return expectations of the investor.... Another way of putting this is that the relationship between the supply and demand, or the affordability and availability of investment capital, is elastic. Grant subsidy can stretch or stimulate either side depending on how it is used within a blended finance structure."[107]
Provides flexibility of products to frontline businesses: Blended finance structures and products have a strong track record in being adaptive to the needs of investees, with the most in-built flexibility of all the subsidy tools.	It is easier for an organisation to restructure a loan they might have from the **Access Growth Fund** than with a traditional bank. For example, initially the interest rate for the Access Growth Fund was set at 5%. This was later adjusted to account for hardships caused by the pandemic.[108] Variations were also applied to a significant number of **Futurebuilders** investments to support investees through difficulty.[109]

Policy objective 4: Facilitating non-financial support for social enterprises and charities and SMEs in deprived areas or led by and/or serving marginalised groups

The colours indicate an overall assessment of whether the policy lever has achieved the stated policy objectives

Assessment	Evidence / example
Provides technical assistance / capacity building for borrowers, supporting deployment: Blended finance products are highly successful at facilitating non-financial support. Blended finance structures, which can co-exist with blended products, don't usually facilitate non-financial support as this is not their purpose. The financing of technical assistance is a major feature of blended finance in a developing world context but less common in the UK outside of Access.	An example of this is **The Haruma Fund** – a $145 million blended private equity fund that invests in agriculture and leverages a $12 million technical assistance facility providing both pre- and post-investment technical support to investee companies.[110] **Access Reach Fund** provides investment-readiness grants to organisations who are already close to the point of taking on social investment. By March 2021, it had awarded 628 enterprise development grants worth a total of £8.52m.[111] The **Resonance Community Developers Fund** is a good example of a blended structure that gives assistance to organisations. **Big Issue Invest's Growth Impact Fund** (not to be confused with the Access Growth Fund) is another.

Barriers to the growth of blended finance and opportunities for strengthening

Stakeholders interviewed for the report highlighted the potential for investee organisations to misunderstand the true cost of capital where grant is involved and automatically assume that grant and loan blends are better than a loan on its own. For example, in the COVID-19 pandemic, one investor offered 0% interest loans which were less popular despite being cheaper than their grant / loan offering. Such experiences suggest that the market could benefit from all-round better information about the cost of capital and how it is arrived at. This type of work is already being undertaken by Good Finance.[112]

Additionally, looking ahead, stakeholders expressed a desire to see a greater use of grants to facilitate technical assistance to social enterprises and charities, including investment readiness programmes that can help to secure greater levels of private investment in future. The Reach Fund does much of this, but will be fully spent by 2026. Technical assistance can be useful in providing reassurance to new investors in sectors that are traditionally considered high-risk,[113] and many investees in the social investment market would likely fall into this category. Technical assistance can also help with upskilling, capacity, business planning, market testing and engagement and other business development activities.

Despite the significant benefits outlined above, the use of grant and loan blends as a tool by investors remains limited. Significantly, Convergence (which considers global blended finance usage) found that most investors tend to participate in blended finance only on a one-off basis rather than making it a regular part of their investment activities.[114] Only 1/3 of the 1450 organisations they identified as having invested through blended finance had made more than a single blended transaction, and only 22% had made more than 3 commitments which would classify them as 'active' blended finance investors. Among the challenges is to create a grant subsidy structure that works for all parties involved.

Convergence definition of blended finance: "Blended finance is the use of catalytic capital from public or philanthropic sources to increase private sector investment in sustainable development." This definition includes both grant for blend and guarantees.

In addition, blended finance structures and products are heavily reliant and restricted by the limited availability of public grants which enter the market in a piecemeal fashion. Prior to 2020 the growth of global blended finance flows had remained steady at around $9bn a year for 5 years. In 2020 however, as the global financial system was impacted by the COVID-19 pandemic, flows decreased sharply to only $4.5bn – less than half of the 2019 scale. Convergence suggests a range of possible factors to this drop, including a matching 50% decrease of public concessional funding being channelled towards blended finance transactions.[115]

Considering this reliance, a significant and enabling opportunity for the sector is a long-term, reliable source of grant for the sector of suitable scale to mount blended finance structures and which would provide greater confidence and clarity among investors on a longer time horizon. Without this long-term funding source, sector stakeholders voiced concerns that this subsidy type is prevented from reaching the scale of other policy levers. Recently published research delivered by New Philanthropy Capital and commissioned by DCMS considers the potential solutions in depth and highlights that up to £300m over 10 years is the scale required.[116] Stakeholders also highlighted the importance of a market actor with relevant experience from financial to legal in creating such blended finance structures and products, and can provide advice to others.

If the grant became more widespread, it is likely that more private sector investors would enter such as high net worth individuals, trusts and charitable endowments.[117] Indeed, the Individual Impact Investing Commission estimates that there is well over £1bn from high net worth individuals alone which could be channelled into the impact investing market more generally if the range of barriers were appropriately addressed.[118] While some philanthropic investors may voice concern over their money being used to subsidise the returns of investors, others will view their precious grant being used wisely to lever in additional investment capital and achieve even greater social impact for the causes they care about.

3.2.1.4. SWOT analysis

STRENGTHS	WEAKNESSES
• Can be targeted at particular social issues and/or marginalised communities • Can be designed to leverage significant additional investment, especially from mission-led sources • Shown to support enterprise resilience and growth	• Reliant on concessionary capital (i.e. grant) being sustained • Need to be designed with the needs of numerous stakeholders in mind, adding complexity. This can also be a strength where new partnerships are created • More complex and time consuming to structure than high street loans
OPPORTUNITIES	**RISKS**
• Ability to leverage significant amounts of commercial private capital to support government priorities such as levelling up • International context shows there is more potential for growing this subsidy type to support policy priorities • Expanding concessionary capital provision to other sources e.g. philanthropy or trusts and foundations, where it allows them to use their grant more sustainably and to attract more resources to support their mission • Significant opportunity to support levelling up priorities due to strong potential to reach underserved communities	• Lack of sustainable provision of concessionary capital • Potential for investee organisations to misunderstand the true cost of capital where grant is involved

3.2.2. Guarantees

3.2.2.1 Definition and purpose

A guarantee is an agreement that a third party, such as a government, a development agency, or a foundation, will repay the lender (partially or fully) if the borrower defaults. Guarantees are defined by the OECD as an 'insurance policy' that protects the lender from the 'risks of non-payment'.[119] Guarantees are mainly issued at deal level but can be assigned at the portfolio or vehicle level too. In the UK's social impact investment sector, a key guarantor is the government; the government provides guarantees in the sector by underwriting loans made by capital providers to social enterprises and charities and impactful SMEs.

From 1981 to March 2020, the UK government guaranteed over £6.5bn of loans:[120] through the Small Firm Loans Guarantee (1981-2008) which enabled access to guaranteed loans of up to £250k; and the Enterprise Finance Guarantee (January 2009-March 2020) introduced after the global financial crisis with a maximum guaranteed loan size of £1.2m, that could reach a larger pool of borrowers affected by the increased credit rationing of the time. These schemes enabled about 3,000 loans to be approved annually, which translated to an average annual government guarantee liability of approximately £300m[121], pre-pandemic. Since COVID-19 however there has been a large increase in the use of guarantees: guaranteed loans of more than £70bn have been issued to 1.5m firms under the various COVID-19 guarantee schemes.[122] These include: the Bounce Back Loan (BBL) Scheme (open from May 2020 to March 2021)[123], Coronavirus Business Interruption Loan Scheme (CBILS) (March 2020 - March 2021)[124], and Coronavirus Large Business Interruption Loan Scheme (CLBILS) (April 2020 - March 2021), and the successor to these schemes, the Recovery Loan Scheme (RLS) (April 2021 to June 2022).[125] Further detailing on the loan guarantee schemes with relevance to the social impact investment sector is included below.

The purpose of guarantees is twofold: to enable and enhance lending to borrowers considered too risky or unbankable; and to reduce the risk to the investor as certain risks are transferred to the guarantors.[126] For example, a guarantee can provide or enhance access to finance for an organisation that may lack assets which can be used as collateral and/or a proven record of financial sustainability, as the real or perceived risk of providing capital to such an organisation will be shifted from the lender to the guarantor. This is why they are so relevant for social enterprises, charities and impactful SMEs served by CDFIs, many of which fall into this category of borrower. They are often used to stimulate parts of the economy during economic instability or downturn, or to support certain government policy objectives.

Guarantees have the potential to mobilise private capital. A study by the Global Impact Investing Network (GIIN) found that the size of a median guarantee, in the US, was $2m while the median fund or project size was $20m, creating a 10x mobilisation ratio[127]; examples of capital mobilisation include the achieved 3x mobilisation by GuarantCo[128] and the targeted mobilisation ratio of 10x by the European Fund for Sustainable Development (EFSD).[129]

3.2.2.2. Data and examples of key schemes

Prior to the pandemic, there were a few guarantee schemes available to the UK social impact investment sector:

<table>
<tr><th>Scheme</th><th>Model</th><th>Benefits to social impact investment sector</th></tr>
<tr><td>The Enterprise Finance Guarantee (2009)[130]</td><td>Providing a 75% government-backed guarantee for investors to facilitate lending to small businesses that are viable but unable to obtain finance due to having insufficient security.[131] Guarantee claims are capped at a maximum of 20% gross (15% net) of annual lending. In the first three years of its existence, the estimated benefits from the businesses that drew out an EFG loan in 2009 included 6,500 new jobs, 12,375 jobs saved and economic growth worth £1.1bn.[132]</td><td rowspan="2">The Enterprise Finance Guarantee scheme and ENABLE Guarantees Programme have been notionally accessible to the UK social investment sector, but in the main the programmes have been difficult to access particularly for lending to social enterprises and charities.

Reasons given for their inapplicability to the UK social investment sector include the requirements around charities' trading activities, the cost of capital to the borrower and the guarantee cover which can be affordable to mainstream SMEs but present a challenge to social enterprises and charities.</td></tr>
<tr><td>The ENABLE Guarantees Programme[133]</td><td>Portfolio level intervention to UK banks, UK branches of foreign banks, asset and asset-based finance providers, and certain other categories of lenders that lend to viable SMEs operating in the UK. The guarantee covers a portion of the portfolio's net credit losses, in excess of an agreed first loss, against a certain fee.</td></tr>
<tr><td>The EU Programme for Employment and Social Innovation (EaSI)[134]</td><td>(not available to UK businesses since Brexit)

The €96m EU Programme for Employment and Social Innovation (EaSI) Guarantee is targeted at European microcredit providers and social enterprise investors and implemented through the European Investment Fund.[135] The capped guarantees provided partial credit risk protection to lenders and investors in microfinance and social entrepreneurship segments, enabling them to finance micro borrowers, micro enterprises and social enterprises that they otherwise would not, due to risk considerations. For microfinance, the guarantee is applicable to portfolios of products of up to €25,000, while for social entrepreneurship it is applicable to portfolios of products of up to €500,000. The benefiting enterprises should have an annual turnover or annual balance sheet total not exceeding €30m.</td><td>The EaSI guarantee has enabled both microfinance institutions and social investors to finance entities they would otherwise consider too risky.

It has been applied to 156 contracts, providing a total guarantee amount of €401.2m which is expected to unlock €2,617.6m in financing for micro-enterprises and €1,402.4m in financing to social enterprises. The guarantee scheme is currently enabling support to 129,178 micro-enterprises and 4,769 social enterprises in 31 countries.[136] There were 29 UK companies that benefited from the scheme.</td></tr>
</table>

CASE STUDY

Coronavirus Business Interruption Loan Scheme (CBILS)

The use of guarantees by UK social impact investors has significantly increased following the COVID-19 pandemic and CBILS can be considered a case study in designing guarantees that have spurred investment into social enterprises and charities. Key elements of the CBILS design have solved longstanding issues that previously saw many social enterprises and charities not participating in former guarantee schemes such as EFG and ENABLE - e.g. the requirements around charities' trading activities and the guarantee fee of 2%. The removal of a CBILS portfolio cap also doubled the external leverage that non-profit lenders Community Development Finance Institutions could achieve with their underlying risk capital compared to EFG which had a portfolio cap of 20%.

CBILS was designed in response to the cashflow disruption faced by businesses across the UK from COVID-19.[137] One of many schemes (including, as mentioned above BBLS, CLBILS, and RLS) initiated in the pandemic, CBILS was particularly focused on businesses operating in the UK with a turnover less than £45m and financing need of up to £5m, and that generate more than 50% of their income from trading. For registered charities, the requirement of generating over 50% of income from trading activities was not applicable. CBILS was implemented through a list of accredited lenders ranging from high-street banks, challenger banks, asset-based lenders and smaller specialist local lenders.

Features of CBILS:[138]

- The scheme focused on enabling access to credit to businesses that would be considered viable by the lending entity, if not for the effects of the pandemic.
- Provided coverage of up to 80% of the loss amount, with no portfolio cap which differentiates it from EFG.
- No guarantee fee for the borrower, which also distinguishes it from EFG where the borrower paid an annual guarantee fee of 2%.
- Interest and fees for the first 12 months paid; however interest rates may vary between lenders.
- The guarantee could be used for term loans, asset finance, overdrafts and invoice finance.
- The guarantee could also be used for refinancing with or without an increase in original borrowing amount.
- Repayment terms were up to six years for term loans and asset finance, and up to three years for overdrafts and invoice finance.

- No personal guarantee required from enterprises for facilities below £250,000; for facilities above £250,000 personal guarantees may be required but may not be the borrower's principal private residence and recovery from personal guarantees are capped at 20% of the outstanding balance after proceeds of the business assets have been applied.
- Unlike the EFG, CBILS operated as a notified scheme and not under de minimis, therefore any previous de minimis State aid would not impact an organisation's eligibility for CBILS. By contrast an organisation that has received public support of de minimis State aid beyond €200,000 equivalent in previous three years would not be eligible for EFG.[139]

CDFIs (not-for-profit, locally-based lenders), aided by loan guarantees, have long played an important role in channelling capital to small local firms. CBILS provided even higher levels of support and had the impact of doubling the volume of CDFI lending capacity compared to EFG, supporting more disadvantaged SMEs across the UK.[140]

In order to make CBILS more easily accessible to charities and social enterprises, Social Investment Business (SIB) created the Resilience and Recovery Loan Fund, designed to issue loans backed by CBILS. Big Society Capital invested £25m into the fund, and Access made a further £4m of grant funding available alongside the loan. The fund was delivered by SIB and seven other experienced social investment partners: Big Issue Invest, CAF Venturesome, Charity Bank, Resonance, Social Investment Scotland, Social and Sustainable Capital and Wales Council for Voluntary Action. The fund finished with £28m in total funding approved to 77 charities and social enterprises.[141]

In summary, CBILS provided appropriately high coverage, was simple to use, waived fees and was accessible to social enterprises and charities and non-profit community based lenders CDFIs (Community Development Finance Institutions) in a way that previous guarantee schemes had not been.

US examples are instructive in how enabling well-structured guarantees can be for spurring social impact investment. US foundations have played an active role in providing guarantees in a way that UK foundations have yet to fully embrace. Guarantees have been used by US foundations to leverage investment from mainstream commercial investors; and in building out the US CDFI sector. For example in the Healthy Neighbourhoods Loan Pools, a $4m guarantee sourced from multiple foundations leveraged $40m of investment from banks. The investment was used for loans targeting homeowners to purchase, refinance and renovate homes in Baltimore, US.[142] Foundations like Kresge in the US curate guarantee portfolios as part of their overall impact strategy. Since 2011, they've built $70 million in guarantee commitments and unlocked $780 million in investor capital for projects they care about, without dipping into their endowment.[143]

In the US the government has also played an active role in using guarantees to build the CDFI sector. The US CDFI programme launched in 2010, providing federal backing for the US CDFI sector through credit enhancement. The programme allowed eligible CDFIs to raise bonds of $100m or more with a 100% federal guarantee. Over $1.6 billion has been channelled into the CDFI sector as patient, cheap capital using this tool.[144] By effectively acting as a collateral substitute, loan guarantees from state and federal programmes allow banks to make loans targeted to small businesses that might otherwise not obtain funding on reasonable terms because they are unable to offer sufficient collateral. The most sophisticated CDFIs in the US also employ guarantees in a strategic manner themselves to drive economic growth for their local communities. For instance, Hope Enterprise – a $283M loan fund – established a credit union affiliate to partner with, and uses its own capital to guarantee the loans of the credit union, enabling the latter to take more risk than traditional depository institutions.[145]

3.2.2.3. Analysis of effectiveness

Policy objective 1: Growing the local economy and social economy, particularly in deprived areas

The colours indicate an overall assessment of whether the policy lever has achieved the stated policy objectives

Assessment	Evidence / example
Lever more & new sources of private capital at scale: Guarantees have a strong track record in leveraging private capital by de-risking investments, creating investment products that wouldn't otherwise exist. Guarantees can be particularly useful in mobilising capital during periods of economic volatility when the risk appetite in the market is low, and investors are wary of allocating capital. Guarantees can also be useful in new and developing markets where there is limited data on risk profile for investors to base their decisions on.	The **Global Impact Investing Network** (GIIN) found that the size of a median guarantee in the US was \$2m while the median fund or project size was \$20m, creating a 10x mobilisation ratio.[146] Specific international examples of capital mobilisation include the achieved 3x mobilisation by **GuarantCo**[147] and the targeted mobilisation ratio of 10x by the **European Fund for Sustainable Development** (EFSD).[148] While post pandemic guarantees have been substantially more able to lever private capital into businesses which create social impact, 30% of SME lending from Responsible Finance members (members are **CDFIs**) was supported by the EFG prior to COVID-19. [149] Set-up in 2018, the **Community Investment Enterprise Facility (CIEF)** used the EFG, and later the CBILS and then RLS, to leverage in £30m of investment from Big Society Capital and £25.5m in match funding from Triodos and Unity Trust Bank. Managed by Social Investment Scotland, the fund has invested into four CDFIs across the UK between 2018-25.[150] In the second quarter of 2020, at the start of the pandemic, these CDFIs deployed nearly three times more loans and four times more capital, compared to the first quarter of 2020.[151] Overall these small businesses in receipt of CIEF loans employed 4,070 people.
Specifically supporting social enterprises and charities / SMEs in deprived areas Guarantees in themselves aren't targeted at enterprises in deprived communities, but the way they are used by social lenders can be significantly targeted, particularly when combined with other subsidy types like Community Investment Tax Relief and grants. Guarantees help overcome higher real or perceived risks by investors of investing in enterprises in less developed markets, including more deprived areas. However, this is reliant on guarantees being accessible to socially minded lenders.	**CDFIs** have a strong record in utilising guarantees to increase lending in deprived areas, lending £114m so far through CBILS and RLS.[152] 93% of CDFI SME lending and 79% of CDFI social enterprise lending is outside London and the South East, and 46% of CDFI SME lending is in the UK's 35% most deprived areas.[153] The **Community Investment Enterprise Facility,** noted above, made more than 50% of loans in the bottom 40% most deprived areas in the UK and close to a third were made in the bottom 20%.[154]

Policy objective 1: Growing the local economy and social economy, particularly in deprived areas	
The colours indicate an overall assessment of whether the policy lever has achieved the stated policy objectives	
Assessment	**Evidence / example**
Specifically supporting social enterprises and charities / SMEs led by and/or serving marginalised communities: As above, guarantees in themselves aren't targeted at enterprises in underserved / marginalised communities, but the way they are used by social lenders can be significantly targeted. As for the above objective, this is reliant on guarantees being designed in a way that is accessible for socially minded lenders.	13% of total **CDFI** loans have been made to ethnic minority-led businesses and 60% of CDFI lending goes to women-led businesses. This indicates significant success given only 6% of UK SMEs employers are ethnic minority-led and 16% are women-led.[155] N.B. guarantee-backed loans account for a proportion of all CDFI loans. The **Community Investment Enterprise Facility** made more than 12% of its loans to applicants from Black, Asian and ethnically diverse backgrounds, and 18% of its loans to female-lead applicants.[156] Social Investment Business collected data on the accessibility of the **Resilience and Recovery Loan Fund**, which provided loans to social enterprises and charities during COVID-19, and found that less than 40% of BAME-led organisations who applied were deemed eligible for investment. This compares to over 90% of women-led organisations. Of those that were eligible, there was a significant drop-off rate again in terms of approval. A similar trend was seen for LGBT-led organisations around eligibility although a higher proportion of LGBT-led organisations that were eligible were approved for loans.[157] Subsequently, Social Investment Business's successor fund, the **Recovery Loan Fund**, bolstered its offering by working with a grant provider, Access, to enable it to reach black and minoritised ethnicities, showing how the combination of tools is particularly effective as well as the importance of design. Amongst other things the grant has enabled the fund to reduce its minimum loan size from £100k to £50k for social enterprises and charities led by black and minoritised ethnicities as well as provide unrestricted grants alongside the loans of up to 100% of the value of the loan if needed.
Growing and building financial resilience and sustainability of social enterprises and charities: The guarantees introduced since the pandemic, and deployed to social enterprises and charities through a large number of specialist social lenders, have been highly important in helping those organisations sustain and / or pivot their operations while experiencing disruption to their normal model as a result of COVID-19.	For example, the **Royal Society for Blind Children** supports blind and partially sighted children and young people and their families. The charity has a proven track record of attracting donations however COVID-19 delayed major fundraising events, including the London Marathon which raises consistent amounts annually, and resulted in delays in processing legacies which are already committed. A £250k loan from the Recovery and Resilience Loan Fund provided working capital so that the charity could have a clear line of sight for 24 months, so rather than downsizing and cutting back, they were able to expand their reach, reduce the cost of service delivery and increase customer engagement.[158]
Builds a sustainable market for social impact investment: Guarantees are contributing to building an intermediary market of specialist social lenders who are adept in delivering this subsidy tool while creating familiarity between larger, mainstream investors and these niche social lenders. This is, over time, helping to build a sustainable market by developing a track record and the networks and relationships needed for future capital to invest.	Guarantees have succeeded in supporting a sustainable market of 25 business lending CDFIs with the track record and relationships needed for future capital to continue investing and scale. See Responsible Finance's **Annual Industry Report** alongside the **Knowledge Centre** for the **Community Investment Enterprise Facility** for examples of this. The US CDFI market is also instructive of where, with long-term support through guarantees, the opportunity for a sustainable, scalable market has been met. The **Resilience and Recovery Loan Fund**, set-up by Social Investment Business to make CBILS more accessible to social enterprises and charities during the pandemic, received investment capital from Big Society Capital (BSC). However, the successor fund, the **Recovery Loan Fund,** backed by RLS, went on to mobilise investment from not just BSC several investors as the track record of the product builds: Fusion21, The Archbishops' Council, MFS Investment Management and Treebeard Trust.[159]

Policy objective 2: Helping investors participate in the social impact investment market

The colours indicate an overall assessment of whether the policy lever has achieved the stated policy objectives

Assessment	Evidence / example
Reducing risk of higher risk or less proven investments, thereby improving risk/return: Effective at reducing the risk to investors, thereby catalysing new and additional investments where they would not otherwise be made.	**The Collaborative Healthy communities**: A US initiative where Kresge Foundation provided a $5m guarantee to leverage up to $132m (26 times the sum of the guarantee) from a wide range of investors. The figure includes senior debt from CDFIs, Goldman Sachs and others ($52m), junior debt from the Rockefeller Foundation ($3m), equity investment from individuals and corporates which also benefited from federal income tax credit ($33m) showing how subsidy tools can be used in combination. Other sources ($44m) include state and local contributions, a grant from a federal agency, and philanthropists.[160] The investment went into loans targeting health centres in the US.[161] In the UK, sources of capital to non-profit CDFI lenders such as BSC and social banks Triodos and Unity Trust Bank relied upon a loan guarantee scheme, and would not have been possible without it. Of course, the volume of lending is sensitive to the terms of the guarantee, particularly the amount of coverage and any portfolio cap. For example, Responsible Finance reported that on average, third party funding of CDFIs increased from between £1 and £2 for each £1 of risk capital under EFG, to between £2 and £5 for each £1 of risk capital under RLS.
Subsidises operational costs of delivery by lender: Guarantees can be designed in a way that reduces the operational costs for the lender. However, this is dependent on the design and doesn't always happen in practice. Guarantees that enable significant amounts of capital to be leveraged creates scale which may mean operating costs do not need to be subsidised.	Since the **RLS** was introduced in April 2021, CITR accredited organisations including Social Investment Business have benefitted from a fee discount of 50 basis points (bps) on the Scheme Lender Fee, a "social premium", meaning their fee is 100bps rather than 150bps.[162] This is in recognition of the fact that CDFIs and other social lenders operate in ways that are demonstrably solving for additional market failures and the discount has been highly beneficial to the sector. Additionally, while CBILS and its successor, RLS, charge a fee to the scheme's lenders, they do not charge a fee to the borrowers. This distinguishes it from the EFG where the borrower paid an annual guarantee fee of 2%. Interestingly, this is much preferred by lenders as, under EFG, borrowers viewed the annual guarantee fee as a type of insurance should they find themselves unable to repay which they reported became unhelpful.
Reduces complexity for investors: Guarantees are a well known tool for investors; the complication often arises for the investment intermediary / lender as they seek to access the guarantee and design the guarantee structure. Investment intermediaries / lenders report that guarantees are opaque, administratively burdensome and complicated to use, however important strides have been made on this since the pandemic by the British Business Bank, and this complexity shouldn't be passed by the lender onto the investor.	SIB's **Recovery Loan Fund**, mentioned above, has been successful in bringing in a diverse group of investors: founding investor the Fusion21 Foundation, the Church of England's social investment programme, Big Society Capital, MFS Investment Management and Treebeard Trust.[163] The process of accessing government guarantees prior to the COVID-19 pandemic was noted as particularly complicated by investment intermediaries / lenders. Schemes such as the ENABLE Guarantees Programme, often included a highly administrative application process and detailed eligibility criteria for the lending organisation.[164] According to one bank, in order to access such complicated schemes, capital providers have to calculate the guarantee amount their proposals are eligible for and file onerous paperwork: to undertake this process, they may have to employ third party services.

Policy objective 3: Better tailoring capital to the needs of social enterprises and charities and SMEs in deprived areas or led by and/or serving marginalised communities

The colours indicate an overall assessment of whether the policy lever has achieved the stated policy objectives

Assessment	Evidence / example
Improve affordability for investees or reduce other accessibility barriers: It is clear that guarantees enable lending to enterprises which wouldn't otherwise occur, on better terms than would otherwise be available to them - particularly those with insufficient assets that can act as collateral or track record. This is because inherent in the guarantee model is the reduction of risk to the investor; this enhances the credit standing of the borrower and so they can borrow more cheaply. The tailoring of capital is of course dependent on the terms of the guarantee and only since the onset of the pandemic have guarantees from the UK government been appropriately tailored to the needs of social enterprises and charities. Additionally, guarantees can be mixed with grant to tailor the pricing further.	This is evidenced, albeit for more mainstream enterprises, in the **EFG** programme which at the time made up 1-2% of the total SME lending market. The scheme was designed following the global financial crisis, and channelled capital into enterprises in the mainstream market, which as a result of the crisis were perceived to have become riskier. A study reviewing companies that received EFG support in 2009, alongside a control group of unassisted companies, found that the guarantee scheme enabled businesses that lacked collateral or track record to access credit.[165] Importantly, even though the businesses lacked collateral they were found to be 'not ailing or weaker' than other businesses. The various characteristics of pre-pandemic guarantees including the guarantee coverage, the guarantee fee, portfolio cap, etc. responded to the needs of mainstream SMEs, but not to the needs of social enterprises and charities. Amendments to these have been key in improving the affordability for social enterprises, charities, and SMEs creating social impact. By the end of 2020 the CDFI sector's **CBILS** lending totalled £63 million, with an average loan of £110,000 over 5 years at 12.29% interest. The **RLS** has enabled the **Recovery Loan Fund** to offer loans to social enterprises and charities from from £100k to £1.5m over 1-6 years at 7.9% per annum fixed and with an arrangement fee of 2.5-3%. All loans of up to and including £250k are provided unsecured.[166]
Provides flexibility of products to frontline businesses: While guarantees enable access to finance which would not otherwise exist, they typically lead to standardised product offerings, with lenders unable to provide as much flexibility as loan and grant blends to tailor products to borrower's needs. This depends on the design of the scheme and what's eligible and allowable with there often being a trade-off between scale and individual flexibility. The ability to access guarantee-backed loans can also be dependent on state aid rules (incoming subsidy control regime), meaning frontline enterprises which have already received some subsidy in the past may be prevented or limited from borrowing using guarantee-backed schemes.	By the end of 2020 the CDFI sector's CBILS lending totalled £63 million, with an average loan of £110,000 over 5 years at 12.29% interest.[167] The median amount of finance applied for by social enterprises is £50,000.[168]

Policy objective 4: Facilitating non-financial support for social enterprises and charities, and SMEs in deprived areas or led by and/or serving marginalised groups

The colours indicate an overall assessment of whether the policy lever has achieved the stated policy objectives

Assessment	Evidence / example
Provides technical assistance / capacity building for borrowers, supporting deployment: Guarantees aren't designed to provide technical support, at least directly. However, when used by social lenders, the subsidy can enable the lender to provide additional technical assistance. However, this outcome is reliant on the strategies of social lenders which may utilise guarantees, rather than being inherently designed to them. Additionally, by improving the terms for investees - e.g. the lowering of interest rates and requirement of collateral - borrowers retain more resources and are more able to pay for such support themselves. Nonetheless grants were viewed as the most effective type of subsidy for this purpose, best supporting enterprises who are not yet able to take on investment to become 'investment ready'.	A practitioner interviewed for this research noted that guarantees reduce the cost for CDFIs of providing loans, enabling them to deliver more pre and post-application support to investees: CDFIs have provided 16,550 hours of investment readiness support to businesses and social enterprises and 16,100 hours of post-loan support to businesses and social enterprises The interviewees also stressed that, even though guarantees can incentivise investors to support social enterprises and charities and impactful businesses, the required level of sophistication and infrastructure on the enterprise side is often not developed, and grants are seen as the type of subsidy that can best deliver such capacity building.

3.2.2.4. SWOT analysis

STRENGTHS
- Good at leveraging large amounts of capital through a standardised system
- Appropriate for stimulating investment in policy priorities and during turbulent economic times
- Familiar tool among investors including large institutions
- Can bring new investors onboard and can cover the operational expenses of lenders

WEAKNESSES
- Those that we have seen in the UK are not designed to serve deprived areas and/or marginalised communities, but social lenders who utilise guarantees often target these groups
- Given they are standardised, they are not as good at providing tailored capital, including smaller deals, lower cost or flexibility
- Enterprises which have already claimed some subsidy may be restricted from benefiting from guarantees under state aid/ subsidy control regulations
- Aren't inherently designed to facilitate non-financial support, but social lenders like CDFIs can use guarantees in order to provide this

OPPORTUNITIES
- Can reach scale if future schemes are designed appropriately
- Can provide a channel to larger-scale investors

RISKS
- Impact, reach and success hinges on design
- Could add administrative burden and time to set up depending on central processes
- Design may inadvertently exclude some parties if not clear on objectives upfront
- If only in place for a short period of time, it may undermine its success, especially re leverage
- Design can be restricted by competition regulation

3.2.3. Tax reliefs

3.2.3.1. Definition and purpose

Tax reliefs are designed to incentivise certain activities, often particular types of investments, by offering individuals or organisations a reduction in their tax obligation. Governments use tax reliefs to address market failures, further economic priorities and direct activities towards their economic and political priorities.

Tax reliefs are a familiar tool to many investors, and when designed appropriately can provide a substantial incentive for new investments to be made, especially in enterprises which would otherwise fall outside of the risk appetite of certain investors. As such, tax reliefs can channel capital towards parts of the market which require it.

One characteristic which distinguishes tax reliefs from other forms of subsidy is that they can be designed to target specific investor groups including individuals, corporates and charitable foundations in a way that is not possible with other policy levers. The ability to access investment capital from individual investors opens up a new source of capital for charities and social enterprises and SMEs creating social impact. Importantly, this can be inclusive, with individual investors ranging from HNWIs investing in the thousands, all the way through to members of the local community utilising tax reliefs to invest small amounts in a community pub.

In the US there is also another angle to using tax policy to drive investment with a social purpose. There, charitable foundations are mandated to distribute at least 5% of their investment assets annually for charitable purposes, either via grants or repayable finance. Failure to do so results in a 30% tax on the shortfall (i.e., the difference between the actual distribution and the 5% requirement).[169] The payout requirement is likely to be incentivising those foundations considering social impact investment strategies.

3.2.3.2. Data and examples of key tax relief schemes

There are a range of tax reliefs in the UK designed to incentivise investment into organisations which the government deems deserving of such financing, either due to their potential importance to the economy and/or the wider societal purpose they serve or to address market failures and create sustainable markets.

<table>
<tr><th>Scheme</th><th>Model</th><th>Benefits to social impact investment sector</th></tr>
<tr><td>Enterprise Investment Scheme (EIS)</td><td>EIS, launched in 1993, incentivises individuals to invest equity or shares in promising start-ups in the UK. Investors can claim initial income tax relief of 30% of investment worth up to £1 million per tax year. The investments are not subject to Capital Gains or Inheritance Tax.[170] Companies can raise up to £5 million each year, up to a total of £12 million, including amounts received from other venture capital schemes.[171]</td><td rowspan="2">Social enterprises and charities are permitted to consider seeking finance from EIS and SEIS investors but do not always meet the requirements due to their legal form or business structure. Chiefly, trading charities do not qualify for EIS and SEIS as they cannot issue shares. For those social enterprises who can, eligible social enterprises have to satisfy a trading test to demonstrate that their activities do not substantially include non-trading activities. Furthermore, usage amongst social enterprises has declined in recent years since the 'risk to capital' condition when introduced in 2018. The condition stipulates that the investment being made 'has objectives to grow and develop its trade in the long-term' and that there is a significant risk that there will be a loss of capital of an amount greater than the net investment return. This means that social enterprises which are looking to raise investment to fund the development of community assets, e.g. a community pub, no longer have the option of using EIS or SEIS.</td></tr>
<tr><td>Seed Enterprise Investment Scheme (SEIS)</td><td>SEIS launched in 2012 and is similar to EIS but focused on very early-stage companies and offering a greater level of income tax relief of 50%. The limits are also slightly different for companies.[172]</td></tr>
<tr><td colspan="3">Two tax reliefs specifically focusing on disadvantaged communities and social enterprises and charities were introduced as a response to the challenges the EIS and SEIS criteria posed in order to help level the playing field. In section 4.2.3.3. we focus on analysing the effectiveness of these tax reliefs - CITR and SITR - and base our assessment on their track record to date, rather than the potential for tax reliefs more widely. This is illustrative in and of itself that a tax relief's impact, reach and success hinges on its design.</td></tr>
</table>

Scheme	Model	Benefits to social investment sector
Community Investment Tax Relief (CITR)	Launched in 2002, CITR, incentivises individuals and organisations to invest in businesses and other enterprises (including non-profits) in disadvantaged areas by investing in CDFIs.[173] Wholesaler CDFIs distribute funding to retail CDFIs, which directly invest in the enterprises. The tax relief is worth up to 25% of the value of the investment in the CDFI, spread over 5 years (5% per year). Individuals receive income tax relief and organisations receive corporation tax relief. For example, an individual investing £40,000 into a CDFI would receive £10,000 in income tax relief - £2,000 per year over 5 years. This is in addition to the return on investment – although there is little or no protection against risk. The maximum loan that CDFIs can make is £250,000 for non-profit enterprises and £100,000 for profit-seeking enterprises. Non-profit enterprises are defined here as: • Public sector projects, or; • Projects benefiting charities and other non-profit-distributing bodies which are engaged in public function, or; • Small-scale projects of a purely local nature.	From 2002 – 2017, CITR generated £145 million of investment into CDFIs, facilitating £127 million of lending into small enterprises in disadvantaged communities. This investment has created over £1.5 billion of value to local economies, with a cost to the taxpayer of around £36 million.[174] Statistical data shows that from the financial year 2017-18 to 2020-2021, CITR raised a further £72m, bringing the total to £218m.[175] Individuals have invested around £100 million via CDFIs which are also banks, and £7 million into non-bank CDFIs. The rest has been invested by banks claiming corporation tax relief.[176] Charity Bank is one example of an investor who has utilised the offer. The bank is the scheme's most significant user, making more CITR qualified loans and investments with CITR attached each year: for every £1 of CITR, Charity Bank makes £8 of loans.[177] CITR's requirements on postcode lending and lending to disadvantaged groups compels Charity Bank to focus on deprived geographies and marginalised groups.
Social Investment Tax Relief (SITR)	SITR, launched in 2014, incentivises individuals to invest in social enterprises and charities by offering a reduction of 30% of the investment in that year's income tax bill. Investors can invest up to £1 million per year, directly into enterprises or indirectly via investment platforms, and must retain the investment for at least three years. It was modelled on EIS to provide familiarity for investors and fund managers,[178] but with a focus on social enterprises and charities instead of start-ups.[179] The scheme was introduced to address the struggles facing social enterprises and charities in raising finance, both because of often being ineligible to partake in other tax relief schemes such as the EIS, and because of the prevalent perception that a focus on impact could compromise profitability.[180] Through SITR, an individual investing £40,000 would for example receive £12,000 in relief on their current year's income tax bill. This is in addition to the return on investment – although, like CITR, there is little or no protection against risk. Individuals can buy shares or lend money. The inclusion of both debt and equity investment differentiates SITR from EIS and SEIS, which only apply to the latter. SITR defines social enterprises as charities, community interest companies and certain types of community benefit societies. As with EIS and SEIS, the enterprise must be engaged in a qualifying trading activity, which excludes those solely reliant on voluntary, donated or investment income. Enterprises must have a statutorily defined asset lock, which excludes certain community benefit societies and charitable community benefit societies, and all co-operative societies. They must also have no more than 250 employees or more than £15m in gross assets.[181]	To date, over 180 investments have been conducted using SITR, totalling £18.6million.[182] SITR has roughly a 60:40 split between equity and debt, with many organisations issuing community shares alongside the relief. While SITR was originally aimed at the HNWI investor, the design of the scheme is considered to have restrained growth among this investor type.

CASE STUDY

Social Investment Tax Relief (SITR)

Using tax relief to support social enterprises and charities has been an innovative concept. The evidence shows that SITR has supported the growth of the social economy to an extent, although its design as well as other factors such as poor awareness amongst investors have limited its success.

HMT estimated that total SITR deal flow would be £83.3m in the first 3 years but SITR only achieved £5.1m during this period.[183] While there are around 180,000 charities, community benefit societies and community interest companies legal structures in scope for the relief, analysis by Get SITR suggests a potential market size of over 30,000 organisations that could realistically consider making use of the relief.[184] To date far fewer have applied with SITR delivering £18.6m of investment into 185 organisations.[185] In 2019, Social Investment Business (SIB) commissioned research which found that SITR was not meeting the specific needs of social enterprises and charities. It found that SITR faces five key challenges:[186]

- **a lack of awareness** – out of the 30,000 organisations that could realistically consider making use of SITR, only 505 have applied for the relief since its launch in 2014.[187]
- **slow and frequent legislative change** – previous legislative changes to SITR were impacted by significant procedural delays, plausibly hampering the improvement and use of the relief. The regularity of changes to the scheme have also prevented continuity and market confidence.
- **unfit for purpose** - SITR was found to fall short of effectively addressing the specific needs of charities and social enterprises. The research referenced a number of eligibility exclusions as a key driver of this, e.g. energy generating activities and restrictions on hiring out of premises, which community organisations often do to generate additional revenue. The rules around charities taking on investment for use by trading subsidiaries were also felt to be complicated and not appropriate for many charities.
- **process challenges** – The report found that the general experience of the application process for SITR was negative, with many experiencing waiting times stretching up to 6-10 months, which could create uncertainty for potential investors.
- **a lack of pipeline or mismatch between supply and demand** – the scale and risk profile that commercially minded investors are looking for often do not match that which social enterprises and charities are able to offer. It might also be that there is a current lack of appropriate platforms or adequate support to enable compatible investors and investees to identify each other.

Responses to HMT's 2021 call for evidence reflected many of the same challenges, with around three-quarters of the respondents reporting that they had difficulty using SITR. Reasons cited included low awareness, unclear or insufficient guidance and complex eligibility restrictions. Another related reason that was cited was that social enterprises and charities often had limited resources to manage SITR's complex processes.[188] For example, one investment intermediary interviewed for this study reported that around half of their community share investors qualifying for SITR do not claim the relief for this reason.

It is important to note that a number of the challenges described are the unintended consequence of restrictions aimed at preventing aggressive tax planning strategies and ensuring the tax relief is operating efficiently.

While there is constructive criticism from the sector on SITR, particularly around its track record in mobilising capital at scale, there is support expressed for the relief too, mainly focused on its ability to provide tailored capital to social enterprises and charities and target specific investor groups as we highlight in the table below.

However despite these bright spots, endorsements and importance, SITR has fallen short of its potential. A tax relief for social enterprise should be the ideal fit – scalable, adaptable, avoiding dependency on subsidy and encouraging risk-taking, but SITR as currently executed constrains that potential. The view widely held in the sector is that SITR has the potential to be a far more effective policy lever and reach individual investor groups that other policy levers cannot, but that a significant redesign that maintains the core objective while addressing the issues around eligiblity and process is needed for that potential to be realised.

3.2.3.3. Analysis of effectiveness

In what follows we focus on the effectiveness of the existing social impact investment tax reliefs - CITR and SITR - and base our assessment on their track record to date, rather than the potential for tax reliefs more widely. This is illustrative in and of itself that a tax relief's efficacy is highly dependent on having the right design principles and application.

Policy objective 1: Growing the local economy and social economy, particularly in deprived areas

The colours indicate an overall assessment of whether the policy lever has achieved the stated policy objectives.

Assessment	Evidence / example
Leveraging more and new private capital at scale: This type of subsidy has been significantly successful in achieving government policy objectives in certain contexts, as exemplified by the long track record of EIS and SEIS tax reliefs. However, due to their design they are not successful at supporting social enterprises and charities. CITR has been successful at leveraging capital into enterprise lending in disadvantaged and deprived communities through CDFIs. It is increasingly integral to the capital raising strategy of many of them. Its impact is multiplied when paired with the Recovery Loan Scheme. SITR, due to a range of factors including its design, has not been successful at leveraging capital at scale to support its target beneficiaries. Tax reliefs can be successful at achieving their policy objectives, but this is highly dependent on the right design principles and application.	CITR: CITR has had significant success at mobilising investment into marginalised communities. From 2002 – 2017, it generated £145 million of investment into CDFIs, facilitating £127 million of lending into small enterprises in disadvantaged communities. This investment has been estimated to have created over £1.5 billion of value to local economies, with a cost to the taxpayer of around £36 million.[189] Statistical data shows that from the financial year 2017-18 to 2020-2021 CITR raised a further £72m, bringing the total to £218m.[190] SITR: Since 2014, SITR has mobilised £18.6m of investment into 185 organisations.[191] SITR: **Future Wolverton**: In 2019, a Community Benefit Society in Milton Keynes acquired and restored a derelict schoolhouse, and reopened it as a community hub. Money was raised through Community Shares Booster – a £3M programme funded by Power to Change that offers development grants and up to £100k match funding to projects that demonstrate high levels of community engagement, innovation and impact. They invested on equal terms with 125 community shareholders, many of which were eligible to claim SITR. The community share offer attracted a total of £121,666.[192]

Policy objective 1: Growing the local economy and social economy, particularly in deprived areas

The colours indicate an overall assessment of whether the policy lever has achieved the stated policy objectives.

Assessment	Evidence / example
Growing and building the financial resilience and sustainability of social enterprises and charities: Tax reliefs have varied potential to grow and build the financial resilience and sustainability of enterprises depending on their design and uptake. CITR, given it improves access to and affordability of capital, is seen as doing this moderately well. SITR enables significant tailoring of capital to enterprises which make use of it. This can translate into positive impacts on the financial resilience and sustainability of enterprises, but due to its low uptake this hasn't been demonstrated at scale.	SITR: Positive organisational impacts resulting from the use of SITR through the **SIS Community Capital scheme** included: **Just Trading Scotland** is a fair-trade enterprise which was set up to facilitate the import and distribution of fairly traded food products to the UK. SITR enabled them to fund a step-change in their growth as part of a rebrand and repackaging exercise and reach a wider retail market. In doing so they have been able to use trade to help grow a global supply chain that gives smallholder farmers and craft workers a fair and equitable way to sell their goods. **Street League** supports 14-30 year olds to make the transition from school or unemployment into sustainable and fulfilling jobs. They use the power of sport to build positive relationships with young people. SITR helped to fund a new mobile team to run rural football academies across Scotland.[193]
Specifically supporting social enterprises, charities and SMEs located in deprived areas: CDFIs have successfully proven that tax reliefs - namely CITR - can be geographically targeted at areas of deprivation which are underserved by mainstream finance.	Overall, 93% of CDFI SME lending and 79% of CDFI social enterprise lending is outside of London and the south east. It is estimated that CITR comprises 10% of CDFI lending.[194]
Specifically supporting social enterprises, charities and SMEs led by and/or serving marginalised communities: SITR could be said to do this indirectly, to an extent, as is only accessible to social enterprises and charities which are proportionally more likely to be led by and serving marginalised communities. CDFIs disproportionately serve SMEs led by marginalised communities - e.g. ethnic minority-led businesses - and so CITR also does this, but not by design, rather due to the social purpose of CDFIs.	Overall, 13% of CDFI loans have been made to ethnic minority-led businesses and 60% to women-led businesses. This indicates significant success given only 6% of UK SMEs are ethnic minority-led and 16% of are women-led.[195] It is estimated that CITR comprises 10% of CDFI lending.[196]
Delivering a sustainable social impact investment market: Tax reliefs are generally created to alleviate temporary or permanent market failures or achieve a policy objective. Reliefs like CITR and SITR can leverage additional investment into the social investment market (while they exist - they are reviewed every 7 years). They do have the potential to create a sustainable market for social impact investment - for example, through building a track record, growing investors' familiarity with social investment products, and developing intermediary markets. However, to date this potential has not come to fruition for SITR.	SITR: **SIS Community Capital scheme:** The first UK co-investment fund that raises capital using SITR, run by Social Investment Scotland. A total of £399k was invested into 7 charities and social enterprises across Scotland, and investors received full capital back with interest.[197] Progression of social bank sector to greater sustainability - e.g. one quarter of all the deposits of Charity Bank are CITR based.[198]

Policy objective 2: Helping investors participate in the social impact investment market

The colours indicate an overall assessment of whether the policy lever has achieved the stated policy objectives.

Assessment	Evidence / example
Reducing risk of higher risk or less proven investments, thereby improving risk/return: The underlying investments can be inherently risky (either perceived or real) - and the tax reliefs do not reduce that risk, i.e. the likelihood of default. However, tax reliefs compensate investors for some of the risk taken, providing an added financial incentive when they are less motivated by the social impact aspects.[199] The coverage is not as substantial as guarantees where in CBILS, for example, the government guarantees up to 80% of the loss amount. The buffer against loss is a maximum of 30% for SITR.	The track record of CITR - and to a lesser extent SITR - does indicate that investors have been mobilised to invest in CDFIs and thus the social impact investment market. CITR for example lowers the cost of capital by giving investors 5% per year in tax relief (for 5 years) who are then prepared to accept a lower rate of return. CITR: **Charity Bank** is one example of an investor who has utilised the offer. The bank is the scheme's most significant user, making more CITR qualified loans and investments with CITR attached each year: for every £1 of CITR, Charity Bank makes £8 of loans.[200] SITR: In 2020 the Community Shares Unit reported that of those community share investors influenced by the offer of tax relief, 70% have invested more than £1,000 in community shares overall and 24% have invested more than £10,000. In contrast, 71% of those not influenced by tax relief invested less than £1,000 in total and only 5% invested more than £10,000. This indicates that the tax relief influences community share investors to invest more.[201]
Subsidises operational costs of delivery by lender: CITR is used to subsidise the operational costs of the intermediary. Some of the benefit may be passed on to the enterprise raising the investment. SITR however applies directly to enterprises raising investment and cannot directly subsidise operational costs of the lender as such.	In the stakeholder interviews one organisation noted that it uses CITR to subsidise its costs to the extent that it enables or enhances lending terms that would not otherwise be possible.
Reducing complexity for investors: Claiming tax reliefs can be administratively burdensome for investors (and investees alike) - particularly as these investors are often members of the general public rather than financial institutions. CITR is easier to use than SITR as the administration is often handled by intermediaries rather than individuals. However, organisations lending using CITR must be profitable over the years they wish to claim the tax relief (up to 5 years) which can introduce additional pressures. Overall the complexity and ease with which schemes can be accessed is dependent on a number of factors, including design, intermediary provisions and familiarity with the tool.	SITR: Before claiming SITR, each investor must receive their own individual compliance certificate from HMRC, which has been applied for by the social enterprise and passed on to them. The interviews for this study highlighted that the requirement for those claiming CITR to be profitable can lead to investors asking investment intermediaries to cover the charge if they're not profitable in a particular year to make up for the lack of tax relief.

Policy objective 3: Better tailoring capital to the needs of social enterprises and charities and SMEs in deprived areas or led by and/or serving marginalised communities

The colours indicate an overall assessment of whether the policy lever has achieved the stated policy objectives.

Assessment	Evidence / example
Improve affordability for investees or reduce other accessibility barriers: SITR has been successful at enabling investments which are affordable - e.g. 5-6% - with SITR products offering some of the lowest interest rates of all the subsidy tools. Although, this has not been demonstrated at scale due to the low take up of the relief. SITR is also considered particularly patient as the terms dictate that an enterprise must not begin repaying the investor until 3 years and 1 day has passed since the capital was borrowed.	SITR has enabled lending at much lower interest rates to organisations that do not have security in the form of a substantial asset. For example, Resonance's SITR loans are currently offered at 6-7% total cost per annum when otherwise this figure would be significantly higher. CITR: the CDFIs are the "investees" and the tax relief has lowered the cost of capital for them, which they may choose to pass on to borrowers. However, while the CITR has been seen to improve the accessibility of products for borrowers it hasn't necessarily resulted in a low cost of capital for enterprises, with CDFI enterprise lending averaging around 12% per annum.[202]
Increases flexibility of investment products to frontline businesses: The SITR investments which are 'DIY' - meaning social enterprises and charities set them up themselves without an investment intermediary - and those which are through community shares raised on a crowdfunding platform offer a particularly high degree of flexibility as they are free to set their own terms. For example, length of time until repayment, cost of capital, and they can also take on small amounts from a large number of investors. CITR is less flexible. In theory it only subsidises costs to the intermediary (CDFIs) and it is up to the CDFIs whether the cost reduction is passed onto the lender.	**The Spotted Cow** is a community hub that offers a bar, restaurant, Post Office and B&B under one roof. They used SITR to raise £277,000 through community shares at a rate of 3% over 3 years (min). **Portpatrick Community Benefit Society** used SITR to raise £39,700 through community shares to save their local harbour. The terms were 1.5% interest rate over a duration of 5 years. Local restaurants, shops and businesses benefit from the influx of visitors to the newly refurbished harbour.

Policy objective 4: Facilitating non-financial support in deprived areas or led by and or serving marginalised communities

The colours indicate an overall assessment of whether the policy lever has achieved the stated policy objectives.

Assessment	Evidence / example
Provides technical assistance / capacity building for borrowers, supporting deployment: CITR reduces the cost of providing loans for CDFIs, enabling them to deliver more pre and post-application support to investees. There has been some limited anecdotal evidence of SITR deals resulting in support between the investor and organisation. However, SITR also creates a substantial need for support among investees because of its complexity. Overall, facilitation of non-financial support isn't an inherent feature of tax reliefs.	SITR: Investor support is minimal where there are funds intermediating. However, in 'DIY' SITR deals there are various anecdotes of investors providing in-kind support. Community businesses such as pubs that are funded through SITR and community shares are also in the unique position where many of their investors are actually their customers. CITR: As noted above, CDFIs provide thousands of hours in business support alongside their lending.

3.2.3.4. SWOT analysis

STRENGTHS

- Track record of achieving policy objectives if designed well
- Can provide substantial tailoring of capital for borrowers, including affordability, patience and flexibility of capital
- Policymakers can target particular investors of their choice (deepening on design) including individuals

WEAKNESSES

- Can be an unfamiliar tool to investors with the administrative cost and complications off-putting relative to the tax relief received
- Competition regulation can restrict the parameters of the scheme

OPPORTUNITIES

- Has the potential to unlock new sources of capital for the social impact investment market which guarantees and blend cannot - specifically, individual investors including high net worth individuals and / or members of the general public

RISKS

- Impact, reach and success hinges on design
- Lack of consistency and confidence in the longevity of the tool, especially where the future is unclear and rules change frequently
- Greater risk of abuse than with other tools, which may restrict the design of the scheme

4. Conclusions

This evaluation of the three different types of government subsidy – grants, guarantees and tax reliefs – in the context of social impact investment has highlighted several important differences in how they have been used to date which we highlight in the following conclusions. It has also shown that these differences in their usage are largely driven by design choices and there is a much wider set of possible outcomes for these tools, with the international examples and barriers identified providing a view on this. The tools are complementary to one another, none of them providing a complete solution, but bringing added value when deployed together, allowing their different strengths and weaknesses to complement and compensate for each other.

Grant

- Blended finance structures and products must balance a wide range of interests - the requirements of the capital providers, the constraints of the grant source, the objectives and needs of those delivering the funds and the needs of enterprises that the programme will ultimately serve. Despite this, they have shown to leverage private capital especially from mission-led and socially-minded investors while delivering a product that enterprises need and would otherwise not exist.
- Through their provision of capital which is more affordable, flexible and patient in the UK there are good examples of blended structures and products being well suited for small and early-stage social enterprises and charities, where the tool has been applied over the past 5 years, as well as during periods of economic volatility due to the speed by which they can be delivered.
- While guarantees have a stronger track record in leveraging private capital, grants typically allow for the highest degree of flexibility. Guarantees have enabled larger volumes of lending to happen on standard terms however grants enable higher degrees of flexibility in terms, and with capacity building support alongside. This has enabled social investors using grants to reach deeper into marginalised communities. For example, the Recovery Loan Fund, backed by the RLS guarantee, has also taken on grant to deepen its reach. Amongst other things the grant has enabled the fund to reduce its minimum loan size from £100k to £50k for black and ethnic minority-led social enterprises and charities as well as provide unrestricted grants alongside the loans of up to 100% of the value of the loan if needed.
- Those interviewed reported that over time, loan and grant blends can reduce grant-dependency for social enterprises and charities. By taking on repayable finance that they would not otherwise, they are able to grow new sources of income such as through trading while reducing their reliance on other income streams such as charitable donations.
- Both Access's blended structure and products are well regarded, with all stakeholders, as well as independent evaluations, being positive about the model and the impacts being achieved.
- Despite these benefits, there are currently too few blended finance structures and products to fully realise the potential of the tool, with the level of blended finance flows heavily reliant and restricted by the limited availability of public or philanthropic grants.
- Considering blended finance is overcoming persistent market failure, a significant and enabling opportunity for the social impact investment sector is a long-term, reliable source of grant to mount blended structures and products. This would support sustained market development and also help to attract other grant funders and investors.

Guarantees

- Guarantees can be most powerful for de-risking investments and mobilising investors for whom the risk of capital loss would otherwise be too high or may be suited to making lower risk / return investments. While other subsidy tools do indeed de-risk investments, guarantees have done so in larger volumes and are arguably the most efficient, as the subsidy is only paid out in the event of default. They have proven particularly helpful during periods of economic volatility when there is a high priority to mobilise capital to on the ground organisations but private capital, given the economic context, tends to become highly risk averse.
- Guarantee schemes were out of reach of many social investors up to the pandemic when positive changes were made, with important strides being made by the British Business Bank. Key changes to guarantee coverage, fee and portfolio cap, amongst others, enabled guarantees to better respond to the needs of social enterprises and charities, and SMEs in the most deprived communities or led by and/or serving communities marginalised or underserved groups - e.g. enabling lending on accessible terms to organisations unable to provide assets as collateral. This can multiply the benefits by enabling the creation of products which address a number of policy priorities. Interestingly, around 30% of CDFI loans were covered by guarantees even before the pandemic.
- While CBILS was more accessible than historic schemes, the Resilience and Recovery Loan Fund (RRLF), backed by CBILS, failed to penetrate marginalised communities: less than 40% of BAME-led organisations that applied were deemed eligible for investment, compared to over 90% of women-led organisations. This is where fund design, but also the combination of schemes - e.g. a grant blend and guarantee - can be helpful. Taking the learnings from the first fund, the successor to the RRLF (the Recovery Loan Fund, managed by Social Investment Business) worked with grant provider, Access, to lower eligibility thresholds even further for social enterprises and charities led by people from black and minority ethnicities.
- The US CDFI sector is instructive, showing that well-designed, guarantees with higher coverage can catalyse significant sector growth. Combining learnings from the use of guarantees in the US market with the relative success of CBILS and RLS underscores the potential positive impacts for the social impact investment sector for maintaining a guarantee scheme that is accessible to charities and social enterprises, and impactful SMEs.

Tax relief

- EIS and SEIS can technically be used by community enterprises and social enterprises, as well as social ventures such as those invested in by Bethnal Green Ventures. In reality, access is restricted.
- CITR is well understood by those who have utilised it, and is facilitating a flow of capital into 20 of the 35 CDFIs that it seeks to target. Its potential could be maximised through greater awareness and education among those investors who have not engaged with it to date and through further improvements to its design.
- SITR requires changes in order to fully realise its ambition. HMT estimated that total SITR deal flow would be £83.3m in the first 3 years but it only achieved £5.1m. Currently over 180 organisations have availed themselves of the tax delivering £18.6m of investment since 2014. Several factors have inhibited its growth: restrictions on eligible trading activities (excluding the most proven social enterprise business models); a lack of awareness of the relief; widespread belief that SITR was too similar to EIS and not targeting the specific needs of charities and social enterprises; slow administrative processes around the relief; and unclear or insufficient guidance on its uses.
- A tax relief for social enterprises should be the ideal fit – scalable, adaptable, avoiding dependency on subsidy and encouraging risk-taking, but SITR as currently designed constrains that potential. Enabling social enterprises and charities to use the relief to (for example) develop properties, and simplifying terms around investment subsidiaries and ownership restrictions, would enable better uptake of the relief.
- Tax reliefs have been used consistently by governments to deliver policy objectives such as economic growth, tackling market failures and creating social value. While the UK tax schemes are not fully delivering on these objectives for the benefit of social impact investment, if designed appropriately they have the potential to do so.

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7. Annex 1. The role of other policy levers

Beyond subsidy, there are other policy levers available to the government that can be used alongside subsidy to address the broader range of barriers and catalyse further social investment. These were mentioned frequently by stakeholders. They include:

- Regulation – such as establishing frameworks, disclosure requirements and taxonomies around social and environmental objectives, or as in the US, the legal requirement for private foundations to annually distribute 5% of their assets – particularly focused on increasing investor participation.
- Accelerators and Incubators – to support early-stage organisations and which often rely on public sector or university funding - hence focused on facilitating non-financial support.[205]
- Infrastructure provision – such as the development of support networks for particular communities, geographies or business models, or the creation of data and information networks – addressing the policy goals of growing the social economy and increasing investor participation.
- Market-building and championing – such as Big Society Capital's role in developing the market to date, focused on growing the social economy and increasing investor participation.