

Evolution, not revolution

Insights from 10 years of
social investment

Insight Report 3

June 2018

2018 marks the 10-year anniversary of our Social Investment Fund. As an active proponent of the social investment market we've taken the opportunity to celebrate the fund's achievements and reflect on what we've learnt along the way. We've considered our approach and provided some insights and reflections as we look back over 10 years and start thinking about where we're going as an investor in the future.

At the Esmée Fairbairn Foundation, we try and avoid making claims on any achievement or progress since we know that it would be unjustified. This report tries to stay true to that tradition whilst at the same time sharing, with pride, the learning and insights that we have gained from our 10 years as a social investment practitioner. The 'Esmée Way' is characterised by three things: the first is understanding that what makes a good social investor is deep knowledge and expertise of the issues and sectors we invest in; the second is that social investment sits alongside grants and contracts in a kaleidoscope of funding options for organisations on the ground; the third is that the practice and ethos of investing changes fundamentally if impact is fully respected as a key consideration.

Our approach, or 'the Esmée Way' is described in this document. We hope it is helpful but, more than anything, that it raises awareness of where and how social investment can sit usefully alongside other tools and forms of funding to help the remarkable organisations who do so much on behalf of all of us.



Caroline Mason

Caroline Mason
Chief Executive

Introduction

Esmée Fairbairn Foundation has a £45m Social Investment facility. The funds are a separately managed allocation of our main endowment and invested to support social, artistic and environmental impact.

Our stated objective is to achieve a net breakeven position across the portfolio as a whole and recycle the funds.

Our investments include loans, bonds, equity, and quasi-equity. We invest in a diverse range of organisations including charities, social enterprises, community benefit societies and other social investment funds.

126
investments

£48.2m
committed

Generating a positive
return 1% net IRR

£40m
invested

Worked
with over 50
co-investors
across the
public, private
and social
sectors

£18.2m
repaid
to date

45% of funds
drawn have
been recycled

£1.4m written off and
£1.3m of provisions made



Caroline Mason, Trupti Patel,
Jules Tompkins and Sharon Shea,
our social investment team

Our investments are helping to:



lay a network of 480km of broadband
cables between Manchester and
Edinburgh (B4RN);



open a pub generating profits that
fund new theatre productions each
year (Live Theatre);



house 1,339 people at risk of
homelessness (Real Lettings Property
Fund and National Homelessness
Property Fund);



create hundreds of new habitats for
the protected species of Great Crested
Newt (South Midlands Newt
Conservation Partnership);



transport over 23m passengers on
buses run by one of the largest social
enterprises in the UK (HCT Group);



create a flotilla of boats made from
recycled plastic found in the River
Thames (Hubbub); and

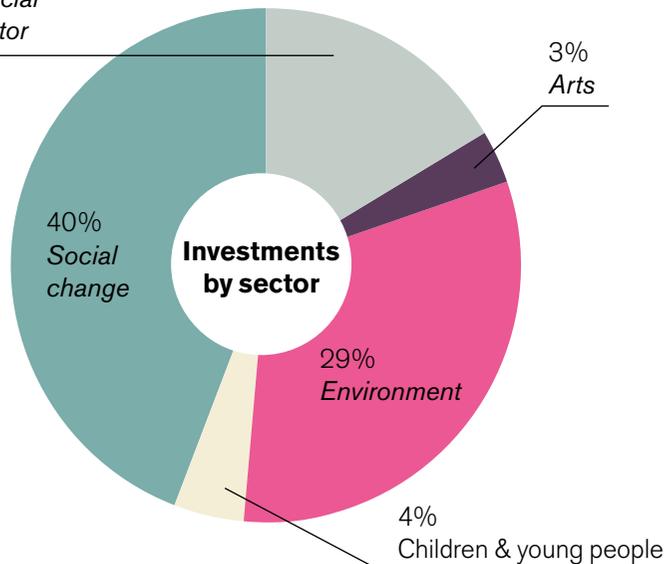


purchase £13.8m of land across the
UK, transferring 1150 hectares into
the ownership of conservation
organisations (RSPB, Wildlife Trusts,
Woodland Trust).

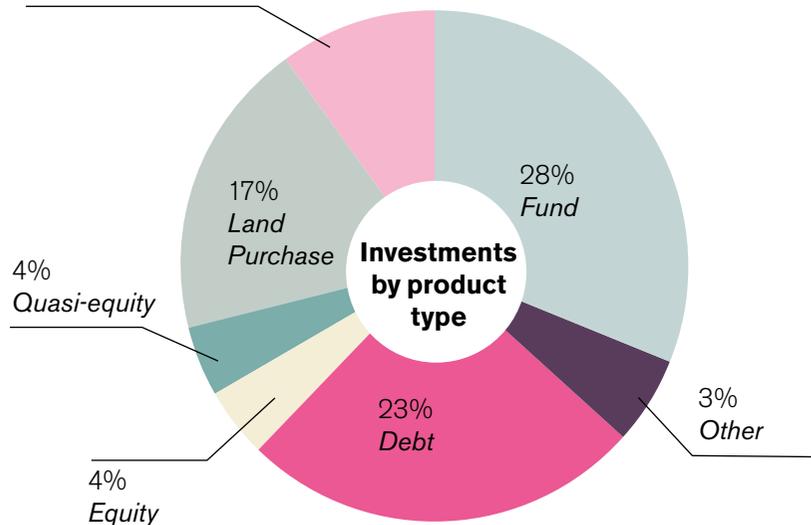
Celebrating 10 years of social investment

Snapshot 2013

15%
Building the social investment sector

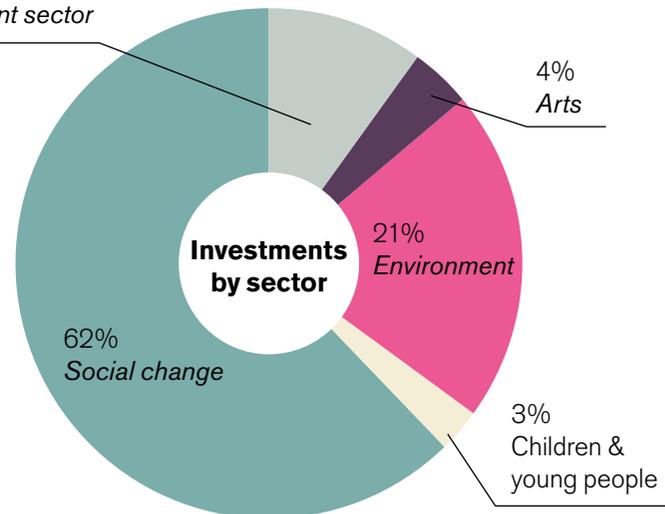


5%
Social Impact Bond

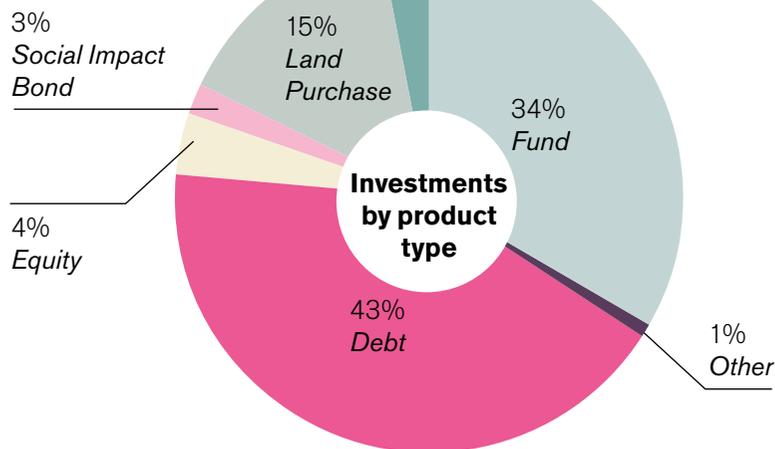


Snapshot 2018

10%
Building the social investment sector



2%
Quasi-equity



Our portfolio is dynamic, changing all the time but looking back over the years, we've seen it evolve as the market has expanded and the appetite for social investment has grown. Taking the past five years for example, as Big Society Capital has become established, we reduced our market building activities from 15% to 10% and have increased our investment through debt from 23% to 43%, reflecting our move closer to the organisations we support through our grant making. We've seen our capital repayments go from £1.99m in 2013 to £18.2m in March 2018 and we are thinking about our future, so we can continue to invest where we're needed, and are asked to, by those that understand best what the issues are on the ground. The picture also highlights areas where we'd like to do more. Our level of investment in the Arts and Children & Young People sectors have not increased over the past five years, remaining overall at 2013 levels.

How is our money invested?

Our Insights

126 investments have provided a lot of opportunities to learn what works, but also to understand when things haven't gone to plan and what could have been done differently.

Looking Ahead

- 1. Can we capitalise organisations better?**
- 2. The risks for our portfolio and the market generally**
- 3. How social investments have influenced the way we invest our endowment: our new ESG policy**

The Esmée Way

1. Impact first

Social, environmental and artistic impact is our starting point.

2. Understanding what organisations need

Some of our most impactful investments result from the Social Investments and Grants Managers working together to address issues faced by a particular organisation or sector.

3. Just one tool in the box

Our aim is not to find opportunities to use social investments but to use them to help organisations thrive and create impact.

4. Bring more money into the sector

We have always had an objective to grow the wider social investment market by facilitating the flow of new money into the sector and encouraging the adoption of social investments.

Executive Summary

1. Start with the impact, not the investment vehicle. Identifying the right financial mechanism to support impact starts with fully understanding the issue to be solved. Being led by those on the frontline helps to maximise the potential from an investment. We haven't always got this right. There remains a tension in some sectors between the familiarity of debt and the need for longer-term patient capital like equity.

2. Good impact investing relies on an in-depth understanding of the issue being tackled and the sector you're investing into. In our case, we can draw on the extensive expertise gained from our grant making and in-house sector experts. For sectors where we don't have the required knowledge or technical expertise in-house, we engage external specialists and try to share this wherever possible with other co-investors.

3. Trust and relationships are key to our social investments. This is reflected in our collaborative approach to due diligence, the desire for simplicity in our legal agreements and our light touch monitoring post-investment.

4. Relationships with investees need to be balanced and set out from the start. We've learnt it's difficult sometimes to be a financial investor and a social impact partner at the same time. Communication and a mutual understanding of expectations is key.

5. Keep it simple. Overly complex legal agreements and monitoring arrangements can burden and distract investees. We have also found investment structures like quasi-equity can be more difficult to arrange and implement in practice.

6. Our flexibility is an asset. The process of making and managing social investments can unfortunately, at times, be slow and complex. We aim to be flexible in our decision making so we can respond at the right time, like when our Land Purchase Facility requires fast turnaround times. We're prepared to make concessions in our terms and conditions if it helps deepen impact and we take a pragmatic approach if things don't go exactly to plan.

7. Impact measurement is a challenge. For organisations working on complex issues, success is not defined by houses built, job numbers or exam results. And social investment often plays a small part in a wide range of support individuals receive. Attempting to define the total impact of Esmée's social investment fund would not be helpful to us or others. It is more important that we learn from each investment and use that learning to refine our approach as we go, increasing the strength of support for each organisation we fund.

8. It's still early days for social investments and our learning is evolving. The market is young and social investments are long term. It is important to allow time for new models and ideas to prove themselves and resist the temptation to celebrate early successes too quickly at the risk of putting unnecessary pressure on the organisations we invest into. A fuller picture of our impact and learning will evolve over a longer time frame.

9. We've underestimated the difficulties faced by a social enterprise aiming to disrupt or launch in commercial markets. Our social investments in this area have tended to fail more than they've succeeded. We've learnt that we need question more why the organisation is best placed to launch such a product or service, what competitive advantages do they bring, do they have the right people with expertise of operating in commercial markets and do they have sufficient funding for the long term.

10. Foundations play a key role in the sector. There is a growing number and diversity of social investors mostly thanks to Big Society Capital's role in the market. However, there is still a role for foundations to play, particularly in supporting models which are early-stage and unproven and therefore demand a higher risk appetite.

Our insights

126 investments have provided a lot of opportunities to learn what works but also to understand when things haven't gone to plan and what could have been done differently. As an active player in the social investment market we've watched it expand and transform over 10 years.

1.

Can we capitalise organisations better?

There is a considerable amount of money in the social investment market but social investors (including us) struggle to properly capitalise organisations. We work in short cycles and our investees are constantly needing to refinance. This makes them take small steps and uses up a lot of their resources instead of being able to focus on their mission. We are exploring more long-term, patient capital structures such as equity, particularly in capital-intensive sectors such as financial exclusion.

2.

The risks for our portfolio and the market generally

We have deliberately not set any criteria or limits at the portfolio level to allow ourselves to be true impact-led investors, to not dictate terms to investees and to allocate funding to meet demand where it is needed most. For example, we do not have a financial return target or a maximum allocation criterion for sectors or product types. However, this means that we are not building or managing our portfolio in the traditional manner and may be over-exposing ourselves to certain types of risk e.g. government / policy risk, interest rate or property-market risks.

The key risk in our portfolio is government policy. Any change in policy – either at the local or central level can detrimentally affect organisations' business models and our investments in them e.g. changes to housing benefit.

3.

How social investments have influenced the way we invest our endowment: our new ESG policy.

In 2017, our decision making for social investments was shifted from a separate committee to our regular grant applications committees involving all Trustees. This has allowed our Trustees to develop a greater knowledge of impact investing.

We have subsequently agreed to trial a new approach to investing a portion of our main investment portfolio in strategies with enhanced environmental, social and governance (ESG) impact. These are investments in funds which are looking to achieve impact alongside financial return, but which don't currently fit our criteria for mainstream investments due to size, focus or risk profile.

While this "ESG incubator" only concerns a small percentage of our endowment, it is already proving an interesting way of aligning our resources with our expertise and it is making our relationship with our investment advisors more encompassing.

Looking ahead

1. Impact first

Social, environmental and artistic impact is our starting point.

Impact leads our social investment strategy: we work with our investees and partners to understand how social investments can help deliver against their social, artistic and environmental objectives. The money we invest comes from our endowment and with that comes the responsibility to strike a balance between the potential impact, the risks and financial returns. We don't have set prescribed terms of investment, each investment is considered on its own merit. The financial returns we have sought from investments have typically ranged from 0 to 7%. This flexibility enables us to take risks and support proposals at an earlier stage, as well as help more mature organisations grow, when we think the impact justifies it.

The Esmée Way

Case study: Fair for You

Backing new ideas and market disruptors

Fair for You opened its online doors in 2015 providing small loans towards the cost of household goods for people on low incomes and experiencing financial exclusion. The organisation aims to tackle the unfair practice within the high-cost rent to own sector. Esmée provided £70K of grant funding at the ideas stage to support Fair For You to develop its plans before committing a £500K investment alongside three other foundations. Fair for You is now working towards achieving scale and has supported 15,155 people to date, providing £7.1million in loans.

Investing in a start-up business operating in a highly aggressive and competitive market, with a customer base facing huge levels of disadvantage and deprivation is very high risk. We did it because the potential for Fair For You to fight financial exclusion is great.

→ **It's a long journey for Fair for You where its only way to compete and gain a sizable market share is by scaling and raising more capital. This takes time and the inherent risks of a start-up means that mainstream social investors are unable to get on board early.**

Angela Clements, CEO of Fair for You:

“Fair for You would not exist without social investments. In the past 20 years or more in the UK, all credit solutions designed to serve low income households who can't turn to their bank for mainstream credit have been introduced by equity invested organisations with a high profit objective. This represented a huge market failure in the UK, and for us to develop a consumer led solution that was actually designed for the benefit of this low income demographic needed support of social investors that are looking to support initiatives that drive and address social change in the UK.

Esmée were the first to take time to understand us, with some grant funding that allowed us to carry out the market research that provided the information we needed to scope the solution. They also worked hard to form the founding funding that was needed to get us through the early proof of concept and development phase.”

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flexible to suit your budget

WHEN WE CALL, YOU TELL US...

- ✓ 26 weeks
- ✓ 52 weeks
- ✓ 78 weeks

13 Place Dishwasher FDFEX11011P

8 programmes and digital display

52 weeks at £6.65

Basic Price £307.99

Total Fair For You price £367.73

£6.65 per week

2. Understanding what organisations need

Some of our most impactful investments result from the Social Investments Managers and Grants Managers working together to address issues faced by a particular organisation or sector. Our Grants Managers have an extensive expertise in the sectors in which they specialise and we build long term relationships with the organisations that we invest into.

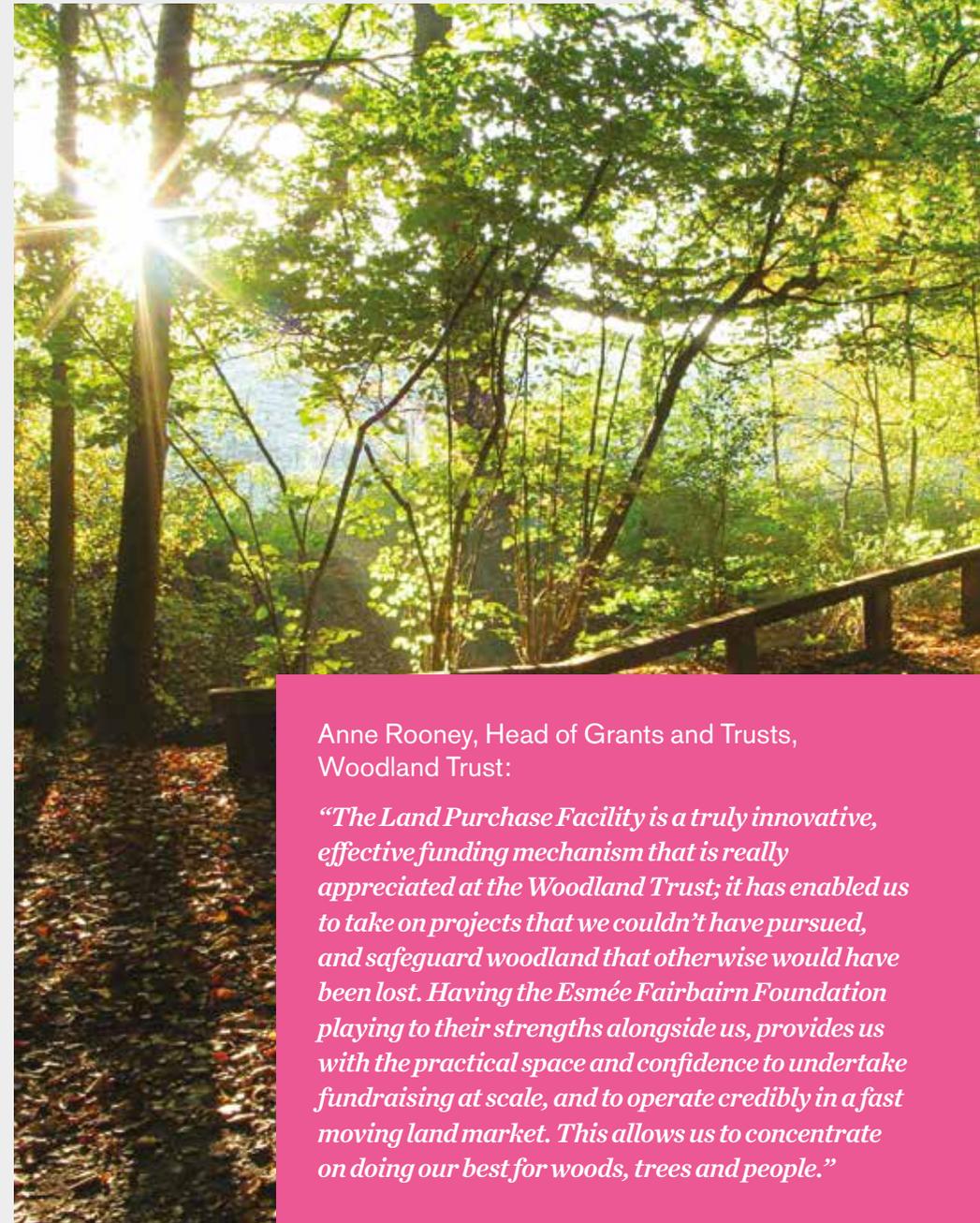
Case study: Land Purchase Facility

Staying close to our grantees' needs

We developed our bespoke **Land Purchase Facility** in response to environmental organisations highlighting the challenges they faced in securing land of high conservation value due to insufficient reserves and time. The £10m facility is used to purchase land of high conservation value. Once purchased we lease the land to our partner conservation organisation (the RSPB, the Wildlife Trusts, and the Woodland Trust) with the option for them to buy in two years' time at the price Esmée paid for it plus a small interest charge. This gives the organisation a window to fundraise. The facility has been used 19 times to date and been 100% successful in transferring ownership to our partner organisations.

→ **The simplicity of the facility and the low costs associated with it greatly facilitate its use.**

Fingle Woods, Woodland Trust



Anne Rooney, Head of Grants and Trusts, Woodland Trust:

“The Land Purchase Facility is a truly innovative, effective funding mechanism that is really appreciated at the Woodland Trust; it has enabled us to take on projects that we couldn’t have pursued, and safeguard woodland that otherwise would have been lost. Having the Esmée Fairbairn Foundation playing to their strengths alongside us, provides us with the practical space and confidence to undertake fundraising at scale, and to operate credibly in a fast moving land market. This allows us to concentrate on doing our best for woods, trees and people.”

Case study: Prison Advice and Care Trust (Pact)

Building long-term relationships

Prison Advice and Care Trust

provides support to prisoners, ex-offenders, people with convictions, their children and families, during imprisonment and resettlement back to the community.

During the course of our relationship, we have provided a combination of grants and social investments to support their work. Most recently, we have provided a loan to develop the 'Family Tree Café', a catering service in prison visit halls.

The Family Tree Café aims to help rebuild ties with families and the wider community. It is partially staffed by prisoners and provides opportunities to gain skills and qualifications. In addition, a proportion of the profits are reinvested in the prison's family services facility under a profit sharing agreement with the host prison.

→ **Prison Advice and Care Trust is an example of an organisation which we have been able to support with various types of funding as its business needs progressed. In the past year it has been looking at new ways to deliver services using the range of funding available. Its model moved away from grants funding to become more enterprising, developing ventures which lend themselves well to loan investments.**



Copyright Pact / Andy Aitchison

Andy Keen-Downs, CEO of Pact:
“The support of Esmée Fairbairn Foundation has been critical to our organisational development over the past decade. We are focused on our mission, sustainability and reaching more people with good services, and we have pioneered services based on listening to our service users. The challenge of new ideas is that we are always one step ahead of policy and commissioning. And we work with the Ministry of Justice, the Department that has seen the most severe cuts, in a sector

where VCS organisations operate on the thinnest reserves. This has meant that we have needed different kinds of financial support at different times whilst at the same time developing the evidence base in order to create a market for us to operate within. Grant funding remains crucial, but the opportunity to develop the charity’s business capabilities through flexible forms of capital investment has enabled us to grow significantly, which means that we now support over 100,000 families a year.

What we have particularly valued is a mix of grant and loan facility, including smaller sums, to enable us to get ready whilst awaiting new commissioning opportunities, and to give us essential working capital which is essential for growth.”

3. Just one tool in the box



Bristol Braille

Our aim is not to find opportunities to use social investments but to use them to help organisations thrive and create impact.

Our social investments are aligned to the same funding priorities as our grant making, enabling us to consider proposals through a wider funding lens and draw on the sector expertise of our Funding Team.

Different organisations need different funding tools at different times, increasingly we try to use the right 'tool' at the right time, be it grants, investment or other resources. This means we can also be flexible, providing organisations with the space and resources they need.

We often grant fund early stage ideas, leading to investment when the time is right (see Bristol Braille). Similarly, we invest in the growth of established organisations which we then also grant fund to support their innovations (see HCT).

Case study: Bristol Braille

The right funding at the right time

Bristol Braille has developed an innovative multi-line digital braille reader, the Canute, designed to make braille more accessible and relevant in the modern world and help reverse the decline in braille literacy. Bristol Braille had already received grants from a number of other funders before they approached us for a potential investment.

We provided an initial grant of £48K during the development phase followed by a loan of £200K to provide capital during the final stages of pre-production. The product will launch in 2018.

→ Our grant was designed to strengthen Bristol Braille's business plan. When we see potential for impact and a social investment opportunity, we can use grant funding to help the organisation progress quickly to a stage where repayable finance is appropriate for its needs.

The Esmée Way

Case study: HCT Group

Market Innovation

HCT Group has grown from a small community transport provider operating in Hackney in the early 1980s to a multi-million-pound, award-winning social enterprise operating bus services across the UK. We invested into HCT Group as part of a cohort of social and private sector investors providing over £10m to fund organisational growth.

In 2018 we made a new investment in HCT Group, committing a mix of grant (£170K) and loan funding (£200K) to support an ambitious social franchising model, the first of its kind in the community transport sector. HCT Group will work with a group of smaller community transport operators as they seek to move away from a reliance on grants and adopt a more enterprising approach.

HCT Group used the range of funding and relationships available to them in order to support innovation and deepen their social impact.



HCT Group

Social investments can be a great tool to achieve impact but they are not always the answer.

Whilst 63% of our investees have also received grant funding from us either before, during or after the investment, only 1% of our grantees have received a social investment from us in the past 10 years.

For example, it might not be viable to invest in befriending and re-orientating services for migrants and refugees, access to justice for sex workers victims of crime, or generally campaigning work. This is one reason why social investments haven't been taken up more broadly by all Trusts and Foundations.

“We are not against repayable finance ideologically, it is just not the right tool for the field and scale in which we operate. The type of organisations we fund are a million miles away from income generation. It would be a disproportionate use of resources to look for organisations which fit our field and would fit social investments for the number this search would generate.”

CEO of a large foundation.

The Esmée Way

4. Bring more money into the sector

We have always had an objective to help grow the wider social investment market by facilitating the flow of new money into the sector and encouraging the adoption of social investments.

We work closely with other trusts and foundations as well as supporting ways for retail investors to participate in social investment (see Ethex). We look to back market building initiatives with early stage funding (see Resonance) and invest in emerging funds and collaborations that share our ethos and approach to impact. We hope to demonstrate with our portfolio that our assets can be invested in a variety of ways to help deliver our charitable aims.

Case studies: Resonance and Ethex

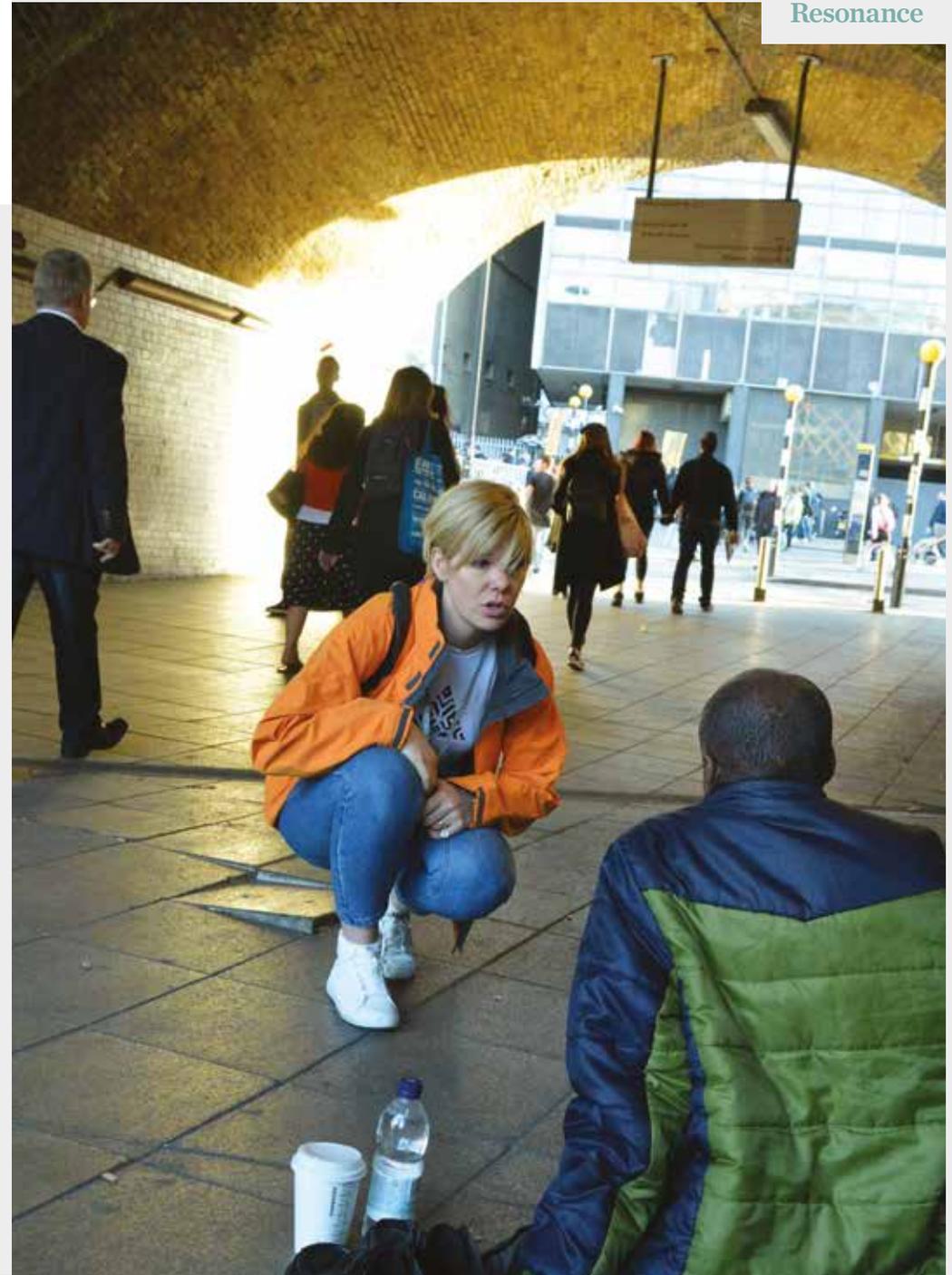
Supporting intermediaries and infrastructure

Resonance is a social impact investment intermediary. Amongst other activities, it creates and manages social investment

The Esmée Way

funds. One of the main barriers to developing a social investment fund is the at-risk funding needed for upfront research and development costs. As intermediaries such as Resonance are one step removed from frontline impact, there is little core funding available for them. In 2015, Esmée Fairbairn provided a £200,000 revolving repayable grant facility to finance the pre-launch costs of impact funds that Resonance has designed. To date this facility has been drawn four times, unlocking £100m of investment into three different social investment funds. By “derisking” the initial development costs, our funding accelerates Resonance’s growth, the impact it creates and creates new investment products that others can also invest in.

Ethex is an online marketplace enabling retail investors to access social investments and for social enterprises to raise such funds. Alongside four other foundations, we funded its start-up via a £10K development grant followed by two rounds of investment (£125K). Since its launch, Ethex has raised £62m from over 8,000 investors many of whom have invested “positively” for the first time. Esmée’s investment is over a 10+ year horizon, demonstrating the need for long-term patient capital.



The insights and learning we've been able to gather have come from 10 years of hard work across the spectrum of investees, co-investors, partners, advisors and the Esmée team – from those instrumental at the beginning, to our team today. To everyone involved, we say thank you.

Our investees:

1927 Productions Ltd
3SC
Almeida Theatre Company Ltd
Ananda Venture GmbH
Arts Impact Fund
Aston Reinvestment Trust (ART)
Auticon Ltd
Autograph ABP
Broadband for the Rural North (B4RN)
Locality
Berks, Bucks & Oxon Wildlife Trust
Big Issue Invest
Birmingham Disability Resource Centre
Bridges Community Ventures Ltd
Bristol Braille Technology CIC
Bristol Old Vic and Theatre Royal Trust Ltd
Bristol Together
Bath & West Community Energy
CAF Venturesome
Centre for Accessible Environments
Charity Bank
Cockpit Arts
Commonweal Housing Ltd
Communities for Renewables

Cumbria Wildlife Trust
Dash Arts
East Lancs Moneyline
Ecology Building Society
Emmaus UK
Ethex Investment Club Ltd
Ethical Property Company Ltd
Fair Finance Ltd
Fair For You CIC
Family Action
Finance South East CIC
Fusion Housing
The Five Lamps Organisation
Generation Community Ventures Ltd
Global Action Plan
Golden Lane Housing Ltd
HCT Group
Headlong Theatre Limited
Herefordshire Nature Trust
Homemaker Solution Ltd
Hubbub Foundation Enterprise Ltd
Key Fund Investments Ltd
London Rebuilding Society
Mustard Seed Property Ltd

Midlands Together
National Botanic Garden of Wales
New Economics Foundation
New Horizons (Connexions Merseyside)
Norfolk Wildlife Trust
North East Social Investment Fund
Live Theatre
Nottinghamshire Wildlife Trust
Our Power Community Benefit Society
Prison Advice and Care Trust
Paper Arts CIC
Parity Trust
United Savings and Loans
Praxis Community Projects
Punchdrunk
Resonance Ltd
RSPB
Scope
Buzzbnk
The Severn Project CIC
Shaftesbury Partnership
Shared Impact
Sheffield Wildlife Trust
Shropshire Wildlife Trust

Social Finance Ltd
Social Investment Scotland
South Midlands Newts Conservation Partnership
Staffordshire Wildlife Trust
StartHere
Street UK
Suffolk Wildlife Trust
Teens & Toddlers
The Conversation UK
The Young Vic
Thera Trust
The Timewise Foundation CIC
The Real Farming Trust
Triodos Social Enterprise Fund
Weston Spirit
Wildgoose Rural Training Centre
Wiltshire Wildlife Trust
Woodland Trust
Worcestershire Wildlife Trust
YMCA London South East
Yorkshire Wildlife Trust

Thank you

We see social investments, impact investing and ESG investments increasingly becoming a standard set of tools alongside our grant making to further our charitable objectives. We operate across the full spectrum of these tools and approaches and we are excited in the potential positive impact they offer.

We will continue to share regular Insight Reports, as part of a commitment to shared learning with those we fund, and with the wider sectors in which we operate.

We hope this insight into how and what we are learning and what we could change as a result is interesting, and welcome any thoughts, comments, and insights of your own. Please contact Gina Crane, Communications and Learning Manager, on communications@esmeefairbairn.org.uk

What now?



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