	a4i – Alliance for Inclusive investment in Social Care & Support Grant N° 600958-EPP-1-2018-1-BE-EPPKA2-KA

D1.2 European Guidelines on Quality Investment Principles for Social Investment

This publication has been produced with the financial support of the Erasmus+ programme of the European Union. The information contained in this publication does not necessarily reflect the official position of the European Commission.

Document identification	
Deliverable ID	D1.2
Version	0.2
Dissemination Level	
Restricted	X
Public	
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1. Purpose of Guidelines

1.1 Why is there a need for new Guidelines

As the State of Play paper makes clear, the a4i research project aims to support the development of more informed and intersectoral working between investors and social care providers to facilitate the delivery of increased and more appropriate levels of care and support. As financial austerity at the government level continues, additional and / or new sources of funding and finance[1] are growing in popularity as a means of securing the increased need and demand for care and support services.

The purpose of a new set of Guidelines therefore, is to help all participating in the social care sector (be that providers, local and national government authorities, lenders, borrowers and service users) to be clear on how best to secure the funding and financing that may now be needed. The Guidelines need to be generic, providing a clear framework for all interested stakeholders on what specific evidence needs to be marshalled to secure the funding and financing needs.

These a4i Guidelines will follow the well used approach already adopted by national and local governments and lending authorities[2], crossing geographical and sectoral priorities. However, whilst these alternative Guidelines are likely to be highly detailed and specific, the a4i approach at this stage is the development of a high-level set, which will then need to be adjusted to suit specific local legal and regulatory requirements and user preferences and expectations.

1.2 The continued role of the state

There are clearly growing opportunities for the private sector to offer funding solutions in the delivery and development of care and support in the social sector across the EU. However, it is important to stress that it is not anticipated [or thought desirable] for there to be no continued state role. Obviously the state (national, regional and local) will continue to play pivotal roles in for example, licensing institutions, regulating health and safety and quality as well as monitoring performance. Although public sources of funding are unlikely to be adequate to provide for all the growing care needs, it is this project's expectations that the state will continue to provide adequate levels of social protection. It is likely therefore that there will be growing need for greater levels of collaboration between service providers (state, third sector and private) to foster innovation and deliver increased levels of service within the financial resources available. The state's role will then also need to ensure service provision is affordable and ensures inclusion for all in need.

<u>State Aids</u>

The provision of social care is undertaken by public as well as private sector organisations. Where funding support (or government support more widely) is given to private sector providers there will be a need to ensure the support offered does not contravene State Aid rules. Whatever financial support is provided, it must clearly be the minimum necessary without giving an unfair advantage to any specific provider.

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[1] Funding and financing in this context are NOT the same. Funding (usually provided by governments) is the financial resource required to support a business proposition whilst the financing is the private sector financing element of the monies used that may (though not always) need to be repaid by the business.

[2] See InvestEU (2019? Under development); EIB (2018); Infrastructure Australia (2018).

Definitions

- The borrower is the provider of the care and support services.
- Funding can come from government agencies, private sector entities or from services users (eg, in the form of service fees and charges).
- Private finance covers a wide array of products from simple, traditional commercial loans, through more structured finance solutions (eg, mezzanine finance, bullet loans, bond financing, etc) to equity investment products. The breadth and variety available will depend on the level and sophstication of the financial sector within which the borrower operates.

1.3 Key stakeholders

As we see from Table 1, the Guidelines will be used by a number of key stakeholders with both unique as well as overlapping requirements. As a consequence, the initial high-level set of generic Guidelines will need to be further developed for the associated training materials to be of relevance to both county and sector-specific preferences, lending and borrowing requirements as well as provider capabilities.

Table 1: Stakeholder roles and responsibilities that the Guidelines need to accommodate

Stakeholder	Involvement / Responsibility	Borrower's response to stakeholder needs
Government bodies - central; national; regional and local	Responsible for establishing central government and / or sector policy that will be key to directing the activities of care and support providers	Deliver the services required to meet the central Government's policy and proposed targets.
	In addition to their legal and regulatory roles, Government bodies can also be interested stakeholders in other ways: - providing funding support (be that up front capital or equity investment) to help the service provider deliver an affordable, quality product; - providing some form of on going revenue support to help cover the operating costs of service delivery;	Demonstrate how the additional / new funds help in the delivery of the outcomes specified by the central government's funding criteria. Demonstrate how financing will be used and, where required paid back on time and in full.

	- - supporting the service user, in whole or in part, through subsidising the users' costs.	
	Will also have the direct or indirect responsibility for all the relevant Regulatory bodies and regulatory policies that set the rules for the effective operation of the care providers	Provide the necessary evidence (initially and on-going) that will confirm the proposed approach to delivery secured with the funding and finance proposed, will meet all known regulatory requirements.
Public authority (national / regional / local)	Will have the legal and possibly statutory responsibility to implement both national, regional and / or local policy established by central government	Provide evidence of how the organisation will deliver to the stated local government policy objectives
	May also have the statutory obligation of being a service provider, or have the right to seek to contract with 3rd party service providers for end users, through the implementation of pre-defined guidelines	Deliver what end-users require and provide evidence that organisation is delivering as per required by the regional authority pre-defined guidelines
	May also provide supporting funding (capital and/or revenue) to facilitate the delivery of services	Use funds in accordance with funding support and provide evidence of such actions
Private sector financial institutions These cover ALL organisations that may wish to lend or invest in the sector. eg, Traditional Banks; Social Enterprise Institutions; Pension Funds; Crowd Funding; Foundations; etc.	Lends or invests funds with the borrower - short-term or long term; - asset backed or cashflow based; - secured or unsecured; -interest payable, deferred or nil coupon; -full repayment of principle or delayed, deferred or cancelled depending on agreed terms MORE?	Need to provide lender or investor with the relevant evidence that allows full credit assessment -financial strength to meet operating and repayment obligations based on realistic assumptions; -appropriate governance and credible senior management arrangements in place; appropriate and effective risk management systems in place; -MORE?

	Lends more Innovative types of funding: - Subordinated or participatory type loans - - performance related loans or non-repayable grants. This funding could be used to replace traditional asset-backed lending but more likely to assist the development of new approaches to service delivery where operational risks are less clear.	As above PLUS provide in-depth evidence that outlines how the borrower will effectively manage the risks associated with doing business differently and the new outcomes expected to be delivered.
	Invest in the business with equity return being clearly related to the risks being taken by the investor - the ability to deliver this required equity return will also depend on operational performance from the growth or new delivery opportunity being exploited (eg, a new market segment, or a new geography) - where lending is also being used the investor will only get their return after loan interest is paid (and ultimately the principle repaid)	Provide the evidence that indicates the factors that will deliver the equity return anticipated by the investor - it is likely that the lender and investor will not be the same institution and so multiplying the evidence needed to secure both financing sources.
Service provider (borrower)	Delivering the new (refurbished) asset being funded by the private finance - this may be to expand geographical stretch and / or to expand any service offering	Provide the necessary assurances that - the organisation has the necessary skills and experience to deliver on time and on budget - is clear how the new asset will be integrated into the operations of the business (delivering any necessary efficiency savings) - the security value of the asset will be as required should it be used as collateral to secure any private finance

	Delivering a new operational model that is funded by the private finance - this may be to expand geographical stretch and / or to expand any service offering	Provide a comprehensive business plan that allows lenders and authorities to undertake detailed risk assessments. - in addition to the financial evidence this will also need to cover the skills and competence available to deliver the new services; the regulatory approvals to operate differently and safely - the approval and buy-in of the staff and unions to operate in a new manner and to deliver the efficiencies assumed in the business plan
Service User	User articulates what care and support is needed - as an individual, outlines own care and support needs to be delivered if self funded - if support is needed, work with advocate to ensure needs fully articulated (may be self funded or paid in part or fully by statutory authority) - work with any relevant statutory authorities to ensure services are acceptable (meet minimum quality standards; providers are suitably licensed etc)	Ensure services provided meet the users' needs within the funding envelope provided or forecast and within regulatory guidelines - need to confirm charges regime for services offered which will need to be 'affordable' - need to show how service quality is secured through sufficiently, suitably qualified staff

2. Guideline elements

2.1 Setting project objectives and the rationale for funding

To secure access to funding (public or private), a project sponsor needs to show how the funds to be secured will deliver the targeted objectives. If more than one source of funds is to be used, the objectives will need reflect how the outputs and outcomes of the project meet these multiple external funders' objectives.

Objectives

The Scottish Housing Regulator (SHR) regulates the provision and management of social and affordable housing in Scotland. It has been clear in its governance reviews of the sector that good governance is an essential element of the long-term viability of a housing association.

In its guidance to housing associations[3] the SHR's suggests the Committee of Management of the Registered Social Landlord agree a clear statement of the organisation's mission and vision, with the objectives then articulating just how the organisation's vision and mission will be delivered[4].

In addition to any statement of objectives, the various stakeholders involved in any project will expect as outlined below.

2.1.1 Project leader

The board or governing body of the organisation seeking to borrow the private sector funding needs to be clear how the project will contribute to the delivery of its long-term strategy. Without such clarity, the board cannot be sure that the management time and effort that will be required to deliver are best allocated. It also means the allocation of internally generated financial resources and any operational and organisational changes necessary to delivery are possible and achievable.

2.1.2 National government authorities

Where national government authorities are involved, they will need to be reassured that the service provider's objectives are appropriately focused on and consistent with the delivery of the relevant associated government policy. They will also want to understand what alternatives projects or organisations may also be able to offer the same outcomes, perhaps for less funding or to a better quality of service.

2.1.3 Local government authorities

Where a local government authority has a statutory obligation for the delivery of services, they will need to understand how the care provider's project will contribute to the delivery of these obligations.

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[3] Housing associations are also called registered social landlords (RSLs) in Scotland
[4] See Scottish Housing Regulator, 2015

They will also want to understand if there is a more cost effective means of delivering and whether there may be any state aid challenges to be assessed.

2.1.4 Funders

Funders will expect to see a clear objective statement that reassures them that the project will contribute to the organisation's long-term strategy, that it is consistent with the organisation's operational expertise and that skills and internal resources will follow. They will also need to be reassured that the private funding provided will help generate sufficient revenues, thus justifying their loan or investment.

2.2 The Business case

Having a clear rationale for the project that helps to justify seeking private funding is only part of what is needed to secure such funding proposed. The potential borrower will also need to provide a detailed business case that shows how it will adapt its operations accordingly and achieve the needed financial, economic and regulatory results.

For the business case to meet the need of government authorities it will also need to include a description of the social needs to which the project answers and how it is anticipated these will be delivered through the use of the funding being secured.

Example: Scottish Housing Regulators guidance on the role of a business plan

The Scottish Housing Regulator5 offers its own guidelines for registered social landlords (RSLs) as an aid to ensuring boards, regulators, lenders and tenants understand how the provision of services will be delivered and can be financially accommodated.

The business plan is a key strategic document which communicates an organisation's vision and objectives, and how it will achieve those objectives. The business plan should be central to the organisation's strategic decisions and operational decisions should be consistent with the strategic decision set out in the business plan. Reporting and monitoring systems should be designed to allow managers and those charged with governance to judge the extent to which the strategic aims are being achieved and to make any necessary adjustments in a timely manner. It is for each RSL to decide how best to achieve this, based on its own circumstances.

Source: Scottish Housing Regulator, 2015

A business case and plan will need to cover the following aspects in detail.

2.2.1 Delivery record

The business plan will need to show just how the project can be delivered on time and on budget.

[5] See Scottish Housing Regulator, 2015

2.2.2 Governance

Does the borrower have appropriate governance in place that will manage the business for the duration of any loan; including legal structure that meets the needs of funders, has appropriate constitutional arrangements in place and is capable of developing and monitoring suitable risk management? As outlined in the State of the Art paper[6], this element is increasingly important if and when less traditional or innovative sources of finance may be perceived as the best way forward.

2.2.3 Skills

The borrower will need to show how it has the required staff and skills internally or access to an appropriate and suitably capable delivery partner.

If the project involves the development of physical assets which is not the borrower's day to day activities, it has to be able to show it has the right project management capabilities and is appropriately supported by the senior management and the board.

If the funding being secured is to allow an adaption or development of new working practices and the introduction of a new business approach, the business plan needs to show how the current staff can be adequately supported to secure the necessary skills, or there will be an adequate level of new staff recruited in a timely manner to ensure effective service.

2.2.4 Finances

All stakeholders will need to be reassured that the organisation has appropriate financial systems and skills in place to manage and monitor the key cashflows.

It will need to show there is a clear understanding of all operating costs and revenues that will be required to deliver for the duration of the loans, including all staffing and other costs and projected revenues. These will have to be adequate to cope with new or different business operations that will be needed following the completion of the funded project which may be higher that business as usual activities.

Where a new asset is being developed, the business plan will also need to outline how will be adequate financial resources and skills to manage and maintain the assets over its lifetime it to ensure the facility remains fit for long-term use.

Where new services are being developed, the business plan will need to show there will be adequate free cashflow to permit effective promotion of the services.

2.2.5 Revenues

To repay the proposed private finance the business plan will need to outline how the associated forecast revenues will be achieved.

If the borrower is seeking to develop a new area of business activity, the plan will need to provide detailed evidence on how this new demand will be secured. If the funded projected is essential to

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[6] See section 4.9 in State of the Art paper

retain existing demand, then the business plan will need to show how this will be possible without disrupting revenues whilst the new project is completed (ie, is there likely to be a period of no revenues during construction or as new operational processes are implemented).

In addition, the business plan will also need to outline the risks of any 'competitors' who may seek to take away existing customers especially if there is a hiatus in delivery.

2.2.6 Regulatory requirements and risks

The need to meet all existing and potentially new regulatory requirements are an essential element of the business plan. This will show how the organisation ensures effective and safe support of its clients, its staff and the wider community within which it will be operating. This will also reassure the various partners about the borrower's ethos and how it sees its role in the wider community.

There is also a need to confirm how the services provided will continue to conform to all human rights and equalities legislation.

2.3 The Funding criteria: how to determine funding needs and allocations

The business plan will provide the essential evidence needed to support access to funding. However, to determine exactly how much funding (and finance) is needed or will be possible to access, requires the development of evaluations; financial, economic, environmental and social. This array of evaluations arises because the various stakeholders are each likely to be looking to meet different as well as inter-dependent outcomes.

2.3.1 The borrower

The borrower will be using the funds to add to its service provision or, to adapt its services to allow it to deliver the same level of service at a lower cost of delivery or, a combination of both.

The question the borrower has to ask to help in decide whether or not to it should seek external funding to deliver its project are:

- Is the additional revenue derived from the new project going to be sufficient to cover the contracted cost of borrowing the finance PLUS allow it to repay the borrowing secured, at the pre-defined date?

- Are the non-financial benefits that the project is anticipated to deliver adequate to justify the additional risks inherent in any new project?

- Are the non-financial benefits of the preferred project greater than the next best alternative use of the internal resources (including manpower and internally generated funds)?

The initial way of testing the strength of the answers to these questions is to undertake a full financial analysis. This will comprise a forecast cashflow[7] that forecast projects out over the period of the borrowing and illustrates the debt being fully serviced (interest paid) and the principle repaid in full[8].

Such an appraisal will need to be augmented by sensitivity analysis that confirms full repayment even with more onerous (less preferential) values chosen for the key cashflow assumptions.

2.3.2 The national government

Although likely to be less involved with the details included in the organisation's financial analysis, the national government will be extremely interested in an understanding of the longer-term community benefits that may arise for the project. If it is giving support (financial or otherwise) the borrower will need to provide a wider economic, social and environmental analysis as a means of providing the evidence the national government bodies may need to provide any requested support to the project.

In some instances there may be the potential for public grants to be reduced should private finance be secured. Any wider economic, social and environmental analysis will therefore need to outline how the public grant is delivering additional benefits which would not otherwise be possible if the project only relies on private finance.

There is no one economic, social or environmental appraisal methodology that can be readily applied so the borrower will need to take time and care in fully understanding just what the preferred option(s) will most likely be in the region and for the sector involved. Annex 1 illustrates the factors that will be assessed in any such wider economic, social, environmental analysis.

2.3.3 The local government

Where local government may well have the statutory authority to secure the delivery of care or social services from 3rd party providers. To aid determining just how much financial support may be possible the following areas will need to be assessed:

- Does the service being offered by the project sponsor contribute to the delivery of the local or national governments' objectives? This is essential if the project sponsor is seeking to develop a new service and so relying on the local authority's financial and regulatory support. If the service does not meet the local authority's criteria, then it will be hard for the authority to enter into any contractual arrangement.

- Does the service provider have the appropriate skills and competencies to deliver and will they meet the necessary standards set by the various relevant regulatory bodies?

- Is the funding going to satisfy any state aid and additionality rules?

- Does the service provider have the correct governance and management capabilities to ensure the effective stewardship of any allocated funding?

[7] Expand what would be in a cashflow forecast – is this needed here or only as part of the training materials?
[8] Example of DFC analysis – is this needed here or only as part of the training materials?

2.3.4 The lenders

The lender's decision on whether, what type and how much to lend will be based on a clear understanding of the financial strength and the financial viability of the lending opportunity. Depending on their individual institutional objectives, they may well also be interested in the social value and wider community benefits that are projected to be deliver through their involvement.

The borrow and other stakeholders are seeking to deliver both financial as well as wider, non-financial benefits. The lender must be reassured that their funds are secure; either they are fully serviced and repaid where this is expected or, the wider social benefits will be achieved to justify and donations provided. In both cases on-going financial sustainability of the borrower must be secured.

Lenders will seek reassurance on the following key areas:

- Are the projected cashflows derived from the project adequate to pay the operating costs (including all maintenance and taxes due), pay the interest on the borrowing, and repay the loan in full on the pre-determined date(s)?
- Is there adequate demand to generate the cashflows over the term of the loan or is there government support to cover and demand shortfall?
- Are the projected wider outcomes adequate to ensure delivery of any performance-related objectives and so secure the equity returns pre-agreed with investors?

As Annex 1 summary shows, the private sector lender will principally determine the level of their financial commitment on the basis of the financial analysis. This will assess the strength of the forecast cashflows and test how robust they are in achieving two key tests:

- Will they achieve the necessary, pre-determined rate of return on the capital and/or equity employed PLUS
- Will they produce a positive net present value (NPV), discounted at the cost of debt or cost of funds employed?

2.3.5 The investors

Much of what is required by the lenders above will also be required by private investors. However, whilst lenders will seek to minimise their risks and secure a guaranteed return (ie, interst and principle fully repaid, an investor will be aiming to maximise their return, reflecting the higher risk they are willing to carry.

The willingness of equity investors9 to forego repayment of principle may be something offered by investors seeking to support wider community and social benefits. Notwithstanding this aim, most

[9] Triodos bank offer a wide array of products for charities and social enterprises from simple loans, to access to bond funding through to equity finance – see https://www.triodos.co.uk/raising-capital.

investors will still need to be reassured the project will be robustly managed and financed so as not to face reputation risk or the need to enforce security through poor operational performance or default

3. Next Steps

To develop a set of training materials based on this generic set of guidelines will require collaboration between the relevant members of the steering group and be done through an iterative process.

3.1 More than one set of guidelines?

We need to reflect on the output of the State of the Art paper that signals the use of innovative financing solutions has so far been limited. This is in part due to a lack of understanding of how to access whatever funding is currently available in the market but is also due to a lack of understanding on the part of lenders and investors as to how to lend to the care and support sectors.

In addition, given the inevitable variations in regulatory arrangements across sectors and jurisdictions means any sets of Guidelines will have to be developed to meet specific sector and county needs and be updated as regulatory arrangements change.

So, the final Guidelines will have to be able to accommodate varying needs with the associated teaching materials being under regular review.

3.2 Detailed lending terms

So far, the Guidelines have not covered any details on possible lending and investment terms. A generic set of Guidelines as these are cannot cover such detail as they would be too many and too wide ranging to be of assistance on any specific project opportunity.

The teaching materials will therefore need to consider the relevant lending opportunities by both geography and sector thus allowing a better understanding of the likely lending and investing institutions that could be involved and so help clarify possible lending terms.

Such an approach would also clarify to what extent national and local authority financial support might also complement the private lending and investors funds which would further influence how much and on what basis private lending may be forthcoming.

Using practical examples and case studies would assist, even if only indicative, to communicate with investors on what the typical investment might look like, its likely duration, what potential returns might be and the associated risks (project, organisational, sector and country), etc.

In turn, such guidelines could help project leaders assess what can be financed through loans and what through investment as well as what would be the typical expectations of lenders and investors.

Annex 1: Appraisals required and metrics used to determine funding needs

Type of appraisal	Who needs it	Metrics to be used
Financial Analysis	• Funders: who require understanding of ability to pay interest and repay loans; the financial sustainability of the proposal and the borrower will be a key feature in how finders review any financial appraisal • Investors: to understand likely longer-term financial returns and likelihood of these being achieved • Asset owners: to understand short and long term operational sustainability • Operators: to understand sustainability of operating model	• Forecast cashflow to allow DCF analysis • Internal rate of return of the cashflows ie, the IRR% • Net Present Value (to determine value for money to public purse) • initial cash requirements (to fund initial capital and project set-up costs) • On-going net revenue (after operating costs) to repay loan obligations
Social cost benefit analysis (SCBA)	• Funders & Investors: who also seek social impact returns (in addition to some(?) financial returns) • Asset owners: to understand what and how wider economic and social impact will be derived • Operators: to understand where and what partnerships will be needed to deliver wider benefits	• Net Present Value (including valuation of wider economic and social benefits) • List of all non-quantifiable costs and benefits (ie, wider externalities) • GDP & GVA (gross and per capita) to capture 'traditional' value metrics
Non-financial factors	• Local and National government authorities alongside some funders and social investors will be seeking wider_community benefits, quality impacts, wider linkages across communities etc	• The metrics used here will need to be developed on a case by case basis

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