Part IV:

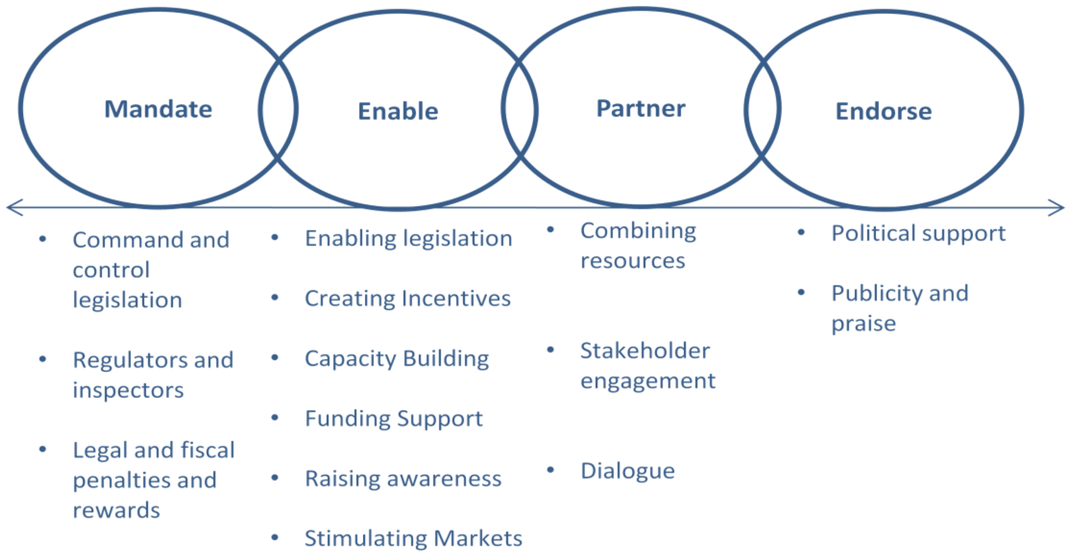
The role of government in promoting access to finance for social economy organisations and concluding comments

Chapter 9

The role for government in promoting finance for social economy organisations

9.1 Traditionally, governments have been the central players in the social economy sector through their grant giving. This inquiry is premised upon an understanding that governments (and philanthropists) alone do not have the resources to fund the sector adequately.[1] Accordingly, there is an emerging role for government to promote finance options through taxation incentives and selective spending. As Diagram 4.1 (page 62) depicts, this emerging role for government cuts across the three layers of a social economy capital market: mainstream financial organisations, institutional and retail investors; financial intermediaries; and social economy organisations themselves.

Diagram 9.1: Options for government



9.2 Diagram 9.1 is taken from the joint submission to this inquiry of the Department of Education, Employment and Workplace Relations (DEEWR) and the Department of the Prime Minister and Cabinet (PM&C). It shows a spectrum of options for the government to assist investment for social purposes: from command and control legislation at the far left of the diagram; to creating tax incentives and funding support to build capacity; to combining resources, convening dialogue and

1 Department of Education, Employment and Workplace Relations (DEEWR) and the Department of the Prime Minister and Cabinet (PM&C), *Submission 9*, p. 10. See also Centre for Social Impact, *Submission 27*, p. 11.

engaging with stakeholders; and at the far right of the spectrum, gaining political support.[2]

9.3 The final chapter of this report examines the evidence that the committee has received during this inquiry on all these options to encourage finance for the social economy sector. The committee has heard evidence that government should:

- more tightly regulate the banks and the superannuation funds to ensure they provide funding options for the sector;
- clarify and widen eligibility for deductible gift recipient (DGR) status;
- provide top-ups, guarantees and franking credits to promote investor confidence in the sector;
- innovate with new policies, such as a variant of the National Rental Affordability Scheme (NRAS) and a pilot social impact bond;
- develop a framework to measure the performance of social organisations as a guide to potential investors of the risks and returns of an investment; and
- use its convening power to establish a Social Finance Taskforce and adopt a long-term perspective in developing strategic financing options for the social economy sector.

9.4 The chapter has three parts:

- the first part presents submitters' and witnesses' views on the current regulatory environment and how it could be improved;
- the second part of the chapter outlines submitters and witnesses' views on the various taxation and spending arrangements that governments can employ to encourage finance for social economy organisations; and
- the final part of the chapter concludes this report, noting the most appropriate role and mindset for government to promote access to finance for social economy organisations.

---

2 DEEWR and PM&C, *Submission 9*, p. 36. The diagram is based on a 2003 World Bank report.

The evolving framework to oversee and regulate the sector

9.5 This inquiry has been conducted at a time of considerable change in terms of government oversight and coordination of the not-for-profit sector (NFP). As chapter 1 of this report noted, this infrastructure of the reforms has been established under the remit of two central departments: PM&C and Treasury (see Diagram 1.4).

9.6 Within PM&C:

- the Office for the Not-for-Profit Sector was established in October 2010. The purpose of the Office is to drive and coordinate the policy reform agenda flowing from the recommendations of Productivity Commission (PC); and
- the Not-for-Profit Sector Reform Council was established in December 2010 for a three year term to provide support to the Office and provide advice to the Government on not-for-profit (NFP) issues, including the role and structure of the new national NFP regulator.

9.7 Within Treasury:

- the new regulator, the Australian Charities and Not-for-Profit Commission (ACNC), will be established on 1 July 2012. It will report to Parliament through the Treasurer and will be staffed by around 90 officers based in both Canberra and Melbourne. The Commissioner will have sole responsibility for determining charitable, public benevolent and other NFP status for all Commonwealth purposes;
- an advisory board to the ACNC will be established on 1 July 2012. The Board will be chaired by Mr Robert Fitzgerald and will have legal, accounting and NFP sector experts; and
- an Implementation Taskforce for the ACNC commenced on 1 July 2011 to ensure the ACNC is ready for operation by 1 July 2012. The Implementation Taskforce will also engage with state agencies to negotiate use of the portal as a 'one stop shop' for reporting to state agencies. It will be disbanded when it has completed its role of setting up the ACNC.

9.8 In its submission to this inquiry, Treasury explained that it is responsible for policy and law design with respect to regulation and taxation of the NFP sector. This includes developing legislation for the ACNC, developing legislation for a statutory definition of 'charity', reviewing fundraising legislation, implementing reforms to better target NFP tax concessions and restating the 'In Australia' special conditions and implementing reform of public ancillary funds. Treasury noted that as part of this process, it is engaging with the Australian Taxation Office (ATO) and the NFP Sector Reform Council. The ATO is currently working to separate and move its registration function to the ACNC.[3]

3 ACNC Implementation Taskforce, Treasury, *Submission 35*, p. 4.

9.9 In terms of tax matters, the PC explained that while the ACNC, as a regulator, will administer the law:

> ...all regulators provide substantial input into policy considerations, based on their experience the reason the commission is so important, and the notion of a one-stop shop regulator is so important, is that it will be the first time that we can actually look at regulation from taxation, corporate governance and perhaps potentially fundraising in a holistic way. At the moment all of these areas are looked at separately and, of course, across the nine governments. I think the regulator will play a role in helping to consolidate consideration of these issues. At the end of the day, at the Commonwealth level, Treasury and Prime Minister and Cabinet will have central responsibility for policy, not the commission itself, but I would imagine it would be a significant imputer into those policy considerations.[4]

Views on the current regulatory environment

9.10 The committee received a range of views on the adequacy and efficacy of the current regulatory environment and how it might be improved. Some, such as Dr Ingrid Burkett, praised the role of regulation and the positive effect it has had in Australia. She told the committee that while there are:

> ...great possibilities in exploring regulatory change and opening possibilities for innovation through such change, I do not see the current regulation as an insurmountable barrier that is inhibiting the growth of the not-for-profit capital market or other forms of impact investment. For me this has been a real shift because 10 years ago I was on the board of Foresters when it operated a superannuation fund and I truly believed that regulatory change was the only way that such an innovative fund could operate. But now I know a lot more about the need for social innovations to be grounded in real structures that people recognise and trust.
>
> This is particularly the case for those innovations involving sectors such as finance or procurement, where regulations are ultimately designed to protect people or public interests. In Australia I think we can be extremely innovative within the current regulatory structures and we should not, as is sometimes the case, use regulation as an excuse for not acting.[5]

9.11 Others were critical of the effect of government regulation in promoting investment in the social economy sector. Mr David Crosbie, Chief Executive Officer of the Community Council for Australia, has argued that while:

> The not-for-profit sector is bigger than other sectors of our economy, including tourism, agriculture and communications...it has not benefited from the kind of strategic investment and reform of these sectors. As a

---

4 Mr Robert Fitzgerald, Commissioner, Productivity Commission, *Committee Hansard*, 26 September 2011, p. 26.

5 Dr Ingrid Burkett, Managing Director, Knode Pty Ltd, *Committee Hansard*, 9 September 2011, p. 31.

> result, there is an immense amount of wasted time, effort and energy in the running of many charities and other not-for-profit organisations. Much of this waste is driven by poor government administration imposing onerous reporting and accountability requirements that serve very limited purposes. This is compounded by the range of regulatory bodies at each level of government, and the seemingly unquenchable thirst from bureaucracies and others for more information about the outputs, rather than the impact, of not-for-profit organisations. Sector reform has been on the agenda of federal and state governments for well over a decade.[6]

Complexity of the regulatory framework

9.12 The 2010 PC report highlighted the need for reform in the current regulation for the sector. It argued that the current regulatory framework for the sector is 'complex, lacks coherence, sufficient transparency, and is costly to NFPs'.[7] It recommended that a national registrar for NFPs be established to consolidate Commonwealth regulation, register and endorse NFPs for concessional tax status, register cross jurisdictional fundraising organisations and provide a single portal for corporate and financial reporting.[8]

9.13 Several submitters and witnesses to this inquiry also commented on the complexity of the current regulatory framework for social economy organisations. In particular, they argued that current arrangements were not conducive to smaller organisations gaining access to finance. For example, the National Disability Services emphasised in its submission that:

> Any initiatives to increase the not-for-profit sector's access to capital should not unnecessarily add to the burden of red tape and regulation that already exists in the not-for-profit sector. The Productivity Commission has highlighted the difficulties already facing the not-for-profit sector in effectively and efficiently delivering services on behalf of Government with over prescriptive requirements, relatively short-term contracts and excessive red tape.[9]

9.14 PILCHConnect told the committee that:

> ...the legal and regulatory regime for the not-for-profit sector is very complex. It can operate as a barrier to effective participation by not-for-profit organisations, particularly those that are small or starting up, and this includes in relation to finance options. Not-for-profit organisations are grappling with the regulatory regime that has been acknowledged as more

---

6 Mr David Crosbie, 'Not-for-profit organisations need a fairer go now', *The Canberra Times*, 7 March 2011, p. 9. Submitted to this inquiry as a supplementary submission by the Community Council for Australia.

7 Productivity Commission, *Contribution of the Not-for-Profit Sector*, January 2010, p. xxiii.

8 Productivity Commission, *Contribution of the Not-for-Profit Sector*, January 2010, p. xxiii.

9 National Disability Services, *Submission 30*, p. 4.

> complex than for business and is often characterised by inconsistencies and duplication.[10]

The need for a differentiated regulatory regime

9.15 Another aspect of the role of government discussed by the committee concerned the possibility of a tiered approach whereby regulations vary according to the financial instrument being used. Mr Christopher Thorn representing Philanthropy Australia told the committee:

> Our view is that, rather than trying to find one set of regulations or structures that sits across the top, there is now with the Office for the Not-for-Profit Sector, the ability to actually have a body that has the visibility and understanding of that and, if you like, set areas of benchmark where someone with TCC status comes along to create a new instrument. The office could actually determine what class or sector of investment that is to ensure the greatest, or the widest, body of investors could invest in that product.[11]

9.16 The committee asked Philanthropy Australia whether the Office for the Not-for-Profit Sector currently has the expertise to develop taxation and regulatory regimes that offer incentives for both profit and not-for-profit organisations. Mr Thorn replied:

> No, it does not, but I think the point is...in terms of a whole-of-government approach it is potentially the body that could coordinate that response across government. We are arguing that if you have an instrument coming forward that needs to be...regulated, or an appropriate benchmark targeted, it would come to the appropriate government to coordinate that classification, if you like, of where that investment should sit.[12]

Social enterprises and not-for-profits

9.17 The committee also received evidence that the current regulatory regime is not sensitive to the different structures, motivations and capacities of not-for-profit organisation on the one hand and social enterprises on the other. The Fundraising Institute Australia (FIA) was one organisation that argued the need for Australian regulation to differentiate between social enterprises and charities. The FIA suggested a better alternative would be the UK model, which recognises this difference by

---

10 Ms Juantina Pope, Senior Lawyer, PILCHConnect, *Committee Hansard*, 9 September 2011, p. 52.

11 Mr Christopher Thorn, Council Member, Philanthropy Australia, *Committee Hansard*, 9 September 2011, p. 47.

12 Mr Christopher Thorn, Council Member, Philanthropy Australia, *Committee Hansard*, 9 September 2011, p. 47.

regulating social enterprises as Community Interest Companies (CIC) (see chapter 8).[13]

9.18 Mount Buffalo Community Enterprise was also critical of the 'one size fits all' approach to regulating the sector. It claimed that currently, the federal and Victorian governments' funding eligibility criteria regards being 'not-for-profit' as a pre-condition for being treated as a legitimate 'community enterprise' or 'social enterprise'. The underlying public policy assumption, it argued, is that 'the notion profit (of itself) and social, community and cultural goals are mutually exclusive concepts'.[14]

9.19 Mount Buffalo Community Enterprise described this assumption as flawed, given that it largely eliminated the potential for socially motivated organisations to access and raise private capital. This, in turn, has the effect of making 'the vast majority of socially-motivated organisations forever dependent on government grants and philanthropy'. Moreover, the enterprise warned that this policy setting runs the risk that the sector will be dominated by social programs 'dressed up as social enterprises in order to access government funding programs'.[15]

Tighter regulation of the private sector

9.20 Other submitters argued that government should be more prescriptive in its approach to encouraging the private sector to invest in the social economy. This approach was raised in two contexts: stricter investment obligations on banks and mandating superannuation funds' product offerings.

Regulating the banks

9.21 Currently, there is no statutory requirement for Australian banks to invest in the social economy sector: their investments are made voluntarily. Dr Ingrid Burkett, Managing Director of Knode (and formerly of Foresters), told the committee that there is a need to 'obligate structural, commercial interest in a social capital market' rather than relying on the goodwill of companies. Dr Burkett noted that while Australia is 'extremely lucky' to have some financial institutions that are 'deeply committed' to contributing to a social capital market:

> ...this commitment is subject to commercial shifts so that when the commercial environment shifts or the CEO changes, for example, then those commitments can alter. This does not always happen and one or two have built up long-term brand and financial commitments that would make it hard to pull out, but the danger is always there.
>
> That is why I would be in favour in the longer term of structural incentives or obligations such as we see, for example, in the US through the

13 Fundraising Institute Australia, *Submission 23*, p. 4. The FIA did note that some aspects of the UK model would not be appropriate in the Australian setting.

14 Mount Buffalo Community Enterprise, *Submission 24*, p. 6.

15 Mount Buffalo Community Enterprise, *Submission 24*, p. 6.

> Community Reinvestment Act and the new market tax credit program that enable the commercial sector, alongside government and not-for-profits, to take their place permanently and structurally in addressing issues such as building our social capital market.[16]

9.22 As discussed in chapter 5, the United States Community Reinvestment Act of 1977 (CRA) requires lenders to meet the credit needs of all communities they are operating in. Lenders are given a CRA rating, which is then taken into account by the regulators when approving new branches and mergers and acquisitions.

9.23 Amendments to the CRA in 1995 explicitly recognised loans and investments to CDFIs as CRA activity. These changes 'served as an incentive for banks to provide low-cost loans and investments to CDFIs, which were able to leverage these resources to finance activities that mainstream institutions found too risky'.[17] These measures, as well as the establishment of a government fund to provide grants to the CDFI sector in 1994, promoted rapid growth in the sector.[18]

9.24 In evidence to the committee, Mr Ian Gill, Chief Executive Officer of EcoTrust Australia, reflected on some of the benefits and drawbacks of the CRA in the US. He noted that while the Act was key to establishing the CDFI movement and ShoreBank in the US, the fact that banks' contributions were legislated—rather than made on a voluntary basis—was unpopular. Mr Gill suggested that:

> [T]here could be a community reinvestment initiative where banks, who are certainly profitable, would voluntarily put aside a portion of their profits in some sort of structure that actually provides that ongoing subsidy to the operation of CDFIs, because there are two things: where does the capital come from and how do you pay for the operations going forward? Paying for those operations is a problem, especially the further out you get, the more remote you are and the further the distance is between your loans and servicing those loans. Usually the further that is the higher the risk goes. So that spread becomes the kind of spread that a bank does not want to talk about, but it is something that needs to be paid for in some way.[19]

---

16 Dr Ingrid Burkett, Managing Director, Knode Pty Ltd, *Committee Hansard*, 9 September 2011, p. 31.

17 Social Ventures Australia, *Community Development Finance Institutions Scoping Study*, December 2009, p. 21.

18 Foresters notes that there are now over 1000 CDFIs operating in the US including community development loan funds, social venture capital funds, community development credit unions and community development banks. Foresters Community Finance, *Submission 4-attachment 1*, 'Financial Inclusion, market failures and new markets: Possibilities for Community Development Finance Institutions in Australia', October 2008, p. 41. Around 70 per cent of these CDFIs have been established since the introduction of these policy initiatives. Social Ventures Australia, *Community Development Finance Institutions Scoping Study*, December 2009, p. 22.

19 Mr Ian Gill, Chief Executive Officer, EcoTrust Australia, *Committee Hansard*, 23 September 2011, p. 16.

Committee view

9.25 The committee notes the apparent success of the Community Reinvestment Act in the US in promoting investment in intermediaries. However, it is wary of copying this approach. Australia's social economy sector is quite different to that in the US both in terms of scale and the culture in which it operates. Australia's banking system is also different, with the US system having many more competitors. The committee believes it would not be appropriate for Australia's competition regulator to take into account a bank's loans and investments in CDFIs when considering merger proposals. The current merger guidelines address the issues that are of direct significance to determining mergers in the banking sector and the Australian economy at large.[20]

Regulating the superannuation funds

9.26 The other suggested area for tighter regulation of the private sector to promote investment in the social economy is to require that superannuation funds offer a social investment portfolio. The idea is that, among the various portfolios offering varying levels of risk in the open commercial market, funds would also be required to offer an investment package weighted to social investments. The return on this portfolio could potentially be at a lower than commercial rate.[21]

9.27 This idea was put to the committee by Mr Toby Hall, Chief Executive Officer of Mission Australia:

> What I am talking about is a significant change. I do not pretend it is easy. It is a question of saying to the super funds, 'We think there is a requirement for you to invest in this kind of infrastructure environment and, if you are not going to create the tool, then we would look at legislation which would require you to do that.' Realistically you are probably only talking about four to five per cent of superannuation funds being invested in that way. Add to that that the type of returns I am talking about would have outperformed every Australian super fund in the last 15 years, you would have to question why they would not look at investment.
>
> ...
>
> If we are serious we have to create a way to free up the capital and, unless the super funds of their own volition start to do it, I think the only way we will get change is through good tax instruments and then a requirement that they invest in a certain proportion of their funds, or are free to put a certain proportion, into social infrastructure, which actually in the end benefits all of their members anyway.[22]

---

20 See Senate Economics References Committee, *Report on Bank Mergers*, September 2009.

21 Productivity Commission, Submission 6, p. 3; See also Mr Toby Hall, Chief Executive Officer, Mission Australia, *Committee Hansard*, 23 September 2011, p. 57.

22 Mr Toby Hall, Chief Executive Officer, Mission Australia, *Committee Hansard*, 23 September 2011, p. 57.

9.28 Chapter 4 of this report discussed the issue of superannuation funds and the sole purpose test. The sole purpose test, legislated under section 63 of the *Superannuation Industry (Supervision) Act 1993*, requires superannuation funds to have regard only for maximising the financial returns for their members. They cannot consider potential social benefits.

9.29 The Association of Superannuation Funds of Australia (ASFA) told the committee that within the industry, there is universal support for the sole purpose test and any attempts to require the funds to invest in a particular asset class would not be supported.[23] Chapter 4 also noted that superannuation funds can invest in social projects that produce a return that is comparable to commercial rates of return. Foresters Community Finance, for example, noted that it was able to operate a superannuation fund with investments of a social nature (see paragraph 4.81).

9.30 Christian Super also downplayed the obstacle that the sole purpose test poses to superannuation funds investing in social investments. Mr Tim Macready told the committee that the fund carefully considers its values while ensuring adequate risk-adjusted returns in making investment decisions. These values are carefully communicated to its members (see paragraph 4.83).[24]

9.31 However, other witnesses noted that engaging fully commercial superannuation funds to finance the social economy may require a review of the sole purpose test. Ms Kylie Charlton told the committee that from anecdotal evidence, genuine engagement of superannuation funds:

> ...will require a rethink of the application of the sole purpose test or an introduction of a mechanism that effectively levels the financial return for such investors, recognising that the delivery of impact typically carries a cost.[25]

9.32 Ms Charlton added that being able to engage superannuation funds, which need to be able to measure their investments and benchmark them against something commercially acceptable, is 'probably going to be very difficult under the current rules, the fiduciary duties and responsibilities they operate under'. She also noted that superannuation funds are not currently asking for more flexibility under the sole purpose test because social capital markets in Australia remain nascent and there are not many products being developed which may challenge the sole purpose test.[26]

---

23 Mr Gordon Noble, Director of Government Relations and Strategy, Association of Superannuation Funds of Australia, *Committee Hansard*, 26 September 2011, p.16.

24 Mr Tim Macready, Chief Investment Officer, Christian Super, *Committee Hansard*, 23 September 2011, p. 2.

25 Ms Kylie Charlton, private capacity, *Committee Hansard*, 26 September 2011, p. 9.

26 Ms Kylie Charlton, private capacity, *Committee Hansard*, 26 September 2011, p. 13.

Committee view

9.33 The committee underlines the imperative for government to encourage product innovation in the superannuation industry so as to cater for diverse retirement needs. This innovation will not be encouraged by mandating a particular product or products. The committee therefore agrees with recommendation 6.18 of the 2010 Super System Review that the government should not mandate superannuation fund trustees to participate in any particular investment class or vehicle.[27]

9.34 In terms of the sole purpose test, the evidence that the committee has received is that there is universal support for the test and that funds can currently make social investments that are consistent with this test. The committee's evidence, moreover, is that the social economy investments that may challenge the sole purpose test have not as yet been developed for the superannuation funds to trial.

9.35 That said, the committee does believe that there is a need for liaison between government and superannuation funds to monitor any emerging issues in terms of social investments that may require legislative or regulatory solutions. This type of dialogue occurs currently between government and superannuation industry representatives on issues relating to infrastructure investment. The committee underlines its recommendation in chapter 2 that a representative of the superannuation industry should be on the Social Finance Taskforce and that the Taskforce should consider measures to encourage superannuation funds to offer social investment products (see chapter 4).

Taxation and spending arrangements to support social economy investment

9.36 The committee has received considerable comment from submitters and witnesses to this inquiry on the importance of the government's taxation and spending arrangements to promote finance opportunities for the social economy sector in Australia. This section presents some of these comments as they relate to deductible gift recipient status (DGR), tax concessions for investments into CDFIs, the use of 'top-ups', government guarantees and franking credits, the National Rental Affordability Scheme (NRAS) and the recent Unrelated Business Income Tax (UBIT) legislation.

9.37 Tax incentives are the main tool that governments have to encourage investors into underinvested or disadvantaged communities.[28] They are used to good effect overseas. Ms Kylie Charlton told the committee that the New Markets Tax Credit in the US and the Community Investment Tax Relief in the UK are good examples of tax

---

27 Review into the governance, efficiency, structure and operation of Australia's superannuation system, (Super System Review), *Final Report*, May 2010 http://www.supersystemreview.gov.au/content/downloads/final_report/part_one/Final_Report_Part_1_Consolidated.pdf (accessed 8 October 2011).

28 Ms Kylie Charlton, private capacity, *Committee Hansard*, 26 September 2011, p. 8.

incentives used internationally to encourage investment in the social economy (see chapter 5). She argued that the Australian government should give consideration to this type of initiative which 'would structurally encourage investors to engage'.[29]

9.38 Ms Charlton also drew the committee's attention to the report by the Canadian Task Force on Social Finance, released in late 2010. The Task Force recommended that consideration be given to similar incentives and raised the possibility of tax supported debt instruments similar to the tax-free municipal bonds in the US.[30]

Deductible gift recipient status

9.39 A key issue raised during this inquiry is the need for government to address confusion and inconsistency around the issue of deductible gift recipient (DGR) status.[31] DGR status is given by the government to certain NFPs to promote philanthropic giving to these organisations. Donations of $2 or more to organisations with DGR status receive a tax deduction. This status also allows NFPs to receive grants from the majority of philanthropic intermediaries.

9.40 In Australia, the scope of eligible activities is narrow relative to that in comparable overseas communities. Only 40 per cent of all tax concession charities in Australia are DGRs.[32]

9.41 There are two ways in which a NFP organisation or fund can obtain DGR status: being listed by name in the *Income Tax Assessment Act 1997* which requires legislative amendment for inclusion (Item 1); and by being endorsed as a DGR by the ATO (Item 2).[33]

9.42 Importantly, failing to qualify for DGR status does not mean that people cannot donate or invest in that organisation. The donor or investor will not receive a tax deduction, but there is nothing stopping the donation or investment.[34]

---

29 Ms Kylie Charlton, private capacity, *Committee Hansard*, 26 September 2011, p. 8.

30 Ms Kylie Charlton, private capacity, *Committee Hansard*, 26 September 2011, p. 8.

31 Mr Nicholas Cox, Chief Operations Officer, YMCA, *Committee Hansard*, 9 September 2011, p. 50; Mr David Ward, Treasurer, Philanthropy Australia, *Committee Hansard*, 9 September 2011, p. 48.

32 Productivity Commission, *Contribution of the Not-for-Profit Sector*, January 2010, p. 177. The *Income Tax Assessment Act 1997* and ATO Regulations govern the types of gifts that are tax deductible. The gift must be a transfer of the beneficial interest in property, it must be made voluntarily, the transfer must arise by way of benefaction and no material benefit or advantage can be received by the giver.

33 Australian National Audit Office, 'Administration of Deductible Gift Recipients (Non-profit sector)', *Audit Report No. 52 2010-11*, p. 38.

34 Mr Michael Hardy, Assistant Commissioner, Australian Taxation Office, *Committee Hansard*, 26 September 2011, p. 4.

9.43 Only certain charities and NFP entities are granted DGR status. A recent report noted that as at July 2010, there are 24 290 organisations that are DGRs.[35] Based on Treasury estimates, the total value of the concession is over $1.1 billion in 2009–10 revenue forgone and almost $2.1 billion in income tax deductions claimed by taxpayers in 2008–09.[36]

9.44 Private ancillary funds (PAFs) cannot provide funds to an organisation that does not have DGR status. As Mr Michael Hardy of the ATO explained to the committee:

> The reason is that when a person makes a donation into a private ancillary fund it is a deductible gift recipient organisation and so the donor receives a tax deduction. If it was then allowed to reinvest its funds into some other charitable or socially desirable organisation that was not a gift deductible organisation you would have circumvented the intention that gift to that organisation directly will not be tax deductible, but if you pass them through a PAF you would have received a tax deduction for it. It is just an integrity arrangement.[37]

9.45 Philanthropy Australia told the committee that in contrast to a PAF, a private charitable trust receives 'no tax deduction for the money going in'.[38] Accordingly, these trusts can distribute to a much wider range of solely charitable purposes because they are not constrained by the requirement to meet the DGR rules.[39]

9.46 There are several categories of DGR status.[40] The main categories are: a public benevolent institution; a harm prevention charity; a health promotion charity; an animal welfare charity; an arts or cultural organisation; an environmental organisation; an approved research institute; and an overseas aid fund. For each of these categories, there are various conditions that must be satisfied if DGR status is to be granted.[41] Most of these categories require an assessment by the ATO. The

---

35 Australian National Audit Office, 'Administration of Deductible Gift Recipients (Non-profit sector)', *Audit Report No. 52 2010-11*, p. 15.

36 Australian National Audit Office, 'Administration of Deductible Gift Recipients (Non-profit sector)', *Audit Report No. 52 2010-11*, p. 36.

37 Mr Michael Hardy, Assistant Commissioner, Australian Taxation Office, *Committee Hansard*, 26 September 2011, p. 3.

38 Mr David Ward, Treasurer, Philanthropy Australia, *Committee Hansard*, 9 September 2011, p. 48.

39 See ATO TR 2005/13 and Division 78A of the *Income Taxation Assessment Act* 1936.

40 Division 30 of the *Income Taxation Assessment Act 1997* specifies 49 categories under which organisations and funds can seek endorsement by the ATO. See Australian National Audit Office, 'Administration of Deductible Gift Recipients (Non-profit sector)', *Audit Report No. 52 2010-11*, p. 38.

41 See PilchConnect, 'Checklist: Deductible Gift Recipient categories', 2011.

categories related to overseas aid funds, environmental, harm prevention and cultural organisations require an approval by relevant Ministers and the Assistant Treasurer.[42]

9.47 The PC report considered the issue of DGR status in some detail. It noted that access to DGR status is a major concern to NFPs where philanthropy is or could be an important source of funding. In this context, it argued that the use of public benefit interest (PBI) status is no longer an appropriate basis for determining DGR eligibility for charitable endeavour.[43]

9.48 The PC argued that the current DGR system distorts philanthropic giving towards organisations with DGR status. It added: 'when all charities aim to provide a community benefit and potentially provide spillover benefits for the community, this raises questions as to the appropriateness of limiting DGR status to less than half of all registered charities'.[44]

9.49 The PC recommended that gift deductibility be widened to include all tax endorsed charities in the interests of equity and simplicity. It recognised the likely financial impact of this proposal noting that if all new eligible donations were claimed, the impact on tax expenditures in 2006–07 would have been an additional $577 million. The PC concluded that given the revenue implications could be 'substantial', a progressive approach is warranted such as incorporating each 'head of charity' separately.[45]

9.50 The PC also observed that while widening the scope of DGR eligibility increases the potential for rorting, this could be monitored through increased reporting requirements for endorsed organisations.[46]

Submitters' views of DGR status

9.51 This inquiry has also received various submissions that DGR status should be widened as a key initiative to promote finance for the social economy sector. The Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA) told the committee that the main legislative barrier to NFP entities accessing capital is the limitations on DGR status which restricts the entity's ability to attract philanthropic capital.[47]

---

42 See Australian National Audit Office, 'Administration of Deductible Gift Recipients (Non-profit sector)', *Audit Report No. 52 2010–11*, p. 38.

43 Productivity Commission, *Contribution of the Not-for-Profit Sector*, January 2010, p. 177.

44 Productivity Commission, *Contribution of the Not-for-Profit Sector*, January 2010, p. 177.

45 Productivity Commission, *Contribution of the Not-for-Profit Sector*, January 2010, p. 177.

46 Productivity Commission, *Contribution of the Not-for-Profit Sector*, January 2010, p. 177.

47 Ms Robyn Oswald, Branch Manager, Money Management Branch, FaHCSIA, *Committee Hansard*, 1 August 2011, p. 5.

9.52 Mr Benny Callaghan, the Chief Executive Office of the School for Social Entrepreneurs, told the committee that there is a:

> ...challenge...around DGR status for early-stage entrepreneurs and innovators. It is a difficult thing to achieve, especially when some of them do not necessarily fit within the PBI constraints, but also because in order to attain DGR status you need to be operating as an established entity and oftentimes in the early stages they are operating as sole traders or under the auspices of other organisations or they are really grassroots community programs. We are talking about 'mumpreneurs', mum-to-mum businesses, grandparents or young people trying to do things at a very local level. DGR status is very important because entrepreneurship is inherently risky. Government funding will not be appropriate for a lot of the students that we support and philanthropy is the most logical way for them to obtain funding. It is beyond logic, though. Philanthropy is telling us all the time that they are interested in funding early ideas but they are unable to because the people that we support do not have DGR status. That is particularly around community foundations. They are the group that are particularly interested in funding early stage ideas. Also, other funds such as SEDIF are not appropriate for very small entities. In order to participate in programs like SEDIF, you would need to have a far stronger cash flow base and risk history to be able to convince those entities to take on such a small initiative.[48]

9.53 The FIA supported the recommendation in the PC's submission to this inquiry of 'exploring options to allow philanthropic foundations and trusts to invest in social enterprises, which is currently not allowed under the current rules for deductible gift recipients'. It argued:

> These foundations and trusts would have an interest in supporting activities that have community objectives that they support, but would also have the incentive and skills to monitor the investment. They may also provide additional expertise, or assist in linking business philanthropists with an NFP they invest in. Government support is indirect, but still considerable, as the funds invested were exempted from taxation in the accumulation phase for the foundation or trust.[49]

9.54 Another perspective was put by Mr Nicholas Cox of YMCA Australia. He told the committee that there is some confusion as to which organisations are eligible for Item 1 DGR status and which are not. By way of example, he noted:

> [W]e have a YMCA in Katherine that was providing direct relief of young offenders through diversionary programs. The ATO deemed that it was not providing direct relief of poverty, sickness or destitution, according to the status, and was not able to obtain the DGR status, yet the YMCA up the road, which was the Darwin YMCA, was quite able to provide evidence

---

48 Mr Benny Callaghan, Chief Executive Officer, School for Social Entrepreneurs, *Committee Hansard*, 23 September 2011, p. 11.

49 Fundraising Institute Australia, *Submission 23, p.*

> that the service that it was delivering was in fact benevolent and therefore was entitled to the DGR status. Perhaps just using that as a case study, internally as part of a YMCA family one was deemed to be benevolent and therefore was able to access the DGR status; another YMCA was not, even though the objects and the intent behind what they were doing was very much the same. I offer that as a bit of a case study whereby there is confusion even internally within our own organisation let alone in various markets or various organisations across the spectrum.[50]

9.55 Further, Mr Andrew McLeod, the Chief Executive Officer of the Committee for Melbourne, argued that Australia's tax arrangements discourage philanthropic investment in Australia from international sources. He gave the example of BHP Billiton which:

> ...currently has a philanthropic fund worth about $60 million at the moment, which they had to place in London. They would have preferred to have placed it in Australia, but the geographic limitation on DGR status prevented them.[51]

9.56 Indeed, Mr McLeod told the committee that the main policy change that he would recommend to government is to remove the geographical limitation of DGR status.[52]

9.57 Philanthropy Australia told the committee that there are 'a lot of organisations' (175) operating overseas with DGR status to which Australians can donate.[53] However, it was critical of the system for granting DGR status noting 'there are...seven different DGRs' with 'restrictions on which...you can make grants to'. It also noted that less than half the tax concession charities are DGRs. Philanthropy Australia suggested that in its view:

> ...part of the role of the ACNC hopefully will be to sort out this distinction between DGRs, charitable status and eventually come up with a much more coherent package. For instance, less than half the tax concession charities—so charities that the ATO have said, ‘You do not have to pay income tax’—are DGRs. Sometimes there is no logic.[54]

50 Mr Nicholas Cox, Chief Operations Officer, YMCA, *Committee Hansard*, 9 September 2011, p. 50.

51 Mr Andrew McLeod, Chief Executive Officer, Committee for Melbourne, *Committee Hansard*, 9 September 2011, p. 20.

52 Mr Andrew McLeod, Chief Executive Officer, Committee for Melbourne, *Committee Hansard*, 9 September 2011, p. 21.

53 Mr David Ward, Treasurer, Philanthropy Australia, *Committee Hansard*, 9 September 2011, p. 48.

54 Mr David Ward, Treasurer, Philanthropy Australia, *Committee Hansard*, 9 September 2011, p. 48.

9.58 Mr Callaghan of the School for Social Entrepreneurs suggested that given the pace of change in early-stage innovation and social entrepreneurship, there may be a system created whereby an applicant for DGR status does not necessarily have to apply through the ATO.[55]

9.59 In June 2011, the Australian National Audit Office released a report on the ATO's administration of DGRs. The report made two recommendations, one aimed at improving the ATO's decision-making in the DGR applications process, the other focussed on improving the effectiveness of risk assessments of DGRs.[56] The ATO agreed with both recommendations and noted that it will implement them as part of the required structural changes in the ATO prior to the commencement of the ACNC from July 2012.[57]

Committee view

9.60 The committee supports the PC in its 2010 recommendation that the federal government should progressively widen the scope for gift deductibility to include all endorsed charitable institutions and charitable funds. However, it believes that this should be done in a systematic and measured way. To this end, it is important that in seeking to widen DGR status, the government considers the proposed statutory definition of charity and carefully considers the impact of extending DGR on federal government revenue. The committee agrees with Philanthropy Australia that there is an important role for the ACNC to clarify the distinction between DGRs and charities with charitable status.

Tax concessions for investments into financial intermediaries

9.61 Chapter 5 of this report noted that the US and UK both operate tax incentive schemes to promote private sector investment into community development intermediaries, and that similar incentives could be utilised to promote investment in CDFIs in Australia. In the US, the New Markets Tax Credits program has attracted over US$29 billion in private investment to the sector, while the Community Investment Tax Relief program in the UK has also attracted significant capital to CDFIs operating in the UK. The main difference between these schemes and the DGR system (which operates to offset the cost of making donations to particular organisations) is that the tax concessions are available to those making debt and equity investments rather than pure donations. This means that investors receive their principle and interest back in addition to receiving a tax credit, thus creating a strong incentive for private investors.

---

55 Mr Benny Callaghan, Chief Executive Officer, School for Social Entrepreneurs, *Committee Hansard*, 23 September 2011, p. 11.

56 Australian National Audit Office, 'Administration of Deductible Gift Recipients (Non-profit sector)', *Audit Report No. 52 2010–11*, p. 30.

57 Australian National Audit Office, 'Administration of Deductible Gift Recipients (Non-profit sector)', *Audit Report No. 52 2010–11*, p. 29.

9.62 The committee recommended in chapter 5 that the proposed Social Finance Taskforce investigate whether or not tax incentives are an appropriate means of encouraging investment in CDFIs in Australia.

Franking credits

9.63 Another taxation-related option to promote finance for the social economy sector is through the use of franking credits. Chapter 6 of this report discussed this option in some detail. The idea is that a franked credit returned to investors in a social economy organisation would bridge the gap between a social and commercial bond offering. In addition to providing a commercial return, the appeal of franking credits is that they are an established form of tax relief and recognised by the ATO.

9.64 Chapter 6 noted the support of The Chris O'Brien Lifehouse and the Benevolent Society for franking credits as a component of certain social bonds for the acquisition of social purpose infrastructure. Lifehouse noted that a neutral tax rate would not improve the return for the self-managed super funds and the PAFs and that a return of six per cent is inadequate. It argued that a franking credit would increase the return to about nine per cent, which would be enticing to investors.[58]

9.65 Chapter 6 also noted that Lifehouse and the Benevolent Society estimate that the opportunity cost to government for the franking credit would be $122 million per annum for five years, and that the proposed bonds could inject $4.1 billion into social infrastructure.[59]

Committee view

9.66 The committee believes that the franking credit option is one that government should examine. Treasury, in collaboration with the proposed Social Finance Taskforce, should conduct its own cost-benefit analysis to verify the appeal of a three per cent higher return to investors in social bonds as against the estimated opportunity cost to government. This analysis should inform a decision by government whether or not to pursue a system of franking credits to catalyse a social infrastructure market.

---

58 Mr Brent Cubis, Chief Finance Officer, The Chris O'Brien Lifehouse at RPA, *Committee Hansard,* 23 September 2011, p. 20.

59 Chris O'Brien Lifehouse at RPA, *Submission 8*, p. 4; Benevolent Society, *Submission 25*, p. 5.

Guarantees and top-ups

9.67 The issue of a government guarantee for the social economy sector was raised as an option by several organisations. Chapter 6 of this report noted the support of The Chris O'Brien Lifehouse for a government guarantee or a system of franking credits to provide a catalyst to develop the social bond market in Australia.[60] The Benevolent Society supported a government guarantee on the basis that if potential investors could be completely confident of the return of their principal, then there would be 'significant additional demand'.[61]

9.68 Christian Super envisaged that a government guarantee 'drastically improves' the risk profile of both the CDFI and the community sector organisation.[62] In its submission to this inquiry, it noted:

> As a keen potential investor in the social economy sector, we have realised the importance of government involvement especially through direct funding and loan guarantees as well as heavy participation of CDFIs as conduits to most of the government's efforts. Such collaborations between CDFI and the government and the resultant innovation have allowed Christian Super to seriously consider investments in the sector.[63]

9.69 Another possible way that government can facilitate finance for the social economy sector is through 'top-ups'. The idea is that government could provide a payment to investors to supplement the finance they have already received. By so doing, the financial return on social investment becomes more attractive and viable. Indeed, in some cases, the investment may not be viable without this additional government assistance.

9.70 The PC told the committee that the merit of a 'top-up' should be considered on a case-by-case basis. Mr Robert Fitzgerald argued that if a particular activity or program was in the public interest, 'it may well be that on a cost-benefit analysis the government [may] determine that it would be more cost effective for it to top up the initiatives of another party'. Indeed, Mr Fitzgerald noted that a number of philanthropists are currently making their payments conditional on pro rata government and NFP financial contributions. While describing these arrangements as 'very exciting', he added:

> We think the government has to be very careful about not crowding out other initiatives. This is a term that people use very dangerously, so let me be very careful. If it is the case that people believe that the government will intervene and take all of the risk, then human nature says that is exactly what they will allow to happen. We would not be supportive of that in these

---

60 See *Submission 8*, p. 3.

61 The Benevolent Society, *Submission 25*, p. 4.

62 Christian Super, *Submission 12*, p. 5.

63 Christian Super, *Submission 12*, p. 6.

> initiatives. We believe that genuine collaboration between government, philanthropists, for profit and not-for-profit is a very appropriate way forward, each of those playing a discrete and important part. What part that is will depend on the actual circumstances. Our report is open. It does not say that you should and it does not say that you should not. It says that you should look at it on a case-by-case basis.[64]

Committee view

9.71 The committee believes there is a role for government to offer top-ups, guarantees and franking credits to encourage investment in the sector. Chapter 6 recommended that the proposed Social Finance Taskforce examine the use of government top ups on coupons and the use of government guarantees to incentivise a social bond market in Australia. The committee also believes these options could encourage the superannuation funds to invest in the social economy sector.

9.72 The committee agrees that there is an important role for government to facilitate financing opportunities in the social economy sector through the tax system and its own payments. While government is well-placed to recognise these opportunities, it must be careful not to crowd-out these opportunities through its own involvement and subsidies. It agrees with the PC's view that wherever the market is responding, the role of government is not to overly intervene.

Unrelated business income tax (UBIT)

9.73 On 12 May 2011, as part of the 2011–12 federal budget, the government announced its intention to tax retained unrelated business income for not-for-profits. This decision follows on from the High Court's recent Word Investments case:[65]

> This measure will tighten tax concessions for charities that run businesses unrelated to their charitable work. This means that from July 1, they will have to pay income tax on the profits they retain in any newly created

---

64 Mr Robert Fitzgerald, Commissioner, Productivity Commission, *Committee Hansard*, 26 September 2011, p. 26.

65 'Word Investments' was a decision of the High Court in December 2008, confirming that ATO charity endorsement was available to an organisation engaged in commercial enterprise, provided that the organisation existed to fund charitable purposes. When applied, this allowed Word's funeral business to be considered charitable because it existed to fund the charitable activities of another organisation. The PC report resulted in recommendations 'that this long standing freedom of charities to engage in commercial enterprise to fund altruistic purposes (whether their own or those of other charities), should continue to be allowed. Corney and Lind Legal Resource Centre, 'NFP Reform - Federal Government to move to shut the "Word Investments" gate and tax charities on unrelated business income', 11 May 2011, http://www.corneyandlind.com.au/resource-centre/not-for-profit/NFP_Reform_Unrelated_Business_Income_2011_Federal_Budget (accessed 22 September 2011).

> businesses that do not go back into their charity work. The move won't affect op shops or small-scale fundraisers such as lamington drives.[66]

9.74 The Government considers the reform 'an integrity measure to ensure that the valuable tax concessions provided to NFPs are being used to further the altruistic activities of NFPs'.[67] The Government's consultation for the measure was announced on 27 May 2011 and closed on 8 July 2011. The consultation paper sought views on approaches to implement the reform.[68] Government intends to begin consultation on an exposure draft of the legislation shortly. In addition, the government is consulting with States and Territories to negotiate a coordinated approach to the reform.[69] Minister Shorten outlined that 'the reforms to NFP tax concessions will not affect the use of tax concessions that support a charity's related commercial activities'.[70]

Concerns raised about the unrelated business income tax

9.75 A number of submitters to the inquiry have expressed concern that the recently announced budget measures will reduce incentive for development of new and existing social enterprise and reduce the ability for the sector to borrow against its own equity. In addition, there are concerns that the measure will act as a disincentive for investment in the sector and cause lenders to take a more restrictive approach.[71]

9.76 The final report of the inquiry *Australia's Future Tax System* noted that the Word Investments decision has 'significantly increased the scope for NFP organisations to undertake commercial activities'. The report noted that the income tax and GST concessions generally 'do not appear to violate the principle of competitive

---

66 Office for the Not-for-Profit Sector website, 'Not for Profit Sector guide to the Budget 2011–12: Budget Measures to Strengthen the Not-for-Profit Sector', p. 9, http://www.notforprofit.gov.au/sites/default/files/files/Not-for-Profit%20Sector%20Guide%20to%20the%20Budget%202011-12.pdf (accessed 22 September 2011).

67 Australian Government, 'A Tax Plan for our Future: Not for Profit (NFP) Sector Reforms', http://www.futuretax.gov.au/content/Content.aspx?doc=FactSheets/reform_for_nfp_sector.htm (accessed 22 September 2011).

68 Treasury, 'Consultation Paper - Better Targeting of Not-For-Profit Tax Concessions', 27 May 2011, http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=2056 (accessed 22 September 2011).

69 Australian Government, 'A Tax Plan for our Future: Not for Profit (NFP) Sector Reforms', http://www.futuretax.gov.au/content/Content.aspx?doc=FactSheets/reform_for_nfp_sector.htm (accessed 22 September 2011).

70 The Hon. Bill Shorten, MP, Assistant Treasurer and Minister for Financial Services and Superannuation, 'Next Stage for Not-For-Profit Reforms Announced', *Media Release No. 083*, 27 May 2011.

71 Corney and Lind, *Submission 3*, p. 1. Mr Ian Minnett, Chief Financial Officer, Australian Eastern Territory, Salvation Army, *Committee Hansard*, 23 September 2011, p. 25; Mr Murray Baird, Director, Australian Charity Law Association, *Committee Hansard*, 9 September 2011, p. 8. See also Treasury's *Not-for-Profit Reform Newsletter*, Issue 1, 14 October 2011.

neutrality'. However, it observed that in some cases, the rationale for exempting activities from income tax is weakened, such as where NFP clubs operate large trading activities in the fields of gaming, catering, entertainment and hospitality.[72]

The National Rental Affordability Scheme and engaging superannuation funds

9.77 This inquiry has received some evidence on the federal government's National Rental Affordability Scheme (NRAS). The Scheme seeks to address the shortage of affordable rental housing by offering financial incentives to the business sector and community organisations to build and rent dwellings to low and moderate income households.[73] The federal government aims to create 50 000 homes and apartments under the NRAS.

9.78 NRAS provides an annual tax free incentive called the National Rental Incentive to businesses and community organisations that build and rent dwellings to low and moderate income households. The rate is 'at least 20 per cent below the prevailing market rate'. In July 2011, the annual income tax-free incentive was $9524 per dwelling, and is indexed each year to the rental component of the Consumer Price Index (CPI). The incentive comprises a federal government contribution of $7143 per dwelling per year paid as a refundable tax offset or payment, and a state or territory government contribution of $2381 per dwelling per year in direct or in-kind financial support.[74]

9.79 Submitters praised aspects of the scheme. Mr Andrew Tyndale from Grace Mutual, for example, told the committee that it is:

> ...a generous incentive, it is a generous indexation and it is very flexible. It was not too prescriptive, which provides a lot of innovation and I think all of those are good factors.[75]

9.80 However, the committee also heard that the NRAS had several flaws and shortcomings. Mr Tyndale argued that the scheme has a 'design flaw' in that it is a tax based program for which superannuation funds have no use. He emphasised that the 15 per cent tax offers no incentive for wholesale institutional funders to get involved.[76]

9.81 Similarly, Christian Super told the committee that from its perspective:

---

72 Australia's Future Tax System Review Panel, *Report to the Treasurer*, December 2009, pp 44-45.

73 Department of Sustainability, Environment, Water, Population and Communities, http://www.environment.gov.au/housing/nras/index.html (accessed 10 October 2011).

74 Department of Sustainability, Environment, Water, Population and Communities, 'National Rental Affordability Scheme', Frequently Asked Questions, http://www.environment.gov.au/housing/nras/index.html (accessed 10 October 2011).

75 Mr Andrew Tyndale, Director, Grace Mutual, *Committee Hansard*, 9 September 2011, p. 62.

76 Mr Andrew Tyndale, Director, Grace Mutual, *Committee Hansard*, 9 September 2011, 62.

> The structure of the National Rental Affordability Scheme provides a lot of the return to investors in the form of a tax rebate. As an investor who is taxed at 15 per cent, we feel that we are not competitive against investors who are getting a much more significant benefit. Retail investors get a 30 per cent or a 40 per cent benefit from that tax rebate. We have looked at a number of structures to seek to split the income and the tax rebate.[77]

9.82 Mr Murray Baird, Director of the Australian Charity Law Association and Chair of the National Housing Company, told the committee that there is a need for government to provide more incentive for charities to participate in NRAS. He criticised the ATO's approach arguing that when charities and PBIs intended to get involved in NRAS, the ATO effectively said that 'their tax concessions would be under threat because the beneficiaries of housing under the scheme would not be poor enough to deserve charity'.[78] He elaborated:

> The challenge for housing associations generally is that they enjoy tax concessions, because they have a social program. Often they enjoy public benevolent institution concessions. However, should they show initiative in projects such as NRAS, they are criticised for going outside the area where the tax office considers them to be benevolent. So, should they help people who are not abjectly poor, that is said to be no longer a benevolent activity and then they have to argue to justify their concessions. It means that they are always looking over their shoulder in doing anything that is entrepreneurial lest they lose their concessions. I think that is an unhealthy way to be working. There is a technical interpretation of matters that means that they constantly have to get rulings on whether they can do the next thing they wish to do. That takes time, it slows down the activity and it adds expense.[79]

9.83 Mr Gregory Peel from Community Sector Banking also noted that NRAS failed to garner support from institutional investor markets. He told the committee that this was partly due to uncertainty in these markets about what NRAS would look like as an investment proposition.[80]

9.84 Mr Toby Hall from Mission Australia suggested that government needed to develop a mechanism to encourage the participation of the superannuation industry and the major banks in schemes like NRAS.[81] Mr Baird noted that the National

---

77 Mr Tim Macready, Chief Investment Officer, Christian Super, *Committee Hansard*, 23 September 2011, p. 3.

78 Mr Murray Baird, Director, Australian Charity Law Association, *Committee Hansard*, 9 September 2011, p. 8.

79 Mr Murray Baird, Director, Australian Charity Law Association, *Committee Hansard*, 9 September 2011, p. 11.

80 Mr Gregory Peel, Chief Executive Officer and Managing Director, Community Sector Banking, *Committee Hansard*, 23 September 2011, p. 52.

81 Mr Toby Hall, Chief Executive Officer, Mission Australia, *Committee Hansard*, 23 September 2011, p. 52.

Housing Company intends to use social bonds to raise capital for constructing dwelling under the Scheme. He told the committee that while the NRAS incentive will assist with cash flow in the long term, there is a difficulty in attracting investors to the first layer of the bonds.[82]

Other criticisms of NRAS

9.85 Mr Tyndale also criticised NRAS for its non-standard indexation. He argued that an investor in the Scheme cannot hedge rental CPI. In other words, an investor cannot bear the interest rate risk between the CPI and rental CPI. As a result, investors cannot get bank finance against the rental incentive because they cannot hedge the rental CPI.[83]

9.86 A more fundamental criticism is that NRAS requires community housing providers to secure substantial amounts of capital to build to become eligible to receive the incentive. Mr Tyndale told the committee that raising $16 billion worth of capital in the sector 'is just not feasible' and as such represents a structural flaw with the NRAS.[84]

9.87 Grace Mutual's suggestion to the committee was that the government should provide an interest free loan funded by government bond issues. Further, it argued that superannuation funds would buy those bonds, thereby providing indirect funding for NRAS. The loan process would be outsourced to a series of approved professional lenders and paid for by the borrowers. In this way, Mr Tyndale argued that the cost to government of NRAS would be significantly less.[85]

Committee view

9.88 The committee believes that while NRAS is a worthwhile initiative, there are several lessons to be learned from the way the scheme was structured. In particular, the committee emphasises that consideration of future schemes along the lines of NRAS must better structure taxation incentives to encourage both charities and superannuation funds to become involved.

---

82 Mr Murray Baird, Director, Australian Charity Law Association, *Committee Hansard*, 9 September 2011, p. 11.

83 Mr Andrew Tyndale, Director, Grace Mutual, *Committee Hansard*, 9 September 2011, p. 62.

84 Mr Andrew Tyndale, Director, Grace Mutual, *Committee Hansard*, 9 September 2011, p. 62.

85 Mr Andrew Tyndale, Director, Grace Mutual, *Committee Hansard*, 9 September 2011, p. 62.

The best approach for government to promote finance for the sector

9.89 During the course of this inquiry, the committee has received evidence on the best approach for government is to assist social economy organisations to access finance. Specific proposals to this end have been canvassed in Parts II and III of this report. The final section of this chapter presents the key elements of what the committee considers to be the best approach for government to promote finance options for the social economy sector. There are five planks:

- a general mindset of encouraging the market to develop its own financing mechanisms rather than stepping in to regulate or to mandate a market response;
- a long-term perspective, supported by stable administrative arrangements, to work constructively with the various stakeholders;
- a commitment to educating and creating partnerships with stakeholders, recognising that in this role governments can, over time, develop a culture of developing and accessing innovative financing options;
- a commitment to developing a common measurement framework that will allow social economy organisations to recognise their performance and investors to recognise their risk and reward; and
- a need for governments to design and implement innovative policies to challenge both social economy organisations and investors to take up new financing options.

Facilitating the market

9.90 Several submitters to this inquiry commented that the best policy approach for government is to offer incentives for social economy organisations and the private sector to build partnership opportunities. The role for government, they argued, should be to facilitate this cooperation rather than actively control this process.

9.91 Mr Robert Fitzgerald, the Commissioner with oversight of the 2010 PC report into the contribution of the NFP sector, identified an important supporting role for government to develop a capital market for social economy organisations. In terms of the PC report, he told the committee that:

> ...there is a fundamental theme to our recommendations, and that is that wherever possible the market should be able to be developed to provide some of these financial inputs. We have not taken an approach where the government should be the principal funder of the sector. We have certainly been very clear that the sector must be the controller of its own destiny and, thirdly, that wherever possible emerging market responses should be

> encouraged, but in so doing we recognise that there may be a role for government.[86]

9.92 Mr Fitzgerald identified Community Development Financial Institutions (CDFIs) as a particular area that needed government support. He noted that in the PC's view, government should provide CDFIs with access to capital as a short-term arrangement in their establishment phase. Importantly, however, the PC does not believe that government should provide an ongoing or permanent pool of funding for the CDFIs.[87]

9.93 In terms of social housing, Mr Fitzgerald similarly identified an important role for government in collaboration with the private sector and the NFP sector. He noted the PC report's case study on social housing which made the point that if a model is to develop, it is critical that there is collaboration between government, the private sector and the NFP sector.[88]

9.94 Abbeyfield Australia, a community housing not-for-profit company, told the committee that there is an important role for government to put funds into the community housing sector. Residents of Abbeyfield Houses pay 70 per cent of their pension or disability support pension, plus federal rent assistance. The CEO of Abbeyfield told the committee that:

> ...the house generates quite little income. An Abbeyfield House today will generate a surplus at the end of the financial year of about $10,000 to $20,000...That is not much return on a capital investment of about $2.5 or $2.6 million.
>
> ...
>
> That is our dilemma and that is why, amongst a whole range of responses that the government has to finance in the community housing sector, Abbeyfield Australia would argue that within that whole broad range of solutions there is a niche where we would argue that the government needs to maintain some scheme to put government capital funds into the community housing sector.[89]

9.95 Christian Super told the committee that government has a crucial role in ensuring that there are investible structures that provide a good risk-adjusted return. It envisaged a stabilising role for government:

86 Mr Robert Fitzgerald, Commissioner, Productivity Commission, *Committee Hansard*, 26 September 2011, p. 20.

87 Mr Robert Fitzgerald, Commissioner, Productivity Commission, *Committee Hansard*, 26 September 2011, p. 22.

88 Mr Robert Fitzgerald, Commissioner, Productivity Commission, *Committee Hansard*, 26 September 2011, p. 24.

89 Mr Chris Reside, Chief Executive Officer, Abbeyfield Australia, *Committee Hansard*, 9 September 2011, p. 66.

> As this would be a new asset class for most investors, ensuring some level of stability in the sector will go a long way in getting private investors comfortable enough to participate. In our view, the government is in the best position to take on the task of stabilising the sector. We have seen the government use its balance sheet to great effect, with minimal real cost, in the guarantee provided to approved deposit-taking institutions. The deposit guarantee increased the competitiveness of smaller ADIs, ensuring a better outcome for consumers by providing downside-risk protection. A similar use of the government balance sheet in the not-for-profit sector through investing, rather than just spending money in the sector and taking on the riskier parts of the investment, will increase the competitiveness of the sector and ensure an acceptable risk-adjusted return for investors. Again, drawing from our experience in the SEDIF program, the government's commitment to be a long-term subordinated co-investor significantly improved the risk profile of the investment and made it investable for Christian Super.[90]

Committee view

9.96 The committee emphasises that government has an important role to play in managing the shift from a sole emphasis on grant funding to creating finance opportunities for the social economy sector. This role may encompass a range of measures including tax incentives and concessions, top-ups and government guarantees. Whatever mix of these measures is adopted, the committee emphasises that the role of government must be to assist the market in the direction it is moving, rather than intervene to control the market. The role of government should not be to regulate the banks to require that they invest in the social economy sector, nor require that superannuation funds offer social economy products.

The need for a long term perspective

9.97 Another issue raised by various submitters was the need for government to think less in terms of short-term grant funding, and more in terms of offering long-term strategic financing options for the social economy sector. In its submission to this inquiry, for example, *New Models New Money*, a coalition of organisations focused on creating financing opportunities for the arts, noted the 'constant uncertainty about future funding and [the] considerable effort expended in chasing support from government'.[91]

9.98 Christian Super emphasised the need for long term funding of CDFIs to assure community sector organisations that the CDFI will be able to perform its duties throughout the investment. Its submission emphasised the importance of CDFIs having 'reliable sources of funding in order to invest in long term assets as well as

---

90 Mr Timothy Macready, Chief Investment Officer, Christian Super, *Committee Hansard*, 23 September 2011, p. 2.

91 New Models, New Money, *Submission 13*, p. 2.

meet short term operating costs to ensure overall business viability'. In particular, it identified a role for government to:

- subsidise staffing costs to ensure that CDFIs concentrate on providing the services to community sector organisations; and
- assist with the capital raising costs for CDFIs with funding in the form of grants, performance based payments or loan guarantees.[92]

9.99 Mr Gill of EcoTrust Australia also impressed the need for government to adopt a long-term view to promote social economy projects in indigenous communities. He emphasised to the committee the need for financing mechanisms and government assisted social economy projects to outlive the political cycle. Mr Gill noted his frustration at this short-term thinking from his experience working in Canada:

> ...we had a CDFI running there that was provided loan-loss reserves by the federal government, which was really the first time the government did something constructive for us. They said, 'You're running a good portfolio, we'll give you a loan loss reserve so you can go to investors and say "80 per cent of any one deal you are doing will be guaranteed by this up to 15 per cent of your total portfolio."' It was a very useful mechanism. It ran for three years. The government changed and a new minister came in and swiped that away not because of performance issues but because of a political change in the wind. It is impossible to set up long-term economic structural change in communities if you are still subject to the vagaries of political change.[93]

9.100 Social economy organisations themselves face a long-term challenge of shifting their mindset to embrace different financing options. Mr Kevin Robbie, the Director of Employment at Social Ventures Australia, told the committee that based on the UK experience, the government has a long-term task of working with specialist intermediaries and social economy organisations:

> It is how you create a culture within the nonprofits themselves so that they are willing to take on debt or take on different types of finance. That was a 10- to 15-year job in the UK working through specialist intermediaries to actually create that culture. Part of it is about managing expectations, because even after a 10- to 15-year period in the UK there is still only, a recent report said, 16 per cent of ideas coming forward that are actually investment ready, and it is bearing the cost of educating the market and having a long-term vision about what you want to do with this market and where you want it to be.[94]

---

92 Christian Super, *Submission 12*, p. 4.

93 Mr Ian Gill, Chief Executive Officer, Ecotrust Australia, *Committee Hansard*, 23 September 2011, pp 13–14.

94 Mr Kevin Robbie, Director of Employment Services, Social Ventures Australia, *Committee Hansard*, 1 August 2011, pp 20–21.

Committee view

9.101 The committee agrees that there is a need for governments to have a long-term view to assisting the development of the social economy sector in Australia. It believes that recent developments, such as the creation of the Office for the Not-for-Profit Sector and the ACNC, provide a good platform for successive governments to develop mechanisms for the development of a robust capital market for social economy organisations. To this end, the committee also highlights the long-term focus of the proposed Social Finance Taskforce (see chapter 2).

Educating and collaborating

9.102 A major theme of this inquiry is the important role for government to educate and connect stakeholders to the opportunities for investment in the social economy sector. Clearly, if social economy organisations are to gain access to finance, it is important that banks, superannuation funds, private ancillary funds and other financial intermediaries understand these organisations' needs and investment opportunities. It is equally important that social economy organisations have an understanding of the investment products that the private sector can offer. In both respects, government has an important role.

9.103 Mr Peter Quarmby, the Executive Director of Community Sector Banking, emphasised in his evidence to the committee the importance of developing partnerships between the NFP sector, the private sector and government. As he told the committee:

> We believe that the non-profit sector has a role to play in its own destiny, in managing its own capital. It has a huge amount of capital running through it and by aggregating its demand we can create greater efficiencies. But we also understand that there needs to be a partnership relationship between the sector, the private sector and government. In a sense, part of the reason for setting up community sector banking was not so much about setting up a bank but changing the way in which the non-profit sector saw itself and saw capital. I believe that this sort of initiative changes the relationship between the sector and government from what potentially can be a master-servant relationship to one of a partnership.[95]

9.104 PM&C emphasised the importance of governments' collaborative efforts in engaging social economy organisations and the private sector. Mr Paul Ronalds, First Assistant Secretary of the Office of Work and Families, stressed that:

> ...government must become much better at using its convening power to catalyse, promote and to encourage the private and not-for-profit sectors as well as individual citizens to become active agents of a change that we would like to see in our society. In our view, the work of this committee can play a very significant role in assisting this change. A policy

95 Mr Peter Quarmby, Executive Director, Community Sector Banking, *Committee Hansard*, 23 September 2011, p. 52.

> environment that encourages more collaboration, like that achieved in the establishment of initiatives such as the GoodStart Childcare initiative, the Social Enterprise Development Investment Fund and the National Rental Affordability Scheme are all very welcome beginnings to this.[96]
>
> ...
>
> The government has very significant convening power to get different sectors to the table. You have heard evidence from a range of different speakers about the need for these complex policy problems that we face to have all three sectors there working them through. You essentially get policy failure when any one sector, particularly government, thinks that they have the full understanding and puts in train a solution without sufficient consultation and engagement to get the perspective that it needs.[97]

9.105 In this context, Mr Ronalds noted three particular initiatives that could have particular merit: a social finance taskforce charged with leading a national dialogue on social investment (along similar lines to that recommended in chapter 2 of this report); social impact bonds; and measuring return on investment.[98]

9.106 The challenge of developing social purpose superannuation investment products is a good example of where government can and must assist learning and collaboration. Mr Fitzgerald of the PC told the committee that if government is not going to mandate that superannuation funds invest a set percentage in social investments, it has a role to assist the superannuation industry to identify and develop appropriate social purpose products. He added:

> This is why government is so essential. It can bring the relevant parties together, identify the appropriate opportunities and then work out those implementation pathways. I cannot give you advice as to how that will happen. The fact is that it has not happened today....
>
> The not-for-profit sector has not been completely dormant in this area, but if you really want to get movement my suggestion is that a proposal that involves at least the Commonwealth government is the first step.[99]

Committee view

9.107 The committee envisages that the role of government in promoting access to finance for the social economy sector must at its core be focussed on convening and encouraging collaboration. As chapter 2 of this report emphasised, one of the main

---

96 Mr Paul Ronalds, First Assistant Secretary, PM&C, *Committee Hansard*, 26 September 2011, p. 28.

97 Mr Paul Ronalds, First Assistant Secretary, PM&C, *Committee Hansard*, 26 September 2011, p. 30.

98 Mr Paul Ronalds, First Assistant Secretary, PM&C, *Committee Hansard*, 26 September 2011, p. 28.

99 Mr Robert Fitzgerald, Commissioner, Productivity Commission, *Committee Hansard*, 26 September 2011, p. 23.

initiatives to this end should be for government to establish a Social Finance Taskforce. As this report's various recommendations make clear, this Taskforce will have an important role advising government and the social economy sector at large of the best way to promote long-term finance opportunities for the sector.

Measuring performance

9.108 Government also has a crucial role to play in ensuring that social returns on investment are measured accurately, consistently and transparently. Chapter 7 of this report noted the particular importance of measurement and evaluation in the context of developing market social impact bonds. The government recognises the importance of evaluating the work of the social economy sector:

> Better measurement of social return on investment is critical for establishing the transparency and accountability of social initiatives for building credibility with investors, funders, donors and the like.[100]

9.109 The PC report devoted two chapters to some of the challenges that NFPs face in producing an evaluation of their activities that are meaningful, comparable and cost-effective. It recommended that Australian governments should adopt a common framework for measuring the contribution of the NFP sector. During this inquiry, the PC returned to this theme of evaluation. Mr Fitzgerald told the committee that:

> In programs like social housing and others where they are long term we need to have good evaluation processes that allow you to adapt the program as the evidence warrants the adaptation. One of the difficulties when you have the private sector involved is that they want certainty. One of the issues with social policy is that often you have to adapt as you learn. Not only do you need early intervention by the government in terms of bringing the right parties together, you need good-quality evaluation frameworks designed at the beginning. You need them to be used to inform and then you need an ability to adapt as you go forward.[101]

Innovating to catalyse the market

9.110 Finally, the committee believes that in seeking to develop a mature capital market for social economy organisations, governments must be innovative and should be encouraged to develop pilot programs that unlock the potential for investment. It commends the federal government for its recent NRAS, Social Enterprise Development and Investment Fund (SEDIF) and CDFI pilot initiatives. The departments' joint submission noted that:

---

100 Mr Paul Ronalds, First Assistant Secretary, Department of the Prime Minister and Cabinet, *Committee Hansard*, 26 September 2011, p. 28.

101 Mr Robert Fitzgerald, Commissioner, Productivity Commission, *Committee Hansard*, 26 September 2011, p. 25.

> Such measures can only be seen as interim steps in market development to provide a 'buffer' to early stages of development and test the market. Succinctly put by the Monitor Institute, 'someone needs to go first'.[102]

9.111 The committee agrees. Government does have an important role in catalysing the market and the NRAS, CDFI pilot and SEDIF initiatives are exemplars of this 'going first' approach. Not only have these programs had a direct impact on investors and social economy organisations, they have—and will continue to—encourage the type of collaborative, longer-term approach that the sector needs to develop a capital market. As Ms Belinda Drew, Chief Executive Officer of Foresters, told the committee:

> ...in the last 18 months to two years of our organisational life, it would be very silly to underestimate the power of government intervention. I mean that in a positive sense. As we have seen government come to the party, if you like, by not just providing funding but actually endorsing the work, that step change has been very significant. In the not-for-profit work that we have been doing in Victoria and Queensland, just by virtue of the fact of the state government funding that front-end work speaks to those sectors that this is something that government actively encourages them to get involved with. That has an enormous and positive impact on how organisations then behave.[103]

9.112 Certainly, there are more opportunities for pilot programs, most interestingly in the area of social impact bonds (see chapter 6). The committee emphasises that with all these new initiatives, it is crucial that outcomes and performance are properly measured and where mistakes are made in program design or implementation, lessons are learned and heeded.

Senator David Bushby
Chair

---

102 DEEWR and PM&C, *Submission 9*, p. 29.

103 Ms Belinda Drew, Chief Executive Officer, Foresters, *Committee Hansard*, 1 August 2011, p. 34.