Review of Allia's charitable bonds

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Introduction

Many charities in the UK are struggling to make ends meet. Income from government and other funders is falling and there is more competition than ever before for unrestricted donations and grants. Charities are looking for new ways to raise the funds they need to help their beneficiaries.

Funders are also feeling the pinch. As the costs of living and doing business rise, private donors, grant-makers and businesses are finding it hard to keep pace with increasing calls for donations. They need new ways to give that do not put them in a financial fix.

One organisation that is attempting to address both of these concerns is Allia. Allia, a community benefit society and exempt charity, has developed a charitable bond mechanism that gives donors a chance to invest their capital funds and generate an unrestricted grant for the charity of their choice.

Allia has commissioned New Philanthropy Capital (NPC) to review its charitable bonds to provide an independent perspective on the mechanism.

About this report

In this report, we look at how Allia's charitable bonds work and ask whether they are a wise choice for funders and charities. We examine how the bonds are structured and analyse the risks and benefits to participants. Our research draws on interviews with people who are already involved with the bond:

- Bill Parsons, Executive Vice President - Human Resources, ARM (a corporate investor);
- Brian Winterflood (an individual investor);
- The Baroness Stedman-Scott (Chief Executive) and Kate Bolsover (Deputy Chairman) from Tomorrow's People (a charity that has benefited from the bond).[1]

Please note that this report should not be seen in any way as investment advice. Instead, it gives NPC's opinion on some of the risks and benefits involved in participating in the bond. Investors who want help deciding whether Allia's bonds are right for them should seek the advice of an independent financial advisor.

[1] Disclosure: Debbie Scott became a trustee of NPC in summer 2011.

1. How the charitable bonds work

Allia has developed a series of five-year charitable bonds that generate up-front donations for charities and give back the original investment plus an optional financial return to investors. Charities promote the bonds to potential investors, who purchase them using capital funds that they want to keep at minimal risk (for example, savings or cash reserves) and that they do not need immediately but will want at some point in the future.

Allia's charitable bonds can be thought of as an ethical five-year savings scheme, where some or all of the interest an investor would earn, plus the profit that a bank would normally take for itself (the arbitrage), is donated to a charity of the investor's choice.

The terms of each round of bonds will reflect market rates. At the time of writing, investors are being offered a return of between 0% and 2% per year in simple interest paid gross at the end of the term. Depending on the return chosen by the investor, charities currently receive between 11% and 19% of the original investment as a donation.[1]

A new round of bonds is due to be launched in September 2011, and the rates on offer are likely to be slightly lower, reflecting economic conditions. Investors and charities can use the investment calculator on Allia's website to look at the rates of return they can expect.[2]

How returns are generated

Funds raised by a bond issue are immediately split by Allia into three 'pots':

1. **Loan pot:** Allia uses the majority of the funds raised by the charitable bonds to make a loan at a fixed rate of interest that reflects market rates. The exact amount loaned out in any one round varies according to the return required by investors and the interest rate on the loans; in the most recent round of bonds it was between 79% and 87% of total funds raised. Interest is compounded over five years and repaid in a single amount at the end of the term. This is then used to repay investors.[3]

   At the time of writing, all loans are made to Places to People Homes, a social housing provider. In the most recent round of bonds, the interest rate on the loans was 4.73% compound.

2. **Allia's fees:** Allia takes a proportion of the funds raised from investors as a fee to manage the bonds and to cover its costs. This fee is currently 2% of the value of bonds raised. However, it is reduced to 1% for any funds over £1m raised by a charity in a single round of bonds.

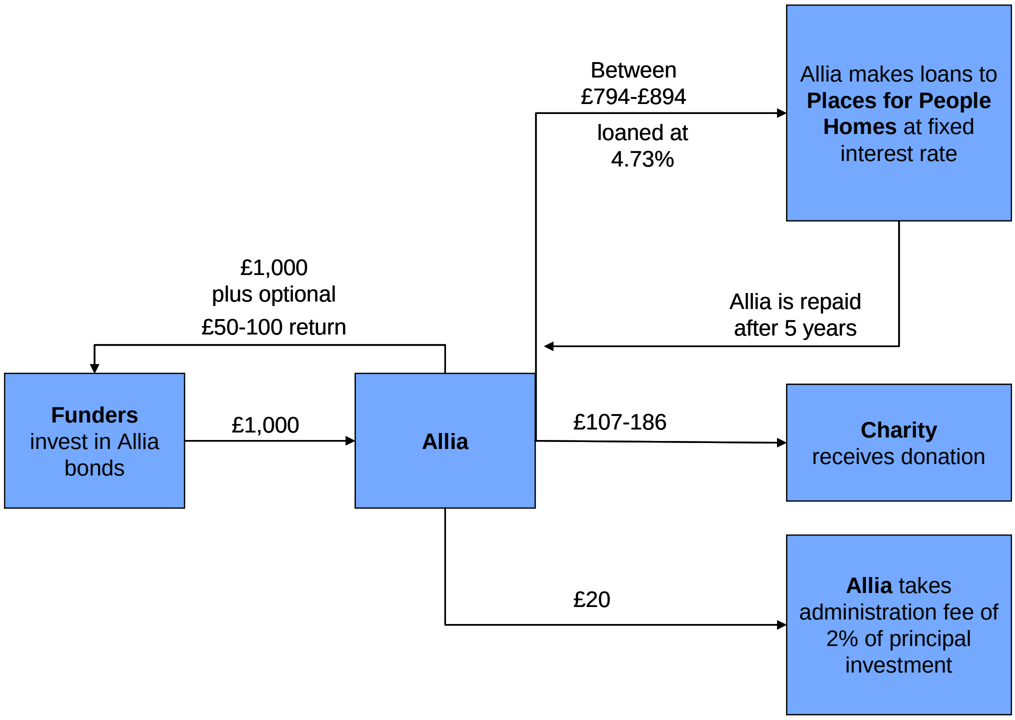
3. **Donation pot:** After the loan has been made and Allia's fees deducted, the remainder of the funds raised are given as donations to the charities selected by investors. These donations are made as soon as the bonds are issued.

   The amount donated is essentially the tax-free interest to be paid by Places for People Homes minus Allia's fees and the return to the investor. Because Allia is a charity it does not have to pay tax on the interest it receives. Therefore, since no tax has been deducted from the donation, no further Gift Aid can be claimed on it.

The model is illustrated in Figure 1.

[1] These figures are based on an interest rate of 4.73% on a loan to Places for People Homes compounded over a term of five years with a single repayment, and that Allia's fees for managing the bonds are 2% of funds invested in the bonds.
[2] www.allia.org.uk/investing/how-it-works/calculator
[3] The exact amount loaned out is equal to the present value of the amount payable to investors on maturity. This means the return of the loan plus compounded interest after five years is exactly the right amount required to repay investors at the rate of return they selected.

Figure 1: How Allia's charitable bonds work *



* Amounts given are based on the bond round at the time of writing. Amounts in future rounds will vary.

The investor perspective

Investors use capital funds that they want to keep at minimum risk to purchase charitable bonds. Investors can select a charity from Allia's membership or suggest another charity to receive the donation from the bond. The charity receives this payment when the bonds are issued.

Using the bond offer at the time of writing as an example: if a funder invests £1,000 in Allia's charitable bonds, the charity selected by the investor will immediately receive a donation of between £107 and £186, depending on the return the investor has asked for. After five years, the investor receives his or her original investment back, as well as interest of up to £100—depending on the return selected at the time of application. Any interest is paid gross and investors need to declare it as income for tax purposes.

Box 1: How funders invest

Investors wanting to invest in Allia's charitable bonds first fill out an online application form at www.allia.org.uk.

Investors then have until the closing date of the bond to make payment. Investors can cancel or withdraw their funds at any point up until the issue date.

The charity perspective

Charities can get involved with the charitable bond by investing in withdrawable shares to become members of Allia. The size of the investment depends on the income of the organisation: £250 for charities with a turnover under £100,000 and £500 for charities with a higher turnover. If the charity decides to stop being a member of Allia, the value of the shares is refunded.

Allia's members also pay an annual registration fee to cover administration costs. Again, this depends on the charity's size: £100 per year for small charities and £250 for large ones.

Once registered on Allia's website, charities can begin promoting the bond to new and existing supporters that might be interested in investing. Allia provides a range of resources and training to support charities with their promotion. It does not conduct any fundraising on behalf of other charities, although it can sometimes meet with prospective funders interested in making a significant investment.

The charities selected by investors do not have to wait until the bonds have matured to receive their donation—it is given when the bonds are issued. There is no minimum amount that needs to be raised and there is no minimum donation. Charities are given investors' details (unless they opt out) and can use these to further engage supporters.

Charities only need to pay the registration fee for the time that they want to be listed as a member and potential beneficiary on Allia's website. They do not need to remain registered for the full five years following a bond issue. However, charities receiving donations are required to report back to Allia and investors using an annual monitoring form, detailing the social outcomes their investment has achieved.

2. Should funders invest?

Funders[1] face both benefits and risks when investing in Allia's charitable bonds. They can generate social benefit, recycle their investment and be innovative in their giving. But they also face the risks of low returns and opportunity costs. Funders should prioritise choosing effective organisations in order to make the biggest impact possible with their money.

Benefits

Social benefits are generated

The biggest advantage of the bonds is that they create a social benefit, often from funds that would otherwise just be sitting in a bank account. They can therefore be a valuable part of an individual's or grant-maker's philanthropy, a business's corporate social responsibility (CSR) or sustainability strategy, or an investor's social investment portfolio.

An added advantage is that the bonds generate social benefit in a number of ways. Most obviously, they generate donations for investors' charities. But Allia also uses them to make loans to the social housing provider, Places for People Homes, which builds social housing in the UK for disadvantaged or vulnerable people.

Grant-makers can also make an impact by purchasing bonds using designated funds that are earmarked as grants but do not need to be paid out for several years.

The investment is recycled or returned

Because investors receive at least their principal investment back after five years, this money can be 'recycled'—used again to support another cause. Allia gives investors with a matured bond the option of rolling it over to another bond. Investors can then choose to support the same cause or a new one. This recycling option makes the bonds an efficient way to give, as it means the same money can go further.

For investors that do not want to recycle the bond, the money is simply returned. ARM, a corporate investor, told us that this made the bonds particularly attractive. It finds lending easier than giving money away because the bonds remain as an asset on its balance sheet and have no direct impact on its profit or loss.

Investors can choose which charity to support

With many forms of social investment, the recipients are fixed. But in Allia's case, investors can decide for themselves which charities from Allia's membership benefit from the donations.

This flexibility allows investors to tailor their investment to their own priorities. For example, grant-makers can select charities that fit within their funding streams. Businesses too can choose charities that fit within their CSR or sustainability strategies.

Investors can suggest charities that are not yet members.[2] Allia then gets in touch with these charities and suggests that they join, so long as they meet certain criteria. At the time of writing, these criteria are:

- The organisation must be constituted as a registered charity or with not-for-profit status.
- The organisation's purpose must be focused on 'giving people a better future'. Charities focused purely on animal welfare, for example, do not currently qualify for support.

[1] By 'funders', we mean individuals, charitable trusts, businesses and anyone else considering purchasing the bonds.
[2] www.allia.org.uk/causes/suggest-a-cause

Investors can be innovative

Allia's charitable bonds are an innovative way of raising money for charity. Social investment (of which Allia's charitable bonds is one type) is an emerging and relatively underdeveloped field in the UK. Businesses and individuals purchasing Allia bonds are therefore part of the first wave of investors getting involved in and supporting this exciting new area.

Funders wanting to know more about social investment should see the Charities Aid Foundation report, *Financing the Big Society*.[1]

Risks

We highlight here some of the main risks of investing in Allia's charitable bonds. However, this is not an exhaustive list and potential investors should consult their independent financial advisor for a full assessment.

Investors receive no or low returns

The maximum return that investors can currently receive on the charitable bonds is 2% in simple interest paid gross at the end of the term (10% after five years). Many investors choose to accept lower returns or even no return at all. This could create two difficulties.

Firstly, investors face the risk that inflation will reduce the value of their capital during the five years of the bond. Inflation rates at the time of writing are around 4%, meaning that even investors purchasing bonds at the higher 2% interest rate are exposed. However, the interest rates paid on many deposit accounts are also below inflation, meaning that investors wanting to keep their funds at a low level of risk may find it hard to avoid being exposed to this risk.

Secondly, corporate investors may find it hard to justify committing funds that generate low or no returns for five years. This may be especially the case for public companies that need to defend their investment decisions to shareholders. However, companies that hold a large amount of cash may not find this to be a problem if Allia bonds are part of the low-risk element of their portfolio of investments.

There may be opportunity costs for investors

Investors should consider what interest they might receive if they placed their money elsewhere. It may be that they can find a better return at a commercial bank for a similar level of risk.

However, based on options available to individuals at the time on writing, Allia's offer appears to be competitive. The choice available to individuals wanting to lock their money away for five years is fairly limited and the highest interest rate we found for a five-year bond was 4.6% per year.[2]

The investor may need the money back before the bond matures

Investors are unable to withdraw their funds before the bond matures at the end of the five years, so they must be fairly certain that they will not require the funds during that period. Investors can transfer their bonds if they find a willing purchaser, although interest-bearing bonds are subject to stamp duty. Allia is looking into the feasibility of allowing investors to withdraw their funds early, probably for a penalty fee.

[1] Charities Aid Foundation (2010) *Financing the Big Society: Why social investment matters*.
[2] www.theaa.com/savings/fixed-rate-savings-accounts-products.html. Accessed 19 August 2011.

Investors may not get their money back

There are two scenarios that could potentially jeopardise investors getting their money back: Allia becoming insolvent, or Places for People Homes failing to repay the loan. However, the risk in both cases appears to be very low.

Places for People received an Aa3 credit rating in 2010,[1] and there is no history of any investor losing money by lending to a housing association.[2] If Allia were to become insolvent, investors would not lose their money. Instead the funds invested would be transferred to an independent trustee—Wrigleys Trustees Limited—which would then return funds to investors.[3]

Investors who wish to add another layer of security can opt into a guarantee, which will ensure repayment in the event of Places for People Homes defaulting on the loan. However, opting in to this guarantee does incur a further charge—3.5% of the original amount invested.[4]

There are no tax incentives for investors

Tax is not an area within NPC's expertise. However, a concern raised in several of the interviews was the lack of tax incentives for investors to place their money in a social investment rather than a commercial investment. Investors are liable for tax on the return they receive on interest-bearing bonds, and those transferring interest-bearing bonds are required to pay stamp duty on the amount the bond is purchased for.[5]

However, investors should bear in mind that the donation generated for charity is tax efficient. The amount donated is essentially the tax-free interest to be paid by Places for People Homes, minus Allia's fees and the return to the investor. Because Allia is a charity, it does not have to pay tax on the interest it receives. Since no tax has been deducted from the donation, no further Gift Aid can be claimed on it.

Allia also believes that its model generates larger donations for charity compared to a situation where an investor donates interest on a commercial bond with similar rates and then reclaims tax via Gift Aid. However, this is not something that NPC can verify.

Donations may not generate social impact

Allia offers its bonds to charities as a fundraising tool, and the listing of a charity on its website does not constitute an endorsement or any evaluation of that charity's effectiveness. The choice of which charity to support is left entirely to the investor.

This means that, although charities are required to report back on the outcomes they have achieved, there is a risk that donations are spent in a way that does not create the benefit the investor hoped for.

To minimise this risk, investors should conduct their own due diligence and donate to charities that they know to be effective. The following section gives some guidance on choosing a charity, which may be helpful for investors who do not have a recipient in mind.

Choosing a charity

Which cause?

A good first step is to think about what cause to support. Allia's requirements mean that only causes *'giving people a better future'* are eligible to receive donations from the bond. But this is a broad category that gives investors a great deal of scope to support charities in many different sectors.

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[1] www.allia.org.uk/wp-content/uploads/Allia_Charitable_Bond1_Offer.pdf
[2] www.publications.parliament.uk/pa/cm201011/cmselect/cmworpen/memo/hb/hb61b.htm
[3] www.allia.org.uk/wp-content/uploads/Allia_Charitable_Bond1_Offer.pdf
[4] www.allia.org.uk/wp-content/uploads/Allia_Charitable_Bond1_Offer.pdf
[5] www.allia.org.uk/wp-content/uploads/Allia_Charitable_Bond1_Offer.pdf

Investors may already have a cause in mind, such as homelessness. But if not, it is worth doing some research to identify a particular area. One starting point is NPC's website, which includes over 80 reports looking at different areas of the charity sector, such as disability, youth offending and violence against women.

Finding a focus

Once investors have chosen a sector, they should consider focusing on a particular area. This is especially important if the chosen sector is very broad—like child poverty, for example. The focus could be on:

- a sub-sector—for example, within child poverty, investors could look at education, housing, or employment;
- a geographic area—for example, a charity working to combat child poverty in an investor's local area; or
- a particular age group—for example, disadvantaged teenagers.

Investors may also want to consider the type of interventions they want to support. One way to think about this is by looking at activities that provide intensive help to just a few people (such as tailored employment support for young people not in education, employment or training) and comparing them with activities that reach more people in a less intensive way (such as a careers advice website for disadvantaged youth).

Finding an effective charity

The final step is to find an effective charity that is going to spend donations wisely. NPC has developed a framework for assessing charity effectiveness, set out in *The little blue book*.[1] This is not the only tool available, but it is a good place to start.

Investors with only a few hours to spend can get quite a long way by looking at the charity's website and its annual report on the Charity Commission's website.[2] Investors should look for information that helps them answer the following questions:

- Does the charity tell me the problem it is trying to tackle?
- Do I know what the charity is doing about it?
- Is it clear what difference the charity is making to the people it is trying to help?
- Does the charity have any evidence (such as evaluations) to back up what it says?
- Is the charity honest about the challenges it faces or the projects that did not work?

By choosing a sector, focusing on a particular issue within that, and selecting effective charities, investors can ensure that their donations make the greatest difference to the people they are trying to help.

[1] Copps, J. and Vernon, B. (2010) *The little blue book: NPC's guide to analysing charities, for charities and funders*. New Philanthropy Capital.
[2] http://www.charity-commission.gov.uk/

3. Should charities sign up?

Allia's charitable bonds are likely to be attractive to charities for many reasons: they generate immediate unrestricted income without any financial risk, and they provide opportunities for charities to build relationships with funders. But charities should also be aware of the risks: charities may struggle to sell the bonds or they may cannibalise funding from other sources.

Benefits

Bonds generate up-front unrestricted income

The biggest draw of the bonds for charities is their ability to generate valuable unrestricted funding. In the last year, £7.4m has been invested in Allia bonds, which have raised around £1.3m for charity. The charity Tomorrow's People raised around £220,000 of investment from a recent bond round, which generated around £41,000 for the charity.

Another attractive feature of the bond is that charities do not need to wait until the bond matures to receive donations. Instead, they receive the funding when the bonds are issued.

Bonds may generate funding from new sources

Most donations are made from funders' surplus or disposable income. But Allia's bonds aim to generate donations by unlocking funds of a different type: money that investors do not want to give away but that they do not need right now. For example, businesses might use their cash reserves to buy bonds. Individuals, on the other hand, might use savings or funds that they plan to give away as legacies after they die, to benefit charities in the meantime.

Allia hopes that grants generated from the bonds will supplement investors' existing donations and increase the overall availability of unrestricted funding to charities. Debbie Scott found this to be true in the case of Tomorrow's People: the bonds generated significant new donations from new funders.

However, it is not yet clear whether unlocking donations from these new sources will increase overall levels of giving for all charities (see Risks below).

There is no financial risk to the charity

Unlike most social investments, Allia's bonds do not require charities to take on any financial risk. Charities do not take on the loan themselves, but are simply the beneficiaries of donations generated by the investment in the social housing provider.

This may make Allia's bonds particularly suitable for charities that are unable to take on their own social investment. They might not have a reliable income stream from which to make repayments or assets to borrow against, shutting them off from a potentially useful source of funding. Allia's product is therefore a good way of getting round this problem. Charities benefit from social investment but do not need to be ready to take on a loan themselves.

There is an opportunity to build relationships with potential donors

Over the five year term of the bonds, charities are required to report back to investors about the social impact they have achieved with the donations generated by the bonds. Charities are also given investors' contact details (unless they opt out). This provides a perfect opportunity for them to build relationships with investors and engage them with the organisation and cause.

The deputy chairman of Tomorrow's People, Kate Bolsover, told us that she first got involved with the charity as a result of investment that her company, Cazenove, made in a bond. When the bond matured, Cazenove became a regular donor to Tomorrow's People. When Kate retired from the company in 2005 she went on to become a trustee of the charity.

Risks

Funds may not raise as much as expected

Two of the people we interviewed found that the bond was a hard sell to potential investors and that there was not as much take up as they had hoped. The annual administration fee that Allia charges means that charities need to be confident that the donations they raise will at least meet these costs.

Based on the current bond on offer, a charity would need to ensure that investors purchase bonds to the value of between £537 and £2,338 in order to break even in any one year. For a charity to generate a £1,000 donation, this goes up to somewhere between £5,907 and £11,688 of bonds. See Box 2 for details of how we calculated these figures.

Bonds may be more suitable for charities that know there is one or more donors interested in making a fairly significant investment in Allia's bonds before they become members.

Bonds may cannibalise existing donations

While some investors see Allia's bonds as an additional way to support a charity, other funders may see them as an alternative to making donations in another way. In these cases, the level of donations received by a charity may stay much the same, or even drop.

It is hard to say how likely this risk is to materialise. Evidence is mixed as to whether donors see social investment products, like Allia's bonds, as in the same category as their other philanthropy, or as something separate. A recent report found that around a third of investors see social investment as a new type of activity, while another third see it as part of their philanthropy.[1]

More investigation is needed on this issue. Until more conclusive evidence comes to light, NPC believes charities should consider the possibility that some investors see the bonds as an alternative, rather than a supplement, to giving.

Charities may not have the financial knowledge and skills to sell the bond

In order to pitch the bonds successfully to potential investors, charities need to demonstrate a good understanding of how the bonds work. For businesses and corporate investors especially, charities need to understand the financial and other incentives that might motivate them to get involved. This knowledge can help to build confidence among potential funders that the bonds are a credible investment. There is a risk that without this financial knowledge, charities may struggle to sell the bond.

Allia does offer training and other support for charities that want help selling the bond.

[1] Elliot, A. (2011) *Investing for the Good of Society Why and How Wealthy Individuals Respond*. The Fairbanking Foundation.

Box 2: Calculating costs vs. donations

Allia's annual members' administration fee is £100 for small charities and £250 for large charities. Charities have to raise at least this amount in donations to break even.

For charities to receive a £1 donation, they need investors to buy bonds worth a great deal more than that. The exact amount depends on the return the investor wants to take and the terms of the bond round. Based on the most recent bond issue:

- An investor taking a 0% return needs to buy bonds worth £5.37 to raise £1 for charity.
- An investor taking a 2% return needs to buy bonds worth £9.35 to raise £1 for charity.

For charities to break even in any one year, they need the return to cover their membership fee. The necessary investment ranges from £537 to £2,338:

- A small charity pays a £100 membership fee in a year. If the charity is raising money through 0% bonds, to break even that year, the charity needs funders to buy bonds worth £537 (£100 x £5.37).
- A large charity pays a £250 membership fee in a year. If the charity is raising money through 2% bonds, to break even that year, the charity needs funders to buy bonds worth £2,338 (£250 x £9.35).

For charities to break even plus raise a £1,000 donation in any one year, the necessary investment ranges from £5,907 to £11,688:

- For a small charity raising money through 0% bonds: (£1,000 x £5.37) + £537 = £5,907
- For a large charity raising money through 2% bonds: (£1,000 x £9.35) + £2,338 = £11,688

These costs represent ranges, and the cost for any given charity is likely to be somewhere in the middle.

4. Conclusion

Allia's charitable bonds are a useful tool to encourage valuable and urgently needed unrestricted funds into the charity sector. These bonds also unlock a new source of unrestricted funding for charities by using funders' capital, rather than their everyday income, to generate donations. Whether they will increase the overall level of unrestricted income available for charities remains unclear and requires further investigation.

Investors

Allia's charitable bonds appeal to all kinds of funders—individuals, grant-makers and businesses—that want to make the most of money they do not need right now.

The bonds should appeal especially to funders who want to take a first step into social investment, or who do not have an appetite to take risks with their capital. The bonds carry a low risk and investors who want their money to be doubly secure can take advantage of the guarantee that Allia offers.

Charities

Through Allia's charitable bonds, charities can benefit from social investment without taking on any financial risk themselves. NPC believes that this makes the bonds particularly suitable for charities that are not able or not ready to develop their own social investment product. In these cases, Allia's bonds allow charities that might otherwise be shut out from social investment to enjoy the benefits it can bring.

However, charities should be aware that on average, between £5 and £9 of bonds need to be raised to generate £1 for the charity. Charities may want to ensure that they have funders ready to purchase a considerable number of bonds if they want to raise significant income from it.

New Philanthropy Capital (NPC) is a charity think tank and consultancy dedicated to helping funders and charities to achieve a greater impact.

We provide independent research, tools and advice for funders and charities, and shape the debate about what makes charities effective.

We have an ambitious vision: to create a world in which charities and their funders are as effective as possible in improving people's lives and creating lasting change for the better.

For **charities**, this means focusing on activities that achieve a real difference, using evidence of results to improve performance, making good use of resources, and being ambitious to solve problems. This requires high-quality leadership and staff, and good financial management.

For **funders**, this means understanding what makes charities effective and supporting their endeavours to become effective. It includes using evidence of charities' results to make funding decisions and to measure their own impact.

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