Inside Track Euro: Think Piece 3
The name is bond…Community Bond

This “think piece” is intended to help provide answers several questions.

Q1. WHAT IS A BOND?

Charitable Bonds provide charities with a unique and innovative way to raise new funds for social benefit. Supporting charity has traditionally been about giving money away. But a Charitable Bond creates a new way to give. As well as making a donation from the money in your pocket, a Bond allows you to support a charity with the way you use your savings. By investing in a Bond, you can immediately release about 20% of the value of your investment for charity, and get all your money back again in five years' time. Charitable Bonds provide a combination of grant funding and capital loans are offered by various organisations. Bonds are a unique financial tool to allow money that might otherwise be sitting in savings accounts to be put to work for social benefit. Investors can use their money to support charity without having to give it away.

Q2. HOW DO BONDS WORK?

A bond is a financial mechanism for investing money in an organisation, like a bank or a company, for a fixed period of time. It’s a contract in which the investor effectively agrees to lend a certain amount of money, and the organisation promises to pay it back (‘redeem’ it) on certain terms at a later date (‘maturity’). Bond agencies offer bonds at fixed denominations with zero interest, so if you buy a £1,000 bond, you are buying a promise that the bond organisation will pay back £1,000 in five years’ time. At the request of one or more charities, the bond organisation may create an offer of bonds on their behalf. The bonds are available to purchase for a fixed period, usually three to six months, and may be bought by organisations and individuals in return for a bond certificate.

When the offer period closes, around 80% of the total raised is loaned at a commercial rate to Registered Social Landlords (RSLs). These are not-for-profit housing providers regulated by the Tenant Services Authority, who use the loans to create urgently needed affordable housing for local communities and key workers. The remaining 20% or so after costs is immediately given as a tax exempt grant to the charity (or charities). After five years, the housing providers repay their loans with interest - taking the fund to its original 100% level - and bondholders are repaid in full. So on an investment of £1,000 for example, around £200 will immediately go to charity while the rest will work to create affordable places to live. In effect, what you give is the interest you might have received over five years had you put the money in a bank or invested it elsewhere.

Example…bonds are offered on behalf of a charity which raise £1 million. Based on a commercial rate agreed in advance, the bond organisation will lend an exact proportion of this to a housing provider so that the sum repaid after five years is exactly £1 million. For example, at a rate of 5% per annum the proportion of the investment loaned would be £783,526. This leaves a balance of £216,473 from which the costs of issuing the Bond are deducted, and the remainder is given as an unrestricted tax-exempt grant to charity. Five years later, the housing provider pays back the money it borrowed plus £216,473 in interest. This totals £1 million, which is then used to pay back bondholders in full.

Q3. HOW IS INVESTING IN A BOND DIFFERENT TO MAKING A DONATION?

Investing in a Charitable Bond is an additional way to support charity. By putting your savings to work for the benefit of others, you can give more than you can afford to donate, or still support charity even if you don't feel in a position to give money away. Alternatively you may prefer investing in a Bond to giving outright. However, you should remember that around 20 per cent of your investment goes to charity, and ensure that buying a bond does not reduce the total amount you give to charity.

Q4. WHAT ARE THE BENFITS OF INVESTING IN A BOND?

- a high-impact, measurable demonstration of CSR in action
- initial investment returned in five years' time
- bonds retained as assets
- a high value, tax exempt yield for charity
- releases instant funds for charity
- five-year CSR dividends from a single transaction

An investment in a Bond will release immediate funding for the beneficiary charity. This up-front grant will be of greater value and more effective in enabling the charity to achieve its mission than an equivalent amount in smaller donations spread over five years. 80% of the proceeds of each Charitable Bond is loaned to a registered provider, for example, of social housing. The proportion to be loaned will be calculated according to the rate of interest agreed, such that the total amount to be repaid after five years equals the amount required to repay bondholders in full. By pooling the capital from multiple investors, the bond organisation is able to on-lend the investment in the Bond at a commercial margin above standard rates. Furthermore, since the bond organisation is a charity the interest gained on the loan is tax free. This means that the proportion the bond organisation needs to loan to the housing provider is lower, and therefore the proportion that is given to the charity is higher. The bonds you purchase are retained as assets. This means that buying a bond may not have any material impact on your Profit and Loss accounts. In the event of changed circumstances the bonds could also be used as collateral against borrowing or transferred to a third party. Investors will be given the opportunity to receive their principal investment at par five years from the date of issue of the Bond. At this point you may choose to donate all or part of your investment to the charity you have supported through the Bond, or to roll all or part into a subsequent Bond if available.

Q5. ARE THERE ANY COPORATE BENEFITS?

Supporting a Charitable Bond is an effective, high-impact way of demonstrating CSR. It not only generates a high return on investment for social causes, it also creates a more dramatic message about your CSR commitment. For example, if you invest £100,000 in the East London Bond at zero interest you may consider there to be an annual opportunity cost to your company. Whether you invest £100,000 in the Bond or give the value of this opportunity cost each year as a direct donation, charged to profit and loss, the cost to the company is the same. However, by investing in the Bond you can announce your six-figure support for charity while retaining the money as an asset on your balance sheet. For the charities, there is greater benefit in receiving a lump sum now than the same amount (or less) over five years.

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Q6. HOW DO I BUY A BOND?

You can buy bonds as an individual or jointly with one other person. There are different values of bond that you can buy (£1,000,000, £100,000, £10,000, £1,000, and £100). This allows you to buy a combination of bonds for the amount you wish to invest, and after five years to invest some or all of the bonds in a new Bond if available, or to donate some or all of the bonds to charity. Once the offer document for a Bond has been published, you just need to complete an application form and send a cheque for the amount you wish to invest. The bonds are officially purchased on the issue date when you will be sent a certificate confirming your purchase.

Q7. HOW MUCH CAN I INVEST IN A BOND?

The minimum amount you can invest in a Bond is £500, and you can invest any amount greater than this in multiples of £100. There are different values of bond that you can buy, at £1,000,000, £100,000, £10,000, £1,000, and £100. This allows you to buy a combination of bonds for the amount you wish to invest, and after five years to invest some or all of the bonds in a new Bond if available, or to donate some or all of the bonds to charity. Once the offer document for a Bond has been published, you need to complete an application form and send payment for the amount you wish to invest. The bonds are officially purchased on the issue date when you will be sent a certificate confirming your purchase.

Q8. HOW WILL MY MONEY BE INVESTED?

To ensure that you get back what you put in, around 80% of your investment is loaned at a commercial rate to one or more registered providers of social housing. These are government regulated housing providers that build, develop and maintain housing for local communities and key workers. They typically support people in need through provision of low-cost rental accommodation and through financial schemes, such as shared ownership, to help those who cannot afford to buy their own homes outright. They may also offer other services such as sheltered housing or at home care. For example, Citylife works with a number of housing providers, both because of the social benefits they deliver and because they are a secure investment.

Q9. WHAT IF I NEED MY MONEY BACK?

Bonds are a fixed-term investment and are not suitable for those who may require access to their money before maturity. However, you can transfer your bond(s) if someone is willing to buy it (them) from you.

Q10. WHAT ARE THE RISKS?

Like any financial investment, investing in a Charitable Bond contains certain risks. Some of the risks are set out below. However, please note that there may be other risks involved in investing in a Bond and certain risks may be due to your individual circumstances. The risks of investment in a Charitable Bond to be very low.

For example…
The loan to the housing provider will be made for a term of five years and at a commercial rate of interest. The total amount repayable under the loan including interest will equal the amount required by bond organisation to repay bondholders in full. The loan is assigned to an independent trustee (see below), which means that

investors are taking credit risk on the housing provider's ability to repay the loan, not on the bond agency financial standing. Registered providers of social housing are regulated by the Tenant Services Authority (TSA), the government regulator for affordable housing. Part of the role of the TSA is to protect tenants' interests by ensuring that registered providers remain financially viable and settling the affairs of any providers who become insolvent. Bond agencies lend to providers that are fully satisfied are of suitable credit based upon reports by the TSA and credit ratings by a bank or independent ratings agency.

<u>The Guarantee</u>
Depending on the arrangements for a particular Charitable Bond, the loan to the housing provider may be backed by a bank guarantee. While the loan is considered a very secure investment, the guarantee provides a further layer of protection. In the event that the housing provider is not able to repay the loan in part or at all, the guarantee means that the bank would pay the shortfall. The arrangements for a particular Charitable Bond will be described in the offer document for that Bond.

<u>The Trustee</u>
The loan, and any associated guarantee, is assigned to a trustee. This means that even if the bond agency were to stop trading, the trustee is in place to receive repayment from the housing provider and then to pay monies it receives to bondholders at maturity.

<u>Social investment and access to capital</u>
A Charitable Bond is a social rather than financial investment. The bonds do not pay interest or provide any capital gain and, except at the bond agency's option (which it may not decide to exercise), the bonds are only repayable on the repayment date. The bonds are transferable, although there is a risk that you may not find a purchaser for bonds, and any purchaser may only be willing to buy the bonds at a discount. This means that the bonds are not suitable for investors who require income or capital gains from their investment or investors who need ready access to their capital.

<u>Credit risk on the housing provider</u>
The bonds are limited recourse to the loan to the housing provider. In the event that the housing provider does not or is unable to repay the loan in full (or at all) then bondholders will not be repaid in full (or at all) on the repayment date. The general assets of the bond agency are not available to make payments to bondholders. As described above, the bond agency only lends to housing providers with a low risk of default.

<u>Credit risk on the guarantor</u>
In the event that the housing provider does not repay the loan in full (or at all) then bondholders who have invested in a Charitable Bond with a bank guarantee may benefit from monies received under the guarantees. However, in the event that the guarantor does not or is unable to pay under its guarantee then bondholders will not be repaid in full (or at all) on the repayment date.