



National Roundtable of Nonprofit
Organisations Limited

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**Mobilising Capital for Australia's Nonprofits:
Where is it needed and where can it come from?**

NATIONAL ROUNDTABLE OF NONPROFIT ORGANISATIONS LIMITED

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Executive Summary

It is sometimes said that Australia's nonprofit sector, or important parts of it, face difficulties in accessing the capital they need to grow, to refurbish ageing facilities or simply to begin operating. These difficulties are said to be a consequence of the drying up of government capital grants and the reluctance of banks to lend to nonprofits.

Research undertaken for this paper finds evidence that for some important groups of nonprofit organisations accessing capital is indeed difficult, even impossible. As a result, some face closure or sale to for-profit enterprises; others are unable to grow and new nonprofits with potentially important social innovations do not progress beyond a plan. There is also evidence that the problem is magnified by a lack of financial skills and of confidence on the part of smaller nonprofits.

The fields where nonprofits are most exposed to this problem are social assistance (previously known as community services), school education, health, community development and housing.

In countries such as the United States and the United Kingdom, governments recognise the need for specialist financial intermediaries and instruments and stimulate investor support for these through the tax system. Similar intermediaries exist in Australia but without support are too small to have an impact.

Several options for addressing the problem are developed. These include piecemeal proposals such as tax free charitable bonds or the encouragement of program related investments by charitable trusts, and an all embracing proposal for a nonprofit development bank.

The size and scope of Australia's nonprofit sector is often not appreciated. A nonprofit organisation is a private organisation formed to provide a service (for members or others), to advance a cause or for religious worship. What distinguishes them from the more common private for-profit organisations is their self-imposed prohibition on the distribution of profit to members or supporters; surpluses are reinvested in the organisation. In Australia nonprofit organisations are particularly important in the provision of education, social assistance and health care, including hospital care and health research. Registered clubs are nonprofit organisations as are most sporting and arts organisations. So too are business and professional associations, unions and political parties. Religious worship is organised through nonprofit organisations (Lyons 2001).

In 2000, the Australian Bureau of Statistics (ABS) estimated that Australia's nonprofit organisations employed over 600 000 people, turned over more than \$30 billion annually and contributed 3.3% to GDP, a contribution equivalent to that of the agriculture industry (ABS 2002).

Although the picture varies industry to industry and organisation to organisation, around 55% of nonprofit operating revenue comes from the sale of goods and services. Government grants and contracts contribute around 30% and donations, foundation grants and return on investments contribute the rest.

It is sometimes claimed that Australia's nonprofit sector, or important parts of it, face difficulties in accessing capital, that is the finance they need to invest in new assets or to

renew existing assets. These difficulties are said to be a consequence of the drying up of government capital grants and the reluctance of banks to lend to nonprofits. It is sometimes suggested that, in the context of increasing competition with for-profit enterprises, these difficulties constitute a crisis which, if not resolved, will lead to a decline in levels of participation by nonprofit organisations in many industries or fields of activity. These claims are based on anecdote and while they provide convincing examples, it is not clear how large the problem is.

The purpose of this paper is to review across the nonprofit sector the extent to which nonprofits face a problem accessing capital. It outlines ways similar problems are addressed in comparable countries, and concludes with a discussion of possible ways for addressing the problem in Australia. It draws on interviews and correspondence with 30 informants from the nonprofit sector (mostly peak bodies) and the finance industry, and also with professionals who help nonprofits raise capital and academics. It also draws on previous Australian studies and some international literature.

The paper has five components:

1. a brief introduction to the variables likely to create difficulties for nonprofit organisations in accessing capital;
2. a summary report of research that explores the extent of that experience and sets out the dimensions of the problem and its likely consequences if not addressed;
3. a discussion of some of the mechanisms used internationally to assist nonprofits access capital;
4. a brief review of similar initiatives in Australia; and finally,
5. a set of options for further steps that could be taken in Australia to address the problem.

Introduction

The need for capital

By capital we mean money that is used to purchase, build or renovate property or to acquire material assets such as technology that have a life of more than one or two years. These various assets are used in the work of an organisation, but are not physically consumed. They must be paid for up-front, but are utilised over many years by the organisation in pursuit of its mission. In the case of a new organisation or one wishing to develop in a new direction, capital can also refer to money that will be spent before any income is received to offset that expenditure.

Many nonprofit organisations find that they face a need for capital at certain stages of their lifecycle. Many need capital to start up – to pay wages before regular sources of recurrent income (eg from the sale of services) are received, to buy equipment or to build specialised facilities. Other longer established nonprofits need capital to acquire extra facilities, to replace old equipment, to adopt new technologies, to develop new programs or revenue generating initiatives. Finally, many long established organisations need capital simply to completely refurbish ageing facilities. The capital required at these three different stages will be referred to as *start-up capital*, *development capital* and *re-development capital*. The purpose for which capital is sought as well as the age of an organisation will each impact on its ability to access capital.

Conventional ways of raising nonprofit capital

Nonprofit organisations are formed to pursue a collective good rather than to enrich their members. To this end their constitutions include clauses prohibiting the distribution of annual surplus to members and, usually, prohibiting the distribution of net assets to members when winding up. Thus they cannot raise capital by issuing shares¹. This is one important way in which they differ from for-profit organisations. It is also a feature that places them at a disadvantage when they compete with for-profits.

Traditionally, nonprofit organisations have found the capital they need from among a variety of sources. These include:

- setting aside annual surpluses over many years to build an endowment or capital fund;
- seeking bequests and then putting them into a capital fund;
- conducting a capital campaign;
- obtaining a capital grant from a foundation or a business;
- obtaining a capital grant from a government department;
- borrowing from a bank or other approved financial institution and servicing the loan from recurrent revenue.

¹ It was once possible to form a company limited by shares and guarantee. They can raise capital by share issue while remaining a nonprofit. There are still a few nonprofits with this corporate form.

In many cases, several such sources will be used.

A few nonprofits have available further specialised sources of capital:

- in residential aged care they can obtain a long term, no interest loan from people who will use the facility (a resident's contribution);
- nonprofits sponsored by large Christian denominations can borrow from specialist, unregistered financial institutions maintained by the denomination, such as a diocesan development fund.

Some of these methods are more suited to some nonprofits than to others, depending both on their size, their location and more importantly on the sort of activities they perform, that is, the industry to which they belong.

Barriers to access

Different groups of nonprofits find it difficult, even impossible to access some of these sources of capital.

Most nonprofits find it difficult to build a surplus. In many there is strong resistance to putting aside money that could be spent providing more services. Nonprofits that mainly rely on government grants or contracts to fund their activities will generally find it difficult to generate a sufficient surplus to build a capital fund. Very few government programs acknowledge the need to service capital costs in their recurrent funding programs. A few, however, allow for rental payments, suggesting that they assume that the nonprofit will lease rather than acquire property.

From the 1960s to the 1980s government grants were readily available to assist the erection of specialised accommodation for older people and people with a disability, governments are now, however, very reluctant to provide capital grants, other than as an act of grace and favour to a specific organisation. In a few programs, as noted, they allow an amount for the cost of capital in their recurrent funding. In school education, the commonwealth government has a capital grants program favouring schools in low socio-economic status areas, but the funds go only a small way to satisfy the demand for capital. One state government (NSW) assists nonprofit schools to borrow capital by subsidising their interest payments.

Bequests are generally made to long established organisations with a high public profile, though also to organisations that have favourably touched the person making the bequest in some way, such as a school or university or organisations offering care and support to people with an illness. Building a capital fund from such a source is a long term task, and many organisations are distracted from that task by the need to apply bequests to meet annual deficits.

While the number of nonprofits that can sensibly anticipate success from a capital campaign is larger than those that will eventually benefit from bequests, capital campaigns are more likely to be successfully pursued by larger, longer established organisations with a strong donor base. Long established elite schools, with a base of wealthy parents and ex-pupils are the most successful at conducting capital campaigns.

None of these forms of capital are accessible to start up ventures. Start up capital, as well as development and redevelopment capital can be obtained from foundations and from businesses in the form of grants, but even here there are difficulties for many nonprofits. Most foundations are restricted in their grant making to support only nonprofits that have secured Deductible Gift Recipients (DGR) status from the Australian Taxation Office (ATO). This makes it impossible to support many new ventures, either because such status has yet to be granted, or because the new nonprofit is ineligible and lacking the influential supporters needed to persuade the Prime Minister or Treasurer to add it to the list of "other" specifically named DGRs that is appended to the Tax Act.

Finally, many nonprofits are unable to access loan finance from banks or other financial institutions because they do not own fixed assets that could be used as security for a loan. As well, loan assessors in most financial institutions find nonprofit balance sheets hard to understand and their business plans challenging because they are not framed along conventional lines. In many cases, for example, they rely on government grants or contracts as their main source of income from which they must service a loan; they might also identify regular income from fundraising and make use of volunteers to reduce their costs: all transactions unfamiliar to the average loans assessor. Loans assessors will wish to see evidence that the nonprofit can service a loan, most usually in the form of a capital fund built from surpluses. The difficulty many nonprofits face in building such a fund has been outlined. Further, when nonprofits have received some government assistance to acquire land or to build a facility, the government sometimes retains a mortgage on the land. Even if it is for only a nominal sum, few financial institutions will wish to secure a loan with a second mortgage. Even without these difficulties, unless the nonprofit is very large or has the backing of a church, lenders will sometimes seek personal guarantees of a loan from directors. This is inevitable in the case of a start up, but will often apply even if the nonprofit has property to mortgage. Not surprisingly, volunteer directors are reluctant to enter into such agreements

The previous discussion summarised the problems that different groups of nonprofits face in accessing various sources of capital. These are a consequence of the nonprofit being unable to meet the requirements needed to access the source of capital. There is a further set of problems that prevents many nonprofit organisations from accessing the capital needed to develop or redevelop. These arise from lack of knowledge and lack of confidence among staff and directors of many nonprofits. They might have assets to secure a loan and an income stream to service it, but do not know how to approach lenders, or they are reluctant to take the risk. The nonprofit may have a capacity to build a capital fund but directors and managers are unaware of the long term importance of doing so. They may be able to raise some capital and/or reduce costs by merging with a similar nonprofit, but are reluctant to take such a step. Some evidence of the extent of these demand side problems is provided in a survey of Victorian nonprofits mainly from the community services, health and community development fields, conducted in 2005 by KPMG for the Victorian Department of Communities (KPMG 2005).

It is clear that most nonprofit organisations face many problems in accessing capital. But how extensive are these problems? Are they significant enough to warrant a policy response? And if so, what options are there?

2. Do Australia's nonprofits face a capital crisis?

The short answer to the question is no. Most of Australia's nonprofit organisations are not in a position where they have an immediate need for capital which they cannot satisfy and without which they jeopardise their future. However, some nonprofits in certain fields, and in regional and rural areas, do face an immediate crisis. As well, over the longer term the difficulties faced by many nonprofits in accessing capital slow the development of the sector. It distorts the ability of many nonprofits to compete with for-profit organisations and inhibits the potential of the sector to be a major source of social innovation. These distortions in the Australian capital market will only be overcome by the development of specialist financial instruments and institutions.

The best way to review the position of Australia's nonprofits is to look at the way the issue manifests itself in different industries, while keeping in mind the earlier elaborated distinctions between small and large organisations and the different purposes for which capital might be needed.

Social Assistance²

The majority of providers of social assistance are nonprofits. Around half of the revenue received by social assistance nonprofits comes from governments, but the degree of dependence on government revenue varies greatly from one organisation to another.

Nonprofits in the social assistance industry vary greatly in size, from less than \$50 000 in annual turnover to some with an annual turnover well in excess of \$100 million. Many stand alone; others are part of wider networks (mostly maintained by religious denominations). Some, particularly those that provide their services through specialised accommodation or facilities have a high, though periodic, need for capital. Those which rely on services in recipients' own homes or in facilities provided by others have a lesser need. Those that provide services that are accessed by a wide cross section of the population, and can therefore charge many a fee for the service are better able to build a capital fund or service a loan than those that work with severely disadvantaged groups who have limited income, such as the homeless, people with disabilities and people living in remote areas.

Most of the last mentioned group of organisations depend on government programs for their income. They should be able to rely on governments to recognise the need to set funds aside for capital renewal. Unfortunately, while a few government funding programs give some recognition in their funding formulas, most do not, forcing nonprofits to look elsewhere for their capital. In some cases funding guidelines actually exacerbate the problem. This is when governments try to claw back surplus funds that the organisation might otherwise put into a capital fund. Some nonprofits caught in this position disguise a surplus in other parts of the balance sheet, but there are limits to this and the absence of a surplus hardly impresses a commercial lender looking for evidence of a capacity to service a loan. These contradictory factors make for an interesting mosaic of capacity and crisis for community services nonprofits when it comes to financing development or redevelopment.

² In 2006, the Australian Bureau of Statistics introduced a new edition of its Australian and New Zealand Standard Industrial Classification (ANZSIC). In this new edition an industry sub-division that had been known as community services was renamed social assistance. The only major change to the composition of the subdivision was the addition of nursing homes, transferred from health services.

In residential aged care for example, all those with high dependency accommodation (nursing home facilities) are on notice that their facilities must meet a new set of standards by 2008. Many will have no difficulty in doing so. They are organisations that have long been well managed and have set funds aside for major refurbishment, even re-location in some cases. All own their land and buildings and can use this to borrow from conventional financial institutions. Fortunately, nonprofit providers are in a better position than for-profits to respond to this challenge, as they generally operate self care units and low intensity care facilities (hostels) as well as nursing homes. Funding arrangements for the former have always enabled them to require new residents who had previously owned their own home to make a contribution (a loan) on which the nonprofit earns interest that can be put into maintenance and to build a capital fund. As housing costs have risen these resident contributions have been increased.

Most for-profits only own and operate nursing homes which are prohibited from charging a resident contribution (the government has recently added a cost of capital component to its nursing home grants). Nonetheless, experts estimate that around 20% of nonprofits in this field will have difficulties finding the capital to meet the new standards because they are small and have not been well managed; or operate in rural areas where property prices have not increased (thus keeping resident contributions low) or they have a clientele which have been largely property-less. In all cases, though, they own land which at least allows them into the conventional loans market. In the growing provision of non-residential or community based care for the aged, several government programs make available funds for short term capital needs, such as for motor vehicles or computers.

The nonprofit provision of child care is slowly declining, and because the industry as a whole is growing greatly, the nonprofit share is dramatically declining. Government programs once encouraged nonprofit providers to start up and manage child care centres. In many cases government “catalysts” encouraged groups of parents to form committees and employ staff to operate centres. Government grants covered most costs and built the centres. Subsequently, government policy changed. No longer would governments make capital grants. Instead, governments encouraged the growth of for-profit providers because they were more easily able to finance the dramatic expansion of services demanded by a changing workforce. Faced with competition and without government capital support, increasing numbers of centres are selling out to for-profit chains.

In other areas of social assistance, such as child welfare, women’s or youth refuges and disability services, there is little or no for-profit competition, but great frustration about the difficulties of obtaining capital. For some, particularly in the disability services field, there is a huge unmet need for capital to massively expand the provision of group homes. Because these require specialist fittings for many of their residents, they must be purpose built or obtained on a long term lease and renovated. Many others, providing vocational programs, day programs and the like are unable to access the small amounts of capital needed to operate efficiently and safely, such as renewing IT systems, or replacing an ageing bus. State government support is available, but it is grossly inadequate. The problem is particularly acute for disability services, especially for the provision of accommodation. Some longer established nonprofits are able to draw on local communities, especially via community service clubs such as Rotary or Lions, but many just stew in frustration, unable to realise their plans.

Community development, including community renewal & job creation³

Governments provide modest funds for to encourage community development and community enterprise. Many of these programs allow applications for modest capital projects, such as renovating an old building for use as a community IT centre. One of the more important developments in the social assistance and some related industries over the past decade has been the emergence, and encouragement of social entrepreneurs and of social or community enterprises. These models of working try to apply the thinking of a business entrepreneur to find creative new ways of addressing old or newly emerging problems, such as the employment of severely disadvantaged people, and to do so in ways that require little or no government assistance. Such endeavours inevitably require creative new ways of funding, especially start up capital. Conventional lenders will rarely countenance such proposals, and even foundations find it difficult to assist as such schemes in start up phase will not have the DGR status that most foundations require, and may not qualify at all. In the social assistance and employment fields, organisations have to meet the test of being a public benevolent institution (PBI) which means providing identifiable form of relief to identifiably poor people. This is a much tougher criterion than is required for organisations in the arts, environment health or sport to qualify.

Health

Constant developments in medical technology create a never ending need for new capital for hospitals. Some hospitals, especially those with a high profile, have been able to find capital for expansion or relocation from a mixture of asset sales, donations (capital campaigns), bequests, surpluses and loans. Some, however, especially in regional centres, are not coping so well. Over the past thirty years, many private hospitals, especially those operated by various Protestant denominations, have been sold to for-profit hospital chains. Most remaining nonprofit hospitals are operated by organisations associated with the Catholic Church. Those funded as public hospitals receive capital funding in state government health budgets. Of those operated as private hospitals, some have faced difficulties finding the capital needed to refurbish and re-equip. Some have been sold to for-profits, but more recently, in NSW at least, the Church has formed an overarching entity to manage many of the remainder (and many aged care facilities as well). This has enabled them to obtain the best financial advice, to pool resources and access other church sources of finance.

The so called health charities, formed around particular medical conditions to raise funds for research, to encourage preventative activities and to support those with the condition or their carers, vary in their capacity to access capital. Some, such as the National Heart Foundation and the Cancer Councils are well able to access the capital they need via their high profile in the community, but many smaller nonprofits have difficulty in obtaining the start-up or development capital they need to grow to a more effective size. Some try to build on the fundraising which may have been their major revenue source from the beginning and others turn to government with all the attendant disadvantages which that involves (inadequate support, red tape and interference with mission).

Other health nonprofits such as those in the mental health field or indigenous health, like community services nonprofits that are dependent on government funding because their client base are invariably poor, are themselves severely disadvantaged in the capital market, for many of the same reasons.

³ This is not a recognised industry class in ANZSIC. Organisations pursuing these activities are mainly found in social assistance.

Education

The most prominent role played by nonprofits in Australia's education industry is in schooling where they hold one third of the market. This share has grown by several percentage points over the past decade. Almost all nonprofit schools are associated with a Christian denomination or a non-Christian religion. On average, more than half their operating revenue comes from government support for their pupils (effectively in the form of a quasi voucher). It is graduated to reflect parents' capacity to pay, but on the basis of the average income of the statistical district in which the parents reside. The rest of the current income of nonprofit schools comes from fees. New schools need capital to start up; others need it to expand or to renew ageing facilities and to introduce new equipment, such as information technology. All established schools have to meet new standards, particularly health and safety standards, to retain their registration as schools. For many this means replacing ageing demountable classrooms.

The long established elite schools are able to rely on capital campaigns and regular tax deductible donations to their school building funds. Their facilities have improved remarkably over the past decade or more, ever since the first government assistance began flowing in the 1960s (initially to enable them to build science laboratories and then libraries). Other schools have relied on the support of their local congregation and from the support of higher levels of the church, such as a diocese or synod. As an example, one Catholic diocesan school system that turns over a little more than \$100 million annually spent \$90 million dollars over past 5 years on major capital works, including \$40 million on a new K-12 school in a rapidly developing area. While government capital grants covered around 8%, the great bulk of the capital was borrowed from the diocesan development fund at near commercial rates. The Diocesan Catholic Education Office estimates that it could spend another \$70 million over the next 5 years, but is unable to service any more loans for several years. That is another manifestation of a capital crisis: there is need for further capital expenditure, loan funds available, but insufficient revenue to service further loans.

Housing⁴

Compared with the United Kingdom or the United States, the nonprofit sector has a relatively small role in the provision of housing for low income or disadvantaged people. While it was nonprofit organisations that pioneered the provision of housing loans to working people, the provision and management of low income rental housing was developed by state government authorities, after 1954 with commonwealth government assistance. Beginning in the 1980s however, nonprofit housing associations emerged to manage housing stock mainly owned by government authorities. Many of these associations are small, but a few large housing associations have developed, with financial and risk management skills beyond those needed to manage housing stock. Many of these large associations also own some of their housing stock and are keen to expand their role, raising capital from private sources to do so. However, the cost structure of housing in highly populated areas of Australia makes it impossible to provide housing to low income Australians (affordable housing) without some form of government support. Generally this support, when it is provided, is in the form of government capital grants which can then be leveraged to raise private capital. This capital is limited in quantity and

⁴ ANZSIC classifies these nonprofits to the residential property operators class where they are of course overwhelmed by for-profit providers as well as government departments.

scope (it is not available in some states), As a result there is a significant constraint on the capacity of housing associations to meet the undeniable need for affordable housing.

Housing associations are indirectly supported by the Commonwealth government through rent assistance paid to people receiving government pensions and benefits (but so too are private landlords renting to low income tenants), and through favourable rules for tax treatment under the GST and for some other state and local government charges. Many housing association leaders believe that as well as direct financial support, governments need to provide greater certainty that particular concessional treatments will remain in place if they are to convince banks or other financial institutions to lend to them over the long term. But the expansion of nonprofit housing provision is intimately tied into a major policy debate about how to expand the provision of affordable and welfare housing generally.

The question of how to dramatically expand the provision of affordable housing has generated Australia's most innovative and sophisticated policy work around how to mobilise private capital for public purposes. Leaders of nonprofit housing providers and peaks have been contributed to this work, along with housing industry peaks, some state housing authorities, the Australian Council of Trade Unions (ACTU) and the university-based Australian Housing and Urban Research Institute (AHURI).

All models envisage some form of government support to lever maximum private capital. Among the various options that have been examined is one for an affordable housing bond, the so-called consortium bond, to be issued by state treasuries and subsidised by the commonwealth. A similar model is the Commonwealth Affordable Housing Credit (CAHC), which would be a special purpose bond issued by the commonwealth with a guaranteed after-tax minimum return (via a return subsidy or a risk guarantee to investors). Finance would be allocated to state housing authorities to dramatically increase affordable housing stock. Nonprofits would mainly be involved in management of some or all of this housing stock. Under another model, commonwealth subsidies (currently paid out as grants to the states under the Commonwealth State Housing Agreement) would be paid to private landlords if they agreed to give lower income tenants a secure long term lease. Again, some of this stock might be managed by nonprofit associations⁵.

But while this sophisticated research and modelling has been going on for many years, it has produced almost no actual policy initiatives. Government treasury departments remain indifferent. It is a sobering reminder of the challenges faced by the nonprofit sector in having its capital problems recognised and addressed by governments.

Religious institutions

This set of nonprofit organisations includes churches, temples, mosques, synagogues and other places set aside for religious worship and also the entities established to govern these religions. The various nonprofits established by these various faiths to provide schools, hospitals and community services are treated separately.

For the most part, the established Christian denominations are rich in real estate and are facing declining numbers of active adherents. They have considerable opportunity to sell or in other ways leverage on their properties to meet any need for development or re-development capital. Most hold their church property through trust structures often with

⁵ Some of the analysis and modelling designed to find the best ways to use government incentives to mobilise private capital for affordable housing can be found at www.ahuri.org.au and www.nchf.org.au .

leading members of the business community as trustees. The Catholic, Anglican and Uniting Churches operate (usually at a diocesan level) development funds that are in effect boutique banks for church bodies in the diocese. These funds are where parishes, schools or welfare agencies will deposit funds and from whence the capital needed within the diocese for start-up, development or redevelopment is drawn. Sometime they take term deposits from lay members of the church, returning marginally less than a commercial rate of interest. They set conventional capital adequacy ratios. They are largely exempted from Australian Securities and Investments Commission (ASIC) and Australian Prudential Regulatory Authority regulation.

Faiths with a smaller and more recent presence in Australia, such as Pentecostals, Orthodox Christian faiths, Islam or Buddhism do not have such an institutional base to draw on. But like the mainstream Christian denominations in times past, they generally have members who are prepared to dig deeply for appeals to build a new place of worship and wealthy members who are prepared to guarantee borrowings. As a class, religious institutions are the best of all nonprofits at fundraising. In 2004, although only 26% of adult Australians gave to religious causes they gave \$2 billion, 36% of all donations.

Creative and Performing Arts

Some aspects of the need for capital faced by nonprofits in the performing arts are shared by all organisations irrespective of size. Other aspects depend very much on size. What almost all of them have in common is that they depend on other organisations, often governments, to provide their venue – whether it is the Sydney Opera House or a church hall. Generally this has to be paid for but it is an operating, not a capital, expense. All performing arts groups have to spend before they receive funds from ticket sales. For major professional organisations the amounts involved are high. This constitutes a short term need for capital which is generally met from existing surpluses, by grants from governments and foundations, sponsorship from business and the pre-selling of tickets through subscriptions. Smaller organisations, formed primarily for their members' enjoyment, rely on fund raising and small grants for short term capital needs. Other types of cultural nonprofits, such as festivals and museums, will also depend on a similar range of sources, but also government grants, to meet capital needs. There does not appear to be any significant unmet need for capital in this part of the nonprofit sector.

Community radio and television are now located by the Australian Bureau of Statistics (ABS) in the information, media and telecommunications industry. Government determination to move both television and then radio broadcasting to digital mode will require broadcasters to outlay significant funds for re-equipment. It is not clear whether government grants will cover all these capital costs born by nonprofits which depend mainly on volunteers with some income from sponsorship and donations.

Employment and Training

Many nonprofits providing employment and training services, often under contract from governments, are large and involved primarily in social assistance. Of those that specialise in the field there is a periodic need to access capital to enable a quick expansion after winning additional government contracts and before any funds start flowing. Mostly, these periodic demands for short term capital are met by an organisation's bank. More successful organisations, for example, some that began as group training providers, often need capital to expand, sometimes overseas and sometimes by take over of other providers. Many find the nonprofit form and the

constraints it places on capital raising onerous and have converted, or are exploring conversion, to for-profit companies.

Sport and Recreation

Most sports require fields or other specialised built facilities to be played. These are generally provided by local or state governments or commercial enterprises. Often a local or regional club will be dissatisfied with the quantity or quality of the facilities provided, but the conventional course is to persuade the owner of the field or facility to improve it. To help in that process, the club will raise funds from members and supporters, or obtain it from a state or national body or an associated registered club. Most local sports clubs are part of a larger framework of regional, state and national bodies. Small grants for projects of a capital nature are available from state and federal governments. Few have an unmet need for capital.

Recreation associations such as hobby clubs are in a similar situation. Capital needs are small and will be met by fundraising or by seeking one-off grants from government.

Registered or hospitality clubs (classified by the ABS to the accommodation and food services industry) have continuing need for capital, to expand or renew facilities so as to hold onto members who expect ever increasing quality in facilities and services. Many smaller clubs have been unable to find this capital and have lost members and eventually been forced to merge with larger clubs or sell their remaining assets and liquidate. Larger clubs have sufficient cash flow to fund asset renewal and can mortgage their existing property to raise loan capital. This is not without risk. During periods of rapidly rising interest rates in the early 1990s, several clubs were forced into receivership when they could not service their now far more expensive loan.

Interest groups

This category of nonprofits includes business and professional associations, unions and various other advocacy organisations, organised to represent the interests of various groups, such as residents of a neighbourhood or single parents and wider public interests such as environmental protection. Most live a precarious hand-to-mouth existence. The main sources of their operating revenue include membership fees, annual conferences, fundraising events and the sale of services such as training or information to members or others. Any expansion, say into providing an accreditation program for members, would be funded by members if they were convinced of its need. Most professional societies and longer established trade associations have accumulated large surpluses and probably used some of it to purchase their office accommodation.

The one group of these nonprofits that have difficulty raising the capital they would like are environment groups that wish to preserve examples of the natural or built environment. Most of these, such as the National Trusts, Bush Heritage or Birds Australia rely on donations of land and money (recent changes to the tax system allowing deductions for donations of property to DGRs will help). Others such as the Victorian conservation co-operatives rely on member contributions. A more interesting example was Earth Sanctuaries Ltd which began raising capital to purchase and fence land for the protection of endangered native species by issuing shares. Returns were financed from a revenue stream basically built on tourism. For a time shares were publicly listed, but the company ran into difficulties and had to downsize and then merge with a more successful ecotourism company.

Overall, with the exception of some conservation organisations, this group of nonprofits appears to experience few capital problems: most have little need for capital and those that might have ambitious plans for new programs have reserves or property to leverage a loan.

3. Factors affecting the nonprofit capital crisis

The above account makes it clear that main reason that many nonprofits with a need for capital are unable to access it is that they cannot pass the tests applied by conventional lenders of capital. The nonprofit form of enterprise is not understood and is deemed to be too risky by conventional lenders. Our interviews with staff of financial institutions and legal and accounting professionals confirmed this. In summary, it is possible for nonprofit organisations to access loan capital, provided they have a property to mortgage or provide as some other form of security and a well established income stream that returns a steady surplus. As well, a board containing leading business figures will give a lender greater confidence. But the problems are not only with the suppliers of capital.

Timid or conservative management and governance

However, there is also a good deal of evidence that nonprofit organisations that need capital and meet the usual criteria for seeking a bank loan fail to seek it. Several small financial institutions that focus on the needs of small to medium nonprofits reported that nonprofits appear reluctant to take the risk of borrowing and so do not try to access the capital that is available. This is also reported by the KPMG study for the Victorian Department of Communities cited above. This reluctance by small and medium nonprofits appears to spring from a short-term focus, a focus which in most cases appears a consequence of dependence on generally inadequate government funding. Nonetheless, it is worrying when a lack of longer term planning is found in organisations providing scarce services to vulnerable people. A solution to the capital problems facing some parts of the nonprofit sector will need to address this timidity and reluctance to take a longer term view if it is to be successful. This is not an insignificant matter. It is possible to argue that the main reason that appropriate vehicles to meet the capital needs of nonprofits have not emerged in Australia is that there is insufficient demand for capital. Many nonprofit organisations can be identified as needing capital, and many of those would agree with that identification, but they do not actively seek capital; they do not convert that need into a demand strong enough to bring forth a supply.

Organisational inertia springing from timidity, lack of competence and an unwillingness to change also afflicts larger nonprofits as well. We were given examples of how significant savings in recurrent expenditure had been (or could have been) gained by sharing back office expenses, such as by organising state level organisations into a national entity, or forming a network of organisations providing similar services. Such savings had (or could have) been used to lever much needed new capital for refurbishing existing facilities or new program development.

Legal constraints

We also heard from charitable trusts and foundations of constraints imposed by the operation of the taxation system. Some foundations, particularly community foundations in rural areas, are frustrated that they cannot make grants to nonprofits that do not enjoy DGR status. These are often the nonprofits that would generate employment, but also the nonprofits that people who might make donations to the foundation would like to see supported and their inability to do so reduces their income. An ambiguous statement in the 2006/07 Federal Budget suggested that this complaint might be addressed, after July 2007. A few larger foundations are able to make grants to non-DGRs. So too are some corporate foundations that are not charitable trusts but simply a unit within the corporate structure funded from operating revenue. But while foundation grants can finance some organisational innovation, they are mostly restricted in what they can support and are too small to have much impact on the major sources of need. Those we spoke to connected with charitable trusts also claimed that they were unable to make loans from their endowment or trust fund to nonprofit enterprises (a small source of capital overseas where it is known as program related investment). They could invest in public companies and other financial instruments but not in nonprofit enterprises. We were unable to confirm this and it may be a consequence of conservative thinking, rather than a correct interpretation of the law (of trusts).

The paper now turns to the solutions to these sorts of problems that have emerged in comparable overseas countries.

4. Innovative mechanisms for helping nonprofits access capital

The specialised needs of nonprofits for capital are given clearer recognition in countries similar to Australia, such as the United States and the United Kingdom. Basically these involve the use of tax assisted, government backed borrowing and specialist financial institutions that make grants, loans and provide appropriate business expertise via training and/or mentoring. It is in the United States that these problems have been most comprehensively addressed.

United States of America

Charitable Tax Free Bonds

In the United States a method of capital fundraising commonly used by large charitable nonprofits is the tax free bond. Essentially, a nonprofit, or group of nonprofits with a need for capital will approach a local, city or state government which, after appropriate planning and approval by the Internal Revenue Service (IRS) will issue 5 or 10 year bonds which generally will be taken up by institutional investors. The returns on these bonds will be tax free and are secured by the government that is issuing them on behalf of the nonprofit. They are extensively used to build or purchase and renovate low income housing, to build, extend or refurbish health and welfare facilities and large cultural nonprofits, such as museums. They are not used by small and medium nonprofits and according to a recent study by the Center for Civil Society Studies at the Johns Hopkins University, many are unaware that this avenue for capital raising exists (Salamon and Geller 2006).

Low Income Housing Tax Credits (LIHTC)

Another method, originally proposed by a large nonprofit low income housing provider, is the use of tax credits, specifically to raise capital for low income housing. Created by the Tax Reform Act of 1986, the Low Income Housing Tax Credit (LIHTC) has, in the past twenty years, created almost 2 million housing units for low income families, and as a consequence, helped revitalise rundown neighbourhoods. The organisational structures that utilise the LIHTC are complex but generally involve a partnership between an organisation that will develop and manage the housing and a passive investor who will provide almost all the funds and will receive the bulk of the tax credit. Usually around 75% of development costs are eligible for the tax credit (Enterprise Social Investment Corporation 2005).

The investor uses the tax credit to reduce their federal tax liabilities (usually spread over 10 years) by the amount invested in the housing project. The developer might be a nonprofit, but is more likely to be a for-profit entity, or a partnership between a for-profit investor and a nonprofit manager. Effectively, it is a method of attracting private funds and management expertise to provide low income housing with a minimum direct government involvement; there is of course a loss to the revenue via the operation of the tax credit. The federal government retains control over the overall liability by determining in a budgetary context the level of tax credits to be issued in a particular year. State housing agencies bid for blocks of these tax credits and then allocate them to development proposals on a competitive basis.

Community Development Financial Institutions (CDFIs)

The need for capital for community development, including low income housing but also social enterprise and community businesses designed to provide jobs and basic commercial infrastructure to disadvantaged neighbourhoods drove the development of specialist financial institutions known as community development financial institutions (CDFIs). These emerged in the United States in the late 1970s as a consequence of the Community Reinvestment Act which threatened penalties for banks that did not make loans in low income neighbourhoods within their areas of operation (the so called “red lining” problem). Banks did not know these areas, and viewed them as extremely risky. However, they found that within many disadvantaged neighbourhoods there were Community Development Corporations (CDCs) that had a good knowledge of what was needed and how to provide it. But the CDCs lacked capital. Banks soon worked out that they could meet their obligations under the Community Reinvestment Act by supplying the capital needs of these CDCs. Many of these CDCs and similar institutions developed into specialist financing institutions, CDFIs.

The essential feature of a CDFI is that it draws funds from several different sources, including grants and loans from governments and foundations and long term loans from conventional financial institutions, sometimes raised by issuing debentures or bonds, including tax free bonds. It then supports nonprofit housing developments and social enterprises (and sometimes small and micro-business enterprises) with an appropriate mix of finance ranging from grants to low income to market rate loans. In addition, and to reduce the risk associated with the investment, it carefully assesses each proposal and works with nonprofit or social entrepreneur to ensure they have a viable business plan and appropriate business and management expertise to carry them into the future. In this respect CDFIs behave rather like a venture capital firm. This mixture of finance plus expertise is a defining characteristic of the CDFI (Parker and Lyons 2003).

Program Related Investments

Another source of loan finance for nonprofit initiatives in the United States comes from foundations, not as grants, but from the investment of a small part of their endowment or corpus. These are called “program related investments”. Basically, the foundation, instead of generating all its revenue by investing in the stock market and commercial real estate, invests a small portion of its endowment in CDFIs in the same way that a bank might, and receives a return on those funds.

United Kingdom

Parts of the nonprofit sector in the United Kingdom also face problems accessing capital, although the government has taken some steps to assist social and community enterprises to access capital. One initiative has been to follow the United States example and to encourage the growth of CDFIs. Following a major review of finance for social development, the United Kingdom government in 2000 introduced tax breaks for investors in approved CDFIs.

A more recent government initiative has been to create a new organisational form, the Community Interest Company (CIC). This new form of company has been designed to facilitate the growth of social enterprise. It is designed as a vehicle to mobilise private initiatives, expertise and capital to address public need. It is permitted to raise capital by issuing a form of equity, though investors will have only limited voting rights and the company’s assets will remain locked into its public purpose. For some, the CIC is a vehicle that will eventually replace the old charity model of mobilising private resources for public purpose. In other words it envisages an equity model of raising capital for private organisations formed to pursue a public purpose. It is too early to say how this new institution will develop.

A further initiative to facilitate the access of nonprofits to capital was the announcement in March 2007 that the government had accepted the proposal of the Commission on Unclaimed Assets and would legislate to establish a social investment bank. With initial capital of at least 250 million pounds, provided from unclaimed assets in dormant bank and building society accounts, the bank would be both a source of equity or quasi-equity for large social enterprises as well as a partner to underpin and significantly expand the efforts of CDFIs and credit unions in lending into low income communities, both to individual entrepreneurs and to community owned enterprises. It would also develop the provision of advice and support for new ventures (Commission on Unclaimed Assets 2007).

Independently of these government supported initiatives some nonprofits and financial institutions have been trying to create a third type of bond market, to add the existing markets for government and corporate bonds. These would be called social responsibility bonds. They hope to attract institutional investors seeking to build a socially responsible dimension to their portfolio and seeking a social as well as a financial return on their investment. Additional purchasers of such bonds would be other nonprofits and individuals seeking to support particular charities by way of a loan rather than a donation. The first such bonds were issued in 2003 by the Triodos Bank on behalf of the disability charity Mencap, to enable Mencap to build housing for people with disabilities. A return of 1% over the inflation rate was guaranteed. Over one million pounds was raised, which was less than was hoped, suggesting that such a market may need encouraging by government tax assistance along US lines.

5. What has been done in Australia?

Existing specialist institutions and instruments

Australia has already some interesting models, but they are all very limited in scope.

There are several CDFI types of entities seeking to help new community enterprises or longer established nonprofits. The closest to a CDFI is Social Ventures Australia (SVA) an initiative of several large community service nonprofits that has been funded by several corporate foundations. SVA seeks out people wanting to start a new nonprofit or radically expand or reorientate an older one and, through a process of review and advice, whittles the list down to two or three a year which it provides more intensive mentoring (using people with business skills). It covers immediate start up capital needs with short term grants. It does not make loans itself, but where appropriate facilitates access to loan finance from banks. It has noted that while many of the nonprofits it assists are developing new ways of working with disadvantaged groups and might reasonably anticipate receiving government support when their new models are proven, this process takes several years, creating a continuing need for developmental capital to scale up the proposal and to carefully monitor and evaluate its effectiveness.

The Community Sector Bank was established several years ago as a partnership between Bendigo Bank and a group of community sector nonprofits. In turn it operates as a franchise of Bendigo Bank, along the lines of the successful community banks pioneered by Bendigo Bank in the mid-1990s. The Community Sector Bank has grown slowly, finding it easier to get nonprofits to deposit with it than to take loans. Loan applications from nonprofit organisations are assessed by loans staff in Bendigo applying similar criteria used to assess conventional commercial loans, though there is talk that this might change and specialist criteria for assessing loans to nonprofit organisations will be developed.

One of the shareholders in the Community Sector Bank is CAF Australia which also has a small fund for lending to higher risk enterprises, but it too has encountered only limited interest in this facility.

The Foresters ANA Friendly Society, a small friendly society operating in Southern Queensland has a Community Trust Investment Fund, which seeks funds from investors and through which it makes small loans to nonprofit organisations. Two or three credit unions in regional areas have begun to make loans to nonprofit enterprises.

The commonwealth government has encouraged the formation of community foundations, especially in rural areas, as a device to fund community development initiatives. These foundations face significant problems of scale and find their scope severely restricted by the tax rules covering the support they can provide from tax assisted donations. No charitable trust or endowed foundation appears to make program related investments; the general belief seems to be that this is prohibited by the rules covering the responsibilities of trustees.

Many of these community development finance providers held a conference in Melbourne earlier in 2006 and agreed to establish an association to advance their shared interests.

The most successful set of specialist institutions to provide capital to certain nonprofits are the church or diocesan development funds. These funds hold probably between \$3 - 5 billion. By providing banking services to a large set of high turnover nonprofits, and sometimes taking term deposits from members of their congregations, these institutions are able to build a deposit base that enables them to meet the needs of other of their constituent bodies for capital. Their strong faith-based bond and the authority of the church structure have enabled these entities to develop and successfully meet the capital needs of a large part of the charitable side of Australia's nonprofit sector.

The only specialised financial instrument to be developed in Australia to assist fundraising by certain third sector organisations is the Cooperative Capital Unit (CCU). This device was established by the 1992 Cooperatives Act in NSW and, while it has not been copied elsewhere, it is likely to be incorporated in the uniform cooperatives legislation that is slowly working its way to adoption by all Australian states. It is available only to trading cooperatives (mutual organisations which while governed differently to for-profit firms, do permit the distribution of profits to members). The object of the CCU is to enable the cooperative to raise capital from within or outside its membership and in a form other than conventional commercial loans. The CCU is a type of hybrid equity; it can be structured as a loan instrument, ie a form of debenture, or as a form of equity giving CCU holders right to a return on their investment based on profit, but with only limited voting rights. The CCU provision has only had limited use, but CCUs issued by a large rural cooperative are listed on the ASX.

In at least one state, Associations Incorporation legislation permits an association to "issue secured and unsecured notes, debentures and debenture stock". It is not known if any association has taken advantage of this entitlement.

At several times in the past, proposals have been developed for a form of tax favoured bond facility. These have been developed in the context of developing employment opportunities in areas of high unemployment (as a structural adjustment instrument) or to assist in rural reconstruction. Proposals usually envisage a central fundraising facility, covering the whole country or a state, with a series of branches or agents that make loans on the basis of local knowledge, but with close supervision from a central office. Funds would be raised by way of issuing debentures or bonds, but because the instrument is a new one and would be viewed by potential investors as a risky one it would require a high rate of return. Because entities that would have loans made to them are likely to be operating at low levels of profitability, requiring a low interest rate on loans, the difference would be covered by tax breaks for investors. In no case was the use of business advisors proposed as a way of reducing the risk of a loan, along the lines of the CDFI model (and as practiced by SVA here). Governments have generally ignored these proposals, although a special form of tax assisted bond, the Infrastructure Bond, was developed by the federal Labor government in 1992. A subsequent proposal to use these as the basis of Pooled Development Funds set up to attract capital into rural and regional areas was insufficiently developed when the government lost office and the scheme was largely abandoned by the incoming Coalition government. A trace of these infrastructure bonds remains but they are mainly used now in tax minimisation schemes. It is understood that on several occasions the present Commonwealth government has been approached with proposals to develop tax free bonds along the US model but has not found the case convincing.

6. Options for further action

There would appear to be a need in Australia for a specialist instruments and/or institutions to provide the specialist capital needs of nonprofits in certain fields. But because these needs and the circumstances of the nonprofits seeking capital are various, such instruments/institutions will need to be flexible. There are several different approaches that deserve further consideration.

Before sketching these options, a short summary of the different types of problems they need to address is warranted.

1. While many large nonprofits possess assets and skilled boards and staff and are therefore able to raise capital from existing institutions, many more are not in such a fortunate position.
2. In some cases, the nonprofit possesses adequate assets but lacks the skills and the determination to borrow. This may even lead to the demise of the organisation. In these cases the problems lie within the nonprofit organisation.
3. Many other nonprofits do not own fixed assets that could secure a loan and so cannot access conventional bank finance for development. Many are able to service a loan, but in the absence of security, banks will not look at them.
4. Finally, there are individuals and groups with ideas for new nonprofit organisations to address old or new problems and provide services in innovative ways and which need start up capital and probably further capital to acquire specialised equipment or facilities. Without assets or an income stream, they are even less able to find capital.

For the most part nonprofits that are unable to access capital are found in social assistance, health, education, housing and community development. With the exception of some in the last field, these are likely all to be charities. It should also be noted that there are few people with experience in the loan making side of the finance industry and an understanding of the risk profile of nonprofit endeavours. The creation of new institutions will initially be slow as experience is developed and good practice routinised.

There are broadly two ways of approaching this issue of institution building. One is to look for a range of different initiatives that address the need for capital in different parts of the sector. As noted above, these needs present themselves in different ways according to the industry and/or the stage of the life cycle reached by the nonprofit. In some cases the vehicles are at hand and with a little support can grow to meet need. In other cases models exist in one part of the sector that could be copied by nonprofits in other parts. The second approach is to describe a single institution that is capable of meeting all the varied needs of the sector; one that is capable of raising capital and appropriately distributing it along with technical support to all of those different parts of the sector.

The remainder of the paper reviews a number of such options. In some cases the difficulties associated with a particular option appear considerable, but we include them in the interest of generating discussion and in the hope that their potential may appeal.

First Approach: a variety of initiatives and forms.

1. Mutual Self-help

Nonprofit organisations in a particular field could explore the possibility of pooling their banking along the lines of the Diocesan Development Funds. In this way those with spare funds would make loans to those needing capital for development. Such an approach would only work for groups of nonprofits that had strong values in common, such as a religious faith. Even so, unless they were part of the same denomination, they would not be subject to the same disciplines as members of the Catholic or Anglican dioceses, and would need to find a legal form to express their common purpose and to continue to bind them to it. There might be difficulties with various regulatory authorities. As well, the experience of the Australian Association of Cooperatives, which attempted to pool the resources of NSW cooperatives and collapsed in 1993 after the default of a large borrower and the withdrawal of a large amount of capital by another, offers a salutary warning.

If successful, this option could address the needs of nonprofits in specified fields, such as groups of schools or disability services for development or redevelopment capital.

2. Foundations as Investors

The scope of foundations could be widened to enable them to assist with the provision of start up capital to public serving nonprofits in the form of grants and loans. In the case of grants, the Tax Act should be modified to enable grants to be made to organisations that meet the charity test rather than exclusively to DGRs (or charities and DGRs, as many DGRs do not meet the charity test). This would provide modest start-up capital to some community development initiatives. In addition, trustee investment acts should be modified to allow trustees of charitable trusts to invest a certain portion of their corpus or endowment in nonprofit organisations in the form of loans. It is unlikely that much new capital would be freed for investment in this way, but it would likely be focussed on encouraging innovation or community enterprise.

If successful, this option could partly address the needs of new and/or innovative nonprofits for start up capital.

3. Seek to expand or replicate SVA.

Social Ventures Australia appears to have created a successful vehicle for assisting nonprofit start-ups. It raises some grant money of its own, and provides initial business training and mentoring. For initiatives that appear to have a chance of success (and it is developing an expertise in nonprofit risk assessment) it mobilises business mentoring and loan capital from banks. It is the closest Australian example of a CDFI. Those responsible for its development are best able to advise on whether it is suitable to expand it or to replicate it, initially in one other centre.

4. Bonds

The Corporations Act could be amended to enable the issuing of tax free charitable bonds by nonprofit organisations that are income tax exempt charities. These bonds would offer investors a rate of return equivalent to government bonds, but if this return was tax free, the real rate of return would be far higher than corporate bonds, indicating the higher risk profile of the investment. Bonds would need to be underwritten by a financial institution

but the real question is the asset backing of the bond. In the United States, these bonds are guaranteed by local or state governments. This ensures that should a bond issuer fail to meet payments the facilities that they are operating (and thus the lives of vulnerable people) are not placed in jeopardy. This method has been successfully used in Australia's past, most noticeably to revive the housing market after the Great Depression, when state governments backed the loans made by banks and insurance mutuals to terminating building societies. The guarantee was hardly ever called on. Governments may be prepared to look at such a proposal given that, for little or no cost to the revenue, it could unlock and apply to a public purpose millions of dollars that would not be otherwise applied.

But contemporary governments might be reluctant to offer such guarantees as these would appear as liabilities on their balance sheets (albeit very small ones). As an alternative, the large financial institutions (eg banks, superannuation funds) that underwrote the issue might also offer such a guarantee. This would be a good example of a community business partnership.

This option would satisfy the needs of large well established nonprofits for development or redevelopment capital. But these are mainly already well served by existing financial institutions. It would be more difficult to structure this option to help smaller nonprofits, especially those without land and buildings or nonprofit start-ups.

5. *Loans facilitator*

A major innovation in the home loans market has been the emergence of mortgage brokers or mortgage originators such as Aussie Home Loans. The mortgage brokers act as intermediaries between banks and borrowers in effect helping them find the best loan to meet their needs. Mortgage originators draw funds from large banks or superannuation funds and lend them to home buyers. The home loan market is vastly different to the almost absent nonprofit loan market, but a specialist nonprofits loans facilitator, with clear expertise in assessing nonprofit risk could act as an intermediary between potential lenders, such as banks and superannuation funds, who avoid the sector because they do not know about it or how to assess its risk. Such specialist facilitators could emerge in different industries or fields in which there are a large number of nonprofits with need for capital, such as school education and disability services. It would seem sensible if such a facilitator had a capacity for providing business advice and training to organisations seeking capital, in the manner of a CDFI. It would not borrow funds in its own right, but provide the assurance to a lender that the loan is not risky. It would only be of assistance to nonprofits that have assets that could be mortgaged to give the lender further assurance of the security of their loan. Such organisations would not require a banking licence.

6. *Legislate a new form of public interest corporation that can raise equity capital*

This could be based on the UK CIC model. It would issue shares to individuals or corporations, such as superannuation or equity investment funds that wished to invest in socially useful or public interest projects. They would receive dividends and be able to withdraw or sell their shares. They would also have some role in the company's governance but its purpose would be limited to its original public interest objects. Depending on the number of shareholders sought, the company would have to issue a prospectus under ASIC supervision. Such companies would need to have strong revenue streams, but would not need to own assets in the first instance. The CCUs created in the NSW Co-operatives Act provide some experience of this model. It has been developed

the UK to assist the emergence of social enterprise. But there is no reason why existing companies limited by guarantee could not move across to the model (as is happening in the UK). However, there are a range of taxation issues that would have to be teased out and resolved before such a model could work successfully. For example, if they were tax exempt (as they are in the UK) they would be unable to give franking credits, thus decreasing the value of any dividend to investors.

Second Approach: A single institution

7. Nonprofit Development Bank

A detailed proposal could be developed for the establishment of a specialist nonprofit financial institution, modelled on CDFIs, but providing capital for the development and redevelopment of existing nonprofits as well for start-ups.

Before approval, such an institution would have to demonstrate to government regulators such as APRA and ASIC that it has a board and staff with skills in managing financial institutions and in assessing loans to nonprofit organisations and that it has a facility to provide business support (training or mentoring or appointing directors to nonprofits seeking to access their loans facility). It would need to convince APRA and ASIC that it operates with different rules to conventional banks, because it is investing in a very different set of organisations and proposing to handle risk in several different ways. Convincing the government regulators would not be easy, but would be assisted if the proposal is developed by people with the highest level of experience and reputation. It should be required to retain conventional capital adequacy ratios. This core capital would have to be supplied by grants from governments or businesses. A single endowment of say \$200 million from the commonwealth government's projected multi-billion surpluses would be the most efficient way of kicking off such a bank. Alternatively, some of the unclaimed assets that currently end up with the public trustees in each state or territory could be utilised for this purpose, as was proposed recently by the Commission on Unclaimed Assets in the United Kingdom and agreed by the government.

To raise its operating finance, the bank should issue bonds or debentures. If it were financed by a large one-off grant from the government, it should have no difficulty in doing this, with the core endowment securing any such issues. Revenue raised by investing the endowment should be sufficient to cover the banks operating costs (including the extra cost of providing appropriate business advice and support to some of the nonprofits it invests in) and also any defaults on the riskier end of such investments (likely to be low). The task would be made easier if revenue generated by the original endowment were tax exempt.

If an initial large government endowment were not forthcoming, the bank would have to rely on smaller government and business grants (for core capital) and funds raised from the conventional market. Although the market for socially responsible investments is rapidly growing and a nonprofit development bank would clearly meet criteria for such investments, it is clear that government support would be required to assist it raise capital. Governments in similar jurisdictions to our own believe there is a need to offer inducements to investors in these public interest entities. One method would be for the government to offer tax free bonds in the manner described above. Another would be to offer a tax credit spread over the life of the loan. Offering tax breaks to investors – either as a tax deduction for returns on bonds or as a tax credit spread over the life of the loan - comes at a cost to the revenue. Such a cost would be small. That cost could be

controlled, and measured, by the commonwealth government limiting the amount of revenue that could be raised in this way on an annual basis, in the way that the US government limits the availability of Low Income Housing Tax Credits.

There are many aspects to the development of such a model that require serious and expert consideration. It would be necessary to pull together a team of people with considerable expertise and standing. It should have considerable appeal to government in that while it requires some largely indirect support; it is largely independent of government. It should be able to marshal hundreds of millions of dollars from the private capital market to apply to the capital needs of services which the government sees basically as its own and also funds innovations that would otherwise look to government for support or would wither.

This option appears to address most of the needs of nonprofits of different sizes and stages in their life cycle for capital. A nonprofit development bank should be able to attract directors and senior staff with high levels of skill, experience and reputation and achieve a size needed to satisfy both potential investors and government regulators. It could develop considerable expertise in the understanding the management needs of effective nonprofits and in developing risk profiles for proposals from nonprofits. Such an institution would not directly address the problem of asset rich but risk averse and badly managed nonprofits. As knowledge grows in the sector that there is a specialist institution that will address both the management and the capital needs of nonprofit organisations, some of these organisations may well approach it for help. If not, consultants or even public officials concerned about such entities would seek to have them make contact.

Conclusion

Australia's nonprofit sector is a vital part of our society; yet significant parts of it face pressing capital needs. More importantly, the capacity of the sector to renew itself and to generate innovative new programs and institutional solutions to social and environmental problems, as it has done before, is inhibited by failures in existing capital markets. Some action is called for in the public interest.

The paper has identified two approaches to action; one with five options, each addressing some of the identified capital needs, and the other describing a new form of organisation that could meet the all the needs of the sector. That second approach would be the most likely to succeed, but precisely because of its comprehensiveness, it will require the largest amount of preparatory work. All options will need a great deal of effort by people skilled in finance and knowledgeable of the nonprofit sector to develop. These are the people who must initially be involved in further exploring and elaborating options, before approaches are made to government to fix the problems that are faced.

It is a matter to which some of the more creative financial minds in business might sensibly address themselves; though solutions will certainly involve legislative change. The important requirement is that attempts to address the problem and elaborate possible solutions must be made in the context of the whole of the sector and not just parts of it. Hitherto, Australians have not been very good at that.

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