

SITR: A SURVEY OF EIS MANAGERS

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INTRODUCTION

Social Investment Tax Relief (SITR) is a tax incentive designed to encourage investment into projects and organisations with the aim to deliver social benefits, as well as financial returns. It's based on the existing EIS reliefs with some key differences:

- Investments can take the form of shares or unsecured debt*
- Investments must be into either a Community Interest Company, a Community Benefit Society or an Accredited Social Benefit Contractor
- The maximum allowable investment into an investee organisation is currently capped at approximately £250,000

*The debt must not be secured against any assets, must not repay the principal within the first three years and must not be preferred to any other investment instruments in the event of a winding up.

In the 2014 Autumn Statement, the Chancellor George Osborne announced that the investment limit would be increased to £5 million in any 12 month period and up to £15 million in the organisation's lifetime. This change is pending, subject to State Aid approval from the European Commission. It is thought that this change would make dedicated retail investment products based on SITR viable, and that as the relief is based on the EIS scheme, current EIS managers may be interested in developing these sorts of products.

Therefore, Big Society Capital has partnered with Intelligent Partnership (IP) in an initiative to understand how EIS managers currently perceive opportunities in the SITR investment market. Step one in this initiative was a survey of EIS investment managers.

THE SURVEY

This survey was carried out over 28 days and was sent out to over 50 EIS managers. We received 22 responses.

The survey was dynamic - answers to the first question were used to place respondents into one of three categories and each category would then be asked a slightly different set of questions. The majority of questions were multiple choice or ranking questions, with a few opportunities for open ended responses. On average, respondents took about 10 minutes to complete the survey.

The following analysis shows the trends and the sentiment of EIS managers towards SITR.

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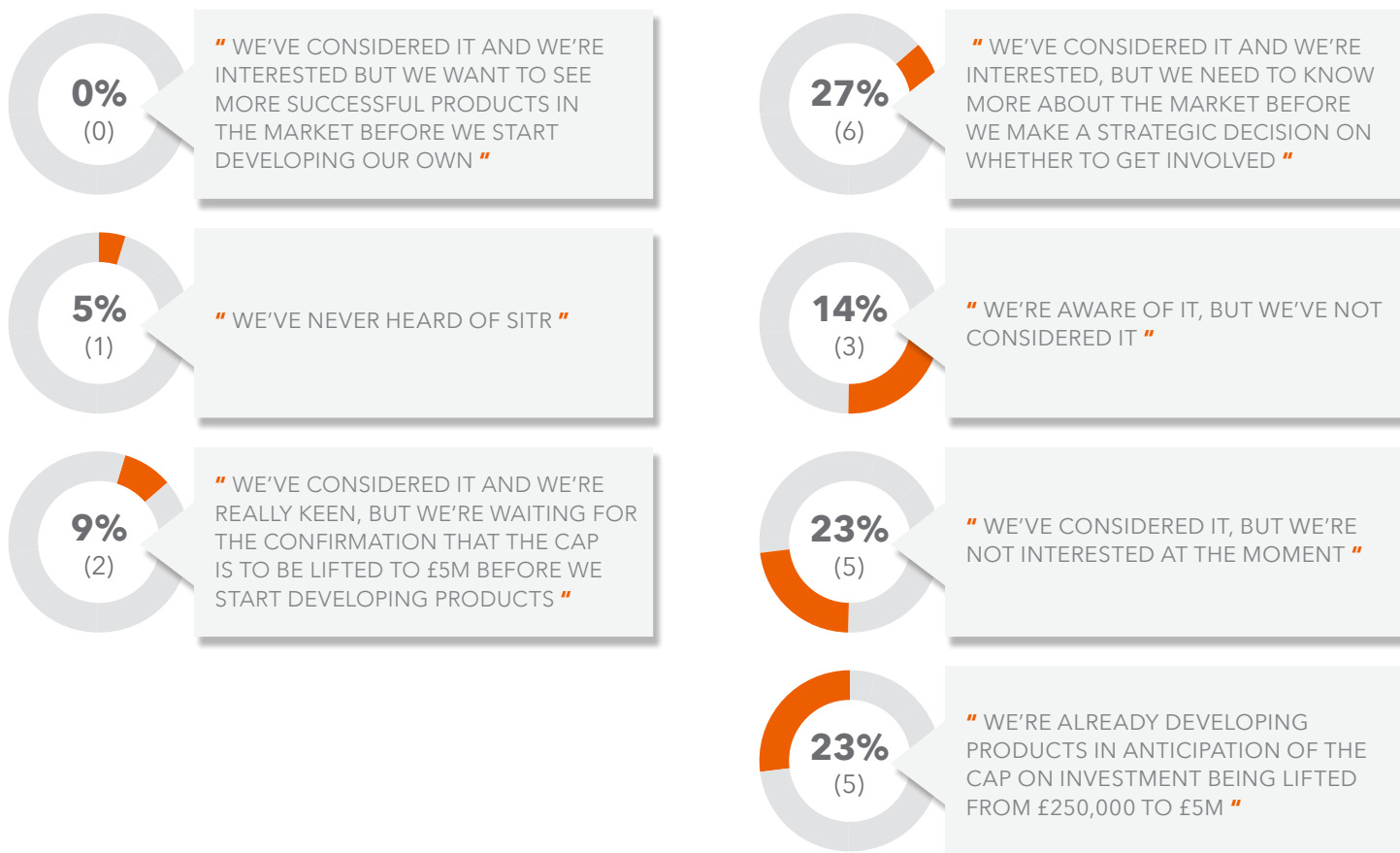


CONTENTS

	<i>Cover</i>
INTRODUCTION	1
CATEGORISING THE RESPONDENTS	3
GROUP A: DISINTERESTED	4
GROUP B: POSSIBLE PARTICIPANTS	5
GROUP C: EARLY ADOPTERS	6
BROADER QUESTIONS	8
SOCIAL IMPACT OF MANAGERS' PORTFOLIOS	8
FEE CONSIDERATIONS	8
FUNDRAISING LEVELS	9
DEAL SIZE	9
LOOKING AHEAD	10
SOCIAL VCTS	10
POTENTIAL AREAS OF SOCIAL IMPACT	11
BARRIERS FOR THE PREPARED	12
SUMMARY	13

CATEGORISING THE RESPONDENTS

Which of the following statements best describes your firm's current stance on Social Investment Tax Relief (SITR)?



This question was used to determine whether firms were interested in developing SITR products, and if so, how much progress they had made to date.

Here's how we categorised the responses:

Group A: "Disinterested"

- We've never heard of SITR
- We've considered it, but we're not interested for the moment
- We're aware of it, but we've not considered it

This group can be considered the most negative, in terms of engaging with the SITR market. It might be a little unfair to include the "We've never heard of SITR" response in this group (potentially they

could be very positive towards SITR, if only they were aware of it), but on the basis that they would be unlikely to develop any SITR products any time soon we added them here.

Group B: "Possible Participants"

- We've considered it and we're interested, but we want to see some successful products in the market before we start developing our own
- We've considered it and we're interested, but we need to know more about the market before we make a strategic decision on whether to get involved

This group can be thought of as interested, but hesitant - they are open to the possibility of entering the SITR

market, but they want to understand more about it, and perhaps see some evidence that it will be a success, before they take any action.

Group C: "Early Adopters"

- We've considered it and we're really keen, but we're waiting for confirmation that the cap is to be lifted to £5m before we start developing products
- We're already developing products in anticipation of the cap on investment being lifted from £250,000 to £5m

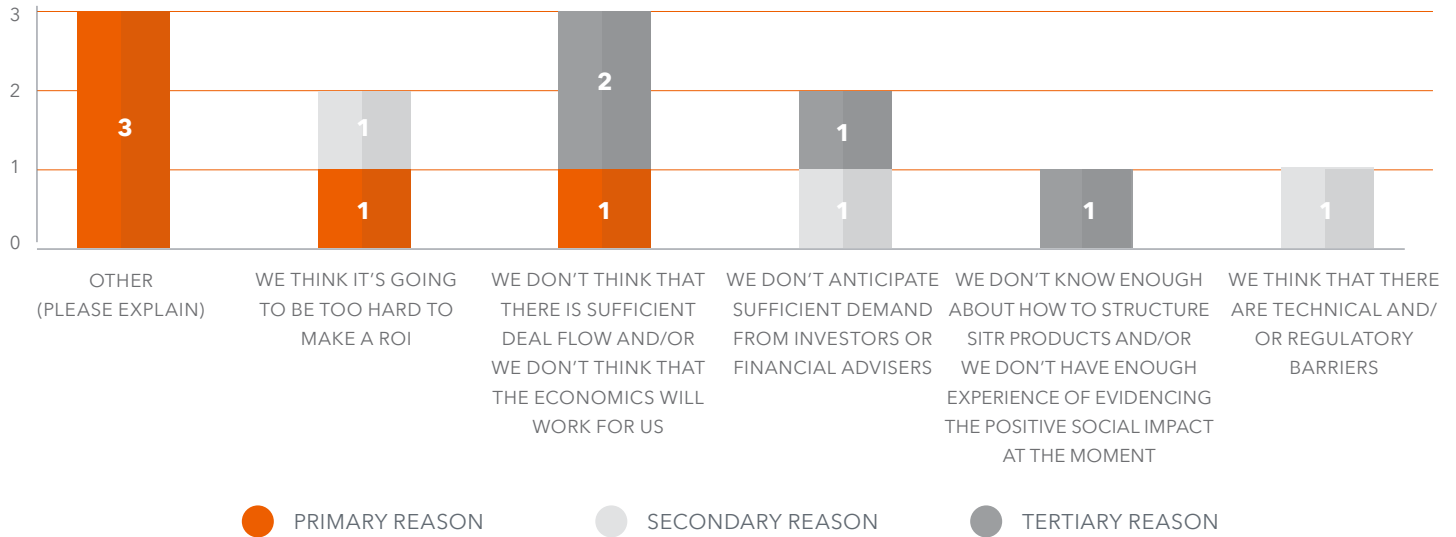
This group were the keenest, and had either already started to take action or were only waiting for the investment cap to be lifted before they took action.

Next, we will take a more detailed look at each of the groups in turn.

GROUP A: DISINTERESTED

What are your firm's primary reasons for not being interested in the SITR market?

"We've considered it, but we're not interested for the moment"

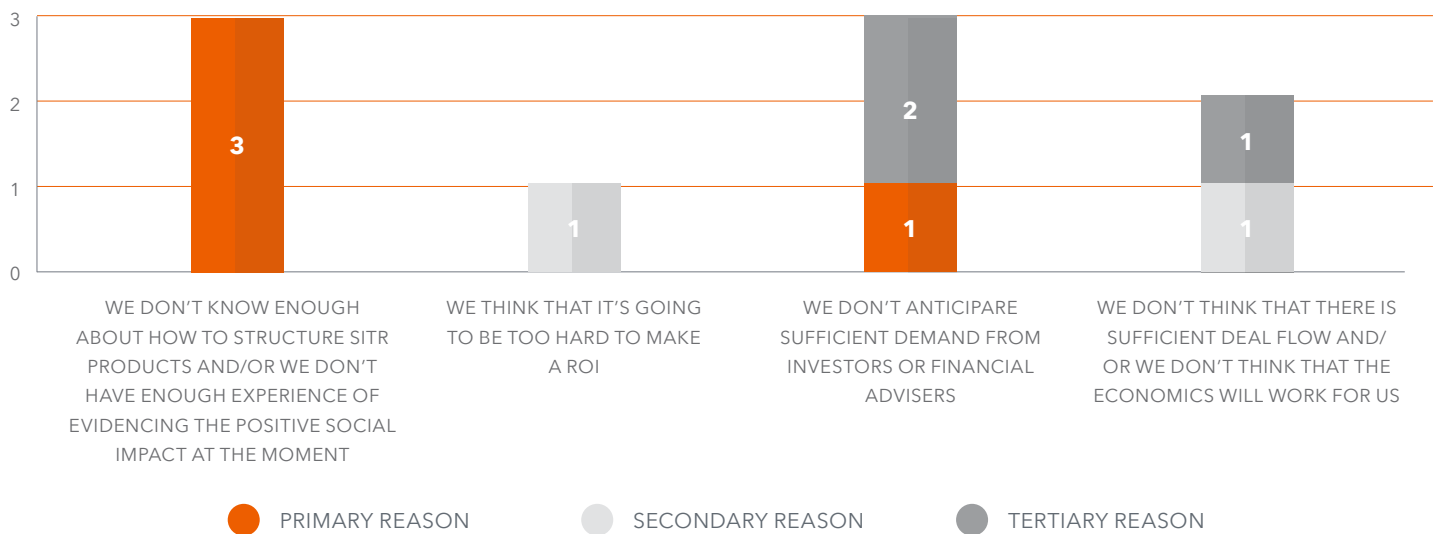


Respondents who had considered SITR, but were not interested for the moment stated that their primary concerns were sourcing deal flow and making the economics work, lack of demand and "other" - comments attached to other included:

- "We think the legislation will be abused and that offers which are created will be designed to offer investors low risk low returns."
- "We believe there is sufficient deal flow and demand from advisers/investors; however, our greatest concern is generating an exit for our investors and currently we aren't seeing the exit potential within most opportunities."
- "Does not fit with our investment strategy."

What are your firm's primary reasons for not being interested in the SITR market?

"We're aware of it, but we've not considered it"



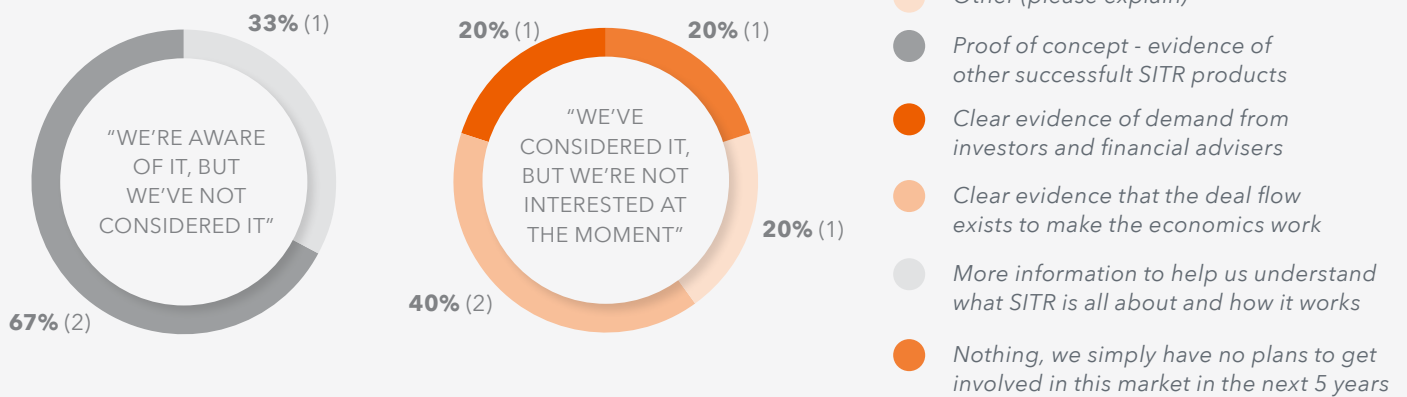
Managers who were aware of SITR product but not interested in developing products, felt that legislation and lack of knowledge about SITR and a perception that there would not be sufficient demand from investors were the primary concerns that were holding them back for the moment.

What one single development would do the most to change your firm's mind about getting involved in the SITR market?

Managers who had not seriously considered SITR wanted to have more information and see more evidence of "proof of concept" before they would consider changing their mind.

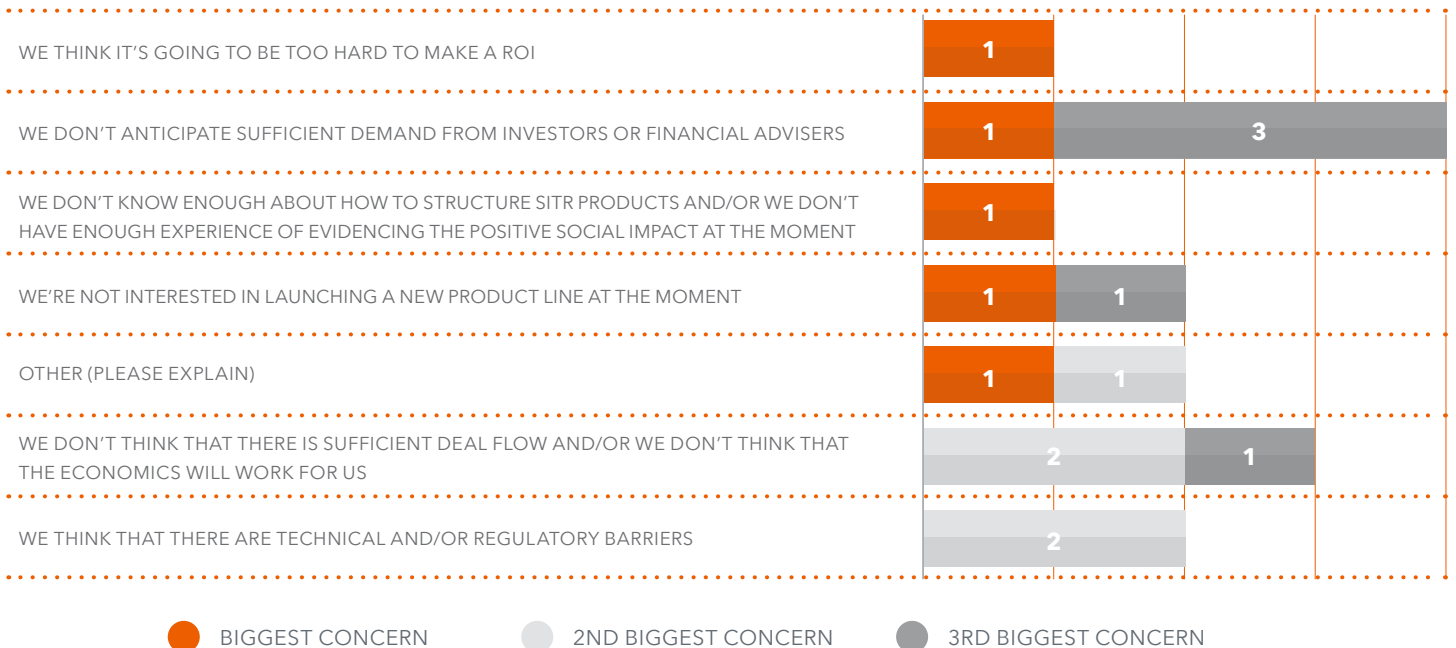
The majority of managers who had considered SITR but were not interested wanted to see evidence that the deal flow exists to make a retail investment product viable. One manager was not interested in getting

involved under any circumstance (but they did state that SITR fell outside of their investment strategy) and one manager stated that they felt that evidence of genuine exit possibilities for investors was required.



GROUP B: POSSIBLE PARTICIPANTS

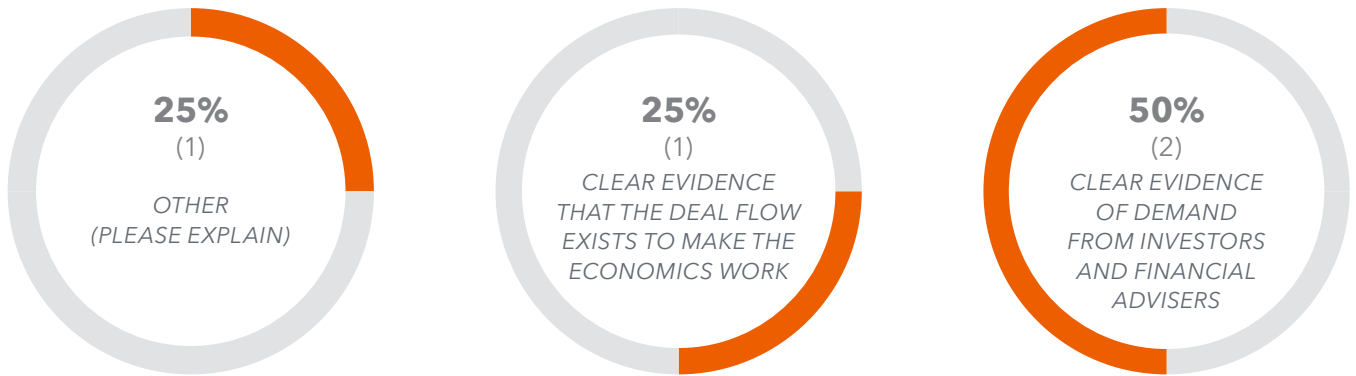
What are the biggest concerns that are holding your firm back from developing SITR products at the moment?



There were a wide range of different concerns that are holding this group back from developing SITR products. However, lack of demand from investors, lack of deal flow and the economics of the product all stood out as big concerns. The majority of this group did feel that they knew enough about SITR.

What one single development would do the most to prompt your firm to get involved in the SITR market?

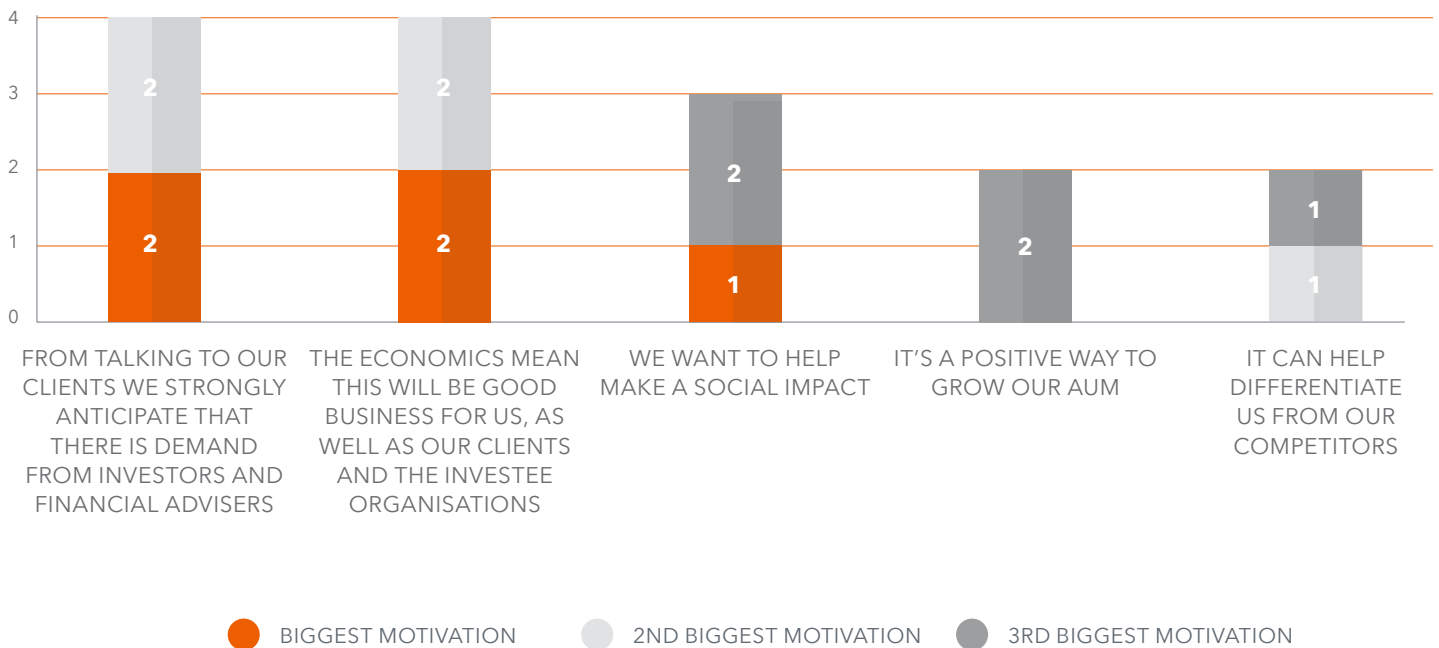
Again, evidence of demand and evidence that the economics would work would do the most to prompt managers in this group to go further in their consideration of SITR products. The respondent in the "Other" category stated: "There is not one single development; all three elements listed in our answer above are necessary conditions."



GROUP C: EARLY ADOPTERS

What are your firm's motivations for considering getting involved in the SITR market?

"We're already developing products in anticipation of the cap on investment being lifted from £250,000 to £5m"



In the early adopter group, in contrast to previous groups it was felt that there would be a strong demand from investors, and that the economics would mean SITR products would represent good business for the firm.

What are your firm's motivations for considering getting involved in the SITR market?

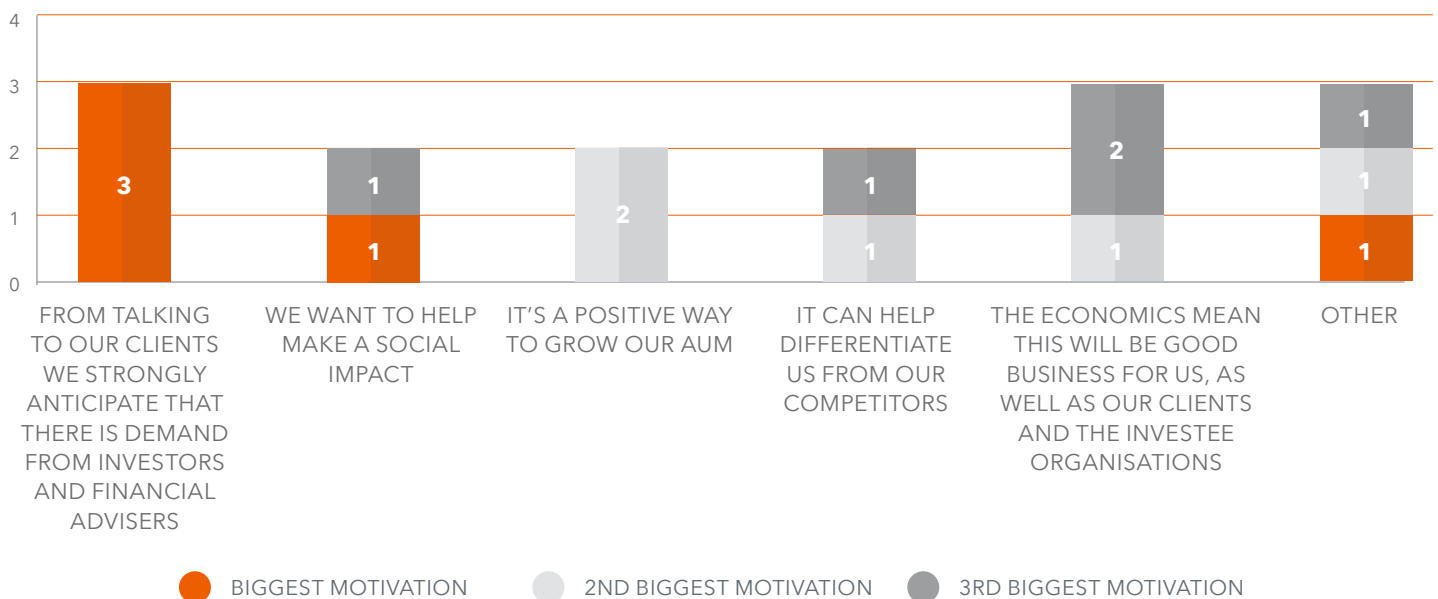
"We've considered it and we're really keen, but we're waiting for confirmation that the cap is to be lifted to £5m before we start developing products"



In this slightly more hesitant sub-set of the early adopter group, respondents were not as certain of the demand or economics, but were interested in making a social impact and differentiating themselves from their competitors.

What are your firm's motivations for considering getting involved in the SITR market?

"We've considered it and we're interested, but we need to know more about the market before we make a strategic decision on whether to get involved"

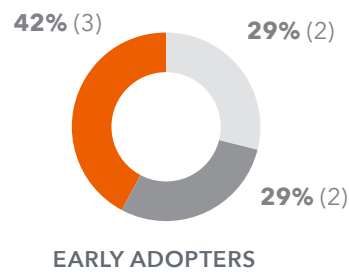
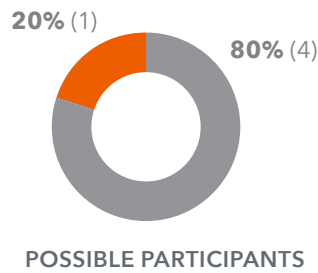


There were a broader range of responses from this sub-set, but they did anticipate strong investor demand and that the economics would work for a SITR product.

BROADER QUESTIONS

- THE CURRENT SOCIAL IMPACT OF MANAGERS' PORTFOLIOS

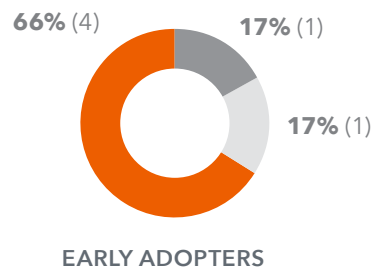
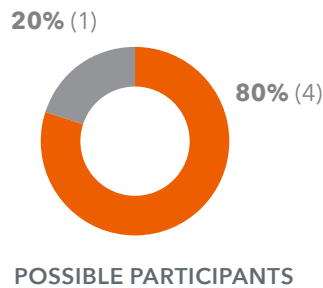
Does your firm consider that its current portfolio of investments have beneficial social impacts? (For example job creation, preservation of the environment, provision of housing)



● NO, this doesn't apply to our portfolio ● YES, almost all of the portfolio has positive social impacts ● YES, to some extent

As job creation is one of the primary objectives of the EIS scheme, we asked the same question excluding this factor:

If we **excluded** the positive social impact of job creation, would your firm still consider that its current portfolio of investments have beneficial social impacts?

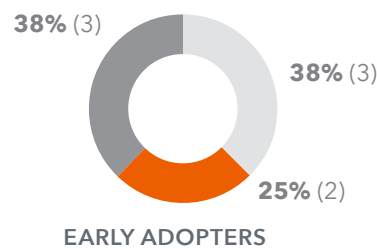
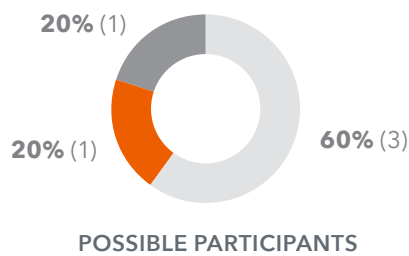


● NO, this doesn't apply to our portfolio ● YES, almost all of the portfolio has positive social impacts ● YES, to some extent

Research from the Boston Consulting Group defines social investments as those that a) are clearly defined a priori and are not an incidental side-effect of a commercial deal and b) that the investor expects a financial return, drawing a line between social investment and philanthropy. Job creation may fall into a gray area for EIS portfolios.

- FEE CONSIDERATIONS

Would your firm consider charging a lower level of fees for a SITR product?

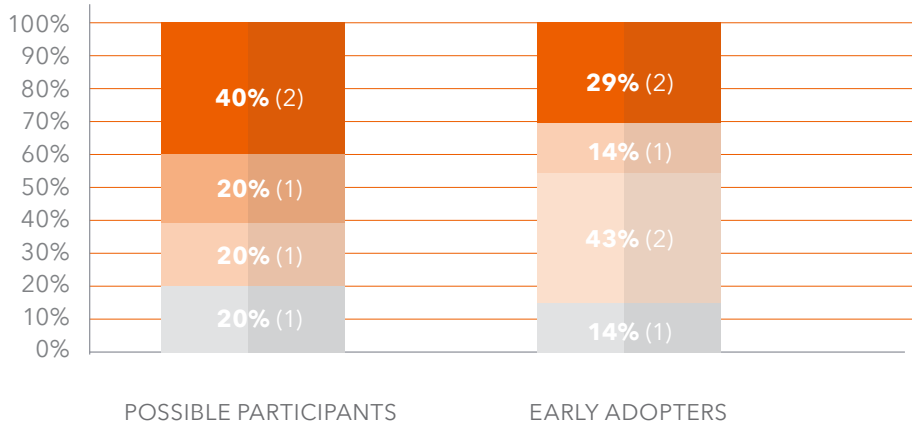


● YES ● POSSIBLY, depending on what we discover about the economics of running money in SITR products ● NO, we would anticipate the fees would have to be higher than our current product range ● NO, we would anticipate the fees would have to be about the same as our current product range

Broadly, managers are anticipating that they would keep their level of fees the same, or lower for any SITR products.

- FUNDRAISING LEVELS

What does your firm anticipate would be the minimum fundraise to make an SITR product viable?



● < £1million ● £1-2million ● £2-3million ● £3-4million ● £4-5million ● £5-6million ● > £6million

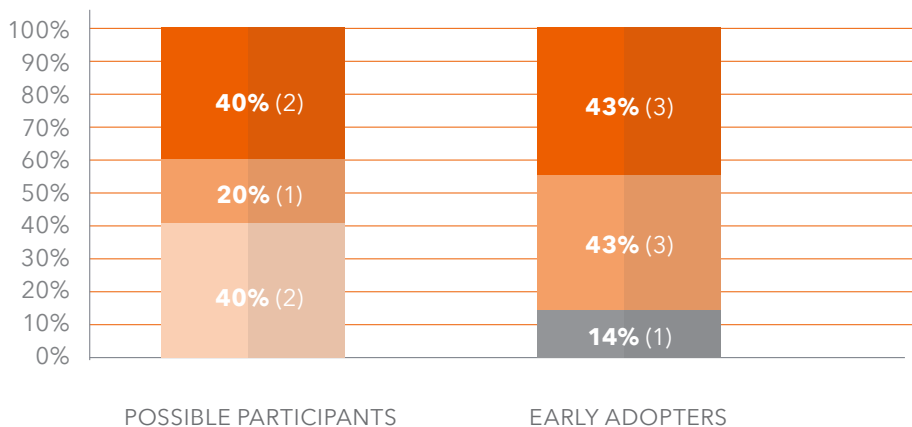
There was a range of responses here, but of the keenest subset of early adopters, 40% felt that the minimum fund size would need to be greater than £6 million

for the fund to be economically viable. The average EIS fund size was just under £13m in 2014, according to Intelligent Partnership's 2014 EIS Industry Report.

Deal flow is likely to be much smaller compared to EIS, which may discourage larger fund managers from getting involved.

- DEAL SIZE

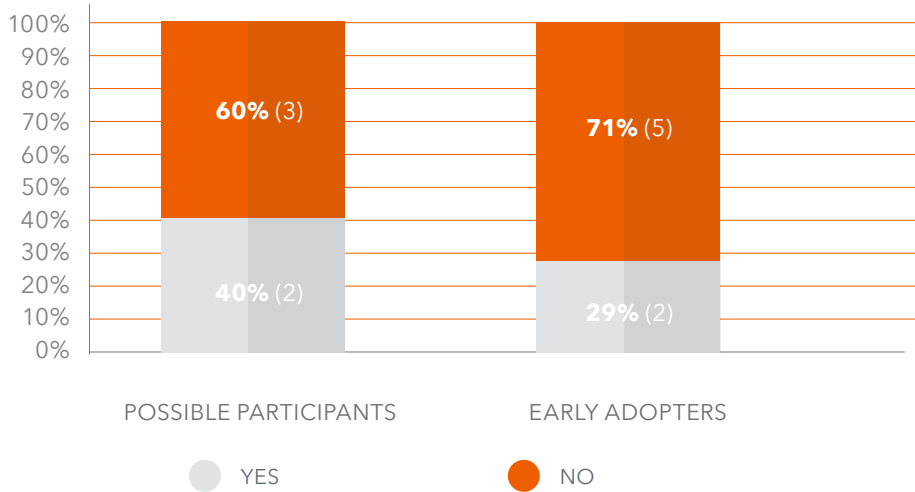
What does your firm anticipate would be the minimum deal size to make an investment into an SITR qualifying organisation via a fund viable?



● < £250,000 ● £250,000-£500,000 ● £500,000-£750,000 ● £750,000-£1 million ● greater than £1 million

We also asked if managers would consider deploying money raised in their current funds into SITR investments, under the current £250,000 limit - on the next page.

Would your firm consider making investments via one of your current funds (not a specific SITR fund) into SITR qualifying opportunities under the current limit of £250,000?



LOOKING AHEAD

What steps have your firm taken so far to develop a SITR product?



"READY TO LAUNCH SUBJECT TO CLARITY ON £5M LIMIT. VIABILITY AND RETURNS MODELLING COMPLETED, BROCHURE PREPARED, INVESTMENT OPPORTUNITIES IDENTIFIED"



"MET AND TALKED WITH TREASURY AND INDUSTRY PROFESSIONALS INCLUDING LAWYERS AND TAX ADVISERS. MET DIRECTORS AND ORGANISERS OF CICS AND COMMUNITY PROJECTS"

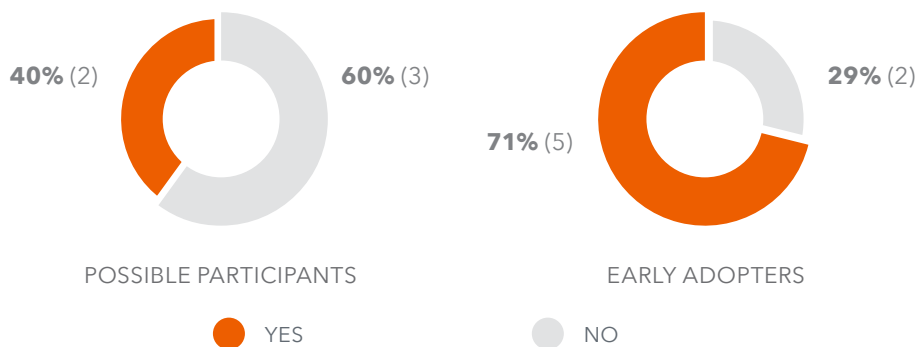


"RESEARCH"

- SOCIAL VCTs

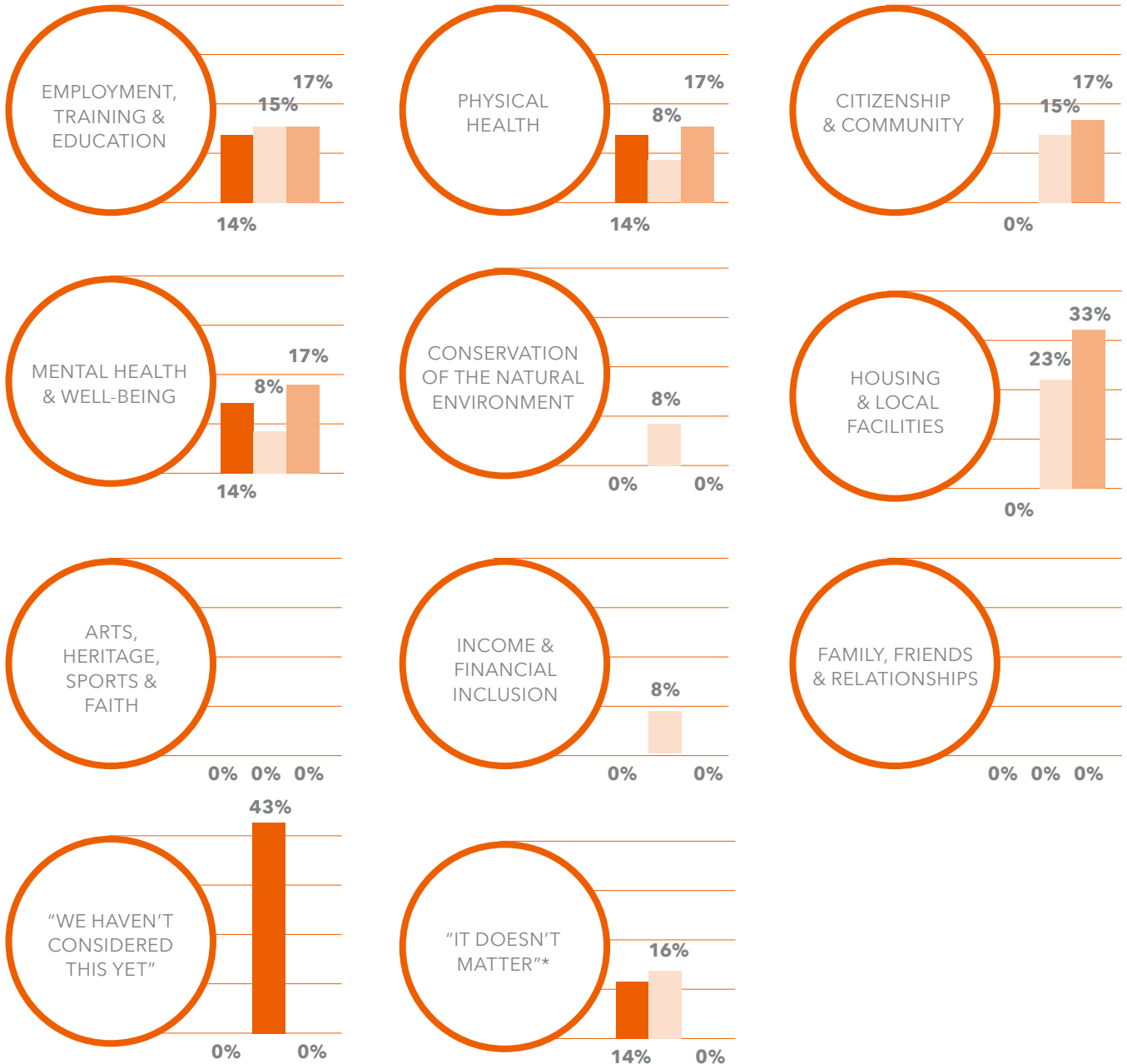
Social VCTs have been mooted, but the Treasury wants to establish if investment providers will develop Social VCT products before the legislation is put in place.

Would your firm be interested in developing a social impact VCT if this structure was approved?



- POTENTIAL AREAS OF SOCIAL IMPACT

What areas of social impact would your firm be most interested in investing in if it did launch a SITR product?



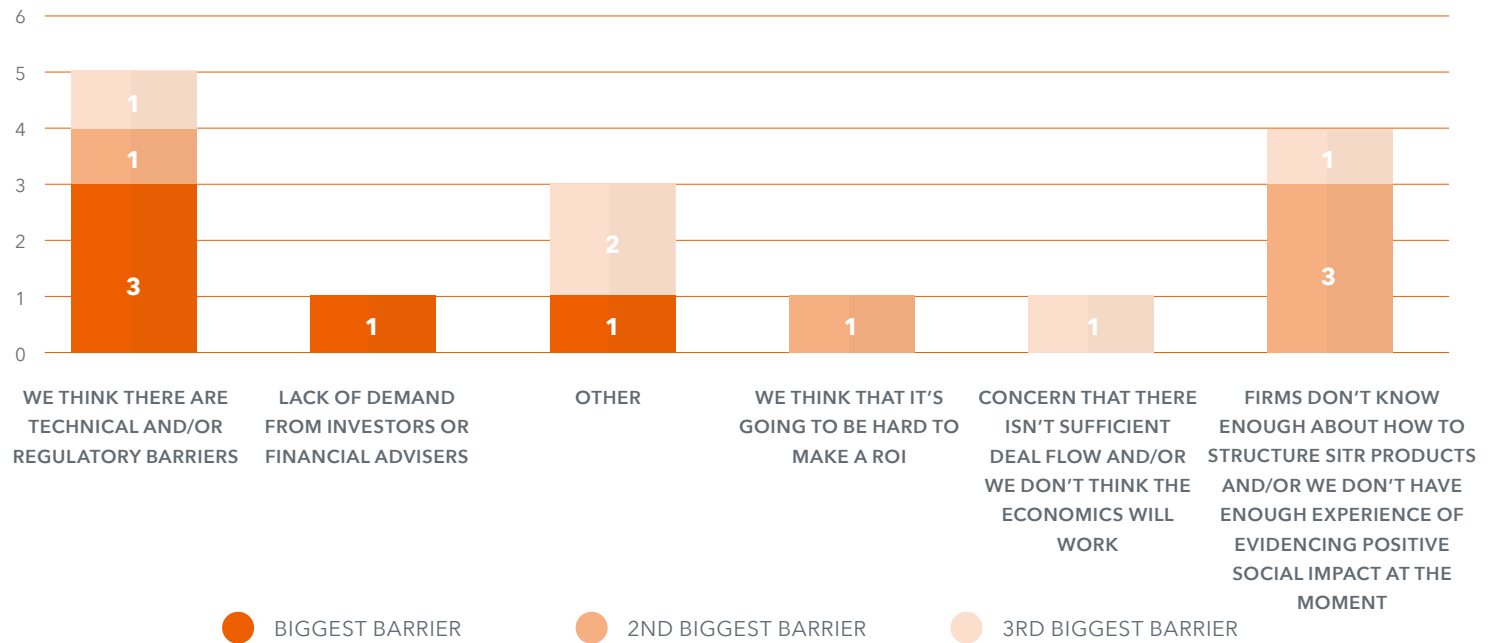
- WE'VE CONSIDERED IT AND WE'RE INTERESTED, BUT WE NEED TO KNOW MORE ABOUT THE MARKET BEFORE WE MAKE A STRATEGIC DECISION TO GET INVOLVED
- WE'RE ALREADY DEVELOPING PRODUCTS IN ANTICIPATION OF THE CAP ON INVESTMENT BEING LIFTED FROM £250,000 TO £5M
- WE'VE CONSIDERED IT AND WE'RE REALLY KEEN, BUT WE'RE WAITING FOR CONFIRMATION THAT THE CAP IS TO BE LIFTED TO £5M BEFORE WE START DEVELOPING PRODUCTS

- BARRIERS FOR THE PREPARED

The managers that are most keen to engage with SITR were asked what they believe to be the biggest barriers. These managers have done the most research and development thus far and their input may be the most valuable.

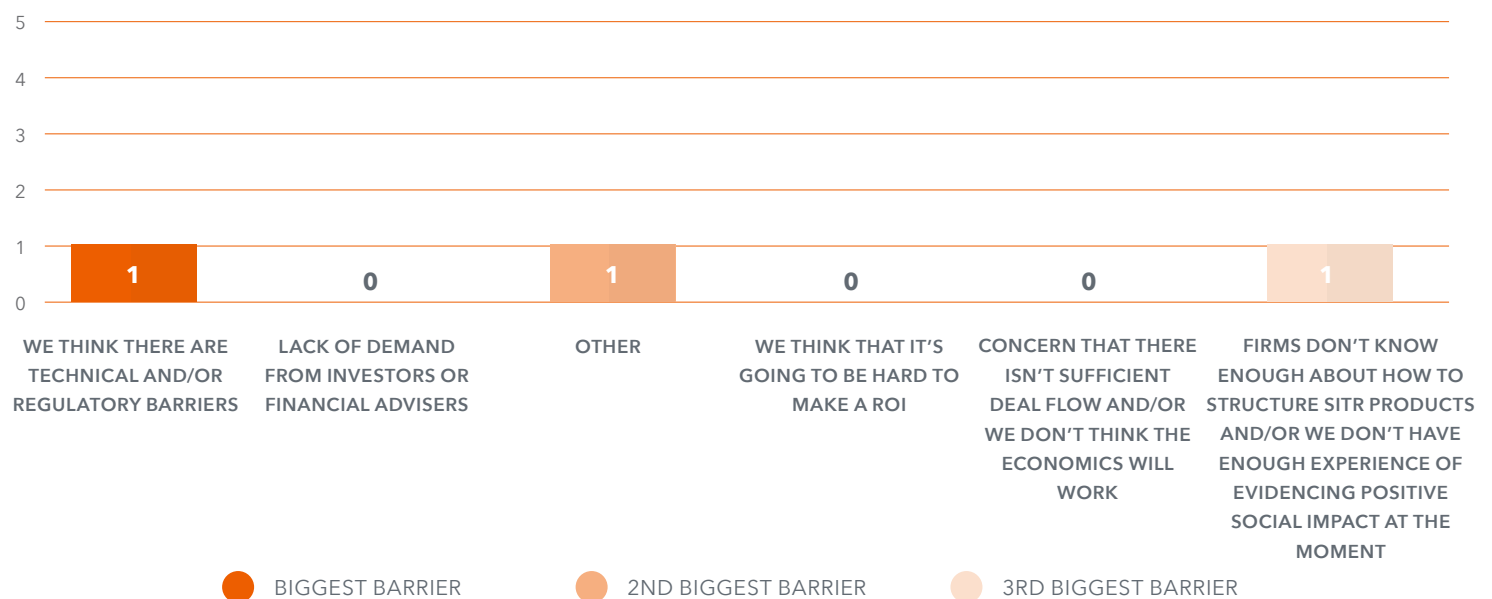
What does your firm think are currently the biggest barriers to the development of SITR products in the investment industry?

"We're already developing products in anticipation of the cap on investment being lifted from £250,000 to £5m"



What does your firm think are currently the biggest barriers to the development of SITR products in the investment industry?

"We've considered it and we're really keen, but we're waiting for confirmation that the cap is to be lifted to £5m before we start developing our own"



IF OTHER, PLEASE EXPLAIN

BIGGEST BARRIERS TO THE DEVELOPMENT OF SITR PRODUCTS IN THE INVESTMENT INDUSTRY?

(OTHER)

" IT IS VITAL THAT THE LIMIT IS RAISED TO £5M (OR CLOSE) "

" AS FUND MANAGERS, WE NEED CLEAR LEGISLATIVE GUIDELINES TO ENABLE US TO STRUCTURE AND PACKAGE AN INVESTMENT PROPOSITION TO INVESTORS "

" POLITICAL RISK - CONFIDENCE IN THE GOVERNMENT NOT TO CHANGE THE RULES "

Knowledge, regulatory and technical obstacles are considered to be the biggest barriers to SITR product development by these managers

What single development in the SITR space does your firm think would have the biggest positive impact right now?



" THERE IS SIGNIFICANT DIFFICULTY IN FUNDING PROJECTS BETWEEN £5M AND £15M FOR SOCIAL INFRASTRUCTURE SCHEMES. THE COSTS OF THE SCHEMES ARE HIGH AND THEREFORE TAX INCENTIVES ARE NEEDED IN ORDER TO DRIVE DOWN THE COST OF INVESTMENT TO MAKE THEM ECONOMICALLY VIABLE "



" EU STATE AID APPROVAL "



" STATE AID APPROVAL "



" CLEAR GUIDELINES ON LEGISLATION "

SUMMARY

The majority of the managers surveyed are aware of the SITR. While a number of them (32%) are either already developing products, or anticipate doing so pending approval of the higher investment limit, 23% have considered it but have no plans to enter the market at the moment.

Managers that have decided not to pursue SITR products cited lack of investor and adviser demand as the main barrier for them to get involved, however the managers that are already developing their products felt very differently - citing

demand as the number one motivation for developing products!

Many firms were prepared to consider lowering their fees on SITR products and their view on minimum fund raises and deal sizes were mixed - but notably, in comparison to other managers, the group who were most advanced in developing SITR products felt that both the funds and the deal sizes needed to be bigger (generally greater than \$5 million and £1 million respectively).

Most respondents stated they would be very unlikely to make a SITR qualifying investment at the current £250,000 limit and, taken in conjunction with some of their comments on what they consider the biggest barriers to involvement to be, this can be considered to be the single most important change that could be made in order to encourage the development of SITR retail investment products among this group of managers.

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PUBLICATION

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