European Commission

# Study on the feasibility of an education and training investment platform

Final report

ICF

FiBS

Education and Training

**EUROPEAN COMMISSION**

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EUROPEAN COMMISSION

# Study on the feasibility of an education and training investment platform

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in association with

FiBS

Directorate-General for Education, Youth, Sport and Culture

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## Table of Contents

## Table of tables



## Table of figures

# Glossary

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| Assets (tangible and intangible) | An asset is a resource with economic value that an individual, corporation or government owns or controls with the expectation that it will provide future benefit.<br>A tangible asset is a physical asset such as land, vehicles, equipment, machinery, furniture, inventory, stock, bonds and cash. As a result, investment can be secured against the asset.<br>An intangible asset is non-physical, such as patents, trademarks, franchises, goodwill and copyrights.<br>Social outcomes are a form of intangible asset (such as skills and qualifications, or new organisations that support social outcomes). Social outcomes are often described as building human and social 'capital', but this form of 'capital', although capable of providing future returns, is intangible. |
| Commissioners | In the context of a Payment by Results (PbR) intervention, a provider is commissioned and contracted to deliver a specified set of results in return for payment. The Commissioner is the government department or agency, acting as counterparty to the contract, that is willing to pay for the contract. |
| Fiscal benefits of social investment | The provision of social outcomes has the potential, over time, to influence the future levels of public expenditure and tax revenues and, particularly, to reduce future spending and/or increase future revenues. The scale of these future benefits is uncertain, but provides a justification for social investment |
| Funding | The provision of financial resources, including grants and various forms of investment, in support of interventions |
| Funders | Funders are legal entities and comprise a potentially wide range of organisations with an interest in the outcomes of the interventions. These include government, private financial institutions and social investors |
| Financial guarantee | An undertaking by a legal entity to cover a specified share of losses incurred by investors, including the risk to lenders of a failure to recover loans, or losses incurred by shareholders.<br>A "guarantee" would seek to underpin the funding and financial returns of the Intervention, which thereby would appear as a liability in the guarantor's balance sheet. A "guarantee" of the performance or delivery of a Service committed by a Provider under such a contract is a commercial, as opposed to financial, undertaking, and, hence, carries different and less onerous, financial obligations. |
| Intermediaries / Financial intermediaries | Organisations that facilitate and broker the development of investment opportunities, but are not necessarily funders. Intermediaries will assist in designing interventions, establishing tariffs for payments by results, and support the undertaking of due diligence.<br>In contrast, Financial intermediaries, for the purposes of this study, are the organisations contracted by the EIB to facilitate the take-up of EIB funds. These organisations are typically national banks, who have the capacity to appraise and take investment decisions, and are willing to contribute their own funding. |

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| Intervention | An activity undertaken in the market by government in pursuit of public policy goals. The activity may be the provision of incentives / penalties or direct action. The social welfare benefits (social outcomes) of the intervention are expected to outweigh the costs of the intervention. In the context of this study interventions that rely exclusively on grant funding would be excluded. In addition, the study assesses the market for investment and excludes interventions that involve only Commissioners and Providers. All interventions must have an element of third party investment. |
| Investment | Investment is the purchase of assets (comprising goods (tangibles) and services (intangibles)) that are not consumed today, but are expected to generate future benefits. Investment of resources (money, time) is undertaken in return for capital gains and/or income. In the context of this study, the return is partly in the form of enhanced human and social capital, as well as comprising a financial return – the 'blended' return. |
| Payment by Results ("PbR") | An intervention in which a service Provider receives a (usually, lump-sum) payment on the achievement of pre-agreed outputs/outcomes, paid by the Commissioner (usually, government) under contractual terms, which set out the required social outputs/outcomes. The payment may include a small premium, if the benchmarks are achieved in full. |
| Results | A collective term for the provision of social outputs and outcomes |
| Social intervention | An intervention where the public policy goals relate to specific social policies. These policies, in the context of this study, relate to the improvement of the education and training of citizens |
| Social investment / Social Investor | The provision of loans, purchase of shares, or provision of guarantees in return for social impact (the asset) and (perhaps, nominal) financial return. The two main ways of funding asset investment are "loan" or "debt", and "equity" |
| Social 'debt' investment | An investment can be described as a "loan" or "debt" when the Funder (lender) will require repayment of the loan against an agreed schedule, and charge an agreed (perhaps, nominal) rate of interest. Lenders may take additional control of the Service delivery by imposing covenants and demanding the right to intervene in the delivery of the Service should performance fall below expectations and before default on the loan arises. |
| Social 'equity' investment | An investment can be described as "equity" investment when funders take a shareholding in the recipient organisations, and receives its return solely through dividends or financial outcomes. The equity investor also carries the delivery and full financial risks of the investment, and is subordinate to lenders in the event of failure. It is probable that an "equity" Funder will wish to exercise a degree of control and management over the delivery of the Service |
| Social enterprise | An organisation engaged in continuous activity of production and/or exchange of goods and/or services, but which has as its primary objective the achievement of a social impact. This does not exclude the possibility of producing a profit. It is expected profits are mainly reinvested in the enterprise |
| Social entrepreneurs | Individuals who seek to invest in and / or to establish and / or manage social enterprise and the achievement of social impact |

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| Social Impact Bond (SIB) | An intervention where the service Provider contracts with a lender to borrow and repay funds to finance the provision of defined social outputs/outcomes. The bond is the contract held by the lender, signed by the borrower, defining the funds to be repaid and under what terms. A Social Impact Bond (SIBs) is a mechanism by which to shift financial risk from service Providers to investors, with investors underwriting service Providers based on their ability to deliver agreed social outcomes in return for a social and financial returns<br><br>Social Impact Bonds are not bonds in the conventional sense. While such Bonds apply over a fixed period, they do not offer a fixed rate of return. Repayment to investors is contingent upon specified social outcomes being achieved. Therefore, in terms of investment risk, Social Impact Bonds are more akin to an equity investment. |
| Social Impact Fund | A fund paid into by social investors (and possibly government) to finance Interventions providing social outputs/outcomes |
| Social output | The direct consequence of the activity undertaken in the Intervention, determined only by the results arising from the Intervention (for example, the provision of pre-school or training places, or the finance for a student loan fund). The ability to deliver social outputs, rather than social outcomes (see below), is more deterministic. |
| Social outcome | A consequence of the intervention, resulting from the take-up of social outputs, but also determined by the behaviour of stakeholders, depending on their interest and the incentives offered (for example, the take-up of places and resulting effects on skills/qualifications; the engagement and participation of young adults in employment; the scale of student borrowing.). There is more uncertainty over the scope to deliver outcomes than social outputs, because other factors can also influence the response to the intervention (e.g. additional policy measures, or changes in economic and social circumstances) |
| Special Purpose Vehicles (SPVs) | A common approach in the delivery of Social Impact Bonds is the establishment, for the duration of an intervention, of a separate legal entity, described as a Special Purpose Vehicle (SPV), charged with the sole purpose and responsibility for delivering the intervention. The SPV enables the Provider and investor to contract with the Commissioner and is the recipient of the funds needed to undertake the Intervention. The SPV ring fences the assets and liabilities of the Provider and funding. It also enables the investor (or lender) to exercise some oversight and control of the intervention. The SPV therefore enables an element of performance management and governance to be exercised, and provides an early warning to investors of difficulties with delivering the intervention |

# 1 Introduction to the study

## 1.1 This report

This is the Final Report of a study commissioned by DG EAC and conducted by ICF Consulting and FiBS to assess the **feasibility of an education and training investment platform, supported by investment from the European Fund for Strategic Investment (EFSI).**

Education and training in this study includes, pre-school/early childhood education and care, primary, secondary, vocational education and training[1] and higher education[2], plus adult learning.

This Report is the final deliverable of the study. It sets out the findings from ten Member State case studies, including Germany, Portugal, Sweden and the UK. Conclusions and recommendations are provided

## 1.2 Purpose of the study

### 1.2.1 The need for additional investment in education and training

The pressure to control public expenditure since the Financial Crisis has affected spending on education and training, with real terms cuts in some Member States. This has exacerbated any pre-existing investment gaps, leading to the 2015 Joint Report[3] to identify the existence of investment gaps and potential sources of investment, including the Investment Plan for Europe (IPE)[4] and, under the new Priority 6, to promote funding models to attract private and other capital.

As a public benefit, education and training services are largely funded by government spending, especially formal education provision. But where specific revenue streams can be identified (funded by government, households, or industry), there is the potential to attract private and/or social investment, in the form of loans from banks / social investors, and/or equity investment in the new services / assets / institutions.

### 1.2.2 The feasibility of using EFSI to leverage additional investment

The purpose of this study is to examine the possibility of exploiting the financial resources available from the European Fund for Strategic Investment (EFSI) to provide additional educational and training outcomes. Funds are typically made available through the establishment of an 'investment platform' established by a National Promotional Agency[5] dedicated to supporting, in this study context, education and training projects that complement the formal provision of education and training in the Member State. In some cases funds may be made available through financial intermediaries contracted by EIB.

The European Investment Fund (EIF) responsible on behalf of EIB for the management of EFSI have been developing new investment 'sub-windows' through which investment might be made available. Within EFSI's initial 'SME' window, a new 'Expansion and Growth' sub-window has been established to target social investment,

[1] Includes courses provided at ISCED level 4 and some short-cycle courses at ISCED 5 depending on national classifications.

[2] ISCED levels 5 to 8. Note that distinction of post-secondary VET and higher education can be sometimes relatively blurred at national level.

[3] Draft 2015 Joint Report of the Council and the Commission on the implementation of the Strategic framework for European cooperation in education and training (ET2020): New priorities for European cooperation in education and training; {SWD(2015) 161 final}

[4] Investment Plan for Europe: Communication Brussels, 26.11.2014; COM(2014) 903 final. See Annex 2 for further details

[5] National Promotional Agencies include National Promotional Banks

and to support social enterprise. EIF have also launched requests for expressions of interest from financial intermediaries to help deliver EFSI in this area.

This resource in turn necessitates an assessment of the scope and opportunities to attract private and / or social investment into the provision of education and training services at sub-national, national and (possibly) international scales.

The leverage of private and social capital with the aid of financial instruments set out in support of the IPE requires that the initial capital invested is paid back and there are opportunities for returns to that investment (which may be nominal for not-for-profit institutions). This in turn requires the identification of revenue streams that might be tapped to facilitate investment.

The study aims to identify current examples, or to propose potential examples, of interventions that seek to bring additional investment to the provision of education and training outcomes and to examine the nature of the funding models and the scope for replication and expansion using EFSI funds.

## 1.3 Structure of the report

The report comprises the following sections:

- Section 2: Summarises investment needs;
- Section 3: Sets out the general funding context and possible options;
- Section 4: Summarises the results of research into case studies of interventions seeking to provide education and training outcomes, mainly adjacent to or outside of the formal publicly funded education and training systems;
- Section 5: Summarises the results of research in other Member States that provide further context and evidence related to the feasibility assessment;
- Section 6: Concludes on the feasibility of using alternative funding sources, to provide additional education and training outcomes, and the feasibility of new investment platforms;
- Section 7: Recommends possible options to make the use of alternative funding sources more attractive and to improve the feasibility of investment platforms.

Supporting annexes provide additional information. In addition we have provided the ten detailed case studies in a companion volume to this Final Report.

# 2 Investment needs

## 2.1 The rationale for investment

EU Member States spend some 800 billion euro a year on education and training (see Annex 3 for details). Limits and cuts in public expenditure on education in several countries have increased the need for additional sources of investment.

Cuts in public spending in the sector now has the potential to create future increased costs for public services and lower tax revenues as a result of, inter alia, lower educational attainment and participation, increased rates of delinquency and rates of offending, and long-term reductions in labour market productivity. We summarise some identified needs below.

This in turn means that there are fiscal benefits to Member States as well as social benefits that support selective investment in education and training interventions, in different educational and training sectors. However, to the extent that this investment is supported by government, it implies the adoption of an 'invest to save' culture which recognises the longer term effects of investment made in the sector now.

The scale of investment need is difficult to quantify, but is likely to substantially exceed the level of private and social investment that might be available for disbursement in this area. The issue then becomes a matter of defining those areas of education and training and the types of interventions that can generate a blend of financial and social returns and of creating investment vehicles that are attractive to investors / lenders; as co-investors with EFSI.

## 2.2 Investment need that might be funded by EFSI

Desk and case study research has indicated that there are a number of important investment needs. These needs tend not to relate to the statutory provision of education per se (the supply of education services), but to particular gaps in non-statutory provision, where the limitations on public sector spending give rise to needs that might be addressed through additional funding sources. The importance and weight given to these needs varies between Member States depending on the overlap with statutory provision and with existing policy responses.

Four particular gaps / needs for investment have been identified:

- **Pre-school provision (ECEC)** – covering both services and infrastructure (buildings). Different Member States have different provisions for pre-school years, with varying levels of support, often depending on particular age ranges and associated government funding and for private services, on the income of parents/guardians. Responding to the needs of low income households, where additional pre-school education is required to offset the deficit in educational attainment by school starting age is of particular interest to social investors, although fiscal returns maybe very long-term;
- **School buildings** – in most cases there continues to be a shortfall of investment in the maintenance and replacement of the stock of schools and colleges to modernise and renew and to keep pace with deterioration and depreciation. This investment gap is already addressed in part by the attraction of private sector investment through the use of public private partnerships (PPP) (see Annex 4 for a fuller description of the nature and use of PPP). Scope for extending the use of PPP might be justified in cases where other infrastructure issues can be addressed, especially energy efficiency of the education building stock;
- **Vocational Education and Training (VET) and Adult Training** – the need for trained and skilled labour continues to be underfunded due to market

failures, (especially 'free-riding' where employers rely on other employers to meet the costs of training), leading to shortages of supply. There are various Member State policy responses including the use of government funding together with the use of employer levies to help address this demand. However, levies are not popular because of mismatches between levies paid and the benefits individual employers receive. Customised responses funded by employers to meet the particular needs of groups of employers could respond to this, including funding for student and adult learners;

- **Disadvantaged groups** – the work has identified various groups of children and students that have particular needs which are not fully met by statutory provision and ad hoc policy responses. These groups include, pupils with particular learning needs, pupils requiring after school support, young offenders, pupils at risk of early school leaving and groups not included in statutory provision such as refugees or certain classes of migrant populations. These groups tend to have inherently higher unit costs of education and hence in times of funding constraints are subject to greater impacts from funding cuts. Responses are likely to have to rely on a mix of funding sources depending on the particular groups targeted:
    - **School drop-out / NEET prevention programmes –** school drop-out is a serious concern across Europe, with concerns over lengthening periods of youth unemployment and lack of participation in education or training. However, while figures are smaller than they were a few years ago, progress might be considered small. In general, repayment of the (private) investment would be via fiscal returns, e.g. future tax revenues, savings in social welfare spending etc.
    - **Support for children with educational disadvantages** – investment needs to support children at school that are disabled, disadvantaged, and those with educational difficulties, e.g. dyslexia; dyspraxia, Asperger syndrome, etc. reflect shortfalls in government resources to adequately tackle such problems. There are a sizeable number of such students possibly up to 10% of the total. These students are often highly motivated and capable of significant achievement with the appropriate support. There are three facets:- a) Investment in the 'fixed assets' needed: conventional private capital may be attracted to this sector, as for conventional education buildings, not least because of its 'community' component; b) Teaching and management of students: possibly, this is best left to national government institutions, as it may be closely identified with the health service sector; and c) Identification of the students' condition in the first place: as for b), but it might also be possible to harness sector-specific philanthropic resources as additional financial support.

## 2.3 Types of intervention

The case study research has identified three broad types of intervention that could form the basis of new investment opportunities:

- Payment by results for educational and training outcomes, paid for by Government as commissioners, justified on the basis of the fiscal benefits that are considered to accrue;
- Loan funds to students and adult learners to increase participation and skill level;
- More conventional public-private partnerships (PPP) to leverage investment into the supply and refurbishment of education buildings.

The second two types of intervention (Loans and PPP) are reasonably well understood, although innovation may be required to address previously observed difficulties. Payments by results projects and the wider use of social investment to deliver education and training results is new and experience is limited. We discuss the nature of this intervention in the next section.

## 2.4 Use of EFSI

In addition to the infrastructure and SME windows, EFSI has made available an equity instrument that is able to invest through financial intermediaries / fund of funds in social organisations, as part of the expansion and growth window. It is not clear to what extent the investments can make use of Investment Platforms, as opposed to contracting with an individual financial intermediary. Further discussion is planned.

# 3 The funding context relating to the provision of education and training services and the possible use of EFSI

## 3.1 Introduction

This section provides a basic description of the funding options and related stakeholders and seeks to clarify the use of specific terminology. This understanding underpins the rest of the Report.

In many countries, education is perceived as mainly, or even solely, a public responsibility, where funding has been almost exclusively from public expenditure. However, this general approach has been supplemented or replaced by alternative approaches to funding and delivery, depending on the country and sector/segment of education. For example, adult education may be paid by participants and employers, whereas early childhood education is often co-financed by parents. Likewise, higher education may be paid by students and their parents via tuition fees, etc.

In many European countries public funding and spending for education has come under greater public scrutiny and accountability, and is no longer increasing as it did in previous times. Indeed, public funds for education are even decreasing in several countries (Eurydice 2014, EUA 2015, 2016), albeit exceptions exist.

The Study is therefore concerned with the pursuit of education and training-related outputs/outcomes through new Interventions, using funding models other than the conventional, fully-funded provision of services through government expenditure, and which might offer an opportunity for the deployment of EFSI funds.

This necessarily broadens the scope of relevant stakeholders with a potential interest to include not just government (and taxpayers) but a range of:

- private 'for profit' financial institutions interested in offering a range of loans, investments and guarantees;
- social investment actors interested in education and training outcomes (including philanthropic capital, charities and third sector organisations more generally), seeking to operate as 'not for profit' funders and seeking a 'blended return' of social impact and repayment;
- social investment intermediaries, seeking to broker, but not fund directly, social investment; and
- service providers delivering specific (and contracted) educational and training outcomes.

This broad perspective of potential stakeholders is important, because the study has identified a variety of possible 'Interventions', which comprise a range of different funding models and associated stakeholders, seeking to deliver a range of different education / training outcomes.

## 3.2 The need for common terminology

A challenge with regards to terminology is that it varies depending on the target audiences and several audiences are addressed through this Report. Among the key audiences are:-

- the formal education sector, comprising of public and private providers and education ministries;
- social innovation, or social investment, practitioners, i.e. (a) those providing funds for improved social outcomes; (b) providers delivering the education processes leading to enhanced social outputs/outcomes; and (c) the ministries,

responsible for paying the agreed payment in case that the outputs are achieved,

- banks, especially the National Promotional Banks (NPBs);
- National Promotional Agencies (often, but not only banks); and
- private / third sector financial, or philanthropic, investors and lenders providing the funds for the intervention; and
- various groups of payees (those charged for receiving services) including employers, households, students and adult learners.

All such stakeholders have their own approach to education, in general, but also in relation to engagement in, and financing of, education.

### 3.2.1 Key terms

This Report covers the interest and early examples of expressed demand for the funding of education and training beyond that provided through general government expenditure, from a range of stakeholders pursuing possible Interventions. These interventions may, in turn, offer scope for the use of EFSI funds to further support opportunities for the enhancement of education and training services throughout Member States.

The first term that needs definition is the 'intervention'. This is a generic term taken to cover all types of approaches and funding models designed to leverage private funding in pursuit of education and training outputs and outcomes. For funders it would constitute the 'project'. However, to be clear, the study is concerned with the possible use and catalytic impact of investment funds provided by EFSI. As such the interventions of interest in this study, by definition, exclude interventions that are exclusively grant funded, and focus on those which require third party finance.

The second term is 'education and training outcomes'. This somewhat cumbersome phrase describes the range of potential socially valuable consequences of the intervention. The study has considered opportunities across the full range of education and training services from pre-school, through primary, secondary and tertiary, and including vocational education and training, and lifelong learning. Outputs are the direct activity-based consequences of an intervention, e.g. number of places provided and outcomes are the intended socially valuable consequences e.g. number of people with new skills)[6]. Outcomes, on the other hand, include the longer term and wider impacts on the economy.  We use 'results' as a convenient short-hand.

In describing such Interventions, care has been taken, to the extent possible, to describe the proposed funding models such that no ambiguity arises as to the character and anticipated performance of such funding support.

Thirdly, given the socio-economic nature of the Interventions, the terms "investor", "lender", "guarantor" and "investment" are only used in this Report in the context of an Intervention where there is an investment in social impact (as the invested asset). Investment implies that a direct financial return is anticipated, either through the payment of a shareholder dividend, or the generation of a capital gain, or both, or in the case of debt, interest (potentially at nominal rates) and repayment. A social

[6] These terms are conventionally used in the context of 'an intervention logic' describing the process of funding and undertaking some activity, producing the intended outputs and leading to policy relevant outcomes. The outcomes and related wider impacts that result can be attributed to the intervention, recognising that there are potentially also other influences affecting the level of outcomes and impacts

impact bond (a loan agreement between provider and funder) would be considered an investment.

A detailed glossary is provided at the beginning for the clarification of key terms.

## 3.3 The development of alternative sources of finance for education and training

The study is focused on the opportunities to use alternative sources of funding to public spending to deliver education and training services, ideally with a specific outcome. For the Commissioner (government), the funding opportunities should lead to services that are either less costly and/or of higher output quality, leading to greater outcomes. These funding sources are the private finance sector and the social investment sector (or some combination).

### 3.3.1 Use of private finance

In recent years, some new forms of private financing have been promoted. As a first and relatively conventional form, so-called Public-Private-Partnerships ("PPP") were established, through which public entities entered into "seemingly" new forms of contractual relationships with private companies, operating under licence or as a concession.  Whereas conventionally the State has paid immediately for the construction of roads, schools or buildings on the basis of a pay for (built asset) delivery, the State now under a PPP enters into a contract, a "concession", where the private company is responsible for the financing of the construction works (roads, schools) and for delivery of the service with the assets so built, and the State pays a rent or concession fee on a long-term contractual basis.

The major distinction to conventional funding is that the State is no longer the principal owner of the assets and responsible for service delivery, so long as the contract is in operation, whereas the private company is. Prior to the use of such a funding mechanism, the State had its own departments that were responsible for the preparatory works (planning etc.), which then led to a tendering process through which the construction company was selected and then paid on delivery of the assets built. The State thereby owned roads, schools and buildings, and was responsible for all issues, apart from the construction works itself. It had to bear also the costs for maintenance etc.

In PPPs the process is different. Even though the planning process remains similar, the private company is responsible for the process of construction, incl. all details, including the upfront and full costs of construction. The private company is also responsible for maintenance of the assets after completion, and the risk of mis-management, failure etc. Private investors and the State sign a long-term contract ex-ante, specifying the asset to be built and regulating the use of the building as a school, plus the rent to be paid to the investors, e.g. an "availability payment", which covers the ongoing operational costs, maintenance and financing costs of the school.

Despite some differences between PPP and conventional contracts between public and private entities, PPP's seem less innovative than they appear, if one follows the political and other discussions on this issue. We will come back to the merits and limitations of PPPs in later sections of the study.

### 3.3.2 Use of social finance

#### 3.3.2.1 Basic approach

A more recent approach to funding interventions in support of public policy goals (sometimes called 'social infrastructure') is social investment or social finance. Financiers provide funds for better social outputs and outcomes, usually but not always on a 'not for profit' basis[7]. While the background and culture of social finance may vary across countries, they share a common interest in addressing some weakness in the current system of public sector provision (for example, the lack of (high quality) services for vulnerable groups) through social finance of interventions that aim to provide additional and/or improved results than the formal public system.

The use of social finance is a relatively recent development[8]. EIF have recently published[9] a Working Paper outlining the need for social investment and promoting the use of the Employment and Social Innovation EaSI Programme with support from EIF in response. EFSI has also specified a window for social investment.

One of the key features of recent interventions pursuing socially valuable outcomes and supported at least in part by social finance, is that the public purse pays only if the expected and contractually specified outputs/outcomes are fully delivered by the intervention, whereas the funders / providers bear the full risk of non-performance of the intervention. Funders with limited resources to evaluate and monitor specific opportunities might be expected to invest in these interventions as part of a wider portfolio of social and non-social investments to reduce the risk of individual interventions[10]. Considerable due diligence is undertaken for each intervention to identify and manage project risks.

This approach has various names, in some countries it is called "Social Impact Bonds", in others "Payment by Results" (PbR) or "Pay for success" in the US. In some countries the notional terminology is even linked to loans or credits (for example, in Germany[11]). Assuming that established performance benchmarks are met, the Provider (or increasingly, a Special Purpose Vehicle (SPV), a legal entity for the purposes of the intervention representing the Provider and funder) receives a payment to reimburse the costs of delivery, including the costs of any loan (Interest) or investment (dividends), sometimes complemented with a small top-up in the form of a "premium".

However, it should be clear that Social Impact Bonds feature contractual arrangements, which must include a "payment by results" approach. But there can be "payments by results" Interventions that do not feature a bond. For the purpose of the study, we use 'payments by results' to describe the general case, but qualified that such arrangement includes the use of third party finance.

The basic funding model comprises three actors:

[7] 'Not for profit' means that the aim is to make a financial return but that this is reinvested rather than taken out by the funder as profit. Social investors have a responsibility to fund holders to make a financial return, even if the primary interest is in the social impact

[8] Although funding for social enterprises such as foundations and associations in some Member States has longer history (see the study: A map of social enterprises and their eco-systems in Europe, ICF Consulting for DG Employment, 2015): http://ec.europa.eu/social/main.jsp?advSearchKey=A+map+of+social+enterprises+and+their+eco-systems+in+Europe&mode=advancedSubmit&catId=22&policyArea=0&policyAreaSub=0&country=0&year=0

[9] Guaranteeing Social Enterprises – The EaSI way, February 2017, EIF Working Paper 2017/39: http://www.eif.org/news_centre/publications/EIF_Working_Paper_2017_39.htm

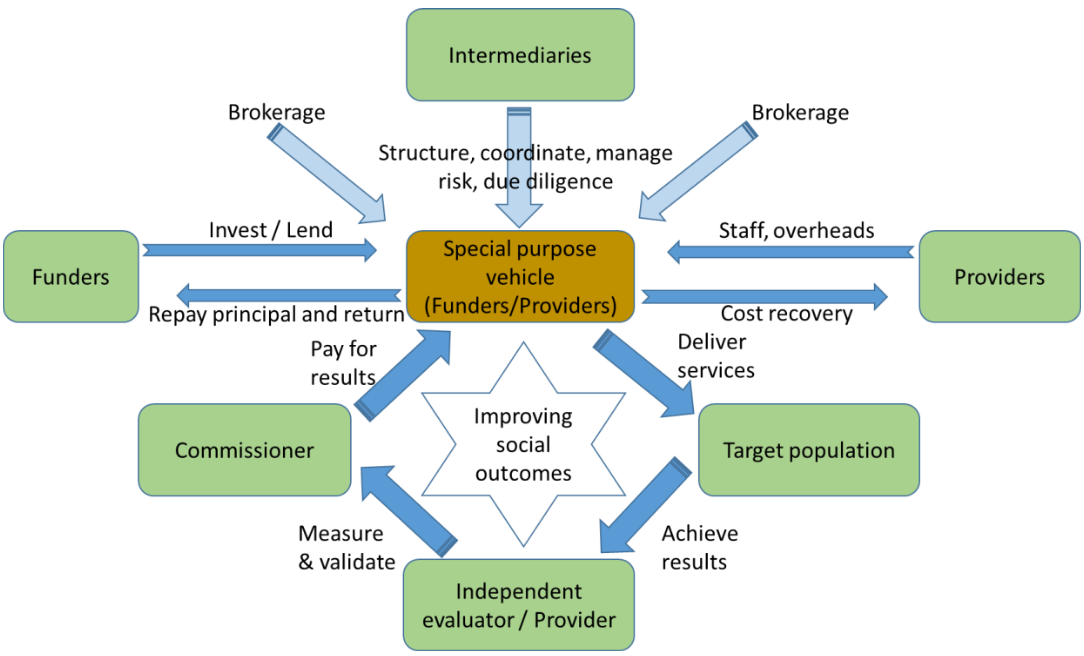
[10] Economically, such a portfolio only makes sense if the premium of these interventions is high enough to fully compensate the loss in some of the interventions, otherwise it reduces only the size of the loss. In the context of socially funded intervention, depending in the interests of the funders, financial loss (or lower levels of financial return) may be acceptable in exchange for the social outcomes

[11] According to a number of studies, the instrument, described is called a „Sozialer Wirkungskredit" (alike "Social Effect/Impact Credit").

- The Commissioners (government departments / agencies) – specifying the number and type of required output/outcomes (results) and the payments available in the event of delivery. This will be based in part on the results of evaluations of past interventions. A commercial contract between the Commissioner and Provider, or an SPV led by Funders with Providers, will be offered;
- The service Providers (of varying legal status, including arms-length government units, private companies, social enterprises, charities), willing to contract to deliver a specified set of outputs/outcomes for a given fee. This is often conducted through the SPV. Providers should also be responsible for ensuring that there is adequate independent monitoring and reporting of the achievement of agreed results, including interim achievements as the basis of billing, and as the basis of the final payment for results;
- The Funders (including social investors, but also private banks), willing to finance (in part or wholly) via loans/equity/guarantees the delivery of the service. A contract to cover the terms of the funding will be agreed with Providers as part of the terms of the SPV. The role of Funders is to ensure adequate cash-flow and/or to take some or all of the risk that contracted deliverables fail to be provided.
- There is also a fourth set of actors – social finance intermediaries. Intermediaries, which tend to be specialist experts or organisations, act to bring Funders and Providers together and broker partnerships, establish metrics for use as the basis of PbR and undertake due diligence. Their activity promotes access to investment opportunities from third sector Providers and Funders, and informs the design of individual interventions. Note this use of the term 'intermediary' should not be confused with the use of "intermediaries" by EIB / EIF to appraise investment opportunities and act as a conduit for EIB funds. These 'financial intermediaries' are typically investment banks.

Figure 1 describes the basic operational payment by results model.

*Figure 1 Overview of third party finance and a 'payments by results' operational model*



#### 3.3.2.2 Incentives and risks of the payment by results model

The actual contracting between actors is heavily case dependent. Typically, Commissioners will contract with a Provider / SPV to provide payment in exchange for specified outputs/outcomes. Providers will contract with Funders (as part of an SPV). In very simple and smaller projects the Provider might self-fund, and even in larger projects will only need to finance part of the cash-flow of the project. However, scaling up of the number and size of Interventions will require additional government spending and associated funding of projects.

The commercial performance contract will define the results to be delivered, details of the target group (size, traits of the group etc.) and the benchmarks of success in relation to certain output or outcome criteria, e.g. the share of participants graduating from lower secondary education, or entering into an employment contract (and the minimum duration the employee has to remain within the company). Specifying the outcome variables, the payment tariffs and expected levels of achievement correctly is clearly of critical importance, and requires detailed financial and social modelling based in part on evaluation evidence.

This contract will also include a payment schedule to allow the costs of the Provider and associated cash-flow to be covered. The actual performance contract is often made between the Commissioner and a Special Purpose Vehicle (SPV) operating on behalf of the Provider and Funder for the purposes of a specific intervention.

The Provider may only receive the amount that covers the cost of service delivery. They may also receive a bonus if benchmarks are met / exceeded. A penalty or reduced payment would result in the event of failure to deliver some or all of the agreed results. Payments can be structured depending on the set tariffs and outcomes achieved and sometimes the use of ceilings to interim payments, to help providers to manage cash-flow. In other cases contracts foresee lump-sum payments topped-up by a very modest fixed premia. Furthermore, it seems that the lump-sum payment is often independent of the precise level of performance, i.e. payment is not sensitive to whether there is marginal over or under performance.

The core principle is that the Commissioner will pay the agreed amount of money only if the established benchmarks are met. In the event that the benchmark is not met, no payment or a reduced payment will be paid, commonly not even covering the costs of provision. The commercial performance contract represents a contingent liability for the Commissioner after signature and before the contract is discharged.

The Provider, depending on funding needs and project risk, enters into a separate contract with a Funder. This may only be for the duration of the specific intervention or a group of interventions. The Funder may provide loans and/or take an equity stake, and bears at least some of the financial, risk of non-performance, e.g. final payment risk. The core element of this contract is the cost of the intervention and the funding conditions. In particular, the volume of funds should ensure that the Provider can deliver the services agreed in the contract with the Commissioner.

Such framework condition highlight some issues:

- the model is biased – the Provider/Funder bears all the risk, the public purse may even benefit if the benchmarks are not fully met (unless the success rate is lower than in other, already established settings). It is this allocation of risk that makes the intervention value for money for government. However, government should also recognise that interventions with too much risk will not be funded, and that there is a requirement for "sensible commissioning";
- the weight of risk provides a strong incentive to providers to 'cherry pick' sub-groups within the target group that are deemed most likely to respond to the intervention and deliver outcomes at a lower cost. Contracts need to anticipate

this response by recognising the sub-groups and introducing quotas across sub-groups;

- such conditions attract either entities who are for whatever reason absolutely convinced that their intervention will be successful and/or can bear the risk of total loss of the funds provided for the intervention. From an economic perspective, this is a bet – nothing else.

In contrast, the public purse can only be a winner, unless the transaction costs of establishing the intervention (which can be significant and which demand a minimums scale) and the outcome payments (when benchmarks are met), are higher than the fiscal benefit, which from an economic perspective would mean that it is a "mis-investment": the costs of Intervention are higher than the (fiscal) benefits. Establishing this balance between Commissioner and Provider requires experience and review.

If this is correct, it seems unlikely that a (large) market for this kind of social investment can be established, as it attracts only providers/funders that can afford to lose or benefit already from the engagement. It is definitely not a market for private/social investment that aims to generate solely positive financial returns, whether small or substantial.

This finding calls for adjustments in order to surmount the limitations on social investment and to more fully address the market failure associated with the current levels of investment in education and training.

#### 3.3.2.3 Overview of the current use of Social Impact Bonds

As noted, Social Impact Bonds (SIBs) are a particular type of a 'payments by results' (PbR) intervention, albeit the most common. The introduction of SIBS in recent years has been tracked by a UK publication[12] (Table 1). Some 40 SIBs have now been introduced globally with a total value of some $216m, with the UK the leading user of SIBs by number, but not by funding level. UK and other EU SIBs are on average considerably smaller than those funded outside the EU, and especially the US.

*Table 1 An overview of the number of SIBs introduced globally*

| | Location | | | | |
|---|---|---|---|---|---|
| Indicator | UK | Other EU | US | Other Countries | Total |
| Number of SIBs | 14 | 11 | 10 | 8 | 43 |
| Total value of SIBs ($m) | 57 | 12 | 121 | 25 | 216 |
| Average value of SIB ($m) | 2.6 | 1.1 | 12.1 | 3.2 | 5.0 |
| Maximum value of a SIB ($m) | 7.7 | 3.3 | 30.0 | 9.3 | 30.0 |

*Source: Social Impact Bonds: The Early Years; Social Finance, July 2016, Annex 1*

A brief review of the titles of individual SIBs listed suggest that in the UK / EU the predominant focus has been on providing support to the young unemployed to enter the workforce.

[12] Social Impact Bonds: The Early Years; Social Finance, July 2016, Annex 1

# 4 Summary of case studies of (social / private) investment in education and training

## 4.1 Education Results Company/Education Investment Fund (Social Impact Facility) (Germany)

### 4.1.1 Context and rationale for the intervention

#### 4.1.1.1 Context and market failure

As in many other countries, Germany faces the problem of a large number of low qualified and functionally illiterate people, whose needs are not fully addressed through available education services. However, rates of fiscal return to investment in the training of these people could be quite substantial (above 10%, sometimes even 20%) but these returns are spread commonly across different government layers as well as the social insurance system, where no layer itself has a return which is high enough to satisfy the return expectations of even social investors, unless almost all fiscal returns are appropriated by the investor.

Furthermore, the funding volumes for each single intervention are rather small, because the political and financial responsibility lies with the municipalities and because interventions are very specific. This leads to limited funding needs for each single case.

So far, there is limited experience with this kind of "Social Impact Bonds/Funds" that could be used to frame the investment in training outcomes.

#### 4.1.1.2 Objectives and target results

To resolve this mix of challenges, a "Social Investment" Platform is suggested as an umbrella to pilot Social Impact investing in Germany. The objective of this platform is to aggregate funding levels, which enable the pooling of projects in order to diversify the risks. It would also allow the trial of different forms of social interventions, to provide empirical evidence that this approach works for both sides involved at this level, i.e. the social investors and the public entities, and that it has a positive impact on the lives of socially disadvantaged groups.

A possible target is that 20-25 projects could be established.

#### 4.1.1.3 Partners

KfW could be a key partner for such a platform, in particular as sponsor. Other partners could be social investors, foundations and the responsible ministries.

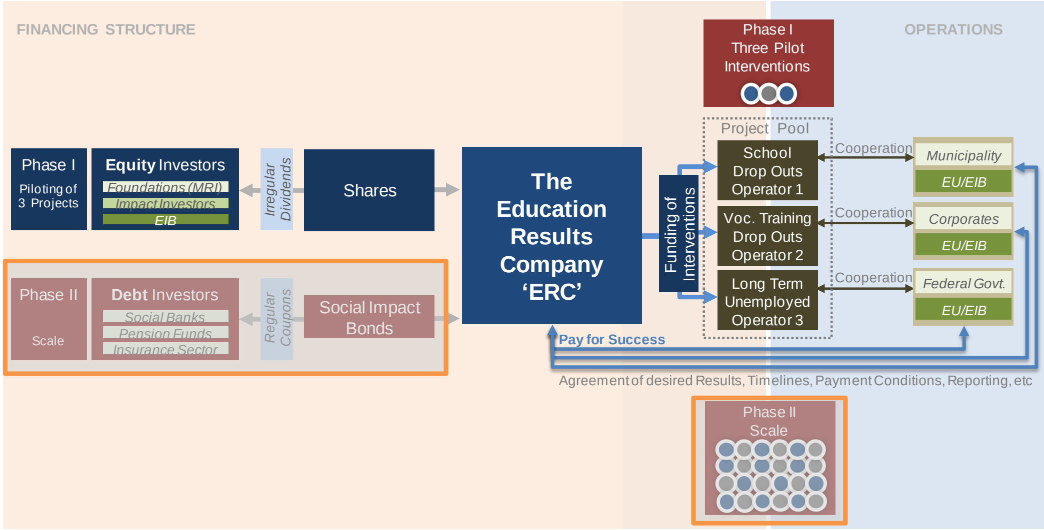
### 4.1.2 Operation of the intervention

#### 4.1.2.1 Scale and funding sources

The investment size of any single intervention is commonly several hundred thousand to 1 or 2m Euro. Funding will come from a joint effort of social investors, foundations, and, possibly, other investors, e.g. private persons. The establishment of a platform would allow an aggregation of investment funds and to diversify the risk portfolio.

### 4.1.2.2 Governance and funding model

*Figure 2 Governance and funding model for the Education Results Company*




### 4.1.2.3 Project suitability for EFSI funding

For the time being, no platform or overall umbrella for social impact investing is available in Germany, which is one factor hampering the extension and scaling-up of such models. Another limitation is the low attractiveness for private investors and the limited possibility to diversify funds, in order to reduce the overall risk exposure. The revenue stream in general is based on the appropriation of fiscal returns by the public purse or a fair premium in case of a payment by results-model. The latter is a pre-condition for any pilot.

At the moment, this model would not be bankable, as the risk exposure is quite substantial for all stakeholders involved, therefore, EIF/EFSI support would be required.

## 4.1.3 Future plans / scope for replication of the intervention

### 4.1.3.1 Scope to scale-up through larger interventions and development of portfolio

The "Education Results Company" in itself is an approach to scale-up and generate experience with this model and to provide evidence that it is feasible. The ERC is a national-level scheme.

### 4.1.3.2 Potential role for EFSI

EFSI involvement could be in the form of co-funding or guarantee.

## 4.2 Adult Learning Loan (Germany)

### 4.2.1 Context and rationale for the intervention

#### 4.2.1.1 Context and market failure

Although adult learning/further education is not linked to very high individual costs, in most cases, professional further education programmes, (whether re- or upgrading as well as specialised training, particularly if directed towards a qualification or certificate, recognised by professional organisations/bodies), request substantial fees. In addition, costs of living and opportunity costs may add up, if the programme is full-time, because of a reduction in working time.

So far, no adult learning loan has been implemented because of limited information on the rates of return, the heterogeneous nature of further education, the high transaction costs etc. Banks are risk averse and offer conventional consumption credits, providing reasonable interest rates for those in employment, higher income etc., i.e. those often not in need of a learning loan. In economic terms, adverse selection of borrowers applies. Public/state-owned banks have not stepped in, because of high transaction costs in relation to state subsidies and the already low market rates.

#### 4.2.1.2 Objectives and target results

The objective is to enable adult learners to attend the programmes they want by providing them with the liquidity to cover tuition fees, additional costs of learning and the costs of living, if applicable, at modest interest rates and in particular for those, who would otherwise not get a loan contract at reasonable rates.

The target is a certain number of learners (e.g. 100 or 1,000), who would otherwise not have been able to participate, entering into a learning programme, graduating successfully and entering into an employment contract with a higher salary than without the programme.

#### 4.2.1.3 Partners

We expect some (federal and/or state) government to partner on this scheme; KfW might be the sponsor. We assume that some private investors, some of which are social investors (e.g. foundations), would join in as well.

### 4.2.2 Operation of the intervention

#### 4.2.2.1 Scale and funding sources

The investment size is likely to be between 100 and 150m Euro, depending on the concrete target groups and the regional/national coverage. Interest has been announced by a state ministry to establish a loan scheme for university-based adult learning and mentioned that a volume of 50m Euro might be realistic. A feasibility study for non-university adult learning estimated a market potential of about 100m Euro, for those in employment. Those who are not in employment and intend to enter into a learning programme and take up a loan may add another 10 to 20m Euro.

Sources of funding are state and private funds. With a view to establishing a better understanding of risks to government on the one hand and to reduce the repayment level for the individuals, particularly those with limited education, the feasibility of using social impact bonds should be piloted and tested, e.g. through the involvement of the Federal Employment Agency.

#### 4.2.2.2 Governance and funding model

The Adult Learning Loan would be run by a management team with experiences from the banking and education sector; incl. Fintech-background. The supervisory board would consist of representatives from ministries involved, banking sector and social investors.

#### 4.2.2.3 Project suitability for EFSI funding

The project is fundable, based on a combination of public and private funds, it is economically viable as the repayment rates are sufficient to recover the basic funds and the interest rate covers additional costs (return to investors, transaction costs etc.) The interest rate is partially to provide an incentive to potential investors. It would aim at 50% crowding in rate of private capital.

Education is a sector which is eligible, the project is in line with EU policy in relation to adult learning and the qualification of disadvantaged groups. It aims to crowd in private funding sources and is complementary to existing programmes, as no loan scheme for adult learning is in place in Germany (apart from KfW student loan which provides funding for the costs of living, by and large, for those entering a public or publicly accredited university).

### 4.2.3 Future plans / scope for replication of the intervention

#### 4.2.3.1 Scope to scale-up through larger interventions and development of portfolio

The concrete implementation depends on the partners and the political interest and the funds available; both depend on future discussions and negotiations. However, since the federal as well as state governments had plans already to implement a loan scheme for adult learning, but did not manage so far, it might even be possible to start a large-scale scheme, addressing the whole of Germany, at once, for the core model, which extends to specific target groups in certain states (e.g. university-based adult learning)

#### 4.2.3.2 Potential role for EFSI

EFSI support would be needed as a complementary co-investor, in order to keep interest rates at reasonable levels, which requires some limitation of the risk of default to private investors. So far, experience with deferment and default rates of adult learning loans is almost non-existent. EFSI funds could serve to increase the endowment of the Adult Learning Loan in this case it would come in as equity. It could also serve as guarantee, in order to limit the risk of private investors.

The management of the Adult Learning Loan will consist of experienced managers.

## 4.3 Energy saving and school rehabilitation (Germany)

### 4.3.1 Context and rationale for the intervention

#### 4.3.1.1 Context and market failure

School renovation is a serious challenge in Germany; according to a recent KfW report, 27bn Euro of investment is needed for school rehabilitation.

Municipalities and states are challenged by the scale of rehabilitation investment, which is particularly an issue for already highly indebted municipalities. These municipalities have to serve their legal obligations first, while other existing needs cannot be addressed, as this would surpass the legally acceptable level of debt.

Energy saving measures could reduce current spending on electricity almost immediately, and free up funds for school rehabilitation. Private investors could step in and help municipalities to keep their own funding requirements low, since the returns are sufficient to allow some of the return to be reinvested into school rehabilitation. However, procurement tendering regulations prevent investors supporting municipalities.

#### 4.3.1.2 Objectives and target results

The core objective of the intervention is energy saving and to make use of the savings for school rehabilitation. The outcome is lower current spending for energy and better school facilities.

#### 4.3.1.3 Partners

The partners would be private investors and reinsurers to guarantee cost reduction for schools, in case energy efficiency is not as effective as contracted. The municipality /school would benefit even if savings are less than expected.

### 4.3.2 Operation of the intervention

#### 4.3.2.1 Scale and funding sources

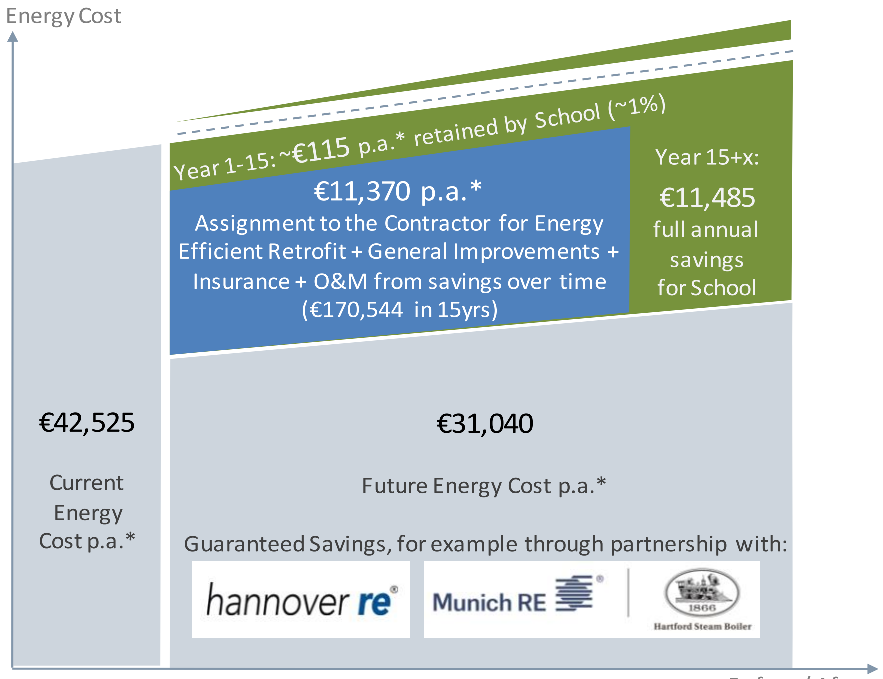
The costs per each single investment are limited to commonly some tens of thousands of Euro, with high transaction costs. Aggregation would help to generate economies of scale and reduce average transactions costs.

Private investors would be capital investors, insurances etc.

#### 4.3.2.2 Governance and funding model

Figure 3 outlines the funding model. Energy saving could reduce the present energy costs of an average school from € 42,525 to €31,040 per annum, which is a total difference of €11,485. As the upfront costs of energy saving are borne by the investor, he gets € 11,370 p.a. for about 15 years, while the rest remains with the school. Out of this amount, the investor covers operation and maintenance, insurance and other costs. After 15 years, the contract with the investor end and the full saving is for the school. In case the costs savings are lower, for whatever reason, reinsurers step into and pay the difference, i.e. they guarantee the financial reward.

*Figure 3 Funding model for energy saving*




• Source: co2online GmbH, Dr. Johannes Hengstenberg, 2016

All described cost savings assume stable energy prices. Higher future energy prices will lead to increased savings, lower prices to decreased savings.

#### 4.3.2.3 Project suitability for EFSI funding

The project is economically and technically viable: the energy saving level and return calculations are based on empirical figures; and private funds for investment are available. The basic limitations are the need for empirical proof for public entities, and tendering regulations that prevent a scaling up of this initiative. Another challenge is to convince public construction entities that energy efficiency can be achieved in existing buildings, with some perception that such savings are only possible through new buildings.

A number of energy efficiency/saving funding facilities exist already, which might be used to challenge the additionality of EFSI funding. In this case, it would have to be proven that these funds cover the combination of energy saving and investment in school rehabilitation.

### 4.3.3 Future plans / scope for replication of the intervention

#### 4.3.3.1 Scope to scale-up through larger interventions and development of portfolio

Once the feasibility and economic benefits are proven, scaling-up is highly likely as it helps to reduce current spending for schools and private investors would also see that the model works and has a low risk profile.

#### 4.3.3.2 Potential role for EFSI

EFSI could provide co-funds to help scale-up for a first implementation round.

## 4.4 Education Infrastructure Company (EIC) (Germany)

### 4.4.1 Context and rationale for the intervention

#### 4.4.1.1 Context and market failure

In the German education system, a need for investment in new education buildings and rehabilitation of existing buildings is well documented[13].

Municipalities and states are struggling with the financing of these measures, because of the lack of funds; private investors have limited incentives for the time being as they expect a rate of return which is commonly above the levels which public agents might be able/willing to accept. The Courts of Audit has criticised repeatedly the commercial terms which are disadvantageous for the public authorities, and implies it would have been less costly to have invested themselves. However, this is not feasible, because of budget constraints and debt limit regulations. If the assessed risk could be reduced, e.g. through guarantees or by co-investment funding with lower rate of return expectations, this barrier could possibly be removed.

It should be noted that the financial capacity of municipalities as well as states depends a lot on the socio-economic profile of its population. The higher the share of those socially worse-off, the lower the tax revenue of municipalities and the higher the need for social welfare spending, which often results in high debt levels, preventing or at least restricting spending for non-statutory provision.

However, the later the school refurbishment takes place, the higher the costs of repair, which commonly increase disproportionately; so, there are (indirect) fiscal benefits from early action.

#### 4.4.1.2 Objectives and target results

Establishing a bespoke Education Infrastructure Company (EIC), the intervention aims to address this investment need through a joint effort of institutions with either different rates of return or through guarantees in order to arrive at average interest rates that are economically acceptable for the Courts of Audit and at the same time attractive to private investors. For a first tranche, a volume of 50m Euro might be a realistic target.

#### 4.4.1.3 Partners

A large number of private investors would be interested to invest, e.g. insurances, capital investors etc., if the rate of return is attractive enough. The common rate of return is approximately 7%, though in the light of the low interest rates, it might be possible to bring this rate down to 4-5%, if the risk exposure can be reduced. Alternatively, involving partners with different needs concerning their rates of return might be another option to arrive at, on average, acceptable/reasonable rates of return.

### 4.4.2 Operation of the intervention

#### 4.4.2.1 Scale and funding sources

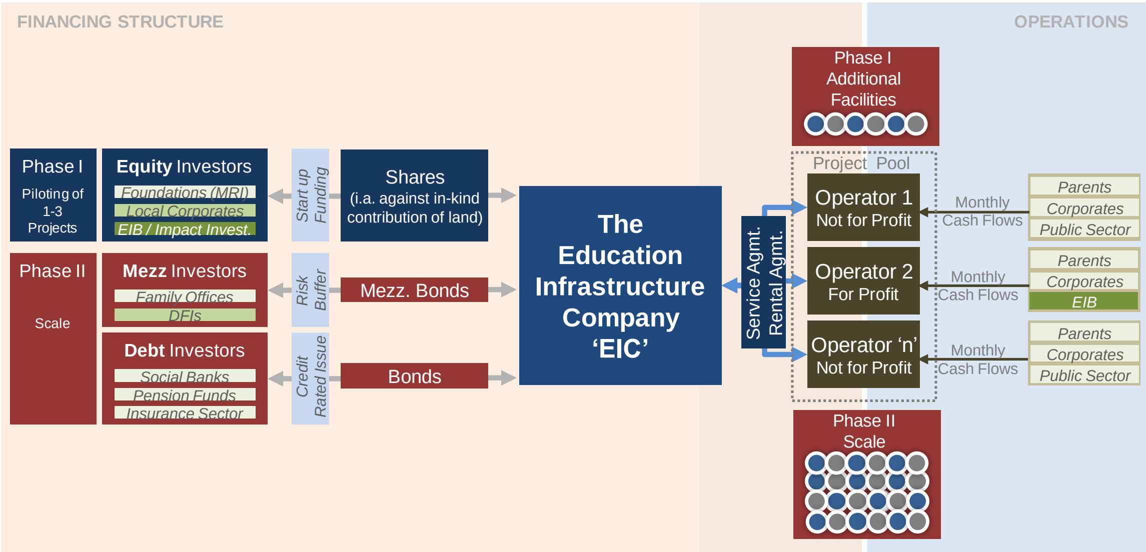
The scale varies substantially from single investments of up to 50m or 100m Euro to large scale investments of several billion Euro.

[13] KfW has conducted interviews with municipalities, stating a need for investment in construction activities in schools of about 34bn Euro, (27bn Euro for rehabilitation; 7bn Euro for new construction). Investment need in higher education is about 40 to 50bn Euro. On March 24, 2017 the Federal Ministry of Family Affairs announced the intention to provide co-funding for up to 100,000 new places.

#### 4.4.2.2 Governance and funding model

In phase I, equity investors provide the start-up funding for the EIC, which can be in-cash or in-kind, e.g. through land, for example, and become shareholders of the company. With this funding, the EIC is in a position to cover the costs of the construction of education buildings, e.g. childcare centres. The buildings are rented/leased to operators, who run the childcare centres and pay a rent for this.

*Figure 4 Governance and funding model for the Education Infrastructure Company*




#### 4.4.2.3 Project suitability for EFSI funding

The projects do employ well established forms of funding, the only "innovative" ingredient is the intention to arrive at reasonable interest rates from the perspective of the public bodies and attractive rates of return for the investor, on average, at the same time. Balancing these two, seemingly, opposite targets is the challenge, which might be a matter of scale and of combination of investors.

#### 4.4.2.4 Future plans / scope for replication and scope to scale-up through larger interventions and development of portfolio

As already mentioned, scaling-up is not an issue of available funds, rather a political issue, in the light of high rates of returns to investors, as claimed by the Courts of Audit. The projects are not limited in terms of regional coverage; thus, the initiative could run at national level.

#### 4.4.2.5 Potential role for EFSI

EFSI could play a key role in extending the total funding volume for investment as a partner, since the EIB requires a lower than average rate of return, helping to bring down the average rate of return, which would make the product attractive for both sides, the public entities, facing the problem of too high interest rates, and the private investors asking for competitive rates of return.

## 4.5 Social Innovation Fund (SIF) - (Portugal)

### 4.5.1 Context and rationale for the intervention

#### 4.5.1.1 Context and market failure

An ex-ante evaluation of financial instruments in the Portuguese ESIF Operational Programme[14] identified the following main market failures:[15]

- Low capitalisation, high financing needs and growing demand for finance from social enterprises;
- No appropriate products from financial institutions, such as commercial banks, for social enterprises, because of:
  - Risk: perception of high risk and no collateral;
  - Return: high transaction costs for expected below-market returns; and
  - Impact: positive externalities not recognised or taken into account as banks cannot monetise them
- Maturity gap (no availability of credit for longer maturities);
- Lack of intermediaries in social financing and social investment in Portugal; and
- Reduced diversity of available financing options; There is high fragmentation and short-term drive of existing philanthropic financing.

Overall, two segments and types of needs were observed:[16] access to funding for social enterprises for organisational improvement and innovation; and social start-ups. The ex-ante assessment estimated the following financing gaps across a variety of fields (education, health, social protection, employment, and justice):

- For investment in innovation by social economy entities: €281.2 million
- For investment in social start-ups: €28.6 million

Interviewees and the material reviewed did not provide any specific estimates covering education and training only.

#### 4.5.1.2 Objectives and target results

The aim of the Social Innovation Fund (SIF) is to support social impact investment by mitigating difficulties of social enterprises to access finance in 'regular' financial and equity markets. It covers two separate financial instruments: loans to social enterprise and equity investment in start-ups.

#### 4.5.1.3 Partners

The main partners of the SIF are:

- The European Social Fund (ESF) managing authority: Operational Programme 'Social Inclusion and employment', one of the thematic operational programmes under Portugal 2020. The 'Mission Structure Portugal Social Innovation' will act as intermediary body;

[14] Quaternaire Portugal (2015). Ex-ante evaluation of the financial tools of Portugal 2020 programmes.

[15] Source: Portugal Social Innovation presentation: 'Social Innovation Fund (SIF) – Background information'. Sent to ICF (not available online).

[16] Based on interview with representatives of the organisation in charge of managing the Social Innovation Fund (the mission structure) conducted by ICF on February 2017.

- Financial intermediaries: Portugal Social Innovation is currently negotiating with a number of commercial banks to act as financial intermediaries;
- Fund of funds manager: *PME Investments – Investment Society*, which is a financial society under the supervision of the Bank of Portugal[17];
- Recipients of loans and equity: social enterprises.

Payees are social enterprises who make use of the loan or equity instruments available through the SIF on the contractual basis that they repay loans and related interest payments / agreed dividends.

- In the future, financial intermediaries could be asked to pay small fees into an EFSI platform, in return for accessing part of the SIF fund.

### 4.5.2 Operation of the intervention

#### 4.5.2.1 Scale and funding sources

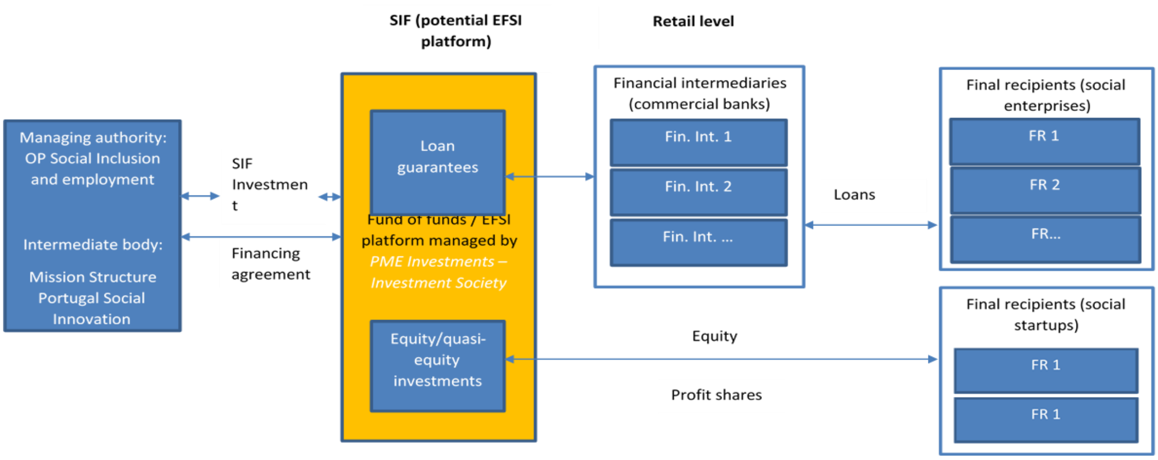
At this stage, the SIF is supported by the Portuguese ESF operational programme (€95 million) and a contribution from the Portuguese government (€17 million). Financial instruments in the SIF have been developed in cooperation with the European Investment Bank's investment advisory hub.

The use of EFSI funding to scale up the SIF budget envelope, and the involvement of private investors is under consideration. Income generation (interest payments and loan repayments) would come from social enterprises supported, with the government or the EIB providing a certain level of guarantees in case incomes don't materialise.

#### 4.5.2.2 Governance and funding model

The potential funding model is presented in the following diagram:

*Figure 5 Funding model for the Social Innovation Fund*




*Source: Portugal Social Innovation presentation: 'Social Innovation Fund (SIF) – Background information'.*

#### 4.5.2.3 Project suitability for EFSI funding

Overall, the project would be suitable for the use of EFSI funding if other social/ private co-investors can be found that suit the requirements of the programme. There is a clear preference on the side of the managing authority for the involvement of a single large social investor, rather than corporate investors strictly interested in

[17] Website: http://www.pmeinvestimentos.pt/en/

financial returns. Furthermore, a SIF using EFSI would need to be set up in a complementary way to what is currently being offered.[18]

### 4.5.3 Future plans / scope for replication of the intervention

#### 4.5.3.1 Scope to scale-up through larger interventions and development of portfolio

The investment opportunity consists of scaling up the Social Innovation Fund in Portugal to fill a financing gap of an estimated €197 million.[19] Only part of the SIF will be targeted at education and training.

#### 4.5.3.2 Potential role for EFSI

Interviews indicated that EFSI could support the current SIF and the fund manager by helping to:[20]

- scale up activities;
- increase the stop value for guarantees offered to financial intermediaries;
- allow support to enterprises based in regions currently not eligible for SIF support;
- allow CAPEX investment, which are currently not possible under ESF rules.

According to interviewees, financial intermediaries in Portugal would prefer SIF to be funded through EFSI rather than ESF as they perceive EFSI to have less constraints as regards the setup of individual instruments.

[18] Based on interview with representatives of the mission structure conducted by ICF on February 2017.

[19] Proportion of financing needs identified by ex ante assessment not covered by current SIF programme budget.

[20] Based on interview with representatives of the mission structure conducted by ICF on February 2017.

## 4.6 Social Impact Bond (SIB) - (Portugal)

### 4.6.1 Context and rationale for the intervention

#### 4.6.1.1 Context and market failure

An ex-ante evaluation of financial tools under the Portuguese Operational Programme for European Structural and Investment Funds reported the following financing gaps in the area of social innovation:[21]

- €281 million for investment-innovation in social economy organisations
- €28.6 million for innovative social entrepreneurship start-ups

No breakdown is available to estimate the investments required for the area of education and training. According to the ex-ante evaluation, the Portuguese financial markets are not prepared to provide traditional financing in the field of social innovation and risk capital funds (in particular *Business Angels*) have not yet paid attention to the potential of this sector.

#### 4.6.1.2 Objectives and target results

The main financial tool proposed to address the above mentioned needs is the Social Innovation Fund (see other project description for Portugal). A Social Impact Bond (SIB) call for proposals has been introduced as a way to showcase and test innovative financial instruments, and to complement the Social Innovation Fund.

Both tools -the Social Innovation Fund and the SIBs- are being implemented by the Portugal Social Innovation initiative launched in December 2014, coordinated by the 'Mission Structure Portugal Social Innovation' and co-funded by EU Structural Funds. Its tools focus on innovation and social entrepreneurship and cover all social areas including education and training.

SIBs are directed to the delivery of services in the field of public policies. Their impact is measured against specific social results – e.g. revenue realised on the government side (tax income) or foregone government expenses (such as foregone unemployment benefits).[22]

#### 4.6.1.3 Partners

The participants of the Portugal Social Innovation SIBs are partnerships composed of:[23]

- One or more social investors
- One or more public sector entities
- One or more implementing entities (service providers), usually social entrepreneurs and social enterprises

The payee is the Portuguese ESF Operational Programme 'Social Inclusion and Employment'. The intermediary entity currently managing SIBs is the 'Mission Structure Portugal Social Innovation'. This mission structure is a type of public legal entity with independent management and a limited lifetime (2014-2020). It manages part of the EU structural funds allocated to Portugal and was created with the aim of

[21] Quaternaire Portugal (2015). Ex-ante evaluation of the financial tools of Portugal 2020 programmes. To estimate financing needs the report used estimates from a research project by the IES-Social Business School and the IPAV-Padre Antonio Vieira Institute. Funded by Calouste Gulbenkian Foundation, EDP Foundation, Operational Programme on Competitiveness. Website: http://www.mies.pt/index.php/en/

[22] Portugal Social Innovation Initiative, call 2016.

[23] Notice of the Operational Programme Social Inclusion and Employment (POISE-39-2016-07).

catalysing the slowly emerging market of social investment in Portugal. It reports directly to the Portuguese government.[24]

Public sector entities with responsibilities in the public policies relevant to the funded initiatives commit to facilitating implementation but do not receive funds.[25]

### 4.6.2 Operation of the intervention

#### 4.6.2.1 Scale and funding sources

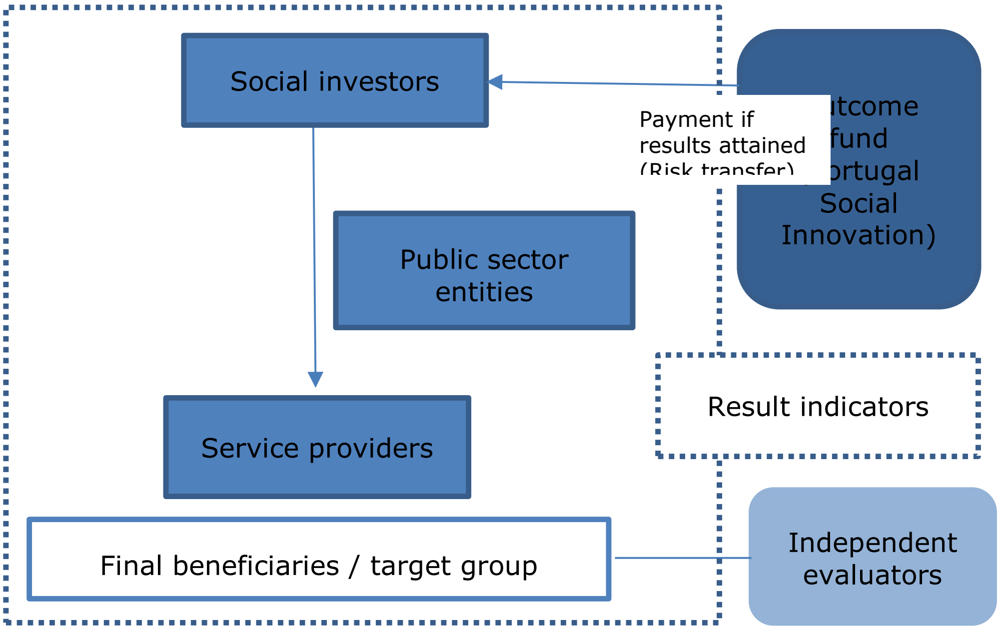
The overall investment need in the area of social innovation is estimated at €309.6 million (see above).

The 2016 SIBs call had a budget of €3.5 million to cover a variety of thematic areas (social protection, health, justice, employment and vocational education and training). The 2016 SIB call established that the needs for public funding of each project have to be above €50,000. This suggests that individual SIBs are expected to be relatively small-scale and a maximum of 60 projects can be supported per call. If the average project size is similar to the pilot 'Junior Code Academy', the SIB call would be able to support 25 projects each year with the current budget. Funding for the current setup of the SIB calls for proposals comes from the Portuguese ESF operational programme.

#### 4.6.2.2 Governance and funding model

The current funding model is presented in the following diagram:

*Figure 6 Delivery framework – Portuguese SIB outcome fund (Social Innovation Initiative)*




*Source: Portugal Social Innovation website*

#### 4.6.2.3 Project suitability for EFSI funding

Whilst there is currently no clear purpose for EFSI in the delivery model, EFSI support could be used to either scale up the outcome fund or offer more attractive outcome prices to potential social investors.

[24] Source: Resolution of the Portuguese Council of Ministers nbr 73 – A/2014.

[25] Notice of the Operational Programme Social Inclusion and Employment (POISE-39-2016-07).

### 4.6.3 Future plans / scope for replication of the intervention

#### 4.6.3.1 Scope to scale-up through larger interventions and development of portfolio

The results from the first call –not yet available- will help assess the interest in SIBs, the extent to which there exists unmet demand, and the potential for their expansion in terms of size and number.

#### 4.6.3.2 Potential role for EFSI

As above, there are potential roles for EFSI support in the future which however will need to be further evaluated once demand for the first call for proposals can be assessed in detail.

## 4.7 Guarantee scheme for student loans (Portugal)

### 4.7.1 Context and rationale for the intervention

#### 4.7.1.1 Context and market failure

Based on a needs assessment conducted in 2014, there is currently a financing gap in the Portuguese market for student loans between €11 and 15 million each year. In the aftermath of the financial crisis, there was also a significant reduction in public student support and commercial products for student loans and tightened lending conditions.[26]

After being put on hold due to shrinking public budgets, the former guarantee scheme for student loans is currently being reactivated. A new financial instrument with €10 million of support from the European Social Fund (ESF) is being created with funds from the Human Capital Operational Programme. The mutual guarantee based on this new financial instrument is expected to be launched in 2017.

The scheme concerns exclusively higher education including graduate and post-graduate studies. Loans are also available for students that need financial support to participate in an Erasmus+ mobility.

#### 4.7.1.2 Objectives and target results

The loan scheme with mutual guarantee for higher education students enables financial intermediaries to offer loans with low interest rates. Interest rates are further reduced for students with better academic results (students with an average annual grade of 16 or over out of 20 pay 80% of the interest).[27]

Any higher education student can apply for a loan. In some cases loans are used to complement grants for people who face financial difficulties. The most frequent loan holders are students who applied for a grant and did not receive it but still have an economic situation that would prevent them from attending higher education without financial support.[28]

#### 4.7.1.3 Partners

The loan scheme for higher education students, as in the past, will be implemented by financial intermediaries, in most cases commercial banks. The entity coordinating the guarantee fund is SPGM-Investment Society, a mutual guarantee society. ESF funds are used to provide a counter-guarantee against the prime guarantee fund.

### 4.7.2 Operation of the intervention

#### 4.7.2.1 Scale and funding sources

Currently €10 million of ESF funds and €1.8 million from the Portuguese government are foreseen to provide the counter-guarantee for the scheme (representing roughly 10% of the expected lending until 2020). If as before, this amount covers 10% of the overall lending during the programme period 2014-2020, the overall value of loans provided would be at €118 million i.e. €17 million/year. €59 million are provided as guarantee fund by SPMG, covering around 50% of the expected overall lending to students until 2020. Whilst the scheme is being finalised and some details haven’t been confirmed, the previous setup guaranteed 100% of each loan with 'stop loss' of 10% of the global portfolio of each bank.

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[26] Based on an interview with a representative of the Human Capital Operational Programme conducted by ICF.

[27] Based on an interview with a representative of the Human Capital Operational Programme conducted by ICF.

[28] Based on an interview with a representative of the Human Capital Operational Programme conducted by ICF.

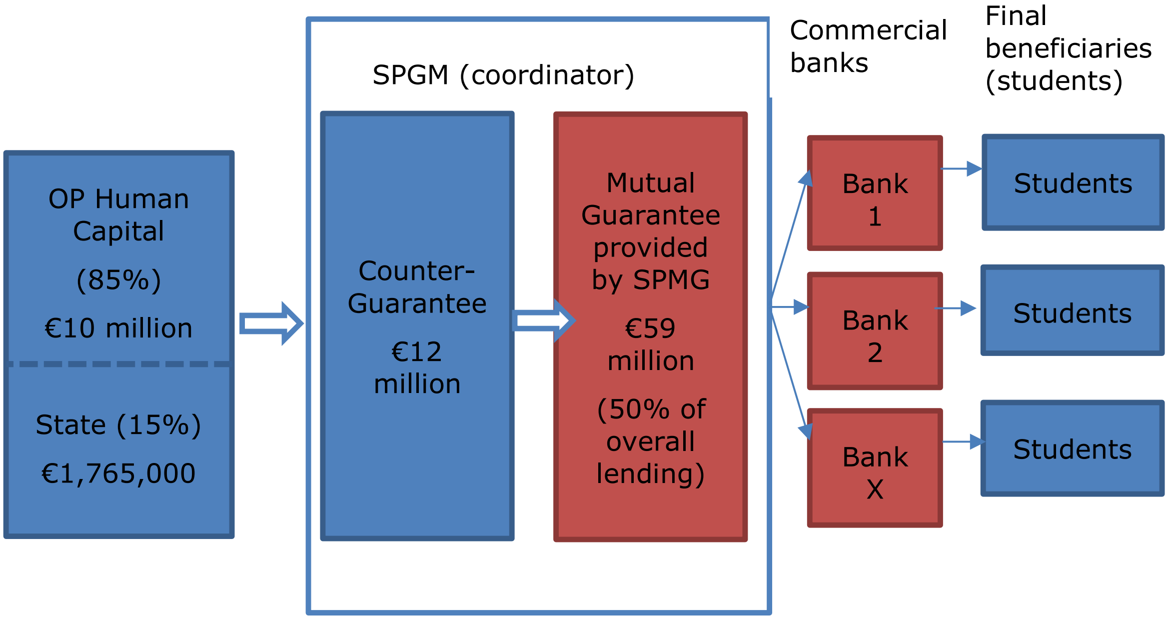
*Table 2 Funding sources of the guarantee scheme for student loans (according to ex-ante assessment)*

| | **Amount** |
|---|---|
| ESF funds | € 10,000,000 |
| Portuguese government | € 1,765,000 |
| *Sub-total public funds* | *€ 11,765,000* |
| Potential bank financing (with an estimated 'stop loss' of 10%) | € 117,650,000 |
| Of which, contribution of SPGM entities | € 58,825,000 |

### 4.7.3 Project Delivery Framework

Figure 7 assumes a total lending volume of €117,650,000, based on the ex-ante assessment. The 10% risk coverage is provided by the OP Human Capital and the State (€11,765,000). The mutual guarantee societies would cover 50% of the bank lending, with a stop value of 15%.

*Figure 7 Delivery framework for the Guarantee Scheme for Student Loans*




*Source: based on ex-ante assessment.*

#### 4.7.3.1 Project suitability for EFSI funding

The guarantee fund would be suitable for EFSI support, however there are careful considerations which would have to be made about the added value and displacement effects.

### 4.7.4 Future plans / scope for replication of the intervention

There are a number of ways in which EFSI might be used to scale up and increase the reach of the guarantee scheme.

- First, EFSI could help to increase the counter guarantee and address concerns by financial intermediaries that the stop value of 10% is insufficient;
- Secondly, EFSI could help to increase the overall size of the guarantee, if the current estimates of the financing gap are exceeded by actual demand; and

- Thirdly, the scheme might be expanded to cover international students on top of Portuguese students. Currently, close to 10% of the students in the Portuguese higher education system are foreigners; however, a large share come from non-EU countries, most significantly from Brazil and Angola.[29] Thus, an expansion of the scheme to cover other EU nationals is not likely to bring a significant increase in the number of loan holders, but an expansion to cover other international students might be considered.[30]

[29] In 2014/2015 there were 33,148 foreign students out of a total of 343,612 students in higher education (including students participating in international mobility). The most frequent countries of origin were Brazil (8,486), Angola (3,631), Spain (2,918), Cape Vert (2,458) and Italy (2,034). Source: Directorate-General of Statistics of Education and Science. Student Profile 2014/2015.

[30] It should also be considered that there are alternatives for supporting separate financial instruments covering EU nationals, such as the Student Loan Guarantee Facility (SLGF) established by the EIF and financed by Erasmus+ to support EU students doing a Master's in another EU country. There is therefore a certain degree of complementarity between a potential use of EFSI and the EIF’s SLGF scheme.

## 4.8 Investment in Higher Vocational Education (Sweden)

### 4.8.1 Context and rationale for the intervention

#### 4.8.1.1 Context and market failure

In the market of accredited Higher Vocational Education (HVE) in Sweden, the national agency for higher vocational education (MYH) turns down around 400 to 500 educational programmes which apply for accreditation – and the related grants – every year due to budget constraints.[31] At the same time, there has been a noticeable growth in demand for HVE in Sweden, with applications from prospective students growing by 35 per cent between 2012 and 2015. The research conducted by the study team further suggests that on average, attending a HVE programme increases the graduates' chances of employment, as well as the average annual income of those who find employment.

#### 4.8.1.2 Objectives and target results

The purpose of the intervention would be to satisfy currently unmet demand for HVE programme funding. Unmet demand is particularly high in thematic areas of finance and administration; computing/IT; technology and manufacturing; care and nursing as well as infrastructure planning. These are also the areas where MYH receives the largest number of applications from education providers, and by implication labour market demand is highest.

The target outcome of the intervention would be to fund 400 high-quality HVE programmes in the areas above, supporting between 10,800 to 13,500 additional students willing to pay tuition fees to obtain a HVE diploma.

Furthermore, Swedish students are entitled to access a student loan scheme run by the government, therefore any increase in student numbers might result in further resource needs to support a corresponding extension of the government's student loan scheme. [32]

#### 4.8.1.3 Partners

Likely partners of the intervention would involve the MYH, as accreditation body for additional HVE programmes to be provided and supported by the intervention, the ESIF managing authority, and education providers applying for support and accreditation.

### 4.8.2 Operation of the intervention

#### 4.8.2.1 Scale and funding sources

Research conducted suggests that it would be possible to double the volume of HVE programmes currently supported by MYH, whilst preserving quality and avoiding cross-funding. This would translate into possible investment volume of 210 million Euro per year. Current unmet demand would allow investments between 65 to 85 million Euro (6,000 Euro per student). Sources of funding would be EFSI, combined with additional investment by corporate investors (e.g. companies interested in

[31] The national agency for higher vocational education allocates government grants only to certified/accredited programmes.

[32] Nation-wide study-aid in Sweden is managed by the national board for student aid (Centrala Studiestödsnämnden, CSN). So there might be further resources necessary if the overall number of HVE students is increased through further HVE programmes, and this does not result in a decrease of student numbers for other type of higher education. In 2017, the overall annual study aid offered by the agency for full time students amounted to 50,080 SEK (around 5,300 EUR), out of which 14,240 SEK (around 1,500 EUR) are provided as grant, and the remainder as repayable loan.

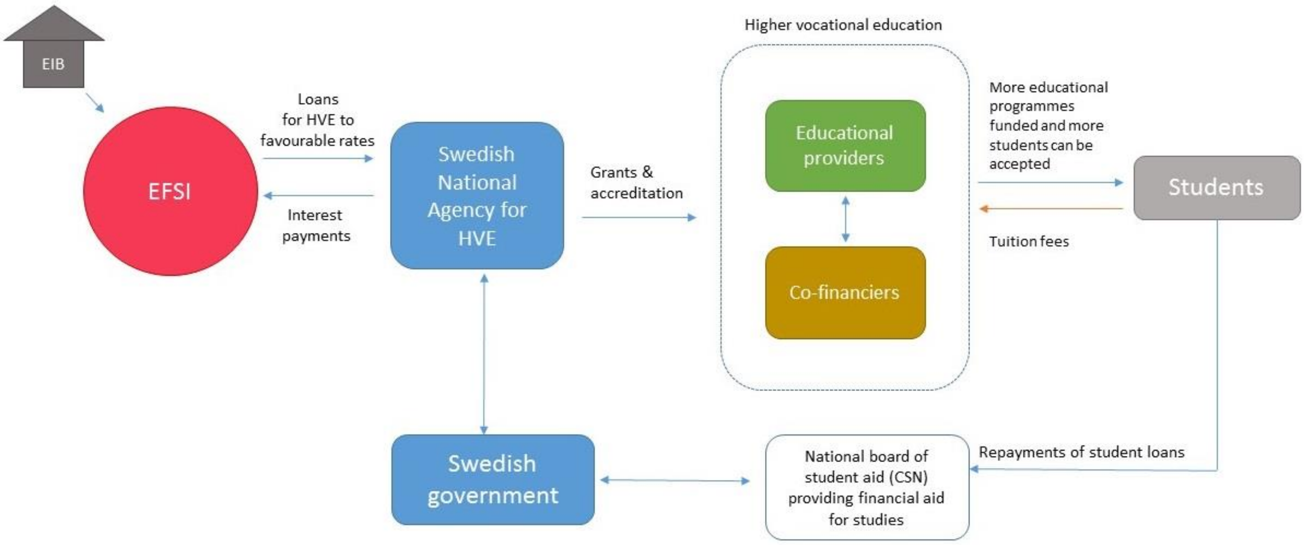
employing HVE graduates) or institutional investors, and some element of tuition fees paid by students.

#### 4.8.2.2 Governance and funding model

There are two delivery frameworks which could help meet currently unmet demand and make use of EFSI support.

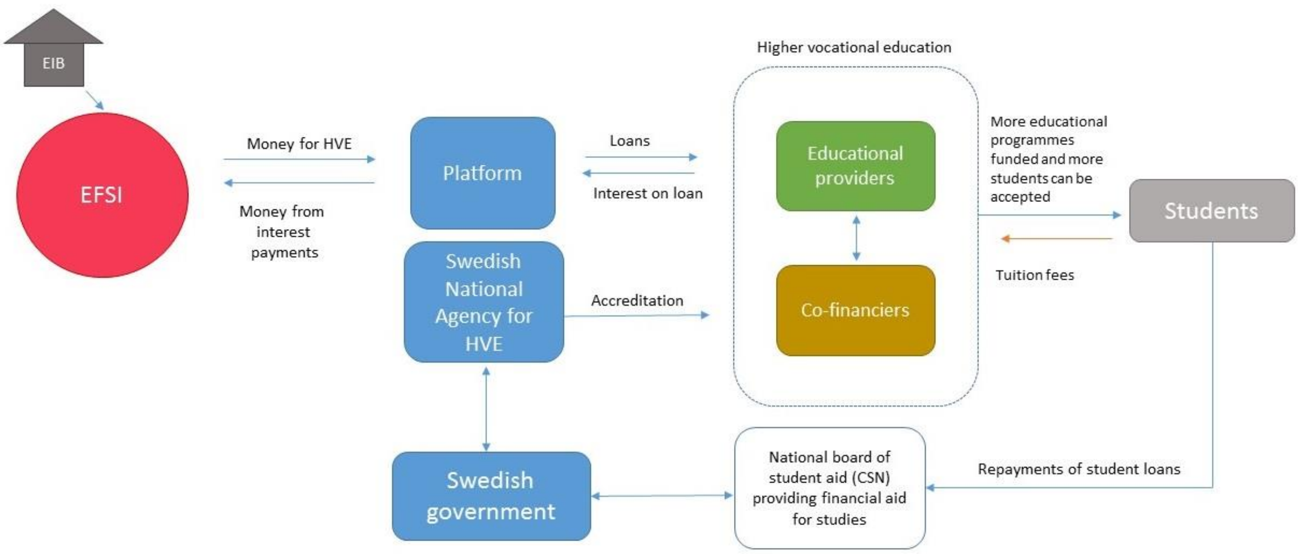
In a first setup, EFSI together with a private co-investor would provide direct lending to the agency. This delivery framework is presented below in Figure 8**Error! Reference source not found.**.

*Figure 8 Delivery framework I – The agency as a borrower*




A second delivery framework would involve the setup of an investment platform for HVE, which would offer attractive loans exclusively to programmes which have been vetted by the agency but could not be funded through government grants. The MYH will still accredit those programmes. This delivery framework is presented in Figure 9 below. This would necessitate a platform sponsor, unlikely to be the national agency itself.

*Figure 9 Delivery framework II – using a dedicated lending platform*



#### 4.8.2.3 Project suitability for EFSI funding

In principle the project is considered suitable for EFSI funding. However a number of key assumptions have been made. First, for any of the above propositions to work there needs to be no institutional or legal barriers for the agency to receive loans. Furthermore, the legal and political framework would need to allow the setup of a platform in the case of option II sketched out above.

Another assumption is that educational providers who are not funded through government grants currently are ready to borrow and are able to pay the cost of capital on it.

The large amount of unmet demand for HVE programmes in Sweden suggests that investments in HVE programmes are bankable and can generate sufficiently attractive revenue, with only moderate risks.

The main challenge remaining is to offer a suitably attractive revenue for investors. An income stream from student tuition fees might not generate enough returns to render the project attractive for private investors, and margins on potential student loan products might be capped by the very favourable conditions offered by government loans offered to students. Therefore, alternative revenue options such as reversed funds should be considered.

### 4.8.3 Future plans / scope for replication of the intervention

#### 4.8.3.1 Scope to scale-up through larger interventions and development of portfolio

On the national level, the intervention might be scaled up depending on future demand for HVE programmes. Given different legal and political frameworks, it seems unlikely that an expansion beyond Sweden would be feasible, given the large costs in platform management this would incur.

#### 4.8.3.2 Potential role for EFSI

There is a clear role for EFSI involvement as described above. Risks are limited, given the proven private and social returns to HVE graduation. However a change of the political or legal framework would severely reduce the investability of the proposed intervention.

As outlined above, funding at the project level is currently limited, and stakeholders as well as desk research have confirmed that there is scope and space for scaling up current levels of accredited HVE provision across Sweden.

In terms of governance, there is currently no structure in place that could take over management of an investment platform. However, certain experience with financial instruments, as well as ongoing cooperation with the European Investment Bank, exist within the Swedish managing authority for European Structural and Investment Funds (ESIF).

## 4.9 Social Impact Bond (SIB) interventions in education & training (UK)

### 4.9.1 Context and rationale for the intervention

#### 4.9.1.1 Context and market failure

There is a number of SIBs in the UK focusing on additional support services for young people. These SIBs do not focus exclusively on education, but educational achievement is usually one of the key SIB outcomes paid for by the commissioners.

Further investment in SIBs could help to address the following issues in UK education:

- There is a substantial gap in attainment for pupils with special needs, suggesting their needs are inadequately met by existing provision (Big Society Capital 2015);
- The proportion of NEETs in total population aged 16 to 24 is still substantial, reaching more than 12% in 2015;[33] and
- Current demand for child care cannot be met in a number of localities in the UK.[34]

#### 4.9.1.2 Objectives and target results

The main purpose of the intervention is to expand the use of SIBs to improve:

- Transition of students from difficult social backgrounds from secondary education to employment or further education;
- Transition of students aged 16 to 18 with special educational needs and disabilities from secondary education to employment or further education; and
- Provision of pre-primary education to children from low-income families who are at-risk of requiring additional educational support in primary education.

For the first two types of interventions, the ultimate SIB outcomes are typically qualification achievement and/or progression into employment. For the last type of intervention, the ultimate SIB outcome could be reduced use of additional support services in primary education by targeted children.

#### 4.9.1.3 Partners

The intervention would require involvement of the following actors:

- Commissioners who pay for the SIB outcomes upon their achievement. In the UK context, this is usually central/local government.
- Social investors who value SIB outcomes to be achieved per se, and are therefore ready to invest into SIBs despite modest investment return coupled with high intervention risk.
- Service providers such as charities or social enterprises that are responsible for the delivery of the SIBs on the ground.

### 4.9.2 Operation of the intervention

#### 4.9.2.1 Scale and funding sources

Based on rough estimates made by interviewees, the demand for finance to deliver SIB interventions in education & training could range from £20m up to £120 million in

[33] http://www.ons.gov.uk/employmentandlabourmarket/peoplenotinwork/unemployment/bulletins/youngpeoplenotineducationemploymentortrainingneet/2015-08-20

[34] Children and Young People Now 19 (August 2014)

the next 5-10 years. The scale of the intervention crucially depends on the willingness of central/local government to commission SIBs and pay for their outcomes.

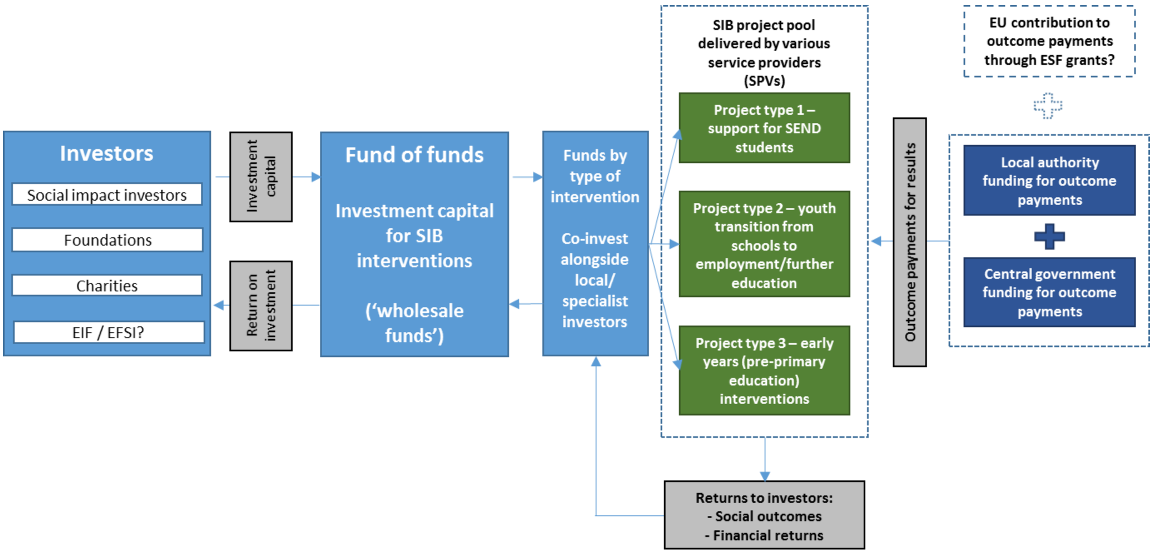
Qualitative research indicated that the demand for finance can largely be covered by national social investors. However, there was interest in the use of EU grant finance, which could be used to co-fund SIB outcomes alongside local/central government.

#### 4.9.2.2 Governance and funding model

The scale of the intervention could provide scope to set up a national investment platform. The platform would receive 'wholesale' funds from social investors for subsequent allocation to a range of individual SIBs. It would likely be a fund-of-funds that would co-invest alongside local investors into relevant SIB opportunities. It could do so through a number of individual sub-funds targeting specific types of education and training interventions.

The commissioners would pay for achieved SIB outcomes to service providers, who would in turn distribute returns to funders. These transactions may be exercised through an SPV.

*Figure 10 Delivery framework*




#### 4.9.2.3 Project suitability for EFSI funding

SIBs could be suitable for EFSI funding, but there are a few issues that complicate this assessment:

- The research on additionality of SIB interventions is very limited. It indicates that SIBS could lead to substantial government savings, but so far it does not provide conclusive evidence of SIB effectiveness compared to other type of government interventions.
- A diverse range of (often relatively small-scale) SIBs would have to be aggregated into a single investment opportunity to allow for EFSI funding. This can be difficult because identifying suitable SIBs often requires considerable experience with investing into services to be delivered and knowledge of local partners who could deliver them.
- The economic viability of the projects is less of an issue – average return across UK SIBs was estimated to be between 3 to 10%, so there could potentially be sufficient returns on investment to attract EFSI funding.

### 4.9.3 Future plans / scope for replication of the intervention

#### 4.9.3.1 Scope to scale-up through larger interventions and development of portfolio

The potential to scale up the intervention to national level crucially depends on the willingness of commissioners to fund further SIBs. The key factors constraining the SIB commissioning are perceived to be:

- up until recently, the lack of activity of the UK Department for Education in this area.
- the progressive de-centralisation of UK educational policy – local authorities often don't have enough time, budget and expertise to commission SIBs.

The qualitative research indicated some potential to replicate this intervention in other EU Member States that are currently experimenting with SIBs.

#### 4.9.3.2 Potential role for EFSI

There is little perceived need for EFSI funding to expand the use of SIBs at current levels of activity. There is a range of UK social investors who are willing to fund additional SIBs. EFSI funding would, to a large extent, lead to crowding out of available national funding rather than setting up of new SIBs if not accompanied by government commitment to a much greater scale of use of SIBs to address education and training needs.

However, this may be a specific situation to the UK, where there is a relatively well developed social investment market and high investor willingness to fund SIBs. In other EU Member States the situation may be very different, and where the constraint is less government spending and rather the lack of social investment sources.

## 4.10 Provision of small-scale finance to social sector organisations focusing on education & training services (UK)

### 4.10.1 Context and rationale for the intervention

#### 4.10.1.1 Context and market failure

There is a well-documented gap in access of social sector organisations to small-scale debt finance (Social Enterprise UK, 2013, Cabinet Office, 2013). This limits the number and size of social sector interventions to address some key issues in the UK educational system (Big Society Capital 2015):

- GCSE exam results shows a substantial underperformance of pupils from low income compared to their peers;
- Young people with low levels of educational attainment are at a much greater risk of becoming 'NEET' (Not in Education, Employment or Training) than their peers;
- There remains a substantial gap in attainment for pupils with special needs compared to their peers; and
- Current demand for child care cannot be met in a number of localities in the UK.

#### 4.10.1.2 Objectives and target results

The main purpose of the intervention is to provide small-scale unsecured debt finance (up to £150,000) to social sector projects aiming to:

- Increase/improve provision of pre-primary education;
- Improve support for pupils with special educational needs or disabilities (SEND) by selling specialist services to schools;
- Increase educational attainment and employability of disengaged youth by providing out-of-school activities;
- Increase educational attainment and employability of disengaged youth through provision of vocational education; and
- Improve key employability skills of adults, such as literacy and numeracy.

While the objectives of this intervention are similar to the SIB intervention described in section 4.9, the means of support are different:

- This intervention focuses on provision of small-scale debt finance (up to £150,000) to organisations delivering the funded projects, who then need to repay these loans based on their income from various sources.
- Funders in SIB interventions can potentially provide much larger sums to organisations delivering SIBs and their repayment will depend solely on achievements of specific SIB outcomes to be paid for by local/central government. Funders can provide this finance through other means than unsecured loans (i.e. equity) and can have more control over the delivery of the intervention, for example when they set up an SPV together with organisations responsible for intervention delivery.

#### 4.10.1.3 Partners

The intervention would require involvement of the following actors:

- Social investors willing to provide small-scale unsecured debt finance to often high risk projects;

- Funders to provide grant finance to support realisation of the intervention;
- Central and local fund managers to disburse small scale finance to social sector organisations; and
- Social sector organisations to deliver projects aimed at improvements in the educational system.

### 4.10.2 Operation of the intervention

#### 4.10.2.1 Scale and funding sources

Qualitative research suggests the demand for finance across all UK social sector organisations delivering education & training interventions could be around £40 million, potentially even higher. However, there is no quantitative evidence available to corroborate this number.

Currently, some of the social sector demand for small-scale debt finance is covered by the Access Growth Fund.[35] This fund aims to provide a total of £45 million to social sector organisations through financial products that blend small unsecured loans with grants.

#### 4.10.2.2 Governance and funding model

There is some interest in setting up an investment platform to provide small-scale debt finance to social sector organisations. This platform would most likely need to be set up at national level and invest into a broad range of education & training projects. The platform would likely be a fund-of-funds, which would set up multiple smaller funds in partnership with local/specialist fund managers. These local fund managers would then provide small-scale debt finance (up to £150,000) to fund project delivery.

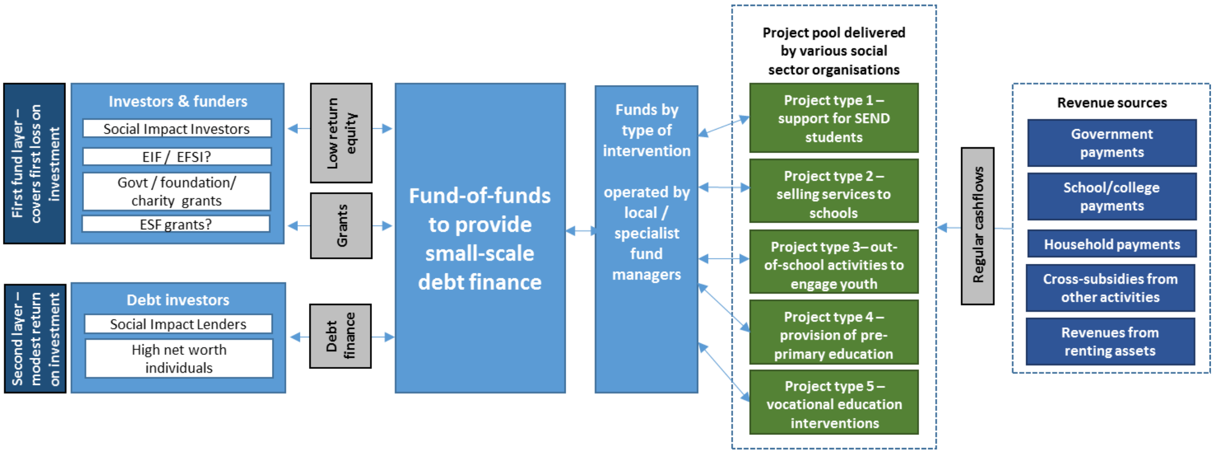
The platform would likely have two investment layers:

- First layer would consist of grant providers and impact investors willing to accept zero or very low return on their investment. This layer would cover the expected first loss on investment, creating safer and potentially more profitable investment opportunities for the second layer of investors.
- The second layer would consist of social investors (and potentially some high net worth individuals) who require relatively modest rates of return on their investment. The rate of return could be somewhere around 5%.

The revenue sources include payments from a range of actors typically involved in payment for education services.

[35] https://access-socialinvestment.org.uk/growth-fund/

*Figure 11 Delivery framework*




#### 4.10.2.3 Project suitability for EFSI funding

EFSI funding could be suitable for this intervention, but there are important challenges:

- Low returns on investment. The expected first loss on investment is high (between 10 to 30%). It could be partially covered by grant finance, but the return on EFSI funding would still most likely be lower than 5%.
- Aggregation of a large number of diverse small-scale projects into a single investment opportunity large enough to warrant EFSI investment. Identifying credit-worthy social sector organisations requires considerable experience with investing into services to be delivered and good knowledge of the local social sector.

### 4.10.3 Future plans / scope for replication of the intervention

#### 4.10.3.1 Scope to scale-up through larger interventions and development of portfolio

- A national investment platform could be set up to provide debt finance to education & training projects, providing a total funding of around £40 million. A broad range of education & training interventions would need to be covered to ensure sufficient number of projects can be funded. Assuming an average loan size of £75,000, there would need to be an annual demand for loans from over 500 credit-worthy social sector organisations providing education & training services.

#### 4.10.3.2 Potential role for EFSI

There is some scope for EFSI investment into this opportunity. For example, EFSI could provide funding of about £20 million to be matched by national investors at a one-to-one ratio. This would lead to a total investment supply of about €40 million, potentially covering the investment needs of social sector organisations delivering education & training services.

# 5 Additional Research

## 5.1 Other national experience of using social / private investment for education and training

### 5.1.1 Belgium

Belgium has seen a number of EIB loans in school refurbishment and construction, totalling EUR 300 million in lending between 2012 – 2016.[36]

As regards private investments in intangible assets in education, there is little comprehensive research. The overall demand for impact investing, and the readiness of Belgian investors to support social investments have not been reviewed in detail to date. However, there seems to be an increasing awareness in the investment world, but for the time being they remain a specialist subject pursued by a small group of private investors and some commercial banks such as Degroof.[37]

Following a feasibility study[38] and a two-year preparation period, Belgium's first social impact bond was launched in January 2014: *Garantie financière pour l'innovation sociale en matière d'insertion professionnelle des jeunes en Région de Bruxelles Capitale*. [39] The purpose of the SIB is to reduce unemployment among young migrants in Brussels by matching them with local retirees to connect migrants with existing employment networks and to increase their professional opportunities and well as to create intergenerational and intercultural links. The idea was born from the current situation in Brussels where migrants are faced with several barriers to productive employment, which besides potential educational and linguistic obstacles involve the lack of access to employment networks.

The stakeholders involved include the Brussels-based non-government organisation "Duo for a Job", Kois Invest acting as intermediary, and *l'Observatoire de l'Emplois bruxellois* (Brussels Observatory of Employment) acting as independent evaluator. The intervention focuses on 18-30-year-old migrants who are non-EU, US, or Canadian nationals who speak either English, French, or Dutch, legally residing in Brussels and registered at Actiris, the government employment agency. The intervention scheme involves individualised follow-up of the participants' job-searching activities.

The SIB is funded through investments totalling EUR 234,000 from several investors, which makes it a smaller SIB than most that are currently in operation globally. This is due to it being intended as a pilot project to first test the mechanism in Belgium. The project aims to help 35% of the cohort find employment who would otherwise have remained unemployed. As an evaluation metric, the employment rate of the project participants will be measured: if the project is deemed successful, investors will see returns of up to 6%. On the other hand, they will lose money if the participants' employment rate increases at a slower rate than that of a control group. Overall, the state will save an estimated EUR 35,000 per employment reinsertion. Hence, if one third of the participants find employment who would otherwise have remained unemployed, the state saves roughly EUR 2 million – a figure eight times higher than the initial cost of the intervention.

[36] http://www.eib.org/infocentre/press/releases/all/2013/2013-206-belgique-financement-europeen-pour-les-ecoles-francophones-belges

[37] See e.g. Denoël, Nicolas (2014), Developing Social Impact Bonds in Belgium, Master thesis at Louvain School of Management under the supervision of Prof. Mikael Petitjean.

[38] Dermine, Thomas (2014), Establishing Social Impact Bonds in Continental Europe, M-RCBG Associate Working Paper Series No. 26 (online: https://www.hks.harvard.edu/centers/mrcbg/publications/awp/awp26 ).

[39] https://data.gov.uk/sib_knowledge_box/brussels-migrant-uemployment

The cohort size is 180 migrants participating over a period of 3 years. As the estimated number of Brussels residents that fit the criteria selection amounts to 6,200, the SIB only treats 3% of these people which leaves considerable potential for expansion of the scheme if deemed successful. The contract spans a period of 2 years, and repayments to the principal investors will be made per semester, with final payments due by October 2017.

### 5.1.2 Netherlands

In the Netherlands, the system of lump sum funding does not offer much incentive to look for alternative finance for those education providers who are accredited by the central government (i.e. eligible for lump sum funding). The introduction of further performance based government funding could potentially change this overall picture, and offer cases for EFSI funding in the future.

A clear case for further private sector involvement can be seen in the area of vocational education and life long learning, however these are largely met by bilateral cooperations or short term, non formal courses offered by so-called 'company schools'. Government is keen to incentivise companies to support more formal, long duration courses, but no candidate projects for EFSI which would lend themselves to aggregation and are sufficiently attractive for larger private investors were identified.

In the area of social investments, demand for impact investment exceeds supply. An interviewee from the Society Impact agency which matches entrepreneurs and business ideas with investors, suggested that there is large potential particularly for further social impact bonds.

The core impediment of the sector currently is the lack of a large scale outcome funder, such as a specific government commitment or a dedicated fund. Other issues might be that social entrepreneurs often lack a strong business model, and a rather small average size of project which makes investments unattractive due to high overheads, and a lack of long term balance sheet funding.

Challenges of the social investment market are seen by some stakeholders to be further impeded by the lack of direct government policies. Whilst there is generally a preference for keeping the sector strongly market driven, stakeholders in one study have argued for the state to guarantee impact investments and associated loans made by way of a unified guarantee model.[40]

Without a clear commitment of the central government or a managing authority it is difficult to see how EFSI could support e.g. an outcome fund for SIBs in the Netherlands (see section 5.2.1 below).

As regards the use of EIB support in the education sector, two EIB loans have been signed in the Dutch university sector. The first project in 2013 marked the first EIB engagement with an education institution in the Netherlands and provided €230 million to the Vrije Universiteit Amsterdam, contributing to the redevelopment of the Zuidas campus.[41] The second EIB loan in the area of education and research has been agreed with Delft University of Technology, Erasmus University Medical Centre Rotterdam and Leiden University Medical Centre, and provides €90 million for the setup of a new research facility.[42]

[40] https://www.tno.nl/downloads/Rapport%20sociale%20ondernemingen2.pdf

[41] http://www.eib.org/infocentre/press/releases/all/2013/2013-141-eib-supports-vrije-universiteit-amsterdam-campus-development.htm [accessed 31st October 2016].

[42] http://www.eib.org/projects/pipelines/pipeline/20120328?f=search&media=search

### 5.1.3 Spain

No potential areas for EFSI intervention were identified in Spain. Whilst the share of private investment in Spanish education institutions in 2013 was 12% in primary and secondary education, and 31% in tertiary education, most private expenditure comes from households.[43] The most common type of collaboration between public and private sectors in education is publicly-funded private schools. There is demand from families and new schools continue to open. These schools are mainly owned by not-for-profit religious or civil society organisations, and supported by the government. The same can be said of other programmes for students who have not finished lower secondary education, or students with disadvantages.

These schools are frequently owned by non-for-profit private entities, and therefore don't lend themselves to EFSI intervention. No examples of social investments in the education and training sector were identified.

Private funding is more welcomed in projects involving transversal areas such as ICT. There are already schemes in place promoted by foundations sponsored by private companies. These promoters do not expect to receive any direct financial returns to their investment, which can therefore be considered a grant. It is difficult to envisage any EFSI involvement in this part of the Spanish education and training sector.

Some large private companies offer traineeships or grants for higher education students. The type of action varies depending on the company, and can target university and/or higher VET students. For instance, Repsol offers traineeships to Bachelor and post-graduate university students, as well as higher VET students on an array of fields relevant to their business (engineering, quality, security and environment, marketing, etc.).[44] Iberdrola has an international grant programme open to university graduate students for post-graduate studies in the energy sector.[45] The returns in this case seem to be related to the opportunity to create a pool of potential future employees already known to the company and trained by it, therefore these programmes are set up on an individual firm level, depending on specific recruitment needs.

The EIB has supported a large number of projects in Spain, and according to the EIB website 74 contracts have been signed so far in the education sector.[46] These include a EUR 180 million loan in the education sector as part of the "plan Navarra 2012", which was mainly invested in infrastructure and equipment in primary and secondary schools as well as universities and vocational training.[47] A number of further schemes are currently under review, such as support for a loan programme as part of the ESIF operational programme of Andalucia 2014-2020.[48] There has also been notable EIB support to student loan schemes, totalling at EUR 222.5 million over the last years.[49][50]

[43] OECD (2016). Education at a glance 2016: OECD indicators. Indicator B3.

[44] https://www.repsol.com/es_es/corporacion/empleo/te-buscamos/estudiantes/

[45] https://www.fundacioniberdrolaespana.org/webfund/corporativa/iberdrola?IDPAG=ESFUNAREFEIPOST

[46] http://www.eib.org/projects/loan/list/index.htm?from=&region=1&sector=5001&to=&country=ES

[47] http://www.eib.org/infocentre/stories/all/2015-april-01/education-and-health-in-navarre-get-a-boost.htm

[48] http://www.eib.org/projects/pipelines/pipeline/20140504

[49] http://www.eib.org/infocentre/press/releases/all/2013/2013-172-el-bei-y-santander-firman-tres-acuerdos-para-facilitar-el-acceso-al-credito-a-pymes-y-jovenes-y-realizar-inversiones-en-infraestructura

### 5.1.4 Poland - Bank Gospodarstwa Krajowego (BGK)

**BGK investment in education sector**

Since 2010, BGK has financed around 70 projects with the total financing envelope of around PLN 450 million (circa EUR 100 million) which gives an average funding of PLN 6.4 million (EUR 1,6 million) per project. Typically, projects have been financed from three sources:

- EIB loans: 29 projects;
- EU structural funds [ESIF] financial instruments under JESSICA 2007-2013 initiative: 19 projects;
- Own bank's resources provided to municipalities: 23 projects.

Projects cover all educational levels, from pre-schools establishments to universities. In the case of pre-school education organisations, the bank has financed mostly the construction of new buildings and expansion/ adaptation of existing infrastructure. At the primary and high school level, projects typically focused on modernisation, expansion or financing of construction of new sport facilities (sport halls, sport pitches etc.). Under JESSICA, the bank has also financed revitalisation of some cultural heritage buildings that have been occupied by schools/universities as well as some projects that envisaged an increase in energy efficiency.

With a few exceptions, virtually all beneficiary projects involved public/ municipal entities. In some specific areas where private entities play a meaningful role (i.e. tertiary education), student population decline has been a major drag on investment. The number of projects that generate or have potential to generate stable revenue streams is perceived by BGK as limited[51].

**BGK organisational approach**

BGK responsibilities for investment in education projects are spread across the organisation. There is no single department nor individual with responsibility for the sector, nor any dedicated investment programmes / instruments that target the sector. In contrast, the bank has for instance a designated team managing investment in the health care sector.

The lack of a targeted internal structure does not mean that the bank deliberately prioritises other sectors. It is rather seen as a function of several factors including, *inter alia*, the banks' focus on larger projects, which are comparatively less numerous in the educational sector than in other sectors. For similar reasons, the bank has not pursued any in-depth assessment of the market potential in the educational sector in Poland.

**Social investment**

BGK supports investment in the social economy *via the* National Fund of Social Investment that offers preferential loans and guarantees.[52] The fund draws also on the financing available from EU structural funds.

[50] http://www.eib.org/infocentre/press/releases/all/2016/2016-038-eib-and-microbank-announce-agreement-to-facilitate-access-to-finance-for-masters-students-in-european-universities

[51] View expressed by the BGK during the consultations

[52] BKH, 2017. Wsparcie podmiotow ekonomiii spolecznej. Available at: https://www.bgk.pl/fundusze-i-programy/wsparcie-podmiotow-ekonomii-spolecznej-w-latach-2014-2020/

**EFSI**

BGK has an interest in promoting EFSI-supported projects and has been discussing potential new projects with their promoters and the EIB. None of these projects are from the educational sector.

The bank considers that in the case of the educational sector the greatest challenge is the relatively small size of projects which are not considered suitable for EIB funding.

## 5.2 Role of the Structural Funds and Managing Authorities

The study has examined the possible use of ESIF (and especially the European Social Fund (ESF)) to leverage Member State interest in the use of EFSI and the development of Investment Platforms.

Interim findings suggested that there was some difficulty across the Member States examined, in establishing the identity of potential platform sponsors to take forward the development and management of an Investment Platform for education and training. The platform's focus on intangible assets means that commercial banks and, as far as we can establish, National Promotional Banks have only limited interest.

The potential of social investors to take on the role is constrained to some degree by their lack of familiarity with such instruments, and operate at a scale that would mean the funding risks and transaction costs of developing project pipelines would be too high.

One possible solution suggested was to use the institutional capacity of the European Social Fund (ESF) Managing Authorities and Operational Programmes to take forward the responsibilities for the Platform. The feedback from Member States was not encouraging. Whilst acknowledging that legally such a role could be taken on with the approval of Member State ministries, there was only very limited awareness of the potential role or interest in the role of EFSI in the area of education and training. There was no real interest either of providing management time or contributing Platform funding through financial instruments.

The one exception was in Portugal (see the case study above) where the ESF has been used to create a financial instrument in support of social investment, but not just targeted at education and training. Such an instrument is seen as providing the basis for future co-investment with EFSI, with a social investor as intermediary and Platform Sponsor.

A summary of the feedback is given below.

### 5.2.1 Views of selected Member States

**Lithuania**

There is no awareness of the possible availability of EFSI in the ESF Agency work so far; and has not been used by Lithuanian authorities in social and employment policy fields. However, there are two EFSI projects approved in Lithuania for energy and transport in late 2016.

In principle, the ESF Agency works on the basis of current legal acts which entrust the Agency certain Tasks, such as administering ESF projects. They also coordinate with other bodies administering EU programmes such as Leonardo, Erasmus, Marie Curie and others to ensure that the same projects are not double-funded.

The ministries of employment and education are overseeing the ESF Agency and are its main policy making bodies. So if a new task to act as a Platform Sponsor for EFSI would need to be at the initiative of the ministries. In principle, the legal basis does not need to be amended, as there is scope for the Agency to take new tasks in the current mandate.

However, there is no appreciation of the scope to use EFSI in the area of social and employment policies generally; and there would need to be considerable learning and examination before the feasibility of sponsorship could be considered.

**Germany**

The possible use of EFSI has not been discussed with the German ESF authorities. The German authorities perceive the Juncker's Fund as a fund for infrastructure projects, but not for social policy or labour market policy related subjects.

There is scope for credit-based financial instruments available in the ESF, but so far German authorities have not been interested in this link and they do not see the obvious link to the ESF.

In Germany, they have some experience of using a loan approach in the ESF. In the national Operational Programme, they have a micro credit fund to support recent start-ups. A similar approach was also implemented in the 2007-2013 period.

In theory, it is legally possible that the ESF MA in Germany could get involved in EFSI. They have experience of using loans in the ESF and could be willing to try out and find creative solutions. However, the overall administration culture is for only limited risk-taking so there would need to be very clear guidance on how the Juncker's fund would work in the area of social policy in practice, clarity on for example the rules on national co-financing.

**Netherlands**

In the Netherlands there have been no joint ESF/ESFI discussions. The current ESF regulation already offers the option of using financial instruments, which are considered a similar approach to the EFSI.

However, authorities in the Netherlands have expressed no interest in any credit related financing from EU sources; with the minimisation of financial risk and avoidance of liabilities informing their approach. The strategy is to use ESF to fund simpler projects and to fund more complex projects through national programmes. The same logic would apply to EFSI and hence no interest in EFSI in the Netherlands.

Education and training activities which might command a charge are considered to be well provided such as training activities for schools, VET and training for employed people.

The education and training system in the Netherlands is considered to be in excellent condition; the funding is adequate and facilities are excellent, so there is no real demand for additional resources.

MAs could legally act as a Platform Sponsor for the EFSI (the Agency Agentschap SZW is the official MA). The Agency manages not only the ESF, but also the European Migration Fund, some social assistance functions. In principle, the ministries delegate the management tasks to the Agency and it is paid for undertaking these tasks. Any new responsibilities would need to be defined and funded.

**Spain**

The use of EFSI has not been discussed in relation to the ESF and ESF authorities in Spain, although there is some limited experience of working with EIB in the context of ESF programmes. For example, in Madrid there is a new micro credit financing instrument for newly established self-employed managed by the EIB, but this is a small activity, 25 million euros. There was also some discussion with EIB/EIF over the possibility of pilot initiatives to fund financial instruments in support of increasing training in SMEs, but implementation was not agreed.

ESF Operational Programmes have been adopted in Spain in December 2015, and it was decided that long-term investment is less important than immediate, direct investment in social and employment services to help prevent unemployment becoming entrenched. This means that EFSI which is considered a source for longer-term investment is not so relevant for ESF programmes in Spain.

So far Spain authorities have shown no interest in EFSI. Due to Spain's regional structure, there are 23 regional OPs. The costs of engaging with EIF and examining the investment opportunity are considered too high in terms of the complexity and hence requirement for the administrative capacity needed.

Legally, the National Ministry of Employment is the Managing Authority. In principle, it could also manage the EFSI. At the regional level, ESF management arrangements vary, and the feasibility to manage EFSI would need to be tested, but in principle, authorities can be given additional tasks. However, given the burdens n Managing Authorities additional grant funding would probably be required.

**UK**

As in other countries, the ESF MA in the UK could in principle take on the legal possibility to act as a Platform Sponsor. However funding for the additional capacity would need to be found.

# 6 Conclusions - Lessons from case studies and other Member State research

There are investment opportunities, especially for social investors backed by the EFSI guarantee, to invest in interventions which generate a combination of social and financial returns (the 'blended' return). These investment opportunities arise where there are recognised positive externalities to be achieved from the intervention.

Opportunities for the funding of interventions that monetise and reduce the negative externalities associated with under-investment by government tend to lie outside, or adjacent to, the formal education and training systems, and include for example: (a) the need for investment in special needs of pupils/students; (b) the education deficit of pre-school children associated with low household incomes; and (c) the training needs of the young unemployed (especially recent school leavers without qualifications).

In all these cases, the longer-term fiscal benefits for government can be expected to exceed payments for additional education and training services.

Other, more commercial, opportunities also exist, including the development of new loan products for students/ adult learners, and the generation of cost savings (e.g. from energy efficiency initiatives in schools), which can then be recycled into education and training.

## 6.1 Summary of the range of interventions

### 6.1.1 Types of intervention

The case study research has identified a range of potentially fundable interventions (i.e. investment opportunities), covering both the provision of tangible assets (mainly related to buildings) and intangible assets (a range of services leading to social impacts) in the education and training sector.

In the case of investment in tangible assets, conventional public-private partnerships might be used, with the risk for EFSI that such opportunities are not sufficiently innovative to be considered 'additional'. However, the case studies demonstrate innovative ideas which should be of interest.

In the case of intangible assets, the opportunities and associated risks may satisfy 'additionality' concerns, but the level of return may be too low to support EFSI involvement, as discussed below. The range of opportunities for social investment reflect the wide range and variety of target social outcomes, including additional pre-school / early childhood education provision (especially targeting low income households), special educational needs, youth unemployment/NEETs, and adult / vocational learning.

### 6.1.2 Scale of investment opportunities and returns in the education and training sector

#### 6.1.2.1 Scale of investment opportunities

The case study research and review of social investment markets suggest that the scale of investment required for individual interventions varies by application. A payment by results (PbR) project with an outlay in the order of, say, €1 million is typical for local, municipal scale interventions in education and training opportunities.

Further, across a region or country, there may be a significant number of like opportunities, which, when aggregated, amount to €50-100m overall. However, assembling the projects into a portfolio / platform, to which many investors could confer resources, is likely to be a major undertaking, requiring considerable up-front funding and patience.

In the case of state and national student loan fund proposals, these represent a different scale of opportunity, with a possible state/regional fund starting at, say, €50 million, but which could be two or three times larger at national level.

Investment opportunities based on tangible assets, especially educational buildings, represents a bigger opportunity in value; potentially into € billions depending on the scope and willingness of Member States to adopt PPP-type models. However, we note that there is increasing reluctance by Member States (for example the UK and the Netherlands) to use PPP for the supply/refurbishment of education buildings, on the basis of the higher costs and the classification of such projects as being on the government balance sheet. There is also a continuing use of conventional EIB loan finance in this area, especially in higher educational buildings.

#### 6.1.2.2 Possible investment returns

Establishing the possible range of investment return for different investment opportunities is difficult given the embryonic nature of projects and their diversity. In the case of social investment, the return depends heavily on the government view as to the value of a given social impact, in part informed by estimates of future cost savings (from avoiding social problems) and tax receipts from higher earnings. Experience of UK SIBs is that returns in the range of 4-7% may be possible over the contract period (typically 3 years).

For loan funds, higher returns of, say, 10% per annum may be viable. For PPPs returns may be compromised by government concerns over being seen to pay more than the costs of funding it themselves. In the case of an energy efficiency-based interventions returns of over 10% p.a. may be possible.

### 6.1.3 Governance and funding models

The case studies suggest that the development and design of interventions to deliver education and training outcomes using social or private finance is still highly immature, with the exception of PPPs for school buildings. This means that each intervention follows a bespoke governance and funding model; and that the variability in the type of intervention is reflected in the use of different governance and funding models for each individual intervention. In the case of SIBs, however, there is now enough experience in non-education contexts to define the general model as described in Section 3.

The ESF-backed Social Innovation Fund in Portugal is the only case study of a portfolio approach with the potential to deliver (some) education and training outcomes, with loan funding across a range of social enterprises. The other cases have bespoke arrangements at the level of the individual intervention.

Even in the UK, where arguably the social investment market is most developed, there is limited experience of developing a fund of funds approach for SIBs, although attempts are being made to develop 'wholesale funds' for social investment[53]. Instead, each intervention has its own special purpose vehicle. Even where a number of (non-education) SIBs are being commissioned at the same time in different locations (for example, around tackling problems of young 'NEET' adults or homelessness) each individual intervention is commissioned, funded and managed separately.

The UK examples reported above represent the 'state of play' in the interest and current planning for the use of portfolio approaches, using a fund of funds model.

[53] For example the UK Growth Fund has piloted the use of a wholesale fund for disbursement across community development finance institutions

For larger interventions such as adult loan funds or school refurbishment, bespoke governance and funding arrangements would be normal and taken forward by large individual investors.

This overall level of immaturity has implications for the capacity to design Investment Platforms, with the identification of potential sponsors especially difficult given the early stage in the development of the social investment market in Member States and lack of institutional development.

## 6.2 Future plans / scope for replication

### 6.2.1 Scope to scale-up

With the exception of possible PPPs and loan funds, interventions are too small and fragmented to form the basis of Investment Platforms. Hence, this will require Member States to take a lead in stimulating the requisite capacities, perhaps capitalising on the use of institutional experience developed to deliver Structural Funds, but recognising the current general lack of interest as expressed by ESF Managing Authorities. The Portugal Social Innovation Fund might establish a useful precedent.

In the case of funding PbR projects, Member States and the social investment community will need to consider the development of national scale, social impact funds. We consider the nature of such a fund in the next section, but such funds would require Member States to commit additional public expenditure to the commissioning of education and training outcomes in recognition of the potential fiscal benefits.

A detailed response to the recent EIF request for expressions of interest from financial intermediaries to deliver social investment, and the capacity of interested intermediaries to operate at the level of individual interventions of the type identified, is still awaited. If market interest is high, then the need for Investment Platforms might be avoided, with reliance placed on individual intermediaries building the requisite portfolios.

Early feedback from EIF suggests there is an encouraging level of interest shown from financial intermediaries and commissioners in the piloting of PbR projects but also confirms that PbR is still a nascent instrument whose use is likely to be piloted selectively by sector and geography, depending on social priorities. As such the awareness, especially of commissioners and intermediaries, of the possibilities needs to be raised,

### 6.2.2 Potential role for EFSI in funding the delivery of education and training outcomes

The case studies have identified, subject to institutional capacities, investment opportunities to which EFSI could contribute and which could enable the repayment of capital invested, with the prospect of some, albeit modest, financial return. In so doing, the presence of EFSI would lower the risk exposure to national investors and enable some leverage especially of social investment.

The main obstacles to EFSI participation relate to the lack of institutional capacity and, to some degree, lack of interest at Member State level to take forward the development of new funding vehicles.

## 6.3 Overall conclusions on project feasibility

To benefit from EFSI support projects need to satisfy EIB due diligence tests as well as an assessment by the EFSI Investment Committee to determine whether they are eligible for backing under the EU guarantee.

We briefly summarise below, based on the case studies, the ability of interventions directed towards education and training outcomes to satisfy these tests and associated criteria.  In summary, education and training projects need to be:

- **Economically and technically viable** – projects that are capable of repaying capital and loans. There is limited technical experience of payments by results (PbR) projects in this field (mainly relating to support for young unemployed). Technical competences in relation to student or adult loan funds and PPPs are well established;
- **Eligible and consistent with the EU policies** – and contributing to one or several objectives set out in the EFSI Regulation - education and training projects fit well with the strategic objectives of EFSI, especially in relation to the need to support the development of human capital;
- **Mature enough to be bankable** – Student or adult loan funds and PPP have demonstrated to be bankable. The bankability test is harder to satisfy given the lack of experience with payments by results (PbR) projects in this field, but evidence does confirm the potential to provide financial return based on fiscal benefits;
- **Provide additionality** – With the exception of PPPs, the required innovation and the probable higher risks associated with the education and training interventions should satisfy an additionality test, and in the case of PPP the cases demonstrate there is scope for innovation;
- **Maximise where possible the mobilisation of private *(and/or social)* sector capital** (italics added) – The extent of mobilisation will be subject to the institutional capacity of the emerging EU social investment market in general, and by the willingness of Member States to commission payment by result interventions in particular on the basis of the blended returns achievable.

## 6.4 Overall conclusions on the feasibility of establishing investment platforms

Assuming that co-investment from EFSI is through an investment platform, but recognising the current EIF efforts to recruit financial intermediaries to support social investment, each investment platform will need to be set-up by an organisation (platform sponsor) able to be the driving force in the creation of the platform.

The sponsor needs to establish:

- the investment needs,
- the sectorial and geographical focus,
- the business case,
- the sources of funding,
- the risk-sharing agreements, and
- decision making rules.

The sponsors will usually come up with the investment idea for the platform to deliver. Often, they will provide part of the funding for the platform's activities. Sometimes they would manage the platform.

Any institution or a group of institutions can become a platform sponsor. The following types of entities could be platform sponsors:

i. National Promotional Banks (NPBs)

ii. Government agencies

iii. Commercial Banks and other lending institutions

iv. Investment Funds and Investment Companies

v. Corporates

vi. Body implementing ESIF programme financial instrument

vii. Sovereign Wealth Funds

The case studies indicate some uncertainty and ambiguity over the possible platform sponsor, notwithstanding the need to develop sufficiently large national co-investment opportunities.

With the possible exception of corporates all types of entity are possible promoters.

In the case of platforms based on payments by results, the most likely candidates would appear to be: (i) NPBs, where there is a willingness to consider investment in intangible assets; (ii) government agencies seeking to expand and formalise the use of local level interventions in response to identified national education and training needs; and (iii) ESIF Managing Authorities (especially ESF) with a particularly strong interest in the use of financial instruments.

However, with all these three parties, the study has found no substantial interest or enthusiasm by such entities, reflecting in part: (i) a lack of awareness of the opportunity (both in terms of the actual role of EFSI and the scope to generate financial return); (ii) some concerns over the principle of using third party investors in the sector; and (iii) concern over the up-front costs of establishing the Platform and of generating the necessary pipeline.

# 7 Recommendations to support EFSI investment in Education and Training

## 7.1 Limitations on the use of EFSI for Education and Training

The research throughout this study has revealed some limitations and challenges in relation to establishing social impact investment in education and training on a sufficiently large scale to attract co-investment from the EFSI fund. The reasons for this are manifold:

- Most projects are rather small scale in terms of funding requirement and outreach. The number of individual beneficiaries are commonly very small, often less than 100, and sometimes less than 50 people;
- Payments for results in the education and training sector rely on commissioners accepting that fiscal and economic benefits have potentially long lead-times, lasting decades;
- So far, interventions have been a 'one-off' approach, which means either the investment has been successful and funders receive their premium or reward, or it has been unsuccessful and the funders have lost the funds provided. The absence of a portfolio approach means that there is no precedent for risk-sharing;
- Transaction costs for any single project are high, as the contracts have to address the very specific nature of each individual intervention;
- The success premia are limited and the risk of failure commonly substantial. From an analytical point of view, this is an "unhealthy" shift of risk from the state to the funder, whereas the major return will accrue to the state;
- The "social investors" are foundations or other entities, that can afford some loss of investment capital (whereas they may benefit reputationally, from the social impact achieved);
- The major focus of such "social investors" lies in the innovative education intervention (or any other type of intervention) and the (expected) positive outcome of the intervention. The indirect benefits, of being socially innovative etc., is obviously already a sufficient incentive for these agents;
- Thus, there is only a modest economic, but a major social, impetus for such investors, with a substantial risk of failure (although risk management and due diligence tests are increasing in use);
- The "result" of the intervention can be defined as the direct short-term output of the intervention (e.g. a certain number of dis-advantaged youth graduating from secondary school; a certain number attending and completing a programme; a certain number of adolescents receiving qualifications.). This could provide an incentive to focus on these targets only, rather than on the longer-term effects on the labour market and related effects on tax revenue to government. The longer-term outcomes also need to be defined and linked to issuing additional payments;
- The longer-term fiscal returns are often substantially higher than the short-term effects indicate (e.g. medium-skilled people have a much lower risk of unemployment, a higher income, a higher employment rate, retire on average latter etc.), and, thus, the premium paid to service providers, which is based on short-term results covers only a very small share of the total return etc.;
- Based on this analysis, it is striking that the public agents do not commission more social investment projects, as the fiscal benefits substantially exceed the

costs of commissioning and carry no risk at all. However, public sector spending limits, the consideration of the payment liability as debt, even if it has to be paid only in case of successful intervention, with higher fiscal returns, and the focus on short-term rather than prospective longer-term impacts constrain commissioning. It is also striking that social investors are willing to invest on these terms in pursuit of social impact. This highlights the importance of social impact benefits to the social investors.

The points above should not be misunderstood as criticism of social impact investment for education and training. The critique herein explains why, despite its merits and the strong public interest, the social impact investment market generally, and education and training interventions specifically, are still very limited.

From the review of cases in this study, investment is unlikely to grow substantially without efforts to support the introduction of 'programmes' of interventions rather than relying on individual interventions. So, nothing is "wrong", but the current risks, small scale, and relatively high transaction costs prevent the full exploitation of social impact "investing" in the real sense of the term "investment".

## 7.2 The case for a National Social Impact Fund (SIF) for education and training

The previous analysis indicates that new approaches are needed, if social impact investing is to play a bigger role in the future provision of education and training outcomes. The key features of the new approach are:

- a fairer allocation of risk and return between public and private stakeholders (for example, by establishing interim payments for early results, and additional payments for mid- to long-term achievements, or allowing projects a share of the fiscal benefit); and
- raising the number of projects/interventions to spread the risk and diversify funding / revenue streams.

In the view of the consultants, this calls for the development of a national scale "Social Impact Fund", which has the potential to enter into a number of social impact investments across various sectors of education.

The basic proposition of a Social (Education & Training) Impact Fund (SIF) is that (social and private) investors provide the state with additional resources to increase educational outcomes (e.g. enrolment rates and/or to enhance quality in a certain education sector or in several sectors), and these resources, in turn, provide a set of fiscal benefits to justify the public expenditure to reward the investors.

### 7.2.1 Why should the state be interested in cooperating with the Fund?

The SIF is by design intended to help deliver public policy goals relating to education and training and the related economic and social benefits.

Financially, from the government's perspective, the Fund facilitates increased investment in education / training without relying entirely on public resources. Government will only contract with a PbR and invest in the Fund if government revenues and other defined benefits, in excess of government payments, can be confidently considered to be delivered by the contracted results. In this way the state transfers the risk that the intervention fails to deliver the specified results to the provider.

Depending on the uncertainty over future cost savings/higher revenues, there should be limited risk to the public budget due to the reliance on the future returns unless a guaranteed minimum payment is agreed upon[54].

An obvious, but critical, point is that additional government funding will be needed in the short-term to provide for the costs of additional interventions. This is likely to be constrained by overall public expenditure budget limits. Hard empirical evidence on which interventions are particularly successful is also still rather limited, and makes the justification for 'payments for results' interventions difficult.

Continued work to define and value education and training results is required, accompanied by formal analysis of the fiscal benefits (see below). However, a substantial cultural change is also required in government to prioritise an 'invest to save' approach over immediate and short-term policy responses to social problems.

### 7.2.2 Who may invest in the SIF?

The Fund should be open to any person or organization that is willing to invest and meets standards of governance and probity. In practice, the Fund will be attractive to investors who do not want to settle for lower interest returns from government bonds and who are willing to accept a slightly higher risk. Life insurance companies or foundations may be willing to invest to the extent that the returns are higher than for other low-risk investments.

### 7.2.3 What are the expectations for returns?

As with any investment, the return to the Fund, and thus to investors, depends on the performance of the Fund's income, which itself depends on the fiscal returns and the share that is appropriated to the fund. Strictly speaking, this means that the Fund invests in the early years, with its value increasing only slowly over time, depending on the education sector in which the money is invested.

For investors, the expected return from their investment in the Fund might be expected to be higher than the return from state bonds, while some minor risks remain because of possible economic downturns or crises, etc. In order to make the SIF's attractive to life and other insurance companies, foundations, etc. it might be necessary to discuss a guaranteed return as a lower bound, although this may result in different considerations in relation to public debt. The commitment of a certain share of future tax revenues is clearly not debt for the government, because such payments will have to be made only when, and to the extent, that higher tax revenues are realized or social welfare payments decrease. However, a guaranteed minimum return to the Fund could be viewed as public debt or at least a public liability.

However, the size of the returns will depend on the share of the fiscal returns allocated to the fund. This share will depend on negotiations between the Fund's management and the government. One might expect that the opportunity for government to leverage investment in support of objectives usually only met through government spending, and for investors to monetise a share of the fiscal benefit, would enable a compromise agreement to be reached

Estimating the fiscal returns to public budgets and social insurance systems will need to become more explicit and subject to greater scrutiny, (as noted above). In so doing, these calculations might potentially enable investors to come forward with new proposals to maximise the fiscal benefit and hence the return the SIF.

[54] Government payments to the Fund to ensure a minimum return are a potential charge against the government budget. Recently such government guarantees have been criticized by courts of auditors in Germany, on rather narrow grounds.

## 7.3 Actions to improve the financial performance of payments by results interventions and returns from the SIF

In the context of a Social Impact Fund, action is needed both in terms of improving the returns to individual interventions through contract design and increased sharing in fiscal benefits (see below) and risk sharing across multiple interventions.

### 7.3.1 Contract design

#### 7.3.1.1 Flexibility in profile of target outcomes

Any funder who is not driven by a social impetus alone has an interest, and, in fact, a need to balance profits and losses. With payment by results/pay for success this is not guaranteed at all, unless the portfolio of investments is so large and diversified that the premia of the successful interventions are sufficient to compensate the full losses of failing interventions.

Even this requires a premium that is not just marginal, as a simple example highlights: if only 5 of 100 interventions fail, the premia of the 95 successful interventions have to be more than 5.2% in order to ensure that the basic funding volume does not deteriorate. In case of a failure rate of 10% the premium has to be above 11%.

Recent UK cases have introduced some flexibility within interventions to allow providers to vary their outcomes against a set profile of target outcomes – if there are problems achieving Outcome X, they can re-profile to achieve more of Outcome Y.

#### 7.3.1.2 Performance related payments

Additional funders would step into the "market" if they can expect at least a modest return across all their investment projects. One option (used in the UK) is to revise the contractual design, so that payments are related to the size of performance, e.g. the service provider is not just paid a lump-sum once the benchmark is achieved, but paid an additional premium for each additional person who benefitted from the intervention. This could transform the approach into a "real" model of "payment for performance". This could turn the general approach into a model that is attractive to investors, interested in (modest) financial returns.

#### 7.3.1.3 Use of tax relief

Individual Member States are able to set whatever tax rates they wish for whatever economic activity, within the boundaries of EU state-aid provisions, i.e. any taxation regulation must not reduce competition, or be used to prop up private companies which otherwise might go bust in a competitive market.

In the context of this EAC initiative, where EFSI-supported interventions are more likely to be 'national', as opposed to 'cross-border', the possibility for infringement of state-aid rules on the grounds of competition seems less likely.

Hence, in principle there is no reason why a Member State cannot give special tax relief to EFSI-type interventions for education and training, recognising that such reliefs are a cost to government. The use of tax reliefs would need to be judged on a case by case approach.

### 7.3.2 Sharing fiscal benefits

The financial returns obtained by the SIF would be improved by sharing the fiscal benefits for the public purse between the commissioner (on behalf of the government treasury) and the funder. Depending on the specific design of the "Social Impact Fund" investors can be shareholders in particular projects (e.g. industry, households), loan providers or investment funds (e.g. insurance companies), thereby broadening the financial investment volume.

Enabling higher premiums (i.e. financial return) to the Social Impact Fund from a higher share of a given fiscal benefit could be linked to a requirement to re-invest the returns in further Interventions, once a certain minimum return, which provides an incentive for private investors to invest. It would have to be agreed at the outset what a reasonable return for the "investor" would be, but, given that the State benefits in any case, such a mechanism could generate additional returns without incurring upfront costs and with no, or limited, additional risk.

The share of the fiscal return allocated to the SIF might be between say 25% up to say 50% over the lifetime of an investment, i.e. (theoretically) until the defined cohort that benefitted from the intervention retires, The share might increase as the realised fiscal benefit increases. This would be an added attraction for long-term investors as net returns increase over the life-time of the investment.

### 7.3.3 Risk sharing and the diversity of the SIF

In the context of a SIF operating a portfolio of interventions, financial returns could be used to cross-subsidise financial returns from other interventions funded by the SIF which generate higher social impacts, but lower financial returns.

This raises the question of how diverse the SIF should be, given that investment is needed in a range of educational sectors. The investments in different levels of education have different roles, different time horizons and different rates of return. For example, higher education investment may have a fiscal rate of return of about 20% or more and will start to yield returns in four or five years, while investments in early childhood education may have even higher returns according to Cunha et al. (2006), but they will only start to bring additional returns fifteen years or longer. While most investors tend to have a short investment horizon, some, such as life insurance companies, may have a longer horizon. This clearly suggests that it would be better to establish the SIF more as a 'fund of funds' with several individual funds, one for each level of education. If investors wish to diversify their investments, they can do so by placing their capital in different education funds.

Since the returns may differ significantly and may have very different probabilities and risks, this offers the SIF some flexibility for managing risk and return across funds, but would require the SIIF to be established as a single company. For example the returns to investments with a shorter time horizon, for example to higher education, can be used to boost investments in education sectors with longer horizons such as early childhood education. Provided that the returns arrive as scheduled, some of these early returns to the SIF can be used to increase investment levels in other, more long-term oriented investments, such as, for example, early childhood or primary school education.

## 7.4 Towards a governance structure for the EFSI / SIF co-investment

The Social Investment Schemes, as described under the EFSI Equity Instrument , and specifically the Expansion and Growth (E&G) Window, provides a useful template and precedent for developing an effective mechanism for the promotion of Interventions pursuing social impact through education and training interventions, assisted by the participation of the social enterprise sector and other social organisations. Nevertheless, this E&G Window is in part directed towards interventions in SME developments, which generate commercial and financial outcomes, whereas the results from social impact interventions are likely to be less tangible with a requirement to produce a blend of social impact and financial return.

Given the range of potential social impact interventions (even within the education and training sector), and which, in turn, will not be uniform throughout Member States, there is some benefit in isolating this component of the EFSI Equity Instrument from the mainstream social enterprise support. This could be done by establishing, as a conduit for EFSI co-investment support, a specific Social Impact Fund ("SIF"), to cover a range of education and training interventions capable of generating social impact, not all formulated as a SIB, (for example new student loan funds).

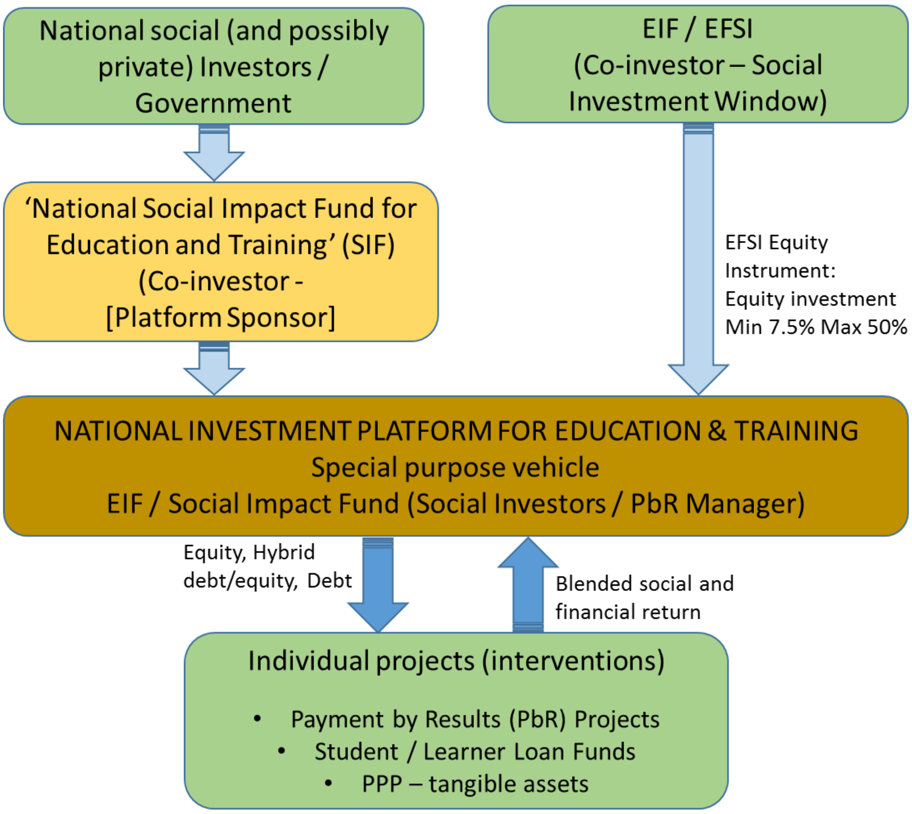
Whereas, under the E&G Window EIF / EFSI has sought a partnership, or co-financing arrangement, with private financiers via "Intermediaries", the institutional framework for promoting and developing Interventions supported by a SIF may be better described as via "Platforms", which could be constituted at either multi-national, regional or national level.

Our view is that subject to the detailed EIF analysis of the responses to their call for Expressions of Interest from financial intermediaries in the use of PbR, an Investment Platform is the optimal choice, despite the need for a Platform Sponsor, because:

- The model of using contracted intermediaries to fund individual interventions is likely to be challenging due the relatively small size of intervention (typically, say, €1 million) and the consequent requirement to aggregate interventions into a portfolio capable of receiving co-investment at scale;
- The Platform offers the advantage of a diversified project flow, attracting different investors operating with differing expectations of returns and different time scales, enabling some opportunity for risk sharing and co-investment opportunities; and
- The criteria for measuring performance and the success (or failure) of any Intervention targeting social impact are, of necessity, diffuse and somewhat subjective, e.g. creation of employment; achievement of vocational skills, etc. Further, such criteria will be interpreted differently across MS, statistically, culturally and nationally. Establishing these criteria across the portfolio should avoid the transaction costs of negotiating these terms for each individual intervention.

An indicative outline of the platform based co-investment proposition is described in Figure 12.

Figure 12 An overview of a suggested co-investment structure for education and training investment




At the outset, some measure of agreement between EFSI and co-investors of the value of social impact and of the required balance of social impact and financial return will be needed. The range of social impacts and types of interventions considered to be eligible for support will be needed; which might be expected to be agreed separately with each specific Platform agreed according to Member State economic circumstances and social needs.

1. Such SIF Platforms would have access to a range of funding sources for application to a similarly wide range of social Intervention, albeit that some sources may be limited to certain Intervention-type. However, it seems advisable that the common guiding principle for support for Interventions by the Platform(s) should be the preservation of capital, i.e. the financial inputs to any intervention, including its preparation, implementation and administration, should, at least, be commensurate with the economic or financial benefit of the outcomes.

Some co-financiers to SIF Interventions, however, may require that the prime condition for any Intervention be measured by the financial benefits alone, whereas others may take a more "social" stance and be satisfied by less tangible outcomes.

2. Funding sources in the social sector, e.g. foundations, trust, etc., are often proscribed, or specific, as to how their funds may be applied in support of social Interventions. Hence, not every opportunity, which a SIF Platform might promote, may be acceptable to them. Hence, there will need to be put in place an acceptance/refusal mechanism for co-investors in the Platform as and when investment opportunities arise.

3. The Platform(s) would have the capacity and flexibility to support Interventions through a range of financial instruments:-

   - Equity, i.e. funding which carries the characteristics of either limitless reward or total loss, with no on-going payments (e.g. as dividends) made to financiers during the period of service delivery;

   - Debt: i.e. loans which should, in practice, be repaid at some future date, e.g. student loans; and

   - Guarantees: the provision of a guarantee to a third party, financier, or co-financier, which will provide full, or partial, compensation in the event of an Intervention failure, however that is measured in financial terms. Such guarantees will not be available to support failures in service delivery.

4. The main SIF-supported Intervention opportunities for consideration by the Platforms could, depending on Member State education and training needs, include:-

   - Payment-by-Results ("PBR")-type Interventions which delivered results supporting education and training provision otherwise foregone, and capable of delivering some fiscal benefit (over varying time periods depending on the intervention);

   - Funding for specific groups of students of various education and training programs otherwise inaccessible to the specific group of students;

   - Public-Private Partnership ("PPP")-type Interventions, which comprise significant investment in capital asset, such that a PPP mechanism and which can be cost-effective; and which is capable of generating revenues to be used to fund additional education and training support (for example through investments in energy efficiency and recycling of energy cost savings).

5. The governance of SIF will, most likely, follow the same framework laid down for EIF / ESIF Equity instrument with respect to representation, limitations of sectoral investments, etc. However, it would seem inadvisable that the SIF Platform should enjoy powers to raise any additional external funds to those provided by EFSI/EIF and their co-financiers.
6. It is noted that under the EIF/EFSI Equity Instrument, EFSI funds stand pari-passu with co-investors, except for social-type investments, where a more flexible approach may be called for. It is recommended that that flexibility is also passed to the SIF Platforms.

## 7.5 Investment risks and risk management

Interventions in the social sector are by nature "high risk". Not only has the Funder to evaluate the financial costs and rewards of an Intervention, but an assessment is also required as to the social uncertainties of, or risks associated with, outputs and outcomes.

### 7.5.1 Description of investment risks associated with the Platform

Conceptually, the risks may be categorised as follows:

**Implementation Risks for Social Investment:**

- General:

  - How are opportunities for Intervention chosen? [Are they competitively bid?]

- Specific to an Intervention:

- Will the Intervention be implemented as planned?
- Are the aims and objectives realistic and achievable?
- What precedents are there for similar Interventions? Where and when?
- What is the experience and capacity of the Provider(s)? [CV's, accounts, etc.]
- Does the Intervention require third party inputs, or are all inputs available and already committed to the Provider?
- Are the required facilities/assets for the Intervention already available and committed?
- To what extent does the Provider have to construct or install assets for the Intervention? Are these funded and readily available within an agreed period?
- What is the timetable from start-up to output/outcome realisation?
- What are the chances of interruptions or delays?
- What are the management and reporting responsibilities of the Provider(s)?
- Can the contract with the provider be terminated? Under what circumstances and how? What are the outstanding liabilities in such circumstances?
- What events constitute Force Majeure? What are the responsibilities and liabilities of the Provider9s) and Commissioner in such circumstances?
- Key staff: identification and issues regarding changes to personnel?
- Changes in the output specification of the contract: how are these managed?
- Disputes: how are they to be resolved? Arbitration? Expert panel?
- Are the assets and operational activities of the provider(s) insured [for accident, third party, etc.]?
- Do the Intervention meet all environmental, social and climate change criteria (viz. Sustainable Development Goals]?

**Output risks of interventions:**

- What are the output criteria which will trigger payments?
- What are the payments to be made to the Provider(s)? What dates? How calculated?
- The impact of inflation and currency exchange rates: how are these assessed? Formulae?
- How are bonuses or penalties measured and calculated?
- Who is the payer? Are they creditworthy? [Are any guarantees needed?]
- Disputes: how are they to be resolved? Arbitration? Expert panel?

**Other Risks:**

- Possibility of Government / political interference?

- Failure of the Provider(s): what liabilities (e.g. to students) are outstanding and who meets those?
- Failure of co-Investors to provide funds when called? [Commitment fees?]
- Are there any balance sheet issues for Government in the use of PbR contracts for delivering public services?
- What responsibilities for due diligence are carried by the Platform Manager?

### 7.5.2 Investor issues and perspectives on risk

Each co-Investor into the National Social Impact Fund will have their own, - often quite limited in scope, - investment criteria and the outputs/outcomes they aspire to achieve. Hence, not all Intervention opportunities will meet their criteria and, thereby, be acceptable to them.

To the extent that such Investors contribute, in whatever form, funding to a Social Impact Platform, they may well require a mechanism, therefore, for approval, or refusal, for participation in Interventions which are more than trivial in value.

Indeed, Fund or Platform Managers may require authority to commit funds to a particular sector, or above a particular value, however the latter is measured, as a matter of course.

Investors may also be constrained by the timescale between investment and possible returns or outcomes, which will need to be allowed for. Much will depend on the target sectors and the intended investment value for Interventions by the Platform(s).

Finally, Investors will review the taxation issues surrounding any Intervention and the rewards accruing. However, EFSI should be alert to the use by Investors of sophisticated investment vehicles and structures, and funding channelled via tax-havens.

### 7.5.3 Platform management

Likewise, each Platform will have to prepare an Investment Plan to attract funds, laying out the aims and objectives, target Interventions, maxim and minima Intervention values, output/outcome response time forecasts, etc..

It is to be expected that the Managers of such Platforms will be constrained by normal fund management regulations, as may be imposed throughout the EU. EIF/EIB will no doubt have precedents for such operations, which can be followed.

Finally, consideration and resource needs to be given to the marketing of the Platform facilities to Social Intervention Providers throughout the Member State.

Given that many such Interventions may be quite small in value, accessibility will be a key issue for many. Given the limited value of some Interventions, and the need to launch the Platform(s) widely throughout the Member State, small-scale Providers will be averse to bureaucratic procedures covering applications and implementation. A balance will have to be struck, if such Interventions are to have market penetration, but not at the cost of appropriate governance and control. Such Interventions, by their very nature, will be higher risk to Investors (and Platforms) than larger Interventions.

Much will depend on the Platform Managers to assess and monitor such Interventions. Further, the cost of administering Interventions will be largely fixed, whether they be large or small, and some small Interventions will require, per € invested, more support than large Interventions.

## 7.6 Next steps in pursuing social investment for education and training

### 7.6.1 A long-term perspective is required

The pursuit the use of social investment and the development of Social Impact Funds (with or without EFSI) to deliver education and training objectives should be seen as a long-term process, recognising: (i) the limited experience with PbR projects; (ii) the current low levels of awareness of the relevant stakeholder community; and (iii) the need to develop an 'invest to save' culture based on a broader assessment of the role of education and training in economic and social life.

The possible availability of EFSI funds provides an incentive for Member States and the EC to investigate the options further. However, in the first instance relevant stakeholders, especially at Member State level, need to have a much better understanding of the opportunities and limitations associated with this form of intervention. Unless a National Promotional Bank seeks to take the initiative, the prospect of developing an Investment Platform will depend upon establishing a mutual understanding of the investment possibilities across stakeholder groups.

### 7.6.2 Flexibility in timing and location of progress will be required

The demand for social investment in the types of intervention identified in the Study are likely to exist in all Member States to varying degrees, but with different views on the priority to be attached.

The opportunities will inevitably be stronger in those Member States that have an interest in the use of social investment generally, and the use of PbR type interventions in particular, to address nationally or locally defined needs. Evidence from the study suggests that currently, there is a relatively strong interest in Germany, Sweden and Portugal in the use of social investment for education and training but with relatively less interest in Spain, Netherlands and Poland.

Analysis by EIF of the interest expressed in PbR in the context of EFSI funding might be expected to provide additional insight on the countries with a particular interest.

### 7.6.3 Awareness raising is required across all stakeholder groups

The use of social investment for education and training brings together four discreet stakeholder groups that have traditionally and institutionally had little interaction.

The first group, **the formal education and training sector,** has had very limited interaction with the funding of educational services and little need to consider investment needs and financing. Rather the focus is on the design and delivery of education and training services within given public budgets.

Funding of the education and training system is the separate responsibility of the second group, **the national, state and municipal budgetary authorities.** Even here the main focus is on the levels of public expenditure required and its subsequent allocation, rather than on new forms of finance. The scope to leverage additional investment is generally not a mainstream consideration.

The third group is the **long established investment community**, comprising: banks, investment, pension fund and insurance companies. Although not necessarily of immediate interest in this context their longer-term engagement will help when seeking to roll-out and scale-up investment programmes.

This investment community has been recently extended to include a fourth group of **social investors and philanthropic capital** that purse financial return, but as a means of realising social benefits. In a few countries, these latter two groups of stakeholders have established well developed, joint working mechanisms, based on a formal recognition of social investment as a separate and legitimate asset class.

Common messages need to be developed for these four stakeholder groups that describe particular opportunities and limitations; and which begin to catalyse a dialogue and interest in the underlying investment case.

Although inevitably framed by Member State interest, there is a role for DG EAC and the Commission more widely to facilitate discussion of the possibilities for using social investment to support education and training policies.

#### 7.6.3.1 Opportunities

Messages include:

- Some investment needs can be met outside the formal public budgeting, where because of a combination of the economic and social benefits someone is willing to pay for improved outcomes. This may be:
  - government, recognising that failure to address needs will have a longer term adverse effect on public finance;
  - employers recognising that failure to invest in additional skills will affect future productivity and their competitiveness; and
  - households wanting to pay for improved services not available from the state, including improved support for special needs, or extended childcare and pre-school teaching;
- Investment projects can be constructed that deliver the requisite outcomes, based on an understanding of the costs and benefits of the investment, and that there are potentially investors to finance the activity, even where returns may be over a number of years;
- Consequently, additional investment can be leveraged into the sector.

#### 7.6.3.2 Limitations

Messages include:

- (Financial) incentives need to be sufficient to reward investors for risks taken in the provision of finance. Social benefits alone are not sufficient. In many cases, it will be government that will need to take the longer view and support investors, with guarantees and up-front payments, although this should be framed by an understanding of longer-term fiscal and wider policy benefits, and the transfer of risk for the successful delivery of contracted results to investors;
- Current evidence on the costs and benefits of responding to investment needs is often weak or non-existent. The feasibility of investment proposals will often need substantial research;
- Because of the costs of establishing feasibility and because many projects are likely to be small in investment terms, responding to local rather than national needs, the administration costs of establishing investable propositions may outweigh the benefits of investment, until experience and demand have been established.

### 7.6.4 Feasibility testing is required where adequate levels of awareness and interest has been established

The final step before considering the detailed mechanisms of a Social Impact Fund or an Investment Platform is to develop and test various investment projects addressing different investment needs as prioritised by Member States.

The project examples contained in this report may provide some stimulus to ideas.

In so far as DG EAC wishes to pursue an interest in the use of EFSI funds for education and training purposes, with a particular focus on PbR, then there are a number of steps that might be taken to support the necessary raising of awareness and promotion of pilot activity:

- Expand the technical expertise available to Commission Services, especially at Member State level given the differences between countries, on the financing of education and training including policy areas that might be regarded as 'adjacent' to the formal system, including early years childcare and services for those with special needs, youth unemployment and older workers. This would deepen an understanding of needs but also investment opportunities;
- Recognise the development of this stream of funding and type of intervention will have interest to a range of Commission Services, including DG ECFIN, DG EMPL, DG REGIO, and inter-service consultations would allow the necessary sharing of experience and development work. This could include ensuring PbR is considered in the context of the roll-out of financial instruments under the Structural Funds in the next programme period;
- Since fiscal benefits are instrumental in supporting the case for PbR, a work programme in association with DG EMPL might be considered to better understand the scale of benefits for different types of interventions over differing periods of time in different countries;
- Managing Authorities for ESF were cautious in expressing interest in the role of possible Platform Sponsor. However, their management capacity, knowledge of the types of investment needs potentially capable of forming the basis of PbR, and ability to develop project pipelines make them good candidates. This potential might be leveraged by encouraging ESF Managing Authorities to take forward the use of financial instruments of which PbR would be one, in the next programme period.

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