ARTs IMPACT FUND

Arts Impact Fund

Insights from the first year

September 2016

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Contents

An initiative of: Bank of America Merrill Lynch, Esmée Fairbairn Foundation, Nesta

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FOREWORD

The Arts Impact Fund is a pilot, multi-stakeholder initiative that exists to test social investment as a way of supporting organisations in the arts and cultural sector. The Fund's stakeholders hope that the portfolio of investees will illustrate examples of sustainable business models, effective approaches to social and artistic impact measurement and attract more capital to the sector. The Fund will also endeavour to talk about the tangible impact made by its investees and how lives and communities have been changed for the better through their work.

The Arts Impact Fund has two years in which to deploy its £7 million capital base, measured from the beginning of operations in June 2015. At the time of writing (July 2016), just over half way through the initial investing period, the team managing the Fund has already learned a vast amount about the current funding environment of the arts and cultural sector, the extent of its understanding of unsecured lending, the suitability of repayable finance and what it's like to manage a project with public, private and philanthropic sector partners.

As part of our commitment to sharing insights from the Fund and the wider agenda of transparency in the social investment sector as a whole, we've decided to share our observations to date in this interim report. We expect to update and add to these findings at the end of the investing period, in the summer of 2017, and again at regular intervals over the loan repayment period, which will extend to the summer of 2022.

Before looking at the lessons, this paper first provides background to the Arts Impact Fund, its aims and offer. A summary of first year activity is then provided, after which we present lessons so far for arts and cultural organisations, investors and policymakers. We close with an outline of our planned activity over the remainder of the current investment period.

In the appendix we have included anonymised information on our nine approved loans to date. We hope this illustrates the various uses for the Fund's capital as well as the business and impact models that will provide us with our returns.

Francesca Sanderson
Head of Arts Investment and Programmes, Nesta

Seva Phillips
Arts Impact Fund Manager

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BACKGROUND

Open for applications since June 2015, the £7 million Arts Impact Fund exists to demonstrate the potential and impact of social investment in the arts to possible investors, eligible borrowers and the broader sector. It is the first unsecured loan fund of its kind in the world explicitly taking into account the artistic impact of the organisations it supports, in addition to the social and financial returns.

The genesis of the project was the coming together of arts funders and stakeholders, including Bank of America Merrill Lynch, Arts Council England, Nesta and the Esmée Fairbairn Foundation to explore the growing market for social investment. Specifically, they were interested in how this growing type of investment capital could be used to bolster sustainability and resilience in an increasingly constrained arts funding environment.

The opportunity aligned with other interests: namely the desire to pilot sector-specific social investment, to explore the benefits of accumulating focused knowledge within one investment team; as well as a desire to prove the concept of pulling together (or 'co-mingling') public, private and philanthropic capital into one funding vehicle, in order to generate synergies. There was also interest in whether suitable metrics could be developed to quantify the artistic impacts of investments in ways that might attract social investors. The Arts Impact Fund also builds on recommendations made in *The New Art of Finance*, a 2014 paper by Nesta, that had called for innovation in arts funding more generally, including a repayable finance fund for the sector.

In terms of wider economic context, the arts and cultural sector are vital contributors to employment and the country's economic growth, generating £7.7 billion in gross value added . Arts and cultural organisations typically operate a variety of business models and are often able to earn revenue through trading (for instance, by selling tickets), which suggests an ability to repay any finance taken on. This is all set against a backdrop of continued depleting grant pots for which there is ever greater competition, which compels us to look at alternative models for investment in the sector.

Aims

As a pilot, the Arts Impact Fund has the following aims:

- Provide affordable repayable finance to arts and cultural organisations generating social impact.
- Encourage and fund development of enterprising and resilient business models.
- Promote the wider positive impacts the arts have on society and support more organisations to benefit individuals and communities through their work.
- By bringing together capital funding from Arts Council England, the Esmée Fairbairn Foundation, Bank of America Merrill Lynch and Nesta, allow public, philanthropic and private funds to work together to support the arts in England in the most effective way.

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Offer

The Arts Impact Fund provides primarily unsecured loans of £150,000-£600,000, at affordable interest rates, repayable over a three to five year period. It funds arts and cultural organisations working in England that are financially resilient, can demonstrate a commitment to artistic impact and deliver social outcomes in at least one of the following areas: youth and educational attainment, health and wellbeing, citizenship and community.

The Fund follows Arts Council England's art form eligibility, meaning that organisations focused on most art forms, including museums and heritage organisations, (but with the exception of film) are eligible for funding. The investment is intended to support organisations through a range of needs - from bridging gaps in cashflows, to developing ideas for generating new income streams, to acquiring or repurposing buildings or other assets with a view to boosting future resilience.

Appendix 1 includes anonymised information on business models and social and artistic impact of our nine approved (but not necessarily completed) deals to date. One conclusion to be drawn from this is that there is no typical Arts Impact Fund investee.

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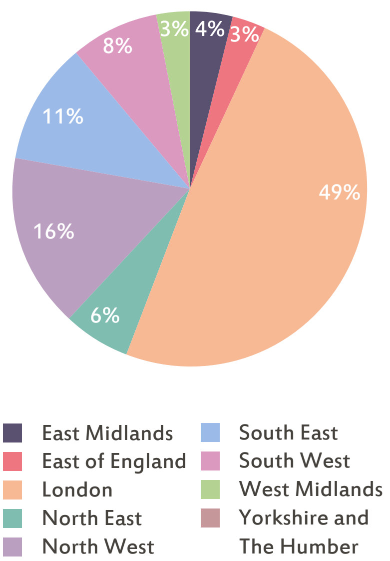
ACTIONS AND PROGRESS TO DATE

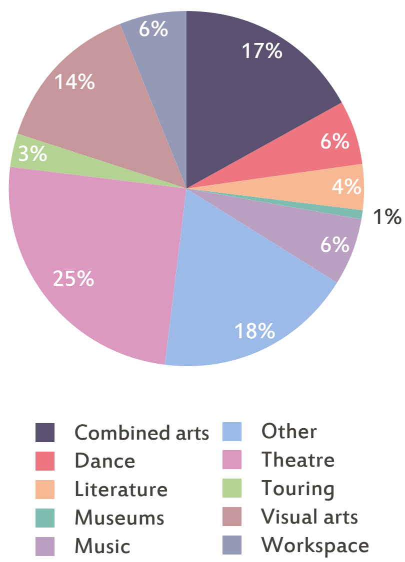
Investments and enquiries

- The Arts Impact Fund received 79 enquiries for loans up to 20 July 2016.
- The median annual income of enquiring organisations was £300,000.
- The average amount of finance requested was £260,000.
- Enquiries were dominated by organisations from London and the South East, although regional diversity is improving as team efforts to raise awareness of the fund outside London start to reap rewards.
- The majority of enquiries' primary impact area related to young people and educational attainment, though we are now seeing a small increase in numbers of health-related interventions and expect to see more as cultural commissioning develops and the Department for Culture, Media and Sport (DCMS) conducts exploratory work about results-based payment contracts in arts and culture.
- Theatre was the most prevalent art form of enquiring organisations, representing a quarter of all enquiries.
- Culture and heritage are underrepresented – the fund team is taking active steps to raise awareness in the culture and heritage sectors through engagement with their respective umbrella bodies.
- Over half of all enquiries have come from registered charities, although the fund is able to invest in any incorporated entity.

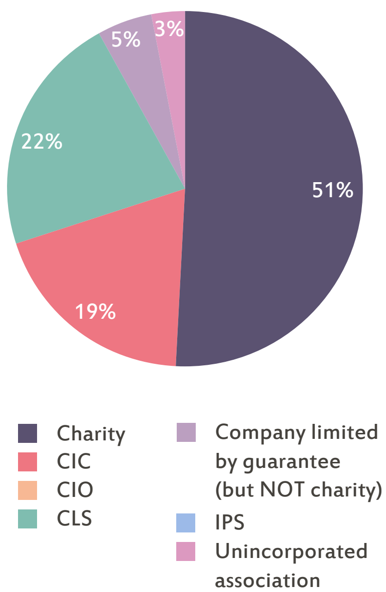
ENQUIRY GEOGRAPHY



ENQUIRY ARTFORMS



ENQUIRY LEGAL STRUCTURES



- To 20 July 2016, the Arts Impact Fund investment committee has met three times. Over the course of these:
  - Following extensive due diligence, the Fund team has taken ten applications forward to committee.
  - Nine applications have been approved.
  - Three loans have been legally completed, with a total loan value of £1.1 million.
  - £150,000 has been drawn down from one applicant.
  - The Fund has invested in a broad range of business models and organisation types - from largely grant-funded Arts Council England National Portfolio Organisations to charities cross-subsidised by commercial activity, to grassroots community-led charities and organisations with a national reach.

Systems and processes

- In the period we have finalised the Arts Impact Fund theory of change, which is included in Appendix 2.
- Set-up and manualised back office systems and processes for handling enquiries, data and undertaking due diligence - the very first steps necessary for a pilot fund.
- Recruited independent investment committee members in addition to our funder representatives: Richard Brass, Chair (co-founder of Impact Ventures UK), Geoff Burnand (CEO, Investing for Good) and Moira Sinclair (CEO, Paul Hamlyn Foundation, formerly of Tricycle Theatre and Arts Council England).
- Developed a framework for looking at the social impact and artistic capabilities of prospective investees in the course of due diligence.
- Co-created development plans with our investees that will set output and outcome targets over the lifetime of a given investment and will outline steps to be taken to improve organisations' standards of evidence.

Communication and raising awareness

- We have communicated the fund's opportunity on social media, through meetings and networking with arts organisations, umbrella organisations and arts funders, including regional UK events hosted by sector partners such as Arts Council England.
- Set up mutual referral and cooperation relationships with a wide network of other social lenders, as well as becoming a referral lending partner of Creative Industry Finance, a programme aiming to match creative industry organisations with suitable funders.
- Made presentations on our innovative fund structure, demand and reception from the sector, and replication opportunities to policymakers in Austria, Estonia, Brazil and Australia, and to interested parties from other sectors, such as sports and agriculture.
- Featured in the DCMS Culture White Paper and across government online collateral as an innovative approach to blending diverse funding sources to develop a helpful tool for a specific sector.
- Hosted an event at Nesta attended by 180 delegates to raise awareness of social investment for the arts and cultural sector, the Arts and Culture Finance Fair.

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LESSONS SO FAR

Arts and cultural sector

1. Arts and cultural organisations with social impact objectives are incredibly diverse in terms of their activities, business models, social impact (desired and achieved), artistic capabilities and degree of professionalisation. However, entrepreneurialism has been the characteristic common to the leadership of all successful Arts Impact Fund applicants, which we broadly define as the ability to come up with creative ideas about business assets and models, and apply them with drive, tenacity and dynamism. This enables successful applicants to identify opportunities to develop the financial sustainability of their organisations
2. There is a distinct trend towards the development of cross-subsidy models within the sector, in which some commercial activity subsidises organisations' social and artistic impact. Successful examples of this activity have the following features:
   a. Use existing assets - buildings, intellectual property, people and their networks.
   b. Group such commercial activity within a separate legal entity, typically a trading subsidiary.
   c. Alignment of interests and management and trustee level.
3. The primary reason why eligible applications have not progressed has continued to be a lack of clarity over either the specific business plan relating to the loan or the revenue streams generated to cover repayment, or risks around additional funding/partners, as well as in some cases lack of clarity around additional social impact.
4. Boards could be more empowered to seek borrowing from social investors even when they do not own a physical asset which can serve as collateral. We have a related observation that trustees seem to be keener on borrowing when they have an asset in place, irrespective of whether it can or will be used as security. We are concerned that such a mentality may fuel sector inequality by perpetuating a sense that social investment is only available for those with significant assets already, rather than being seen as a tool to help build the balance sheets of innovative organisations.
5. Return on investment is not a particularly common measure in arts and culture organisations: whilst we see evidence of occasional projects in the sector which have had breakeven periods of one to two years (annualised ROI of 50-100 per cent), organisations are more likely than their commercial counterparts to make conservative forecasts and this can affect their appetite for debt funding. Seeking to normalise expected return on investment as a metric for decision-making will help to inform a broader debate on investment in the sector and provide a context for considering cost of capital.
6. The arts and cultural sector on the whole tends to exhibit an excess of conservativism in its business modelling, which may be a factor in precluding investment. Whilst business modelling designed to attract commercial venture investment can occasionally err on the side of exuberance, it would be detrimental for arts and cultural organisations to move too far in the other direction, and underexplore or undersell an idea to their Board and/or funders, thus potentially narrowing their financing horizons.

Funders - grant-makers and social investors

7. Deals have largely arisen through word of mouth recommendations, suggesting a strong degree of peer networking and trust within umbrella bodies and frontline organisations. Indeed, the Arts Impact Fund's experience suggests that in terms of building pipeline, there is little substitute to having as many conversations as possible with sector professionals.
8. Robust theories of change and logic models around specific social outcomes remain unusual in the arts and culture sector compared with other social sector organisations. A generally low standard of evidence for the social impact produced by the sector is a barrier to keeping track of outputs and outcomes, the efficacy of particular interventions and the communication of impact. Arts funders should prioritise building organisations' capacities to develop the evidence for their impact, and this will remain a focus of the Arts Impact Fund going forward.
9. At the same time, some organisations have highly sophisticated approaches to capturing social impact data - typically these are the larger organisations with dedicated programme staff in place. Funders could have a convening role to share examples of best practice with those organisations that have less capacity; alternatively, organisations could consider how to sell their expertise to others through training programmes. There are also exciting developments in this area and we look to programmes such as Project Oracle's Arts Cohort of Impact Pioneers as a guide to how the sector might look to progress.
10. Timescales of repayment can be an issue. Our loans for three to five years mean that repayments are steep, and this can put off potential borrowers; even though we can provide flexibility through interest and capital repayment holidays, the fact that the investment must be fully repaid within five years can put a significant strain on cashflows. Longer-term funding would unlock a greater pool of potential borrowers and expand the likely purposes for borrowing to a greater proportion of non-capital projects where refinancing isn't an obvious option.
11. There is work to be done in capturing the interplay between social and artistic outcomes within organisations, so that synergies and a more complete view of impact are fully recognised. We have found that focusing on the three impact areas in particular has sharpened this debate, forcing our applicants to consider the specific social outcomes of their work as distinct from their artistic aims - a new exercise for many of them.

Policymakers

12. There is a need for more standardised metrics of artistic impacts that can fit into existing frameworks for measuring social and financial returns (thereby attracting social investment into the arts).
13. There are significant holes in the arts funding ecosystem – the decision of our funders was to focus on loans between £150,000-600,000 in order to make the pilot fund economically viable; though this range is clearly advertised, demand for smaller loans is still evident. Our instinct, however, is that these loans would be as costly to originate and manage as larger loans, owing to the generally lower level of investment readiness in smaller-scale organisations.

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14. To enable organisations to explore their opportunities for cross-subsidy, support is required to give leadership teams the breathing space necessary to identify these and test their business feasibility. Driving new business ideas forward can be an area where current employees feel under-equipped in terms of skills. There is a role for public funders to support experimentation with new business models and to incentivise sharing of lessons.
15. Policy and market makers designing mixed-capital funds (such as the Arts Impact Fund, which combines public, private and philanthropic capital), need to be mindful of varying investor risk appetites.

Thematic Fund Managers

Here are some additional observations that we have shared in our discussions with parties looking to replicate our model in other sectors; these concern both the design of the fund in terms of funder relationships and the construction of a portfolio:

16. There are many issues to balance: we want our demonstration portfolio for the pilot fund to be as diverse as possible in terms of region, art and cultural form, and purpose of loan. We are also seeking to prove that the fund can be self-financing: i.e. that the costs of management are such that a sustainable lending practice can be established at scale. Fund managers should recognise the tensions here in advance in order to prioritise, particularly at a smaller scale where the costs are proportionally higher.
17. The specialist vantage point afforded by a thematic fund allows us to better understand that sector's particular challenges. For arts and cultural organisations, we believe that there are many ancillary programmes that could meet their needs: for instance, addressing organisations' investment and impact readiness needs, and training-up individuals to become advocates and advisors in the best use of social investment within particular sectors and/or business models. It is worth allocating some resource to ongoing business development around the funding offer in order to take fullest advantage of this opportunity.
18. In order to consider the viability of a mature lending practice at scale, it is useful to consider the economics of the portfolio independently of how a future fund might be structured – flexibility from funders is paramount in developing the means to achieve systemic change. Once some confidence limits around the likely characteristics of a portfolio have been established by the pilot, the optimal funding mix will be easier to determine.
19. Separating revenue and capital funding in a pilot may also help to attract additional revenue funding (such as our impact grant from the Calouste Gulbenkian Foundation) due to clarity of funding model.

WHERE NEXT?

Investments and enquiries

1. We will continue to take applications to our remaining four investment committees, in September and December 2016 and February and May 2017, with a view to fully committing the Arts Impact Fund's £7 million capital over the period.
2. In order to increase the number of enquiries from organisations outside of London and the South East, the Fund team will continue to prioritise publicity and marketing opportunities outside of these areas. At the time of writing, regional events are being planned for Sheffield, York, Leeds and Hull as well as presentations at conferences around the country.

Impact and capacity development

3. The fund team continues to explore ways in which to look at a dimension of artistic impact that incorporates impact made on the individual through artistic work. Three of the fund's investees have participated in Culture Counts' Quality Metrics pilot, funded by Arts Council England, the findings and evaluation of which will inform our own thinking.
4. We will curate a discussion between stakeholders, such as frontline organisations, funders and umbrella bodies around how we can improve the way evidence of impact is communicated.
5. We will also be exploring opportunities to provide greater skills and capacity to organisations that we come into contact with, in terms of investment readiness, for instance development of impact monitoring systems. This will build on our existing relationship with the Creative Industries Finance scheme that provides business support to organisations looking for investment, and our incipient volunteer partnership with Bank of America Merrill Lynch's Arts Champions and Creative Club groups.

Sharing learning

6. We will publish more case studies of the Fund's investments, as they are announced. In addition to this, we will be sharing examples of what works in the sector in terms of business models, impact measurement and theories of change. Some insights into the business models we have funded so far can be found in Appendix 1.
7. We will continue to share learning and insights from the fund in external publications, reporting to stakeholders, events and social media.

Fundraising

8. Based on the strength of demand for the Arts Impact Fund's investment, and the viability (to date) of the social investment model in the arts and cultural sector, we will be developing the strategy and offer for a successor fund to the pilot that we hope will attract significant and diverse new investors to this area.

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APPENDIX 1: PROFILING APPROVED INVESTMENTS

In this table we have outlined the key features of the approved investment applications taken to the Arts Impact Fund's first three investment committee meetings, in November 2015, April 2016 and June 2016. Narrative and non-anonymised case studies for organisations A, B and C (Titchfield Festival Theatre, South East Dance and Bow Arts Trust respectively) can be found on the Arts Impact Fund website. Please note that approved investments do not always lead to legal completion.

Organisation	Art form and primary impact area	Loan purpose	Business model	Social impact	Artistic impact
A	Theatre, Youth and educational attainment	Theatre refurbishment and introduction of renewable energy heating systems.	Majority of income comes from ticket sales and theatre bar. Charity receives very few grants and no funding from Arts Council England (ACE). Staffed entirely by volunteers, which means that there is a low cost base.	Delivers specific productions aimed at schools and undertakes drama based interventions focused on social issues within schools.	Highly prolific amateur dramatics theatre company with strong development programmes for individuals wanting to a springboard into drama.
B	Dance, Health and wellbeing	Bridging finance for a new venue capital project.	Recipient of substantial grant funding from ACE. Other income comes largely from local authority and trust and foundation grants. Habitually works in partnership to deliver projects.	Significant community outreach focus, particularly around health and wellbeing outcomes. Relatively robust approach to data capture and use of external evaluations.	Strong reputation for developing boundary-pushing dance. Systematic approach to audience engagement. Artist development programmes target all levels of career.
C	Studio space, Citizenship and community	24-month credit facility to be used for property acquisitions.	Lets affordable studio space to artists in London and trains artist educators.	Artists engage schools to deliver bespoke skills focused programmes for young people. Outputs extensively tracked.	Helps build links between artists and their communities through 'open studio' weekends. Works in partnership to create new opportunities for artists.
D	Visual arts, Citizenship and community	Refurbishment of a gallery space as well as updating and repurposing retail and catering spaces to drive revenues.	Largely ACE grant funded with an increasing focus on developing commercial trading activity to subsidise core work. Undergoing extensive operational restructuring at the time of investment.	Extensive 'learning and participation' programme, including workshops for schools and families, youth-focused art installations and events.	Strong audience profiling and data analysis. Well-curated programmes with high profile work.
E	Theatre, Youth and educational attainment	Fit-out costs for a commercial hospitality venture wholly owned by a theatre charity .	Extensive commercial cross-subsidy model arising from the existence of a substantial property asset base, acquired with support from the local authority. Also ACE National Portfolio Organisation (NPO).	Runs a number of different community outreach projects and will shortly be launching a creative writing centre for young people, which will be an opportunity to strengthen its approach to impact evaluation.	Well-regarded centre for new playwriting with a strong focus on artist development. Audiences are engaged with work through Q&A sessions and giving feedback, which is systematically reviewed.

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Organisation	Art form and primary impact area	Loan purpose	Business model	Social impact	Artistic impact
F	Visual arts, Citizenship and community	Start-up working capital for a commercial IP-licensing venture wholly owned by a gallery charity.	Traditionally an ACE NPO funded organisation, the charity is making efforts to diversify its income streams by creating a trading subsidiary that will cross-subsidise the gallery's work.	Gallery has a particular thematic focus and promotes greater thematic awareness and understanding amongst its audiences. Undertakes significant efforts to engage underrepresented communities in the gallery.	Engages audiences with artistic content by providing contextual material on exhibitions, workshops and undertaking surveys.
G	Combined arts, Citizenship and community	Development capital for a multi-purpose arts centre spinning out from the local authority.	The arts centre will continue to run existing contracts for the council. In addition, it will open a cinema that will provide cross-subsidy.	Significant community impact, especially relative to an alternative of ceasing provision. Strong outcomes in education, both music and beyond.	Artistic output in concert schedule in venues throughout the site, as well as providing rehearsal and examination space for practitioners.
H	Visual arts, Citizenship and community	Property refurbishment creating a venue for a new education programme.	Refurbishment of property to host more extensive training courses which will grow reputation and subsidise social impact work.	Small visual arts organisation working with hard to reach individuals and artisans to develop artworks in the public realm.	Concentrating opportunities to develop skills in a highly-demanded artistic area with no current higher education provision.
I	Theatre, Youth and educational attainment	Start-up working capital for a digital content production venture wholly owned by a theatre charity.	ACE NPO with significant revenues from box office receipts. Developing a cross-subsidy model relying on more commercial performances.	Theatre runs a number of community programmes that aim to get more young people into theatre production.	Extensive commitment to developing new writing and nurturing talent, from discovery to production.

APPENDIX 2: ARTS IMPACT FUND THEORY OF CHANGE

The Arts Impact Fund is part of an innovation journey that seeks to achieve systemic change in the way arts and cultural organisations are funded. The programme hopes to establish social investment as a standard funding option for the sector that complements all other forms of capital and revenue funding - grants, trading income, philanthropy, sponsorship and commissioning.

We have developed a theory of change for the Arts Impact Fund detailing what we hope to achieve, how we hope we will achieve it, and what we will look for as evidence.

INPUTS

- Investors:
- £ Amount; terms; type (public/private/ philanthropic)
- Expertise – arts, financial, social, policy, networks, legal
- Set-up costs
- Evaluation and Measurement framework
- Human resources:
  - Investment Committee and Advisors
  - Fund Manager
  - Investment Analyst
  - Nesta support

ACTIVITIES

- Designing investment process
- Distribution:
  - raising awareness
  - generating pipeline
- Executing investment process
- Approving investments
- Completing investments
- Monitoring of investments:
  - financial
  - social
  - artistic
- Developing insights and track record
- Aggregating and collating learning

OUTPUTS

- Number of applicants to fund
- Number of applicants to receive investment
- Types of project funded
- Reach:
  - website/blog stats
  - survey output
  - followers
  - conference presentations
  - network
  - newsletter subscribers
  - press
- Distribution of funding to regions
- Distribution of funding to art form
- Distribution of funding to legal structures
- Number of impact reports

OUTCOMES

Arts Organisations are more resilient

- Increased and/or diversified revenue streams amongst AIF investees
- Percentage of trading revenue increased and sustained
- AIF investment terms are met
- Development of more self-sustaining business models

Wider arts sector sees social investment as another funding option

- Growth in the number of enquiries to and deals made by AIF
- Emergence of greater number of enquiries for social investment from arts organisations as a whole

Arts organisations have access to appropriate and affordable sources of funding

- Supply of social investment becomes more diversified (wider product offer) for arts sector, at close of fund (possibility of AIF II included)
- Investors see loans as additional to grants/donations
- Equivalent funding still available in market at close of AIF investment period

New private capital is invested in the sector

- Fund attracts new social investors to arts in general
- Investees leverage further external funding as a result of AIF finance
- A wider range of investors are willing to fund AIF II

Investing in artistic organisations encourages and accelerates artistic excellence and delivery of greater social impact (additionality)

- Arts organisations understand, create and deliver on social impact development plans
- Achievement of key social and artistic output and outcome metrics amongst AIF investees (at an individual investee level)

A clearer understanding of what we mean by social and artistic impact in the arts

- Increased evidence base and improved standard of evidence amongst AIF investees
- A more standardised approach to looking at artistic impact is developed
- Fund is able to clearly communicate the social and artistic impact of its investees at an individual level and explores the possibility of aggregation of outcome data at fund level

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The Arts Impact Fund is hosted by Nesta

1 Plough Place
London EC4A 1DE

@nesta_uk
www.facebook.com/nesta.uk

www.nesta.org.uk

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