THE BOND BUYER

Why social bonds are key to driving more investment in education

By

Mark Medema

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Investing in social causes is on the rise. Investors are increasingly wondering how to use their capital to improve society in the wake of the COVID-19 pandemic and ongoing social unrest.

The trend of investing for both financial gains and social or environmental impacts has been growing in popularity, with the latest estimate from the Global Impact Investing Network (GIIN) putting the size of the market at $715 billion.

However, just $1.26 billion of this total was focused on the education sector, which ranked 12th out of the 14 investment categories tracked by the GIIN. While most impact investors said they planned to either increase (48%) or maintain (41%) their allocations to education over the next five years, some structural or market barriers certainly stand in the way of getting more impact investors interested in education.

The education sector has always been financed in part by outside investors, although these investors may not have thought of themselves as impact investors. General obligation bonds issued by governments are a common way to fund public education. These bonds are typically secured by raising taxes on the residents of a community.

In 2020, the concept of a social bond issued by nonprofits (like a green bond but focused on social benefits rather than environmental benefits) has emerged and taken root in the education sector. Social bonds represent a new milestone in the education space and a key to unlocking the door to impact investments.

There were three social bonds issued in 2020 that focused on education. The first two, by a school district in Massachusetts and a charter school in Los Angeles, were self-designated as social bonds by the issuers.

The third came in August 2020, when the Equitable Facilities Fund (EFF) announced the closing of $204 million in verified social bonds, with the proceeds helping to finance public charter schools that are providing transformative educational opportunities for students, especially in low-income and under-resourced communities. The ‘A’ rated Social Bonds, which were 8x oversubscribed, offered investors a 2.18% return on a 30-year maturity, a similar risk-return profile to muni bonds but with the added impact component.

Impact investors have generally shied away from the education sector, in part because of a lack of investable products that meet their risk-return objectives while also offering the potential to generate positive social outcomes.

Several investment products help meet this double-bottom-line goal for investors in the social sector. Local Initiative Support Corp (LISC) issued a $100 million tax-exempt bond in 2017 with the proceeds used to support a variety of social benefits, including education. Other nonprofit Community Development Finance Institutions (CDFIs) have also issued investment notes for similar purposes, including Capital Impact Partners, Reinvestment Fund and Low Income Investment Fund.

A social bond may represent the next big tool in the impact investor playbook, with a record $154 billion in Social Bonds issued in 2020, easily dwarfing the $17.9 billion issued in all of 2019. But what may differentiate the social bond, making it especially attractive to impact investors, is the fact that it is a marketable security easily traded through traditional investment channels.

The advent of qualified external reviews should also help. Kestrel Verifiers, which verifies bonds for conformance with the Green Bond Principles, the Social Bond Principles, Sustainability Bond Guidelines and the Climate Bonds Standard, provided a detailed Second Party Opinion to certify that the Social Bonds, issued by the Equitable School Revolving Fund (ESRF), were aligned with the Social Bond Principles developed by the International Capital Markets Association (ICMA).

In the official bond offering, the proceeds of the ESRF social bond are defined as “social projects” designed to produce social benefits that “address socioeconomic advancement and empowerment of students from underserved communities,” including families with students living below the poverty line, students with parents that are undereducated, and homeless students.

This independent verification of the bona fide social benefits derived from the bond-financed activities should alleviate concerns about impact-washing and assure impact investors that their capital is generating a positive social impact.

Impact investors should be cheering at the opportunity to earn a financial return while also providing much-needed financing to help reform and improve our education system. Social bonds can play an important role in that transformation.

Ultimately, impact investors will need a range of products to choose from with different risk-return profiles and a variety of potential social impacts. Some impact investors may prefer to focus on a particular community or region (i.e., place-based investing), while other impact investors may want to invest in the education sector more broadly. Some may want to invest in real estate, which tends to be the biggest line item for schools, while others may want to invest in schools directly.

This kind of robust investment marketplace is likely still a few years away. It will take time and energy to standardize products and create efficient investment platforms for all the impact investment products that support schools and education.

But for those who care about education, social bonds represent an innovative investment opportunity that will help catalyze the flow of impact capital into the education sector for the foreseeable future.

Mark Medema is managing director at the National Alliance for Public Charter Schools.

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