Report on the

NSW GOVERNMENT

Social Impact Bond Pilot

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the Centre for Social Impact

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List of abbreviations

ARACY	Australian Research Alliance for Children and Youth
ASIC	Australian Securities and Investment Commission
ATO	Australian Tax Office
BOCSAR	Bureau of Crime Statistics and Research
CLG	company limited by guarantee
CSI	Centre for Social Impact
DGR	deductible gift recipient
GRAM	Group Risk Assessment Model
HNWI	high net worth individual
LLP	limited liability partnership
NPO	not-for-profit organisation
NSW	New South Wales
PAF	private ancillary fund
PPF	prescribed private fund
PPP	public-private partnership
RCT	Randomised Control Trial
ROD	Reoffending Database
SEDIF	Social Enterprise Development and Investment Fund
SIB	social impact bond
SMSF	self-managed super fund
SPRC	Social Policy Research Centre
SPV	special purpose vehicle
SROI	social return on investment
YLSI	Youth Level of Service Inventory

Executive Summary

Traditional ways of funding not-for-profit organisations (NPOs) to deliver programs that address complex social problems are struggling to keep up with demand. Despite record high levels of government funding for NPOs, there is still a significant level of unmet need and new approaches to funding NPOs are being explored.

There is increasing international interest in the potential of one particular type of social finance – social impact bonds (SIBs). SIBs, it should be emphasised, are not a panacea. Their use should complement existing modes used to fund community benefit goals.

In this report, the Centre for Social Impact (CSI) has addressed two key questions:

1. Whether the SIB concept is feasible in a New South Wales (NSW) context; and
2. Whether NSW has the necessary ingredients: market conditions, NGO capacity, social investment interest and government preparedness, for this new approach to funding.

To answer these questions CSI has held detailed discussions with and considered the perspectives of NPOs, social investors/philanthropists and government agencies. The overarching conclusions are that CSI believes that the SIB concept is feasible and NSW does have the necessary ingredients, although there is much work to be done to deliver a SIB pilot.

What are social impact bonds?

A SIB restructures the relationships between government agencies, not-for-profit service delivery organisations and social investors such as charitable foundations and high net worth individuals. Under a SIB, a bond-issuing organisation raises capital from investors based on a contract with government to deliver improved social outcomes that generate future government costs savings. These savings are used to pay investors a reward in addition to the repayment of the principal, if the agreed outcomes are achieved.

SIBs support social innovation by providing a mechanism for investors to fund programs based on early intervention, prevention or breaking the cycle of dependence. They offer the potential to achieve significantly better social outcomes and deliver future costs savings for government. SIBs provide a new model for the sharing of risk between government, NPOs and social investors. They utilise commercial investment expertise and market discipline for the delivery of public services by NPOs.

The groundbreaking UK SIB, launched in 2010 by social finance intermediary Social Finance UK, was aimed at significantly reducing the rate of reoffending by short-sentence prisoners through services delivered by subcontracted NPOs. The UK SIB has identified and addressed a number of challenges and in doing so provided valuable learning, including the recognition that it constitutes only one model and is operating in the cultural context of one jurisdiction and one policy area. A number of initiatives around the world are now considering the wider applicability of SIBs including this study by CSI commissioned by the NSW Government and further pioneering work in the UK by the Young Foundation. These initiatives are exploring the suitability of other policy areas, the feasibility of an NPO issuing the bond as an alternative to using a social finance intermediary, the merits of different levels of risk sharing, and use of a standing payment to cover part of the program delivery costs instead of an entirely performance based payment.

NSW Government SIB pilot

In consultation with a range of NSW Government public servants, CSI has identified a range of policy areas and program interventions that address complex problems and are perceived to deliver significantly better outcomes with the potential for future government costs savings. The policy areas included juvenile justice, parenting support for vulnerable families, disability, homelessness and mental health. CSI investigated the potential programs to assess the evidence of their efficacy and the scale of potential government costs savings. A small number of programs was investigated further to define and measure the desired outcome, target cohort and referral mechanisms, and the effectiveness of the program to achieve the desired outcome(s). These findings were combined with data on program costs and estimated government costs savings to formulate an economic model that could inform the key parameters of a SIB.

CSI has identified a range of NPOs that have the capacity and necessary competencies to host a SIB program and also have the legal powers to issue a bond. The use of a SIB is attractive to an NPO as it provides upfront capital to develop and deliver a program to achieve the agreed outcome over the medium to long term. The use of a SIB frees the NPO from the constraints of traditional government contracts and it distances government from service delivery management and operations. Use of a SIB also provides the basis for the NPO to develop a stronger relationship with social investors which may have long term benefits for the NPO in terms of expanding existing and developing new programs.

CSI consulted with a range of potential social investors and their advisors, who confirmed that there is an appetite amongst investors for the use of SIBs. SIBs offer social investors a method of achieving blended value with both commercial and measurable social return on their investment. A SIB provides social investors with a more effective method of holding an NPO to account in terms of setting targets and monitoring performance akin to that used in commercial investment decisions. Some social investors interviewed expressed a willingness to invest directly with an NPO as an alternative to investing through an intermediary.

Social investors and their advisors noted that the type and number of investors and the investment decision would be different for a pilot than in an emerging or mature market for SIBs. Social investors with a philanthropic mindset may consider a SIB to be a way of recycling their philanthropic resources, and may therefore be willing to risk their capital, whilst other social investors expressed a preference to protect their capital either in part or full. Some social investors interviewed stated that they could utilise philanthropic resources, private ancillary funds (PAFs) or self-managed superannuation funds (SMSFs) – for the latter there was a strong preference to protect their capital.

Options for the structure of the NSW Government SIB pilot

The consultations with government, NPOs, law firms, financial institutions and social investors have led CSI to believe that:

- a social finance intermediary is not necessary for the NSW Government SIB pilot although this remains an option for future SIBs; and
- NPOs that are incorporated have the powers to issue bonds and may be able to utilise Australian Securities and Investment Commission (ASIC) exemptions to simplify the process. Alternatively NPOs may wish to ring-fence risk by establishing wholly-owned vehicles to issue the bond, such as a special purpose vehicle (SPV).

CSI has developed a range of options for the terms of the bond that illustrates different levels of risk sharing across government, the NPO and the social investors. Where there is a higher risk to the invested capital, the reward will need to be greater, while decreasing this risk will lower the rate of return. The possible rate of return will depend, in part, on the chosen policy area and program intervention, and the extent of the potential savings to government.

At one end of the risk spectrum, CSI proposes a structure which is comparable to the UK SIB where the principal and reward payment (return on investment) to investors is fully dependent on the achievement of a successful outcome and where failure means that government pays nothing. This option is attractive to government as there is a full transfer of risk to the social investor, which is reflected in a higher indicative reward payment.

CSI believes that this option would be attractive to philanthropically-minded investors who are supportive of the development of SIBs. However, the number of investors and scale of investment of this type is limited, but may be sufficient for a NSW pilot.

At the other end of the risk transfer spectrum CSI has developed an option which reflects the preference of some social investors to protect their capital and where only the reward payment is at risk. This option would be attractive to social investors who wish to use self managed super funds but it offers little incentive to government as there is only minimal risk transfer to social investors and the NPO.

CSI has therefore formulated **an option where there is a balance of risk sharing between government, NPO and social investors**. Under this option part of the costs the NPO incurs delivering the program will be paid by government through a standing charge, and the remaining costs and reward payment will be dependent on the achievement of a successful outcome. The exact level of the standing charge will be the subject of negotiation between the NPO and government, where the NPO is not only assessing its confidence in delivering the agreed outcome but is also sensitive to the preferences of potential social investors. Government may wish to minimise the level of the standing charge but will also be aware that the NPO and social investors will have limits. Indeed, government may offer a higher level in order to incentivise NPOs and investors. Such a risk sharing arrangement will lead to a moderate level of reward payments. Social investors interviewed responded positively to this shared risk option and the standing charge. CSI considers that this option will be attractive to not only philanthropically-minded investors but also to a wider group of social investors who are prepared to accept non-traditional terms and new and innovative investment models.

CSI recommends that this shared risk option is considered for the NSW Government SIB pilot. The final structure will depend on the program and host NPO selected and the detailed negotiations between government and the host NPO, and the perceived appetite of potential investors.

Challenges

1. **Robustness of evidence and measurement.**
   The construction, issuing and operation of a SIB are heavily dependent on the robustness of evidence and measurement of the efficacy of program interventions. Evidence and measurement give confidence to government, NPOs and investors that the agreed outcomes can be achieved. There has been increasing emphasis in social programs and social interventions in NSW on gathering evidence on client outcomes, but there remains room for improvement in this area, particularly in terms of accepted robust evidence on intervention effectiveness. The emergence of tools such as Social Return on Investment will assist NPOs,

government and investors to assess risk. However, the discussions with government, NPOs and evaluation experts suggest that many NPOs need to invest in developing more robust and continuous performance measurement systems and evaluation methodologies. Government and NPOs also need to consider how they can integrate administrative and program data.

2. **Specific capacity building initiatives will be needed to widen access to SIBs beyond the large NPOs that have already invested in research and evaluation capabilities.**

Next steps

CSI has concluded that the SIB concept is feasible in the NSW context, and that NSW has the necessary market conditions for this new approach to funding to be trialled. **CSI therefore recommends that the NSW Government proceeds to the next stage and invites expressions of interest from NPOs that satisfy the key criteria for the development of a SIB.**

The NSW Government should also signal that they wish to encourage the development of a pipeline of NPOs and programs that are suitable for a SIB by raising awareness and developing NPO capacity and capability to use this new method of funding. This will require a special emphasis on development and use of robust evidence in the effectiveness of social programs and interventions, the development of performance measurement systems, and collaborative relationships with government agencies. The raising of awareness among NPOs and capacity building initiatives should be aimed at all sizes of NPO and also social enterprises.

The NSW Government should undertake initiatives to raise awareness across all NSW Government agencies and develop guidelines on how to assess the suitability of policy areas, program interventions and host NPOs.

The NSW Government could also explore the potential for the application of SIBs in policy areas where there is a shared responsibility and shared funding arrangements with the Australian Government. Engagement with the Australian Government also provides an opportunity to consider incentives and barriers in relation to tax issues and the use of capital held in PAFs and SMSFs.

Finally, efforts need to continue to capture knowledge and share learning across jurisdictions.

Introduction

Traditional ways of funding not-for-profit organisations[1] (NPOs) to deliver programs that address complex social problems are struggling to keep up with demand[2]. Despite record levels of government funding for NPOs[3], there is still a significant level of unmet need and new approaches to funding NPOs are being explored.

There is increasing international interest in the potential of one particular type of social finance – social impact bonds (SIBs). SIBs, it should be emphasised, are not a panacea. Their use should complement existing modes used to fund community benefit goals.

A SIB restructures the relationships between government agencies, not-for-profit service delivery organisations and social investors such as charitable foundations and high net worth individuals (HNWIs). Under a SIB, a bond-issuing organisation raises capital from investors based on a contract with government to deliver improved social outcomes that generate future government costs savings. These savings are used to pay investors a reward in addition to the repayment of the principal, if the improved outcomes are achieved.

In this report, the Centre for Social Impact (CSI) has addressed two key questions. Firstly, whether the SIB concept is feasible in a New South Wales (NSW) context; and secondly, whether NSW has the necessary ingredients for this new approach to funding. The first SIB was launched in the United Kingdom in March 2010. Social Finance UK contracted with the Ministry of Justice to significantly reduce the rate of reoffending by short sentence offenders from Peterborough Prison through a range of resettlement services delivered through NPOs. Social Finance UK has funded the delivery of these services by raising money from investors through a SIB. The principal and a reward payment (return on investment) will be paid to investors if the agreed outcomes are achieved.

The SIB concept is now being actively explored not only by the NSW Government but also by other jurisdictions including those in the UK, USA and Canada. Substantive reports on the potential for implementing SIBs have been published by the Young Foundation (Mulgan et al, 2010) and Social

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[1] Not-for-profit organisations include social and community service organisations, charities, associations

[2] The pressure on funding may increase further if wages rates for social and community service organisation achieve equity under the equal remuneration provisions of the *Fair Work Act 2009.*

[3] The NSW Government currently spends $2.3 billion per annum on social service delivery through NGOs.

Finance UK (Bolton et al, 2010). The potential market for social impact investing and the emergence of a new social impact investing asset class has also been explored by the Monitor Institute (Freireich et al, 2009) and J.P. Morgan (2010).

The context for social impact bonds

NPOs face a range of challenges in resourcing their activities, especially in relation to addressing 'wicked' problems and delivering much-needed services to Australian communities. Over the last decade, government agencies have increasingly used contracts to fund NPOs to deliver public services. These contracts are often perceived as being restrictive, focusing on inputs, process milestones and rigidly defined outputs, rather than achieving measurable outcomes and social impact.

In addition, contract funding may not cover the full cost of delivering the prescribed service and typically provides little opportunity to generate a surplus to reinvest in research and development and social innovation. NPOs are typically dependent on revenue funding and do not have access to capital to invest in innovative solutions or to scale up proven pilot programs.

Charitable trusts and foundations and HNWIs have traditionally provided grants to NPOs to deliver services or test alternative approaches to societal problems. Grants are provided on the basis of trust – trust that the NPO will deliver on their promises and where there is no recourse if failure occurs.

Over the last two decades social enterprises and social businesses have emerged as an alternative approach to creating beneficial social impact. Social enterprises have a social mission but utilise business structures and operate in markets, they seek to achieve a blend between commercial value and social impact. Social enterprises have found it hard to raise sufficient capital to allow them to expand and become financially sustainable. Social enterprises with the support of government and social finance intermediaries are therefore looking for new ways to harness capital for beneficial social impact. In the UK the Social Enterprise Investment Fund was established to provide grant and loan funding for social enterprises working in health and social care. The impending establishment of the Social Enterprise Development and Investment Fund (SEDIF) will fulfil a similar role in Australia and is seeking to "increase capital for social enterprises in Australia".

Social impact bonds: A 21st century solution

Social impact bonds (SIBs) have the potential to re-engineer the relationships between government, not-for-profit organisations and social investors – comprising charitable trusts and foundations and HNWIs.

> *"Under a SIB, a payer (usually Government, at a national, regional or local level) agrees to pay for measurable improved outcomes of social projects, and this prospective income is used to attract the necessary funds from commercial, public or social investors to offset the costs of the activity that will achieve those better results. This approach is possible where better outcomes lead to tangible public financial savings."* (Mulgan et al, 2010).

SIBs are considered to be particularly relevant for programs that address complex problems through early intervention or prevention programs. These programs can break the cycle of behaviour which otherwise would lead to significant future costs for government and poor life outcomes for the individual. There is increasing evidence of the link between investment in prevention and early intervention programs and future costs savings for government and society[4].

The SIB concept requires the measurement of the efficacy of programs and the link between efficacy and savings to government. In other words, the program in question should produce positive impacts for clients over and above those that would otherwise occur, and these outcomes should reduce government expenditure, both in the policy area of interest as well as other related functional areas. The potential to measure the wider social return on investment (SROI) in programs is now being realised in the formulation and increasing use of social impact measurement frameworks e.g. http://www.thesroinetwork.org/.

SIBs provide an opportunity for government agencies, NPOs, and social investors to share risk. SIBs encourage social innovation where traditional funding mechanisms lead to government agencies being risk averse. SIBs also introduce commercial investment expertise and market discipline to the delivery of public services by NPOs. The SIB concept is broadly analogous to public private partnerships (PPPs), which have been increasingly utilised over recent years to attract private investment in to public sector infrastructure projects such as the building of toll roads and hospitals. Although PPPs have a chequered history, they offer important lessons as to when such funding mechanisms are appropriate (Mulgan et al, 2010; Hardcastle et al, 2005).

The emergence of microfinance as a new investment asset class demonstrates that it is possible to construct and implement alternative innovative responses to society's problems.

[4] http://www.preventionaction.org/prevention-news/launch-allen-review-early-intervention-children/5475

Challenges facing the development of social impact bonds

SIBs are fundamentally financial instruments that are dependent on the existence of sufficient evidence to incentivise government agencies, NPOs and social investors to enter into binding outcome-based contracts. The reality is that few NPOs construct pilots or small scale programs in such a way that delivers robust evidence on the effectiveness of the pilot or program. This can only be properly assessed if evidence is available on outcomes achieved by those who received assistance against those who did not. Similarly, few government agencies are expert in commissioning agencies on the basis of outcomes and few social investors are able to assess which programs and host NPOs are competent in delivering the desired outcomes.

Early intervention and prevention programs are typically multi-dimensional and require NPOs to utilise sophisticated case management systems to provide the wraparound services that individuals need. Often these wraparound services involve engagement with a range of government agencies. The complexity of negotiating an agreed outcome, assessing future costs savings and formulating performance measures increases significantly where more than one government agency is involved (Mulgan et al, 2010).

NSW Government social impact bond pilot

As noted in the introduction, CSI has addressed two key questions. Firstly, whether the SIB concept is feasible in a NSW context, and secondly, whether NSW has the necessary ingredients for this new approach to funding. To answer these questions CSI has held detailed discussions with and considered the perspectives of NPOs, social investors/philanthropists and government agencies. This report considers the following issues:

- policy areas, programs and host NPOs that are suitable for a SIB;
- the appetite of social investors for a SIB;
- alternative structures for the SIB;
- the measurement challenges;
- the attributes of a SIB investment term sheet; and
- legal issues.

CSI has benefitted greatly from the expert advice provided by JBWere, Corrs Chambers Westgarth, Macquarie Group and the Young Foundation. Social Finance UK has also shared invaluable learning from their journey in developing and implementing the UK SIB. CSI has also benefitted greatly from engaging with public servants from the NSW Government and representatives from NSW NPOs.

1. Review of potential policy areas, programs and host NPOs

1.1 Introduction

CSI has identified and assessed a range of policy areas, programs and host NPOs which were considered potentially feasible for a SIB, and is recommending two program areas be considered for the NSW Government SIB pilot.

This process has raised awareness of SIBs and generated considerable interest among NSW Government agencies, NPOs and social investors. Although only two program areas have been recommended, the process has created a pipeline of program areas and NPOs that have potential in the medium to long term.

1.1.1 Identifying potential policy areas, programs and host NPOs for a SIB pilot

Over the last two years CSI has promoted social impact investing and monitored closely the development of social impact investment initiatives in Australia and other countries including the United Kingdom, the United States of America and Canada. CSI has held a number of social impact investing events and has a well-developed network of individuals and agencies interested in social impact investment. CSI's first step in identifying potential policy areas, programs and host NPOs was to use this network. This was complemented by systematic engagement with NSW Government human service and justice agencies i.e. the Department of Justice and Attorney General (including Corrective Services), NSW Health, the Department of Education and Training, and the Department of Human Services (including Ageing, Disability and Home Care; Community Services; Housing and Juvenile Justice). A meeting was also held with the NSW Bureau of Crime Statistics and Research (BOCSAR). CSI, in collaboration with Industry and Investment NSW, also organised a workshop for representatives from NSW Government agencies, NPOs, social investors, wealth managers and intermediaries to introduce the concept of SIBs.

1.2 Criteria to assess potential policy areas, programs and host NPOs

1.2.1 Criteria identified in the literature from the United Kingdom

A considerable amount of developmental work on SIBs has been carried out in the UK by Social Finance UK (Bolton et al, 2010) and the Young Foundation (Loder et al, 2010). This development work has identified criteria and critical success factors for formulating a SIB. Social Finance UK considered SIBs to be "feasible" if (Bolton & et al, 2010):

- they address a social problem that has high costs for the public sector and can be measured;
- the costs are such that, if avoided, they will reduce the public sector's expenditure;
- it is possible to identify the individuals that could benefit from the services funded by SIB investment;
- interventions that would deliver improved social outcomes are known; and
- the interventions cost substantially less than the public sector savings that would result from improved social outcomes.

The Young Foundation (Loder et al, 2010) has identified the following "critical success factors" for new models of social investment including SIBs:

Table 1: Critical success factors

Preventative intervention	The intervention is preventive in nature and sufficient funding for the intervention is currently unavailable.
Improves wellbeing in an area of high social need	The intervention improves social wellbeing and prevents or ameliorates a poor outcome.
Evidence of efficacy	The intervention is supported by evidence of its efficacy and impact, giving funders confidence in the scheme's likely success.
Measureable impact	Whether it is possible to measure the impact of the intervention accurately enough to give all parties confidence of the intervention's effect, including a sufficiently large sample size, appropriate timescales and impacts that closely relate to the savings and are relatively easy to measure.
Aligns incentives	A specific government stakeholder achieves savings or lower costs as a result of actions *undertaken by others*. These savings need to be cash releasing and provide an actual saving to government stakeholders.
Savings greater than costs	The savings for the specific government stakeholder are relatively immediate and much greater than the cost of the intervention and transaction costs. This provides investors with enough return to absorb the risks inherent in the scheme, and can provide significant funds for social investment.
Government preference for a SIB	Government policy for the specific agenda is keen on or at least open to the use of a SIB.

These criteria also serve to identify policy areas and programs which are unsuitable for a SIB. The biggest barrier is likely to be the lack of robust evidence of the efficacy and cost saving potential of programs and policy interventions, especially for Australian programs and policy interventions. CSI therefore also looked at the international evidence for programs and policy interventions e.g. the Green Paper Evidence Report *Breaking the cycle: effective punishment, rehabilitation and sentencing of offenders* (Ministry of Justice, 2010).

Using this material and in consultation with the NSW Government and project partners, CSI developed a set of criteria to assess the suitability of potential programs and host NPOs:

Table 2: Selection criteria for program and host NPO

Criteria for selection of program
A "wicked problem" that is of priority for both government and social investors.
Suitable program and length of assessment – where there is an agreed outcome and a simple indicator. A program where the risks of volatility caused by policy change or "externalities" are known and minimised.
Sufficient measurable savings expected to be generated – specifically to NSW Government.
Program evaluation and evidence base on the effectiveness of the program, and existing and ongoing data for measurement: ▪ Service delivery system (Government data and research) ▪ Specific program (NPO) NB. Evidence can be utilised from international sources.
Cost of the program suitable for pilot investment.
Priority area for government.
Criteria for selection of host not-for-profit organisation
Capacity to scale up operations and monitor cohort.
Relationship with government agency.
High profile and strong reputation including: ▪ governance, ▪ financial control, ▪ high quality service delivery, and ▪ monitoring and evaluation systems, including a well-developed client assessment system and outcomes data collection systems.
Existing involvement with social investors.
Track record of social innovation.

1.3 Targeting potential policy areas, programs and NPOs

Although CSI's existing network provided a useful insight into potential policy areas, programs and host NPOs, the key task was to systematically engage with NSW Government human service agencies to raise awareness of SIBs and identify interest in terms of policy areas, programs and host NPOs.

1.3.1 Target policy areas identified

The UK SIB literature focused on criminal justice interventions and specifically the Peterborough precedent SIB that addresses reoffending among short-sentence offenders (Bolton et al, 2010; Loder et al, 2010). Interest in the UK has now widened, with feasibility studies being undertaken in the areas of health, out-of-home care and child restoration, youth unemployment and affordable housing.

The intelligence gathered from CSI's network, meetings with NSW Government human service agencies and learning from the UK identified a range of policy areas suitable for a SIB. CSI assessed the potential of each of these policy areas and consider the following as having the greatest potential for the SIB pilot:

- juvenile reoffending
- parenting skills for at-risk families
- disability
- homelessness
- early intervention
- mental health

1.3.2 Target programs and potential host NPOs

A number of potential program areas were identified by the NSW Government human service and justice agencies across a range of policy areas (Table 3, below). CSI has considered each of these areas. Detailed discussions were held with a broad range of NPOs in these program areas. It is important to note that while some program areas may be unsuitable for the pilot, they may be suitable in the medium to long term. Using the agreed criteria, CSI was also able to identify a number of NPOs which could potentially host a SIB.

Table 3: Summary of meetings

Policy areas
▪ Adult reoffending ▪ Affordable housing ▪ Alcohol and drug rehabilitation ▪ Community regeneration ▪ Disability housing ▪ Disability transition to work ▪ Homelessness ▪ Juvenile justice ▪ Mental health housing ▪ Out-of-home care for students ▪ Student mentoring and literacy

1.4 Potential policy areas, programs and host NPOs identified

CSI has raised awareness of SIBs amongst key stakeholders and identified a range of policy areas, programs and host NPOs which have the potential to utilise a SIB. **The NSW Government should undertake initiatives to raise awareness across all NSW Government agencies and develop guidelines on how to assess the suitability of policy areas, program interventions and host NPOs.**

CSI has assessed these programs and host NPOs using the agreed criteria and identified those which are considered feasible for the NSW Government SIB pilot. **The two policy areas identified as having potential for the pilot are juvenile justice, and parenting skills for at-risk families.**

In addition, CSI believes that there is a strong pipeline of NSW-based programs and host NPOs which, with further work, may be feasible for SIBs in the medium to long term. The further work will require a special emphasis on development and use of robust evidence in the effectiveness of social programs and interventions, the development of performance measurement systems and collaborative relationships with government agencies. **The NSW Government should signal that they wish to encourage the development of a pipeline of NPOs and programs that are suitable for a SIB by raising awareness and developing NPO capacity and capability to use this new method of funding.**

The raising of awareness among NPOs and capacity building initiatives should be aimed at all sizes of NPO and also social enterprises.

A number of potential programs will also be of interest to the Australian Government, where the costs savings will be shared between the Australian and State Governments. Therefore, **the NSW Government could also explore the potential for the application of SIBs in policy areas where there is a shared responsibility and shared funding arrangements with the Australian Government.** Engagement with the Australian Government also provides an opportunity to consider incentives and barriers in relation to tax issues and the use of capital held in PAFs and SMSFs.

2. Investor appetite for a NSW Government SIB pilot

2.1 Introduction

To assess investors' appetite for SIBs, CSI has received advice from JBWere Philanthropic Services (one of Australia's leading advisers to HNWIs) engaged directly with a number of potential individual social investors, participated in a workshop involving potential social investors, and explored international experience including in depth discussions with Social Finance UK and the Young Foundation.

2.1.1 Emergence of social impact investing

The emergence of ethical, socially responsible, sustainable and green investment opportunities confirms that many investors are now thinking in a more sophisticated way than maximising financial return (J.P. Morgan, 2010). The place of social impact investing within a broader investment strategy framework has been articulated by the Monitor Institute who define social impact investing as '*actively placing capital in businesses and funds that generate social and/or environmental good and at least return nominal principal to the investor*' (Freireich et al, 2009). This definition has been broadly adopted, as have the terms *financial first investors* and *impact first investors* which categorise impact investors according to their primary intent. Figure 1 illustrates this blended value where impact investing (top right quadrant) is differentiated from commercial profit-maximising investors (top left quadrant) and philanthropists seeking social and environmental impact (bottom right quadrant). Within the impact investing quadrant different strategies are identified:

- *Financial first investors* (blue box) seek to optimise financial returns with a floor for social or environmental impact.
- *Impact first investors* (orange box) seek to optimise social or environmental impact with a floor for financial returns.

The Monitor Institute (2009) acknowledges that there is potential for philanthropists to move to become impact first investors.

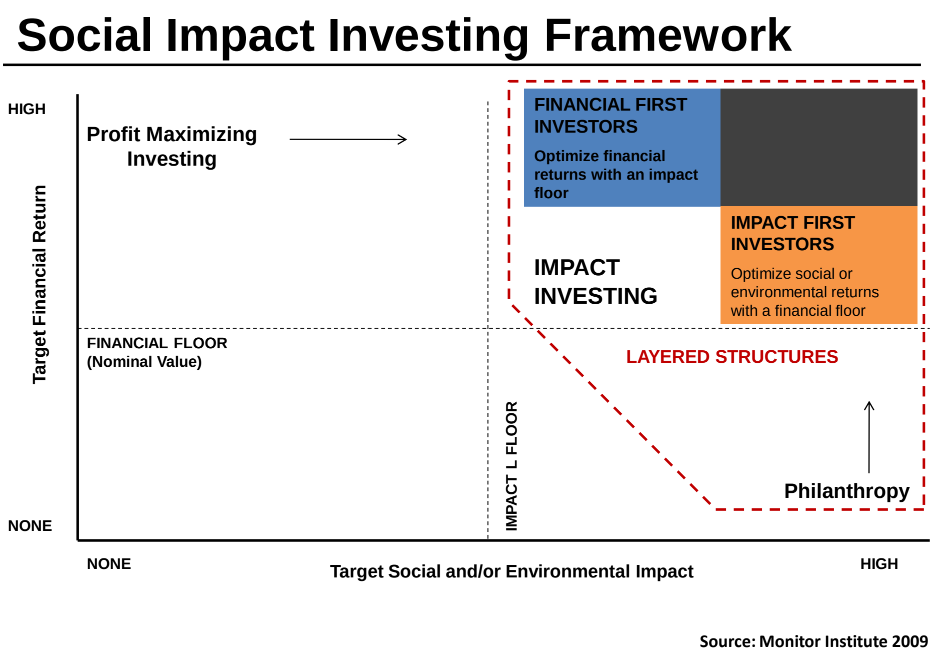

Figure 1: Social Impact Investing Framework

2.2 The landscape of social investors

The landscape of social investors is diverse, comprising (J.P. Morgan, 2010):

- philanthropic foundations including family and corporate foundations;
- private ancillary funds (PAFs – formerly known as prescribed private funds, or PPFs);
- self-managed superannuation funds (SMSFs);
- larger superannuation funds;
- HNWIs and their advisors; and
- commercial financial institutions.

In the UK, the Peterborough precedent social impact bond of GBP5 million was primarily subscribed by UK philanthropic foundations with a track record of engagement with programs in the justice and reoffending policy area (including the Barrow Cadbury Charitable Trust, Friends Provident Foundation, The Henry Smith Charity, Johansson Family Foundation, Lankelly Chase Foundation, The Monument Trust, Panahpur Charitable Trust, Paul Hamlyn Foundation and the Tudor Trust), whilst in Australia the $165 million acquisition of the ABC Learning Centres by GoodStart was partly funded by investments provided by a consortium of HNWIs.

Both the UK Peterborough precedent and GoodStart social impact investments benefitted from contributions from other agencies. In the UK, the Big Lottery (a distributor of funds from the

National Lottery) has allocated GBP6.25 million to not only cover some of the costs of the SIB but also provide substantial funds to cover the reward payments. The Big Lottery involvement is part of their GBP11.5 million program to support the development of social impact investment in the UK[5].

The GoodStart initiative brings together a syndicate of investors comprising three major NPOs ($7.5 million), the National Australia Bank (NAB) ($120 million of secured debt), government ($15 million loan), and social capital investors ($22.5 million). The support of NAB was based on a blended value proposition – commercial and social – with GoodStart constituting a 'once-in-a-generation opportunity to do the right thing in a commercially sensitive manner' (Mathew Turner, NAB, CSI Investing for Impact Conference, 2010). The social capital investors were firstly motivated by a commitment to early childhood learning and, in turn, attracted to the yield of 12.0% p.a., considering it a reasonable return for the assessed risk of GoodStart.

The predominance of philanthropic foundations and HNWIs, as seen in the UK Peterborough precedent and GoodStart, closely reflects the experience in other sectors within impact investing such as microfinance or social enterprise. Philanthropic foundations and HNWIs have typically been the first movers to prove or mitigate the perceived risk of the asset class to enable engagement of institutional investors in due course.

In Australia, many of the larger NPOs have a number of philanthropic HNWIs that support their activities. In engaging with potential host NPOs, CSI targeted these individual philanthropists to test their appetite for SIBs and specifically the NSW Government SIB pilot. There is also a small number of large philanthropic foundations in Australia – including corporate foundations – that have expressed interest in social impact investing.

2.3 Potential scale for the social impact investing market

The Monitor Institute suggests that the potential scale of the social impact investment market is considerable and could potentially reach 1% of all managed US assets (Freireich et al, 2009). Using this same estimating scale, a recent report from the Canadian Social Finance Task Force estimated that social impact investing in Canada could yield CAD30 billion (Canadian Taskforce on Social Finance, 2010).

[5] http://news.biglotteryfund.org.uk/pr_310810_uk_ri_big_paves_way_forward

It is estimated that funds under management in Australia – excluding assets held by superannuation funds – will reach almost $700 billion in 2011 (IBISWorld, 2011). Using the Monitor Institute method of estimating scale, these investment assets alone would generate a social impact investment market in Australia of $7 billion. There are over $1,000 billion of investment assets held in Australian superannuation, of which it is estimated that $326 billion relate to 400,000 SMSFs held by 750,000 Australians (Australian Tax Office, 2011). If the latter generated a further $3 billion, then the overall scale of the social impact investing market in Australia would be $10 billion.

The rapid growth in the number and scale of PAFs offers potential for supporting the growth of a considerable social impact investment market in Australia. It is estimated that there are now over 800 PAFs – with approximately 150 new PAFs approved by the Australian Tax Office (ATO) each year – which have a combined asset value estimated to be in excess of $2 billion, and which currently distribute approximately $150 million p.a. to eligible charities and NPOs[6].

The impending establishment of the Social Enterprise Development and Investment Fund (SEDIF) will also provide a stimulus to the emerging social impact investing market[7]. SEDIF will be based on a cornerstone investment of $20 million from the Australian Government with the principal objective of generating "social impact investment in addition to financial return and increase capital for social enterprises in Australia through capacity building".

2.4 Characteristics of an emerging market and asset class

The intelligence gathered from international sources differentiates between the appetite for a pilot SIB and the long term development of a new asset class.

A pilot SIB is recognised as a demonstrative transaction seeking to prove the acceptability and potential of the SIB as a financial instrument capable of attracting capital to deliver social impact with appropriate risk-reward tradeoffs for all stakeholders. Investor appetite will be largely influenced by an affinity with the chosen impact area and a desire to catalyse new and innovative funding mechanisms to drive social impact. **It is recognised that a pilot will provide learning to inform the development of a market that with sufficient volume and activity will grow to be self-sustaining over time.**

[6] http://www.ato.gov.au/nonprofit/content.asp?doc=/content/00163533.htm

[7] http://www.deewr.gov.au/pages/sedif.aspx

In contrast, SIBs will only emerge as a new asset class once sufficient track record and confidence in their viability as a financial instrument that appeals to a wide range of investors is achieved. Investors' appetite will be influenced by the development of market infrastructure to support SIBs as a new asset class. Such market infrastructure can be expected to include characteristics for a new asset class as identified by J.P. Morgan (2010). This asset class:

- requires a unique set of investment/risk management skills;
- demands organisational structures to accommodate this skill set;
- must be serviced by industry organisations, associations and education;
- encourages the development and adoption of standardised metrics, benchmarks, and/or ratings.

2.5 Characteristics of the target social investors for the NSW Government SIB pilot

The intelligence gathered by CSI and JBWere from discussions with investors and advisors to high net worth individuals suggests that potential social investors in the NSW Government SIB pilot will fall into three main categories:

- Philanthropic HNWIs willing to explore the potential of moving from a traditional donation / grant mindset to "invest" and potentially recycle the same capital for social purpose.
- Already socially-engaged investors, motivated to consider a commercial opportunity to align a return on investment and a social impact focus. These investors will already be involved in ethical, socially responsible, sustainable and green investments.
- The "gatekeepers" of large corporate trustee groups.

Philanthropic and already socially engaged individuals may invest through their family foundations, PAFs or self managed superannuation funds which have an allocation for alternative assets. Senator Nick Sherry has signalled the need for reform to areas of the regulation of superannuation funds and more effort in relation to trustee education to assist growing this market for social investment (CSI, 2010).

The advisors and trustees of investment funds may play a key role, however there are a number of advisors and trustees that are actively exploring the potential of social impact investing including JBWere, BT Financial Group and Perpetual.

Across these three groups of potential social investors some general characteristics are required for a SIB, including:

- Investors prepared to accept non-traditional terms in order to achieve social impact
- Investors attracted to new and innovative investment models, specifically investors seeking to be amongst the first Australians to invest in a SIB.
- Investors with the capacity to invest the minimum amount for the minimum term.
- Investors located or associated with NSW.

It is also important to note that potential investors expressed a desire for a stable income over a number of years with few expressing appetite for equity-like risk.

Whilst most of CSI's direct approach to potential individual investors received an enthusiastic response, there was a small number of current philanthropists unwilling to engage because of a general lack of trust in the rationale for the use of a SIB – these individuals were happy to maintain their current grant funding approach and focus on a specific NPO.

From the discussions with philanthropists it was clear that:

- the appetite for take-up will be influenced by the program chosen;
- the investor's relationship with, and confidence in, the proposed host NPO; and
- the terms and conditions of the bond with a range of differing attitudes existing to the desirability of preservation of the principal, to the timing of coupon payments and to the acceptable rate of return.

All potential investors indicated a clear desire for simplicity for the pilot in the knowledge that the first structure chosen may not end up the preferred longer term model. Subject to the choice of program and host NPO, there was a reasonable level of confidence that raising $5 million was certainly achievable and $10 million was not out of the question. A return premium over the market cash rate was identified as desirable and a term of five to seven years preferable.

2.6 Taxation and regulation policy considerations

In discussions with potential social investors considering the suitability of an investment in a SIB from a PAF, the question of regulatory treatment was raised. The *Private Ancillary Fund Guidelines 2009* requires PAFs to make annual distributions (i.e. grants) totalling 5% of the prior 30 June value to 'eligible organisations' which are essentially defined as organisations holding deductible gift recipient (DGR) status. An investment by a PAF into a SIB could not currently be characterised as a distribution to meet this 5% requirement.

In CSI's submission, *Building a Social Finance System*, to the Productivity Commission's *Draft Research Report on the Contribution of the Not-for-Profit Sector* (released 14 October 2009), the need for the introduction of policy to encourage charitable foundations, trusts and PAFs to complement their grant making activity with social impact investment was identified.

Specifically, CSI recommended that social impact investments be counted towards annual mandatory distributions for PAFs.

An additional approach would be to seek clarification from the Australian Tax Office (ATO) as to whether or not the principle prescribed at clause 19.3 of the *Private Ancillary Fund Guidelines 2009* could be applied to an investment by a PAF in a SIB. That is, if a PAF invests in a SIB issued by an organisation with DGR status at a discount to the market price, the PAF would be able to include in its distribution a benefit with a market value equal to the discount: for example, if a PAF investing in a SIB yielding 5% p.a. but with a market value of 8% p.a. would be able to include the 3% discount towards its annual distributions.

2.7 Strategy to engage with potential social investors for the NSW Government SIB pilot

CSI recommends that once the program and host NPO has been decided upon, a multi-faceted strategy to engage potential social investors be developed and the investment capital sought.

CSI recommends that the strategy comprises three strands:

1. **Approaching HNWIs already engaged with the host NPO** provides not only a sound starting point but may also yield a cornerstone investor or perhaps a champion to develop an investor syndicate.
2. **Systematic engagement with advisors and professional trustees** will widen the potential pool of HNWIs and it is recommended that the engagement starts with those already engaged with social impact investing e.g. JBWere, BT Financial Group and Perpetual. Some of these advisors specialise in managing PAFs, which may provide a rich pool of investors. Similarly, advisors specialising in SMSFs may also open up access to potential social investors.
3. **Systematic engagement with charitable foundations**, including endowed family and corporate foundations, with a track record of supporting programs in the selected policy area or who have expressed interest in developing social impact investing. Corporate foundations – especially relating to financial institutions – will be of high priority.

This engagement strategy also provides an opportunity to identify an agency or agencies that could play the facilitating roles of the Big Lottery and charitable trusts in the UK Peterborough SIB. These facilitating roles could include:

- Covering the bond set up and running costs including independent measurement and reporting;
- A cornerstone investor;
- Guaranteeing part payment of the principal and/or the reward payment;
- Support for ongoing learning, a knowledge exchange, and raising awareness of and promoting the use of SIBs.

3. Recommended structure for the NSW Government SIB pilot

3.1 Learning from the UK experience

CSI has had privileged access to the groundbreaking work of both Social Finance UK and the Young Foundation. In 2008, Geoff Mulgan of the Young Foundation promoted the concept of SIBs as part of a wider consideration of investing in social impact and the use of mechanisms such as payment by results and outcome-based commissioning.

The need for an alternative approach is being driven by the recognition that the traditional ways of funding NPOs to deliver programs that address complex social problems are struggling to keep up with demand. The structure of the SIB must therefore articulate the relationships between three stakeholders and their respective responsibilities:

- The NSW Government – the payer providing a commitment to repay the principal and a reward payment if pre-agreed outcomes are achieved.
- Social investors – providing the investment capital and receiving a reward payment.
- Host NPO – delivering a program that can achieve the desired outcome and generate future government costs savings.

The stakeholder relationships using existing funding mechanisms are problematic on a number of counts. Over the last decade, government agencies have increasingly used contracts to fund NPOs to deliver public services. These contracts are often perceived as being restrictive, focusing on inputs, process milestones and rigidly defined outputs rather than driving the achievement of measurable outcomes and social impact. In addition, contract funding may not cover the full cost of delivering the prescribed service and typically provides little opportunity to generate a surplus to reinvest in research, development and social innovation. NPOs are therefore dependent on revenue funding and do not have access to capital to invest in innovative solutions or to scale up proven pilot programs.

Charitable trusts and foundations and HNWIs have traditionally provided grants to NPOs to deliver services or test alternative approaches to society's problems. Grants are typically provided on the basis of trust – trust that the NPO will deliver on their promises and where there is no recourse if failure occurs. SIBs have the potential to re-engineer these relationships, especially where "there are misaligned incentives to develop, fund and deliver preventative services that can save costs down the line and achieve a better result from the system as a whole" (Mulgan et al, 2010).

The groundbreaking UK SIB, launched in 2010 by social finance intermediary Social Finance UK, was aimed at significantly reducing the rate of reoffending by short sentence prisoners, through services delivered by subcontracted NPOs. The UK SIB has identified and addressed a number of challenges and in doing so provided valuable learning, including the recognition that it constitutes only one model and is operating in the cultural context of one jurisdiction and one policy area. A number of initiatives around the world are now considering the wider applicability of SIBs including this study by CSI commissioned by the NSW Government, further pioneering work in the UK by the Young Foundation and exploration in the US by Nonprofit Finance Fund with the support of the Rockefeller Foundation. These initiatives are exploring the suitability of other policy areas, the feasibility of an NPO issuing the bond as an alternative to using a social finance intermediary, the merits of different levels of risk-sharing, and use of a standing payment to cover part of the program delivery costs instead of an entirely performance based payment.

The Young Foundation has identified three broad types of social impact bond: philanthropic, government and commercial (Mulgan et al 2010). For the purposes of the NSW Government SIB pilot, the government SIB is not relevant as it focuses on the relationship between two tiers of government e.g. federal and state, but may be of interest in the future. CSI has therefore focused on the philanthropic and commercial SIB as described below.

3.1.1 Philanthropic social impact bonds

The UK Peterborough SIB is an example of a philanthropic SIB, where funds are secured from philanthropic sources and invested through a special purpose vehicle, which is used to fund a program or programs delivered by one or more NPOs, and involves a contract with central government to repay the principal and a reward payment based on achieving agreed outcomes.

The Young Foundation considers that a philanthropic SIB will facilitate experimentation and innovation, rather than relying on proven models of delivery. It also believes that by using this mechanism, philanthropists will be able to more directly finance outcomes, oversee program delivery and engage with government in a more strategic way. Clearly, such a philanthropic SIB is attractive to government because it transfers a substantial amount of risk to the philanthropic funders. **CSI's discussion with both investors and NPOs revealed that both stakeholders wanted to ensure that government is sufficiently engaged and has some "skin in the game".**

3.1.2 UK Peterborough social impact bond

In-depth discussion with Social Finance UK revealed that the establishment of the UK Peterborough SIB was primarily driven by them operating as a social finance intermediary that engaged social investors, not government or the NPOs delivering the program. The social investors and social finance intermediary – operating through a special purpose vehicle – provided the market discipline and commercial investment expertise to develop the proposition that culminated in contractual relationships between government, NPOs and the social investors.

This is reflected in the organisational structure of the SIB, which utilises a limited liability partnership (LLP), generically referred in Figure 2, below, as “social impact partnership”. Investors hold shares in the LLP, the LLP holds the performance and reward contract with government, and the LLP sub-contracts program delivery to a number of NPOs. The SIB governance and management functions are located in the LLP, which utilises an expert advisory committee to advise social investor shareholders. An expert has also been appointed to the LLP as “project director” to fulfil the senior management role.

The usage of the LLP for the SIB has been styled on a generally accepted legal structure used in mainstream private equity:

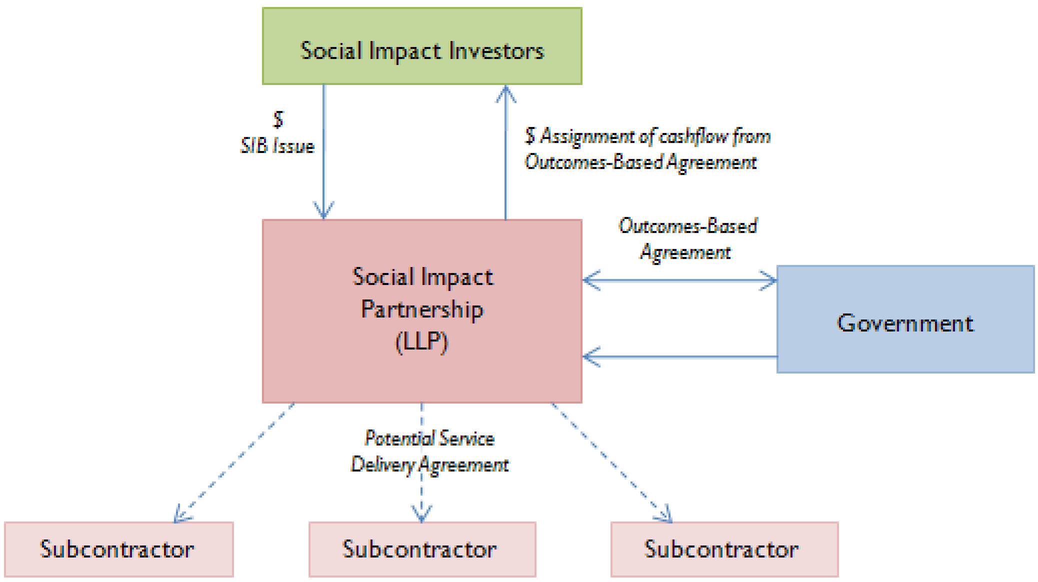

Figure 2: Peterborough bond structure

The structure of the UK Peterborough SIB is relatively complex in terms of the creation of a number of “feeder vehicles” to channel investment from UK charitable trusts and foundations, and US charitable investors.

Although there is a clear transfer of risk from government to the LLP, the risk for the sub-contracted NPOs may not have changed, i.e. the terms of the subcontract with the LLP may not differ significantly from a direct contract with government.

3.1.3 Commercial social impact bonds

The Young Foundation considers that commercial SIBs will become available once a new social investment asset class has been established and the market for SIBs expands. The relatively small number of philanthropically-minded investors for the philanthropic SIB type will be replaced by commercial investors, including banks and superannuation funds (Mulgan et al, 2010). The establishment of a new asset class will also facilitate the development of SIBs that contract with government and deliver large-scale programs through a range of NPOs. However, it is important to note that this will only be possible if the methods of measuring program performance and risk become more sophisticated and more widely used by NPOs, and where these measurement systems are perceived as being robust by potential commercial investors (Mulgan et al, 2010).

It is likely that the development of the market for SIBs will happen differentially, with some policy areas and programs maturing before others. Similarly, there will be some NPOs that are early adopters, whilst others will initially fail to respond to the opportunities offered by SIBs.

3.2 The context for the NSW Government SIB pilot

There are some fundamental differences between the NSW Government SIB pilot and the UK experiences described above. Firstly, some investors expressed a preference to have a direct relationship with the NPO rather than a relationship through an intermediary, as is the case in the UK.

Secondly, CSI considers there to be competent NPOs capable of hosting and issuing a SIB without the requirement for a social finance intermediary as was the chosen path in the UK. In particular, the larger human service NPOs already operate within a framework of results-based accountability, employ professional staff, utilise professional advice, are committed to social innovation, engage with social investors, have research and/or evaluation teams and benefit from corporate and financial expertise and advice through their governance structure and strategic relationships.

Thirdly, Australia does not have the same scale of and engagement by charitable foundations and HNWIs in key policy areas as observed in the UK and the social impact investing market in Australia is in nascent stages of development. Social impact investing in Australia may, however, benefit from the existence of PAFs and SMSFs that may provide a vehicle for HNWIs to invest in SIBs.

There are, however, some important similarities, including the lack of robust evidence of the efficacy of program interventions (which is currently particularly evident in the Australian context), and how these translate into real savings for governments, and that the term of the SIB will extend beyond the relatively short electoral and budgeting cycles. **Development of a robust evidence base and the implementation of studies estimating the link between program outcomes and government costs savings should be an immediate priority.**

3.2.1 Potential organisational structure for the NSW Government SIB pilot

In light of these differences, **CSI recommends that the NSW Government SIB pilot be based on an organisational structure where investors and government have direct relationships with a chosen host NPO** (see Figure 3, below) rather than using the special purpose vehicle that features in the UK Peterborough SIB. However, in certain situations an intermediary structure may be the most appropriate.

Legal advice provided to CSI indicates that it is possible for most NPOs to issue a debt instrument such as a SIB (see Section 5 for further details).

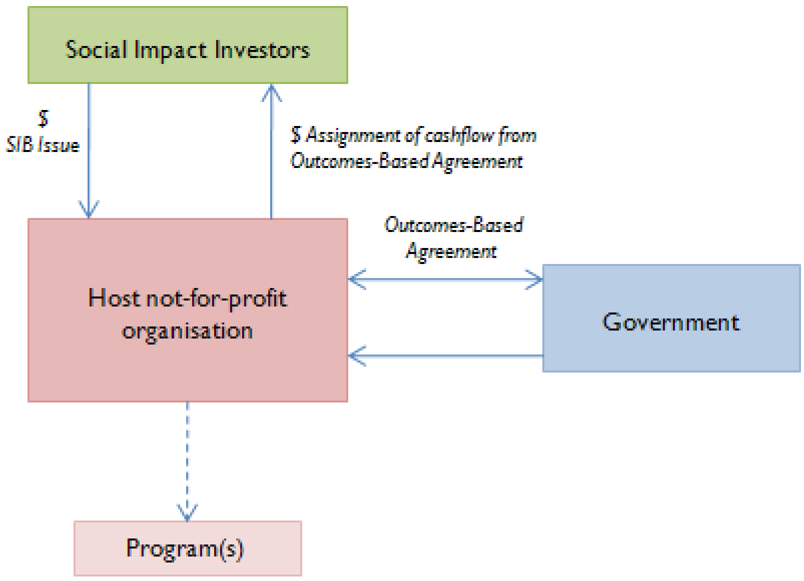

Figure 3: Potential bond structure for NSW Government pilot

The social investors CSI spoke with suggested that appetite for the NSW Government social impact bond pilot will be influenced by a combination of:

- **empathy** with the cause;
- the **reputation** of the host not-for-profit organisation and prior engagement;
- perceived **efficacy** of the intervention program(s);
- the key **terms and conditions** of the SIB – the coupon (interest reward), repayment profile, the term / duration, drawdown profile, and security; and
- the **risk profile** of the Outcomes-Based Agreement (contract) between the host NPO and NSW Government – specifically as reflected in the extent to which the initial investment (principal) is at risk in the event that the program does not achieve the target outcome.

For the NSW pilot SIB structural simplicity was specified as essential by social investors.

3.2.2 Options for the structure and terms of the NSW Government SIB pilot

CSI has developed a range of options for the structure and terms of the SIB that illustrate different levels of risk-sharing across government, the NPO and social investors. Annex 1 provides three alternative structures for a $5 to $10 million SIB with a term of between 5 and 10 years. These structures, including the associated terms and conditions, while informed by CSI's discussions with all stakeholders to the SIB – government, potential host NPOs and potential social investors – can be considered as indicative only. The final structure will ultimately be a function of negotiation following the selection of the host NPO and intervention program, and determination by all stakeholders as to how to allocate the risk of failure to achieve the agreed outcome. Furthermore, the structure will be influenced by the appetite of social investors to accept terms and conditions, particularly in respect of investment return, "at market" or "below market" for the perceived risk of the investment opportunity. Terms and conditions set "at market" have greater potential to increase the attractiveness of the investment opportunity to a broader range of social investors. The assumptions used in developing these three structures are presented in Annex 1.

Option A is comparable to the UK Peterborough SIB, where the principal and reward payment to social investors is fully dependent on the achievement of an agreed outcome, and where failure means that government pays nothing. This option is clearly attractive to government as there is a full transfer of risk to the social investor, which is reflected in the indicative reward payments ranging from "below market" at 13% to "at market" at 18% p.a. This indicative return provides a 1% to 6% premium over the 12% p.a. coupon rate accepted by social investors in GoodStart for the acquisition of ABC Learning Centres, and widely considered as "below market". The premium has been added in recognition of the relative start-up nature of an intervention program under a SIB, vis-à-vis the acquisition of a business operating as a going concern.

CSI believes that this option may be attractive to philanthropically-minded investors who are supportive of the development of SIBs. However, the number of investors and scale of investment of this type are limited, although they may be sufficient for a NSW pilot.

The limitations of Option A have been identified by Harvard Professor Jeffrey B. Liebman:

> *"Entirely performance-based payments are rarely optimal under standard economic theory. When outcomes are partly determined by service provider's effort and partly determined by factors beyond the service provider's control, optimal contracts generally involved a fixed or cost-based payment component, and a performance-payment system."* (Liebman, 2011).

At the other end of the risk transfer spectrum, CSI has developed an option that reflects the preference of some social investors to protect their capital, and where only the reward payment is at risk (Option C). Under this option, the principal is guaranteed, thus making it attractive to social investors where capital preservation is paramount. However, it offers little incentive to government as there is minimal risk transfer to social investors and the NPO.

CSI has therefore formulated an option where there is a balance of risk-sharing between government, the NPO and social investors (Option B). Under this option, part of the costs the NPO incurs in delivery of the program will be paid by government through a standing charge, and the remaining costs and reward payment will be dependent on the achievement of a successful outcome. The level of the standing charge will be determined by the negotiations held between the NPO, government and social investors.

For the purposes of illustrating this option to social investors, CSI has developed an hypothetical case based on setting the level of the standing charge to 70% of the principal of the bond and cost of delivering the program.

The exact level of the standing charge will be the subject of negotiation between the NPO and government, where the NPO is not only assessing its confidence in delivering the agreed outcome but is also sensitive to the preferences of potential social investors. Government may look to minimise the level of the standing charge but will be aware that the NPO and social investors will have limits. Conversely, government may offer a higher level of standing charge to incentivise NPOs and investors to engage.

At this level of risk-sharing, the estimated required level of the reward payment (return on investment) will be between 9% and 14% per annum. Social investors with whom CSI had spoken responded positively to this shared risk option and the illustrative 70% level of standing charge. The risk sharing between stakeholders achieved under Option B with a 70% standing charge is well illustrated by giving consideration to the consequences of a complete failure by the host NPO to achieve agreed outcomes:

Consequences for government:	• Pays NPO for 70% of cost of program. • Cancels program at the end of the contract term, thus does not continue to pay for unproductive programs.
Consequences for host NPO	• Loses credibility with government reducing likelihood of securing further government contracts • Loses credibility with social investors making it difficult to access capital for further programs.
Consequences for social investors	• Receives only 70% of principal back, losing 30% of principal and receiving no economic return for having deployed capital for a number of years.

A standing charge within a shared-risk approach clearly serves as an economic commitment or “skin in the game” by government to work cooperatively with the NPO throughout the term of the SIB recognising that a successful outcome cannot be fully divorced from government policy or regulation. The approach disincentivises host NPOs to promote programs where they are not confident of a successful outcome which minimises risk to government that the agreed outcomes and government savings will not be achieved. For social investors, the approach incentivises them to carefully analyse investment opportunities before committing, and to monitor any investment closely and where possible encourage the host NPO to perform at a level where the agreed outcomes will be achieved. As noted above, the exact level of the standing charge will be the subject of negotiation between the NPO and government, where the NPO is not only assessing its confidence in delivering the agreed outcome but is also sensitive to the preferences of potential social investors. At a 70% level of risk-sharing, the estimated required level of the reward payment (return on investment) will be between 9% and 14% per annum providing a 4.0% to 6.5% p.a. premium over the NSW Treasury Bond rate.

CSI considers that this option will be attractive to not only philanthropically-minded investors but also to a wider group of social investors who are prepared to accept non-traditional terms and new and innovative investment models.

CSI recommends that this shared risk option is considered for the NSW Government SIB pilot.

The final structure will depend on the program and host NPO selected and the detailed negotiations between government and the host NPO, and the perceived appetite of potential investors.

Option A: *No principal guarantee*
Principal repayment and coupon reward payments of the SIB are fully dependent on the agreed outcome being delivered by the host NPO. The successful outcome triggers performance payments under the Outcomes-Based Agreement between NSW Government and the host NPO. CSI recommends that the indicative coupon reward payment rate for baseline performance be between 13.0% and 15.5% p.a. which will increase to between 15.5% and 18.0% p.a. for high performance.
Option B: *Partial principal guarantee*
A shared risk option which, for illustrative purposes, proposes that 70% of the principal repayment of the SIB is covered by the standing payment/availability charge and the payment of 30% of the principal plus the coupon reward payment is dependent on a successful outcome being delivered by the host NPO. On this basis CSI estimates that the indicative coupon reward payment rate for baseline performance be between 9.0% and 11.5% p.a., which will increase to between 11.5% and 14.0% p.a. for high performance.
Option C: *Full principal guarantee*
The principal repayment of the SIB is fully covered by the standing payment/availability charge with only the coupon reward payment dependent on a successful outcome being delivered by the host NPO. CSI recommends that the indicative coupon reward payment rate for baseline performance be between 5.0% and 7.5% p.a. which will increase to between 7.5% and 10.0% p.a. for high performance.

3.3 Next steps

In light of the findings from the review of potential policy areas, programs, and host NPOs (Section 1); the assessment of the investor appetite for a SIB (Section 2); and the review of the options for the structure of pilot SIB (Section 3); CSI has concluded that the SIB concept is feasible in the NSW context, and that NSW has the necessary market conditions for this new approach to funding to be trialled.

CSI therefore recommends that the NSW Government proceeds to the next stage and invites expressions of interest from NPOs that satisfy the key criteria for the development of a SIB.

4. Economic and financial modelling

CSI's review of potential policy areas, programs and host NPOs has identified two potential program areas for the NSW Government SIB pilot:

- **juvenile justice** programs
- **parenting skills for at-risk families** programs

Both of these program areas largely satisfy the full range of eligibility criteria with indicative but not fully robust evidence of efficacy of the chosen program(s) and the potential to achieve significant future savings for the NSW Government. The primary purpose of the initial review process was to understand better the nature of the evidence necessary to appropriately implement a SIB and recommend program areas for further investigation with a view to developing economic and financial models that can be used to confirm their suitability for the SIB.

4.1 Economic and financial models

The economic model focuses on the following parameters:

- Size and characteristics of the treatment cohort.
- The criteria and mechanism for referral into the treatment cohort.
- The outcome measure that defines performance and triggers reward payments.
- The size of differential outcome achieved by the treatment cohort.
- The link between the outcome measure and government savings.
- The potential range for performance (treatment effect) – in terms of base level performance above which reward payments will be made – and any cap to limit rewards where there is high performance.
- Fixed and variable/unit costs for delivering the program(s) – especially in the context of scaling up programs.
- Fixed and marginal costs for future savings to the NSW Government.

In developing the economic model, attention is also paid to the robustness of the evidence for program efficacy including levels of participation and treatment effect, and how the counterfactual will be calculated and measured during the duration of the SIB. The existing degree of robustness in the evidence base of the programs in question is below that which is desirable but is generally above that evident in many social programs in Australia. However, there is significant potential for improved robustness in the evidence base for the relevant programs.

The financial model focuses on the following parameters:

- Investment term duration.
- Value of principal/amount of investment required.
- Budget for program including fixed and variable/unit costs, management fees, measurement costs, and governance costs.
- Timetable for draw downs and reward payments.
- Cashflow.

For each selected program, CSI undertook a detailed assessment of each of these parameters utilising existing documentary evidence and evidence gathered directly from the relevant government agencies and host NPO. For each parameter the quality of the evidence was assessed; where available, independent peer-reviewed evidence scored highly whilst self-reported anecdotal evidence received a lower score.

CSI has developed pilot economic and financial spreadsheet models designed to be linked so that changes in the economic model can flow through to the financial model and ultimately to the investment term sheet. These pilot models are also designed to facilitate sensitivity analysis to test the full range of potential performance levels. The pilot models were developed to test the waters with respect to the development of comprehensive models designed to assess the potential costs savings to government of social program interventions financed by a SIB.

4.2 Options for measuring performance of the treatment and control cohorts

One requirement for the program to be suitable is that adequate data be available for a cost-benefit analysis to be carried out. A cost-benefit analysis is concerned with estimating the differential value of a program or measure. In other words, a cost-benefit analysis compares the value (costs and benefits) of the program with some specified alternative. In this case, CSI is particularly interested in the costs savings to government of the implementation of a pilot: what savings accrue to government as a result of implementing the pilot program over and above what would have otherwise occurred. Requirements for a cost-benefit analysis include sufficient data on inputs and outcomes for the project and an ability to attach a dollar figure to each. A counterfactual is also required, to determine what would have happened if the intervention had not occurred.

The complexity of the problem and treatment program may make it difficult to complete a cost-benefit analysis and it may therefore be necessary to use an alternative method such as a cost effectiveness analysis, which also uses economic analysis to compare the relative costs and outcomes of two or more programs using a ratio typically based on cost per unit of outcome.

There is increasing interest in using a hybrid version of cost-benefit analysis – Social Return on Investment (SROI) – which seeks to monetise the value of social outcomes including use of proxies. SROI is increasingly used by NPOs in developing programs (predictive) and occasionally in evaluating programs (retrospective). For the NSW Government SIB pilot, CSI has focused on the use of cost-benefit analysis.

Data relating to the counterfactual can be generated via a randomised control trial (RCT) or be derived from quasi experimental data. The RCT is often seen as the 'gold standard' approach and in many circles, including in the health sciences, is the only acceptable method for deriving the relevant data. However, although a rigorous approach to measurement is required to satisfy all the SIB pilot stakeholders, a carefully designed and implemented quasi-experimental approach has significant pragmatic advantages, particularly given the pilot nature of the project.

4.2.1 Randomised control trial

Under the RCT approach, potential clients of the program are randomly allocated to the 'treatment' and 'non-treatment' categories. The treatment group comprises those who receive support under the program or intervention, while the non-treatment group comprises those who do not receive the intervention, but continue the previous level of service. Under certain conditions the estimated difference in outcomes between the 'treatment' and 'non-treatment' categories represents the differential impact of the program on client outcomes.

Despite the appeal of the RCT method, an RCT may be difficult to implement successfully in a social setting and can be ethically problematic.

The RCT must comply with a number of conditions if it is to produce an accurate measure of the differential impact of a program. The first is that the composition of the treatment and non-treatment groups should be roughly equivalent. Randomisation is likely to achieve this result if the sample is large enough, but may not do so with relatively small samples. The second condition is that the process of randomisation does not introduce an element of bias into the study. A third major condition that needs to be fulfilled by an RCT is that non-participants retain their 'non-treatment' status throughout the period of analysis.

Finally, it is important to recognise that the RCT provides evidence on differential outcomes but may not provide evidence for particular client sub-groups. Moreover, the RCT design, by its very nature, does not allow for the modelling of the joint decision by the potential client and referral agency to participate in the program. In addition, by following a prospective study design, there are risks that the 'treatment' and 'non-treatment' groups may suffer high attrition rates over time. Obviously, the same point applies to any prospective study and not simply to an RCT prospective study.

In addition to these technical difficulties surrounding the implementation of RCTs, there are often ethical concerns with RCTs in the social policy field. These concerns relate to the fact that the program or intervention in question will generally be presumed to be superior to the counterfactual, which is, after all, why the program has been implemented. This creates an obvious ethical problem for researchers and service providers alike.

4.2.2 Quasi-experimental approach

In a quasi-experimental approach, program participation is left to follow its normal course. The task facing the researcher is then to estimate the effectiveness of the program on client outcomes, controlling for confounding influences and in particular differences in the composition of the treatment and comparison groups. Longitudinal survey data (prospective and otherwise) and time series data may be utilised to assess the effectiveness of social programs. When longitudinal survey data is used, matching techniques may be used to match program participants with (eligible) non-participants.

In the UK Peterborough SIB, each short sentence offender in the program leaving prison is matched with ten other short sentence offenders leaving prison outside the program in the same period. The matching is done through use of the Police National Computer and the variables used include age, ethnicity and offending history.

The quasi-experimental design has the obvious advantage that it can be applied to existing rather than custom-built longitudinal survey data. Another advantage is that the decision to participate in the program can be modelled, as can outcomes from program participation conditional upon program participation. However, the major drawback in terms of an analysis of a pilot program is that the data necessary for the quasi-experimental analysis often doesn't exist in extant data sets.

4.3 Learning from the UK

The learning from the UK is that the process of developing the economic and financial models is complex, time-consuming and resource-intensive. The cohort definition, referral mechanism, outcomes measure and reward metrics, and counterfactual measurement all require in depth and iterative negotiations between the host NPO and the NSW Government agencies. In addition to senior management the host NPO will need to engage expert staff responsible for the following areas:

- operations;
- finance;
- performance management, information and reporting; and
- research and statistics.

The NSW Government will also need to engage staff from the relevant human service agency and treasury. The deep and iterative engagement between the host NPO and NSW Government is a critical step in the development of the pilot SIB. The involvement of an independent facilitating agency may help this engagement process so that all issues are satisfactorily addressed by both sides and that all components of the economic and financial models are robustly constructed.

4.4 Juvenile justice

CSI has formulated an initial economic model based on a juvenile justice intervention. The model at this stage is limited only to the direct cost inputs of a juvenile justice intervention. Expenditure savings to government from successful juvenile justice interventions will accrue across a range of functional areas in addition to Juvenile Justice. One obvious area for further development is police costs.

The economic model considers indicative NSW Government savings achieved across a number of NSW Government agencies, including:

- Juvenile Justice – custodial sentences
- Juvenile Justice – community supervision
- Juvenile Justice – remand
- Justice and Attorney General – children's court
- Juvenile Justice – Youth Justice Conferencing
- Juvenile Justice – post-release support programs

Two broad outcome measures have been considered – a reduction in the number of repeat offenders and a reduction in the total number of cautions, conferences, and proven court appearances. The latter is deemed preferable because it is more closely related to costs savings and will incentivise the targeting of the most challenging serial repeat offenders. Any measure considered should account for the severity of the offences.

From an evidence perspective, the juvenile justice policy area is attractive. The Bureau of Crime Statistics and Research (BOCSAR) collects and collates data on adult and juvenile offending and has developed the:

- Reoffending Database (ROD).
- GRAM, the Group Risk Assessment Model statistical technique that is designed to obtain more accurate estimates of trends in reoffending by adjusting for the characteristics of offenders coming through the justice system; GRAM is a predictive model for reoffending and is used for the reoffending measure in the State Plan, where performance is based on actual to predicted.

In addition, Juvenile Justice uses the Youth Level of Service Inventory (YLSI) risk assessment tool, which is the primary tool used to assess young offenders' risk of reoffending.

The existence of these data and risk assessment methodologies are also highly relevant for defining the cohort and referral mechanism. There are, however, still issues and problems which require thorough investigation. Many of these issues relate to precise definitions, the ability to make direct comparisons and degree of utility for the purpose of the SIB.

A quasi-experimental method using GRAM may be possible and have advantages for modelling existing behaviour – provided that the data and definitions are adequate. If this is not the case, an RCT would be the preferred method for developing a counterfactual. The RCT could use the YLSI risk assessment tool to profile offenders and this approach would also ensure that consistent data is collected to facilitate future learning. The RCT random allocation process may however have an impact on the scale of the treatment and control groups, where the treatment group is insufficient in scale to deliver the level of costs savings necessary.

The referral mechanism also needs further investigation to finalise definition, cohort criteria and method of implementation. A juvenile with a caution is likely to have a different "tariff" to a juvenile who has experienced custodial sentences. This tariff will articulate the risk of reoffending and also relates to a program with the required level of intensity. Any service deliverer would need to develop internal criteria for allocation to high, medium and low intensity programs so that costs are kept under control.

BOCSAR has access to GRAM and YLSI risk assessments which can be used to profile individuals and randomly allocate them to either the treatment or control group. BOCSAR is then able to measure the number of cautions, conferences and proven court appearances if they were to constitute the outcome measure and also the basis for ultimately making reward payments if the treatment group is significantly better than the control group. At this stage, further work is required on the precise level of performance for the agreed outcome measure, the difference between treatment and control which will trigger reward payments, and any cap on rewards if there is high performance.

Further work is also required on the costs of delivering the proposed program(s). This cost will be heavily influenced by the cohort definition and referral mechanism, which in turn will have implications for the potential savings to NSW Government. This cost will contribute to the decision on the size of the principal for the SIB. The learning from the UK also suggests that intensive work is required on the business plan and budget.

4.5 Parenting skills for at-risk families

CSI has also assessed the suitability of a program to support at-risk families with young children to adequately support and care for their children. Children in out-of-home care are overrepresented in the juvenile justice system, have higher rates of homelessness once leaving care and have poorer education and employment outcomes.

An economic model has been constructed. It is envisaged that there is potential to achieve significant savings for the NSW Government by reducing existing out-of-home care costs through supporting families to improve their functioning to the point where it is safe for their children in out-of-home care to return (known as restoration). It is also envisaged that significant future costs savings for the NSW Government will be achieved by addressing risk-of-harm factors early, preventing children at risk from entering out-of-home care by ensuring their safety with their families.

CSI has explored a number of profiling tools that could be used to develop a referral mechanism for the program. However, further work is required to refine this mechanism, develop a definition of the cohort and ensure that a counterfactual can be constructed to determine the costs savings created by the program.

Further work is also required to determine the various costs to government, cost of the program and the level of performance for the agreed outcome measure that will trigger the reward payments.

4.6 Conclusion

CSI has examined the type of evidence and modelling necessary to successfully implement and monitor a SIB, and considered two candidates for the NSW Government SIB pilot: a juvenile justice program and a parenting skills for at-risk families program. CSI has developed pilot economic and financial models designed to test the waters with respect to the development of a comprehensive model to assess costs savings to the NSW Government of social program interventions. Our preliminary analysis suggests strong potential for sound economic and financial modelling in both program areas.

There is a strong need for investment in the development of a robust evidence base and the implementation of studies estimating the link between program outcomes and government costs savings.

5. Legal advice

Section 3 describes a range of alternative organisational and bond structures for the NSW Government SIB pilot. **CSI recommends that the host NPO issues the SIB or utilises a wholly owned special purpose vehicle for this purpose.** CSI has explored the legal, regulatory, tax and risk issues associated with such arrangements, and has not found any impediment for either arrangement.

5.1 NPO to issue the SIB

Legal advice provided on a pro bono basis by Corrs Chambers Westgarth confirms that a charitable NPO – which is a public company limited by guarantee (CLG) – is likely to be able to issue a debenture instrument like a social impact bond. CLG governing documents typically have the powers of a natural person including the power to borrow and to grant security. It can also be assumed that the purpose of the SIB will be in line with the NPO's charitable objects. Charitable organisations can also utilise a number of Australian Securities and Investment Commission (ASIC) exemptions which may make this option attractive.

Some NPOs have been established through statute rather than standard incorporation and must therefore be assessed on a case-by-case basis. Typically, however, they are likely to have the appropriate powers or have the option to set up a special purpose vehicle with the appropriate powers.

5.2 NPO to issue the SIB through a wholly-owned subsidiary

The host NPO may chose to ring-fence risk and issue the SIB through a wholly owned subsidiary. This is considered to be a viable and a straight forward arrangement but may rule out use of certain exemptions and/or benefits available to charitable organisations.

5.3 Prospectus vs. offering memorandum

A key issue for the final recommended organisational and bond structure is the legal status of the issuer and the type of issue documentation required. The development of a prospectus is likely to take many months and incur significant costs, as well as encourage investors to seek more in depth advice. It is therefore desirable for the issuer to be able to utilise one of the exemptions from the ASIC with regards to issuing a prospectus and licensing requirements.

Charitable organisations benefit from such exemptions. There are also relevant broader exemptions including where the offer is made to specified people who are presumed not to need disclosure because of financial capacity, experience or wholesale status and where the offer is made through a financial services licensee.

If a suitable exemption can be utilised then once the details of the term sheet are agreed it will be necessary for the issuer, assisted by third party expertise, to prepare an Offering Memorandum to present the SIB to potential investors for consideration. The core components of such an Offering Memorandum will include, inter alia:

- an overview of the host NPO (including organisational information, track record, management team, financials and governance);
- the purpose of and need for the SIB;
- a program description (including track record, target client group/geography, measurement, anticipated outcome and operating budget);
- an overview of the Outcomes-Based Agreement (including investor payments) with government;
- a SIB detailed term sheet;
- risk factors and mitigants; and
- a timetable.

6. Audit and performance reporting body

The NSW Government SIB pilot will require an appropriate independent audit body and performance reporting protocols that are acceptable to the main stakeholders: social investors, the NSW Government, and the host NPO.

6.1 Criteria for an independent audit and performance reporting body

Section 4 has articulated the challenges in developing agreed outcomes and measurement frameworks, especially in relation to the trigger mechanism for reward payments to be made to investors. **It is therefore essential that a credible independent body performs the audit and performance reporting role for the benefit of all stakeholders.** This independent body must be able to secure relevant information not only from the host NPO but also from relevant government agencies. These flows of information in to the independent body should be established as part of the contract between the host NPO and the relevant government agency.

6.2 Reporting protocols

The learning from the UK and development of the economic model for juvenile justice in NSW has revealed a number of challenges for measurement, including the duration of the measurement period to capture the treatment effect e.g. reoffending behaviour over 24 months. There is also likely to be a significant lag between the end of a measurement period and when the data is available for analysis. It is therefore likely that each cohort measurement may not be completed until 6 months after the end of the 24 month period to capture the treatment effect. However, once the SIB is up and running for 3 years then outcome measurement will take place annually.

Given the delay in reporting the outcome measurement, **CSI recommends that an annual reporting template is utilised that captures relevant information on the operation of the program(s), including inputs and outputs.** The content of the template can be informed by experts.

6.3 Learning from the UK

In the UK, the Peterborough SIB is being audited by an independent assessor who is considered to be an expert in the field of reoffending and in undertaking robust evaluations. This role will also provide an opportunity to identify learning and to share this learning in a transparent way with all stakeholders. The investors in the UK Peterborough SIB also benefit from expert advice from an Advisory and Operational Review Committee. It is understood that the costs of the independent assessor and advisory committee are being met by the Big Lottery. The Big Lottery is also funding Social Finance UK to raise awareness of social investing and to develop other potential SIBs.

6.4 Options for the independent audit and performance reporting body

For the NSW Government SIB pilot, the role of the independent audit and performance reporting body could be performed by a professional service firm, a government agency or an academic institution that is acceptable to all stakeholders. This role is of critical importance and should be costed in to the structure of the SIB although alternative funding or pro bono arrangements could be used.

In 2010 the Professional Partnership Project was established. This is a unique partnership between the Australian Government and the four key professional services firms: Deloitte, Ernst & Young, KPMG and PricewaterhouseCoopers. This project was designed to provide pro bono support to social enterprises however the scope of the pro bono project could be extended to include this role in relation to SIBs. CSI has discussed this role with one of these leading professional service firms and received confirmation that they have the necessary expertise and the proposed tasks are comparable to those already performed for commercial, government and individual clients.

A candidate from the public sector is the Audit Office of New South Wales which conducts audits for the Auditor-General. The Audit Office conducts both financial and performance audits not only for government agencies but also arms-length and independent NPOs (e.g. Centennial Parklands Trust). As part of its mainstream activities it audits the main NSW Government agencies that will be involved in the SIB, e.g. Juvenile Justice, if a juvenile justice program is chosen for the SIB pilot. The Audit Office is able to provide independent critical analysis.

The Audit Office of NSW is also planning to assess in 2011 how well Juvenile Justice is managing the increasing number of juveniles on remand in Juvenile Justice Centres, which may provide an opportunity if juvenile justice is chosen for the SIB pilot. The Audit Office of NSW can operate across all policy areas; however there are also relevant specialist government agencies that could fulfil the audit body role in specific policy areas. For example, if juvenile justice is chosen for the SIB pilot, then the Bureau of Crime Statistics and Research (BOCSAR) could be commissioned.

This role could also be performed by an academic institution that has expertise in evaluation, performance measurement, social impact and financial instruments that deliver blended value. CSI has such expertise along with other institutions that may also have field specific expertise e.g. Australian Research Alliance for Children and Youth (ARACY) and the Social Policy Research Centre (SPRC).

An academic institution could also perform a broader learning and knowledge sharing role. This role would include elements relating to NPO capacity building and organisational change, cost-benefit and cost-effectiveness analysis, evaluation and social impact measurement methodologies, economic and financial modelling, risk analysis, outcome measurement, outcome commissioning, investor relations and investor market analysis. The learning and knowledge-sharing role will also facilitate the development of a social finance and social impact bond market.

6.5 Recommendations

CSI recommends that the NSW Government SIB pilot is subject not only to independent auditing and reporting but is also overseen by an expert advisory committee. This committee can help design the audit and annual reporting protocols and provide expert advice to all stakeholders. In addition, **CSI recommends that an independent body is also tasked with the capture of learning and the wider sharing of knowledge** including hosting state, national and international events and a virtual knowledge exchange.

Whilst the costs of the audit body, advisory committee and experts could be included in the core costs of the SIB, **CSI recommends that additional funding be secured so that the pilot can be fully exploited** in terms of evaluation, knowledge sharing, and raising awareness of social impact investing. In the UK these additional activities are funded by the Big Lottery, which may be used as a precedent to secure funding from a charitable trust.

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Annex 1: NSW Government SIB pilot: Summary alternative term sheets

Transaction Description	***NO Principal Guarantee Social Impact Bond OPTION A***	***PARTIAL Principal Guarantee Social Impact Bond OPTION B***	***FULL Principal Guarantee Social Impact Bond OPTION C***
Principal Guarantee within Outcomes-Based Agreement between NSW Government and Lead Delivery Agent[i]	0%	70%	100%
Investor Type	Philanthropically minded individuals/institutions committed to the Program. Impact investors attracted to the opportunity to be among the first Australian to invest in a Social Impact Bond or committed to the development of a social finance market in Australia.	As per Option A PLUS Impact investors prepared to accept non-traditional terms in order to facilitate significant community outcomes. Impact investors attracted to new and innovative investment models.	As per Option A and Option B PLUS Trustees of Private Ancillary Funds, Charitable Endowment Funds and other charitable foundations. Investors interested in socially responsible investing or ethical investing. Self managed super funds of philanthropically minded individuals or with an allocation to alternative assets.
Issuer[ii]	Lead Delivery Agent; or Wholly owned, special purpose subsidiary of Lead Delivery Agent	Lead Delivery Agent; or Wholly owned, special purpose subsidiary of Lead Delivery Agent	Lead Delivery Agent; or Wholly owned, special purpose subsidiary of Lead Delivery Agent
Purpose	Net proceeds from the issue of the Social Impact Bond will be used by Issuer to fund the [PROGRAM DESCRIPTION] which is anticipated to [EXPECTED OUTCOME]	Net proceeds from the issue of the Social Impact Bond will be used by Issuer to fund the [PROGRAM DESCRIPTION] which is anticipated to [EXPECTED OUTCOME]	Net proceeds from the issue of the Social Impact Bond will be used by Issuer to fund the [PROGRAM DESCRIPTION] which is anticipated to [EXPECTED OUTCOME]
Amount[iii]	$5-10 million	$5-10 million	$5-10 million
Term[iv]	5- 10 years	5- 10 years	5- 10 years
Principal Drawdown[v]	Multiple tranches over [X years] determined according to agreed drawdown schedule	Multiple tranches over [X years] determined according to agreed drawdown schedule	Upfront upon financial close
Principal Repayment	Subject to Issuer delivering Base Case Outcome, repayment will occur progressively throughout the term of the SIB commencing [no later than year 4] and will align to timing of certification of outcome for each cohort	Guaranteed Principal[vi]: Paid progressively throughout the term regardless of outcome commencing [no later than year 4] and aligned to the timing of certification of each cohort. Non-guaranteed principal (30%): Subject to Issuer delivering Base Case Outcome, repayment will occur progressively throughout the term of the SIB commencing [year 3] and will align to timing of certification of outcome for each cohort.	Guaranteed Principal[vii]: Paid progressively throughout the term regardless of outcome commencing [no later than year 4] and aligned to the timing of certification of each cohort.

Transaction Description	*NO Principal Guarantee Social Impact Bond OPTION A*	*PARTIAL Principal Guarantee Social Impact Bond OPTION B*	*FULL Principal Guarantee Social Impact Bond OPTION C*
Coupon[viii] *Base Case Outcome p.a.* *High Performance Outcome p.a.*	 13.0-15.5%[ix] 15.5-18.0% Subject to outcome delivered by the Issuer, paid progressively throughout the term of the SIB commencing [no later than year 4] and aligned to timing of certification of outcome of each cohort	 9.0-11.5%[x] 11.5% - 14.0% Subject to outcome delivered by the Issuer, paid progressively throughout the term of the SIB commencing [no later than year 4] and aligned to timing of certification of outcome of each cohort	 5.0-7.5%[xi] 7.5% - 10.0% Subject to outcome delivered by the Issuer, paid progressively throughout the term of the SIB commencing [no later than year 4] and aligned to timing of certification of outcome of each cohort
Security	Limited recourse (including Outcome Based Agreement and Proceeds Accounts)	Limited recourse (including Outcome Based Agreement and Proceeds Accounts)	Limited recourse (including Outcome Based Agreement and Proceeds Accounts)
Outcomes Audit	[INDEPENDENT THIRD PARTY]	[INDEPENDENT THIRD PARTY]	[INDEPENDENT THIRD PARTY]
Reporting Requirements	Annual and semi-annual financial statements Program performance report annually (including outcomes)	Annual and semi-annual financial statements Program performance report annually (including outcomes)	Annual and semi-annual financial statements Program performance report annually (including outcomes)
Advisory Committee	Advisory Committee comprising relevant professional expertise to represent investor interest through [quarterly] engagement with Lead Delivery Agent. Any investor holding more than 20% of the SIB to have the right to sit on the Advisory Committee.	Advisory Committee comprising relevant professional expertise to represent investor interest through [quarterly] engagement with Lead Delivery Agent. Any investor holding more than 20% of the SIB to have the right to sit on the Advisory Committee.	Advisory Committee comprising relevant professional expertise to represent investor interest through [quarterly] engagement with Lead Delivery Agent. Any investor holding more than 20% of the SIB to have the right to sit on the Advisory Committee.
Broker[xii]	[SELECTED FINANCIAL INTERMEDIARIES AND WEALTH MANAGERS]	[SELECTED FINANCIAL INTERMEDIARIES AND WEALTH MANAGERS]	[SELECTED FINANCIAL INTERMEDIARIES AND WEALTH MANAGERS]
Issuance Costs[xiii]	5%	5%	5%

[i] The Outcomes-Based Agreement to be entered into between the NSW Government and Host NPO could be written on the basis that all payments by NSW Government to the Host Service Delivery

1. standing payment/availability charge paid regardless of outcome; and
2. performance payment paid dependent on outcome.

The standing payment/availability charge has been assumed to be set at 70% of the principal amount of the SIB for the Option B: PARTIAL Principal Guarantee and 100% of the principal amount of the SIB for Option C: FULL Principal Guarantee. Furthermore, a lag of more than four years before payment of the first amounts under the Outcome Based Agreement is not considered acceptable to investors.

[ii] Two key factors influencing the choice of Issuer will be:

1. available exemptions from the Australian Securities and Investment Commission ("ASIC") in regards to prospectus and licensing requirements; and
2. limiting investor recourse to a restricted group of assets of the Lead Delivery Agent.

ASIC Class Order CO/02/184 provides an exemption from the fundraising, managed investment, debenture and licensing provisions of the Corporations Act for charitable organisations, albeit such exemption does not extend to subsidiaries of charitable organisations; further legal advice has been sought on what exemptions could be applied to subsidiaries of charitable organisations. Limited recourse may be achieved through: (1) security deed providing investors with limited recourse over a restricted subset of assets of the Lead Delivery Agent; or (2) the establishment of a wholly owned subsidiary/SPV of the Lead Delivery Agent.

[iii] Based on indicative feedback from NSW Government as to the potential size of the SIB pilot, coupled with cost of Programs under consideration and estimated investor appetite for SIB pilot.

[iv] Final term chosen will be influenced by the Program and, in turn, the timing associated between investment and outcome.

[v] Final drawdown profile will need to take appropriate account of: (1) chosen Program with specific regard to timing of expenditures and outcomes; (2) ease for investors to manage investment; and (3) level of principal guarantee.

[vi] Refer Footnote (i)

[vii] Refer Footnote (i)

[viii] The commencement and frequency of payment of the coupon will be dependent on the timing for measurement of agreed outcome however it is considered that a lag of more than four years before payment of the first coupon would not be acceptable to investors.

[ix] Benchmarked to the social capital of GoodStart (12%, 8 years) with slight premium to recognize the start-up/growth phase of the Programs being considered for the SIB pilot.

[x] Benchmarked to NSW Treasury Bond rate with a 4.0% to 6.5% premium recognizing the at risk of the coupon and a portion of the principal, the delayed payment of the first coupon given linkage to outcome and reduced frequency of coupon payments vis-à-vis standard NSW Treasury Bonds at 6 months.

[xi] Benchmarked to NSW Treasury Bond rate with 0.0% to 2.5 % premium recognizing the risk of the coupon, the delayed payment of the first coupon given linkage to outcome and reduced frequency of coupon payments vis-à-vis standard NSW Treasury Bonds at 6 months.

[xii] Depending on the strength of the financial expertise of the Lead Delivery Agent, it may be necessary to select one or more financial institution or wealth managers to act as a Broker(s).

[xiii] Refers to upfront costs of issuance including distribution, legal, regulatory, etc.

the Centre for Social Impact

CENTRE FOR SOCIAL IMPACT
LEVEL 6 EAST, AUSTRALIAN SCHOOL OF BUSINESS
UNIVERSITY OF NEW SOUTH WALES, SYDNEY, NSW 2052
p 02 9385 6568 | f 02 9385 6161 | e csi@unsw.edu.au | www.csi.edu.au