Lessons from the 2015 requests for social impact investment proposals

In the first year of implementing the *NSW Social Impact Investment Policy*, the NSW Government held two requests for social impact investment proposals (RFPs). The Office of Social Impact Investment (OSII) received 37 proposals across both RFPs.

The majority of proposals satisfied the threshold criterion of delivering social impact, but there was a lot of variability in how organisations interpreted what was required. We would like to share with market participants our observations and feedback to help you understand what we are looking for in proposals for future RFPs.

Please note: These observations are not intended to replace the *Principles for Social Impact Investment Proposals to the NSW Government*. They should be read together, as well as with future formal RFP documents, to understand what is required of proposals.

1. What should be included in proposals to increase the chance of being selected for joint development?

As with any tender process, proponents should review the RFP documents carefully. The social impact investment RFPs clearly state evaluation criteria and describe information that should be included when responding to criteria. They also suggest a structure (optional) for the submission to ensure proponents include everything we need to assess and score their proposal. This structure acts as a good checklist.

Generally, it is important to include the following to maximise your proposal's overall score:

i. A clear and comprehensive description of the proposed service and target clients.
ii. Responses to all evaluation criteria.
iii. A preferred position, if outlining options in your response to criteria.

Firstly, proposals should include a clear and comprehensive description of the proposed service and target clients. We have reviewed many proposals that have not done this, making it difficult to understand the components of the service, how clients will move through it, and the link between the service and outcomes. Sometimes, it is not clear who the service will target or the characteristics of the client group (e.g. age, location, demographics). It is often not clear how eligibility for the service will be determined or how clients will be referred to or begin the service. A clearly defined program logic for the service is useful for mapping inputs, outputs and outcomes, and we suggest including one in your proposal (see Question 2). A process map may also help to illustrate referral and service delivery processes.

It is also important to:

- describe the counterfactual and how it will be created, and address potential ethical issues
- identify the proposed location of the service and explain why it was chosen
- explain how the proposed service aligns with government policy and how it will interact with other government services.

Secondly, proposals should address all evaluation criteria. We have seen many proposals that do not fully address all criteria, often in the *value for money* or *sharing of financial risk and return* sections. Remember, all evaluation criteria are weighted equally. If you fail to address one of the criteria, you risk losing up to 25 per cent of your possible score. Regardless of how strong other elements of your proposal are, it is very difficult to achieve a high score if you do not respond to all criteria. Not responding to all criteria may also make your proposal non-compliant.

Thirdly, proposals need to clearly outline a position. We expect you to be willing to negotiate any and all aspects of your proposal should it be selected for joint development. However, we need to understand your preferred position in order to score your proposal appropriately. Some proposals have provided a number of 'options' for different aspects of their proposals (e.g. different ways to measure performance), without also stating their preferred option. This makes it very difficult to score proposals as we cannot score all options. To ensure your proposal receives the appropriate score, it must clearly identify a preferred position, the rationale for that position, and indicate whether or not the stated position is negotiable.

2. What is a program logic and why is it important?

A program logic tells the story of a proposed service – how it works and why. It should clearly show how inputs, activities and outputs are expected to contribute to the intended outcomes of a service, including what should be measured (and the methodology). In essence, it should show who the service is intended for and how the different components of a service will achieve the stated impact of a proposal. If measurement is not based on robust program logic, it risks not measuring the most important things and wasting resources. We expect to see a program logic in every proposal.

3. What evidence of service effectiveness is expected? What if the service is entirely new?

We recognise the tension of demonstrating a proposal is evidence-based and also innovative. However, at this early stage in the market, we are looking for proposals to outline a reasonable level of evidence that a service is likely to achieve the outcomes it is designed to. This means your proposal should:

- Include a review of evidence, including the results of rigorous, independent evaluations of the service or service components and other academic literature, with a focus on quantifiable client *outcomes* as a result of participating in a service (as opposed to how many clients were served over a period of time or the favourableness with which clients rated the service).
- Demonstrate that the service incorporates nationally or internationally accepted principles for good quantifiable outcomes in the policy or service area. These are often described in the Statement of Opportunities or the RFP, itself. A proposal that relies on evidence from other states or countries should explain how the service will be adapted for NSW.
- Include a program logic or theory of change that clearly links inputs and activities to outputs and outcomes.

We take a broad view of innovation, not just whether the proposed service is entirely new. For example, we consider whether a proposal:

- brings together different service components in a new way
- uses new technology or applies existing technology creatively
- applies new funding models
- applies an established service model in a new and innovative way, or to a different location, client group or issue.

4. What size should the principal investment be?

This is a common question to which there is no clear or correct answer. From the government's perspective, the transaction size (or investment principal sought) should be driven by the proposed service and size of the client group. The intention of the principal amount of social benefit bonds, and similar social impact investments, is to cover the cost of running the service, usually until the government begins making outcome payments, which may differ depending on the transaction (see Question 5). Therefore, the size of the proposed investment principal should reflect operational costs during the time before outcome payments begin.

5. What is an outcome payment? How does it relate to a standing charge?

An outcome payment is a payment from the government to a service provider on the basis of performance against pre-agreed target outcomes. Payments may vary depending on the level of performance (i.e. a sliding scale could be used) and the timing for measurement (see Question 6). Outcome payments are made only once service delivery has begun and outcomes have been measured. This means that the costs of service delivery will not be fully covered by the government until and unless the agreed performance has been achieved. This is in contrast to other funding arrangements that make upfront payments to cover the costs of delivering the service.

A standing charge is a payment from the government to help a service provider with working capital (i.e. for the costs of service delivery prior to outcome payments) and to balance the financial risk profile for participants. The NSW Government has indicated it is willing to pay a standing charge of up to 50 per cent of the service delivery costs. This is not a government guarantee but an early payment that is then deducted from outcome payments once outcomes have been measured. A standing charge may be paid as a one-off payment or as a regular payment throughout the life of the transaction (e.g. quarterly).

Proposals can include other measures along with those used for outcome payments. For example, a health-related proposal may include an outcomes payment for a decrease in hospitalisations but may also measure patient satisfaction and wellbeing.

6. When should outcome payments be made?

The timing of outcome payments should be considered in relation to the financial structure of the transaction and will differ from proposal to proposal. It really depends on the outcomes a service is trying to achieve and the amount of time needed to measure whether those outcomes have occurred.

Using preventing reoffending as an example – where the outcome measure is the rate of re-incarceration 12 months after release from prison – the timing of outcome payments might look something like this:

Timeline	Milestone
Month 1	Referrals and service begins.
Month 12	Referrals to the first cohort to receive the service are finalised.
Month 13	Referrals to the second cohort to receive the service begin.
Month 24	Measurement date for the first cohort who have been out of prison for 12 months.
Month 28	First outcome payment made, including the time it takes to extract data from government systems and calculate performance.
Month 36	Measurement date for the second cohort. Subsequent measurement dates every 12 months.
Month 40	Second outcome payment made. Subsequent outcome payments made four months after date of measurement.

Note, as outlined in Question 5, the standing charge is deducted from the outcome payment so that the calculation resembles the following (in a baseline scenario):

> Outcome payments for each cohort = 100% of service delivery costs for the cohort – standing charge paid in the cohort's referral period

7. What do you mean by 'appropriate sharing of financial risk and return'?

Generally, the government prefers that the majority of risk is taken by investors and/or proponents. At minimum, the government prefers to take on no more than 50 percent of the financial risk. This means that proposals should clearly outline the costs and benefits to each party of a transaction, preferably for each year of the transaction and overall, in various performance scenarios, so we can assess the level of risk assumed by each.

Proposals should also clearly explain the proposed payments in each performance scenario. For example, in a baseline scenario, government payments may only cover service costs, while in a 'good performance' scenario, they may cover service costs plus a performance or bonus payment for achieving outcomes beyond the baseline (usually a share of the net savings as a result of the outcomes achieved). Conversely, in a 'below performance' scenario, perhaps only a proportion of service costs will be covered by government payments, demonstrating the proponent and/or their investors are willing to share the risk of underperformance.

Proposals should also describe how benefits will be shared among parties. While the returns will be a share of the savings, they should be appropriate to the amount at risk. It cannot be assumed that 50 per cent of the benefits is an appropriate return for assuming the risk of 50 per cent of the service costs. Proposed returns need to reflect the market return for the amount at risk. Understanding the nature of these benefits is also important – are benefits likely to be cash savings, avoided costs or productivity gains? The answer to this question has important implications for how, and the extent to which benefits can be shared.

Please keep in mind that we can only consider benefits that accrue to NSW Government, not to the Commonwealth Government.

8. What financial information should be included in proposals?

At minimum, the cash inflows and outflows of all parties for each year of the contract period should be clearly set out. This may include:

- the government (standing charge and outcome payments, savings that accrue over time)
- the service provider (receipts and payments)
- investors, if relevant (payments to and from).

Any savings to the government that are expected to accrue beyond the contract period should also be included. You should also specify the preferred frequency of payments – will they be monthly, quarterly or annually? The cash flow modelling should reflect this preference. As an outcomes approach is favoured, outcome payments would be made in arrears, though the timing of standing change payments may be negotiable where a sound rationale is provided.

Ideally, cash flows will be modelled for at least three performance scenarios – baseline, good performance, and below baseline. You should specify the assumptions that underpin each of these elements, including the number of clients going through the service.

9. Are we required to use intermediaries to prepare a proposal?

Using intermediaries or other consultants is not required to respond to social impact investment RFPs. However, you should make sure you have a sound understanding of what is needed for all parts of the submission, particularly the measurement framework and financial model. These are often areas in which intermediaries or consultants can add value to a proposal.

10. Are consortia and other partnerships encouraged?

Consortia and other partnerships are encouraged but are not essential. A defining feature of social impact investment is the opportunity to partner in new ways to achieve better outcomes for clients. As this is still a developing market, it is likely that the right partners can bring extra resources and expertise to enhance your proposals, and the service itself. The OSII encourages this culture of partnership and collaboration among market participants for future transactions.

11. Should we provide any supporting information?

Yes. The OSII believes that a strong proposal should clearly state assumptions and outline supporting information and evidence, where appropriate and within the page limit. For example:

- citing references and providing links, where possible, for evidence of the service's effectiveness
- providing supporting information about how counterfactuals are arrived at, and proposed service delivery costs and financial benefits in financial models is strongly encouraged
- in principle agreements with or letters of support from potential partners, including government agencies (especially at the local level).

12. Should we address any requirements our proposed service may have of existing government services and infrastructure, such as information technology (IT) systems?

Yes. Proposals should identify whether aspects of their service (and its related ability to achieve outcomes) depends on referring clients to existing government services. For example, this may involve referring clients to community mental health or drug and alcohol services. Where this is the case, the costs to government of providing services to these clients should be factored into the financial model.

In addition, proposals should also address whether a government IT system or any other system is required to support the proposed service. This is important because incompatible infrastructure could potentially create delays in the implementation phase and cause material increases to service delivery costs. Therefore, proponents are encouraged to consider these issues in their proposals.

13. Should we include an implementation plan? What information should be included?

Yes, a high level implementation plan should be prepared for all proposals. The plan can be as simple as a table of key timeframes and milestones, such as:

- enter and conduct joint development phase (estimated six months)
- market the investment product, where necessary
- activities to prepare for service delivery, including the time and process to acquire infrastructure and other resources
- commencement of referrals and service delivery period
- further rollout or scaling up of the service over the contract period.