

Social Impact Investment Policy



**Leading the way in delivering better
outcomes for the people of NSW.**

Social Impact Investment Policy

Delivering better services and results for the people of NSW is a key priority for the NSW Government. When it comes to tackling our most pressing social issues, we recognise that Government cannot solve them alone. By harnessing the innovation and capital of the non-government sectors we can deliver better outcomes for the most vulnerable people in our community.

Social impact investment is an emerging approach to tackling social challenges that brings together capital and expertise from across the public, private and not-for-profit sectors. What makes social impact investment unique is that it combines all four of the following attributes:

-  **Outcomes**
Measuring and paying on outcomes
-  **Innovation**
Setting incentives and removing input controls for services
-  **Prevention**
Shifting spend away from high cost acute services to prevention
-  **Partnerships**
Sharing of risks and benefits across the government and non-government sectors.

In 2013, the NSW Government pioneered Australia's first two social benefit bonds, seeking to deliver better services and results for families at risk.

- » Newpin Social Benefit Bond – this bond funds the expansion of a UnitingCare Burnside program (Newpin) that works intensively with families to either safely return children in care to their families, or prevent children from entering care. With a principal of \$7 million, the bond targets a financial return of 10-12% per annum for investors over its seven year term.
- » The Benevolent Society Bond – this bond funds services for up to 400 families to help them deal with issues such as domestic violence, substance misuse, mental health, unstable housing and family functioning. The bond raised \$10 million in private capital.

Building on the successful launch of the initial bonds, the NSW Government is committed to finding other opportunities to use social impact investment to deliver better services and results.

Why the NSW Government supports social impact investment

Social impact investment has the capacity to deliver:

1. Better services and results

Social impact investment provides an opportunity to identify and test new and innovative ways to address social challenges, with a focus on measurement and delivery of outcomes.

2. Better partnerships between the government and non-government sectors

Social impact investment is an opportunity for governments to play an enabling role by creating the conditions for the non-government sector to do what it does best.

3. Better value for taxpayers

A strong social impact investment market will provide better value for money for the people of NSW, by driving greater contestability and innovation in service delivery, and paying for results delivered.

It is estimated the Australian social impact investment market could reach \$32 billion in a decade.

Impact-Australia, 2013

Current limitations on the growth of social impact investment in NSW

The NSW Government recognises that there are barriers to the growth of social impact investment in NSW, including:

- » limited proven models to build investor confidence
- » a lack of quality data to measure and quantify many outcomes
- » diverse views on how to measure outcomes, for example, cash savings versus avoided costs
- » the need for Government to see genuine risk-sharing in transactions
- » sufficient capability and capacity across Government and social sector organisations
- » economies of scale and diversification necessary for larger investors and funds to invest.

Addressing these challenges is critical to realising the potential of social impact investing.

Ten Actions

Our commitment to social impact investment

The NSW Government is committed to 10 actions, which will deliver more social impact investment transactions and grow the social impact investment market.

A. Deliver more social impact investment transactions

1. Target delivering two new social impact investment transactions to market per year

The NSW Government wants to participate in new social impact investment opportunities. To help stimulate continued growth in the market, Government will target bringing to market two new social impact investment transactions per year. Providing more investment opportunities in the social impact investment sector will not only help drive capacity, scale and diversification for investors, but also a greater understanding of, and appetite for, risk across both the public and private sectors.

While the Government-led social benefit bonds have experienced early success, Government will also explore other investment models that involve clear risk sharing among participants. This could include outcomes-focused grants, payment-by-results contracts, incentive payments, layered investments and pooled investments (Appendix 1 has more information on these investment models).

The NSW Government's commitment to new social impact investment transactions will build on the good work that is already being done to introduce innovative and outcome focused partnerships between Government and non-government service providers, and will facilitate further growth in the social impact investment market.

2. Publish Social Impact Investment Principles

The NSW Government will publish Australia's first Social Impact Investment Principles. These principles will identify the elements that Government seeks in social impact investment transactions. The principles will also provide a standardised risk definition, outline Government's benchmark approach to risk allocation, and set out how Government would seek to share risk for different transaction types. The discipline involved in social impact investments ensures that all parties receive benefits and value appropriate to the risk they assume.

The definition and allocation of risks between parties is a critical issue in any transaction. In the public private partnership space, the introduction of standardised guidelines has reduced transaction costs, and increased investor certainty.

3. Publish benchmark cost and outcomes data

We will establish a program to make the benchmark costs of key policy areas publicly available via a public database. We will also develop a framework of social outcomes that are sought and how they will be measured.

When Government is directly involved in a transaction, a key component of social impact investment models is an agreed method of measuring and quantifying government costs. To develop appropriate financial models, government agencies and their partners need information about what it currently costs Government to deliver services.

4. Deliver a Social Impact Investment Statement of Opportunities

The social impact investment market is a source of new and innovative approaches to address social challenges. However, it is important that Government's limited resources are focused on those areas which have the greatest likelihood of success and meet Government's priorities.

The NSW Government will periodically identify its priorities for future investment opportunities, through a published Statement of Opportunities. This will be based on Government priorities and where Government considers there are strong opportunities for better outcomes, based on feedback from the market and other stakeholders. The Statement will include metrics required for the development of robust proposals including proposed outcome measures and cost/savings data.

The Office of Social Impact Investment (see below) will serve as a central hub to receive and assess social impact investment ideas put forward by the sector and the public service.

B. Grow the market and remove barriers

5. Hold a series of social impact investment roundtables and market sounding sessions

As part of building the market and to prepare for future transactions, Government will hold a series of roundtable events to connect with potential investors, service providers and intermediaries. This will provide an opportunity for the Office of Social Impact Investment to consult with stakeholders on the NSW Government's next steps. This will help us understand if Government's policies are meeting the requirements of different types of investors, removing barriers to participation, and facilitating organisations and Government sharing best practice and data.

6. Aim to establish an Intergovernmental Taskforce on Social Impact Investment

The NSW Government recognises that improved personal wellbeing and better social outcomes are goals of both state and federal governments. Both governments benefit financially from better addressing social challenges – either through reduced spending on welfare and improved taxation revenue at a federal level or reduced cost of, or demand for, services at the state level.

Given the shared interest in outcomes, the NSW Government will seek to establish an Intergovernmental Taskforce on Social Impact Investment, with representation across state and territory governments and the Commonwealth. The Taskforce will identify investment opportunities with shared benefits, and address practical barriers to successful transactions, including data, taxation treatment, investment rules, legal limitations and other matters. It will also seek a consistent approach to governments' role as a facilitator and enabler of the social impact investment market.

7. Promote understanding of the social impact investment market

The Office of Social Impact Investment will facilitate knowledge-sharing and capacity-building to broaden and deepen the potential social impact investment market. This will include a Knowledge Hub accessible via the Office's website. The Hub will publish discussion papers to engage broader stakeholders and seek feedback on Government's approach to social impact investment, along with other resources.

C. Build the capacity of market participants

8. Improve government agency readiness for social impact investment

We are committed to improving government agencies' capacity to identify and engage with social impact investment opportunities. This includes opening up opportunities for the market to bring forward innovative proposals, and engaging with potential investors and intermediaries, through opportunities such as the Premier's Innovation Initiative. The NSW Government will also work with stakeholders on procurement challenges, and explore options for providing procurement guidance for stakeholders.

9. Facilitate non-government sector preparedness for social impact investment

The evaluation of the joint development phase for the social benefit bonds found that social service providers would need assistance to participate in a bigger social impact investment market. The NSW Government will investigate and implement appropriate methods for working with the sector to build their organisational capacity in areas such as outcomes measurement, and financial and contract negotiation.

10. Publish a Statement of Success

Practical evidence of social impact investment success will grow over time as domestic and international experience of social impact investment expands and more data becomes available.

At this emerging stage, the NSW Government recognises it can play a useful role in explaining the practical benefits of social impact investment models. To this end, Government will regularly publish progress of NSW Government social impact investment projects, including metrics on both costs and outcomes.

This work will be informed by international experience, and discussion of how measurement could be used by the social impact investment community for investments with different risk profiles.

How the NSW Government will implement this Policy

Office of Social Impact Investment

To facilitate this work, the NSW Government has established an Office of Social Impact Investment as a joint initiative of the NSW Department of Premier and Cabinet and the NSW Treasury. The Office's work will be overseen by an interagency Steering Committee and will receive input and guidance from a group of experts with relevant expertise and experience.

NSW Social Impact Investment Expert Advisory Group

The NSW Social Impact Investment Expert Advisory Group is formed by experts in both government and non-government sectors to provide advice to the NSW Government to facilitate the work to grow the social impact investment market in NSW and to raise awareness of social impact investment. It is chaired by Professor Peter Shergold AC, Chancellor of the University of Western Sydney. The members have skills and expertise in the areas of social finance/impact investment, philanthropy, legal, public administration, innovation, and social sector management or service provision.

Collaboration with key stakeholders

The Office of Social Impact Investment will work with government agencies and key stakeholders in the market to ensure its work is collaborative and meets the needs of all parties. The development of transactions in particular will be collaborative and build on the model used in the joint development phase of the social benefit bonds. This will ensure government agencies, service providers and investors have appropriate terms and processes for successful implementation.

An International G8 Taskforce on Social Impact Investment is also working on growing the market globally. An Australian Advisory Board reporting into that Taskforce recently launched a plan to grow the market in Australia, which involves three working groups to focus on implementing different streams of work. The Office will work closely with these working groups to align activities and ensure consistency towards achieving the common goal of growing the market for this exciting and beneficial area of investment.

Appendix 1

Social impact investment models

This appendix describes some of the social impact investment models of interest to the NSW Government. In addition to social benefit bonds, many government agencies are already exploring and using these types of investments including outcomes-focused grants and payment-by-results mechanisms.

Social benefit bonds

Social benefit bonds (or social impact bonds) are a financial instrument that pays a return based on the achievement of agreed social outcomes. Private investors provide the capital to deliver a program or service and the savings generated from achieving better outcomes enables Government to repay the upfront investment and provide a return. Social benefit bonds are among the first and best known social impact investment products originating in the UK. Along with NSW, social benefit bonds have also been developed in North America and Europe.

Outcomes-focused grants

Outcomes-focused grants are provided on the basis that the service or project is evaluated and the outcomes achieved are measured. This approach can help build the capacity of social sector organisations to collect data and measure outcomes, contribute to work to cost social outcomes, and build the social policy evidence base for what works. In this model, grants may be offered by public or private organisations as a one-off or they could be pooled together as co-contributors to a fund.

Payment-by-results contracts

Under a payment-by-results contract, Government pays a provider to deliver a public service based on the results achieved. This may mean that the provider is responsible for covering the initial costs of delivering services. A social benefit bond is a special type of payment-by-results contract that helps providers to access working capital from investors to deliver services in advance of getting paid. If the provider achieves the results specified in the contract, investors receive a return on their investment. But there may be other ways to access working capital, through private sources, a provider's own resources or a risk-weighted payment from Government.

These types of contracts may also involve an element of reinvestment. This sort of arrangement is usually incorporated in contracts with not-for-profit organisations that receive payments for outcomes that exceed their service delivery costs. The additional funds are reinvested in service delivery as a requirement of the contract.

Incentive payments

Governments can also offer additional payments to providers, beyond the cost of delivering a service, if 'stretch' targets are met. They can be used in traditional, payment-by-results and other outcomes-based contracts. As with payment-by-results contracts (see above), the additional payments may be required to be reinvested in service delivery.

Layered investments

Layered investments are structured to combine different types of capital in non-traditional ways, commonly disrupting the traditional risk-return equation so that investors taking greater risk may get a lower return. This role is often filled by governments or philanthropic foundations to attract other investors. Goodstart Early Learning raised \$95 million to purchase 678 childcare centres from the ABC Group with a layered investment structure that combined senior and subordinated debt. This brought together a diverse group of investors, including the National Australia Bank, the Australian Government, private investors (including family trusts and private ancillary funds), and the Goodstart Syndicate. Goodstart had a net surplus of \$3.56 million and reduced bank debt by \$27.5 million in 2012-13.

Pooled investments

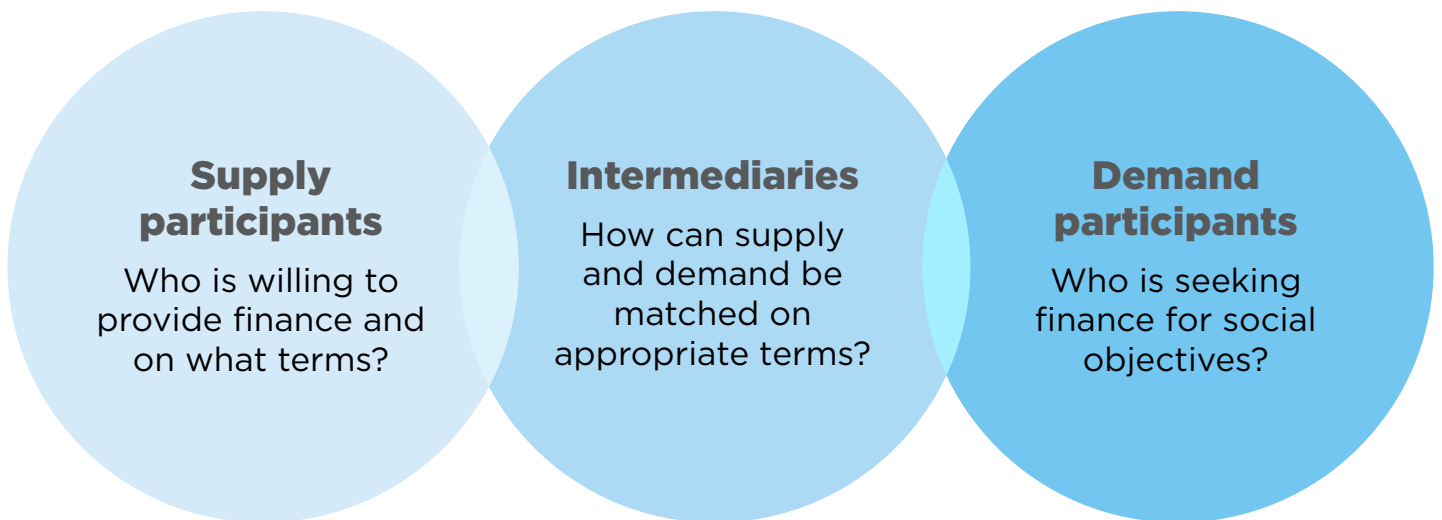
Pooled investments bring together (often) smaller amounts and different types of capital in one place to create more capacity to invest and direct capital. This is how investment funds operate, managing capital on behalf of many investors. Large, high performing social impact funds have started to emerge, some with portfolios in excess of US\$100 million.

Goodstart had a net surplus of \$3.56 million and reduced bank debt by \$27.5 million in 2012-13.

Appendix 2

Social impact investment market participants

The market participants can be presented in three different groups as below.



Enabling environment

What is the context in which the market operates, including direct and indirect government participation?

Supply participants are different types of investors who are willing to provide finance. Social impact investors include:

- » wealthy individuals and families
- » philanthropic foundations, including public and private ancillary funds
- » financial institutions, including banks, credit unions and development finance institutions
- » superannuation funds
- » retail funds or trusts.

These investors provide finance with the expectation of financial and social returns. The extent of these returns may vary from investor to investor, but each investor wants to see both the social outcomes and the financial gains the investment has generated.

Demand participants are those seeking finance. In social impact investing, they are often organisations with a social purpose, such as non-profits and social enterprises, seeking capital to deliver a service or program. To attract investment, these participants must ensure that their proposals are robust and be able to demonstrate a positive social impact and potential for a financial return to investors.

A diverse & strong intermediary sector is critical to the development of a social impact investment market.

Some commentators have suggested there is a cultural mismatch between government agencies, social sector organisations and potential investors, with a lot of work needed to understand each other's perspectives. Intermediaries can help with this and play an important role in matching 'supply' with 'demand' by:

- » helping social sector organisations access finance by sourcing and pooling capital
- » structuring deals and financial products
- » building the skills and capacity of social sector organisations to develop and negotiate investment-ready proposals
- » educating and raising awareness among investors about social impact investing
- » helping investors find opportunities through advisory or match-making services.

A diverse and strong intermediary sector is critical to the development of a social impact investment market.

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