

# The Archerfish Foundation | Discussion Paper

## *Social Impact Bonds... a pathway to better social outcomes in New South Wales?*

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***The Archerfish Foundation aspires to be an ideas incubator for innovative ideas in social provision that work***

*Our objective is to:*

- Act as a repository for novel ideas, sourced globally, for the delivery of evidence-based practices in the area of social provision - health, education, social welfare, housing, and (juvenile) justice.
- Source, formulate and advocate innovative ideas in the provision and financing of effective services.
- Promote the use of methodologically rigorous outcome & economic evaluation practices in social provision.
- Build networks of interested, active young professionals, linking them to intellectually energetic institutions, think tanks and mentors.

### **Abstract:**

Social impact bonds (SIBs) are a financial instrument that allows not-for-profit organisations to raise capital from the private sector to fund successful interventions. The bonds are underwritten by a state agency responsible for that sector. The not-for-profit organisation uses the capital to deliver a specific intervention, if it works (determined by a change in effect size) the investors are repaid the principal with interest proportional to the interventions success.

Social impact bonds could provide a useful vehicle to finance preventative interventions 'that work' in social provision (health, education, juvenile justice etc). The state is incented to underwrite bonds that fund evidence-based programmes that have been shown to improve socially desirable outcomes because future expenditure on crisis intervention's is avoided.

SIBs were developed in the United Kingdom and are currently being trialled in an intervention used to reduce recidivism amongst prisoners who have served relatively short sentences. This paper looks at whether Social Impact Bonds could be implemented in New South Wales and discusses some of the implications for public policy.

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## Contents:

	<i>Page:</i>
<i>Abbreviations</i>	3
<i>Glossary</i>	3
<b>1. Our Purpose</b>	<b>4</b>
1.2. Where are we coming from?	4
1.3. Disclaimer	4
<b>2. The Basics</b>	<b>5</b>
2.1. What are Social Impact Bonds?	5
2.2. How do they work?	5
<b>3. Foundation Concepts</b>	<b>6</b>
3.1. Service Delivery	6
3.2. Service Innovation	7
<b>4. Configuring Social Impact Bonds for New South Wales</b>	<b>8</b>
<b>5. The Target Audience</b>	<b>10</b>
5.1. Investors	10
5.2. Recipients & Issuers	10
5.3. Advisors	10
<b>6. Outstanding Issues</b>	<b>11</b>
6.1. Risks	11
6.2. Issuance	11
6.3. Markets for Bonds and Trading	11
6.4. The Independent Umpire	11
<b>7. Critical Success Factors</b>	<b>13</b>
<b>Appendix 1: Criminal Justice and Recidivism</b>	<b>14</b>
<b>Appendix 2: Frequently Asked Questions</b>	<b>15</b>
<b>Appendix 3: The Issuance and Redemption Process</b>	<b>18</b>

## Abbreviations:

<b>CSSA</b>	Catholic Social Services Australia
<b>DEWR</b>	Department of Employment and Workplace Relations
<b>IRR</b>	Internal Rate of Return
<b>NFP</b>	Not for Profit
<b>NGO</b>	Non Government Organisations
<b>NP</b>	Net Present Value
<b>SIB</b>	Social Impact Bond
<b>TAF</b>	The Archerfish Foundation

## Glossary:

<b>BOND</b>	A financial instrument that allows an issuer to raise capital. The bond issuer is obliged to repay the initial amount borrowed (the principal) plus additional interest payments over the life of the bond.
<b>COUPON</b>	The rate of interest the bond issuer pays to the bondholder.
<b>DEBT</b>	That which is owed to a creditor.
<b>EFFICIENCY</b>	The use of resources in a manner that maximises the potential output from the given inputs.
<b>INCREMENTAL COST EFFECTIVENESS</b>	The incremental benefit of an intervention relative to its alternatives.
<b>INTERNAL RATE OF RETURN</b>	The rate of return on an investment calculated to assess the attractiveness of an investment.
<b>MARGINAL COST</b>	The change in cost when the quantity produced increases by one unit.
<b>MATURITY</b>	The date at which the bond principal (and any remaining interest) is paid to the investor.
<b>MONOPOLY</b>	A market in which there is only one provider of goods and/or services.
<b>NET PRESENT VALUE</b>	A figure that provides the current value of an investment, it is calculated by discounting all current and future cash flows by an appropriate interest rate.

## **1. Our Purpose**

### **1.1. Where we are coming from**

This paper describes the concept of Social Impact Bonds and shows how the concept might be adapted for use in New South Wales (NSW).

Formally, this is piece of policy advocacy. The authors would be pleased to transfer the burden of advocacy of Social Impact Bonds to interested parties in the NSW public sector, if there was interest in adopting the idea and carrying it forward as a policy proposition. Self-evidently, given the commitment of public funds required to implement the idea, the authors recognise the limitations on their ability to carry the idea forward without unequivocal support.

Additionally, this idea has not been market tested with representative Not for Profit sector service provider organisations nor potential donors. Informal discussion with some private sector bond market participants have suggested that financial services organisations with social responsibility and citizenship mandates would be keen participants in a social bond market.

### **1.2. Disclaimer**

Translating innovative ideas in social provision from a foreign jurisdiction to NSW is challenging. The configuration of roles and responsibilities, especially when financing issues are considered, is not directly comparable between systems of government even between those that share Westminster traditions. The authors have taken some liberties in assuming activities that might be undertaken by NSW agencies, particularly NSW Treasury in implementing social impact bonds. Nothing in this paper should be taken to mean that these ideas have been endorsed by NSW Treasury or any other NSW State agency.

## 2. The Basics

### 2.1. What are Social Impact Bonds?

Social impact bonds (SIBs) are an innovative financing mechanism for non-state providers that generate a financial return to private investors proportional to the achievement of socially beneficial outcomes.

Social Impact Bonds are designed to serve the interests of Not for Profit (NFP) organisations, social policy makers, program designers and decision makers. Consistent with the recommendations of the Productivity Commission, Not for Profits and charities should be able to access private-sector, debt funding which enables rapid scaling up of, often new and innovative, social provision programs.

The implementation of Social Impact Bonds enables governments to directly commission and incent the achievement of contracted social outcomes at less than the State's incremental cost by paying performance leveraged coupon rates. Social Impact Bonds hold the promise of being optimally, economically efficient vehicles for achieving many social policy objectives and sought after outcomes not presently delivered by the public sector.

### 2.2. How do they work?

Social Impact Bonds are a method for raising private sector funding for the capital costs of scaling up and delivering innovative social provision initiatives developed by not-for profit agencies. Contingent upon the debt issuer achieving contracted outcomes, public sector funding repays the bond principal, while making provision to offer incentive interest rates for the achievement of large effect sizes, that is, differences that make a difference.

Bonds shift the risk of non-performance to private sector investors to the extent that failure to achieve contracted effect sizes results in forfeiture of debt servicing costs. Investor's principal is not guaranteed and is at risk to the issuer's malfeasance.

The key benefit to the State is that it is contracting for specific levels of outcome and paying only for incremental improvements in preferred social outcomes at less than the adjacent State agency's incremental cost to achieve the same outcomes.

The key benefit to the not for profit sector is that it is able to access investment to leverage innovative ideas in service provision that might not otherwise be funded by traditional sources of funding, donations and case funding. Additionally, social bond investors are incented to invest their time, effort and skills in not for profit entities as well as their capital.

### 3. Foundation Concepts

Social Impact Bonds (SIBs) have been characterised<sup>2</sup> as a class of financial assets that entail raising money from third parties in the private sector and making repayments according to the social impacts achieved.

In the UK, whence they originated, SIBs arise from a political philosophy that attempts to insert market disciplines into the delivery of public services<sup>3</sup>. In some quarters there is a belief that social provision has a). been cornered by and is delivered by oversized state agencies which crowd out innovative provision from the non-government sector (mainly, NFPs and NGOs), and b). are increasingly inefficient as a consequence of their capture by interests of the service providers' stakeholders at the expense of funders and service recipients.

The Special Commission of Inquiry into Child Protection Services in NSW by Wood reached essentially these conclusions with respect to the Department of Community Services. Wood's conclusions were in large part anticipated by Garling in his report into Acute Care Services in NSW Public Hospitals. Easterly<sup>4</sup> (2002) and Niskanen<sup>5</sup> (1968) offer good descriptions of how bureaucracies behave like monopolies driving the 'price' of services above marginal cost and under-provisioning services relative to non-bureaucratic competitive outcomes. Easterly notes that this is typically tackled as a principal-agent problem where the principal constructs a contract with incentives to craft an optimal outcome. SIBs are fully consistent with this approach, in that the principal contracts with a provider for a specific outcome.

SIBs have been endorsed within the [UK] *Smarter Government* white paper published in December 2009. The paper states that government will "pilot Social Impact Bonds as a new way of funding the third sector to provide services... This has the potential to radically change how government funds the third sector, by rewarding social investors for work which reduces future social costs"<sup>6</sup>.

#### 3.1. Service Delivery

SIBs are designed to re-energise and refocus the delivery of social provision by re-writing expectations for efficient and effective service delivery. In theory, SIBs are a hybrid financial instrument with some of the characteristics of a bond but also with characteristics of equity, wherein return is related to performance. In practice, SIBs are raised and funded to commission and incentivise the delivery of specific social outcomes in contrast to (block/bulk) funding mechanisms which typically fund inputs and process-intensive activities.

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<sup>2</sup> Loder, J, Mulgan, G. Reeder, N & Shelupanov, A. (2010). "Financing Social Value: implementing Social Impact Bonds." *The Young Foundation*. Available online: [http://www.youngfoundation.org/files/images/SIB\\_paper\\_Jan\\_10\\_final.pdf](http://www.youngfoundation.org/files/images/SIB_paper_Jan_10_final.pdf), accessed 8<sup>th</sup> April 2010.

<sup>3</sup> The prevailing rhetoric of the UK government is emphasis on smarter not smaller government. In a speech [7 December 2009] then Prime Minister Gordon Brown stated, "*Civic society will have a crucial role to play in this third generation of public services... Early intervention aimed at prevention helps families in crisis more effectively and is less costly in the long run. So we will pilot a new way of funding the third sector to provide such services. What we call social impact bonds - money paid out now to deal at root with the causes not the symptoms of a problem - will reward social investors for work which reduces future social costs, for example, in seeking to lower the reoffending rate of those coming out of prison.*"

<sup>4</sup> Easterly, W. (2002). "The cartel of good intentions: the problem of bureaucracy in foreign aid." *Journal of Economic Policy Reform*. 5(4): 223-250.

<sup>5</sup> Niskanen, W. (1968) The peculiar economics of bureaucracy, *American Economic Review Papers and Proceedings*, 58, 293-305.

<sup>6</sup> See: HM Government. (2009). "Putting the frontline first: Smarter Government." London. Available online: <http://www.hmg.gov.uk/frontlinefirst.aspx>, accessed 21<sup>st</sup> April 2010.

Broadly, the mechanics of the bonds are that NGOs and NFPs issue debt in the form of a bond which is purchased by private sector actors. Bonds earn a rate of interest equal to the risk-free rate (say 90 day Treasury Notes, presently ~4.86% per year). In the final year to maturity bonds attract an incentive rate of interest which is predetermined and proportional to the value of the social outcomes achieved by the NGO/NFP. Additionally, the bonds may assume the character of a step-up hybrid bond by including a 'step up' interest rate payable annually to the NGO/NFP for evaluating and reporting its provisional progress towards the achievement of the contracted outcomes, i.e. the outcome levels that would earn the maximum coupon rate. In order to better align the incentives of the NGO/ NFP to achieve the maximum coupon rate, the bond may contain a provision to share the coupon between the issuer and the investor at a predetermined rate.

The liability for all interest payments (both step-up and incentive) rests with NSW Treasury. For instance, the first UK implementation of SIBs was announced in London, by the UK Government in March 2010. A charity, St Giles Trust established a project named *Through the Gates*, which endeavours to quickly re-establish released prisoners into the community to intercept what is often a rapid path to re-offending. (See Appendix One for a program description and summary economic evaluation). With existing contracted, case-based funding in place from the London Probation Service *Through the Gates* raised a £5m bond to fund an expansion of its existing program to provide support services to up to 3,000 prisoners leaving prison in Norfolk (Eastern England) during the next six years.

The bond coupon rates are escalated by the achievement of independently measured reductions in reoffending rates. If the charity can demonstrate a 10 % reduction in re-offending rates, the bond's investors will earn an internal rate of return of 7.5%, where the coupon is paid by the Ministry of Justice; if the charity's efforts achieve lower re-offending rates, investors receive a proportionately greater return, capped at 13%. The broader reasoning is that society as a whole benefits from the achievement of sustained reduced recidivism and rapid engagement of released prisoners in the productive economy, and that these benefits should be shared with investors (or the charities themselves if investors choose to sign over their returns). The key benefit to the relevant State agency (in this case, Ministry of Justice) is that it is paying only for incremental improvements in preferred social outcomes.

### **3.2. Service Innovation**

In its review of the Not for Profit sector, the Productivity Commission<sup>7</sup> noted as one of its key points, "[t]here is potential for greater social innovation but the business planning capabilities and incentives for collaboration need to be strengthened. Further there is a need to strengthen the capacity for NFPs to access debt funding for social investment." The market approach to social provision embodied in SIBs speaks directly to the Commission's adverse commentary on the inhibitory effect on prevailing contracting practices including overly prescriptive requirements, increased micro-management, requirements to return surplus funds and inappropriately short-term contracts, all of which contribute to degrading the efficiency and effectiveness of NFPs' deliveries of services.

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<sup>7</sup> See: Productivity Commission. (2010). "Contribution of the Not for Profit Sector", Research Report, Canberra. Available online: <http://www.pc.gov.au/projects/study/not-for-profit/report>, accessed 21<sup>st</sup> April 2010.

## 4. Configuring Social Impact Bonds for New South Wales

Within the broad principles of private sector risk and return, focus on outcomes and measurability, social impact bonds can be readily customised to meet the needs of NGOs, NFPs that operate in broadly different areas. This section briefly outlines how Social Impact Bonds might be configured in order to be integrated into the delivery of social provision services in New South Wales.

Bonds may be characterised in terms of a generic set of operational aspects that are common to all social impact bonds and a feature set that may on occasion be used to customise bond operation for issuers with unique requirements. The core principles are:

1. The primary participants are an NFP or NGO with an innovative service delivery programme capable of delivering social provision outcomes with measurable effect sizes; a private sector purchaser of the NFP's issued debt; a state agency, typically Treasury, which pays an incentive coupon rate in the final year to maturity and repays the bond amount, contingent upon the NFP achieving contracted measured outcomes. Treasury's liability for performance leveraged coupon rates is capped at a predetermined rate which might approximate 13% internal rate of return.

Additionally, a fourth participant, an independent advisor (retained by Treasury) advises on expected outcomes under the counterfactual, recommends the structure of incentive coupon rates and audits the measurement of outcomes and achieved effect sizes.

2. Debt funding is raised from private sector investors; the amounts may vary between \$1m and \$10m; the period to maturity is typically 5 years but may vary subject to unique aspects of the service delivery model and subject to the agreement of all participants. The bond purchaser accepts liability for capital loss if the issuer defaults or for coupon loss if the NFP fails to achieve even a baseline level of contracted outcome.
3. The liability for incentive coupon payments rests with NSW Treasury.
4. There is strict separation of interests between Treasury (and its advisors) and all other participants in debt issuance, redemption and outcome evaluation.
5. Treasury reserves the right to preferentially support bond issuance to NFPs which address strategically important areas of social provision.
6. Treasury expects to apply incentive coupon payments to final outcomes. For example, a programme to reduce juvenile offender recidivism may measure post-release reoffending rates amongst the treatment cohort as a final outcome.
7. Unequivocally, Treasury will consider only proposals where benefits substantially exceed costs.

*The optional feature set includes:*

1. Treasury may support step-up hybrid bonds in which an additional coupon may be payable annually to the NFP contingent upon the NFP implementing an outcome-oriented reporting system in order to report indicative annual outcome

performance levels accurately describing the rate of closure on the target performance level required to achieve maximum coupon payments.

2. Treasury will support coupon splitting arrangements in which the bond issuer and bond purchaser agree to share a predetermined split of the incentive coupon.
3. Treasury may, in some circumstances, forego insistence on contracting for final outcomes in favour of intermediate outcomes. For example, intermediate outcomes for a juvenile reoffending programme might include stable employment, stable living arrangements and verified drug free status.
4. Treasury may agree to early redemption of capital and incentive coupon payments where a predetermined pattern of outcomes and effect sizes has been achieved.
5. In conjunction with step-up hybrid bonds (see #1, above) and to incent long-acting programmes where the lead time for preferred outcomes is lengthy, Treasury may support annual interest payments to the issuer equal to the risk-free rate. It is expected that this feature will be reserved for sought-after outcomes in education, out of home care / family preservation and youth mental health initiatives.

Treasury expects to implement a funding offset for SIBs from the budgets of the social provision agencies most closely related to each SIB. This might be achieved by incrementing the agencies' efficiency dividend targets.

## 5. The Target Audience

### 5.1. Investors

It is expected in the UK that the investors in SIBs will be trusts and foundations, commercial investors, and high net worth individuals. In Australia, many of the same groups might be expected to participate as well as corporate entities with Social Responsibility and Citizenship mandates. In order to speed investor acceptance and uptake, it might be expected that the State Government (through Treasury, TCorp and the State agencies) might participate at the margins as an occasional issuer of debt; Treasury and the State agencies would be the funder of incentive coupon payments.

Upon successful completion of the intermediate and/or final outcomes of the programme the State government undertakes to return the investors capital and pay an incentive-based coupon rate proportional to the value of the outcomes achieved.

### 5.2. Recipients/Issuers

The selection criteria for target service providers should, in the first instance, reflect strategic priorities in State social provision, e.g. child welfare, adolescent and community mental health services, respite care for families, juvenile justice, or in those areas where the achievement of the State Plan would be beneficially impacted by alternative provision and funding arrangements. In each case, service providers should be qualified by on-going contracts or, preferably, case-based funding in their area of service operations. Credit-worthy recipients will likely have trialled the service delivery program for which they are seeking bond finance and will be able to demonstrate both credible effect sizes for their program as well as rapid scalability contingent upon the receipt of funds.

### 5.3. Advisors

Independent advice to investors and government (as the incentive coupon funder) will be required in the likely absence of ratings agencies, such as *Moody's* to rate bonds. The greatest challenge will be in establishing and warranting a counterfactual for setting base and incentive coupon rates and then measuring actual performance against the counterfactual to determine achieved effect size.

Additionally, it is expected that private sector originators will be engaged by NFPs to prepare bond documentation, Treasury submissions and they may potentially underwrite the bond or assemble investors. *Social Finance*<sup>8</sup> fulfilled this role with respect to *St Giles Trust*. It is essential that Treasury adopt a policy of encouraging multiple originators to operate in the bond origination space to avoid the risk of a single originator assuming a role of gatekeeper to Treasury funds.

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<sup>8</sup> <http://www.socialfinance.com>

## 6. Outstanding Issues

The purpose of SIBs is to facilitate rapid scalability of social provision programs developed or implemented by NFPs, NGOs, etc who are willing to take prudent financial risks to address areas of unmet need or to create interventions designed to ameliorate holes in the social safety net. These organisations typically have agility and responsiveness not present in large State agencies which tend to focus their resources on legacy programs.

### 6.1. Risks

Incentivised funding strategies are not without precedent in Australia – the Department of Employment and Workplace Relations' (DEWR) initiative, *Jobnet* provided laddered payments to employment services providers as a function of achieved employment rates of jobseekers with varying disability levels. Catholic Social Services Australia (CSSA) in a report commented adversely on the perverse incentives that arise inadvertently in the design of employment programmes noting that incentivisation schemes can induce gaming of the payment system by providers, compounding the disadvantage of long-term jobseekers. Maintaining the quality, sustainability and equitable access to intervention program outcomes is a challenge in all forms of social provision.

An additional risk is that comparatively few NFPs are culturally attuned to the discipline of regular financial and performance management and reporting that would be associated with a rapid inflow of debt funding.

### 6.2. Issuance

The terms and conditions of most commercially issued and traded bonds require conformance to six core covenants. It is proposed that SIBs will also conform to uniformly standard clauses with respect to:

- a) Cross default
- b) Change of control
- c) Negative pledge
- d) EBIT interest coverage
- e) Majority of noteholders clause
- f) Leverage ratio with respect to all debt incurred by the issuing entity.

### 6.3. Markets for bonds and trading

It is recognised that the market for trading SIBs would likely be illiquid at least in the early stages of bond development, but over time there might be opportunities for the development of a secondary market but the nature of this market will be dictated by issuance decisions. There may potentially be a role for TCorp as a market maker in SIBs trading.

### 6.4. The Independent Umpire

Treasury would be expected to approve the coupon rate, and the schedule of incentive coupon payments. It would be expected to do so based on expert commissioned advice on the counterfactual and the estimated saving pool accruing from the flow of the expected benefits.

Advisors would be expected to provide guidance on setting and determining outcomes achievement criteria

## 7. Critical Success Factors

It should be self-evident that SIBs should operate within a comprehensive set of governance guidelines that bind all participants. The following factors are critical to the success of the social impact bonds in New South Wales:

- Clear delineation of all source and application of funds for the bond, interest payments, and step up payments to ensure that the bond is appropriately priced.
- The program in question must have clear and measurable high priority social outcomes that are apparent over a 5-year period.
- The cash savings to Government from achieving the outcomes must exceed the costs.
- A robust evaluation methodology and suitable evaluator to be identified in advance of commencement of the pilot
- SIBs serve to reward the development of innovative cost-effective approaches to social provision. Ideally, the likelihood of an innovative programme achieving positive outcomes should be supported by research such as on similar programs inter-state or overseas. Alternatively, effect sizes from small-scale pilots supported by rigorous impact evaluation methodology would be well regarded.
- There are identified investors and these investors are willing and able to carry the risk on incentive payments and return of bond capital
- The not for profit operator/s has/have a sound record in service delivery of this sort the program
- All pilot program parameters are subject to independent review by parties including T-Corp before commencement of the pilot
- All Government procurement, probity and ethical requirements are met in establishing the pilot.

## Appendix 1: Criminal Justice and Recidivism – *Through the Gates*

Frontier Economics observes in their analysis of the economic impact of St Giles Trust's *Through the Gates* program<sup>9</sup> that reoffending rates in the UK are high (estimated to exceed 60% in the first year post release) and costs the economy over £11 billion a year. Reducing reoffending rates of ex-prisoners by 10% could save over £1 billion for the UK economy.

*Through the Gates* offers three core services:

1. Pre-release familiarisation and immediate post release meeting
2. Housing support.
3. Employment, ID and benefits support.

Additionally, the Service arranges referral to specialist services (mental health and substance misuse), used by 5% of their clientele.

Using “top down” and “bottom up” approaches Frontier Economics estimated the cost of reoffending as lying between £80,825 and £162,225 per offender in 2009 prices. In their subsequent analysis, Frontier Economics used the conservative estimate. The per person cost savings, conditioned on the effectiveness of the *Through the Gates* program ranged from £8,616 to £28722.

The net benefits due to the *Through the Gates* program were £10.4 million and the costs of running the program £1.05 million, giving an incremental cost benefit ratio of *Through the Gates* of 10. In other words, each unit of investment leverages a ten-fold increase in the social value of reduced re-offending.

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<sup>9</sup> See *Pro Bono Economics* at [http://www.probonoeconomics.com/pdf/St\\_Giles.pdf](http://www.probonoeconomics.com/pdf/St_Giles.pdf). Accessed 17<sup>th</sup> April 2010

## Appendix 2: Frequently Asked Questions

### 1. *How do SIBs work and who pays for what?*

The general design principles for SIBs are: Charities and Not for Profits issue a bond (i.e. incur debt) typically to the amount of \$5m but may range between \$1 and \$10 million. The bond is typically used to fund the rollout of a new or innovative community service; the service may involve, for example, reducing juvenile re-offending rates or improving literacy and numeracy skills for a target population.

The key requirement is that the service will deliver quantifiable, cost effective results that make a measurable difference in the community. That is, a difference that makes a difference. A bond is a promise to repay an amount of money some time in the future, typically five years. The charity that issues the Social Impact Bond promises to repay the amount of the bond in full to the investor at the end of the agreed term (e.g. 5 years). However, if the NFP's service delivery performance meets contracted expectations, the NSW government repays the bond in full. In some circumstances, if performance falls short of contracted performance but exceeds an agreed benchmark, the NSW Government will repay a proportionate amount of capital. The investor's capital is not guaranteed and is at risk to the NFP's default or catastrophic non-performance.

In the final year of the bond the government promises to pay an incentive coupon rate which may be between 20% and 30%, contingent upon the achievement of agreed outcome levels in an area of social provision. The incentive coupon will be capped so as not to exceed 13%, internal rate of return. SIBs include a provision for the investor to share the incentive coupon payments with the charity. The government may also pay a "step-up" rate equal to ~2% to the charity on the condition that the charity publishes annual performance reports that satisfy conditions set by the government.

### 2. *What advantages do SIBs offer investors?*

In the final year of the bond, investors receive a high rate of return guaranteed by NSW State Government conditional only upon the achievement, by the issuer, of predetermined performance hurdles or effect sizes. Investors have the opportunity to maximise their utility as community re-investors and builders by sharing their bond returns with the issuer. In many instances, investors will have the opportunity to directly involve themselves with their "community-builder" of choice as mentors and advisors.

### 3. *What are the risks faced by investors?*

Investors' capital is not guaranteed and is at risk to the issuer's default. Investors will be incited to do their own due diligence on the management, performance history and service model value proposition of each investment opportunity. See the investigation by Frontier Economics of *Through the Gates'* value proposition and independent guidance to investors.

4. *What can be done to provide greater transparency of the issuer's performance?*

SIBs have a provision for a “step-up” annual interest payment valued at ~2% of the bond's value. The step up payment is made to the bond issuer contingent upon the issuer publishing annually detailed performance records showing their achievement of milestones on the path to the achievement of the maximum incentive coupon rate. The step-up coupon rewards the issuer for publishing auditable performance reports not for the achievement of intermediate performance outcomes. Charities will be incented to put in place financial and performance reporting systems and will be rewarded for doing so with returns from “step-up” interest payments. Bond issuers will be encouraged to broaden their base of support and engagement with the investor/donor community by taking up opportunities for mentoring and guidance from sophisticated investors with robust links to the philanthropic community.

5. *Can an investor sell his/her SIBs?*

Presently, a secondary market for SIBs cannot be guaranteed. By ensuring that SIBs are issued under standard documentation enforcing compliance with six standard debt issuance covenants (cross default, change of control, negative pledge, EBIT interest coverage, majority of noteholders clause, leverage ratio with respect to all debt incurred by the issuing entity) the chances of encouraging the emergence of a market maker and the development of a secondary market will be improved.

6. *How do charities or not-for-profits benefit from SIBs?*

Not all charities are equally likely to benefit from SIBs. Bonds will be most beneficial to charities, etc that have innovative ideas for serving their clientele, but insufficient operational funds to scale up, i.e. hire more staff, purchase or lease equipment and facilities to launch or execute new service delivery models. Bonds serve to accelerate new service provision by rewarding innovation.

7. *How do SIBs benefit NSW Government and its taxpayers?*

SIBs encourage the emergence of innovative, results-oriented providers as opposed to providers whose funds seeking is primarily to sustain infrastructure expenses. Many very capable organisations in the NFP sector simply lack enough scale to make a lasting impression on the social provision landscape. A robust funding mechanism will enable outcomes-oriented and ideas-driven organisations to make a sustainable difference to their clientele. It is expected that organisations which are funded to test out innovative ideas in social provision, particularly in the areas of juvenile justice and youth mental health services may establish partnerships with state agencies to share and extend the scope of their ideas.

8. *Why isn't SIBs a Commonwealth initiative?*

Presently, most community services such as health, education, social welfare, justice, disability services etc are delivered by State not Federal entities. Commonwealth endorsement of SIBs might lead to advantaged tax treatment of SIB returns in the hands of both private and corporate investors. Which should have the beneficial consequence of deepening the pool of potential investors and speeding adoption of SIBs across all states.

9. *Would bonds be limited to agencies that have funds to repay the principal or to projects where the social outcome will enable the repayment of capital over time e.g. microfinance initiatives?*

No, while it might be helpful to think of SIBs as a kind of scaled up microfinance project, microfinance projects aim to achieve a nil final balance so that capital is not consumed but recycled through multiple projects. The key difference between microfinance and SIBs is that SIB capital is repaid in full by the government, contingent upon the issuer meeting contracted outcomes.

10. *What is the current status of SIBs in the UK.*

- Social Impact Bonds (SIBs) enjoy bipartisan support. They were initially championed by the former UK Labour government, but are also supported by the current coalition government.
- Statements from the UK Treasury indicate support for the wider use of SIBs across government departments if the initial trial proves successful. The chief secretary to the Treasury, Liam Byrne was quoted in parliament: “*The Department for Children, Schools and Families have pledged to explore the potential of SIBs to lever in additional resources to support early intervention approaches with children and young people*”<sup>[10]</sup>.
- There is some speculation that the first SIB may be oversubscribed, indicating that the market is receptive to the concept of SIBs<sup>[11,12]</sup>. This means that our potential investor market may be larger and more diversified than we initially expected.

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<sup>10</sup> Mair, V. (2010). “Treasury hints at more Social Impact Bond trials” *Civil Society*. April 20th. Accessed 25<sup>th</sup> August 2010. Available Online:

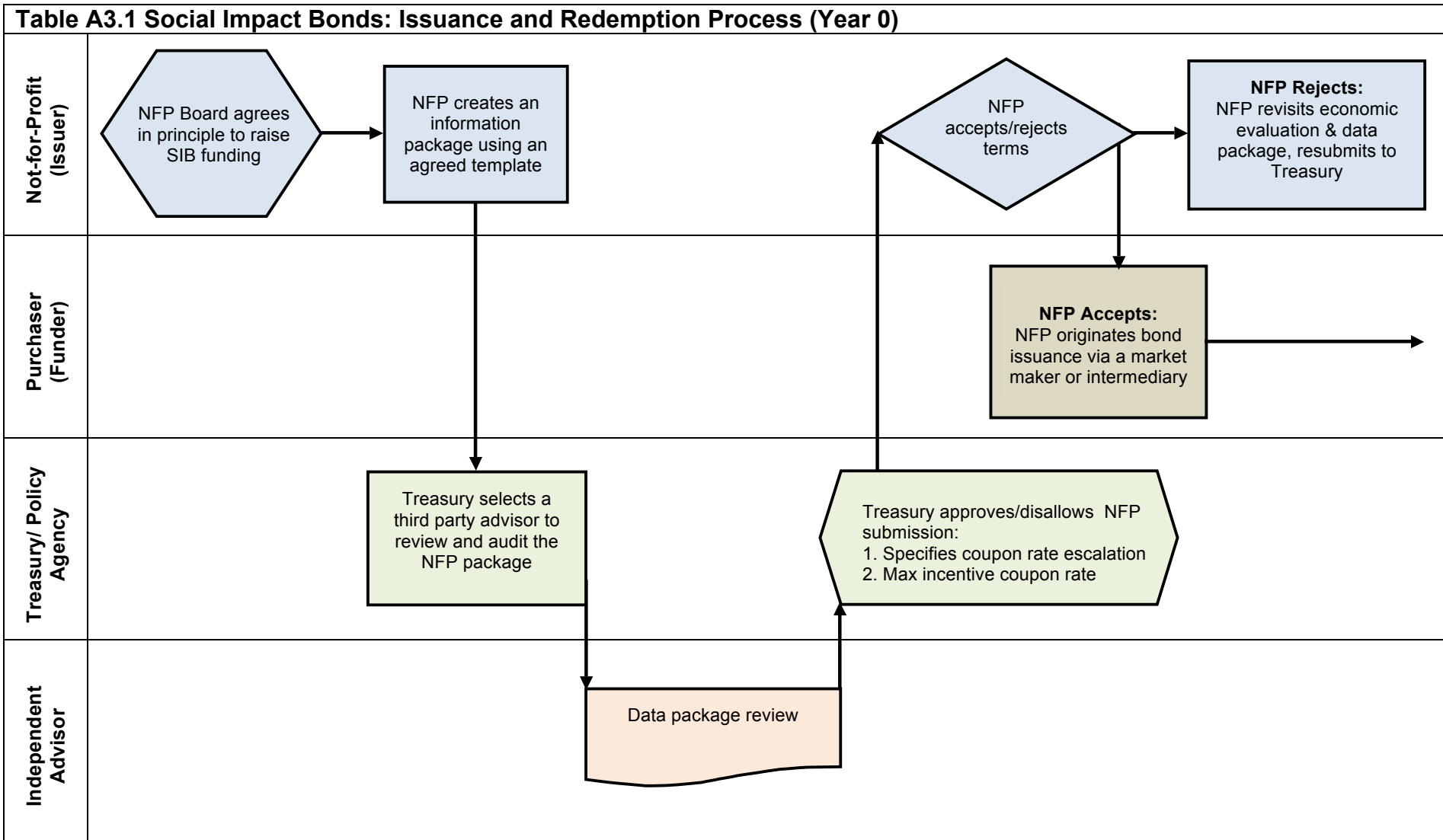
[http://www.civilsociety.co.uk/finance/news/content/6476/treasury\\_hints\\_at\\_more\\_social\\_impact\\_bond\\_trials](http://www.civilsociety.co.uk/finance/news/content/6476/treasury_hints_at_more_social_impact_bond_trials)

<sup>11</sup> Mair, V. (2010) “Government social impact bonds trial set to exceed target” *Civil Society*. August 11<sup>th</sup>. Accessed 25<sup>th</sup> August 2010. Available Online:

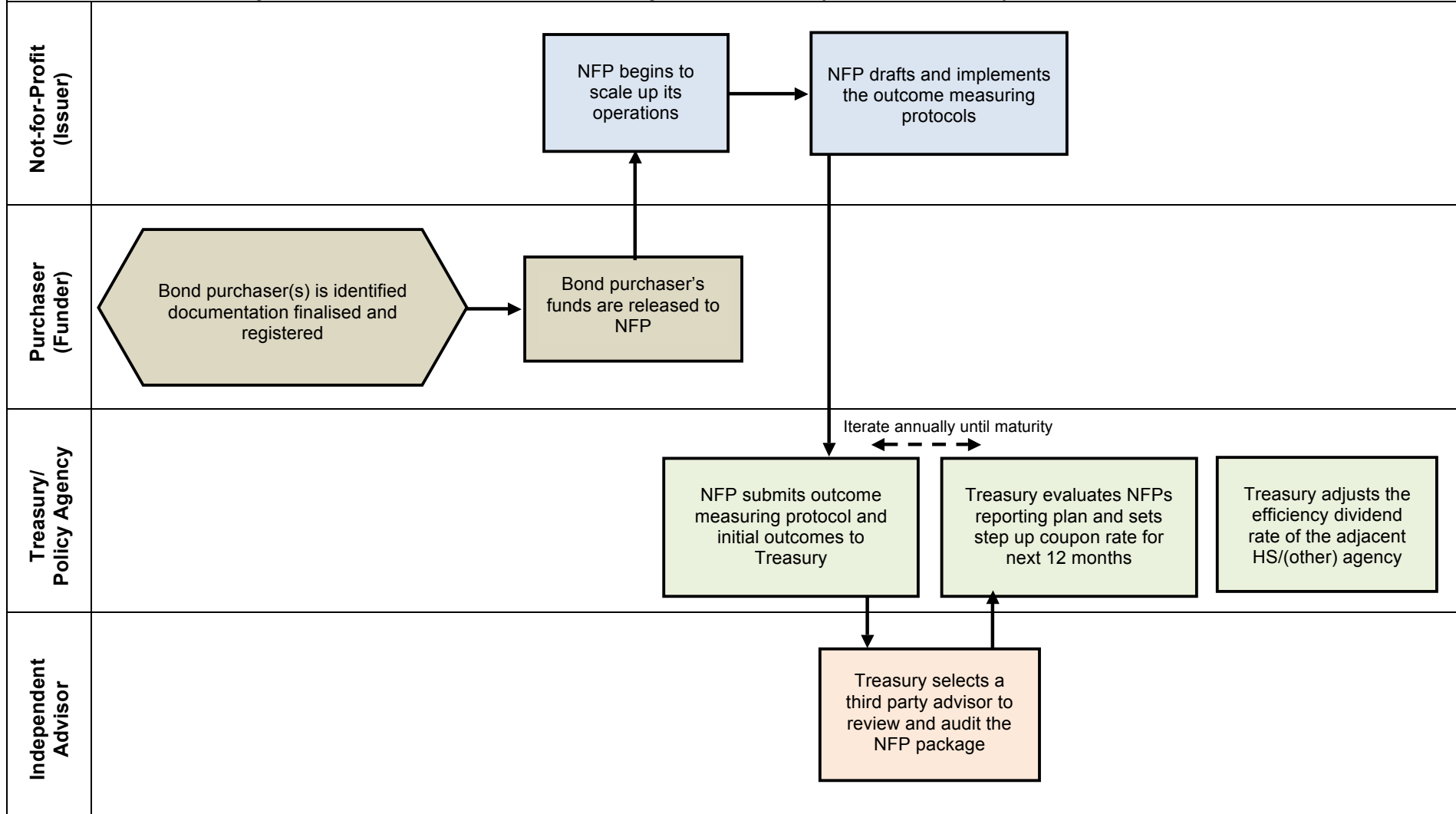
[http://www.civilsociety.co.uk/finance/news/content/7110/first\\_trial\\_to\\_encourage\\_investment\\_into\\_the\\_voluntary\\_sect\\_or\\_set\\_to\\_be\\_oversubscribed](http://www.civilsociety.co.uk/finance/news/content/7110/first_trial_to_encourage_investment_into_the_voluntary_sect_or_set_to_be_oversubscribed)

<sup>12</sup> Hann, P. (2010). “A Captivating Start for Social Impact Bonds”. *Suite 101.com* August 13<sup>th</sup>. Accessed 25<sup>th</sup> August 2010. Available Online: <http://investment.suite101.com/article.cfm/a-captivating-start-for-social-impact-bonds>

### Appendix 3: The Issuance and Redemption Process for a generic social impact bond



**Table A3.2 Social Impact Bonds: Issuance and Redemption Process (Year 0,1,2... t-1)**



**Table A3.3. Social Impact Bonds: Issuance and Redemption Process (Year *t*)**

