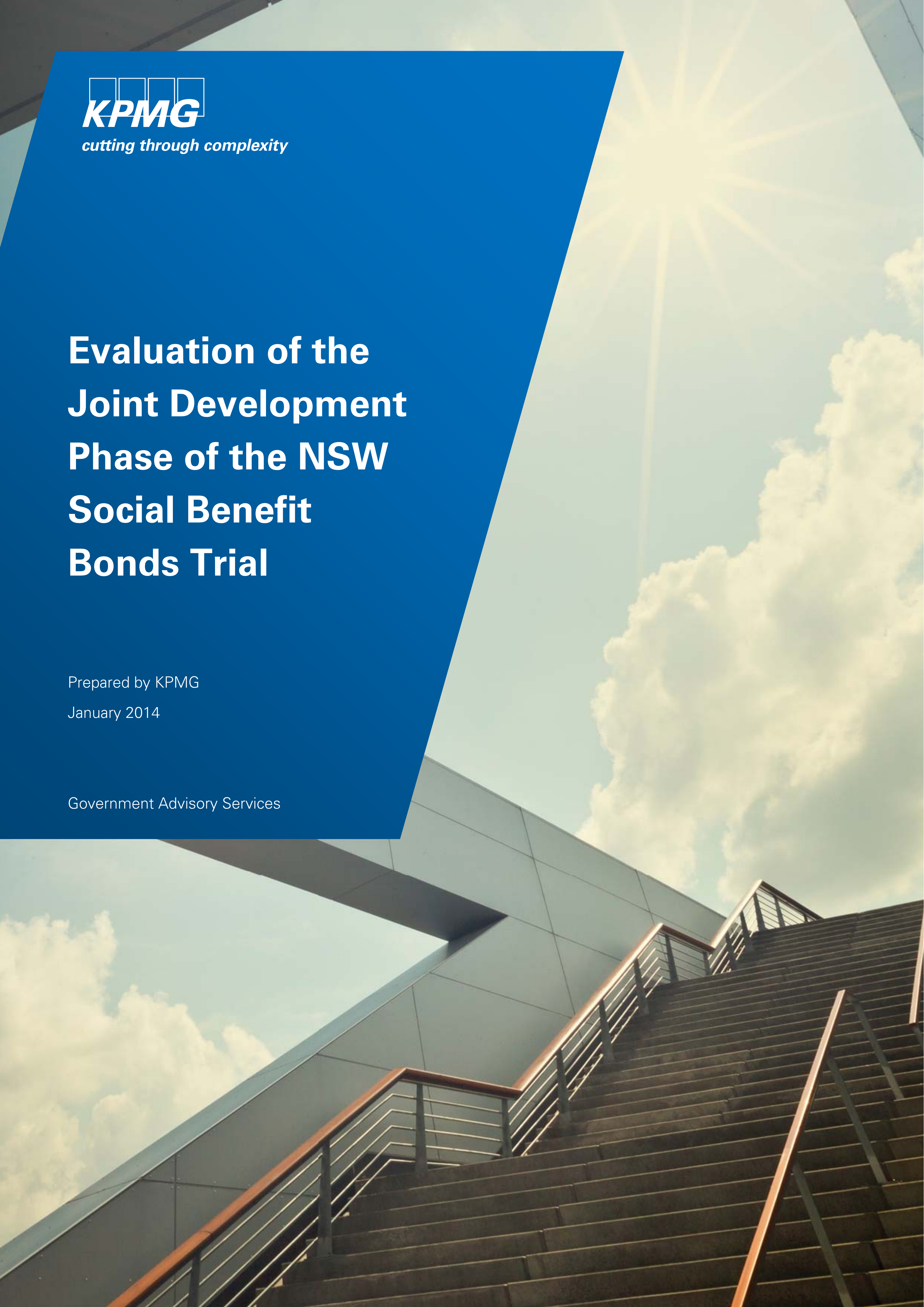

KPMG
cutting through complexity

Evaluation of the Joint Development Phase of the NSW Social Benefit Bonds Trial

Prepared by KPMG

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Government Advisory Services

Disclaimer

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Executive summary

This evaluation documents the planning and development of Australia's first social benefit bonds and considers what has been achieved and what can be learnt so far.

Social benefit bonds are a form of payment by results (PBR) scheme in which private investors provide up-front funding to service providers to deliver improved social outcomes, with the rate of return to investors dependent on program outcomes. Social benefit bonds are concerned with better outcomes and more effective service models.

The evaluation of the planning and development of the bonds has found:

- *Social benefit bonds are viable in New South Wales (NSW)* – Two bonds have been successfully developed, showing that the financial instrument can be used in the Australian context. Although the bonds are viable it is recommended that other PBR contracting schemes and impact investment options are also explored.
- *The development of the bonds has produced positive outcomes* – There have been positive gains for both NGOs and government from involvement in the bonds including an improved understanding of what the bonds can offer. In particular, there has been increased attention and understanding of program outcomes and measurement of them.
- *If future bonds are to be developed, capacity building is vital* – Capacity needs to be developed within government, in NGOs and within financial intermediaries, to develop future bonds, improve data and contracting capacity, and develop and catalyse the social impact market. Central government could develop a social benefit bond unit to capitalise on the experience of the Trial, drive future bonds, and develop resources. The Trial has led to an improved understanding of research and evidence but improved capacity for data capture and analysis in both government and NGOs is vital for future bonds. The NSW Government's recent mandate for program evaluation and the establishment of a Program Evaluation Unit within NSW Treasury will assist in this regard. Building on the experience of the Trial, NGO capacity to be able to contract for outcomes can be developed further, and financial intermediaries, can build the understanding and knowledge of impact investing in the financial sector.

It is expected that future transaction costs of bonds will decrease as capacity is built and the field matures.

The planning and development of the NSW Bonds

The process

Central agencies within NSW Government initiated and led the Social Benefit Bonds Trial to test proof of concept in the NSW context. The Trial consisted of three phases: planning, a request for proposal (RFP) and negotiation in a Joint Development Phase (JDP). As may be expected in a new area, the Trial required a significant amount of resources: the JDP took around 12 months to complete (equivalent to six full-time workers over one year).

NSW Treasury adopted the role of project manager, facilitator and independent negotiator to drive collaborative decision making. Advice to the Trial has been provided by an independent group of subject matter experts – the Expert Advisory Group.

The outcomes

The Trial has resulted in the development of two Social Benefit Bonds in early intervention:

i. **The Newpin Bond –** A $7 million bond over seven years is funding UnitingCare Burnside's (UCB) Newpin program, which provides support for families to facilitate their child's return from foster care. Principal repayment and financial returns are paid to investors dependent on the restoration rate of children to their families.

ii. **The Benevolent Society Bond –** A $10 million bond over five years is funding the Resilient Families service, which provides intensive work with up to 400 families and children for 12 months, including up to nine months post-crisis support. There are two tranches of investment, with principal repayment and financial returns to investors differing and dependent on the performance of the service.

Key lessons

As a result of the development process there has been increased interest and understanding across the three sectors – government, NGOs and financiers. There were specific areas of learning in the following areas:

- **Capacity –** NSW Treasury adopting the project management role worked well to drive and coordinate the project. However, some line agency staff with competing priorities were challenged to have capacity to work on the project. As the first of its kind, there has been significant learning from the Trial for participants. The bonds require skills and expertise across a broad array of areas (measurement, social programs, contracting and finance). Hence it was recognised that NGOs with reputation, capacity and scale were chosen for the Trial. Development of skills within NGOs and government in measurement, contracting and financial modelling are vital for future bonds.
- **Collaboration –** There was effective collaboration in the Trial which resulted in the successful negotiation of two bonds. This was facilitated by NSW Treasury's project manager role, the goodwill associated with the Trial, and the successful involvement of a financial intermediary to navigate different competing perspectives. Agency engagement was a critical success factor.
- **Contracting –** It was challenging to work without a precedent and contracting templates in NSW. Each bond took many months to negotiate. Participants' familiarity with large transactions affected whether they saw the contract as complex and over-specified or not. Development of an operations manual in 'plain English' was seen to be helpful.
- **Prevention and early intervention** – There was support for the choice of out-of-home care (OOHC) and recidivism as policy areas which are seen to be expensive for government; although the outcomes in each area could be specified using binary outcomes which were simple, there were seen to be challenges in the measurement and capture of savings.
- **Measurement of outcomes** – Measurement was one of the key challenges in the Trial. There were different views on how savings should be measured and calculated, and there were difficulties in determining outcome measures (as data are designed for casework and administration not outcomes measurement). Despite the challenges, an agreed position was reached and the Trial has led to an increased understanding of defining and measuring outcomes for those involved in the Trial.
- **Innovation** – The Trial can be seen to be an exercise in innovation – financial and contracting innovation, as well as leading to a new emphasis on

measurement. The structure allows flexibility for changes/innovations in service delivery during the term of the contract and this is different to existing service specification approaches. However, there appears to be a contradiction between service innovation and developing a bond with a sound evidence base.

- **Social investment** – The Centre for Social Impact (CSI) feasibility study noted that the 'first structure chosen may not end up the preferred longer term model'[1]. The Trial has generated conversation, engaged investors, raised awareness and according to our SMEs interviewed 'created intrigue' for people on financing solutions to social challenges aside from traditional funding sources. In addition, the Trial successfully attracted investors and both bonds were issued. As with any new asset class, it was challenging to match investor expectations with the product.

Future directions

Build capacity

Capacity for future social benefit bonds can be built via linking in with international initiatives and networks as well as through the following initiatives:

i. **Drive the development of future bonds from within government** – Capitalise on the skills and expertise that have been gained within NSW government agencies in the development of bonds. This could be achieved through the establishment of a social benefit bonds unit. In addition, government should encourage the development of catalyst units outside government.
ii. **Develop resources** – This could include social benefit bonds toolkits, templates for legal contracting for PBR agreements, guidance on contracting for social benefit bonds (that can be adapted as required), and a payments by results framework can be developed for government to determine when social benefit bonds or other PBR schemes should be used.
iii. **Transfer knowledge** and skills gained in the Trial through skills transfer workshops across the three sectors (government, NGOs and finance).
iv. **Engage NGOs through market sounding** – Develop an ongoing dialogue with the sector in order to educate the sector about social benefit bonds, highlight NGO areas of opportunity as well as concerns, and work in an iterative way on future bonds.
v. **Improve the evidence base of social programs** – Build on the recent policy initiatives of NSW Government to improve data, outcomes measurement, and knowledge and capabilities in the area. Infrastructure and methodology to measure the economic savings from social programs could also be developed and explored in future social benefit bonds.

Build the investment market

Though this evaluation concentrates on the development phase of the Social Benefit Bonds Trial, there are wider implications that can be considered to grow a future social benefit bonds market.

As a new investment approach without a track record, and the first of its kind in Australia, social benefit bonds are breaking new territory. Development of a new capital market takes time and there are several specific processes which can facilitate its development. International work by the World Economic Forum has investigated how to mainstream impact investments and Australia can learn from this work.

Building on the success of the Trial, facilitation work could include:

- Development of resources to educate financial advisors and investors about social benefit bonds and set clear expectations around financial risk and return
- Capability development within the financial sector so that social benefit bonds can be assessed by brokers who are trained to assess investments
- Utilising financial intermediaries in future social benefit bonds.

'Hearing of the 'good news' stories and the successes of the current Trial will increase investor interest' SME

Learning from the Trial

Learning from the development of the Trial, there are some areas which could be done differently next time.

The procurement model could be varied so that the cohort, the outcomes and the evidence base is further specified in the tender documents; and the bonds can be structured so that smaller NGOs can group together to participate in a bond. Although the scoping study did not recommend the use of financial intermediaries, and the RFP left the question open, participants in the Trial were positive about the role that Social Ventures Australia (SVA) played in the development of one of the bonds. Literature also suggests that financial intermediaries play an important role in bond development through: designing contracts, raising investment capital and managing contracts[2].

Building the knowledge base

NSW Government has made a commitment to learn from the development of the Social Benefit Bonds Trial and this is the first in a series of reports documenting the Trial. In a transparent process external evaluators will independently assess the outcomes from the Newpin program and the Resilient Families service. In addition a final report will examine the overall effectiveness of the Trial. That final report will revisit the level of investor interest in social benefit bonds, re-examine whether there has been capacity building in the NGO sector and gauge the level of government savings that were in fact realised.

1

Introduction to the evaluation

1.1 Aim

NSW Treasury engaged KPMG to document and evaluate the initial planning and development of Australia's first social benefit bonds Trial. A social benefit bond (also known as a social impact bond) is a payment-by-results mechanism where a positive social outcome is funded thereby reducing future costs to government.

The aims of the evaluation are to:

- Provide a realistic, transparent and independent account of the planning and development of the Trial
- Understand key lessons learnt through documenting stakeholder experiences, and critically reflecting on the processes and outcomes achieved to date
- Inform future policy directions concerning social benefit bonds and payment by results (PBR) mechanisms by considering whether the current Trial is achieving its objectives, offers value for money, and is catalysing social finance and innovation in social services
- Provide a baseline for future evaluation reports through development of a baseline regarding the impact of the pilots on the investor market and investors' decision to invest, NGO sector sentiment, the costs and resourcing during development and how the structures work in practice.

This is the first of several evaluations of the Trial. Each program involved with one of the Social Benefit Bonds will be evaluated and an evaluation of the overall effectiveness of the Trial will also be conducted in several years' time.

This evaluation has been conducted at a similar stage of development as the RAND Europe evaluation which examined early lessons learnt from the world's first social impact bond trial – the Peterborough Trial[3].

1.2 Scope

This report touches on the planning and design of the Trial including the Request for Proposal (RFP) phase, and concentrates on processes and outcomes of the JDP. In this phase government, non-government organisations (NGOs) and financiers negotiated to develop the bonds.

As the recidivism bond is still in its development phase the details of the negotiation and development of this bond are not covered in the report.

1.3 Method

The evaluation documents the views and experiences of those involved in the Trial. Interviews were conducted with 21 stakeholders including government agencies subject matter experts; the Expert Advisory Group; Government Steering Committee; service providers; investors and financial intermediaries; and selected non-participating NGOs. In addition data sources included:

- Reports and published articles (on social benefit bonds, social impact investment and PBR)
- Transaction costs (time and costs data)
- An electronic survey of Social Benefit Bond investors and those who were interested but did not invest in the Trial.

The evaluation data was collected from September to October 2013.

1.4 Structure of this report

This report has been structured as follows:

- Section 2 describes the planning and development phases of the NSW Social Benefit Bonds Trial
- Section 3 summarises the outcomes of the Trial by reference to the bonds and structures which have been established
- Section 4 considers the key lessons learnt
- Section 5 provides the benchmarks which have been set for future evaluations of the Trial
- Section 6 discusses the future directions of social benefit bonds in NSW.

There are also appendices to the report to provide further context and information:

- Appendix A is a glossary for the report
- Appendix B provides background and context to social benefit bonds more generally
- Appendix C provides a list of stakeholders who were consulted in the evaluation
- Appendix D provides further detail of the evaluation methodology
- Appendix E provides further information on the two bonds which have been developed and launched
- Appendix F summarises PBR mechanisms, for reference
- Appendix G lists tables, charts and figures in the report.

2

Planning and development of the NSW Social Benefit Bonds Trial

2.1 Context of the NSW Social Benefit Bonds Trial

There have been several parallel policy initiatives which led to the investigation of social benefit bonds for NSW. With the growth of vulnerable populations, there has been recognition that government alone cannot finance the social services sector. There has been a policy shift away from government to non-government organisations for provision of services. Alternative sources of funding have been sought, including the potential to access capital through financial markets.

Nationally, there has been review of the non-government sector and investigation of a capital market. In the 2010 Productivity Commission report (Contributions of the Not-for-Profit Sector) the importance of strengthening the capacity of NGOs to access financing for social investment, and the shift by mature investors from philanthropy to social investment was highlighted[4].

In 2011 the Senate Economics Reference Committee published *Investing for good: the development of a capital market for the not-for-profit sector in Australia*. This report recognised the importance of building a capital market for NGOs in Australia; it examined the global context of social investing, and made a number of recommendations as to how government could facilitate the development of the social investment market[5].

In addition to these background reports, in 2011 the Australian Government developed an innovative investment fund. The aims of the Social Development and Investment Fund (SEDIF) were to:

- Improve access to finance and support for social enterprises; and
- Catalyse the social investment market in Australia.

Each SEDIF received a portion of $20 million in grant seed funding from government, which was matched by private investors. The total SEDIF investment pool is $40.6 million[6].

At the same time as these developments in Australia, the first social impact bond was being developed in the United Kingdom (UK) in 2010. In the Peterborough initiative, the UK Ministry of Justice and the Big Lottery Fund financed a financial intermediary (Social Finance) for services to be contracted for offenders serving short prison sentences. There was £5 million of investment funding; if reconvictions dropped by at least 10 per cent compared to a comparison group, an outcome payment would be made by the Ministry of Justice giving investors a return on their investment[7]. (More detail on the development of bonds internationally is given in Appendix B).

2.2 Planning (Stage 1 - the feasibility study)

A visit from the founder of the financial intermediary working on the UK bond (Sir Ronald Cohen) sparked interest in NSW in 2010. New South Wales Government commissioned the Centre for Social Impact (CSI) to examine the feasibility of social benefit bonds in NSW. In partnership with a number of organisations already familiar with social benefit bonds, including Social Finance UK, CSI published their findings in February 2011[8].

The study found there were policy areas and programs for which social benefit bonds would be an appropriate model of financing. The following policy areas were short listed as suitable for a bond:

- Disability support services
- Parenting skills for at-risk families (out of home care, i.e. OOHC)
- Homelessness
- Juvenile re-offending
- Mental health.

The study also found that there were a range of NGOs that had the capacity, competencies and legal powers to issue a social benefit bond; and there were indications of investor appetite for social benefit bonds in NSW[9]. The biggest barrier that was identified for NSW was the lack of evidence on the efficacy and cost savings of social programs.

Watching the international developments with interest and with a scoping study already conducted, in March 2011, the then-NSW Premier announced an interest in developing social impact bonds for NSW. The initial press was positive, and a number of NGOs and public figures advocated for the bonds[10,11].

2.3 The RFP (Stage 2)

2.3.1 Aims of the Social Benefit Bonds Trial

In September 2011, NSW Treasury launched the Social Benefit Bonds Trial with the release of an RFP[12]. The stated aims of the bonds were to:

- Increase funding for **prevention** and early intervention programs in a sustainable manner
- Improve **accountability** for the effectiveness of expenditure on social services
- Catalyse the development of the **social finance sector**
- Harness the **innovation** capacity of both investors and service providers
- Improve the **evidence base** for, and focus on measuring the impact of, social services.

Although it was recognised that there was a high degree of interest and necessary market conditions for social benefit bonds in NSW, a number of obstacles were identified that needed to be overcome to remove 'significant uncertainties' that surrounded social benefit bonds at that time[13]. These included:

- Establishing an accurate data baseline upon which to measure improvements in service delivery
- Identifying whether sufficient collaborative work could be conducted between the proponents and the government for a feasible social benefit bond.

To assist with the development of the bonds and to provide advice to the NSW Government on social investment more generally, an Expert Advisory Group comprising independent experts was appointed in the RFP phase.

2.3.2 The procurement process

The NSW procurement was an open process with a public tender. The RFP specified two priority areas: out-of-home care and criminal recidivism. The RFP was not prescriptive so that proponents could develop details around the target cohorts, the outcome measures, estimates of savings and the service models. It was anticipated that the bonds would run for five to eight years.

Those involved in the planning phase of the Trial sought the involvement of smaller NGOs through encouraging partnerships between NGOs (either under a lead NGO or through the use of intermediaries). The RFP specified that a single organisation or consortia could submit a proposal. For example, a large organisation could partner with a number of smaller NGOs[14].

In addition, a public information briefing was held and was attended by 105 representatives of service providers (NGOs), investors, financial intermediaries, consultants and government officials not involved with establishing the Social Benefit Bonds Trial. The procurement process was two-staged: an RFP stage and then a development stage (the JDP) where proponents would work with government to develop a bond. Either side could exit the JDP.

NSW Treasury received a number of responses[15] and because of the strength of the proposals decided to enter the JDP with three proponents (rather than the two indicated in the RFP):

i. UnitingCare Burnside
ii. The Benevolent Society
iii. Mission Australia.

Although there was a suggestion that a bond partner could constitute a partnership between NGOs, the RFP process resulted in the selection of three large and well-known NGOs who were selected to work with government in the Joint Development Phase. These organisations were seen to best meet the selection criteria. The skills and experience required were 'organisational and legal capacity' to: issue and manage a SBB, deliver high quality services and respond to varying levels of performance over the life of the bond[16].

In March 2012, the successful proponents were invited to enter into the JDP where they would work with government to develop the financial instruments and service arrangements for the respective Social Benefit Bonds[17]. It was anticipated that this phase would take six months.

Media reaction to the tender was mixed: despite the continued optimism of a number of stakeholders, articles in Banking Day and The Sydney Morning Herald had more cautious views. The articles questioned whether an appropriate level of planning had been conducted, whether smaller NGOs had the capacity to be involved in the Trial, and whether there was investor appetite for the bonds[18,19].

2.4 The Joint Development Phase (Stage 3)

Subsequent to the procurement process, the JDP was a stage to develop the selected bonds in order to make them suitable for contracting and launching. Features of the bond pilots which were negotiated and/or developed over the course of the JDP included:

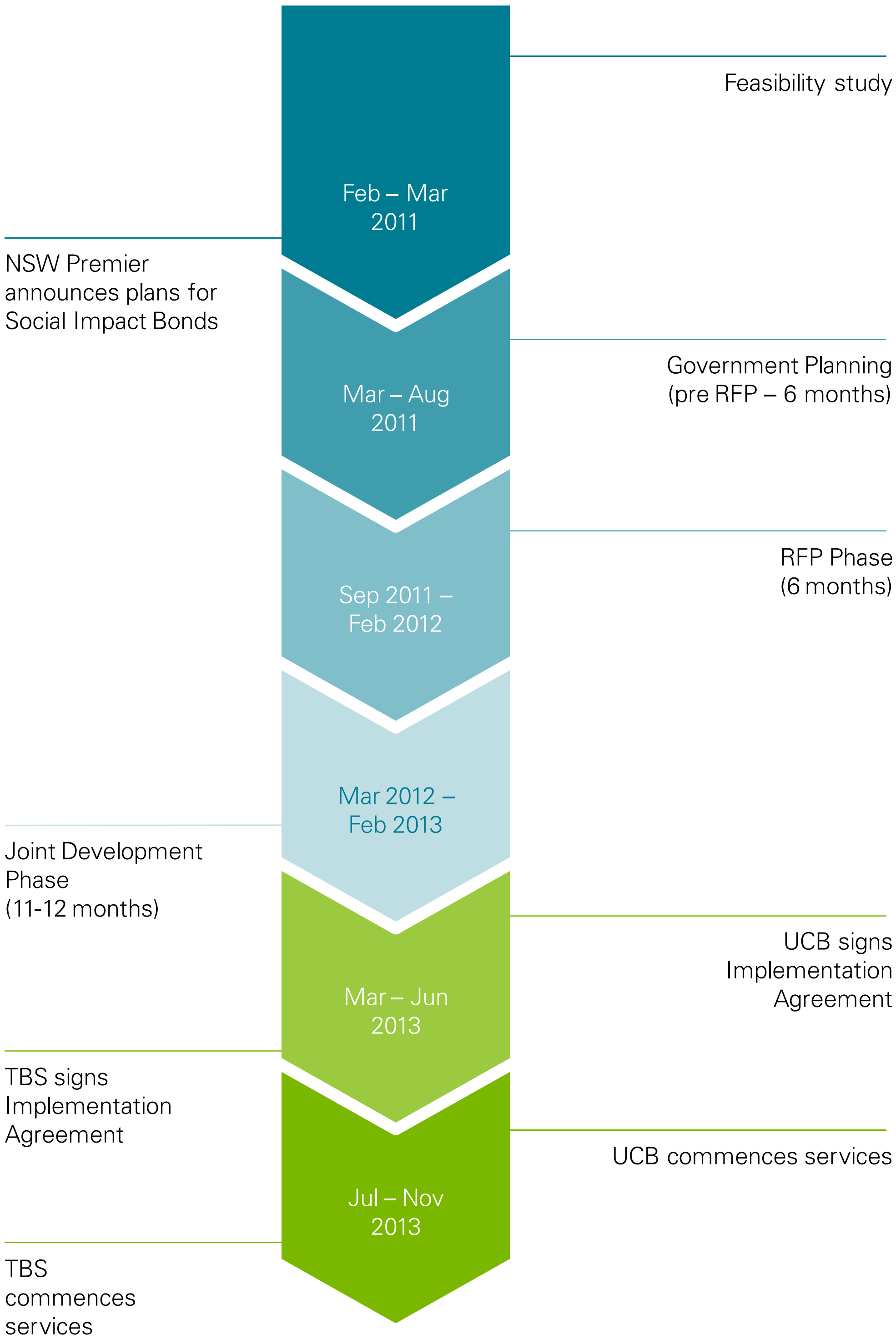
- Contractual relationships and legal structure
- Payment structure
- Risk allocation between parties
- Determination of cohorts
- Development of outcome measures.

The JDP for each bond involved the relevant line agency (Department of Family and Community Services (FACS) for the OOHC bonds and Corrective Services NSW for the recidivism bond), bond proponents and legal advisers including the Crown Solicitor's Office.

The overall process was facilitated by NSW Treasury, with a Treasury representative assigned as the project manager for the JDP. Advice was provided by the Expert Advisory Group as required and key decision making rested with the Steering Committee. The timeline for the development of the Bonds is shown in Figure 1.

The two OOHC bonds have completed their JDP and have been launched, while the recidivism Mission Australia bond is still in development. (Hence details of the development of the recidivism bond are not included in this report).

Figure 1: Chronology of events



3

Outcomes of the Joint Development Phase

3.1 The two OOHC Social Benefit Bonds

The outcome of the JDP has been the development of two Social Benefit Bonds for the Newpin program and the Resilient Families Service. A third bond is currently under development in the area of criminal recidivism.

The two bonds are summarised in Table 1 and further detail on each program is given in Appendix E.

Table 1: Summary description of the two completed bonds

	The Newpin Bond	The Benevolent Society Bond
Description	Australia's first social benefit bond. Raised funds to support children and young people in OOHC to be safely restored to their families or to prevent them from entering care. Newpin is a long-term, intensive support program that works with families to improve parenting so children can live safely with their families.	Australia's second social benefit bond. Raised funds for The Benevolent Society's Resilient Families Service, which helps families address issues such as domestic violence and substance misuse, mental health, unstable housing and will improve family functioning and relationships. Keep children out of the child protection system and keep families safely together over the long term.
Performance measure	The restoration rate of children who enter the program.	The service aims to keep children out of the child protection system.
Bond class	One class	Two classes: class P and class E
Capital raised	$7m	$10m
Clients	700 + families (of which approx. 55% will have at least one child under the age of five in OOHC)	300 + families (at least one child under six years of age and will have been recently reported to FACS as at risk of significant harm, ie ROSH)
Term	7 years	5 years
Investor principal guaranteed	50% guaranteed to be repaid at the maturity date 100% repaid if the restoration rate reaches 55%	Class P – principal repaid on redemption Class E – 100% principal at risk

	The Newpin Bond	The Benevolent Society Bond
Interest	Minimum interest rate is 5% p.a. over the first 3 years Maximum interest rate is 15% p.a. over the full term Target is 10-12% p.a.	Class P – 0-10% depending on level of performance Class E – 0-30% depending on level of performance

Source: NSW Treasury

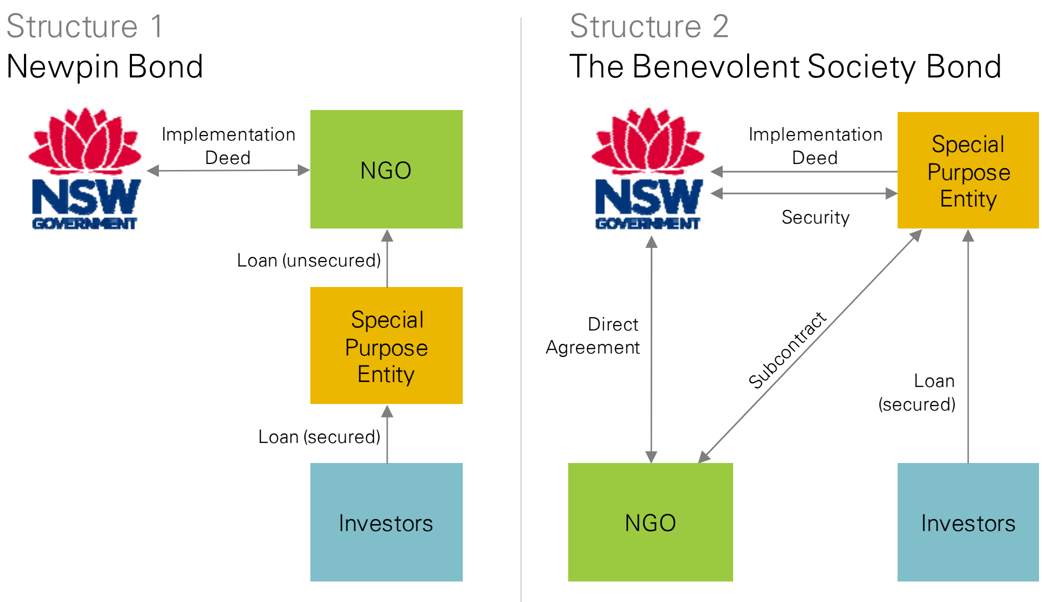
There are key differences in the contracting and financial structure of the two bonds as well as the outcome measures:

The contracting structure

The Newpin Bond involves government directly contracting with a service provider. A separate arrangement is established between the service provider and investors through a special purpose entity (a trust) which is being managed by Social Ventures Australia (SVA).

The Benevolent Society Bond also involves a special purpose entity but in this arrangement the entity has a number of different agreements with government, investors and the service provider. In this model, a more complex suite of contracts were required to formalise the relationship between parties, the flow of funding, the required actions from each party, and which parties were considered secure creditors of the special purpose entity. As stated by a legal SME, the second structure had ''a full suite of capital market documents behind it''. There is also a separate agreement between the government and the service provider (see Figure 2). This model required a longer timeframe to finalise and required additional transaction costs for government.

Figure 2: High level representation of the two bond structures



Source: Trevor Danos[20]

The financial structure

The Newpin Bond comprises one bond class, for which a minimum of 50 per cent of the investor's principal is guaranteed to be repaid at the maturity date, and the full principal will be repaid if the restoration rate reaches 55 per cent. The minimum interest rate is 5 per cent per annum over the first three years and the maximum interest rate is 15 per cent per annum over the full term of the bond.

The Benevolent Society Bond comprises two bond classes:

- **Class P** bonds are senior bonds for which the principal is repaid on redemption and return between 0 and 10 per cent interest commensurate with performance; and
- **Class E** bonds are subordinate bonds for which the principal is only repaid should the trust still have assets and return between 0 and 30 per cent interest commensurate with performance.

The measurement of outcomes

The Newpin Bond assesses the intervention's performance using a binary outcome of whether a child is restored to their family for 12 months, or not. In contrast, The Benevolent Society Bond uses graded outcome measures. An 'improvement percentage' is the proxy for these outcomes, and is derived from three measures – entries into OOHC, helpline reports, and commenced Safety Assessment and Risk Assessments.

Both the Newpin and The Benevolent Society Bonds establish a counterfactual. For Newpin this consists of an historic baseline for three years, which will then move to the use of a control (comparison) group when a group of sufficient size has been created. The restoration rate (number of children restored, divided by the total number of children in the program) is the basis for interest payments to investors.

The Benevolent Society Bond assesses performance by comparing the outcomes for the intervention group to a matched control group (i.e. those not receiving the intervention). The extent to which the intervention can reduce the number of entries into OOHC, helpline reports and visits to the family compared to the matched control group determines the interest payments under each of the bond classes.

An independent assessor will be employed to certify the calculations of the outcome measures for both the Newpin and The Benevolent Society Bonds.

'Three informative failures would be ***more informative*** *than three tepid successes'*

Expert Advisory Group member

4 Key lessons learnt from the Trial

4.1 Capacity

Finding – The bonds require agency engagement and officers with specific technical skills. Dedicated positions are required within government to drive development. NGOs were seen to require capacity, scale and credibility to participate in the Trial.

As the Trial was the first of its kind in Australia, there was no experience in the area. Hence capability and capacity are key dimensions in the development of the bonds in both the government and NGO sectors.

4.1.1 Government capacity

From interviews it emerged that:

- Government officers who did not have positions dedicated to the bond found it difficult to juggle their regular work with development work for the social benefit bonds.
- Although skills and capacity may exist, agency engagement is a determining factor as to whether these skills are able to be deployed.
- Although staff had skills in funding, contracting, policy and implementation, no one in Australia had yet experience in developing a social benefit bond. There are few people who already have expertise across all the domains required (including financing, measurement, social programs, and contracting). The domains required are broad and complex and require specialist knowledge.
- Individual advisors were influential and steered the bond development in certain directions.

What worked well:

- Treasury having a dedicated project manager to devote to the bond development
- Agencies developing positions which were devoted to the project management of the bonds.

4.1.2 NGO involvement

NGO capacity

From interviews it emerged that NGOs need to have the following features in order to be successfully involved in social benefit bonds:

- **Scale:** in order to have the resources to deliver under a social benefit bond and assume the risks of a social benefit bond arrangement

- **Credibility:** in order to increase the marketability of bonds and give confidence to investors
- **Capacity**:
  - Skills in tendering, commercial negotiations (including being able to engage consultants and lawyers), research, data and evidence base, and financial modelling
  - Positions to devote full-time to the bonds
  - Knowledge of social benefit bonds and being able to assess the associated risks (financial as well as reputational) to the organisation
  - Some financial knowledge even if a financial intermediary is used.

Stakeholders generally perceived that it was appropriate to engage well established NGOs in the Trial or believed that government had sought larger NGOs given the high profile nature of the Trial.

> *'Organisations were selected for the Trial that have the balance sheet to take risks and absorb downside'*
>
> NGO representative

What worked well:

- Organisations with the capacity and resources to focus on bond development
- Research capability within the agency (and prior work on defining the cohort and outcomes)
- Partnering with a financial intermediary with financial modelling skills and experience in other Australian impact investments.

NGO views on bonds

General feedback from participating and non-participating NGOs indicated that service providers are supportive of PBR schemes. They recognise social benefit bonds as 'one method of funding service delivery'. There is however hesitation amongst some stakeholders about support for social benefit bonds in particular. The sector views are closely tied to the issue of capacity. Whilst recognising the catalysing effect of the Trial, NGO stakeholders recognised that social benefit bonds are one form of contracting or financing which can be more complex than other forms (such as a loan or an outcomes based funding model).

> *'Bonds are a type of payment by results scheme and the NGO sector has wanted more of these schemes'*
>
> NGO sector representative

It was recognised that large NGOs tend to have high profiles, more resources and specialist skills. Overall, stakeholders considered that many NGOs in the sector do not have all of the requisite skills and knowledge to be able to participate in a social benefit bond.

> *'Some of the deals that are put together to make it work are quite complicated'*
>
> NGO representative

The NGOs participating in the Trial identified particular areas of caution relating to social benefit bonds:

- Defining outcomes and the counterfactual
- Modelling the returns to investors based on social outcomes
- Choosing the client cohort without 'cherry picking' the easiest clients.

NGOs also mentioned that social benefit bonds would only be suitable for particular programs or policy areas where impacts are readily measurable. There was also comment that social benefit bonds should not be an opportunity for government to 'step away' or diminish their role in human services.

4.2 Collaboration

Finding – Collaboration across sectors was challenging and was assisted by the involvement of NSW Treasury and a financial intermediary.

The RFP noted that one of the unknowns in the Trial was whether there could be effective collaboration across sectors and agencies to produce a viable bond. Collaboration was challenging, and a recurrent theme in the interviews was the different perspectives of those involved. Because of its structure, the parties involved in the development of bonds (government, service providers, and financiers) come from different worlds with different frames of reference.

Collaboration was seen to be challenging due to a lack of shared knowledge and understanding of:

- Commerciality
- Assumptions around financial risk
- Government processes and requirements
- The availability of data
- Service specifications
- Outcomes measurement.

Stakeholders who were interviewed agreed that in order to successfully work together, the participants had to learn from each other and 'lift their gaze'. There was an increased understanding of the different interests and perspectives involved.

What worked well to develop successful collaboration:

- NSW Treasury as project manager was seen to drive the project, to be impartial in the negotiations and effectively used formal decision making processes including a running sheet of decisions
- A financial intermediary was useful in navigating the different perspectives.

4.3 Contracting

Finding – Views on the complexity of the contracting reflected participants' prior experience.

The key challenges in legal and financial contracting were:

- Lack of a precedent and contracting templates in NSW
- The time taken ('months and months' according to a legal SME) to understand the proponents' operations and negotiate the financial structure

- Parties involved in the negotiation and contract drafting were familiar with different decision making processes
- The bonds were perceived to be complex which was seen as a major hurdle during the contracting process and contributed to high transaction costs
- Different legal structures for each of the bonds were seen to add complexity (SMEs and government officers reported).

Individuals involved in the contracting process had little or no experience with social benefit bonds nor with other complex contracting arrangements, which is likely to have magnified the perception of complexity. Several respondents held the view that if more bonds were issued they would not take as long because the financial and legal structures would be familiar.

In contrast to those who perceived the bonds as complex, those familiar with the structure and commercial arrangements of a traditional Public Private Partnership (PPP) viewed the contracts as relatively small (in keeping with their small value) and did not see the contracts as complicated nor as costly to develop as a PPP. However, PPPs are a larger scale and the person most familiar with PPPs commented that the transaction costs associated with the Social Benefit Bonds as a proportion of the value of the deal were larger than for PPPs and made them an unviable transaction if only considering this aspect.

> *'Traditional PPP transactions are so large and complicated that they are not economically feasible to pursue, due to substantial transaction costs, unless they are of significant scale'* PPP SME

Another feature was to draft and finalise the financial structure before the legal structure. Overall, it was reported that the drafting of the contracts proper for the first bond took between five and six weeks.

What worked well:

- Using the Peterborough Model as a template
- Using a detailed terms sheet assisted parties in reaching agreement on commercial terms
- Development of an operations manual in 'plain English' that covers issues not in the contract
- Central oversight by NSW Treasury on the drafting process, with experience from the first bond translating into efficiencies in drafting the contracts for subsequent bonds.

4.4 Prevention and early intervention

Finding – There was support for the choice of both policy areas which are seen to be expensive for government; although the outcomes in each area could be specified using simple binary outcomes, there were seen to be challenges in the measurement and capture of savings.

Stakeholders involved in the Trial were positive regarding the choice of the two policy areas. Stakeholder comments on the pros and cons of each policy area are provided in Table 2 below. Both areas were identified as areas of high cost to government and offered binary outcomes for measurement.

The RFP for the Trial defined prevention and early intervention as services that mitigate the escalation of social problems and are the counterpoint to acute and crisis services[21]. The RFP sought services in the prevention and early intervention spectrum and both of the OOHC bonds deliver on this. The third bond dealing with adult recidivism is not seen as early intervention, but as prevention of re-incarceration.

Table 2: Stakeholder views of policy areas

Pros	OOHC	Recidivism
High cost	✓	✓
Clearly identifiable cash savings	✓	
Binary outcome (in or out of care/ prison)	✓	✓
Outcomes are simple to understand	✓	✓
Savings apply to one government agency	✓	
Clearly measureable economic savings	✓	✓
Prior social benefit bond in the area		✓
Prevention	✓	
Cons		
Unstable policy environment	✓	
Possible ethical issues[22]	✓	
Difficulty in realising cashable savings		✓
Difficulty measuring and capturing savings (including economic benefits)		✓
Savings experienced across multiple agencies		✓

Source: KPMG

What worked well:

- Choosing policy areas that are high cost to government in which effective intervention will result in savings to government
- Choosing areas with outcome measures that can be binary and easy to understand.

4.5 The evidence base

Finding – Measurement was one of the key challenges in the Trial. There was a lack of appropriate data, different views on how savings should be measured and calculated, and there were difficulties in determining outcome measures. Despite the challenges, the Trial has led to an increased understanding of measurement of outcomes for those involved in the Trial.

One of the aims of the NSW Trial was to improve the evidence base for social programs and it was foreshadowed in the CSI scoping study that the lack of an evidence base would be the biggest barrier for social benefit bonds in NSW.

> *'Competing demands challenged FACS information management and performance measurement staff when providing data'*
>
> Government representative

4.5.1 Availability of appropriate data

Several government interviewees involved in the planning stages noted that in order to not stifle innovation, the government did not specify the cohort in the RFP. Thus data on the cohort, outcomes and the baseline were not prepared in advance. These items were to be developed in the JDP. This resulted in the following challenges:

- A baseline had not been established before the Trial and government information that was being collected was not appropriate to be used for the counterfactual
- There was a lack of readily available appropriate data which meant that resources had to be devoted to developing the data and attending to data requests
- The data available is designed to support casework/administration rather than measuring outcomes
- A misalignment in expectations of timing and availability of data (which stakeholders labelled an 'information asymmetry'). NGO partners thought that data was readily available so there was a sense of dissatisfaction when it took up to 6-8 weeks to receive data
- A lack of certainty around what data was needed leading to a high volume of data requests. One agency received around 40 data requests over several months which resulted in an opportunity cost, whereby the agency could not respond to requests *not* related to the Trial in a timely manner
- There were examples of under-resourcing and of staff having competing demands which made it difficult to respond to proponents' data requests.

There is variation in the policy areas in the amount of data available to government and proponents. In the justice portfolio there is a statutory government agency that works independently from the principal agency to undertake research and provide statistics for crime and recidivism (the NSW Bureau of Crime Statistics and Research). This valuable resource is not available for parties involved in the OOHC bonds.

4.5.2 Measuring savings

There were different views as to how savings should be measured. The Steering Committee made a decision to use a financial model and measure 'actual savings' from which to pay for the bonds. The rationale for using a financial model was that it was easy to understand by a wide range of stakeholders and there was a lack of data on economic benefits.

Several stakeholders would have liked to see a broader economic model used, in which savings and avoided costs as a result of positive impacts of a service on the individual, family and broader community were included.

NSW Treasury noted that different proponents had differing approaches to, and capability in financial modelling. This resulted in a large number of iterations between proponents and government agencies. It was suggested that this could be minimised by identifying a standard methodology for financial modelling. Not only would this minimise the number of model iterations, but also assist in making valid comparisons between different bonds.

4.5.3 Determining outcome measures

There was agreement that robust outcomes measures needed to be developed as all parties have a stake in the validity of the data:

- Proponents wanted to maximise the likelihood that their programs would show positive outcomes
- Government wanted to ensure the validity of data before repaying investors
- Intermediaries wanted to protect investors' interests.

However, determining outcome measures took a long time for each bond due to the following challenges:

- A lack of experience in defining and measuring outcomes and in outcome based contracts
- Lack of availability of appropriate data
- Balancing the conflicting agendas of each party.

NSW Treasury reported that outcome measures needed to be simple enough for investors to understand, but agency positions on outcomes changed over time. At first there was advice that investors wanted a binary, as opposed to multi-dimensional, outcome measure. However, when the implications of a binary measure became evident NGOs wanted a detailed outcome measure that would capture even minor positive outcomes.

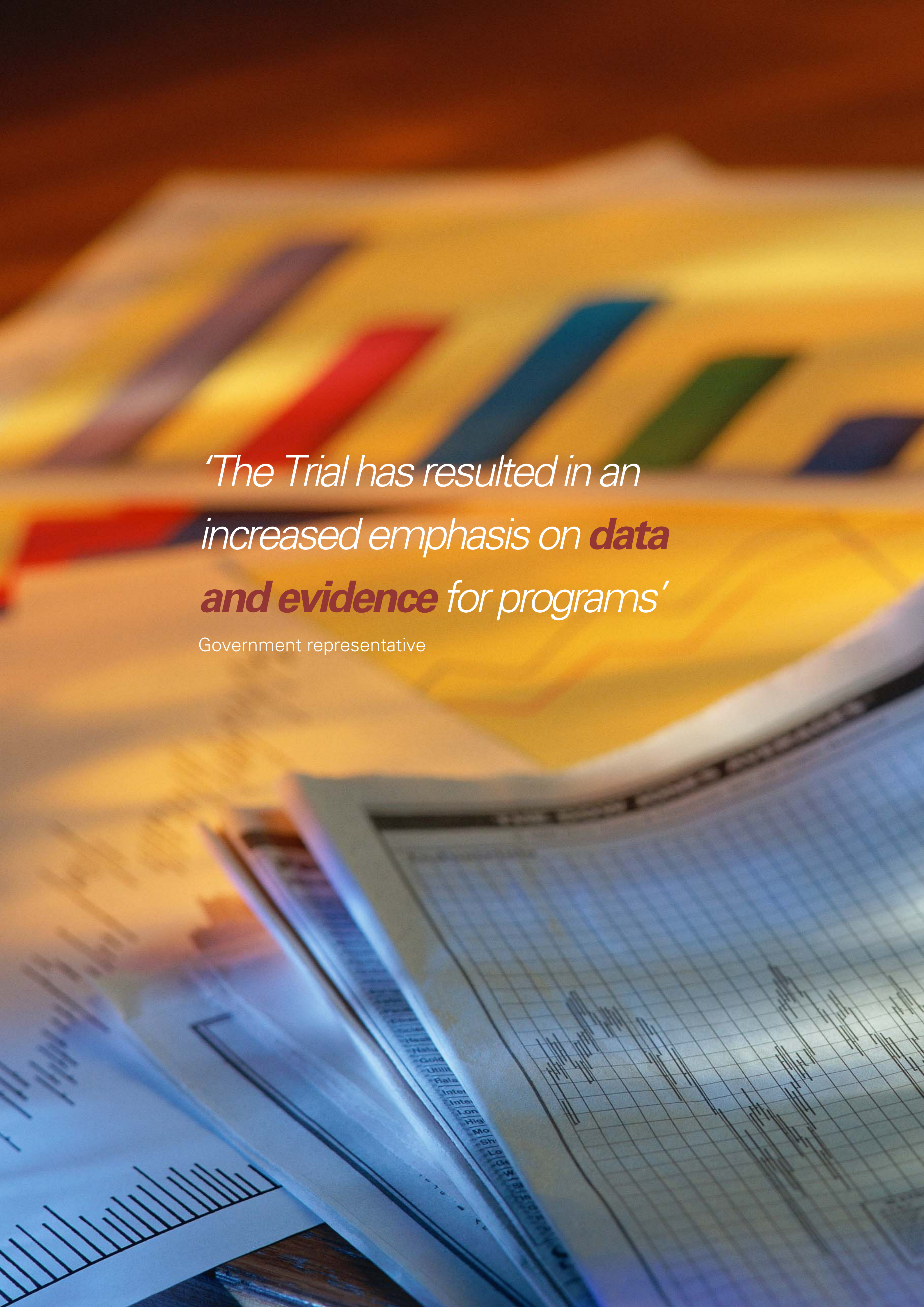
4.5.4 Developing the evidence base

Although there were measurement challenges, there was acknowledgement that as a direct result of the Trial, line agencies, central agencies and proponents are now more knowledgeable about defining outcomes, measurement and the evidence base of programs. An NGO reported that the Trial has had a 'domino effect' regarding development of the evidence base at the organisation, and they are now examining outcomes in all their programs.

An Expert Advisory Group member noted that there is 'genuine global shift' to better measurement and evidence so the increased focus on measurement could not be solely attributed to the social benefit bonds.

What worked well:

- The involvement of research and evaluation experts was invaluable in specifying and developing outcome measures
- The collaborative approach in the bond development led to increased knowledge and understanding of measurement issues; this included discussion on defining the cohorts and agreeing on outcome measures.



'The Trial has resulted in an increased emphasis on ***data and evidence*** *for programs'*

Government representative

4.6 Innovation

One of the stated aims of the NSW Trial is to increase innovation. Participants in the Trial saw the Trial as an exercise in innovation to:

- Widen the array of mechanisms by which governments can commission their services
- Incentivise public servants and NGOs to properly define outcomes, including against future performance counterfactuals
- Improve the measurement of public and social impact (including 'savings')
- Facilitate cross-sectoral collaboration in the design and delivery of the programs and services
- Allow the NGO sector (with private sector support) to initiate their own approaches to the creation of public value, unencumbered by government micromanagement of their business
- Fund human services prevention measures rather than simply directing expenditure to crisis interventions.

> *'The Trial is encouraging people to think laterally '*
>
> NGO representative

In the RFP it was stated that innovation was to be developed in two specific areas: service innovation in NGOs and financial innovation in the investor market.

It was expected that service innovation would be developed through focusing on payment by outcomes:

> NGOs are encouraged to be more responsive to community and sector needs and identify improved professional practices, as well as innovative new approaches that deliver better outcomes[23].

For the purposes of this report, successful innovation is defined as:

> 'the creation and implementation of new processes, products, services and methods of delivery which result in significant improvements in outcomes efficiency, effectiveness or quality'[24].

4.6.1 Service innovation

> Finding – There is a contradiction between service innovation and developing a bond with a sound evidence base.

Although the RFP was not prescriptive regarding the choice of cohort and services, the programs that have been selected are not seen to be particularly innovative as they are not 'new' programs. The Newpin program is a pre-existing program; and the Resilient Families Service is based on other international programs and has been tailored to NSW. Despite this, there is still opportunity for innovation to occur within the model at the service delivery level as the Trial rolls out.

Whilst acknowledging that service innovation is one of the Trial's aims, a number of government officers mentioned that innovation and the necessity of an evidence base are competing forces in the design of a social benefit bond. They commented that if there is good data and a solid evidence base then it is likely that there are already effective programs in an area and there may be little in the way of service innovation.

Another (NGO) stakeholder also challenged the need for service innovation, noting that while service providers should be open to innovation, sometimes service providers 'just need to do more of what works'.

4.6.2 Financial innovation

Finding – The Trial is an exercise in financial innovation.

There was agreement that the Trial was an exercise in financial innovation of a new product and form of contracting that has not been previously used in NSW.

The direct effect of the NSW Trial on the investment market is discussed further in the following section.

What worked well:

- By design, the Social Benefit Bonds are an innovative financial instrument
- The innovative approach in the Trial has had a domino effect within government and NGOs and has been a catalyst to further thinking about social investment and the measurement of social outcomes.

4.7 Social investment

The Trial consisted of pilot testing a new financial product (a social benefit bond) and because of this there would be challenges that are unique to a new asset class. The CSI feasibility study noted that the 'first structure chosen may not end up the preferred longer term model'[25]. Before the Trial, there was testing of the market to gauge investor appetite. It was found that there was an appetite for social benefit bonds and that take-up would be influenced by:

- The program chosen
- Credibility of the NGO
- Terms and conditions of the bond (including whether there was preservation of the principal, timing of payments and rate of return).

Although investors weren't directly involved in the development of the Bonds, their interests and views were represented by the financial intermediaries.

One of the key challenges was assessment of the new asset class; there was seen to be little experience in understanding the fiduciary and regulatory requirements and a lack of skills in assessing the risk/reward profile. Discussions focused on the degree of financial risk assumed by the parties, whether the two bonds had to have the same structure, and whether superannuation funds could participate.

- **At risk principal** – A major issue was the amount of the total principal Government would 'guarantee'. In developing The Benevolent Society Bond, NSW Treasury introduced an upfront standing charge to assist the structure to support the guaranteed principal to Tranche P investors. Although this charge was a key enabler for the Bond, NSW Treasury reported that the structure does not set a precedent for all future bonds. There is an expectation in a mature market when investors become confident of the bond as a sound financial instrument, a similar upfront standing charge will not be required.
- **Comparativeness between the two bonds** – There was a perception that government insisted on comparativeness between the two bonds in terms of the risk return profile and the expected payout rather than accepting that if the

TBS bond was targeted at large scale institutional investors that certain features need to be in place to make it attractive.

- **Superannuation funds –** There was a lack of engagement and participation from superannuation funds, reportedly because of so-called 'fiduciary duties' that constrain investment from those that maximise risk-adjusted return. There was some level of stakeholder uncertainty as to whether superannuation funds were constrained due to regulation, and some stakeholders suggested that improving the communication regarding the risk/reward profile of the bond would promote investment.

  In Australia, Christian Super Fund's partnership with Foresters (under SEDIF) represents an important step in whether superannuation funds' can invest in impact investing instruments. According to the Senate Economic Committee Inquiry into the not-for-profit sector, Christian Super Fund made this SEDIF investment within their standard investment portfolio. Although this indicates that the barriers may be perceived as opposed to structural, regulatory clarity is nonetheless important in helping gain the critical mass of investors required for the success of social benefit bonds[26].

Despite these challenges the Trial is seen as successful in catalysing social investment. The SVA survey shows that funds invested in the Social Benefit Bonds are 'new' and not a diversion of funds that would have otherwise gone into philanthropic donations. In addition to successfully raising funds for the two Social Benefit Bonds, there has been a stimulation of interest. A financial SME reported that the Trial has generated conversation, engaged investors, raised awareness and 'created intrigue' for people on financing solutions to social challenges aside from traditional funding sources. Stakeholders who arranged the financing for the bonds have stated that their organisations have been invited to present at seminars and other events on the topic. Positive media coverage has also played a role in generating interest in a new product.

What worked well:

- The involvement of the Financial Intermediary was seen as essential in developing the financial structures of the bonds
- Introduction of an upfront standing charge payment.

5

Setting benchmarks

An aim of the evaluation is to set benchmarks for future evaluation reports in terms of the transaction costs. Future reports can monitor the effort expended in developing social benefit bonds in the future. The evaluation also sets benchmarks for future examination of investor interest in, and NGO sector perceptions of, social benefit bonds. The NGO sentiment is discussed in section 4.1.2 NGO involvement.

5.1 Transaction costs of the JDP

The first benchmark is an approximation of the labour effort involved in developing the social benefit bonds in the NSW context.

5.1.1 Basis of preparation

The table following summarises the approximate resource effort, that is, labour hours, expended by all associated organisations in the planning and development of the Social Benefit Bonds. Extrapolation methods were employed to convert financial costs to labour hours and to apply consistent measurement to the way in which organisations had prepared their labour data.

For example, some private organisations suggested that they had provided assistance to the development of the Social Benefit Bonds on a pro-bono or heavily discounted basis. By capturing the labour hours spent developing the Social Benefit Bonds, rather than the financial costs, a more robust measure of effort expended is captured.

It is important to note that the labour hours presented are approximations, which were prepared on the basis of information provided by stakeholders. The findings are presented as an average of the costs of planning for and developing each of the bonds.

5.1.2 Findings

The findings indicate that the development of the Social Benefit Bonds was very labour intensive for all the stakeholders involved. Overall the number of hours equates to six FTEs working solely on the development of one social benefit bond over an intensive 12 month period (based on a 5 day workweek of 37.5 hours).

At an aggregate level, the largest resource effort (in terms of labour hours) was committed by the line agencies and service providers. The financial opportunity costs have not been costed and attributed to the participating stakeholders because there is minimal basis for comparison, i.e. some stakeholders do not have a charge out rate, whilst those that do would vary to a material degree between each other.

It is important to note that as these bonds are the first of their kind in NSW and Australia, some of the associated research and development costs might be lower in future pursuits, due to building capability and potential process efficiencies gained through lessons learned.

Table 3: Average labour resource committed to the planning and development of each bond

	Central Agencies*	Line Agencies	Service Providers	Government Advisers	Service Provider Advisers	Total (hrs)
Average number of labour hours per bond	1,692	3,630	2,984	2,262	1,144	**11,712**

*Central agencies provided data related to labour time expended on the JDP only.

Source: Agencies and service providers

5.2 Investor interest in social benefit bonds

5.2.1 The size of the social impact market in Australia

There have been a number of attempts to quantify the size of the global impact investment market. JP Morgan and Global Impact Investment Network estimate that a minimum of approximately US$36 billion has been invested in impact investments[27]. However, a more conservative estimate puts the market size at US$25 billion[28].

In 2009, JP Morgan and the Rockefeller Foundation estimated that the impact investment market could grow to between US$400 million and $1 billion by 2020[29]. Supporting that forecast, Monitor Institute estimated that within the next six years the market may constitute 1 per cent of total managed assets, which equates to approximately US$500 billion[30]. A more recent estimate by the Global Sustainable Investment Review 2012 reported US$89 billion in impact investment globally[31].

In contrast, there has been little research to quantify the size of the Australian impact investment market. There is not yet data available to quantify the size of impact investment markets in Australia. Estimates compare the size of the market based on UK and US data[32].

One estimate puts the size of the Australian capital market for social investment at $10 billion, of which $7 billion is in managed funds (investment funds managed by an agent on behalf of an investor) and $3 billion is in superannuation funds[33]. Another source values the estimated market potential at $18 billion, based on a proxy of 1 per cent of total assets under management in Australia[34]. While a third source based on JB Were calculations, estimates the size of the market to be A$300 million in 2012 ('with total capital managed of A$2 billion, growing to around A$32 billion over 10 years'[35]).

A baseline can be established by examining the state of the social financing/impact investing market before the Trial. Recent work has documented up to 30 impact investments in Australia -- a mix of social enterprises, social enterprise funds, organisations and projects that return social benefits along with financial benefits[36]. With the development of the Social Benefit Bonds Trial in NSW, there is now opportunity for NSW to progress to the second phase of development of the investment market i.e. marketplace building where infrastructure will reduce costs (see Table 4).

Table 4: Development of the global social impact investment market

NOW

Uncoordinated innovation	Marketplace building	Capturing the value of the marketplace	Maturity
Disparate entrepreneurial activities spring up in response to market need or policy incentives. Disruptive innovators may pursue new business models in seemingly mature industries. The industry is characterised by a lack of competition except at the top end of the market.	Centres of activity begin to develop. Infrastructure is built that reduces transaction costs and supports higher volume of activity.	Growth occurs as mainstream players enter a functioning market. Entities are able to leverage the fixed costs of their previous investments in infrastructure across the higher volumes of activity. Organisations may become more specialised.	Activities reach a relatively steady state and growth rates slow. Some consolidation may occur.

Source: Monitor Institute[37]

Two surveys have been conducted of the social benefit bond investors: SVA surveyed Newpin Bond investors, while the current evaluation surveyed The Benevolent Society Bond investors. A breakdown of investors in the TBS Bond is shown in Table 5.

Table 5: Breakdown of investors in TBS Bond

Type	TBS Tranche P = $7.5m (per cent of total invested)	TBS Tranche E = $2.5m (per cent of total invested)
Corporate	13.3	6.0
Ethical institution	6.7	6.7
Financial institution	34.7	26.0
Foundation	12.7	22.0
Individual	23.3	26.0
NFP	6.7	20.0
Trust	2.7	0

Source: Westpac and CBA

5.2.2 Investor profile for Newpin Bond

As documented in SVA's Newpin Investor Survey[38], the Newpin Bond attracted investors that were interested in commercially competitive returns on investment, as well as social impact. The investors for The Benevolent Society Bond were drawn from a range of areas. Almost half were high net worth trusts and around a third were institutional investors and high net worth individuals.

The two main drivers for investment were 'the potential to impact the lives of vulnerable children' as well as the 'financial return structure'. The bonds attracted new investment in impact investing as almost 80 per cent of investors would have used their funds for a commercial investment aligned to their existing portfolio structure if they had not invested in the bonds.

5.2.3 Investor profile of The Benevolent Society Bond

The TBS Bond investors who responded to the survey were private foundations/trusts, private ancillary funds, a fund manager, and an advisory group, with holdings of either $50,000 to $100,000 or $200,000 to $400,000 in the bonds.

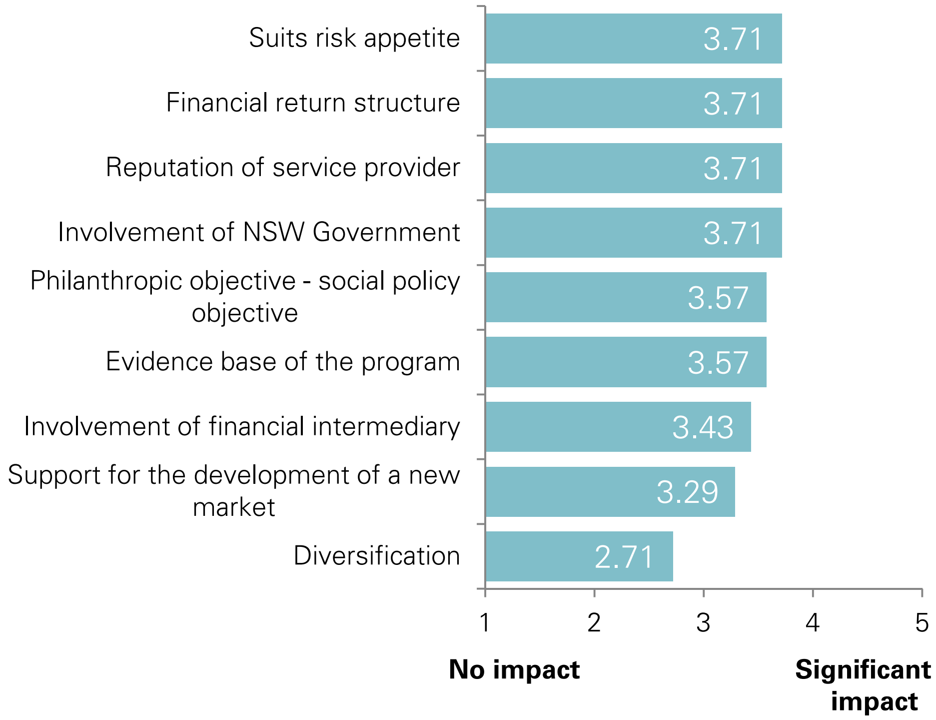
The respondents to the survey represent a small sample size of the market and the findings should be considered in light of this. Participation in the survey was voluntary and those that chose to respond remained anonymous. The findings provide information on the investor profile and factors that are relevant to investor decision making which can be compared in future evaluation reports.

History of participating in social financing arrangements

Around 85 per cent of respondents are more involved in social impact investing now than five years ago. The decision to invest in the Social Benefit Bonds did not appear to be related to the respondents' level of current community investment and involvement in social financing. Approximately half the respondents had been involved in social financing arrangements prior to investing in the Social Benefit Bond, through either (in order of most common) supporting social enterprise, social investing, donating and social impact funds.

There were several factors of equal weight which impacted on an investor's decision to invest; financial factors (risk appetite, financial return structure) were equally as important as the reputation of the service provider and the involvement of NSW Government. The main factors impacting the investor's decision to invest are shown in Figure 3.

Figure 3: Main factors impacting investor decisions to invest



Source: KPMG investor survey

Determining factors

The main due diligence issues which investors took into account were:

- Level of downside risk compared to rates of return
- Evidence of efficacy of the program.

Together, these findings suggest that investors in the Social Benefit Bond expect a market competitive financial return. Hence similar to the SVA findings, 71 per cent of respondents stated they would have invested in regular commercial investments had they not invested in a social benefit bond, rather than invest in or donate to a social cause.

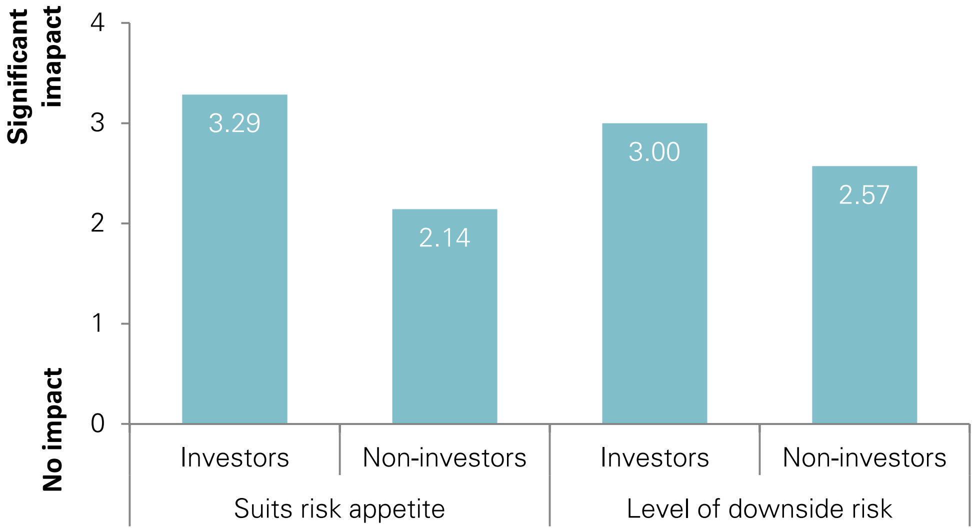
Investing in future social benefit bonds

Asked if they would invest in social benefit bonds in the future, most investors responded that they would need to see the results of the Trial and ensure their next investment has the right risk/return attributes.

> *'We need to ensure that future transactions are commercially viable. The social angle is the icing on the cake, but we need a premium on return to reflect variable risk and guarantee of principal.'*
>
> Investor survey participant

As shown in Figure 4, the same sentiment was held by non-investors. However, compared to investors, non-investors reported that the risk profile was a slightly less important precondition for future investment in SBBs.

Figure 4: What are the pre-conditions for your organisation to invest in a social benefit bond in the future?



Source: KPMG investor and non-investor surveys

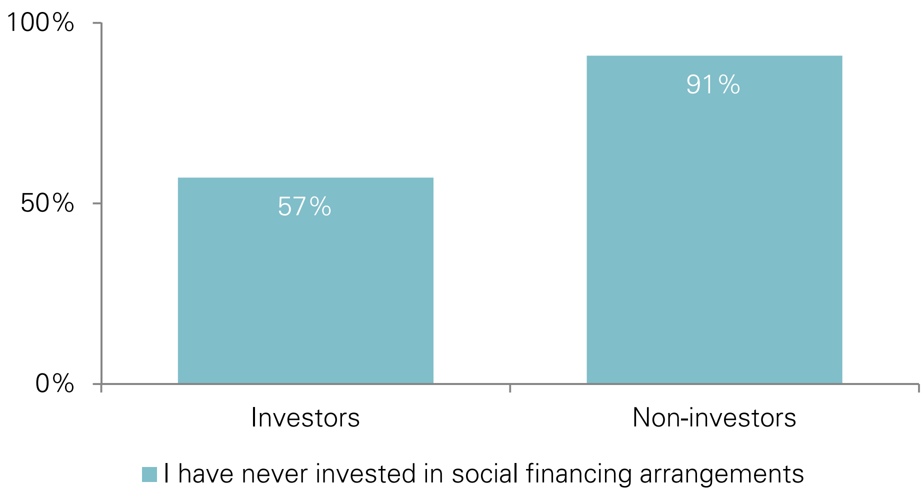
5.2.4 Non-investor interest in social benefit bonds

A survey was also conducted of those that did not invest in the social benefit bonds (see Figures 4, 5 and 6). The respondents were corporate foundations (27 per cent) and intermediaries/investment advisers (27 per cent). Other respondents included a fund manager; institutional investors; a private foundation/trust; and individuals.

History of involvement in social financing arrangements

In contrast to those that invested in the social benefit bonds, nearly all non-investors (91 per cent of respondents) had not previously invested in social financing arrangements (as shown in Figure 5). The few who had been involved in social financing arrangements were involved in donations and a social impact fund.

Figure 5: Proportion of investors and non-investors who had never previously invested in social financing arrangements



Source: KPMG investor and non-investor surveys

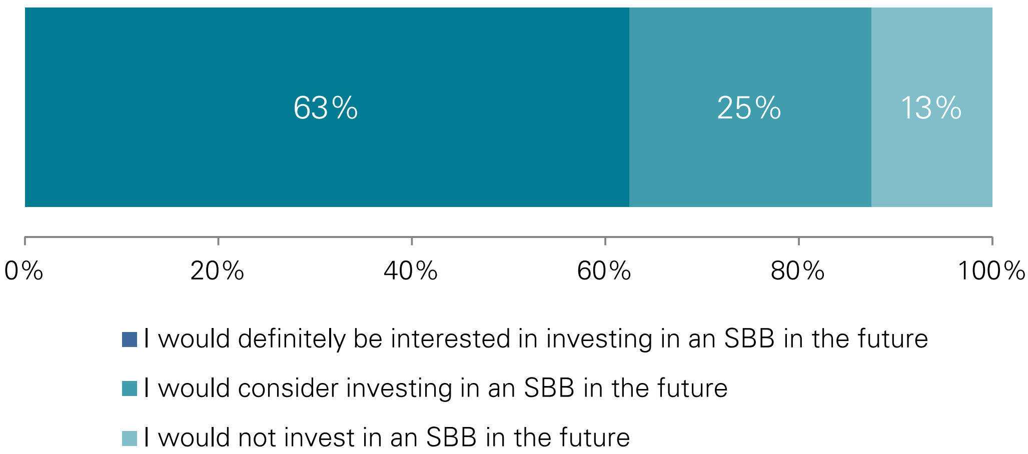
Why they chose not to invest

Over half (55 per cent) of the non-investors did not invest in the Trial as they did not know about it, while around one third were waiting for the outcomes of the Trial. An appetite for investment was indicated: just over 60 per cent of respondents reported that they would definitely be interested in investing in a social benefit bond in the future (Figure 6).

Non-investors who were waiting to see the outcome of the Trial emphasised that there needs to be an appropriate risk/return profile for social benefit bonds. The following is a summary of their views:

- **Evidence** – There needs to be more detailed explanation and evidence to support how social factors affect the likelihood of achieving a return
- **Competitive** – Return needs to be competitive for the level of risk. The respondents suggested that at the moment the return might not reflect the level of risk and uncertainty
- **Stability** – There needs to be a guarantee of capital and regular (stable) returns, for example, coupon payments.

Figure 6: Non-investor's interest in investing in a bond in the future



Source: KPMG non-investor survey

6

Future directions

From the challenges discussed in the report, a number of key learnings for the future have been highlighted.

6.1 Framing social benefit bonds along two continuums

Increasing the pool of payment by results

Although the Social Benefit Bonds have shown that it is possible to attract investors to a product that provides both a financial and social return, they are only one of a number of PBR schemes. Government could consider other payment by results mechanisms and introduce increased accountability through a variety of outcomes based contracts.

To determine when social benefit bonds or other PBR schemes should be used, a payment by results framework can be developed for government. The framework would clarify the key features of PBR schemes and key dimensions of the schemes (including level of complexity, the number of parties involved in the contract, and the preconditions required). Given the work that has been done in the Trial, the starting point for PBR schemes could include government funded programs and services in OOHC and recidivism.

In addition, a wider performance review of contracts could be undertaken with a view to transferring some of the features of the Social Benefit Bond contracting arrangements into existing NGO contracts as they roll-over, or into new contracts. This could include funding early intervention, improved data collection and reporting, and increased accountability through regular review of performance metrics in a continuous feedback and development cycle.

Broadening the type of impact investing

The Trial is pilot testing one particular model of impact investment – social benefit bonds. Variations on the model and other impact investment models can be developed and tested.

Impact investing is an investment approach which 'crosses asset classes, sectors and geographies'[39]. The focus is on the intention to create social, environmental and/or cultural benefits with the investment. To date, the most common form of impact investment in Australia has involved debt financing (organisations borrowing money to fund their activities), which can be through micro-financing, crowdfunding or larger transactions[40]. But it could also include equity investment such as community and employee ownership models. Variations on the impact investment model are being developed and tested elsewhere; there is also investment activity that had previously not come under the impact investing definition, but can now be recognised as such – including community cooperatives and mutuals[41].

6.2 Capacity building for social benefit bonds

If future social benefit bonds are to be pursued in NSW different dimensions of capacity building will need to be considered. The broad range of information available can be shared via networks and forums such as the recently launched Global Learning Exchange of the UK Cabinet Office[42].

Driving the development of future bonds

There are different options to drive the development of future social benefit bonds.

i. Drive bond development from central agencies

NSW Treasury now has the skills and expertise in development and implementation of the bonds. This experience could be drawn upon to develop a social benefit bonds unit.

In the UK, The Centre for Social Impact Bonds was set up in the Cabinet Office late in 2012 to address barriers in developing social impact bonds. In NSW central agencies, including the Department of Premier and Cabinet, are reviewing the role of social investment in delivering services.

ii. Develop catalyst units outside government

In NSW, development has been led by central government, while in the UK development has been led by government as well as financial intermediaries.

In contrast Robinson has noted in the US the role of a catalyst unit outside government at the Harvard Kennedy School[43]. Professor Liebman and the Social Impact Bond Technical Assistance Lab are assisting states with design and procurement of social benefit bonds.

Developing resources

Resources can be developed that build knowledge and capability as The Centre for Social Impact Bonds has done in the UK. Resources can include:

- Social benefit bonds tool kits which are an introduction to bonds (outlining how bonds are designed and developed and the necessary pre-conditions for them)
- A template for legal contracting and guidance on contracting for social benefit bonds, that can be adapted as required
- A template for payment by results agreements
- Decision trees for considering when PBR schemes and social benefit bonds are suitable
- Decision trees on assessment of various types of risks for NGOs
- A payments by results framework for government[44].

Knowledge sharing and dissemination of information and resources could also be undertaken through development of a clearinghouse[45].

Knowledge transfer

There is consensus that the Trial resulted in significant development of knowledge, skills and understanding of social benefit bonds for each party. To capitalise on these learnings it is suggested that knowledge development occurs through skills transfer workshops across the three sectors.

In these forums participants will become aware of the interests of government, NGOs and financiers, and will learn about modelling outcomes and savings, and assessment of various risks.

Market sounding to engage NGOs

Engagement of the NGO sector can be successfully undertaken through market sounding. This process can assist to:

- Educate NGOs about bonds and other PBR mechanisms
- Highlight opportunities and barriers for NGOs to government
- Engage NGOs as partners in the design and development of future bonds.

In New Zealand, the Ministry of Health and the Treasury are undertaking early market exploration on social benefit bonds[46]. Over 300 NGO participants attended forums on social benefit bonds allowing the government to gauge and respond to participants' concerns.

Improving the evidence base

One of the most critical areas for development if social benefit bonds are to be developed in the NSW context is improvement in the evidence base. In contrast to the UK context there has not been a history of payment by results in NSW.

Although a renewed emphasis on program evaluation has begun within NSW Government (with the establishment of a program evaluation unit within NSW Treasury, and a Department of Premier and Cabinet policy directive)[47], substantial capability building is needed in both government and NGO human service sectors.

The development of the social benefit bonds has highlighted:

- Gaps in data (including inadequate coverage, poor quality and unclear child welfare outcomes data)
- Limited monitoring of outcomes in social services (in both the government and non-government sector)
- A lack of technical expertise and knowledge in measurement.

The justice area is well served by the Bureau of Crime Statistics and Research which operates independently from the principal agency and publishes high quality evaluations and research. The child welfare area would benefit enormously from a similar independent centre being established.

Although the Trial itself is improving the evidence base, transaction costs in future SBB Trials could be reduced through investment in the evidence base more broadly. This would include developing improved data so that outcomes can be monitored as well as developing research and evaluation capabilities in government and non-government agencies.

6.3 Growing the investor market

The findings suggest areas that NSW can investigate to further grow the investor market:

- Government can address investor concerns in an iterative process of development of future bonds, and provide clarity on financial risk and reward profile of the bonds
- Outside of government, those with a catalyst role can develop resource materials and expand networks to educate others about social benefit bonds
- To attract institutional investors and superannuation funds – consider areas for SBBs that enable strengthening of returns (lower the level of risk and/or increase the return to investors)
- Although it is likely that superannuation funds are permitted to invest in social benefit bonds, the issue around fiduciary duty needs clarification. For superannuation funds to invest in social benefit bonds the following should be developed:
    - An accepted framework for the inclusion of impact investments within modern investment portfolios
    - A broader range of appropriately designed impact investment opportunities
    - Infrastructure that is used by investors to appraise and manage impact investments.
- Financial intermediaries can continue to work alongside government in future social benefit bonds, raise investment capital and educate about social benefit bonds. Part of this could be to work with staff of foundations and trusts who are experienced with grant making but may not have the ability to assess a social benefit bond, or work with investment professionals who adhere to a principal of optimising financial return but may not have experience of assessing social impact.

The recent report on mainstreaming impact investment by the World Economic Forum is highly relevant to how NSW could grow the investor market[48].

The four barriers identified to growing the impact investment market have played out in the Social Benefit Bonds Trial in the NSW context:

i. *Early stage eco-system* – Investors perceive the market as 'niche, early stage and immature'; there is a mismatch between investors' expectations of a commercial rate of return which is not delivered by all products; and products do not usually have a track record
ii. *Deal sizes are relatively small* – Transaction sizes need to be sufficiently large to attract superannuation funds and other 'big' investors
iii. *Impact investments are difficult to fit into traditional portfolios* – Investment professionals are not really sure where impact investments belong alongside traditional instruments
iv. *Measurement of 'social returns' is not easy* -- Measurement of social returns is complex and costly, evaluation of the counterfactual is not always available and investment advisors are not skilled in assessing these metrics.

The recommendations of the World Economic Forum for mainstreaming impact investments are shown in the following table.

Table 6: World Economic Forum selected recommendations to mainstream impact investing

Role	Areas for NSW to consider – World Economic Forum Recommendations
Role of impact investment funds	– Be clear and transparent about the financial returns that are generated and report the results to a third-party – Create a system for measuring and reporting the social and environmental impact that is achieved – Consider creative and innovative strategies to attract capital from large-scale limited partners.
Role of impact enterprises	– Build capabilities that make it easier for investors to allocate capital – Proactively measure and report on social impact – Strive for competitive differentiation and strong financial management.
Role of philanthropists and foundations	– Help to lower investment risk by providing grants to early-stage impact enterprises and by providing anchor investments to impact investment products and funds – Break down the silos that exist between the investment and programme teams – Promote greater collaboration among foundations to help lower due diligence costs.
Role of government	– Cautiously revise regulations that restrict willing capital into impact investments – Help de-risk the ecosystem through innovative funding mechanisms.
Role of intermediaries	– Aggregate data on impact investment deals and publish the findings – Promote a common platform that aligns capital and deal flow – Advocate for a baseline set of principles to define the practice of measurement.

Source: World Economic Forum

6.4 What could be done differently next time

Learnings from the experience of the Trial indicate there are a number of areas that could be done differently next time.

There are contrasting views on whether to go forward with another bond straight away or whether to wait for the findings of the Trial to be evident. Although there is investor interest, there are also cautionary voices that recommend that there should be a pause from any future social benefit bonds straight away as there is 'deal fatigue' from the past 18 months.

6.4.1 Reduce transaction costs

As a Trial and the first of its kind there have been high transaction costs. Many of the areas that are discussed in this 'Future Directions' section have an impact on the transaction costs. Transaction costs could be reduced in development of future bonds through the following:

- Choice of similar policy areas for development – A future bond would capitalise on learnings from the Trial to produce efficiencies (e.g. defining the cohort, defining outcomes)
- Choice of policy areas with an established evidence base (or that is the subject of a successful overseas bond) that is investigated before the Trial

- Using legal contracting templates that can be adapted
- Developing positions devoted to design and implementation of bonds so that skills can develop
- Using a bond structure that has already been tested in the Trial – the documentation for the two bond structures (e.g. legal contract, commercial term sheet and operations manual) should form the basis of templates for future social benefit bonds, with provision to work out the finer details and make adjustments as necessary
- Using a bond structure that is less costly for government – for government there are less transaction costs when government contracts directly with the service provider which then establishes a separate arrangement with a special purpose entity (a trust) which is managed by a financial intermediary.

6.4.2 Vary the procurement model

There are two areas in which the procurement process could be varied in a future bond. Because of the challenges in the NSW Trial in developing the cohort and specification of the outcomes, it is recommended that the cohort and evidence base is specified at the RFP phase. To encourage the participation of smaller NGOs it is recommended that structures are developed that encourage the participation of smaller NGOs in a bond.

Specify the cohort and the evidence base

The first area that could be varied in the procurement process is the degree of specification of the cohort, outcomes and the evidence base in the tender.

Robinson has noted that three procurement models have emerged internationally for social impact bond procurement:[49]

i. Government working closely with an intermediary to identify problems which are suitable for a social benefit bond (e.g. Peterborough Trial)
ii. Government identifying areas for development and procurement using its existing in-house expertise (e.g. local authorities supported by UK Cabinet Office)
iii. Government soliciting suggestions through an RFP (e.g. Massachusetts and NSW).

In contrast, to the NSW Trial, the UK Department of Work and Pensions for the Innovation Fund defines the cohort, specifies the outcomes and the evidence base in the tender documents.

> *'It is recommended that government explore some areas where there is a strong evidence base and specify the outcomes and the cohort in the tender'* SME

Those involved in the Trial have suggested criteria (many of which relate to measurement) for selection of policy areas for possible future social benefit bonds, (shown in Table 7 following)[50].

The choice of an area with binary outcomes, and measuring variations in outcomes appears to be contradictory. It is noted that binary outcomes are simple to measure and are useful for defining outcomes for payment purposes. However, there was acknowledgement that there needs to be a more nuanced approach to measuring the quality of program outcomes in a program evaluation.

Table 7: Participants' views on selecting future policy areas

Criteria	Description
Preventative intervention	The policy area must be 'early in the cycle' of curing social problems and address the root causes of disadvantage (as opposed to crisis management).
Binary outcomes*	The outcomes of the intervention are binary (not cumulative or progressive) i.e. a client will be in one of two states as a result of the intervention e.g. in or out of prison, in or out of employment, in or out of care.
Measure variations in outcomes*	Measure nuances in the quality of the outcomes (e.g. the frequency, type and severity of reoffending) rather than a binary measure.
Attribution of causality	The positive outcomes can be directly attributed to the intervention.
Unbiased measurement of outcome	Use measures that cannot be manipulated and are independent.
Measurable impact	The impact of the intervention can be measured accurately.
Stakeholders are onboard	The policy area can be 'sold' to the public and there is alignment of interests for parties involved.
Measurable savings	Financial savings can be measured. Ideally there is a method of measuring savings across multiple government agencies. Broad economic savings are calculated and used to establish the true benefits to the wider community.
Savings greater than costs	Savings for government are greater than the cost of the intervention, the implementation and other associated transaction costs i.e. there is an overall net financial gain.

*See note in text.

Source: KPMG

Structure a bond for the participation of smaller NGOs

There are several models which suggest that smaller NGOs can work together and work collaboratively to participate in larger contracting arrangements.

- Resource sharing by small to medium NGOs to reduce the overhead associated with social benefit bonds
- Development of a cooperative structure for small to medium NGOs to be able to participate in a future social benefit bond and use a partnership model to share skills and expertise and collaborate on service delivery.

> *'Don't under-estimate an organisation's capability to take on joint ventures, particularly 2nd and 3rd tier sized NGOs'*
>
> NGO sector representative

6.4.3 Involve financial intermediaries

Although the CSI study did not recommend the use of financial intermediaries and the RFP left the question open, several financial intermediaries were involved in the development of the bonds. Investor interests were represented in negotiations by Westpac and CBA in The Benevolent Society Bond, by SVA in the UnitingCare Burnside Bond and by another financial intermediary in the Mission Australia Bond.

This last mentioned financial intermediary, exited from the process part way through the JDP because mutually agreeable terms could not be reached.

There was positive feedback from participants in the JDP regarding the involvement of SVA, Westpac Institutional Bank (WIB) and the Commonwealth Bank (CBA) in the Trial. SVA was seen to have specific skills and experience relevant to the Trial. It is not possible to generalise from the Trial, as the success of SVA may be due to their skills and experience rather than a generalised role of an intermediary.

Participants were also positive about the involvement of WIB and CBA in the Trial. They were seen to bring a lot of expertise in performing commercial due diligence, providing advice on the structure and operations of the instrument and communicating investor needs. There were, however, challenges on both sides: neither parties had the same central interests. With no experience in other social benefit bonds, banks could strengthen their knowledge and understanding of the context of social policy and the way the NGOs and government operate. On the other side, the banks saw that government and NGOs could place a greater emphasis on the commerciality of the bonds, particularly around the terms of the transaction (measurement, payment, and principal guarantee). In the end the bonds were oversubscribed, as the banks were able to bring investors on board, which was certainly viewed as a positive. There is literature to suggest that the use of intermediaries is vital in the development of the bonds as they will drive it forward and manage it and are personally invested in it.

Robinson[51] has noted three distinct functions of social benefit bond intermediaries:

- as outcome identifiers and contract designers, working alongside government commissioners;
- as raisers of investment capital; and
- as ongoing contract managers of the service supply chain.

6.4.4 Choose early intervention areas

Two of the three bonds involve programs that could be considered to be early intervention.

As early intervention is seen to offer the greatest amount of savings: it is recommended that the government explores early intervention policy areas in future social benefit bonds.

The UK Department of Work and Pensions, for example, is funding an Innovation Fund (£30 million over 3 years) in which Round 2 is concentrating on prevention so that disadvantaged 14 to 15 year olds avoid ending up 'NEET' (not in education, employment or training)[52].

Examples suggested for the NSW context include homelessness, maternal and child health, and preventative health interventions such as juvenile mental health services.

The justification for early intervention and savings from programs should be expanded to incorporate economic and not just financial benefits for government.

As the economic benefits of early intervention can span private and public sectors, government should consider a mechanism to estimate and track these benefits and seek contributions from these sectors to the costs of developing and implementing social benefit bonds.

6.5 Future evaluation reports

This report which examines the JDP of the Trial is the first in a series of reports documenting the Social Benefit Bonds Trial. This report has identified three key areas that will be monitored in future evaluation reports:

- Future reports can monitor the development of the investor market through repeating the survey undertaken through this study. The survey and the take-up of the bonds have shown an increasing investor interest in investing for social impact.
- Future reports can monitor whether there has been capacity building for NGOs and whether structures have been put in place that allow NGOs to work in partnership on future social benefit bonds. This report has found that the NGO sector is generally supportive of PBR schemes, but that structures will need to allow for NGOs to partner and share risk and resources to deliver shared outcomes.
- Future reports can monitor the effort expended in developing social benefit bonds in the future. The resourcing of the development of a social benefit bond is significant. Monitoring will allow assessment to be made as to whether, as expected, there is improvement in the efficiency of the development process.

Future evaluation reports will independently assess the outcomes from the Newpin program and the Resilient Families Service. In addition, a final report will examine the overall effectiveness of the Trial. That final report will revisit the key aspects outlined above i.e. the level of investor interest in social benefit bonds, whether there has been capacity building in the NGO sector and gauge the level of government savings that have in fact been realised during the course of the Trial.

6.6 Conclusions

There has been much enthusiasm for social benefit bonds on the world stage. From a relatively small investment in a new financial product in the UK the idea rapidly spread.

The NSW government has set up the first Australian social benefit bonds. In contrast to the experiment in the UK, NSW Treasury has driven the test of concept in Australia.

The NSW Trial has pushed many of the boundaries and there are marked variations in the NSW Trial from the UK approach. In NSW a logically sequenced approach was undertaken with a market testing study and then, going to market to develop bonds in OOHC and recidivism. Central government (NSW Treasury and Department of Premier and Cabinet) hoped for innovation and firmly espoused that NGOs know their communities best. Hence many aspects of the bond, including the detailed specification and modelling of the cohort were open.

Despite the enthusiasm for social benefit bonds and the real sense of achievement of those participating in the Trial, the lack of specification of cohort was one area which several officers in government said they would do differently next time. The openness of the specification was not rewarded with innovation in the service specifications and a trade off was acknowledged between having a strong evidence base and being able to innovate. The lack of detailed planning and specification of the cohort was unanimously agreed as a factor that contributed to the time taken in the JDP. If specification of the cohort is undertaken in the RFP phase, it will still take time but will be undertaken up front by government, rather than in a JDP. It will also mean that the NGOs would not be involved in the development of the cohort, which they saw as a genuine partnering opportunity rather than a top down approach. For those familiar with complex contracting it was no surprise that the JDP took time.

Through leaving open the specification of the structure of the bonds, the NSW example did not prescribe the use of a financial intermediary nor dictate the structure of the bond. This resulted in healthy variation – for the three proponents that entered the development phase there were three different roles that financial intermediaries indicated they were going to play. As a trail-blazing exercise the Trial has, as expected, been costly and labour intensive and has been carried forward through goodwill and philanthropy. As each product has been customised the contracting has been complex without off-the-shelf products. The NSW experience certainly does not suggest that the social benefit bonds are a quick fix for NGOs to fund programs, for financiers to find a new investment or for government to bring private funding into the sector.

Although the NSW experience has been a success in attracting investors to a new financial product, this report offers some areas for development for those who are considering developing social benefit bonds in the future:

- Social benefit bonds are complex financial instruments which can take many forms and are one of a range of payment for outcome mechanisms. A framework across government would assist in identifying which mechanism should be used in a particular circumstance.
- Social benefit bonds play out differently in different contexts. The quality of the data was a particular challenge for child and family outcomes in the NSW context. Outcomes contracting and social benefit bonds are reliant on outcomes data. A social benefit bond highlights the need for high quality

outcomes data, transparency and accountability of programs in NGOs and in government. This is a key area for NSW to develop capacity in the NGO and government sector in the future.

- There is a confluence of global factors suggesting that investors are interested in social impact investment; for the market to be developed there are some specific steps that can assist consolidation and a role for financial intermediaries as well as government to play.
- Although it was seen as an appropriate decision to go ahead with NGOs with scale and reputation for the Trial, the capability of smaller less resourced NGOs will need to be considered if complex PBR arrangements become the norm. There are several models which suggest that smaller NGOs can work together and work collaboratively to participate in larger contracting arrangements.

Moving from the kernel of an innovative idea which brings together parties in a new contracting arrangement in social services, charting through the several years of planning, negotiations and development, NSW has tested and proven that the concept of social benefit bonds is viable in the NSW context.

Appendices

Appendix a. Glossary

Table 8: Glossary

Term or Acronym	Definition
Binary outcome measure	An outcome measure which is dichotomous that is, it has two possibilities (eg dead or alive, pregnant or not)
Counterfactual	The situation that would occur in the absence of any program or intervention
CSI	The Centre for Social Impact
Expert Advisory Group	A group of independent experts that provide advice to the NSW government on social investment and the development of social benefit bonds in NSW
FACS	Department of Family & Community Services is a NSW Government agency that delivers services to disadvantaged individuals, families and communities. Is the state's statutory child welfare and child protection agency
Feasibility study	A study published by CSI that examines the feasibility of developing a social benefit bond in NSW
Financial intermediary	Advisers with an understanding of financial markets and products that channel funds, either directly or indirectly, between investors and proponents
JDP	The Joint Development Phase was the second phase of the NSW Social Benefit Bond Trial, during which the three bonds were developed in conjunction with proponents
Mission Australia Bond	A social benefit bond currently in development and focused on reducing adult re-incarceration. Potentially the third social benefit bond developed in Australia
Newpin Bond	The first social benefit bond developed in Australia and is aimed at assisting vulnerable families
NGO	Non-government organisation
OOHC	Out-of-home care
Outcome measure	A measure of the degree to which the social programs have achieved the outcomes that were mutually agreed with NSW government to trigger financial repayments
PBR	Payment by results is a funding arrangement whereby repayments are made based on the degree to which programs meet mutually agreed outcomes or results
PeterboroughTrial	The first social benefit bond developed in the world, which is aimed at reducing recidivism in a cohort of offenders at Peterborough Prison in the UK
PPP	Public Private Partnership
Proponent	An entity, typically an NGO, who submitted a proposal to develop a social benefit bond in the RFP phase of the Trial.
RFP	The Request for Proposal is a phase of the NSW Social Benefit Bond Trial during which potential proponents developed and submitted their proposed social benefit bond structures

Term or Acronym	Definition
Risk profile	The degree to which each party bears the financial, legal and reputational risk associated with the social benefit bond
ROSH	Risk of significant harm is a classification given to those children whose safety and wellbeing has been assessed by a FACS caseworker as being substantially threatened
SEDIF	Social Enterprise Development and Investment Fund
SME	Subject Matter Expert
Social benefit bond	Also known as a social impact bond or pay for success bond, it pays a return to investors based on the achievement of agreed social outcomes
Social impact investment	An investment that aims to achieve positive social outcomes, in addition to achieving a financial return on investment
SVA	Social Ventures Australia
TBS	The Benevolent Society
The Benevolent Society Bond	The second social benefit bond developed in Australia and is aimed at assisting vulnerable families
UCB	UnitingCare Burnside

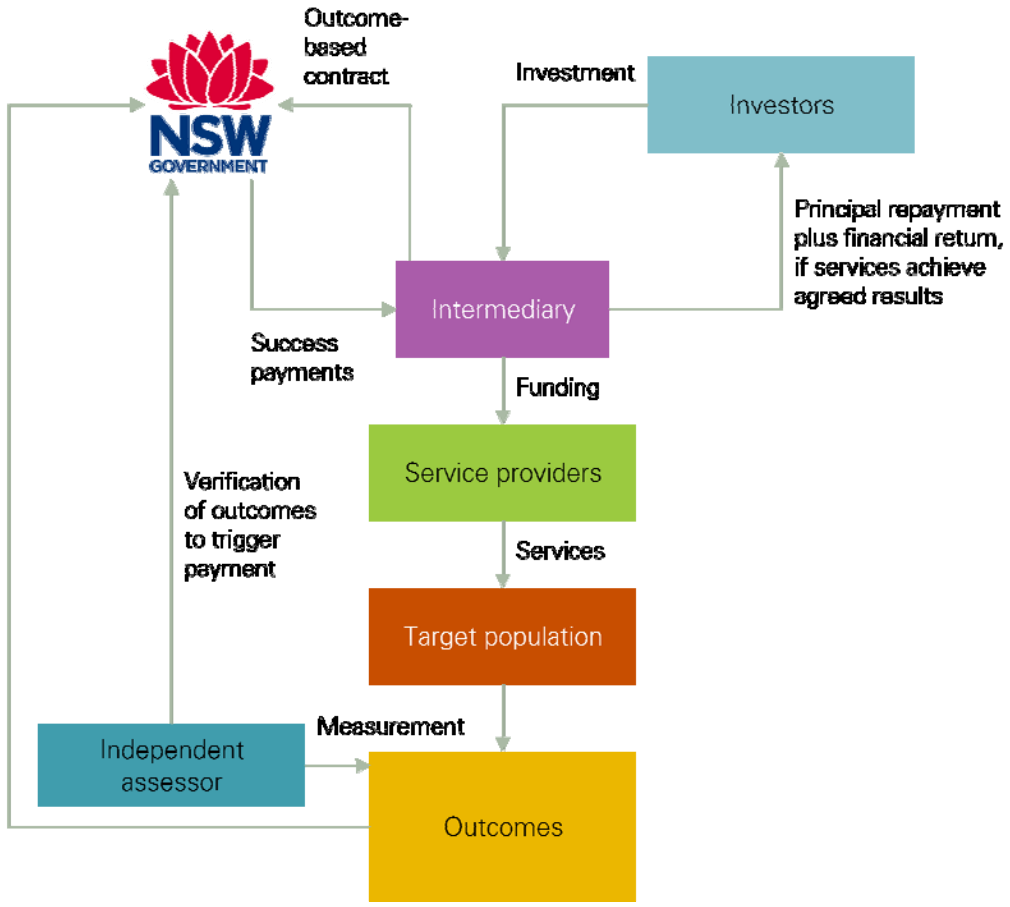
Appendix b. Background to social benefit bonds

Definition

Social benefit bonds (also known as social impact bonds or pay for success bonds) are a form of PBR scheme which has recently gained interest worldwide. It signals a change to traditional funding models used by government by introducing a third party – private investors. Private investors provide up-front funding to service providers to deliver improved social outcomes. If these outcomes are delivered, there are cost savings to government that can be used to pay back the up-front funding to investors as well as provide a return on that investment (Figure 7). In this way, social benefit bonds can fund early intervention or prevention efforts that can break a cycle of behaviour or disadvantage, which would otherwise lead to significant future costs for government and poor life outcomes for individuals.

If designed well and appropriate pre-conditions exist, social benefit bonds offer unique benefits for government, service providers, investors and the public[53]. Outcomes are transparent and measurable, investors know what they are paying for, service providers have the opportunity to innovate in services and access funding they may not otherwise have, and government can share the cost and risk of service provision. They also utilise commercial investment expertise and market discipline for the delivery of services by NGOs[54].

Figure 7: Conceptual map of a social benefit bond structure.



Source: New Zealand Ministry of Health

Types

There are two main types of social benefit bond structures:

- Government contracting with service provider/s, who may or may not engage a financial institution to market the bonds and raise funds from investors
- Government contracting with a financial intermediary who raises funds and engages service provider/s to deliver the services.

The Peterborough Social Impact Bond

The inaugural social impact bond was launched in September 2010 at Peterborough, UK, in the area of adult reoffending. It involved the second type of social benefit bond structure (government contracting with financial intermediary, Social Finance).

This six-year bond should support around 3,000 short term prisoners from Peterborough prison, serving less than 12 months, to receive intensive interventions both in prison and in the community. Under the bond, if there is a sustained reduction of 10 per cent in reoffending behaviour (the number of times an offender is reconvicted within 12 months of leaving prison), investors receive a return of 7.5 per cent per annum. The reoffending rates of the intervention group are compared to a control group of 10,000 prisoners also serving less than 12 months in other prisons across the country but without the support of the services provided by the bond.

International development

Social benefit bonds are now being implemented or explored for feasibility in the United Kingdom (local councils), Singapore, the United States (Massachusetts and New York City) and Canada.

The development of social benefit bonds is the culmination of a long-term reform in government that began in the 1980s. Over the past three decades there has been an increasing trend of governments to contract out services to test the hypothesis that public services might be better provided by NGOs.

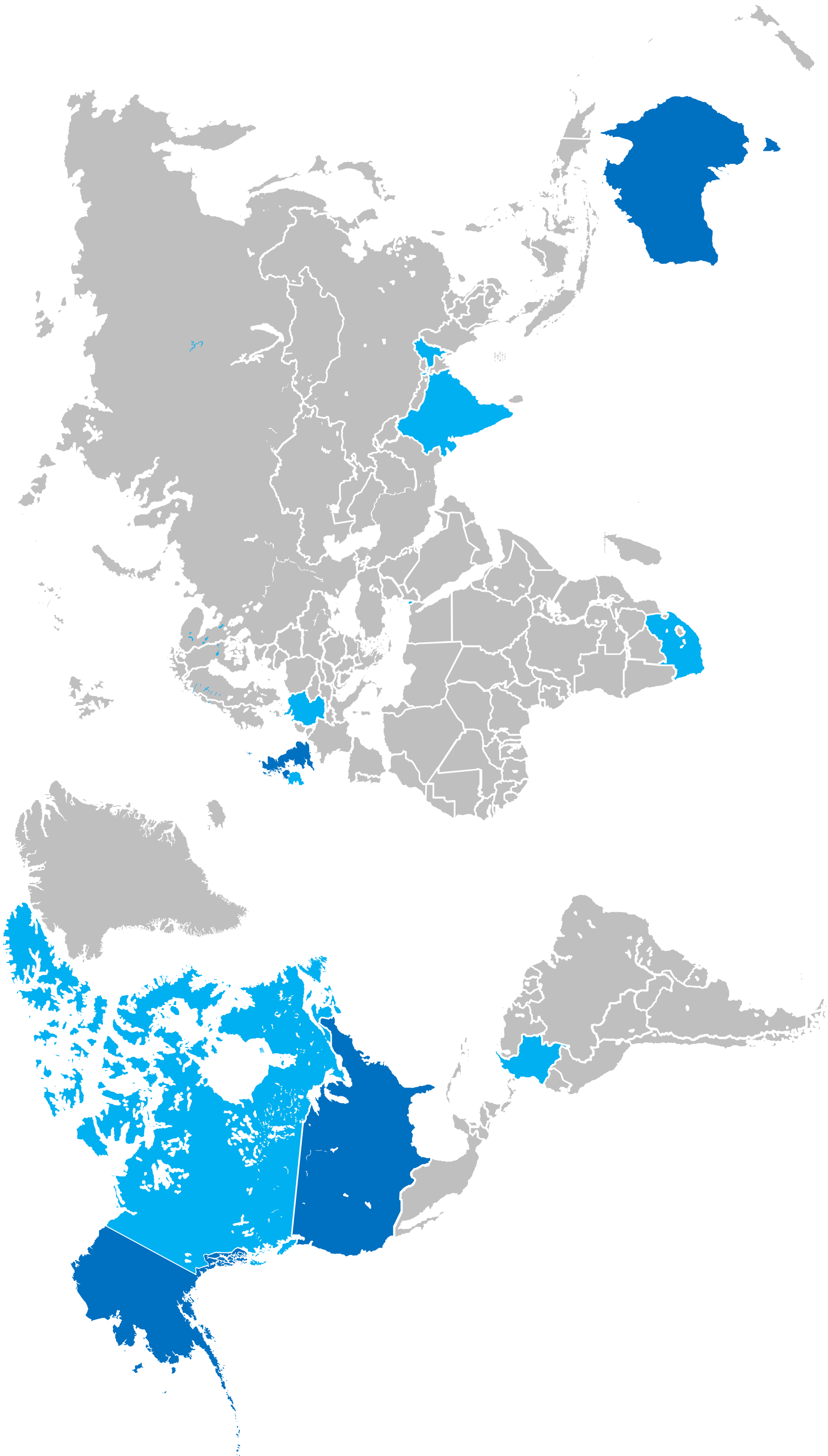
The shift began with the commissioning of public services. By outsourcing services to NGOs, governments maintain their ability to shape the terms of service delivery, whilst reaping the potential cost savings that result from organisations providing those services more efficiently.

More recently, some governments have started to employ PBR arrangements. At one end of the spectrum, in a fully mature model, governments are only required to pay the service provider if they meet mutually agreed outcomes and all the financial risk is transferred to the service provider. In other models a proportion of payment is dependent on outcomes' which provides an incentive to service providers to achieve outcomes and a proportion of risk is transferred. By concentrating on outcomes, government typically forfeits the right to closely specify the terms of service delivery in these arrangements.

Social benefit bonds can be considered one of a repertoire of PBR arrangements, each of which may be appropriate for a policy area and/or service offering. Some of the crucial differences in these arrangements are discussed in the findings section of this report.

As of November 2013, a number of jurisdictions around the world have developed or are in the process of developing social benefit bonds. Given the different social, economic and political circumstances, there are structural differences in social benefit bonds. The highlighted areas on the map following (Figure 8) represent where social benefit bonds have been developed or are in the process of being planned and developed.

Figure 8: Map of social benefit bond development around the world



Source: http://www.instiglio.org/

Note: Development Impact Bonds, which are based on the model of Social Impact Bonds, provide upfront funding for development programs by private investors and are being developed in Pakistan, Uganda, Mozambique and Swaziland.

Appendix c. List of stakeholders

Stakeholders who were consulted include those involved in the Trial (government agencies, SMEs, the Expert Advisory Group, Government Steering Committee, service providers, investors and financial intermediaries), and as well as three NGOs (in the child welfare and justice areas) who did not participate in the Trial and investors, as shown in Table 9.

Table 9: List of stakeholders

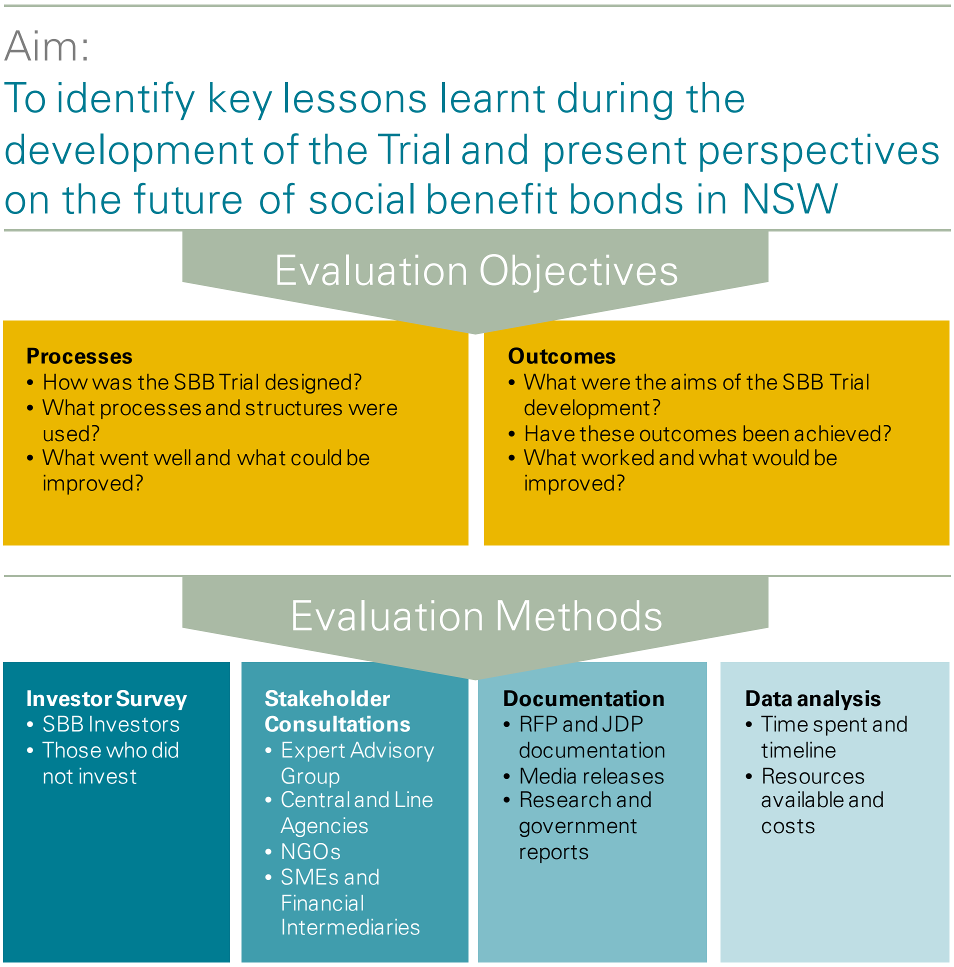
Category	Stakeholders	Individuals who participated in the Trial
Central agencies	– NSW Treasury – Department of Premier and Cabinet	✓
Subject matter experts	– Centre for Social Impact – Government advisors – Sector advisors	✓
Project Working Groups	– Expert Advisory Group – Line agencies - Department of Family and Community Services; Corrective Services NSW – Steering Committee – Newpin Bond proponents – The Benevolent Society Bond proponents – Mission Australia Bond proponents – Crown Solicitors Office – Legal advisors	✓
Other	– NGO sector – two peak bodies (representatives from the NSW Council of Social Services, and the Australian Council of Child Welfare Agencies) and three organisations – Investor market – 24 survey respondents (5 not eligible)	✗

Source: KPMG

Appendix d. Evaluation methodology

The overall evaluation methodology was agreed between NSW Treasury and KPMG. Figure 9 provides an overview of the evaluation methodology.

Figure 9: Diagram summarising the evaluation methods



Source: KPMG

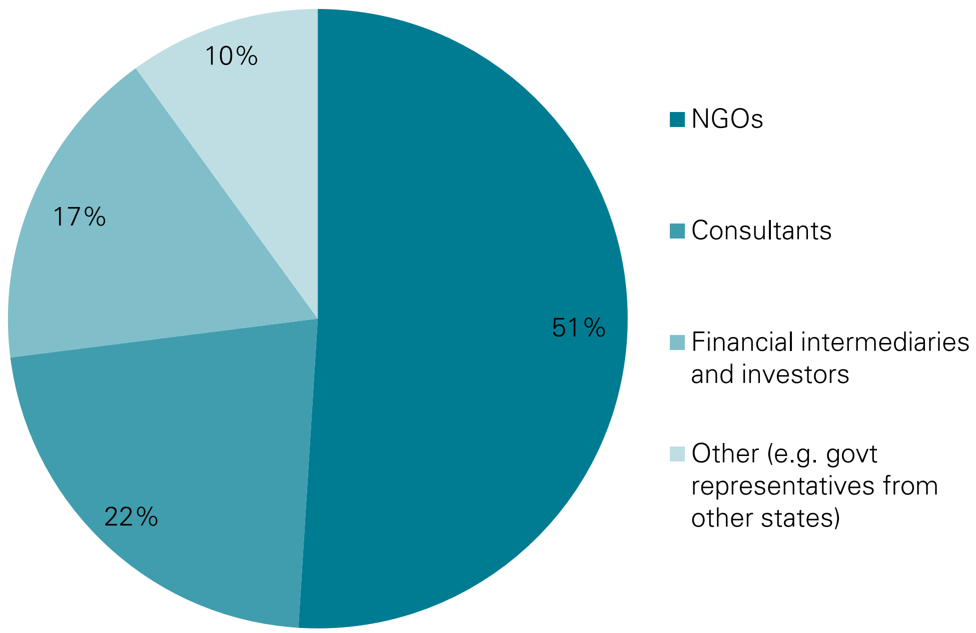
Documentation review

The following documentation was collected and reviewed:

- Published articles on social benefit bonds, social impact investment and payments by results literature
- Documentation on the NSW Social Benefit Bonds Trial, including the report by CSI, documentation on the NSW Treasury website, media releases and information memoranda
- RFP and associated working papers, including the attendance sheet at the RFP information session. At the information session, around half of the attendees

were NGOs followed by consultants and investors/financial intermediaries. A breakdown of attendees is shown below.

Figure 10: Breakdown of attendees at the RFP information session



Source: NSW Treasury

- Documentation relating to governance structures including Terms of Reference of governance mechanisms such as the Steering Committee, Expert Advisory Group and Working Groups
- Internal documents from NSW Treasury, SVA, SMEs and CSI
- Time registries and costs (costings of bonds development).

Stakeholder consultation

Consultations formed a vital part of the evaluation, providing direct information from people involved in the design, planning and development of the Trial. The views of the broader investor market and the NGO sector were also canvassed, relating to their perceptions of the Trial, social benefit bonds and other similar mechanisms.

There were two modes of stakeholder consultation:

- Stakeholder interviews, which were the primary method of engaging key stakeholders as much of the information required was descriptive in nature.
  - Intensive interviews of one hour duration were conducted with stakeholders who were involved in the JDP of the Trial. These interviews were generally face-to-face interviews.
  - Light-touch interviews of 20-30 minutes duration (either face-to-face or over the telephone) were conducted with a broader group of stakeholders (including those involved in the planning and RFP phase) and some NGOs who did not participate in the Trial.

A list of stakeholder groups has been provided in Appendix C.

All interviews were semi-structured and an interview guide was developed for each stakeholder depending on their involvement in the Trial. Interviews were conducted by two KPMG project team members, including one note-taker.

- An electronic investor survey was developed to:
  - understand interest and/or involvement in the Trial and overall interest in social benefit bonds
  - establish a 'baseline' in terms of interest in social investments and comment on how this compares to five years ago
  - assess how the Trial has fostered social investment
  - understand the impact of investing in social benefit bonds on other community or investment commitments of the organisation
  - understand the pre-conditions to grow a sustainable social financing sector.

  The survey was distributed to: investors in the Social Benefit Bonds, those who were interested and did not invest. The survey was piloted with a select group of people to test the clarity and interpretation of survey questions, flow and sense from the perspective of the different investor types targeted, and overall user-friendliness in an online format.

  The survey was then distributed through the following channels to investors:

  - Institutional investors, being the Commonwealth Bank of Australia, Westpac, UBS and JB Were
  - Finance services industry – social finance forum.

  A short introduction to the survey was emailed to these key contacts for forwarding to survey respondents about the evaluation project. The survey form itself had further details of the project, KPMG's privacy policy (to protect the anonymity of survey responses) and the KPMG project team members who could be contacted for survey assistance or further information about the project.

Data analysis

Data were collected on timelines, costs and resources used during the development of the Trial. The data was analysed to consider:

- whether resources were adequate for the Trial development
- transaction costs for the Trial (including time spent)
- overall cost effectiveness of the development process.

Analysis was also undertaken for the data collected in the other stages of the evaluation:

- Documentation review
- Interviews with stakeholders
- Investor survey.

The findings from each data source were sorted and categorised into themes and relationships between themes were investigated. The evaluation team also undertook triangulation between data sources to strengthen findings.

Appendix e. Further detail on the two bonds

The Newpin Bond

Funds for the $7 million bond for the Newpin program were raised by June 2013 and the program went live on 1 July 2013. There are three key parties to this social benefit bond:

- UnitingCare Burnside, as the service provider
- SVA, who was engaged to market the social benefit bond and raise funds
- NSW Government (including FACS as the line agency).

The Newpin program is designed to increase parents' capacity to care for their children, with the aim of building a health family environment to support children to be safely restored to their families or prevent their entry in to care. It is an intensive therapeutic centre-based program for families with children aged less than five years who are either in statutory OOHC or are with their respective family, but are at risk of entering care. There are three cohorts of families under the program:

- Those who have had one or more children removed from the family's care to OOHC
- Those who have active child protection case involvement, whose child(ren) are at ROSH and who have been assessed as safe with plan
- Those who do not have any active child protection case involvement but have multiple vulnerabilities and would benefit from involvement in the Newpin program (note these families may meet the ROSH threshold but may not have been allocated a case officer)

The funds raised from the Newpin Bond will be used to maintain UCB's four current Newpin centres and, depending on their performance, establish a further six Newpin centres.

For the first cohort, successful restorations of children to their families will result in children exiting the OOHC system and releasing cost savings to the NSW Government. Therefore, the rate of return to investors is based on the rate of restorations of children to their families. For this cohort, the restoration rate is essentially the number of restorations (net of counterfactual restorations – being restorations that would have occurred in the absence of the Newpin program) divided by the number of clients.

The target rate of restoration for the Newpin program is 65 per cent and if achieved, it is expected that investors will receive a 12 per cent return on investment and receive 100 per cent of the principal repayment upon maturity. The performance-based return on investment has been capped at 15 per cent.

If the restoration rate is below 55 per cent there is no payment to investors. The principal repayment falls below 100 per cent if the restoration rate as at 30 June 2020 is below 55 per cent.

However, as an incentive to invest capital, the investors were ensured a minimum 5 per cent interest payment in the first three years regardless of the rate of restoration. There is a guarantee that the principal repayment will not fall below 50 per cent.

The Benevolent Society Bond

The Resilient Families Service has been recently implemented under the $10 million social benefit bond (the funds were raised in September 2013). The term of the Social Benefit Bond is five years. The main parties involved in the development of the bond are:

- A consortium of TBS (as service provider) and Westpac and Commonwealth Bank of Australia (who have raised funds from their investors)
- NSW Government (including FACS as the line agency).

Under this social benefit bond, there are two tranches of bonds -- a senior tranche ($7.5 million) and a subordinated tranche ($2.5 million). There is an upfront standing charge of $5.75 million to facilitate establishment of the program. TBS draws on the bond issue proceeds to pay for the service.

The Resilient Families Service is based on international evidence including the Homebuilders® model from the US. Under the service, TBS will deliver intensive family support services over a period of five years to selected families referred by FACS based on specified criteria. The families have at least one child aged under six years (including unborn children) at risk of significant harm who have been assessed by FACS to be Safe with Plan.

In working with children identified as being at risk of serious harm, the program is at the 'pointy end' of child protection, that is, families where a serious risk to a child has been identified, but where the child has not been removed. The households are likely to present multiple, challenging issues that will not be resolved easily.

The service involves an initial intensive intervention of 6-12 weeks to address crises and stabilise the family environment. After the initial period, the service provides support for up to nine months post crisis to embed sustained changes. Following exit from the program, there are staff check-ins with families.

The rate of return to investors is based on a 'performance percentage', which is the difference in the improvement between children receiving the service, and matched children in a comparison group. The improvement is defined as a reduction in contact with the child protection system (that is, entries into OOHC, helpline reports, and Safety Assessment and Risk Assessments).

Interest payments are different for investors in each tranche though if the performance percentage is less than 5 per cent, no interest payment is payable for investors in either tranche. The maximum interest payment payable under the senior tranche is 10 per cent, and the subordinated tranche is 30 per cent.

Appendix f. Payment by results mechanisms

Social benefit bonds are one of a number of payment by results mechanisms, some examples of which are shown in Table 10. For further information on payment by results mechanisms and the issues involved see Sturgess, G.L. & Cumming, L.M. 2020 Public Services Trust (2010) Payment by Outcome: A Commissioner's Toolkit.

Table 10: Examples of payment by results funding arrangements

Arrangement	Description
Commissioning	Commissioning is the process of specifying, securing and monitoring services to meet people's needs. Typically, commissioning refers to a government contracting services from an external service provider.
Payment by results	A funding arrangement between government and a service provider whereby disbursements are triggered by the service provider achievement mutually agreed outcomes. The outcomes can include time taken to achieve the results, gradations in the results (e.g. decreased number of days in out-of-home care; number of re-offences), as well as taking into account the quality of the outcome (child's health and wellbeing; seriousness and type of re-offending). The payment structures used in a PBR scheme can vary in the form it takes within a contract and can include the following structures: – Bonus payments or incentive payments which are linked to target outcomes – Penalty payments which link financial sanctions to failure to reach target outcomes.

Source: KPMG

Appendix g. List of tables, charts and figures

Tables

Figures

Inherent limitations

This report has been prepared as outlined in the Introduction Section. The services provided in connection with this engagement comprise an advisory engagement which is not subject to Australian Auditing Standards or Australian Standards on Review or Assurance Engagements, and consequently no opinions or conclusions intended to convey assurance have been expressed.

The findings in this report are based on a qualitative study and the reported results reflect perceptions of the Joint Development Phase (JDP), but only to the extent of the sample surveyed. Any projection to the wider stakeholders is subject to the level of bias in the method of sample selection.

No warranty of completeness, accuracy or reliability is given in relation to the statements and representations made by, and the information and documentation provided by, NSW Treasury's personnel and stakeholders consulted as part of the process.

KPMG have indicated within this report the sources of the information provided. We have not sought to independently verify those sources unless otherwise noted within the report.

KPMG is under no obligation in any circumstance to update this report, in either oral or written form, for events occurring after the report has been issued in final form.

The findings in this report have been formed on the above basis.

KPMG Corporate Citizenship

At KPMG, commitment to local communities is at the heart of our values and we believe we can play a fundamental role in helping to solve important social and environmental issues through our Corporate Citizenship initiatives. As part of this commitment, the firm actively encourages our people to participate on the boards of not-for-profit organisations. In this regard, one of our Partners, Mr Robert Warren, currently holds a directorship with The Benevolent Society, one of the parties to the 'TBS SBB consortium'. We assessed this potential conflict of interest arising from this directorship prior to accepting the engagement and confirm that appropriate ethical dividers were established at the commencement of the engagement. As such we are comfortable that this potential perceived conflict was appropriately managed and mitigated to an acceptable level.

The ethical dividers also extended to KPMG team members who had provided historical financial advice to NSW Treasury on the relevant social benefit bonds, and limited the involvement of other KPMG team members who were involved in the tender phase of the Social Benefit Bonds Trial.

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